



OUTLOOK INDONESIA

MONTHLY UPDATE- JANUARY 2019

FROM THE AMERICAN INDONESIAN CHAMBER OF COMMERCE

HIGHLIGHTS

Darmin Predicts 5.3% Growth

Budget Deficit Improves

Indonesia Completes Freeport Transaction

Tsunami Warning System Needs Updating

US-Japan-Indonesia Energy Project Commences



UPCOMING/RECENT EVENTS

December 5

Beyond 2019: Indonesia's Economic Outlook

featuring



Vasuki Shastry, Standard Chartered

Notes

INDICATORS

US\$= 14,350

JSX= 6274 (last)

BI Rate: 6% (7 day Repo)

Inflation: 3.13

Reserves: 117.2 \$billion

(source: Bank Indonesia)

JSX= Jakarta Stock Exchange

THIS WEEK IN INDONESIAN HISTORY

1968

The Ford Foundation announces \$1 million in grants to Indonesia, the first since closing its office in 1965

❖ 2018: A YEAR OF RED INK

Commentary by Wayne Forrest

Looking back at 2018 one sees a year many of us might otherwise want to forget; it was a true test of Indonesia's capacity for resilience. Amid a string of natural and human disasters; an uncertain economic environment involving the country's major trading partners (EU, China and the US); a yawning current account and trade deficit; Indonesia managed a low-inflation, fiscally-secure growth rate of 5%. The country and the economy are on track to improve in 2019. 2018 highlights are presented first followed by a brief outlook for 2019.

Politics and Law

- Indonesia's anti-corruption efforts continued in 2018 but a new law (MD3) could be used to shield members of Parliament. Senior Parliament heavyweights were arrested and one was convicted of corruption. Setya Novanto (former Speaker and Golkar Party chairman who had evaded arrests several times for other infractions) finally was convicted and sentenced in one of the country's largest scandals, involving the theft of over \$100 million from an electronic identity card program. Deputy speaker Taufik Kurniawan was named a suspect in a bribery case involving a scheme to secure the transfer of funds from the state budget to a district government in Central Java.

- Parliament passed controversial laws against the LGBT community as well as one that insulates its Members from criticism, perhaps even granting them immunity from prosecution (MD3). President Widodo did not oppose the bill as it was being drafted but did not sign it. It automatically became law and he urged a judicial review.

- Surveys of Indonesians report an increase in the acceptance of corruption (54% say it's OK) as well as a rise in intolerance (59% say they refuse to accept non-Muslims as legislative candidates).

- 17 provinces and hundreds of districts held regional elections in June. Many involved mixed party tickets of secular moderates with more Islamic-oriented politicians. In general, moderate candidates won.

- 2014 Presidential rivals President Joko Widodo (Jokowi), and Gerindra Party Chairman, Prabowo Subianto, built coalitions among Indonesia's 11 main parties to contest the 2019 election. Jokowi was reportedly forced into choosing an older Islamic cleric Ma'ruf Amin as his VP running mate and Prabowo picked a young businessman-turned-Vice Governor of Jakarta, Sandiaga Uno, as his running mate. Jokowi currently has a healthy lead in most polls.

- Draft Law on state owned enterprises (SOE). In another example of overreach by Indonesia's Parliament, the law would vest more decision-making in Parliament over daily decision-making in SOE's, as well as enterprises where the government is a minority shareholder, in effect expanding its powers into the executive branch.

Security

- Indonesia experienced two major tsunamis (Sulawesi, Sunda Straits) and a major earthquake in Lombok that killed thousands and displaced over a million people. One of the nation's largest private airlines, Lion Air, suffered a major crash.

- Suicide bombings by 2 families at 3 churches and a police station in Surabaya showed that the influence of middle east-inspired Islamic extremism persists. The pain of seeing parents and their children involved in the attacks was widely felt by Indonesia's populace.

