



# OUTLOOK INDONESIA

MONTHLY UPDATE- JANUARY 2020

FROM THE AMERICAN INDONESIAN CHAMBER OF COMMERCE

## HIGHLIGHTS

Worst Floods in 5 Years  
State of Indonesian Manufacturing  
China Captures Cellphone Market  
Indonesia Rejects China's Claims to Natuna Sea  
Lowest Inflation in Years



## UPCOMING/RECENT EVENTS

**December 5th, 2019**

### New Directions in Indonesia's Investment and Tax Policies



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## INDICATORS

**US\$ = 13,961**  
**JSX = 6257 (last)**  
**BI Rate: 5%**  
**Inflation: 2.72%**  
**Reserves: \$126.6 billion**

(source: Bank Indonesia)  
JSX= Jakarta Stock Exchange

## THIS WEEK IN INDONESIAN HISTORY

**1961**

**President Soekarno launched an 8 year development program aimed at achieving "Indonesian socialism"**

## ❖ 2019: YEAR OF TREADING WATER

*Commentary by Wayne Forrest*

Politics dominated 2019 as it was an election year characterized by a stormy Presidential campaign, violent demonstrations by supporters of the losing candidate (Prabowo), and a serene October inauguration. Economically, Indonesia tread water, reinforced its value-added and resource nationalism priorities, maintained its macro stability and 5% growth rate, continued some modest deregulations, but saw itself on the short end of countries attracting new foreign direct investment, especially from companies relocated production out of China. Consequently, towards the end of the year, after the President's second term Cabinet was installed, the government began a course correction that will take shape in 2020. ([2020 Outlook begins on page 5](#))

## ❖ 2019 HIGHLIGHTS:

### Economy

- GDP growth rate for 2019 hovered around 5%, the same as its been for the past several years, mirroring the average rate over the past 20 years. President Jokowi's goal was 7%, the rate needed to absorb most new entrants to the labor market. As in the past, most of the growth is being produced by consumption rather than foreign investment or trade.
- The rupiah gained 3.73% versus the dollar, rebounding from 2018 when it lost 12%.
- Although Bank Indonesia (central bank) lowered rates several times and eased lending conditions in response to deteriorating external factors (from 6% to 5%), inflation remained low, averaging 3%.
- Further stability was gained via successful government bond auctions and other macro-prudential measures.
- The average rate of inflation over 2019 was 2.72% reflecting the government's food price stabilization measures.
- Fiscal deficit widened to 2.2% of GDP, under Indonesia's self-imposed 3% limit, but still a major concern heading into 2020. Slowing global growth contributed to lower commodity prices and lower tax revenues, which continue to be under target, notwithstanding the 2018 tax amnesty and inter-country sharing of tax data.
- The manufacturing sector, accounting for only 20% of GDP, remains a focus of government policy but without much headway. The textile/garment sector appears to be weakened by cheaper imports and a slowdown in overseas markets. Little progress was made on converting informal jobs to formal ones, as manufacturing remained stagnant and the corporate purchasing index dropped to 2016 levels.
- Garment makers grew exports 20% but lost ground domestically due to a flood of cheaper imports. As a consequence, higher tariffs were imposed in November.
- Cars sales were down in 2019.
- Indonesia's equity market closed about 2% lower, year on year. Bright spots continued to be Indonesia's digital companies: e-commerce, fintech, and payments. The better positioned firms will be those investing in good cyber-security.
- The failure of state insurance firm Jiwasraya left 14,000 policies hanging as well as a stain on financial regulators.
- President Jokowi's infrastructure build-out continued in 2019 with the successful completion of several toll roads, power plants, airports, dams, smelters. The President also unveiled a \$33 billion plan to move the nation's capital to a new city to be built in East Kalimantan by 2030.
- The digital economy was a bright spot, growing from \$27 billion to \$40 billion, generating new employment, and fostering greater financial inclusion.

