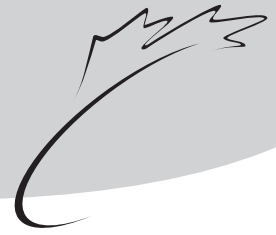




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INDONESIA

Indonesia is one of the largest agri-food markets in South East Asia, and generally imports about 18% of its annual wheat requirements from Canada. In addition, as the second largest producer and exporter of palmoil in the world, it exerts a significant influence on world and Canadian oilseed prices. This issue of the *Bi-weekly Bulletin* examines the situation and outlook for Indonesia's agricultural sector, and prospects for trade with Canada.

Background

Indonesia is the world's fourth largest country and has a diversified resource base consisting of primary energy sources, mineral deposits, timber, and various agricultural commodities. Indonesia's economy is market-based, but the government continues to play a significant role in administering prices for basic consumer goods such as fuel, rice, and electricity.

The population of Indonesia was about 228 million people in 2001 which has grown at an average rate of 1.6% over the last 5 years. About 25% reside in urban areas and 75% in rural areas and a steady migration has been taking place out of rural areas.

High levels of economic growth during the decade prior to the Asian financial crisis masked a number of structural weaknesses in Indonesia's economy. The legal system was weak, and there was no effective way to enforce contracts or collect debts. The banking system was unsophisticated, with widespread violations of banking regulations. There were economic distortions created by non-tariff barriers, domestic subsidies, and export restrictions.

The financial problems that surfaced in Asia in 1997 quickly created an economic and political crisis for Indonesia. In response to the crisis, Indonesia floated the *rupiah*, raised key domestic interest

rates, and tightened fiscal policy. The government also took custody of a significant number of private sector assets through the acquisition of non-performing bank loans, and certain corporate assets were acquired through a debt restructuring process.

The effects of the financial crisis on Indonesia's economy were severe. Real gross domestic product (GDP) decreased by about 14% in 1998 and, by mid-1999, the economy had virtually bottomed out. Furthermore, a weak *rupiah* negatively affected Indonesia's ability to import rice, worsening food shortages brought on by the El Niño-induced drought. To help deal with the financial crisis, Indonesia and the International Monetary Fund agreed on an economic reform program aimed at economic stabilization and the elimination of policies standing in the way of an economic recovery.

Indonesia's economic outlook began to improve in mid-2000, driven largely by an increase in exports, positive growth in the manufacturing sector, and increased household consumption. Higher oil prices helped improve Indonesia's trade balance, but the recovery was limited by continued weakness in the foreign investment sector.

SITUATION

Agriculture

Agriculture accounts for about 21% of Indonesia's GDP, and the sector provides employment for about 45% of the population. Indonesia's main agricultural products are rice, corn, palmoil, copra, cassava, peanuts, rubber, poultry, beef, pork, and eggs. Farming is labour intensive due to the relatively small size of Indonesia's farms, and many farm families live at a subsistence level.

Indonesia's government introduced policies for food self-sufficiency in the early 1970s. These policies included subsidies for purchases of crop inputs such as fertilizer and herbicides, improved access to irrigation through credit programs, and other incentives to encourage more efficient farming operations. Nevertheless, Indonesia still had difficulty meeting its goal of food self-sufficiency due to its economic and financial troubles.

More recently, Indonesia's economic recovery has been focussed on increased production and exports of palmoil. The strategy included a controversial sale of 265,000 hectares (ha) of oil palm plantations to Malaysia's Kumpulan Guthrie Bhd in late-2000. Guthrie purchased 24 plantations for a reported US\$368 million (M) and took over US\$43M of debt that had accrued to the operations. The purchase helps Guthrie deal with the problem of land shortages in Malaysia, and

it allows them to capitalize on the availability of low-cost labour in Indonesia and the greater output from newly matured palm trees. Although Malaysia and Indonesia are very competitive in the palmoil market, Malaysia has superior planting technology that can be applied in Indonesia to the benefit of both parties.

Indonesia's National Logistics Agency (BULOG) is responsible for maintaining government control over essential food commodities. The degree of control that the agency exerts varies between commodities. Rice, for example, is marketed through the private sector, but BULOG sets support prices for rice and sometimes influences prices by buying and/or selling rice on the open market. BULOG, until recently, was responsible for imports and domestic pricing of wheat and wheat flour.

Trade with Canada

Canadian **exports** of agricultural and agri-food products to Indonesia averaged CAN\$195M during the past decade, peaking at CAN\$386M in 1996-1997. Bulk grains constitute about 90% of Canada's total agri-food sales to Indonesia.

Canadian **imports** of agricultural and agri-food products from Indonesia during this same period averaged CAN\$159M, peaking at CAN\$220M in 1997-1998. About half of Canada's annual imports from Indonesia are natural rubber, followed by: cocoa and cocoa products (15%); coffee, tea, maté and spices (14%); and fish and crustaceans (8%).

