INDONESIA

Population : 270,625,568 (2019)
GDP per capita : US$3,932.211 (2019)
Country risk assessment : A4 (2019)
Business Climate : B

STRENGTHS

- Diverse natural resources (agriculture, energy, mining)
- Highly competitive thanks to low labour costs
- Dynamic tourism industry
- Huge internal market
- Strong banking sector
- Sovereign bonds rated “Investment Grade” by the three main rating agencies

WEAKNESSES

- Low investment rate
- Exports of commodities increasingly dependent on Chinese demand
- Infrastructure shortcomings
- Persistent corruption and lack of transparency
- Very extensive archipelago with numerous islands and diverse ethnic groups and religions
- High unemployment and poverty rates sharpening inter-ethnic tensions

COUNTRY RISK

ECONOMY

Indonesia is seen as a future economic giant. It is the largest economy in Southeast Asia and the world's seventh by purchasing power parity. The country hasn't suffered negative GDP growth since 1998, but economic growth has been stagnant at around the 5% range over the past years; it decreased slightly to 5.03% in 2019 and is projected to remain at 5.07% in 2020 and grow to 5.22% in 2021. The key drivers of the economy are private domestic consumption - stimulated by its huge market with a growing middle class of nearly 70 million people (55% of GDP), while the major issues are the ongoing trade tensions between China and the US, the country's two biggest trading partners, and the prolonged depreciation of the Rupiah.

According to the IMF, the authorities have had early successes in reducing fuel subsidies and in the expansion of conditional cash transfers and public investment. The budget deficit has been decreasing over the past few years; it rose slightly to 1.7% in 2019 and the estimations for 2020 (1.8%) and 2021 (1.7%) are set to remain stable. Inflation was estimated at 3.2% in 2019 and is expected to remain at the same level in 2020 and 2021, thanks to lower inflationary pressure from the government-regulated prices. Public debt

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has shown a significant improvement since the Asian Financial Crisis in 1998 (150%) of GDP), but it rose slightly to 26.8% of GDP in 2019. Three social programmes (RPJMN, PNPM Urban and PAMSIMAS) have been launched to ensure that the poorest strata of the population have access to healthcare and education. Other structural issues that remain to be tackled include a large public infrastructure gap, high labour informality and youth unemployment, and low educational attainment. Environmental protection also remains a major challenge. The government hopes to take advantage of the country's strategic location between Asia and the Pacific in the current unfavourable international context (weakening demand from China and falling commodity prices), and aims to be in the top six largest economies by 2030.

Although it has been decreasing over the last decade and estimates of IMF are optimistic, the unemployment rate remains high (5.2% in 2019), and many people continue to work in vulnerable conditions. Indonesia has achieved enormous gains in poverty reduction, cutting the poverty rate by more than half since 1999, to approximately 9.4% of the population in 2019, but the country has still one of the fastest rising inequality rates in the East Asia region according to World Bank.

INTERNATIONAL TRADE

Indonesia is very open to foreign trade, which represents 43% of its GDP (World Bank, 2018). The main exports are mineral fuels (23.3%%), animal and vegetable fats and oils (11.3%), electrical machinery (4.9%), vehicles (4.2%), and rubber (3.5%) rubber (4.6%). Indonesia mostly imports mineral fuels and oil (16.7%), machinery and computers (14.4%), electronic apparatus (11.4%%) and iron and steel (5.4%). Indonesia is the second world's largest exporter of thermal coal used in power stations and has two major customers, China and India, the planet's two largest coal importers.

China remained Indonesia's largest trading partner in 2018, buying up 15.1% of exports, followed by Japan (10.8%), United States (10.2%), and India (7.6%). The main suppliers are China (24.1%), Singapore (11.4%); Japan (9.5%), and Thailand (5.8%). China and Indonesia are forging closer economic ties as the two countries face threats to their trade relations with the United States due to protectionist actions taken by President Donal Trump.

In 2018, Indonesia recorded a trade deficit of USD 8.4 billion caused by rapidly rising imports and a slowdown in automobile parts and vegetable oil shipments. Exports grew to USD 180.2 billion while imports grew to USD 188.7 billion. Despite the government's efforts to mitigate the widening trade gap, the current account deficit in the second quarter of 2019 hit USD 8.4 billion (3% of GDP). The country is betting on bilateral and multilateral trade agreements to revive the sluggish non-oil exports within the next five years. President Widodo insists on the need to export less raw materials and more processed goods to create more added value and jobs at home.

Main International Economic Cooperation

The country is a member of the APEC, ASEAN, AFTA and the ASEAN - China Free Trade Area.

The country have signed a trade agreement with 21 other countries in the São Paulo Round of the Global System of Trade Preferences among Developing Countries (GSTP).

INVESTMENT

FDI flows into Indonesia have grown and their base has been expanding thanks to relisient economic growth, low government debt and prudent fiscal management. In 2018, FDI investment in Indonesia reached USD 21 billion, an increase from 2017 (+6.8%) (UNCTAD World Investment Report 2019), and based on the data from the Investment Coordinating Board (BKPM), FDI levels grew to USD 13 billion in the second quarter of 2019, mainly in electricity, gas and water, transportation and telecommunication. FDI growth is attributed to a set of economic policy packages that was implemented by the Indonesian government over the last years, mainly focusing on deregulation, law enforcement and business certainty, interest rate tax cuts for exporters, energy tariffs cuts for labour-intensive industries, tax incentives for investment in special economic zones and lowered tax rates on property acquired by local real estate investment trusts. The 2018 increase is mainly explained by intra-ASEAN investments (from Singapore). One of the biggest projects was in infrastructure, the new segments of the Jakarta Light Rail Transit. New SEZs also contributed to the increase. Indonesia lowered the minimum equity requirement for foreign investors and abolished the approval requirement for several business transactions involving foreign investors. FDI stock reached USD 226 billion in 2018, less than in 2017 (-2.2%) and represents 22.1% of the GDP. Singapore remained the largest source of investment, followed by Japan, China and Hong Kong.

The Indonesian government was able to improve the overall atmosphere of the market in 2019 by consolidating political and economic stability and through structural reforms that have removed some investment risk. However, several obstacles remain, such as the rising cost of credit, excessive and unpredictable regulation, the poor quality of infrastructure, the terrorism risk and a high level of corruption. In the long term, however, Indonesia's current economic situation may well be the right time to invest in the country, especially in its financial instruments. President Widodo has announced plans to improve the country's position in the Doing Business report published by the World Bank with the goal of reaching 40th position globally. Following a bold reform programme aimed at liberalising the economy and reducing investment barriers, Indonesia fell one spot to 73rd out of 190 in the Doing Business 2020 survey. At the same time, however, a recent Constitutional Court decision granting more regulatory authority to regional governments could pose a challenge to ongoing investment climate improvements.

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