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## ECONOMY:

### • Lowest Inflation in Decades

Indonesia recorded inflation of 2.72 percent in 2019, the lowest level in around two decades, thanks to lower inflationary pressure from government-regulated prices, Statistics Indonesia (BPS) announced on Monday. The figure is far lower than the government's 3.5 percent target as stated in the 2019 state budget and is within Bank Indonesia's target of between 2.5 and 4.5 percent. The 2019 inflation is the lowest since 2012 when the agency began recording the movement of the consumer price index (CPI) using the current method of 82 cities, said BPS head Suharyanto. On a longer time frame, last year's inflation is the lowest since 1999 when the CPI increased by 2.13 percent. Core inflation reached 3.02 percent last year, slightly lower than 3.07 percent inflation booked in 2018. Administered prices recorded 0.51 percent inflation, drastically lower than 3.36 percent in 2018. Volatile food inflation stood at 4.3 percent, higher than 3.39 percent a year before. (*Jakarta Post*)

### • State of Indonesian Manufacturing

Two issues have been central to the Indonesian manufacturing industry throughout 2019; the sector's growth continuing to stagnate and the digitalization of industries posing both new threats and opportunities. In particular, the term "deindustrialization" garnered more attention this year following claims made in April by presidential candidate Prabowo Subianto, who argued the country's manufacturing sector was in decline and was being left behind by its peers. Former vice president Jusuf Kalla later sought to shed light on the situation, saying the declining percentage should not be prematurely perceived as a sign the country was experiencing deindustrialization. But the numbers don't lie: while the manufacturing sector's contribution to GDP remains large, its percentage contribution to GDP only amounted to 19.86 percent last year, struggling to remain at the 20 percent mark, Statistics Indonesia (BPS) data showed. The figure climbed to 20.07 percent in this year's first quarter but fell again to 19.52 percent in the second quarter and stagnated at 19.82 percent in the third quarter. Such numbers contrast the sector's achievement in 2001 when its percentage contribution to GDP was close to 30 percent. Additionally, Indonesia's Purchasing Managers' Index (PMI) — a benchmark for measuring manufacturing industry performance — stood at an average of 49.2 points in the third quarter, the lowest since 2016. A PMI reading under 50 represents a contraction. In contrast, Bank Indonesia (BI) was more optimistic as it claimed that the central bank's Prompt Manufacturing Index was at an "expansive" level of 52.65 percent in the first quarter of 2019. The figure stood at 52.66 percent in the second quarter and fell to 52.04 in the third quarter. One reason for the decline is that most manufacturing firms in Indonesia are micro and small firms (99.3 percent), making it difficult for them to grow to a size that makes an impact in terms of productivity, product upgrading, or research and development, a 2019 Asian Development Bank report noted. The report also argued that Indonesia's industrial policy contributed much less to the country's development because it was poorly designed and implemented. "There has been no consistent and cohesive industrial policy in Indonesia since 1966," the January report reads.

### • Trade Deficit Remains a Concern for Policymakers

The government has taken a number of steps, including the issuance of fiscal incentives, to cope with the country's widening trade deficit, but such measures have yet to bear fruit as the deficit remains. The year kicked off with a slow start, as Indonesia posted a US\$1.16 billion trade deficit in January because of declining exports and low commodity prices, according to Statistics Indonesia (BPS). Exports decreased by 4.7 percent

year-on-year (yoY) in January to \$13.87 billion, while imports fell by 1.83 percent yoY to \$15.03 billion. The trade balance continued the negative trend of 2018, when a decline in exports, partly due to the trade war between the United States and China, contributed to an \$8.6 billion trade deficit, the largest in 44 years. "Fluctuating prices of commodities as well as the general downturn in global [economic] growth have been affecting Indonesia's trade balance," BPS head Suharyanto told a press briefing in January. "These factors will make 2019 a bigger challenge for Indonesia."

Last year's deficit has kept the government on its toes to seek trade deals to open new markets that could eventually boost export demand, authorities said in early 2019. The Trade Ministry said in January that it had set a target to sign or at least conclude negotiations on 12 trade agreements, including the Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA) and preferential trade agreements (PTA) with African nations. As of November, Indonesia has concluded at least 11 trade agreements. From January through November this year, Indonesia accumulated a \$3.11 billion trade deficit, significantly lower than the \$7.62 billion recorded over the same period last year, BPS data show. However, despite the decline in the deficit, it is unlikely for the country to record a trade surplus at the end of this year. Should Indonesia book a trade deficit for the full year, the country will witness its second back-to-back trade deficit since its three consecutive yearly deficit from 2012 to 2014, which were caused by the deficit in oil and gas trade.

