



# OUTLOOK INDONESIA

MONTHLY UPDATE- APRIL 2019

FROM THE AMERICAN INDONESIAN CHAMBER OF COMMERCE

## HIGHLIGHTS

Churchill Mining Loses Final Appeal  
EU Threatens Indonesian Palm Oil  
First Subway in Indonesia Opens in Jakarta  
Bali Top Trip Advisor Asian Destination  
New US Embassy Opens



## UPCOMING/RECENT EVENTS

April 9

Indonesia Coffee Forum



3:00 PM  
Indonesian Consulate General (NY)

[Details and Registration](#)

May 1

Indonesia Elections 2019

8:00 AM

at Asia Society

## INDICATORS

US\$= 14,231  
JSX= 6452(last)  
BI Rate: 6%  
Inflation: 2.48%  
Reserves: \$123.2 billion

(source: Bank Indonesia)  
JSX= Jakarta Stock Exchange

## THIS WEEK IN INDONESIAN HISTORY

1964

Local workers take control of 16 British plantations in East Java

## ❖ RESILIENT INDONESIA/FINANCIAL PULSE 2019

*Commentary by Wayne Forrest*

Indonesia is like the folktale character *Kancil*, a small “mouse” deer that despite his size outwits crocodiles, tigers, elephants, using his cunning and resourcefulness to survive in a dangerous world. Given that Indonesia is about to have Presidential and Parliamentary elections next month, the topic of the current BIES quarterly report “Risks, Resilience, and Reforms: Indonesia’s Financial System in 2019”, is particularly timely. Produced by the Australian National University, BIES is a quarterly journal whose contributors often include “rising star” Indonesian economists (Mari Pangestu, Chatib Basri). The report concludes that *Kancil*’s resilience “could be tested sooner rather than later.” Below is a summary of their analysis and recommendations.



### Global Risks

- **Corporate and individual borrowing:** squeezed for most of 2018 as rates rose. Those borrowing in US dollars further squeezed by stronger dollar.
- **US-China trade “war”:** This escalated through most of 2018 and is in a holding pattern now. But China’s supply chain is changing, investors are finding Vietnam is the most hospitable SEA platform to manufacture due to its unitary governance system, proximity and baseline logistics/infrastructure (especially in the South).
- **EU-UK “Brexit”:** Indonesia does not benefit from the uncertainty created by Brexit and from governments backing away from international trade rules and institutions (WTO) that have underpinned Asia’s economic rise.
- **Possible US recession:** predicted for late 2019 or 2020

### Indicators of Indonesia’s Resilience

- **Capital flow reversal:** Since October 2018 the rupiah has gained 9% after dropping below 15,000 during most of last year. Although Indonesia still has a current account deficit, net positions have improved.
- **GDP Growth:** Indonesia’s GDP continues on a 5% growth trajectory and will soon have had 20 years of uninterrupted growth. 2019 growth is projected at 5.2%.
- **JSX:** The Jakarta Stock Exchange Index is up 10% in the last year, outperforming a falling S & P 500 and Nikkei 500.
- **Inflation:** The 2018 average was 3.20% and is currently 2.8%, the lowest its been in 2 years.
- **Unemployment:** Currently 5.3% below the 5 year average of 5.7%.
- **Consumer and business confidence:** Based on surveys, BIES characterizes it as “robust”.
- **GOI budget deficit:** Indonesia by law must have a budget deficit less than 3% of GDP. The deficit shrunk almost a third in 2018 to 1.8%.

### Risks

- **SOEs and Infrastructure Finance:** Indonesia’s logistics costs are far higher than her neighbors in mainland SEA. After his election President Jokowi’s unveiled an ambitious \$363 billion plan to construct new toll roads, ports, bridges, power plants, airports, and reservoirs. Funding was to be 40% from the government’s own budget and 60% from state-owned enterprises and the private sector. The plan is underway but at a reduced pace given difficulties in land acquisition, permitting and financing. By and large SOE’s are doing the building and they have assumed massive loans (often from Chinese institutions) requiring direct government transfers to remain profitable. BIES and other analysts are

