

Indonesia



ECONOMIC OVERVIEW

The macroeconomic situation is stabilizing in Indonesia. The external environment is likely to be supportive for the economy. This positive trend is reflected in the recent upgrade of Indonesia's credit rating by Moody's and Standard and Poor's. However, growth is still largely dependent on consumer spending and investment climate.

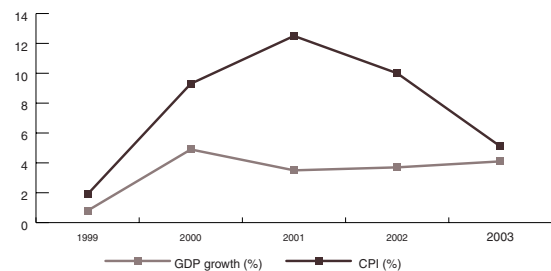
The government decision not to renew the IMF program beyond 2004 found broad acceptance inside and outside Indonesia. The draft 2004 budget is consistent with this decision, and the emerging financing picture seems manageable. To support confidence, the government issued the *Economic Policy Package Pre and Post IMF* in September, spelling out policies to be implemented over the next 18 months. If implemented according to plan and intent, this package promises to improve the investment climate, and reduce policy uncertainty in the run-up to the elections next April for the first run and September for the final run.

GDP AND CPI

GDP (Gross Domestic Product) and CPI (Consumer Price Index) growth rates 1999-2003.

Key economic Indicators	1999	2000	2001	2002	2003
GDP growth (%)	0.8	4.9	3.5	3.7	4.1
CPI (%)	1.9	9.3	12.5	10.0	5.1

Source: Economist Intelligence Unit February 2004



Source: Economist Intelligence Unit February 2004



Area ('000 sq km): 1,900
(US 9,600 – EMU 2,500 – World 133,700)

Capital: Jakarta

Population (million): 211.7
(US 288.4 – EMU 305.5 – World 6,200)

GDP (USD billion): 172.9
(US 10,400 – EMU 6,600 – World 32,300)

GNI per capita (USD): 710
(US 35,400 – EMU 20,320 – World 5,120)

Currency: Indonesian Rupiah (IDR)

Languages: Bahasa Indonesia, English, Dutch and local dialects (Javanese)

Main religions: Muslim, Protestant, Roman Catholic, Hindu, Buddhist

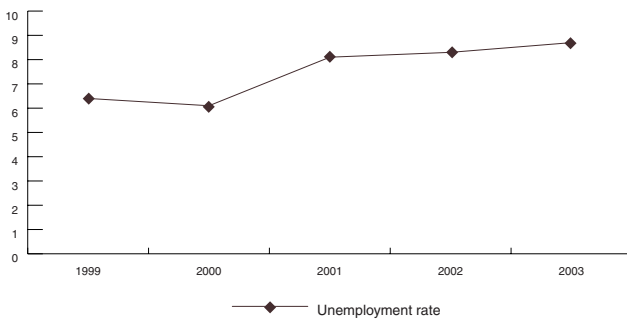
Government type: Republic

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UNEMPLOYMENT

	1999	2000	2001	2002	2003
Unemployment rate (%)	6.4	6.1	8.1	8.3	8.7

Source: Economist Intelligence Unit February 2004



Source: Economist Intelligence Unit February 2004

More than 100.8 million people, or around 67.8% of the total working-age population of Indonesia, were in active employment in 2002. Moreover, the number of workers continues to increase by around 2.5 million people per year.

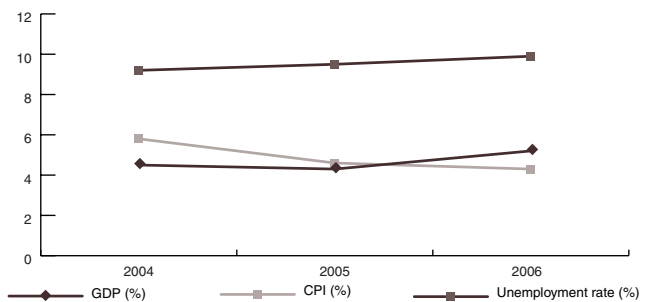
Labor market conditions in Indonesia mean that only 30% of the labor force have worked in the formal sector, while 70% depend on the informal sector. Most workers in the informal sector have an elementary school or junior high school education. Understanding labor market conditions and characteristics is a key part in the process of setting up and formulating national policies.