Canada's wheat exports to Indonesia have averaged 850,000 tonnes (t) during the past decade, peaking at 1.4 million tonnes (Mt) in 1996-1997. Canadian wheat sales to Indonesia dropped off significantly during the financial crisis, but have since recovered to more historic levels. In 2001-2002, wheat sales to Indonesia represented about 6% of Canada's total wheat exports.

The Milling and Baking Industry

Indonesia's milling and bakery industry is undersized for the size of its population. Per capita consumption of wheat flour is relatively low, with about

2.4 kilograms (kg) of flour consumed by urban dwellers and 1.8 kg per annum by rural dwellers compared to about 45 kg per annum in Japan. Indonesia offers great potential as a market for wheat-derived and other products.

The value of Indonesia's wheat product sector is estimated at US\$690M annually, and consumption of these products is directly related to disposable income. Lower income groups consume virtually no bread while higher income groups consume up to double the national average. Of the 4 Mt of wheat milled annually in Indonesia, about 15% or 600,000 tonnes is used for baking bread.

There are at least 400 commercial-sized bakeries in Indonesia, most of which are relatively small businesses. The industrial-sized bakeries are found only in major cities. Bakery products are sold to consumers via the traditional village markets or directly from the bakeries. There are some supermarkets and other modern retail outlets that offer bakery products, but they are located primarily in Indonesia's major cities.

In contrast to the many small baking operations found in Indonesia, the flour milling industry is dominated by a few large firms, some of which are vertically integrated. The largest firm by far is Bogasari Flour Mills and it is owned by Indofood Group, which dominates Indonesia's food processing industry. Bogasari Flour Mills processes about 75% of Indonesia's wheat flour requirements while three smaller mills account for the remainder.

The wheat market has recently been deregulated and many trade barriers have been removed. BULOG no longer holds a monopoly over wheat imports, and this has allowed Bogasari Flour Mills to become a major importer of wheat. Since deregulation, Bogasari Flour Mills has become more commercially oriented, launching new and higher standards of quality for wheat flour aimed at the bread baking industry. The product is milled from hard grain wheat and it calls for strict quality control measures. However, soft wheat flours, which have been traditionally used for products such as cakes, pastry and biscuits, continue to account for about 60% of the wheat flour consumed in Indonesia.

Wheat

Indonesia consumes a significant amount of wheat annually, all of which is imported. Wheat-based products are still considered a luxury item for many Indonesians, and are consumed primarily by higher income families living in urban areas. Instant noodles are a common use for wheat in Indonesia, and the remainder is consumed as bread, pasta, biscuits, and snack foods.

Australia generally captures 60% of Indonesia's wheat market with sales of hard and soft white wheat, while the United States (US) exports both hard red and soft white wheats (20%). Canadian sales to Indonesia are mostly high-quality Canada Western Red Spring wheat, with some sales of durum wheat for the pasta market. The financial crisis seriously affected Indonesia's ability to import wheat, but **consumption** of wheat has increased steadily with the ongoing economic recovery. For 2001-2002, consumption

INDONESIA: WHEAT, PALMOIL, AND RICE SUPPLY AND DISPOSITION									
	WHEAT			PALMOIL			RICE		
	2000 -2001	2001 -2002	2002 -2003e	2000 -2001	2001 -2002	2002 -2003e	2000 -2001	2001 -2002	2002 -2003e
	<i>(July-June)</i>			<i>(October-September)</i>			<i>(October-September)</i>		
thousand tonnes.....					million tonnes.....		
Carry-in Stocks	1,100	1,000	800	679	920	780	6.4	4.8	4.9
Production	0	0	0	7,665	8,640	8,980	32.8	32.0	32.8
Imports	<u>4,069</u>	<u>3,677</u>	<u>4,000</u>	<u>8</u>	<u>15</u>	<u>20</u>	<u>1.5</u>	<u>3.5</u>	<u>3.3</u>
Total Supplies	5,169	4,677	4,800	8,352	9,575	9,780	40.7	41.3	41.0
Consumption	4,120	3,827	4,150	2,856	2,961	3,090	35.9	36.4	36.8
Exports	<u>49</u>	<u>50</u>	<u>0</u>	<u>4,576</u>	<u>5,834</u>	<u>5,980</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total Use	4,169	3,877	4,150	7,432	8,795	9,070	35.9	36.4	36.8
Carry-out Stocks	1,000	800	650	920	780	710	4.8	4.9	4.2

e: estimate, USDA, January 2003 except palmoil which is Oilworld, December 2002

Source: USDA

reached a record 3.9 Mt, up from the previous record of 4.1 Mt in 2000-2001.