*Continued on Page 5*

## ❖ ECONOMY AND BUSINESS:

### • EU Phase Out Threatens Palm Oil Production

Indonesia is adopting a tougher stance against the European Union's plan to phase out the use of palm oil in renewable transport fuel. Given the importance of the industry to the country (largest source of foreign exchange, employing almost 20 million people), losing the EU is a major blow. Indonesia is challenging the decision. The EU has determined that oil palm is a "high risk crop," after a study found that 45 percent of new oil palm plantations opened between 2008 and 2015 were located in high carbon stock area—far more than rival crops like soybean and rapeseed. Indonesia, along with Malaysia, the world's second largest palm oil producer, are of the opinion that a ban on palm oil will only result in more forests being cleared to plant oil palm-substitute crops. House of Representatives speaker Bambang Soesatyo's slammed the EU plan. Bambang's criticism followed a threat from a Trade Ministry director who said on Monday the Indonesian government will encourage palm oil companies to file a lawsuit against the EU if the union does not back down on the policy. The RED II plan was submitted to the European Commission on March 13. If it is approved, the union will put palm oil in its list of unsustainable products, before phasing out its use in biofuels by 2030. Tensions could end in a trade war or at the very least a submission to the WTO.

Coordinating Minister for Maritime Affairs, Luhut Pandjaitan, told a recent palm oil forum that Indonesia would actively defend its interests and might leave the Paris Accord on climate change: "If the U.S. and Brazil can leave the climate deal, we should consider that. Why not?" Pandjaitan said.

### • Indonesia's Gets A Subway

Jakarta's long awaited subway (MRT) has opened heralding a cultural shift for its residents. The north-south branch has been completed and will be followed by east west legs in future years. Like many mass transit systems around the world, the MRT will be heavily subsidized. A trip on the entire 16-kilometer route of the Jakarta MRT, from South Jakarta to the Hotel Indonesia traffic circle, will amount to Rp 14,000 (\$1), which is less than half the cost of using one of the city's ubiquitous on-line motorcycle taxis over the same distance. A fixed fare of Rp 3,000 will apply for entering the MRT system and this will increase by Rp 1,000 for every station a passenger passes.

### • African Coffee in Indonesia

Liberica coffee from Kendal, Central Java, has been turning the heads of coffee fans for its jackfruit aroma and rarity.



Originally from the African nation of Liberia, the Kendal liberica coffee was brought in by the Dutch and is considered rare given its long, tall stem, reports kompas.com. Because of this, farmers are said to have a hard time harvesting the coffee.

"It is sought after by many coffee fans, especially since the coffee is often featured in the media because of its jackfruit aroma," says Widodo, a coffee farmer from Mlatiharjo village in Platean district, Kendal. (Jakarta Post)

*AICC co-hosts a coffee promotion event with Consulate General of Indonesia in NY April 9.*

### • Viscose Rayon: Key to the Fashion Future

Indonesia's Asia Pacific Rayon, or APR, is one of the largest integrated producers of viscose-rayon in Asia. The sustainably-produced fiber is commonly used in outerwear—from casual shirts to coats—and now the company wants it to be used in haute couture as well. It also believes that the increasingly fine fabric can boost Indonesia's textile exports. The company is part of global pulp giant Royal Golden Eagle (Raja Garuda Mas), controlled by conglomerate Sukanto Tanoto, and had just opened a new plant in Pangkalan Kerinci, Riau, early this year. The Riau plant will be capable of producing 240,000 tons of viscose-rayon—soft fiber made from dissolved cellulose—every year. On Thursday (28/03), APR showcased the results of its collaboration with eight Indonesian fashion designers who turned out high-fashion outfits using viscose-rayon as part of the 2019 Indo Intertex fashion and textile exhibition held at JIEXPO Kemayoran in East Jakarta.

"We use sustainable raw material and clean manufacturing to produce our viscose," Cherie Tan, APR's vice president of communications, said at the event. "We track the sources of our raw material and are committed to be transparent about it. We only use dissolved pulp certified to have no deforestation links," she said.