In 1996, open unemployment in Indonesia reached 4.3 million people, or 4.9% of the total population. Three years later in 1999, the number of unemployed had increased to 6.0 million and by 2002 the level had reached 10.1 million. Looking forward, unemployment is predicted to reach 10.8 million in 2004 and 11.2 million in 2005, or around 10.5% of the total Indonesian population.

ECONOMIC FORECASTS

Key economic forecasts	2004	2005	2006
GDP (%)	4.5	4.3	5.2
CPI (%)	5.8	4.6	4.3
Unemployment rate (%)	9.2	9.5	9.9

Source: Economist Intelligence Unit February 2004



Source: Economist Intelligence Unit February 2004

In spite of its challenges, Indonesia is looking set for a year of modest but respectable economic growth of 4-5% in 2004. Amid steady consumer spending and rising international confidence, the economy promises to see a mild improvement in relation to last year. Yet, still bogged down in the aftermath of the Asian economic crisis, Indonesia needs more than that to address its daunting problems.

Consumer spending accounts for more than two-thirds of Indonesia's GDP and will represent the dominant driving force in the recovery. At the same time, investment and exports are likely to make a substantial contribution to economic growth.

In 2004, exports are expected to grow by 2.5-3.5%. Domestic private consumption is predicted to grow by 4.2-5.2%, while investment is likely to grow by 1.6-2.6%. Other key indicators are expected to remain stable, according to central bank estimates.

Not all observers are convinced. The World Bank has warned that over the next three years, the economy will grow only slowly, hampered by sluggish foreign investment, corruption and terrorist threats.

REGULATORY ENVIRONMENT

FOREIGN DIRECT INVESTMENT

Foreign Direct Investment (FDI) started to make significant progress in Indonesia in the 1970s. Over the period the value of foreign direct investment reached USD30 billion per year. This subsequently increased to around USD100 billion per year during the 1980s, and by the year 2000 FDI had reached USD1,167 billion (World Development Report 2003). Rapid growth in FDI is attributable to significant expansion in the international economy, trade and domestic investment. In the 1980s, the world GDO based on market prices was increasing by 3.5% per year, while services and goods export were growing by 6.4% per year, and FDI flow by 40% per year. Due to the significant increase in consumer demand for goods and services in industrial countries, around 90% of foreign direct investment was being enjoyed by developed countries.

Despite the significant increase in global FDI, FDI flow into Indonesia decreased drastically due to monetary crisis. Having stood at around USD8.7 billion in 1990, the level subsequently increased to USD33.9 billion in 1997, before plummeting back down to USD9.7 billion in 2002. As a result, the government declared "Investment Year 2003" based on two reasons: Firstly, the significant decrease in foreign investment during the monetary crisis; secondly, to collect development funds at the end of the working contract with the International Monetary Fund (IMF).

PROPERTY/REAL ESTATE REGULATIONS

The government has enacted a number of policies and regulations with a view to regulating and controlling modern retailers and modern market formats and protecting small retailers and small traders. But so far the implementation and supervision of these regulations has not been strong enough. Legal permits to establish new modern retail / market formats are continuously being issued even in areas where their issue is ostensibly prohibited. As a result, government regulations are in many ways failing to control the existence of modern markets and retailers and small domestic traders are becoming vulnerable.

Reference for managing market and store

The *SK Menperindag* (Industry and Trade Ministry Decree) issued on October 13, 1997 acts as a

reference for managing markets and stores (*Pedoman Penataan dan Pembinaan Pasar dan Pertokoan*) and is intended to protect small and medium-sized traders. Some items stated in this decision as followed:

- Modern markets are allowed to be developed in every provincial capital.
- Their location must comply with either the Local Landscape Plans ("*Rencana Tata Ruang Wilayah Kota*") RTRWK or "*Rencana Detail Tata Ruang Wilayah Kota*" RDTRWK).
- The establishment of modern markets within a secondary area (i.e. out of the provincial capital) requires RTRWK and RDTRWK authorization based on location criteria. Retailers must also obtain "*Ijin Khusus Pasar Modern*" (legal permission for modern markets) from the Ministry of Trade and Industry.
- Without RTRWK and RDTRWK authorization, modern markets cannot be established in secondary areas.

Operating hour

Local DKI Policy (*Perda DKI*) No. 2 Year 2002 regulates closing and opening hours for non-governmental markets (store, malls and groceries) in Jakarta (the capital city of Indonesia):

- Opening hours for non-governmental markets run from 10:00 to 22:00.
- Stores wishing to open outside these hours require special permission from the Governor of DKI.

