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Indonesia revamps economy and may eclipse Germany as the world's 5th largest economy

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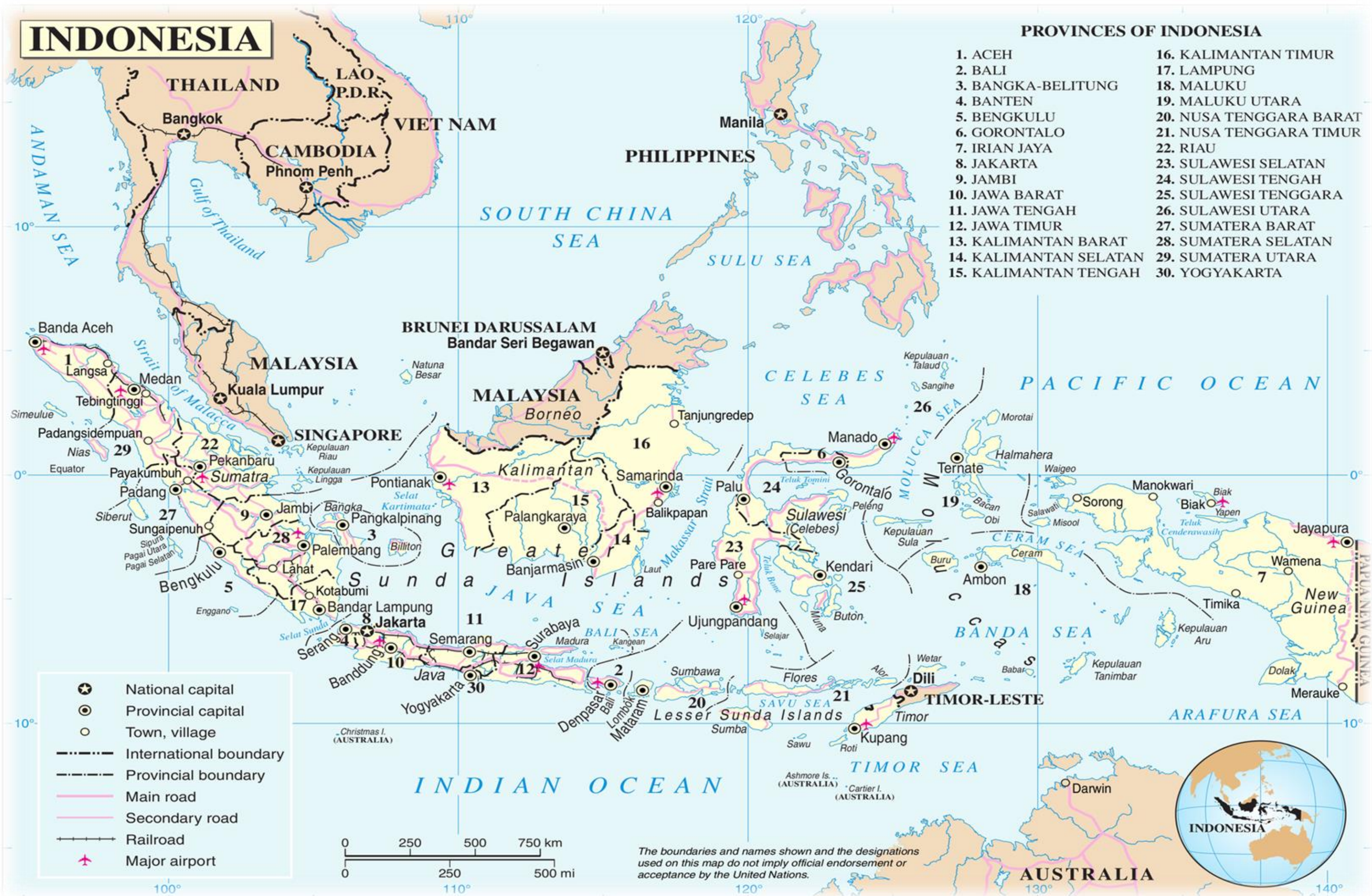

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Indonesia is poised to overtake Germany and the UK as the fifth biggest global economy by 2030 according to various economic models. The 17,000 island nation's ambitions lean heavy on implementation of new bold economic reforms.

