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Can Jokowi Deliver on Ambitious Reforms?

Societe Generale economist says the Indonesian president's plans won't soothe short-term economic woes.

By
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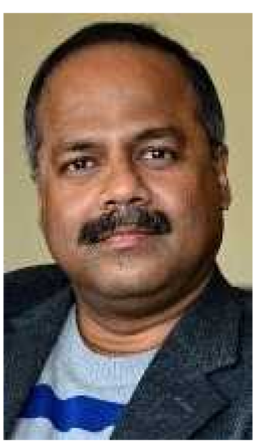
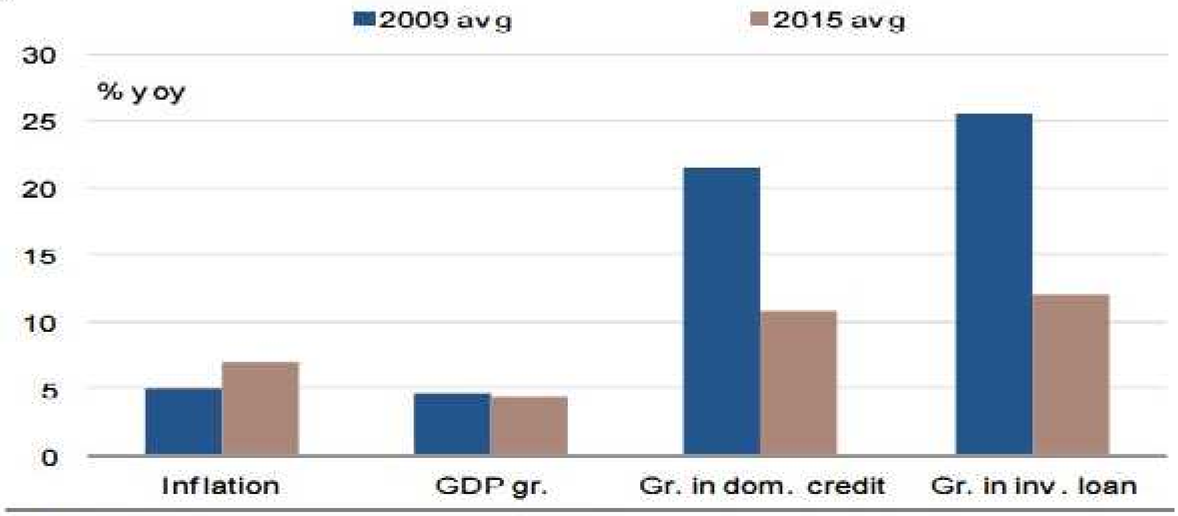
As the first anniversary of the newly elected government approaches, Indonesian president Jokowi is finally stamping his authority to overcome the inertia that has seemingly gripped the policy makers. The initial euphoria of the people's president coming to power and doing the unthinkable (successfully reforming the domestic motor fuel price policy) gave way to despair as the political challenge seemed to have hijacked the president's economic agenda. Rising economic challenge, exacerbated by weak external conditions, has led to dimming confidence of the investors who banked on his ability to cut through the red tape and create enabling conditions for a stronger economy going forward. With Jokowi's dream of propping up GDP growth to 7% year-on-year (by the time his five-year tenure ends) seemingly unachievable, he embarked on the path of winning back the lost confidence. Starting with a reshuffling of his cabinet in August and following that up with a plethora of economic reforms announcements, Jokowi has given the impression that revival of economic fortunes is firmly back on his agenda. Although more clarity is awaited, we believe that the policy measures announced thus far are steps in the right direction, though implementation remains the key. Also, we do not foresee any amelioration of short-term economic pains despite these announcements, more so given a slowing China.



Current economic condition worse than post-crisis period

We believe Jokowi's election as a president was the best thing to have happened to Indonesia. However, we were worried about the political challenge that Jokowi was likely to face, and this made us weary about the likelihood of reforms taking place. Not surprisingly, the economy has been progressively turning out to be weaker now as compared to what it was when Jokowi took over, what with growth slowing down to worrying levels, unemployment rising, weaker currency and elevated levels of inflation. In fact, the economy is in a worse situation now than was the case in the aftermath of the financial crisis.

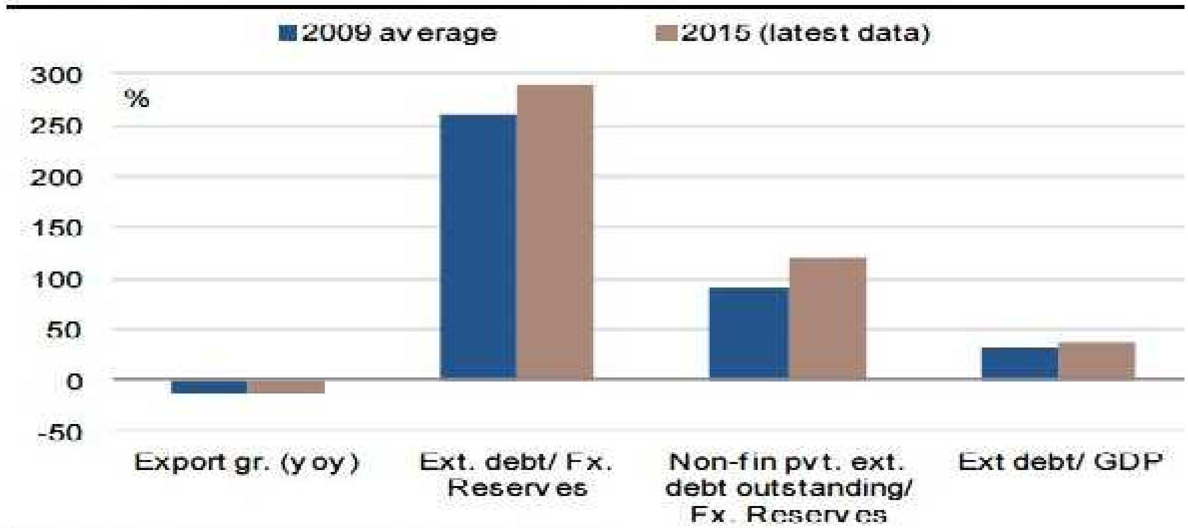
Economy weaker now than it was after the crisis