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❖ ECONOMY AND BUSINESS:

- **Darmin Predicts 5.3% Growth in 2019**

Coordinating Economic Minister Darmin Nasution predicted 5.2 percent gross domestic product (GDP) 2018 growth when all accounts are reconciled. GDP growth was recorded at 5.17 percent in the third quarter, 5.27 percent in the second quarter and 5.06 percent in the first quarter. Darmin also voiced optimism that economic growth would reach 5.3 to 5.4 percent in 2019 and that more companies would list their shares on the Indonesia Stock Exchange (IDX), when he attended this year's last trading day at the IDX in Jakarta on Friday. President Joko "Jokowi" Widodo said in a speech on the same occasion that economic activities in the fourth quarter had driven economic growth higher than in the previous quarter, which was recorded at 5.07 percent.

- **Budget Deficit Improves**

Indonesia posted the smallest fiscal deficit in six years in 2018 and less than initially projected, despite turbulence in its financial markets due to capital outflows, Finance Minister Sri Mulyani Indrawati said in a Facebook post. The estimated budget deficit last year was equal to 1.72 percent of gross domestic product, narrower than both the government's original plan of 2.19 percent and the latest estimate of 1.83 percent, Sri Mulyani said in a message posted late on New Year's Eve. As a percentage of GDP, that was the smallest since 2012, the former World Bank managing director said. "We have done our duty to manage government finances well. The year 2018 was not an easy year with fluctuations in the global economy, commodity prices, capital flows and exchange rate," she said, while also noting higher interest rates at home and globally. (*Jakarta Globe*)

- **Trade Agreements: A Way to Growth**

Indonesia's trade deficit this year, which reached US\$7.5 billion in November, has forced the government to find a way to boost exports. Trade Minister Enggartiasto Lukita said the government could not increase exports significantly this year because of various barriers, particularly the high tariffs imposed on Indonesian products that made them less competitive than the products produced by competitors. "We face high entry tariffs because we have no trade agreements," Enggartiasto said recently, adding that the ministry would accelerate trade negotiations with a number of countries and organizations. He said the government was now negotiating with Mozambique, Tunisia and Morocco, as well as with the European Union and the Regional Comprehensive Economic Partnership (RCEP) to establish trade agreements. However, he admitted that negotiations with the EU and RCEP were not easy because they involved a large number of countries, but the government would attempt to complete the negotiations next year.

- **Freeport and Indonesia Complete Divestment Transaction**

State-owned mining holding company Inalum assumed majority ownership of the local unit of Freeport-McMoRan, operator of the world's second-biggest copper mine Grasberg, with the closure of a \$3.85 billion deal announced 12/21/18. The landmark deal, which hands Inalum a 51.23 percent stake in Freeport Indonesia, ends years of tough and often fractious negotiations over ownership rights to Grasberg as Jakarta pushed for greater control over its mineral wealth. "Today is a historical moment since Freeport began operating in Indonesia in 1973," a smiling President Joko "Jokowi" Widodo told reporters at a press conference. "Everything has been completed, and now all that's left is the work," he added. For Jokowi, seeking re-election next year, securing the majority stake in the mine for Indonesia is a

political boon, and he had urged both sides to wrap up the deal quickly. Indonesia and Freeport agreed in principle in August 2017 to set up Freeport's rights to Grasberg according to a new mining license but the process was held up by numerous issues, including resolution of environmental problems linked to the mine.

Freeport McMoRan chief executive Richard Adkerson said the new permit would give the company clarity over its Indonesian operations up to 2041. "The completion of this transaction reflects the culmination of a multi-year process to accomplish a 'win/win' outcome for all parties. This landmark event establishes the beginning of a new long-term partnership between FCX and the Republic of Indonesia."