### • 860,000 New Investors in 2019

The number of domestic investors in the Indonesian capital market increased by a half to close to 2.5 million this year, reflecting growing interests among locals to invest in financial instruments like stocks, mutual funds and bonds. The Indonesia Stock Exchange (IDX) said the number of single investor identification (SID), the integrated registry number for financial investors in the country, has risen from 1.62 million at the end of last year to 2.48 million at the end of this year. (*Jakarta Globe*)

### • China Captures Indonesian Cellphone Market

Chinese producers have stamped their domination in the Indonesian smartphone market, with Oppo and Vivo dethroning South Korea's Samsung in the third quarter of this year. Smartphone sales in Indonesia totaled 8.8 million in the period, with four major Chinese brands having a combined market share of 74 percent in the period, according to market consulting firm International Data Corporation (IDC) Indonesia. Oppo was the market leader with a market share of 26.2 percent, followed by Vivo (22.8 percent), Realme (12.6 percent) and Xiaomi (12.5 percent). Their combined market share had risen by 20.1 percent from the third quarter of last year. Samsung, who was the top dog last year with a 28 percent market share, has now dropped to third place with a market share of 19.4 percent.

### • Indonesia Receives \$16b Foreign Capital in 2019

Capital flow to Indonesia totaled Rp 224.2 trillion, or \$16 billion, throughout last year — likely to bring the country's balance of payment into positive territory, the central bank announced on Friday. Bank Indonesia also confirmed the rupiah was stronger in 2019 and expected Indonesia's foreign reserves would also increase when the final report is delivered later this month. Bank Indonesia Governor Perry Warjiyo said Indonesia's foreign capital comprised Rp 168.6 trillion in state securities, Rp 50 trillion in stocks, Rp 3 trillion in corporate bonds and Rp 2.6 trillion in Bank Indonesia certificates.

## ❖ POLITICS, LAW AND SECURITY:

- **Worst Floods in 5 Years**



Severe flooding in Jakarta that left swaths of the capital underwater has killed at least 30 people and forced tens of thousands to flee their homes, according to Indonesia's disaster agency. Torrential rains have been pounding the greater Jakarta region since New Year's Eve, causing 62,453 people to be evacuated to temporary shelters, the Indonesian National Board for Disaster Management said in a statement Thursday. Most of the victims died in Bogor district and East Jakarta, the agency said. Among the dead, 17 were swept away by the floods, five were buried by landslides and five were electrocuted. Heavy rains are predicted to continue through to January 10, it added. Jakartans may have grown complacent

and seemed wholly unprepared. The last big floods were in 2014. (*CNN and other reporting*)

- **AGO Launches Criminal Inquiry Into Jiwasraya**

The Attorney General Office is opening an inquiry into a possible corruption case at Asuransi Jiwasraya that has led Indonesia's largest state-controlled insurance company into the brink of bankruptcy. Attorney General S.T. Burhanuddin said on Wednesday his office suspected foul play in Jiwasraya's previous directors' decision to put the company's assets in risky instruments, causing Rp 13.7 trillion (\$986.4 million) in potential state losses by August 2019. "That's the initial estimate. We expect the real figure to be higher," Burhanuddin said. (*Jakarta Globe*)

## ❖ FOREIGN AFFAIRS/US INDONESIA RELATIONS:

- **Indonesia Pushes Back on Chinese Natuna Claims**

Indonesia has dismissed China's invitation to sit down for a dialogue to "manage disputes" over Indonesia's exclusive economic zones (EEZ) in the North Natuna Sea in the Riau Islands province, arguing that there are no overlapping claims there – a message Indonesia has sent consistently since 2016. Following revelations of a wave of illicit activity by Chinese coastguard and fishing vessels in Natuna waters last week, Indonesia summoned Chinese Ambassador to Indonesia Xiao Qian on Monday to lodge a formal protest. The Foreign Ministry said Indonesia would never recognize China's "Nine-Dash Line" – the geo-

graphic expression of Beijing's sweeping claims over the South China Sea – because it was contrary to international law. Chinese Foreign Ministry spokesperson Geng Shuang insisted on Tuesday that the ships were performing "routine" activities to maintain maritime order and protect China's legitimate rights and interests in the "relevant" waters. Using what the spokesman claimed were historical rights in the South China Sea, China maintained it was simply asserting its sovereignty over the Spratly Islands as well as its sovereign rights and jurisdiction over relevant waters nearby. (*Jakarta Post*)