On March 2, 2021, the Indonesian government released *Presidential Regulation 10 of 2021*, which liberalizes many sectors for foreign investment. This is part of the **Omnibus Law**, or the big bang structural reform package, outlined by President Joko Widodo and his vision for 'Indonesia 2045' – the centenary anniversary of the republic – which is aimed at releasing the country from its current middle-income trap trap while maintaining geopolitical independence.

The Omnibus Law is enormous as is set to change 76 existing laws and eliminate 4,451 central government regulations 15,965 regional government regulations. The goal is to stimulate domestic and foreign investments by cutting bureaucratic red tape that has stymied competitiveness by quickly undertake reforms which using conventional law-making would have required years and even decades to revise all laws and regulations. It will also reduce corruption and simplify bureaucracy.

Historical background

After independence from the Netherlands in 1945, President Sukarno ruled for 20 years in a system he called "guided democracy" which relied heavily on traditional village system of discussion and consensus – e.g., a more traditional form of polity.

In 1966 General Suharto took over the presidency and adopted the system of "New Order" that instead of adopting a more traditional Western style democratic polity offered military a dual role ("dwifungsi"). In practice it meant the military, particularly officers, playing a prominent political and civil bureaucratic role. Also, the corporate world was heavily bureaucratized and many of the generals were doing business ventures with some business which resulted in massive corruption/kleptocracy and general inefficiency of the economy.

Against the backdrop of the Vietnam War and Cold War, the government was sternly anti-communist but at the same it was one of the leaders for the Non-Aligned Movement (NAM) following the principles of no formal alignments to any great power bloc that had been agreed upon among a number of newly minted independent countries at the Indonesian hosted Bandung Conference in 1955. Many emerging/frontier (EM/FM) countries admired Indonesia, and some of them adopted the *dwifungsi* model.

Following the Asian financial crisis in 1998, Suharto stood down and a number of constitutional reforms were enacted such as mandating free general elections (every 5 years), direct election of the president (including two terms cap) and the establishment of a Constitutional Court to guard and defend the constitution.

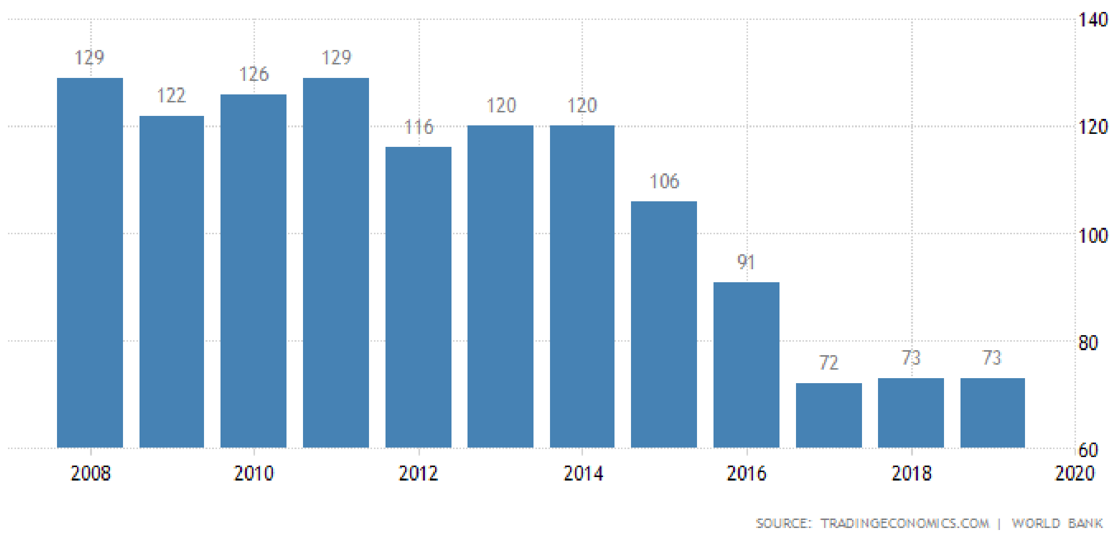
In addition, in 2004 the Dwifungsi system was abolished, forcing any military officer who wanted to pursue a political career to resign their military post first.

Jokowi's pledge for change

In 2014, Joko Widodo ("Jokowi') a former a furniture company owner and mayor of Sulu and Jakarta won the presidential election and lead a coalition government promising reform. He was often seen as Asia's Barack Obama, or a common man who stood for change and optimism about the future.