- **Shortfall in Financing Infrastructure**

The government is facing a financial shortfall of Rp 187.5 trillion (US\$12.92 billion), the Indonesian Infrastructure Society (MII) chairman Harun al-Rasyid said on Tuesday. Harun, who is also an expert at the Bandung Institute of Technology (ITB), expressed pessimism that state-owned enterprises (SOEs) would be able to fulfill the 22.2 percent (Rp 1.07 quadrillion) they were projected to contribute to the infrastructure budget. "Pushing the SOEs' limit will carry high risks, because they also need [a healthy] cash flow for [project] operations, even after the projects have been completed". *Indonesia has turned to the private sector as an alternative but often for projects that have a limited cash flow given their geography. (Editor)*

- **Widest Trade Deficit in 5 Years**

Indonesia posted its widest monthly trade deficit in over five years in November as exports, especially that of palm oil and pulp, slumped, data from the statistics bureau showed on Monday. The deficit in November was \$2.05 billion, compared with October's revised deficit of \$1.77 billion and the biggest trade gap since July 2013, according to Refinitiv data. A Reuters poll had expected a deficit of \$830 million. Finance Minister Sri Mulyani Indrawati has blamed the global economic slowdown for November's widening trade deficit, which was recorded at US\$2.05 billion, an increase from the \$1.82 billion deficit recorded in the previous month. "We have to look at it carefully. China's economic growth is being adjusted both because of its internal policies and the trade war". She said the trade balance would still face challenges in the future because of global uncertainties, particularly those triggered by the trade war between the United States and China. Sri Mulyani also noted that the exports performance was affected by weak commodity prices. "Meanwhile, the [poor] economic conditions in new markets mean there are limited resources for importing," she said, adding that the government would continue to work harder to boost exports. She said the government policy to impose tariffs on 1,147 items as part of efforts to curb imports had started to work. "The volume of imports had in fact declined," she said. (*Jakarta Post*)

- **Low Inflation for 2018**

Coordinating Economic Minister Darmin Nasution said the low inflation rate in 2018 did not result from the people's low purchasing power, but rather the government's ability to gauge the inflation of the people's needs, such as food, distribution, transportation and education. "So if you say it was because of low demands, that was not the case. Because it [inflation rate] was high in the year's onset, and we tried to slow it down," Darmin said at the Indonesia Stock Exchange (BEI) Building in Jakarta on Wednesday, January 2, 2019.

❖ POLITICS, LAW AND SECURITY:

• Some Heated Campaign Rhetoric

In a speech made at the Gerindra Party National Conference in Bogor, West Java on December 17, 2018 Gerindra chairman and presidential hopeful Prabowo Subianto told thousands of his party members that Indonesia could go "extinct" if he did not prevail over President Joko "Jokowi" Widodo in the upcoming election. "We must not lose. If we lose, this country could go extinct," he said. "Because the Indonesian elites are always disappointing, always failing to carry out the mandate given by the Indonesian people." He said the country had been heading in the wrong direction for decades. "If the same system is continued, Indonesia will become weak. Indonesia will become even poorer, even more helpless and could even go extinct," he said. "Pak Prabowo never repents. He's always trying to scare the people," Indonesian Solidarity Party (PSI) secretary-general and Jokowi-Ma'ruf Amin campaign team spokesman Raja Juli Antoni told The Jakarta Post.

• Former Ministers Appointed to Presidential Advisory Staff

Chatib Basri, finance minister during the presidency of Susilo Bambang Yudhoyono, Kuntoro Mangkusubroto, Mining Minister under President Suharto and Syahrul Yasin Limpo, the former governor of South Sulawesi, are among 11 new appointees to the Presidential Staff Office. "Their jobs will be to provide input to the chief of the Presidential Staff Office," Eko Sulistyо, deputy for communication and information dissemination at the office, told Detik.com. The Presidential Staff Office, which was established in 2015, is a nonstructural government agency reporting directly under and reporting to President Joko "Jokowi" Widodo.

