Economic Research

KDN No.: PP14787/11/2012(030811)

MALAYSIAN RATING CORPORATION BERHAD
(364803-V)

Vol.: ER/008/2018

Country Risk Monitor:
Indonesia

Economic Research Division

Quah Boon Huat
Senior Economist
+603 2717 2931
boonhuat@marc.com.my

Indonesia Risk Assessment

The macroeconomic and macrofinancial environment

- The Indonesian economy remains resilient. In 2017, growth improved slightly to 5.1% on the back of higher domestic demand fuelled by a large population with a growing middle class and rapid urbanisation. There was also growth support from the recovery in commodity prices, surge in gross fixed capital investment and improving global trade. Meanwhile, inflation remains benign due in part to structural shifts that have helped shore up monetary policy credibility. The latest available data show the Indonesian economy expanding by 5.1% year-on-year in 1Q2018, compared with 5.0% in the same quarter last year. Over the medium term, the economy is expected to expand within the 5.0%-5.5% range.

- With the authorities keen on maintaining aggregate fiscal discipline, the momentum of the rise of fiscal deficit has moderated and stabilised. It remains close to the legal deficit ceiling of 3.0% of gross domestic product (GDP). Fiscal discipline has ensured that government debt (2017: 29.0% of GDP) remains well below the 60% legal threshold. The government’s debt dynamics are deemed robust to stand up to both standard shocks and stress tests. Over the medium term, debt will likely increase modestly to around 30% of GDP.

- Indonesia remains vulnerable to external risk factors because of its dependence on external financing. This is amply illustrated by its net international investment position of -33.5% of GDP as of end-2017. A shock coming from a sudden large reversal of capital inflows could have significant ramifications for economic, fiscal and financial sector stability. A case in point: the Indonesian Rupiah (IDR) has been hard hit by US interest rate hikes and global trade tensions. To support the IDR, Bank Indonesia has had to raise its key interest rate again on June 29, 2018, the third time in less than two months.

- Indonesia’s narrow tax base is a fiscal concern. Less than 10% of the population, approximately 15% of the total number of employed workers, are obligated to file annual income tax returns. While the percentage of registered employed workers (as a share of total employed) has continued to rise, the percentage of those obligated to file tax returns has trended downwards. Tax buoyancy has continued to weaken, reflecting in part weak tax compliance and declining capability to tap tax potential.

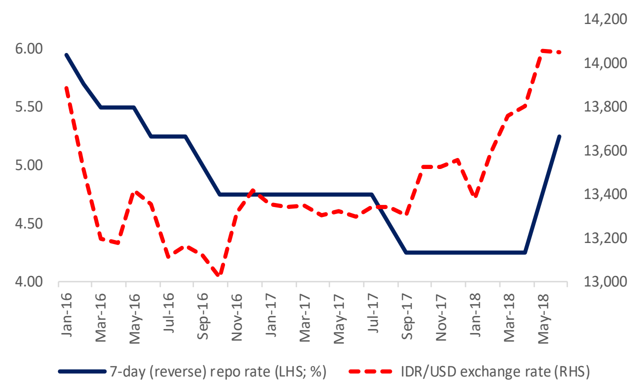
The political, legal, and social climate

- Indonesia continues to do poorly in the “political stability and absence of violence/terrorism” component of the World Bank’s Worldwide Governance Indicators project. In 2017, a divisive religiously tinged election campaign to elect Jakarta’s governor incited political and religious tensions. The viciously fought Jakarta gubernatorial election is important given that it is cementing itself as a battlefield for proxies of national level interests. Considering the divisiveness of the gubernatorial election, there is concern that political and religious tensions could again rise in the run-up to the 2019 presidential election.

- The many sources of terrorism in Indonesia remain unaddressed, notwithstanding the country’s new anti-terrorism law. The nature of terrorist attacks continues to evolve, as evidenced by Surabaya’s ISIS-inspired coordinated suicide bombings of May 13, 2018 where three families, including children, were involved. With the Islamic State (ISIS) squeezed out of its heartland in Syria and Iraq, Indonesians affiliated with it have returned from the Middle East. This lends credence to the view that the Surabaya attacks could be the start of a new, more sophisticated terror campaign in Indonesia.