However, the reforms were on a piece-by-piece basis resulting in mixed results. In 2019, Jokowi won a second term where the reform agenda was given a more prominent.

He pledged to reduce Indonesia's ranking in the World Bank's Ease of Doing Business (EODB) from 73 to 40 – or nearly halve it – in the near-term. Whether he is on the way to succeed or not is hard to measure as in 2020 the World Bank suspended EODB due to allegations data from some countries like Azerbaijan, China, Saudi Arabi and UAE had been deliberately altered.



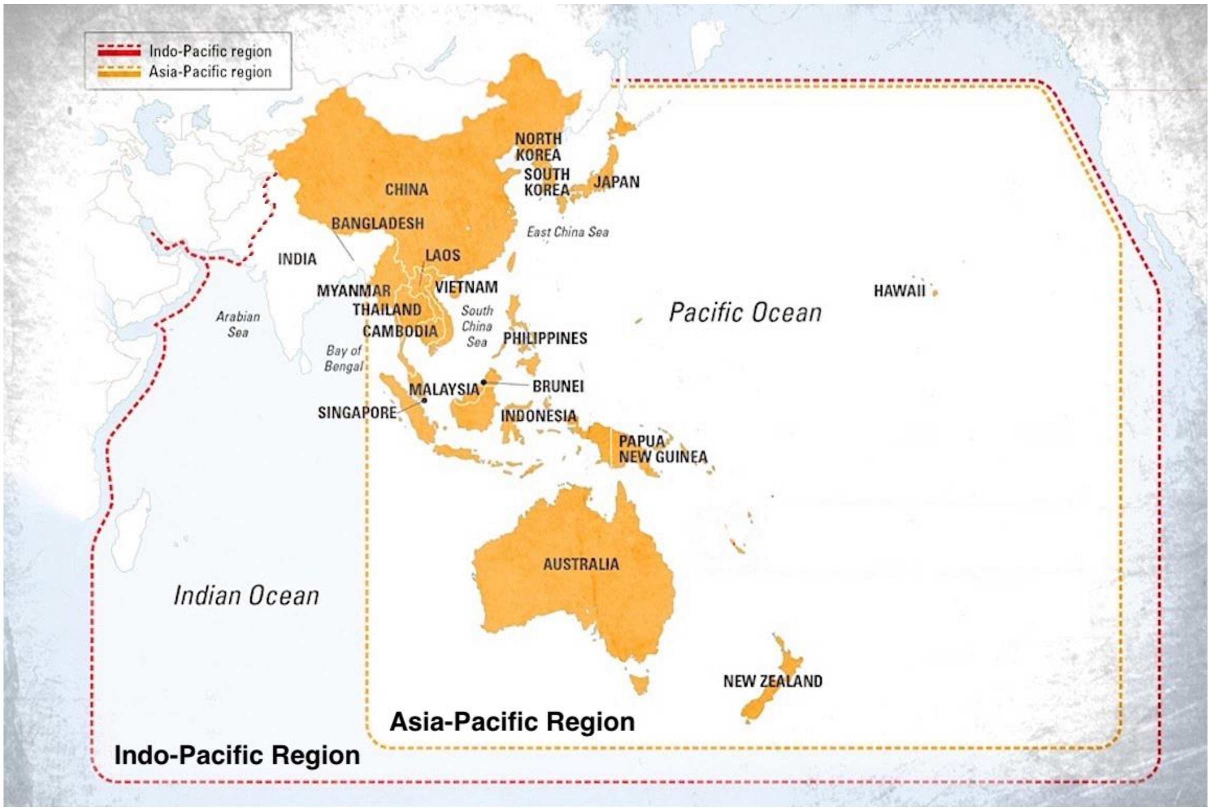
INDOPAC status

The expediency to reform is no chance and closely linked to its geopolitical status. Indonesia is de facto the bullseye in the new US military strategy Indo-Pacific ("INDOPAC") which in March 2018 replaced the previous Asia-Pacific ("ASIAPAC") that had served as the guiding principle since the WWII.