Some retailers want the *Pemprov* (Local Government) DKI Jakarta to issue licenses allowing retailers, malls and groceries to serve the residents of Jakarta 24 hours a day. The DKI government seems in favor of such a plan as long as the goal is to improve service quality. An approval-based scheme now seems to be in operation. So far 24-hour licenses has been awarded to owners of convenience stores such as Circle K, Star Mart and AM/PM.

Tax for service charge

The Indonesia Tax Directorate (*Dirjen Pajak*) has issued circular letter (*Surat Edaran*) SE-14/PJ.S3/2003 on Tax for Service Charge. The letter announced a rise from 4% to 10% in value added tax on services in shopping centers. Bearing in mind that 60% of the charge boils down to electricity, which already carries tax

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obligations, shopping and retail centers feel they are being treated unjustly. They believe they will suffer as a result.

OTHER REGULATIONS

VAT

The government has revised its value added tax policy, adopting a level of 10% on retail products for all modern retailers. The new policy is stated in Kepmenkeu No. 253/2003 about Pajak Perdagangan Ritel (tax on retail trade), which was issued on May 31, 2003 and implemented on June 1, 2003. This 10% applies to the sale via modern retail formats of all agricultural products, as well as breeding and fishing. The policy is not effective for retail traders operating in the traditional market.

Some modern retailers are complaining about the implementation of value added tax for the above-stated products because it will have a direct impact on end customers, increase price by 10% or more. The government's decision is aimed at protecting traditional traders and increasing tax revenues. However, the move also places a bigger burden on modern retail operations and could lead consumers to suffer.

The liberalization of retail trading

The SK Meninvest/No. 29/SK/1998 and Keppres No. 99/1998 policies have effectively opened up the retail market by allowing foreign companies to invest in the wholesale trading and retail sector. These policies make it easier for foreign investors to penetrate the Indonesian retail market, by putting them on an even footing with local retailers.

The Letter of Intent, which relates to Indonesia's economic restructuring policy and was signed by both the Indonesian government and the IMF in January 1998, provides another indication of how serious the Indonesian government is about opening up the retail industry. The agreement states that the government must fully support the liberalization of the retail-trading sector.

As a result of the retail globalization policy issued by the government, foreign retailers are free to develop and expand their business network in Indonesia. Thus local retailers are competing openly with foreign retailers and are no longer protected by regulations. It is now easy for foreign retailers with large capital bases to expand their network and acquire local companies. Indeed this is just what happened in the case of PT Hero Supermarket Tbk., which is now 12%-owned by Dairy Farm International.

DEMOGRAPHICS AND CONSUMER BEHAVIOR

POPULATION

Population evolution

Year	2001	2002
Population (million)	209.0	211.7
Population growth (%)	1.3	1.3

Source: The World Bank Group

Population by age group

2003	%
0-14 years	29.7
15-64 years	65.4
65 years and over ^{est.}	4.9

Source: CIA - The world fact book

INCOME / BUYING POWER

Average per capita monthly expenditure based on core data Socio Economic Survey 2002 shows that average per capita monthly expenditure in urban areas in 2002 was IDR273,294 while in rural areas was IDR152,784. In general average per capita monthly expenditure in Indonesia was IDR206,336 and of those 58.5% was expenditure for food and 41.5% for non-food.

CONSUMER BEHAVIOR / LIFESTYLE

Changes in consumption pattern based on core data from the Socio Economic Survey in 2001 and 2002 are shown in table below. In general, during this period, the percentages of per capita monthly expenditure for food consumption decreased both in urban and rural area.

Average household expenditure patterns

	2000 Urban + Rural	2001 Urban + Rural	2002 Urban + Rural
Food			
Cereals	16.13	13.82	12.47
Tubers	1.03	0.90	0.64
Fish	6.65	6.37	5.17
Meat	3.74	3.43	2.86
Eggs and milk	3.80	3.72	3.28
Vegetables	4.80	4.55	4.73
Legumes	3.07	2.78	2.02
Fruits	2.74	2.43	2.84
Oil and fats	3.06	2.74	2.25
Beverages	3.38	3.36	2.71
Spices	2.05	1.88	1.55
Miscellaneous food items	1.60	1.51	1.37
Prepared food and beverages	6.77	7.93	9.70
Alcoholic beverages	0.11	0.11	0.08
Tobacco and betel	6.89	8.59	6.80
Total of food	65.81	64.13	58.47
Non-food			
Housing and household facility	15.76	16.17	17.80
Goods and services	3.87	4.30	7.50
Education cost	3.60	2.97	2.47
Health cost	1.964	2.42	2.10
Clothing, footwear and headgear	4.61	4.54	5.18
Durable goods	2.31	3.25	4.10
Taxes and insurances	0.68	0.66	0.80
Parties and ceremonies	1.42	1.57	1.57
Total non-food	34.19	35.87	41.53
Total	100.00	100.00	100.00