## ❖ SOCIAL/CULTURE/EDUCATION:

- **Migrant Workers Send Home Three Times as What Their Spouses Earn**

The amount of money that Indonesian migrant workers send home to their family every month often exceeds three times the monthly income of their spouses who decide to stay at home. But unfortunately, lack of financial planning still keeps many of these low-income households under strain, a recent study showed.

The study, titled "Both Sides of the Coin: The Receiver's Story," by US-based international payment company UniTeller, shows the average monthly remittance received by low-income Indonesia households from their family members working abroad is \$547 – three times the average monthly income of \$157 independently earned by the recipients.

The study surveyed 501 adults from low-income households in Indonesia using on-line interviews in September. It was part of a larger study that involved a total of 1,911 respondents among low-income households in Indonesia, India, the Philippines and Vietnam. (*Jakarta Globe*)

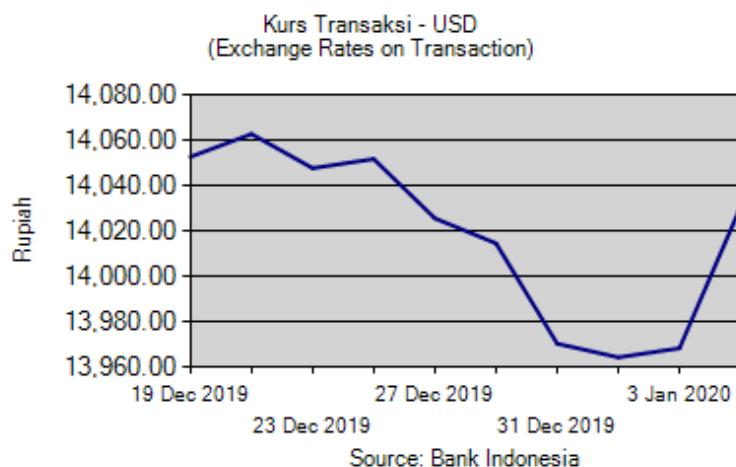
- **US Muslim Supermodel Visits Indonesia**

An Islamic cultural conference kicked off in Jakarta last month to represent Muslim ways in an array of interests and businesses, from travel and sharia banking to digital economy and fashions. Organizers of the Jakarta Halal Things festival invited American model Halima Aden, known as the first model to wear a hijab in the Miss Minnesota USA pageant, and at least 50 speakers to lead discussions in various panels.



## ❖ CHARTS:

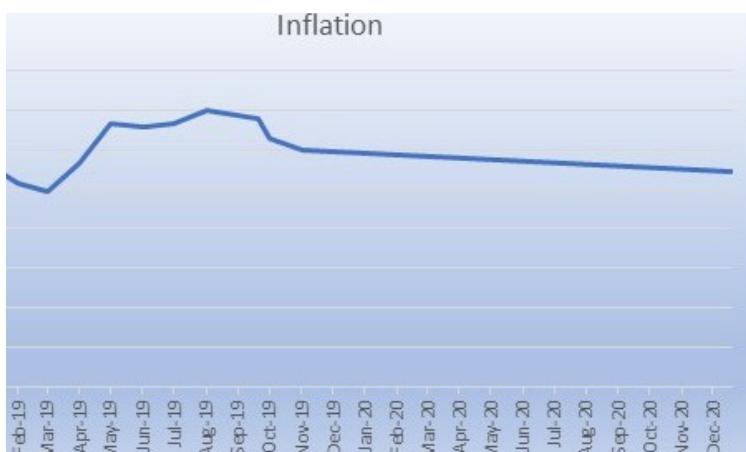
Dollar in Rupiah



Jakarta Stock Exchange Index



Inflation



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- In September the President received a report from the Chief Representative of the World Bank in Indonesia that indicated that Indonesia's was not the location for 33 investors relocating their production from China due to the US-China Trade War. The President's rhetoric and Cabinet choices point to a renewed urgency for reform.