Palmoil

Indonesia's **production** of palmoil has steadily increased and reached a record 8.6 Mt in 2001-2002. Increased production is due largely to a combination of favourable weather conditions and the productivity of newly matured palmoil trees. Another contributing factor is the ongoing research which has improved palmoil yields through varietal development, crop management practices, and processing technology.

Domestic palmoil **consumption** in Indonesia decreased during the Asian financial crisis, but has since returned to more normal levels. For 2001-2002, palmoil consumption is estimated at a record 3.0 Mt, with much of that increase directly related to population growth.

The Indonesian government has traditionally used an **export tax** to help guarantee adequate supplies of palmoil for the domestic market. However, increased exports in 1997 resulted in a scarcity of domestic cooking oil, and the government imposed a ban on palmoil exports in 1998. In mid-1998, the ban was lifted and replaced with a 40% export tax, with the intention that the tax would be lowered once the market stabilized. The export tax has since been decreased significantly, largely on the urging of domestic producers. At the same time, domestic processors objected to the reduction in the export tax, arguing that a lower export tax would create shortages of crude palmoil available for further processing. In March

2001, the export tax on palmoil was further decreased from 5% to 3%.

Exports of palmoil have more than doubled during the past five years and reached a record of 5.8 Mt in 2001-2002. The main markets are in India, the European Union, China, South Africa and Vietnam.

Palmoil has been trading at a discount to soyoil since June 1999 at US\$90 per tonne (/t) in November 2002. However, with record soybean crops forecast in Brazil and Argentina in early 2003, the palmoil-soyoil spread is expected to decrease significantly and is forecast to average US\$50/t in 2002-2003.

Rice

Rice is Indonesia's most important agricultural commodity. Rice **production** accounts for over half of the arable land available for crop production, and more than 90% of Indonesia's rice is grown under irrigation. During the past decade, area seeded to rice has remained fairly stable, averaging 11.4 million hectares (Mha). Production for 2001-2002 is estimated at 32 Mt, down marginally from the previous year.

Rice **consumption** has steadily increased during the past decade, reflecting the growth in Indonesia's population, and its continued reliance on rice as a food source. For 2001-2002, rice consumption is estimated at 36 Mt, up slightly from the previous year.

Indonesia's **imports** of rice decreased considerably during the Asian financial crisis. A serious drought in 1997 affected

yields and, as a result, Indonesia imported a record 5.8 Mt of rice that year. However, Indonesia's economic situation has improved and, with prospects for a stronger *rupiah*, rice imports are expected to increase significantly. For 2001-2002, rice imports were at 3.5 Mt, slightly higher than each of the previous two years.

Corn

Area seeded to corn has remained fairly constant over the past decade, although a record 3.7 Mha of corn were seeded in 1994-1995. Seeded area has since returned to normal levels, averaging 3.0 Mha annually. Corn **production** has varied due to yearly fluctuations in yields, reaching a record 6.5 Mt in 1998-1999. For 2001-2002, corn production is estimated at 6.0 Mt, up from 5.9 Mt during the previous year.

Indonesia's corn **consumption** increased about 25% during the past decade. This is due largely to increased use of corn for feeding livestock as specialized feed lots were established to meet the growing demand for meat and meat products. Corn for human consumption was relatively unchanged for this same period. For 2001-2002, total corn consumption was 7.1 Mt, of which 4.3 Mt was consumed as animal feed.

Indonesia currently has a 0% tariff on corn **imports**. However, the government plans to impose a 30% tariff on corn imports as a means of encouraging domestic production. For 2001-2002, imports were at a near record 1.3 Mt.

Soybeans

Area seeded to soybeans accounts for about 5% of Indonesia's arable land, down from about 7% during the early 1990s. The decline in soybean area is largely attributed to increased rice and palmoil production, and the availability of soybeans at competitive prices. For 2001-2002, soybean **production** was 0.9 Mt, down from 1.0 Mt in 2000-2001.

In Indonesia, soybeans are consumed primarily in the form of food products such as tofu, soymilk and tempeh. This segment of the market has grown by about 30% during the past decade as Indonesia's middle and upper class spend more money on higher-valued food products such as those derived from soybeans. Demand for soyfood products in Indonesia has expanded beyond traditional foods, and now includes the use of tofu for vegetarian

INDONESIA: CORN AND SOYBEANS SUPPLY AND DISPOSITION						
	CORN			SOYBEANS		
	2000 -2001	2001 -2002	2002 -2003e	2000 -2001	2001 -2002	2002 -2003e
	(October-September)			(September-August)		
thousand tonnes.....					
Carry-in Stocks	771	711	721	67	70	70
Production	5,900	6,000	6,100	1,020	860	714
Imports	1,280	1,300	1,300	1,261	1,580	1,600
Total Supplies	7,951	8,011	8,121	2,348	2,510	2,384
Consumption	7,150	7,100	7,200	2,278	2,440	2,314
Exports	90	100	100	0	0	0
Total Use	7,240	7,200	7,300	2,278	2,440	2,314
Carry-out Stocks	711	721	821	70	70	70

e: estimate, USDA, January 2003
Source: USDA

pizzas. For 2001-2002, soybean **consumption** increased slightly.