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RETAIL & CONSUMER SECTOR PERFORMANCE

MAJOR CONSUMER GOODS PLAYERS

Top 10 food companies

Ranking	Company name	Category of products	2003 Sales (IDR billion, excl. VAT)
1.	Indofood Sukses Makmur Tbk	Packaged food	7,274
2.	Aqua Golden Mississippi	Soft drinks	4,370
3.	Nestlé Indonesia	Packaged food	2,922
4.	Indomilk	Packaged food	1,861
5.	Gunung Slamet	Hot drinks	1,831
6.	Coca Cola Amatil Ltd	Soft drinks	1,752
7.	Sinar Sosro	Soft drinks	1,672
8.	Santos Jaya Abadi	Hot drinks	1,626
9.	Intiboga Sejahtera	Packaged food	1,312
10.	Unilever Indonesia Tbk	Packaged food	1,305

Top 10 non-food companies

Ranking	Company name	Category of products	2003 Sales (IDR billion, excl. VAT)
1.	Unilever Indonesia Tbk	Cosmetic & toiletries, household care	5,665
2.	Sayap Mas Utama	Cosmetic & toiletries household care	1,845
3.	Procter & Gamble Home Products Indonesia	Cosmetic & toiletries, disposable paper products	768
4.	SC Johnson & Son (Indonesia) Ltd	Household care	590
5.	Kao Indonesia	Disposable paper products, cosmetic & toiletries, household care	512
6.	Ultra Prima Abadi	Cosmetic & toiletries	434
7.	Tempo Scan Pacific	Healthcare	523
8.	Kalbe Farma Tbk	Healthcare	367
9.	Suryamas Mentari	Household care, disposable paper products	274
10.	Konimex Pharmaceutical Laboratories	Healthcare	339

MAJOR RETAIL PLAYERS

Retail sales

Growth in retail sales (2001 – 2003)

Year	Total (IDR billion)	Growth rate (%)
2001	33,928	N/A
2002	38,573	13.7
2003	44,483	15.3

Source: Prospect of modern retail business in Indonesia

In terms of market share, modern retailers account for around IDR35.5 trillion, based on a network totaling 2,815 outlets which spans the whole of Indonesia. While modern retail outlets are still mainly concentrated in Java (87.5%, or 2,595 outlets), the remaining 12.7% (378 outlets) are widely spread outside Java. The biggest concentration is in Jabotabek where there are 1,633 outlets (54.5%).

The largest ten retailers are estimated to dominate around 70% of the modern retail market on a national scale. Matahari holds the biggest share of the market with 13.5%, followed by Makro 12%, Alfa 8.5%, Ramayana 8.5% and Carrefour 7.6%. Figures for market share and sales at this scale is still just estimates.

Top 10 retailers

Ranking	Group name	Brand stores	Format	Number of stores	Sales 2003 (IDR billion, excl. VAT)
1.	Matahari Putra Prima	Matahari	Department store	123	5,980
2.	Makro Indonesia	Makro	Hypermarket	13	5,396
3.	Alfa Retailindo	Alfa	Hypermarket + convenience stores	36	3,769
4.	Ramayana Lestari Sentosa	Ramayana/Robinson	Department store	85	3,650
5.	Carrefour Indonesia	Carrefour	Hypermarket	11	3,504
6.	Hero Supermarket	Hero Pasar Swalayan	Supermarket	113	2,948
7.	Indomarco Prismaatama	Indomaret	Convenience store	800	2,263
8.	Inticakrawala Corporation	Indo Grosir	Supermarket	6	2,033
9.	Goro Bhatara Sakti	Goro 33	Hypermarket	5	1,170
10.	Lion Super Indo	Super Indo	Supermarket	38	985

Source: Prospect of modern retail business in Indonesia

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RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

CHALLENGES

High risk political climate

One of biggest considerations for local or foreign companies, or individuals wishing to run retail operations in Indonesia is the country's high-risk political climate.

However, retailers still see potential. Although Wal-Mart withdrew from the country a few years ago and Makro downscaled its expansion plans, Dairy Farm, Carrefour and even Tesco are among those still interested in either entering the market or increasing presence.