The company hopes its fine viscose-rayon can soon be found on the catwalks of Paris, Milan and New York as part of the couture collections of many creative young designers from Indonesia trying to make it on the world stage. (*Jakarta Globe*)

### • Regions Hold Back OSS

Even as the government boasts about the important role of the Online Single Submission (OSS) system for accelerating the issuance of investment licensing arrangements, most regencies and municipalities are not ready to implement it. One of the problems is that most of the regions do not have the digitalized detailed spatial plans (RDTR) for quickly identifying the project locations that badly need to accelerate the process of licensing arrangements.

Coordinating Economic Minister Darmin Nasution said the availability of digitalized RDTR in each region was badly needed for the optimal operation of the OSS system.

"With the availability of digitalized RDTR, potential investors only need to point to the coordinates of their project locations and the OSS system could immediately identify the location," Darmin said as quoted by kontan.co.id.

The OSS system has been operated by the Investment Coordination Board since early January after previously being operated by the Economic Coordinating Ministry since it was launched in July 2018. (*Jakarta Post*)

### • Shortage of Tax Payers

Spokesman for the Directorate General of Taxation Hestu Yoga Saksama announced there were only 10.93 million individual and institution taxpayers that have filed their annual tax return forms (SPT Pajak) up to Saturday, March 30.

"From the listed taxpayers there were 18.3 million annual tax return forms, which is just 59.7 percent of what we expect," said Hestu in a text message to Tempo on Sunday, March 31.

## ❖ POLITICS/LAW/SECURITY:

### • Churchill Mining Loses Final Legal Battle Against Indonesia, Must Pay \$9.4m

An international tribunal has dismissed claims by Churchill Mining against the Indonesian government for damages arising from the 2013 revocation of the London-listed firm's mining licenses in East Kalimantan, a top government official said in Jakarta on Monday. The British miner and its Australian subsidiary, Planet Mining, had plans to explore a 35,000-hectare coal mining concession in the Busang area in East Kalimantan after their acquisition in 2008 of a 75 percent stake from local company Ridlatama. However, two years later, then-East Kalimantan district head Isran Noor revoked Churchill's license based on accusations of illegal logging. The license was subsequently awarded to another Indonesian company, the Nusantara Group, which is majority owned by presidential candidate Prabowo Subianto whose group had vacated their license after not finding sufficient coal. Churchill believes the success of their exploration activities prompted Nusantara to find a way back in, partially through document falsification.

Churchill sued the district head for the revocation of its mining licenses that made up the East Kutai Coal Project, claiming that the action breached the United Kingdom-Indonesia and Australia-Indonesia investment treaties. Churchill filed a legal suit to the International Center for Settlement of Investment Disputes (ICSID) in 2013, claiming \$1.3 billion, reital for its investment in the project. In its legal demand, the British miner accused both the Indonesian government and the regional government of having conducted "indirect expropriation" and

breached the "fair and equitable treatment principle." This decision was an appeal of a 2016 ICSID decision and now ends the six-year dispute. The tribunal will soon process the legal costs of \$9.4 million awarded to the Indonesian government. Justice Minister Yasonna Laoly told reporters in Jakarta. "This has been a long battle... This is Indonesia's first huge win in this kind of lawsuit, and [we] got a significant award out of it," he added. (*Editor's note: The case-- even though it is celebrated by the Indonesian government-- will likely negatively potential foreign investors in the mining sector. )*

### • Current Polls

President Jokowi maintains a lead of 19 points over his rival Prabowo in all but one recent poll. However, the active part of the Presidential campaign-- rallies, meetings etc.-- Officially began March 23 so sentiment could change. This year's April 17 election also includes a vote for Parliament. It will be the first simultaneous ballot. Indonesians are becoming more independent-- some might say apathetic-- in their attitudes towards political parties. Most voters identify with a party only because of the Presidential candidate, not its platform or ideology. Polls also indicate that several established parties (PPP, PAN, Hanura) may not win enough votes to seat a representative in Parliament. PDI-P, the party of President Jokowi and its chairwoman Megawati, could be the main beneficiary and could come out of the election with a larger proportion of seats (33%). A recent voter survey by the firm Charta Politik ranked the following issues in order of prime importance: (1) cost of living, basic necessities, (2) lack of jobs, (3) cost of education and health care. Corruption ranked sixth.

