Treasury & Capital Market

A year of solid progress in Treasury and Capital Market Business

The year 2005 marked the completion of a crucial part of a three-year plan to transform the Treasury & Capital Market operations of Bank Danamon. In 2004, we completed the first phase by building depth and experience in our dealing team, while successfully developing new products, working closely with other business groups within the Bank. In 2005, product innovation expanded into several new structured products. This was boosted by the introduction of a new state-of-the-art dealing and processing system.

The new system is front-to-back, encompassing straight through processing. This involves full automation from front desk dealing, allowing real time update of dealer positions and integrated risk assessment and information management for Treasury as a whole. This covers all activities including foreign exchange, money market, derivatives and structured products. All back office processing, transaction handling and ledger posting is also automated. These facilities provide customers with a better service, enhanced products and a faster response in order to benefit from market opportunities. At the same time our improved capabilities contributed to sustaining the Bank's reputation as the preferred local house for financial market products.

As the Bank's asset base grew, Treasury achieved improvements in the funding mix, using longer term structured funding. We successfully launched the Bank's first ever floating rate certificate of deposit for US$ 100 million one year funding. A significant part of the Bank's bond portfolio was sold at an attractive return despite the downturn in bond prices.

Treasury was recognized in the Asiamoney FX Poll in 2005 and awarded the "fastest mover with second highest market share" in corporate bond activity by the Asian Currency Bond Benchmark Survey for 2005.

Due to the Bank's improved financial condition and strong balance sheet, an upgrade was given in Pefindo rating to idA+, and a higher than sovereign rating was given by Standard & Poor's.

Various Treasury events, including economic seminars, workshops and customer gatherings were held in 2005.

The next stage in the three year plan is a continuation of these achievements into 2006 as we focus on increasing Treasury's contribution to overall earnings through enhanced asset and liability management and deeper penetration of the treasury market with more sophisticated products. During 2005 we have already made a number of innovative offerings.

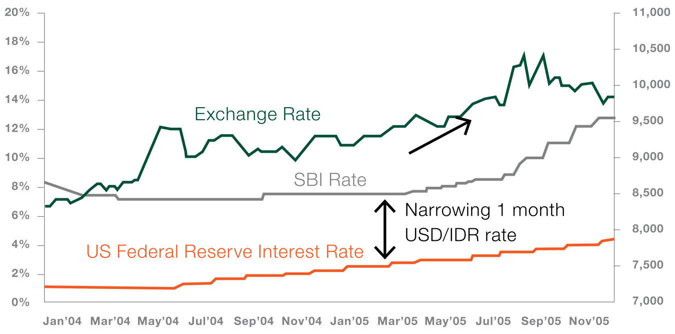
In foreign exchange we developed a new hedging facility providing more attractive terms than a regular forward contract. We launched a new interest rate option as an effective hedge against interest rate fluctuations. For clients seeking enhanced investment yields we offered a number of choices including a swap-based deposit product, a new treasury deposit offering both superior yield and capital protection and a new currency deposit with additional enhanced features.

A year of volatility in Indonesia financial market

Changing sentiment and volatility were the main themes dominating market conditions for 2005. Indonesian financial markets were impacted by the increase of global oil prices, which widened the budget deficit as the cost of fuel subsidies increased. At the same time a narrowing of the US$/Rupiah interest differential had a weakening effect on the Rupiah which had fallen to a level of Rp11,900 by August 2005. The Rupiah subsequently firmed as interest rates were raised in the fourth quarter of the year.

Rising interest rates and a weakening Rupiah plus a rule change on marking to market the value of bond funds triggered a massive redemption of bond holdings, as investors lost confidence. This prompted a shift in liquidity offshore and into the local US Dollar deposit market. The stock market driven by foreign flows, reached a new record of 1,292 for the Jakarta Composite Index (JCI) in August and closed the year up 16% to 1,163. A late cabinet re-shuffle in the year was well received by markets in general.

A narrowing differential between SBI and Fed rates impacted the Rupiah / US Dollar exchange rate in 2005



(Source: Bloomberg)

Money market rates witnessed big gyrations. From time to time during the year liquidity movements resulted in overnight rates of 50% or higher, however stability around a level of 15% was achieved by the end of the year. Bank Indonesia tightened liquidity by raising statutory reserves for commercial banks and sought additional reserve requirements from those banks with low loan to deposit ratios.