The new INDOPAC strategy added India and the Indian Ocean as major strategic theatres, reflecting that India serves as a pivotal counterweight to China. Moreover the Indian Ocean acts as an important maritime route for trade and commodities transported from EU, Middle East and Africa to China and North Asia. A practical example of this is China's use of gas/oil pipelines in Myanmar which are offloaded at ports and then transported by pipelines into Yunnan in China. Interestingly, despite the ongoing military coup in Myanmar the pipeline is still functioning 100%.

In essence, Indonesia is where the point where the Indian Ocean meets the Pacific Ocean. It is also party of the Malacca Strait (together with Malaysia) which is a major potential choking point for trade/imports of goods and energy shipped to China and North Asia.

Another military choking point is the Sunda Strait, 24k wide, which connects the Indonesian islands Java and Sumatra; recently unmanned drones were reportedly found there which was believed to be deployed to map in great details the best routes/hiding places for Chinese submarines on their way to Indian Ocean and beyond.



This status helps to explain why the newly appointed Japanese Prime Minister Yoshihide Suga made his maiden overseas trip to Indonesia and Vietnam in October. He was quickly followed by the US Secretary of State Mike Pompeo who flew into Indonesia after earlier visited the Western rim of INDOPAC - India, Sri Lanka and the Maldives.

Earlier in the year, US had requested for landing and fuelling rights in Indonesia for its P-8 Poseidon maritime patrol aircraft that monitor China's military activity, particularly in the contested South China Sea. Given its NAM policy Indonesia rejected the request, despite seeing a number of intrusions into their territorial water by Chinse fishing ships as well having a contested claim on part of the South China Sea.

Nonetheless, shortly afterwards US symbolically extended the status of Indonesia as the *only* Asian country that still fully receives the Generalized System Preference (GSP) which is a duty-reduction system to promote growth in developing countries. In contrast, US had eliminated fully/partial the GSP facility for other trading partners including India, Turkey and Thailand.

Even so, the reality is that China is Indonesia's dominating trading partner accounting for 30.5% of total imports and 18.4% in exports in 2020. The US accounts for mere 6.0% of imports and not even among the top 10 for exports. And if Indonesia stagnates it will fall further under Chinese geopolitical and economic influence.

Omnibus Law

The gambit is to restructure Indonesia Inc. as much as possible and hope that will be sufficient to attract foreign investors. Foreign direct as percentage of GDP stood at 1.9% in 2020, which is way below 3% in Thailand and 6% in Vietnam.

The Omnibus Law has been passed and signed off by President Jokowi covering 11 clusters:

1. Relaxation of licensing requirements

2. Investment growth

3. Employment and Labour

4. Ease (in obtaining permits) for empowerment and protection of MSMEs

5. Ease of doing business

6. Research and innovation

7. Government administration

8. Imposition of sanctions and penalties

9. Land procurement

10. Government investment and national strategic projects

11. Economic Zones.

Given the size and complexity of the program, details are gradually being worked out by the politicians and bureaucrats where the first set of information released only in the local language Bahasa Indonesia.

What we know for sure these changes have been adopted:

Labour laws – reduces statutory severance packages from a maximum of 30 months' salary to no more than 19 months' salary; simplifies work permits for expatriates.

Corporate tax – income tax reduced to 22% for private companies and 19% for Indonesia-listed companies, which will be further cut to 20% and 17%, respectively, in 2022.

Property sector – foreign ownership of property relaxed.

Negative list – replaced by a "positive list" which gives foreigners access to various industries which had been previously been strictly reserved for locals and local companies.

Sovereign wealth fund – has been established to improve capital allocation/efficiency for key areas such as infrastructure investments. With an initial target size of $10bn it will be run on commercial basis by professionals (lawyers, PE investors and accountants) and overseen by a board consisting of technocrats, backed by money from the government as well as foreign institutional investors with following institutions reported capital commitments: Japan Bank for International Cooperation ($4bn), US International Development Finance

Corporation ($2bn), Caisse de Depot et Placement due Quebec ($2bn), Algemene Pensioen Groep of Netherlands ($1.5bn) and Macquarie, the Australian investment bank ($0.3bn).

Merger of Islamic banks – Indonesia has merged three Shariah Bank units from state-controlled banks (Bank Mandiri, Bank Rakyat and Bank Negara Indonesia) into one big lender called *Bank Syariah Indonesia*. With a population of 270m where the majority are Muslims the case for Islamic banking is clear. In 2020, Islamic banking assets accounted for 6% of total assets. According to DinarStandard, Indonesia ranks fourth among Islamic banking led economies after Malaysia , Saudi Arabia and the UAE. It is up from 10th in 2018, and it is likely Indonesia to take the no. 1 title over the next few years in Shariah banking.