## ❖ FOREIGN AFFAIRS/US INDONESIA RELATIONS

### • New US Embassy Opens

(*Excerpts of remarks by Ambassador Donovan*)

This celebration comes at a very opportune time, as this year we are also celebrating 70 years of diplomatic ties between the United States and Indonesia. The United States was one of the first countries to recognize Indonesia's independence, establishing our first embassy on December 28, 1949. When President Truman appointed the first U.S. ambassador to Indonesia, H.

Merle Cochran, he reaffirmed U.S. support welcoming Indonesia into the "community of free nations." This building is the latest example of that enduring commitment to our partnership and the Indonesian people. The partnership between the U.S. and Indonesia is built on a foundation of shared democratic values and common interests, such as education, sharing expertise, and innovating to create a brighter future.

## ❖ SOCIAL/CULTURE/EDUCATION:

### • Trip Advisor Rates Bali #1 Asia Travel Destination

The popular web-based travel organization, Trip Advisor, rated Bali #1 in Asia and #5 in the world as a travel destination. Its description is: "Bali is a living postcard, an Indonesian paradise that feels like a fantasy. Soak up the sun on a stretch of fine white sand, or commune with the tropical creatures as you dive along coral ridges or the colorful wreck of a WWII war ship. On shore, the lush jungle shelters stone temples and mischievous monkeys. The "artistic capital" of Ubud is the perfect place to see a cultural dance performance, take a batik or silver-smithing workshop, or invigorate your mind and body in a yoga class."

### • No Food and Drinks on New Subway

President Joko "Jokowi" Widodo inaugurated on Sunday the first phase of the Jakarta Mass Rapid Transit – vital infrastructure expected to reduce some of the world's worst traffic congestion. The 16-kilometer transit line, built at a cost of Rp 16 trillion (\$1.1 billion) funded through a soft loan from the Japan International Cooperation Agency, connects Lebak Bulus in South Jakarta to the Hotel Indonesia traffic circle in the downtown area



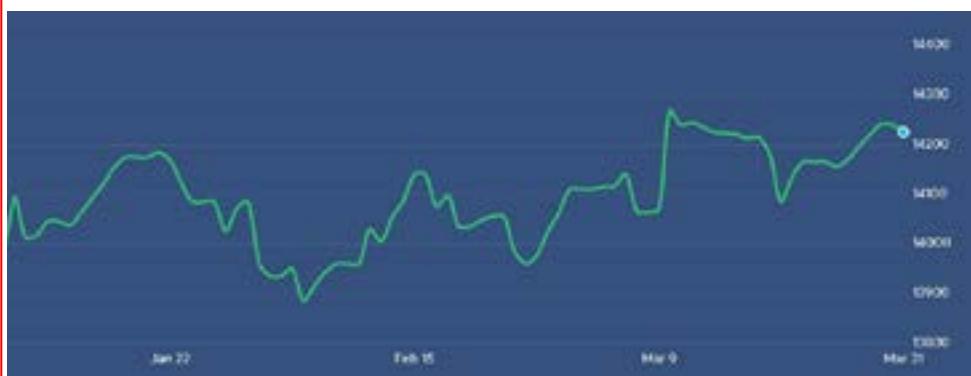
of the capital. The Jakarta MRT is served by 16 six-car trainsets that can transport a total of up to 130,000 passengers per day. There are 13 stations along

the 16 km route, which takes 30 minutes to complete.