### Trade Relations:

- USTR began a review of Indonesia's eligibility to continue to receive benefits under the generalized system of preferences program (GSP). This program gives tariff reductions covering \$2.1 billion (mostly manufactured products) of a total of \$18.4 billion of Indonesia's exports to the US. Commerce Secretary Wilbur Ross traveled to Indonesia in November 2019 to discuss GSP and other issues with President Jokowi. A decision is expected in 2020. If past reviews are any guide, Indonesia and the US will come to acceptable terms so that the benefits remain.
- The EU rescinded its program promoting palm-based biodiesel to be used in European power plants because of rainforest degradation. The program will be phased out gradually by 2030. Indonesia launched a WTO suit challenging the EU's move. Meanwhile Indonesia ramped up its own biodiesel program requiring up to 30% palm-based fuel, the highest mandated mix in the world.
- After Indonesia moved forward its nickel export ban from 2022 to 2020, the EU filed a WTO suit, claiming the policy subsidizes its stainless-steel producers. Indonesia announced its intention to develop electric batteries and automobiles, attracting a Chinese battery maker.

### Politics:

- The April rematch of President Jokowi and Prabowo Subianto turned out not to be of any measurable substance. Jokowi won by 11 points, larger than his 2014 margin. Although on the surface the rhetoric between the candidates was heated their policy differences were minimal. In May deadly riots challenging the results marred an otherwise peaceful vote.
- Soon after President Jokowi was inaugurated in October he appointed his rival, Prabowo, Defense Minister, confirming that Indonesia's political parties are heavily driven by oligarchic behavior. Only a few parties (and their backers) want to be left in opposition without access to ministry-driven patronage.
- For the first time Indonesia ran both Parliamentary and Presidential elections at the same time, a huge undertaking that was successfully managed. There was little evidence of vote tampering but plenty of evidence of vote "purchasing", especially in non-urban regions.
- The lame-duck Parliament tried unsuccessfully to pass unpopular laws that spurred the largest nation-wide protests since 1998 and the fall of Soeharto. A new criminal code outlawing adultery, non-married couples living together, abortion, and effectively banning gay and lesbian relations was pulled and could be revisited in 2020. Also, left off the table was a new mining bill as well as a bill ending direct elections.
- However, a bill did pass that appears to denude the independent powers of the Anti-Corruption Commission (KPK). Although protesters demanded Jokowi revoke it through a Presidential decree, he seems unlikely to do so.
- Jokowi's second-term Cabinet keeps a mixture of experienced hands and new faces. Sri Mulyani and Luhut Pandjaitan remain in their powerful positions as Minister of Finance and Coordinating Minister of Maritime (Mines and Energy). Two ministers under 50 from the private sector take on the important portfolios of Education and State-Owned Enterprises (SOE's). Erick Thohir is already shaking up the management of important SOE's such as the state electric company (PLN) and Nadiem Makarim (founder and CEO of tech unicorn GoJek) has been tasked with reforming Indonesia's public schools and their curriculum to achieve what President Jokowi calls a "mental revolution".
- The future of direct elections for the President as well as local governors was called into question by several major political figures including Tito Karnavian, the new Home Affairs Minister.

### Security:

- A series of deadly suicide bombings in Surabaya and Medan, including women perpetrators, and the knifing of Wiranto, Coordinating Minister for Politics and Security, stunned much of the country and seemed to have drawn a line in the sand for President Jokowi.
- This was reflected in his appointment as Minister of Religion, Fachrul Razi, a former general, who favors non-religious attire in the workplace and a new plan to vet public employees who espouse radical Islamism.
- Protests and riots broke out across Papua and West Papua after an incident in Surabaya where Papuan students were labeled "monkeys" and "pigs". At least 33 people were killed in the riots, prompting tens of thousands to flee the region and causing losses amounting to US\$33.8 billion.