• Tsunami Demonstrates Need for New Warning System

As Indonesia reels from the carnage of yet another natural disaster, authorities around the globe are working on how they can prepare for the kind of freak tsunami that battered coasts west of Jakarta this month. The Dec. 22 tsunami killed around 430 people along the coastlines of the Sunda Strait, capping a year of earthquakes and tsunamis in the vast archipelago, which straddles the seismically active Pacific Ring of Fire. No sirens were heard in those towns and beaches to alert people before the deadly series of waves hit shore. Seismologists and authorities say a perfect storm of factors caused the tsunami and made early detection near impossible given the equipment in place. But the disaster should be a wakeup call to step up research on tsunami triggers and preparedness, said several of the experts, some of whom have traveled to Indonesia to investigate what happened. "Indonesia has demonstrated to the rest of the world the huge variety of sources that have the potential to cause tsunamis. More research is needed to understand those less-expected events," said Stephen Hicks, a seismologist at the University of Southampton. The eruption did not rattle seismic monitors significantly, and the absence of seismic signals normally associated with tsunamis led the Meteorology, Climatology and Geophysics Agency (BMKG) initially to tweet that there was no tsunami. Muhamad Sadly, head of geophysics at the BMKG, later told Reuters its tidal monitors were not set up to trigger tsunami warnings from non-seismic events. Fumihiko Imamura, head of Japan's International Research Institute of Disaster, told Reuters he did not believe Japan's current warning system would have detected a tsunami like the one in the Sunda Strait. (*Jakarta Globe*)

❖ FOREIGN AFFAIRS/US INDONESIA RELATIONS:

• White House Statement on Sunda Straits Tsunami

The United States conveys our deepest condolences for the loss of life and destruction from the tsunami that struck West Java and southern Sumatra, Indonesia, on December 22. We continue to monitor the situation closely and are in close communication with Indonesian authorities. Our thoughts and prayers are with all those in Indonesia affected by the natural disaster. We are currently not aware of any U.S. citizens directly affected, but stand ready to assist as needed.

• US/Japan/Indonesia Energy Project Hailed

During a December 19 groundbreaking ceremony in Cilamaya District, West Java, United States Ambassador to Indonesia Joseph R. Donovan Jr. hailed the contributions of American and Japanese companies in what will be Indonesia's first

power plant integrating natural gas infrastructure and power generation. Ambassador Donovan noted the project, known as Jawa 1, is a product of the Japan-U.S. Strategic Energy Partnership (JUSEP) and represents the "high-quality, sustainable, private-sector-led growth" that JUSEP supports across the Indo-Pacific. Ambassador Donovan explained that helping Southeast Asian nations build liquefied natural gas (LNG) infrastructure is a major focus of President Trump's Indo-Pacific Strategy and its Enhancing Development and Growth through Energy program, or Asia EDGE. Asia EDGE and JUSEP aim to catalyze – not replace – private sector investment by enabling energy sector reforms and growing sustainable and secure energy markets throughout the Indo-Pacific. The Ambassador also congratulated GE on its role in the project.

❖ SOCIAL/CULTURE/EDUCATION:

• Sports Top Google Search List

Google data has shown that eight out of 15 of the most trending keywords in Indonesia were related to major sporting events, particularly soccer matches. "These were the keywords that rose the fastest in searches this year compared to last year, not the most searched keywords," said Google Indonesia search marketing manager Mira Sumanti on Thursday.

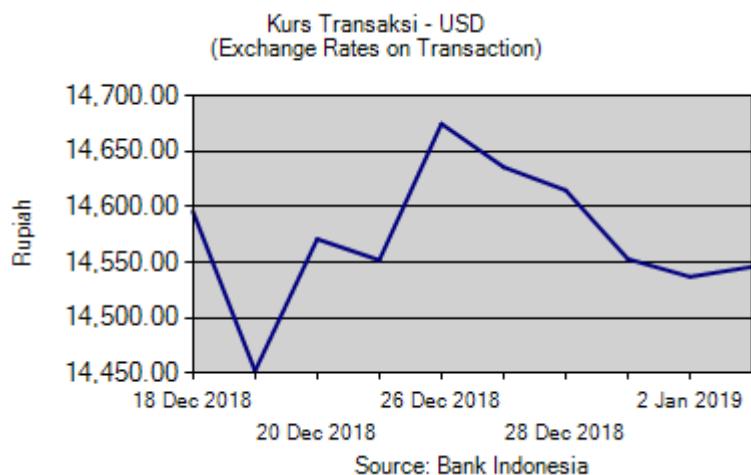
The Year in Search 2018 list shows that the most trending search words included, among others, the Russia World Cup, Asian Games, ASEAN Football Federation (AFF) Cup and even the Asian Games theme song "Meraih Bintang" by singer Via