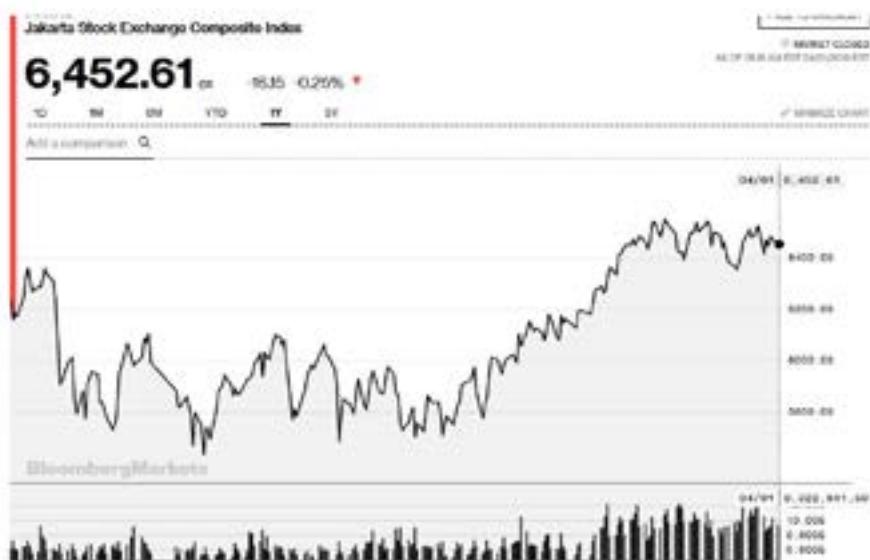
"Today marks a new era we will have with the first phase of the MRT being operational," President Jokowi said in his keynote address. "Be patient and make sure you follow the queue. Don't jostle with each other. Be disciplined, by making sure you know the schedule. Don't let yourself get stuck in the door when the doors close," Jokowi said in a joking tone. Additionally the MRT will attempt to enforce a no food or drink policy. Fares are heavily subsidized as they are on most mass transit systems worldwide.

## ❖ CHARTS:

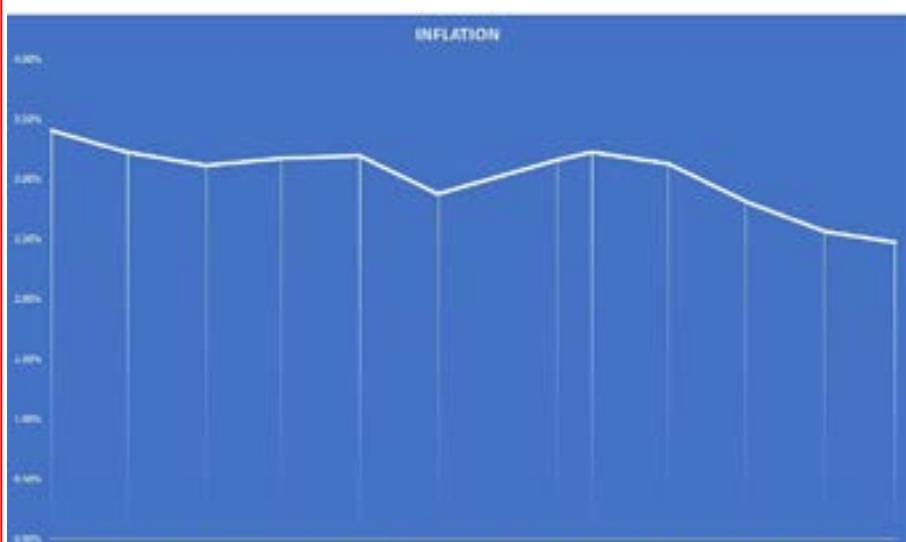
Dollar in Rupiah



Jakarta Stock Exchange Index



Inflation



concerned about SOE health and overleverage. Can they survive a liquidity or solvency problem? What if oil and the US dollar trend upwards?

- **Banking Sector Liquidity:** Indonesian banks today are required to hold capital above internationally recognized norms (Basel III); they are buffered at rates higher than most Asian banks. By and large most banks have taken steps to curtail spurious lending and non-performing loan ratio is below 3 %. Although the sector can be characterized as solvent the concern in liquidity and the dependence on foreign capital. Government policy encouraged more lending throughout 2018 and the loan-to-deposit ratio grew to an average 93.8% with some smaller banks above 100%. Liquidity in the system is still dependent on foreign inflows into Indonesian debt and equity instruments. Concerns that banks were moving into a danger zone abated after capital flows returned during the last quarter of 2014. However, Indonesia needs to continue to deepen its capital markets by all means necessary including: financial inclusion, e-banking, joining international protocols on swaps and derivatives, and creating more products ( mutual funds, revenue-backed bonds), and increasing direct foreign investment.

### Public and Private Debt

- **Government:** 97% of the government's debt is long term, 80% is in bonds. 41% of the bonds are held by foreigners. Risk of capital flight remains but is currently on the low side given US Fed statements that interest rates will remain unchanged for 2019.