Soybean **imports** have more than tripled during the past decade due partially to a 0% import tariff. For 2001-2002, soybean imports were at a record 1.6 Mt.

OUTLOOK

Indonesia is emerging as a powerhouse in world palmoil production. In contrast to Malaysia, which has very little undeveloped land suitable for palm tree cultivation, Indonesia has a huge reserve of untapped land that is fertile, flat, and located in the proper climate zone. Easy access to rivers makes the land ideal for palm tree cultivation.

Indonesia has a large domestic pool of local labour to handle the harvest of palm fruit. However, it continues to rely on Malaysian and Chinese investors for the expertise and technology necessary to develop palm production. In fact, much of the investment in Indonesia's palm production is directly linked to the large palmoil refining plants in Malaysia.

Indonesia is restricted by trade barriers to export palmoil to the larger markets. India, Pakistan, Bangladesh and other southeast Asian countries have implemented restrictive tariffs and non-tariff barriers to protect their domestic processing industries. This type of protectionism prevents Indonesia from achieving its full potential as a palmoil producer and exporter.

Indonesia's future economic development also hinges on its ability to deal with political uncertainties. In recent years, the uncertainty has been reflected in a weak *rupiah*, rising inflation, and slowing economic growth.

However, the value of Indonesia's *rupiah* has strengthened significantly since last year at this time. As well, it appears that the performance of Indonesia's *rupiah* is now more closely tied to economic fundamentals rather than the political and social factors that have influenced it in the past.

The Indonesian economy is expected to grow in 2002, supported by increased consumption and investment. Improved global economic conditions are expected to contribute to higher exports and imports. Indonesia's progress in carrying out banking reform and dealing with corporate debt restructuring has also helped to improve its economic outlook.

Domestic demand for consumer products in Indonesia is expected to continue increasing, supported by low interest rates and higher real incomes. Improvements in Indonesia's social and political environment are also expected to translate into higher levels of foreign investment.

Wheat

For 2002-2003, Indonesia's wheat **consumption** and **imports** are forecast at 4.2 Mt and 4.0 Mt respectively. Due to low supplies caused by the drought in 2002, Canada's share of the Indonesian market is expected to decrease. Wheat exports are forecast to fall by about 50% from the 0.7 Mt Canada exported to Indonesia in 2001-2002.

Palmoil

For 2002-2003, palmoil **production** is forecast at a record 9.0 Mt, up from the previous record of 8.6 Mt in 2001-2002. Both **consumption**, forecast at 3.1 Mt, and **exports**, forecast at 6.0 Mt, are a record.

Rice

Indonesia's rice **production** is forecast at 32.8 Mt, up slightly from 2001. **Consumption** is forecast at 36.8 Mt, similar to 2001-2002, and **imports** are expected to decrease to 3.3 Mt, from 3.5 Mt in 2001-2002.

Corn

Corn **production** is forecast to increase slightly to 6.1 Mt, corresponding with a small increase in domestic **consumption**, which is forecast at 7.2 Mt. Similarly, **imports** are forecast at 1.3 Mt.

Soybeans

Indonesia's soybean **production** is forecast at 0.7 Mt, down from 0.9 Mt in 2001-2002. **Consumption** is forecast at 2.3 Mt, down from 2.4 Mt in 2001-2002, and **imports** are forecast at 1.6 Mt, up slightly from 2001-2002.

Implications for Canada

Canada's major competitor in Indonesia's wheat market is Australia, which has a distinct advantage by virtue of its proximity to this important market and the subsequent lower freight costs. However, Indonesia's steady population growth, increased urbanization, and higher disposable incomes are expected to increase demand for high-quality and consumer-ready food products. As well, the establishment of bakery schools and institutes in recent years has helped Indonesians develop their skills in baking technology. These developments are expected to improve Canada's prospects for increasing sales of high quality wheat to Indonesia over the long-term.

For more information, please contact:

Stan Spak,
A/Oilseeds Analyst
Phone: (204) 983-8467
E-mail: spaks@agr.gc.ca

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500-303 Main Street
Winnipeg, Manitoba, Canada R3C 3G7
Telephone: (204) 983-8473
Fax: (204) 983-5524

Director: Maggie Liu
Chief: Fred Oleson

Editor: Gordon MacMichael

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