Vallen. The most searched words in the "characters" category included the U-23 national soccer team, Indonesian Asian Games Organizing Committee (INASGOC) chairman Erick Thohir, men's doubles shuttler Kevin Sanjaya and men's singles shuttler Jonathan Christie who "exploded ovaries" after his post-victory shirtless photos went viral on social media.

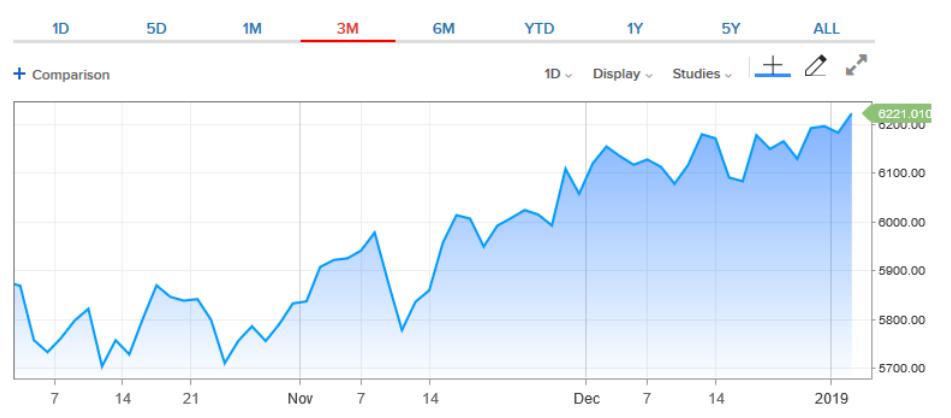


❖ CHARTS:

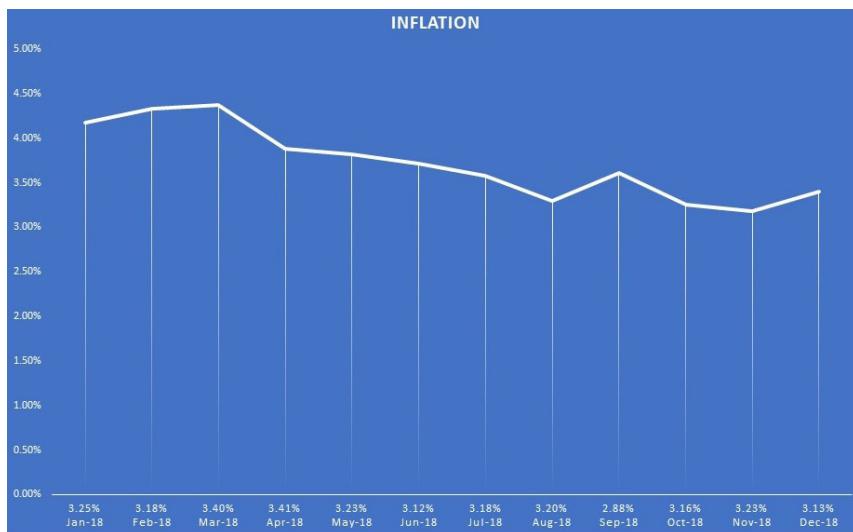
Dollar in Rupiah



Jakarta Stock Exchange Index



Inflation



Foreign Affairs

- Indonesia used its ongoing economic partnership negotiations with Australia to exercise its position in support of a Palestinian state, slowing Oz's decision to move its embassy from Tel Aviv to Jerusalem. It concluded agreements with EFTA (4 small European nations including Switzerland) and held bilateral trade discussions with Peru and Ecuador.
- It hosted 3 major world events in Bali: IMF-World Bank Annual Meetings, One Ocean Conference, and the first World Conference on the Creative Economy.
- President Jokowi met Vice President Pence in November at the ASEAN Summit. They discussed cooperation on freedom of navigation in the South China Sea, North Korea, agreeing on a free and open Indo-Pacific, and increasing two-way trade.