### Social/Education:

- Indonesian students achieved very low PISA Scores (an international test for 15 year-olds) compared to their peers worldwide and in southeast Asia. Out of 79 assessed countries Indonesia ranked 73rd in math, 74th in reading, and 71st in science. The scores dropped from the previous test in 2015. However, Indonesia has made strong strides in enrolling more children and achieving a basic literacy rate of 95%.
- The creativity of the 35 year-old Harvard alum Nadiem Makarim, who founded the ride hailing service GoJek, may bring fresh ideas and solutions (including technology) to the Education Ministry.
- The #MeToo movement arrived in Indonesia in the case of a university student whose rape ignited a national campaign against sexual harassment and victim blaming.

## ❖ 2020 OUTLOOK

Indonesian leaders realize they have a demographic bonus, over 50% of its 270 million are under 30, but yet underemployment is chronic, and manufacturing jobs are not being created fast enough. President Jokowi began his second term in October 2019 seeking to reverse these trends.

Two key pieces of legislation slated for 2020 embody the government's stepped-up posture to attract foreign investment: an Omnibus Bill on taxation and an Omnibus Bill on Job Creation. The implementing regulations for each bill would also be simultaneously drafted. The President believes that he has spent sufficient political capital with all but two political parties in his Cabinet, giving his coalition 75% of the votes on paper. However, Indonesia has no experience in enacting Omnibus Laws: they encompass thousands of article amendments and close to 100 laws. Both bills are slated for passage in 2020. If passed expect:

- Tax rates to fall from 25% to 20.
- Expatriates would not be taxed on worldwide income
- The negative list of investment would be changed allowing more generous terms for foreign investment
- Relaxed rules on penalties and pre-paid VAT
- Restrictions in the labor law would be eased to encourage manufacturing investment
- Overlapping and duplicative national and regional permitting rules for buildings and land will be eliminated and synchronized.

### Legislation

The tax law will probably pass first without a long deliberation; everyone loves to see taxes lowered. Due to the changes to labor rules, the bill on job creation will take longer and it's entirely possible the President will face challenges from within his own coalition as well as street protests from workers. His own party, PDI-P, has in the past bucked changes to the labor law and its generous severance provisions. Given the heavy involvement of Indonesian conglomerates in political parties, easing rules regarding foreign investment such as opening sectors will also be a challenge. The President's rhetoric since 2014 has been for ground-breaking reform but government policies have usually fallen short given his preference for consensus over confrontation. Furthermore, lacking a strong power-base within even his own party, dominated as it is by its chairman former President Megawati, the President can get isolated if the longer-term interests of his supporters (i.e. the positioning of her daughter as a future candidate for high office) do not conform with his. **In the end, the President will get the changes he is seeking, although they may be watered down.**

### Economy

- GDP growth will remain in the 5% range but inflation will pick up and the rupiah will head back over 14,000. The potential for more rather than less volatility in Indonesia's partners (EU/Brexit, US/election, China/Hong Kong/trade war) could push GDP growth lower.
- President will make further positive management changes within his Cabinet, state-owned enterprises, while pushing ministries to perform better. These changes will mitigate a more threatening international environment, building on the strengthening digital economy.

### Politics

- Jokowi will resist efforts to amend the Constitution to end direct elections, even those from within his own party. If they come at all, they would be more forceful at the end of his 5 year term.
- 2020 will be a year of consolidation but not without the unpredictable effects of calculations of those seeking power in 2024.

### Law/Governance

The massive failure of the state insurer, **Jiwasraya**, is a potential landmine for the President. If there are no prosecutions, Indonesia's reputation will suffer further, battered as is by the downgrading of the KPK (Anti-Corruption Commission) which has gone months without any arrests since its enabling law was revised. The President, however, reappointed Yasonna Laoly Justice Minister who has not focused on ending the judicial mafia that has led to many bizarre judgments against foreign companies. On the other hand, the respected new Coordinating Minister of Politics, Law, and Security, Mahfud MD, has promised a new truth and reconciliation commission to review long standing human rights cases, but has not yet addressed the issue of the malignant court cases that damage the investment climate. Combined with the anti-corruption commission's loss of independence, unfortunately, fundamental judicial reform is not a priority.

*(These views are the author's and do not necessarily reflect those of AICC or its members.)*