1. The Government of Indonesia has consulted the Fund under Article XIV, Section 4, of the Fund Agreement concerning the further retention of its transitional arrangements.

2. Rice production was lower in 1961 because of adverse weather conditions and mineral production showed a mixed picture. The output of certain industries such as textiles, cement, and paper was higher, but production in other industries was lower than in 1960. The severe curtailment of imports in 1962 is expected to result in a substantial reduction in manufacturing output as a number of plants may have to operate at reduced levels of capacity or close down.

3. The excessive monetary expansion recorded during the past year was attributable principally to the rapidly mounting budget deficit financed almost entirely by Central Bank borrowing. Bank credit to State enterprises also increased substantially, while a smaller increase was registered in the case of the private sector. As a result of the large monetary expansion and the unsatisfactory supply situation, notably with respect to rice, prices rose exceptionally sharply in the latter part of 1961 and in the first three months of 1962. Thereafter, the rice supply and price situation improved, but other prices continued their strong upward movement. The estimated budget deficit in 1962 is larger than in the past year, and provisional data indicate that monetary expansion continues unabated. Immediate measures for eliminating the budget deficit are needed if an aggravation of the already serious inflationary situation is to be avoided. At the same time severe restraint on bank credit to State enterprises and the private sector should be exercised.

4. The balance of payments shifted from a surplus in 1960 to a substantial overall deficit in 1961. The trade surplus was much smaller as exports declined and imports increased, and there was a sharp reversal in capital movements from an inflow in 1960 to an outflow in 1961. This was due in part to a heavy schedule of loan repayments which will continue in 1962. There was a large decline in international reserves during 1961 and in the first months of 1962.
5. Import restrictions were intensified in June 1961 and again in October. In March 1962, an export retention arrangement was introduced which substantially increased the complexity of the multiple rate system by adding several new exchange rates and greatly widening the spread. In July the effective exchange rate for tourists was sharply depreciated. In October imports were reclassified and import surcharges were increased resulting in a further widening of the spread, although the number of rates was somewhat reduced. The Fund believes that the present exchange-system has serious disadvantages for Indonesia and urges that immediate steps be taken to simplify and reform the system in conjunction with measures aimed at eliminating the existing inflationary pressures.

6. In concluding the 1961 consultations, the Fund has no other comments to make on the transitional arrangements maintained by Indonesia.