Economy

- Indonesia's rupiah had its worst performance since 1998, losing 12% of its value. It headed south of 15,000 but ended 2018 closer to 14,600.
- The Jakarta Stock Index was down 2.57%. However, there were a record 57 new listings although the value was lower as many were small digital startups. Indonesia currently has 4 unicorns and expects a fifth in 2019.
- Bank Indonesia intervened mightily throughout 2018 in response to US Fed rate increases raising its prime rate 6 times from 4.25% to 6%.
- Sectors experiencing solid growth were the digital economy and infrastructure. One foreign consultancy believes Indonesia's e-commerce market grew 78%, the highest in the world.
- Indonesia's trade deficit widened, in part due to slowed exports to major markets. Foreign direct investment was also down compared to previous years.
- Fiscal policy emphasized stability over growth: controlling inflation, prices, and narrowing the current account deficit by curbing imports. SOE's assumed a high amount of debt to complete infrastructure projects and nationalize mining companies. Increased tax revenues helped the government shrink its budget deficit.
- GDP growth hovered around 5% all year. Indonesia continued to make reforms to the regulatory and investment regime. Changes to the negative investment list were marginal and not necessarily in sectors featuring high foreign demand.
- In December, Indonesia concluded its purchase of Freeport Indonesia shares maintaining the essential elements of its 1991 contract of work that extends management and fiscal authority to its parent company through 2041. The tortuous nature of the negotiations had impacted the overall investment climate for several years and it should now improve. The \$3.85 billion purchase by a SOE, PT Inalum, resulted from an international bond issue. Indonesia has not backed away from its resource nationalism, however.
- The December 2018 linking of the major sections of the Trans Java Highway is a key milestone in the current administration drive to lower logistics costs.

2019 Outlook

- No major government decisions will be made between now and the April 2019 Presidential election.
- Growth will remain in its current 5-5.2% holding pattern, one that has existed since the last years of the previous Administration. A coalition of oligarchic interests maintained through Indonesia's 5 dominant political parties resists deeper structural changes that could advance higher levels of economic growth.
- Economic issues will dominate the rhetoric of the campaign with strong nationalist/populist messages created by both candidates. However, expect religion to be a factor.
- President Jokowi double digit advantage in most polls is buoyed by recent lower energy and food prices, as well as "victories" such as the majority ownership over a world class asset, the Grasberg mine (Freeport) and completion of important toll roads. The President has benefited from lower world wide energy prices that have helped him maintain costly gasoline subsidies for the past two years. Other policies to kick start infrastructure via SOE's may have achieved results sooner but aggravate concerns over the future role of the private sector in Indonesia's economy. Many of the decisions he has made over the past 4 years appear to solidify his political position in a shifting coalition of parties mostly backed by oligarchic interests of one kind or another. His rival Prabowo, ironically a product of the Suharto era military/business elite, already is running against them. He will paint the current administration as in league with corrupt and foreign interests. It remains to be seen how much Jokowi's reputation as a non-elitist reformer has suffered through 5 years of compromise and pragmatism. His transformation from small city reformer to a Suharto-like master pragmatist, willing to placate religious fundamentalists and a his acceptance of a large bureaucracy and state-owned sector controlled in part by political parties, is probably not temporary and will likely persist into a second term. The attraction of China as model of economic development and the current US administration's move away from its traditional position atop a global rules-based order are intertwined troubling developments for the business community no matter who becomes Indonesia's next leader.

(These views are solely those of the writer and do not necessarily reflect those of the American Indonesian Chamber of Commerce or its members.)