- **Private sector:** Has been increasing its foreign-denominated debt since October as the rupiah began appreciated.

### Crisis Framework

The long shadow of the controversial 2008 Bank Century bailout remains. After the 2008 global crisis Indonesia created a financial system crisis prevention system based on a new 2016 law dedicated to creating it. The law requires a coordination between 7 agencies and a Crisis Committee of 4 (Finance Ministry, Bank Indonesia, Financial Services Authority, and Deposit Insurance Agency). No one entity can act alone in the event of a crisis as occurred in the past. The bank bailout mechanism of the past has been replaced by one in which shareholders are made creditors and unsecured liabilities are written down or terminated. Banks are supposed to have enough assets to stabilize themselves in a crisis as well as a plan regarding assets that can be sold or restructured.

This system has been yet to be tested an analysts are concerned that the Crisis Committee can act quickly enough in the event of a crisis. The concern is that the many contingencies and required inter-agency coordination could prevent individual institutions from taking responsibility to solve the case of an illiquid bank. The paradox is that the new law was designed to address the lack of individual responsibility in the first place.

### Regional and Global Safety Nets:

BIES states that Indonesia has access to many bilateral currency swap facilities and multilateral support from trusted institutions such as the World Bank, Asian Development Bank, IMF, and the Chiang Mai Initiative (CMI).

Stung by what is now perceived to have been bad advice from the IMF in 1998, Indonesia tends to avoid its support as it did in 2008. Given that the World Bank usually offers its support via the IMF and the CMI is untested, BIES believes Indonesia would have to rely on a patchwork of loans and currency swaps with regional partners in the event of a major crisis who themselves may be in a similar situation. Some level of risk remains within the external "back stop".

### Future Reforms

- **Role of Bank Indonesia (BI):** BIES suggests that Bank Indonesia should be reinstated as the "lender of last resort". Amendments to the law on BI should allow it a clear macroprudential mandate covering systemic risks throughout the whole financial system, not just banks. The Crisis Committee would have input but the ultimate decision on providing liquidity support would be BI's.
- **OJK and Conglomerates:** The horizontal nature of Indonesian conglomerates, who are allowed to operate in many business sectors where there can be conflicts of interests (i.e. a bank may own a property company). Holding companies of these groups may not be regulated making it difficult for OJK to apply regulations to the whole group. OJK should have primary authority maintain financial stability and stronger authority over conglomerates.
- **Legal Indemnity:** The 2016 Financial Crisis law should be amended to limit the liability of officials who make policies and "good faith" decisions in the financial sector.

### The Future of Indonesia's Financial Sector: Importance of Financial Deepening:

- **Capital Base:** Indonesia remains behind many of its neighbors in the depth of its capital markets and the size of its capital base (bonds plus equities). Total assets in Indonesia's financial sector equal about 70% of GDP, compared with about 400% in Korea, 300% in China and South Africa, and 200% in India.
- **Deposits:** Its 20 year average ratio of financial system deposits to GDP is 34% compared to over 60% for India, 55% for Philippines, 100% for Thailand, and 110% for Malaysia. Banks must compete with the government bonds for funds and usually offer lower rates.
- **Dominance of banks:** Non-bank financial institutions and the capital markets combined make up only a third of Indonesia's financial assets. For too long Indonesia has not paid enough attention to enabling the development of long-term institutional investors such as insurance companies, pension funds, and mutual funds. It may take a larger role for foreign players to bring in tried and true practice and the necessary long-term investing approach.
- **Fintech:** Indonesia is making strides in bringing e-banking via smartphones to all communities. These efforts should be expanded using the successful models in India and China.
- **New instruments:** Even with Indonesia tax amnesty efforts and its inclusion in international sharing of financial data Indonesia needs more incentives to keep capital in the country. Developing more money market products such as floating rate notes, certificates of deposit, mutual funds and commercial paper would help.

### Conclusion

BIES authors conclude: "In sum, strengthening financial resilience in Indonesia requires short- and long-term reforms. The spill-over-rich international environment of recent years, in which financial and policy developments in one country have had significant implications for other countries, shows no signs of abating. The resilience of Indonesia's financial system could be tested sooner rather than later."