Not everyone welcomes reforms. Protesters have opposed the labour reforms and some people have called for the Constitutional Court to intervene.

There is also fear of political re-alignments by the country's political parties.

Recent concluded local elections saw Gibran Rakabuming Raka and Bobby Nasution, the son and son-in-law of President Widodo to be elected as mayors in the provinces. An academic study from North-western University in the US found that 146 of the local election came from political families, up from 52 in 2015. Though the high number might reflect that the two terms cap is working and they try to use their fading political capital/patronage on their children.

Hunting for new opportunities

Indonesia with a population of 270m where many belong to generation Z is an alluring consumer market. This is particularly in the more affluent area where a slew of new companies have built size and momentum helped by fresh capital injections from Western and Asian investors. Many have now reached decacorn/unicorn valuation status and are set for listings in Indonesia and the US/Asia (dual listings).

Top names includes: **Gojek** (Super App), **Tokopedia** (E-commerce), **Gopay** (E-payment), **OVO** (E-payment), **Traveloka** (Online Travel), **Bukalapak** (E-commerce), **Dana** (E-payment), **Ruang Guru** (Ed Tech platform), Link **Aja** (E-payment) and **Zenus** (Ed Tech platform).

Another area of great interest is electric vehicle (EV) sector. Indonesia is the world's largest producer of nickel laterite ore, which is the primary input in the lithium-ion batteries that are used to power EVs. Indonesia accounts for 30% of global reserves of nickel. Several Asian battery manufacturers are heavily invested in Indonesia, and the government aims to produce 200,000 EV by 2025. Tesla is said to have recently submitted a proposal to the Indonesian government for the establishment of a battery production facility in the country. This is on the back of the automakers strive to secure nickel supplies for its larger 4680 cells that is planned to be used in future Tesla vehicles such as the Cybertruck and the Semi models.

Shine or fade

Indonesia will have to live up to its big bang reforms in order to secure its long-term geopolitical and economic future. The NAM status is not cost free with increased competition between China and US, where both parties are vying for increased influence and access. Economically global supply chains are becoming more intricate and complex with minimal acceptance for political follies or administrative inefficiency.

Indonesia has to navigate skillfully between (a) China that is seeking qualitative and technological breakthrough (5G, AI etc) during its new 14th 5-year plan (2021-25) which was passed by the National People's Congress in Beijing last week; (b) the US which under President Biden which is yet to put muscles and dollars behind the INDOPAC strategy; And (c) Other M/FM countries which offer new trading potentials.

Indonesia assumes the chairmanship of G20 and ASEAN in 2023. Adapt or fade and it will have a large polatform to showcase its big dreams.