Source: BPS; SG Cross Asset Research/Economics

For better understanding, we have used the average performance during 2009 and the average performance to date in 2015. As can be seen from the charts above, except for exports shrinking a tad less than it did in 2009, performance on all other macro metrics has deteriorated. During this period, total external debt increased by 76% (though the overall debt to GDP ratio remains manageable), while external debt of the private non-financial entities more than doubled, a large part of which is un-hedged. This raises the spectre of default by the private companies, especially given that the IDR is flirting with its 1997 (Asian crisis) lows. S&P, which rates Indonesia below investment grade, has cut its ratings of seven Indonesian companies so far in 2015 due to foreign currency exposure. In fact, since 2012 Indonesia's total private foreign debt has exceeded its total public sector debt and roughly a fourth of private debt is short term in nature.

External conditions weakened further



Source: BPS; SG Cross Asset Research/Economics

Worryingly, Indonesia is also experiencing a deterioration of its twin deficit. While the country's current account balance was in surplus on 2009 and the budget deficit was less than 2% of GDP, currently, both the current account deficit (CAD) and the budget deficit threaten to touch 3% of GDP.

Reshuffling cabinet – First step to reinvigorate the ailing economy

When Jokowi decided to reshuffle the cabinet in August 2015, it was aimed at addressing the twin challenge of reversing the economic slowdown while at the same time keeping the key figures within the party happy. His decision to induct technocrats rather than career politicians to oversee economic policies was a step in the right direction. He appointed Darmin Nasution, a former central banker, as chief economic minister. Nasution is regarded as highly competent in both monetary and fiscal policies, and his appointment will likely ensure improved policy coordination. A lack of policy and ministerial coordination has so far been a big stumbling block against the ushering in of appropriate economic reforms. His second important appointee was Tom Lembong, a Harvard graduate, as a trade minister. Lembong worked at Morgan Stanley and Deutsche Bank before co-founding a private equity firm in Singapore. His appointment is perceived as a way to counter rising concern about Indonesia's protectionist trade policies. In addition, his appointment of Teten Masduki, an anti-corruption crusader, as his Chief of Staff is expected to give more teeth to Indonesia's drive against corruption.

The reshuffling of the cabinet is seen as a balancing act by Jokowi as he tries to ensure that his economic agenda does not get derailed while at the same time he does not antagonize his party colleague and coalition partners.

Reform packages – Intention needs to be backed by action

The Indonesian economy is currently at a crossroads. Despite the high expectations for the growth potential of the economy, there is now a growing concern that rising protectionism and uncertainty regarding economic and administrative reforms could impede gains in productivity, innovation and competitiveness. Indonesia's inability to regain competitiveness despite a sharp depreciation of the currency is as much a commentary on global weakness as it is on the overall level of competitiveness of the economy. A sustained decline in competitiveness would risk the economy being caught in the 'middle-income trap' as investment and growth slow, and incomes stagnate.

As the confidence of foreign investors took a beating, given the palpable sense of drift in policy making, president Jokowi announced a series of economic reforms packages since early September that were designed to re-invigorate the economy and attract foreign investment. The package, (to be announced in three tranches, of which two has already been announced and the third likely to be announced next week) included a mix of tax holidays, focused investment in infrastructure and changes to existing regulations that would help eventually improve Indonesia's ranking in the 'Doing Business Index'.

On 9 September, Jokowi announced (the first package) a slew of measures aimed at changing existing regulations and simplifying the process for obtaining permits for infrastructure projects. Without going into the details, he promised to bring about a change in about 89 regulations with an aim of making the domestic manufacturing industry more competitive – a pre-requisite for reducing the country's excessive dependence on commodities. The second package, which was announced on 29 September, was aimed at simplifying permitting procedures, making the process to obtain investment permits faster and cheaper for investors. Minister Nasution announced that the time required to process investment permits (for industrial estates only) would be cut from eight days to just three hours. However, this fast service will only be available to those companies that invest at least IDR 100 billion (approx. USD $7 million) and plan to employ at least 1,000 people. Furthermore, the processing of permits in the mining and geothermal sectors will be slashed from up to four years to just 15 days. The third package, which would be announced next week, would likely focus on lowering gas, diesel and electricity (for industrial users) prices to avert more layoffs in Indonesia's manufacturing industry. Also, the government may lower lending rates in order to boost credit expansion, which is at a multi-year low.

While we welcome these announcements, we do not think that there would be any short- to medium-term impact on the economy. We feel that implementation would take much longer than the government expects. There have been announcements made by the earlier governments as well, but most of these have failed to come to fruition. Implementation would be the key, and given the deeply entrenched problems, progress will likely be slow. We also believe that some of the stated objectives are way too ambitious. For example, the ability to reduce the time required to process investment permits from eight days to three hours is quite unrealistic in our view.

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