Impact on regulations

The overall number of policies issued by the government involving retailers and shopping centers entrepreneurs is ultimately putting a burden on consumers. While the government gives a variety of unreasonable excuses to raise tax and local authority income, entrepreneurs will ultimately pass the additional costs onto the consumer.

With government policy leading to soaring electricity and gas costs, rising VAT and higher parking tariffs, most retail entrepreneurs are likely to increase the prices of their products by between 2-3%. The act of setting retail prices should ensure retailers' profits do not decrease. As usual the end consumer will be hardest hit.

OPPORTUNITIES

Consumer demand

Consumer demand is expected to remain the main driver for the Indonesian economy over the next 12 months. Car sales are strong with Astra reporting domestic sales up 24% yoy in September 2003.

Consumer confidence is rising and though recent retail sales by volume have been flat they should increase as the post-Ramadan and Christmas festive season approaches. This has already prompted a lift in advertising expenditure. However, both automotive and retail sales are expected to slow as the 2004 elections approach. By contrast, September indicated a 39% yoy fall in foreign investment approvals to USD1.1 billion while domestic investment approvals for the 12 months to September (a yoy breakout was not provided) fell 19% to USD2.3 billion. Local analysts suspect that 80% or more of the USD1.1 billion in foreign investment approvals was due to local entrepreneurs seeking a more tax-effective status, with the 10% being state asset sales to foreign firms and only 10% representing approvals were for increased capacity or new projects.

Although inflation has been stable at just over 6% it is expected to increase slightly as the year-end festive season gets underway bringing a mil increase in the 1-month certificate of deposit (SBI), which is currently at 8.46% (down a remarkable 440bp so far this year). Apart from this seasonal occurrence inflation is expected to moderate. In common with some other regional currencies the Rupiah has followed the USD down on both the Euro and the Yen and is likely to remain weak over the next 12 months due to political uncertainties and market concern over financial stability following Indonesia to make an early exit from the IMF program.

EMERGING TRENDS

Hypermarket leadership

The modern retail market is predicted to reach IDR80.7 billion in 2007, representing growth of IDR9 billion per year in value terms. The biggest contributor to this growth is the hypermarket segment (36.7%), which emerged as the main format in 2003.

MARKET SHARE - MODERN RETAILERS IN INDONESIA (IDR billion)

Year	Supermarket	Share (%)	Hypermarket	Share (%)	Minimarket	Share (%)	Dept. Store	Share (%)	Total	+/- (%)
2001	11,783	34.7	10,108	29.8	2,212	6.5	9,824	29.0	33,928	
2002	12,808	33.2	12,292	31.9	3,002	7.8	10,471	27.1	38,573	13.7
2003	14,330	32.2	14,678	33.0	3,693	8.3	11,782	26.5	44,483	15.3
2004	16,320	31.7	17,426	33.9	4,353	8.5	13,324	25.9	51,422	15.6
2005	18,689	31.1	21,093	35.1	5,171	8.6	15,178	25.2	60,131	16.9
2006	21,363	30.7	25,108	36.0	6,146	8.8	17,072	24.5	69,688	15.9
2007	24,429	30.2	29,659	36.7	7,308	9.0	19,371	24.0	80,767	15.9

Source: Prospect of modern retail business in Indonesia, 2004

Increasing market share of foreign retailers

As foreign retailers continue to penetrate the Indonesian market, the major domestic retailers are stepping up efforts to compete. Competition is likely to get more fierce as global retailers enter Indonesia following the 2004 general election.

At present, domestic retailers represent 74.3% of the modern retail market, while foreign retailers account for 25.7%. Based on estimated growth of around 19-23%, foreign retailers could represent as much as 31.1% of the market in 2007, while domestic retailers look set to see market share slide to 68.9% with average growth of 14% per year.

Repositioning of domestic retailers

In the last two years, some domestic retailers have begun to reposition. Matahari has returned to the Galeria format, with Mega M, under one brand, "Matahari". The move is based around a one stop shopping concept (department store and supermarket) and is effectively targeting the middle to lower class market segment. In 2003, Matahari launched a new concept, namely Matahari Market Place under the hypermarket format. Similarly, So Rimo, which had previously been cultivating the upper-middle class market, is now focusing on the middle-class segment. The strategies being implemented by Matahari, Hero and Rimo are aimed at confronting tight competition in the lower-middle class market, which is an exceptionally large segment.