Chinese Loans to African Governments vs. Eurobond Debts

Country	China Eximbank	CDB	China Supplier's Credits	TOTAL Chinese Debt	Total Eurobonds as of 2019	Total Chinese Debt as % of Eurobonds	DaMina Risk of Eurobond Pari Pasu Default following China 'Brady' Plan
Angola	$ 8,272	$ 26,589	$ 22	$ 43,145	$ 5,000	*863%*	*High*
Cameroon	$ 5,034	$ 2	$ 2	$ 5,561	$ 750	*741%*	*High*
Tanzania	$ 2,378	$ 200	$ -	$ 2,640	$ 600	*440%*	*High*
Mozambique	$ 2,018	$ 179	$ -	$ 2,290	$ 727	*315%*	*High*
Zambia	$ 3,760	$ 1,002	$ 673	$ 8,634	$ 4,250	*203%*	*High*
Benin	$ 1,686	$ -	$ -	$ 1,909	$ 1,089	*175%*	*High*
Kenya	$ 7,878	$ 867	$ -	$ 8,900	$ 7,000	*127%*	*High*
Rwanda	$ 222	$ -	$ -	$ 290	$ 400	*73%*	*Medium*
Senegal	$ 1,998	$ -	$ -	$ 2,019	$ 4,189	*48%*	*Medium*
Namibia	$ 270	$ -	$ 223	$ 538	$ 1,250	*43%*	*Medium*
Cote d'Ivoire	$ 2,710	$ -	$ -	$ 2,783	$ 8,113	*34%*	*Medium*
Ghana	$ 1,585	$ 1,000	$ 599	$ 3,499	$ 11,082	*32%*	*Medium*
Nigeria	$ 4,903	$ -	$ 390	$ 5,293	$ 18,642	*28%*	*Medium*
Gabon	$ 450	$ -	$ -	$ 735	$ 3,409	*22%*	*Medium*
Seychelles	$ 34	$ -	$ -	$ 34	$ 169	*20%*	*Medium*
Morocco	$ 1,022	$ -	$ -	$ 1,030	$ 6,695	*15%*	*Low*
Egypt	$ 767	$ 2,600	$ -	$ 3,421	$ 29,014	*12%*	*Low*
South Africa	$ -	$ 3,131	$ -	$ 3,819	$ 40,176	*10%*	*Low*
Mauritius	$ 414	$ -	$ -	$ 492	$ 7,020	*7%*	*Low*
Liberia	$ 50	$ -	$ -	$ 50	$ 950	*5%*	*Low*
Tunisia	$ 143	$ -	$ -	$ 146	$ 8,038	*2%*	*Low*
Sudan	$ 5,027	$ -	$ 598	$ 6,495	$ -	*649500%*	**No Eurobonds*
Rep of Congo	$ 4,812	$ -	$ 238	$ 5,070	$ -	*507000%*	**No Eurobonds*
DRC	$ 3,325	$ -	$ -	$ 3,345	$ -	*334500%*	**No Eurobonds*
Zimbabwe	$ 2,692	$ 40	$ 290	$ 3,288	$ -	*328800%*	**No Eurobonds*
Uganda	$ 3,110	$ -	$ -	$ 3,181	$ -	*318100%*	**No Eurobonds*
Equatorial Guinea	$ 1,198	$ -	$ 478	$ 1,699	$ -	*169900%*	**No Eurobonds*
Djibouti	$ 1,261	$ -	$ 150	$ 1,467	$ -	*146700%*	**No Eurobonds*
Mali	$ 909	$ -	$ -	$ 989	$ -	*98900%*	**No Eurobonds*
Botswana	$ 90	$ -	$ -	$ 931	$ -	*93100%*	**No Eurobonds*
Togo	$ 773	$ -	$ -	$ 853	$ -	*85300%*	**No Eurobonds*
Niger	$ 332	$ -	$ 352	$ 703	$ -	*70300%*	**No Eurobonds*
Guinea	$ 273	$ -	$ 335	$ 646	$ -	*64600%*	**No Eurobonds*
Eritrea	$ 589	$ -	$ -	$ 605	$ -	*60500%*	**No Eurobonds*
Chad	$ 586	$ -	$ -	$ 590	$ -	*59000%*	**No Eurobonds*
Madagascar	$ 435	$ -	$ -	$ 435	$ -	*43500%*	**No Eurobonds*
Mauritania	$ 381	$ -	$ -	$ 431	$ -	*43100%*	**No Eurobonds*
Malawi	$ 262	$ -	$ -	$ 262	$ -	*26200%*	**No Eurobonds*
Sierra Leone	$ 48	$ -	$ 176	$ 224	$ -	*22400%*	**No Eurobonds*
South Sudan	$ 158	$ -	$ -	$ 158	$ -	*15800%*	**No Eurobonds*
CAR	$ -	$ -	$ 60	$ 103	$ -	*10300%*	**No Eurobonds*
Burundi	$ 36	$ -	$ -	$ 86	$ -	*8600%*	**No Eurobonds*
Cape Verde	$ 43	$ -	$ -	$ 49	$ -	*4900%*	**No Eurobonds*
Comoros	$ 39	$ -	$ -	$ 39	$ -	*3900%*	**No Eurobonds*
Lesotho	$ 27	$ 2	$ -	$ 37	$ -	*3700%*	**No Eurobonds*
Ethiopia	$ 8,069	$ 655	$ 4,165	$ 13,796	$ -	*1380%*	**No Eurobonds*
Algeria	$ -	$ -	$ -	$ 9	$ -	*900%*	**No Eurobonds*
TOTAL	**$ 80,561**	**$ 36,772**	**$ 8,751**	**$ 145,729**	**$ 158,563**	*92%*	

Source: Johns Hopkins SAIS/BIS/ DaMina

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