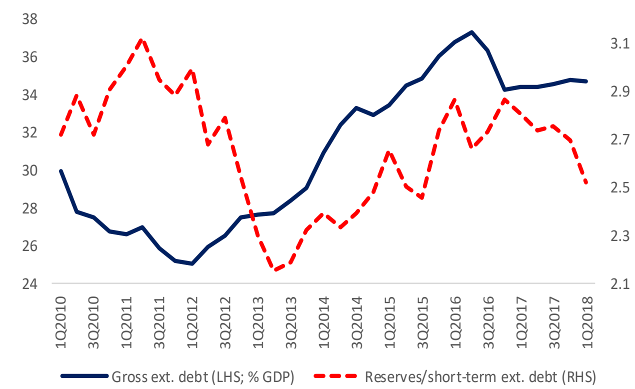
- Governance and institutional issues continue to be risk factors, and government policy backflips, including that on mining policies in 2017, for example, have caused alarm among foreign investors. Notwithstanding ongoing reforms, widespread corruption, a weak legal system and social instability, among other things, continue to make Indonesia a difficult place to do business. It is important to note that reforms at the central government level may not necessarily trickle downwards to the local government level, where it sometimes matters most. Indonesia is ranked at a lowly number 72 out of 190 countries in the World Bank’s Doing Business 2018 report.

Chart 1: Policy rate and IDR/USD rate



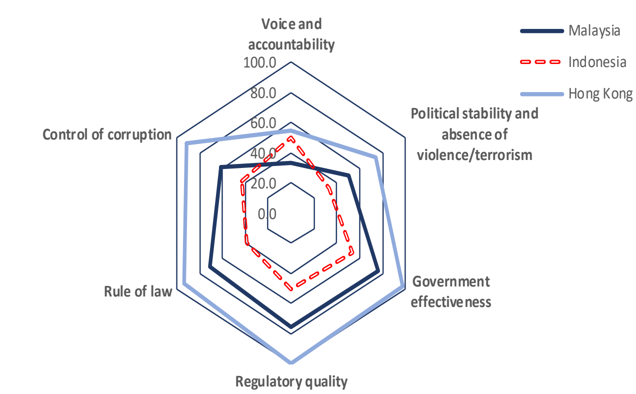
Source: CEIC, MARC Economic Research

Chart 2: External debt and international reserves



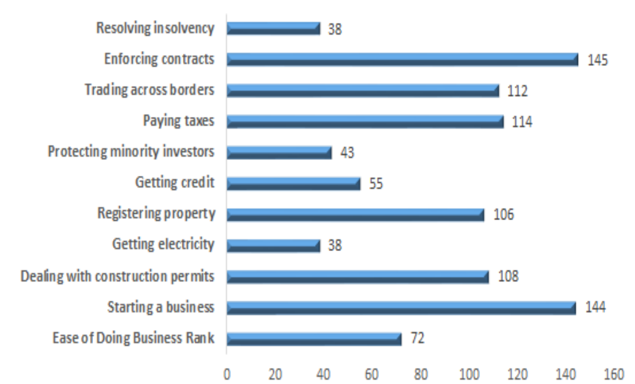
Source: IMF, MARC Economic Research

Chart 3: Worldwide Governance Indicators, 2017 Update



Source: World Bank
Note: Percentile ranking

Chart 4: Indonesia: Ease of Doing Business 2018



Source: World Bank
Note: Ranking out of 190 countries

Table 1: Selected economic indicators

	2012	2013	2014	2015	2016	2017
Real GDP growth (%)	6.0	5.6	5.0	4.9	5.0	5.1
CPI inflation (%, annual average)	4.0	6.4	6.4	6.4	3.5	3.8
Fiscal balance (% GDP)	-1.8	-2.2	-2.1	-2.6	-2.5	-2.5
Government debt (% GDP)	23.0	24.9	24.7	27.5	28.3	29.0
Gross external debt (% GDP)	27.5	29.1	32.9	36.1	34.3	34.7
Current account (% GDP)	-2.7	-3.2	-3.1	-2.0	-1.8	-1.7
Net international investment position (% GDP)	-39.3	-40.6	-43.1	-43.8	-35.8	-33.5
International reserves (USD billion)	112.8	99.4	111.9	105.9	116.4	130.2

Source: World Bank, IMF, Bank Indonesia, CEIC, MARC Economic Research

Disclaimer

Published and Printed by:

MALAYSIAN RATING CORPORATION BERHAD (364803-V)
19-07, Level 19, Q Sentral, No. 2A, Jalan Stesen Sentral 2, Kuala Lumpur Sentral, 50470 KUALA LUMPUR
Tel: [603] 2717 2900 Fax: [603] 2717 2910 E-mail: marc@marc.com.my
H-page: www.marc.com.my