

Highlights of the week



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Jokowi, the Army and the election

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PLTU Riau-1 corruption case reveals dark side of electricity business

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Investors show lack of interest in latest oil and gas auction

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***Extras: Macroeconomic Update - June trade surplus eases worry over current account deficit**

Tenggara Strategics is a business and investment research and advisory institute established by the Centre for Strategics and International Studies (CSIS), The Jakarta Post and Prasetya Mulya University. Combining the capabilities of the three organizations, we aim to provide the business community with the most reliable and comprehensive business intelligence related to areas that will help business leaders make strategic decisions.

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POLITICS

Predicting Prabowo's political ploy

Incumbent President Joko 'Jokowi' Widodo's political maneuvering has been discussed exhaustively ahead of the 2019 presidential election. Predicting the potential strategies of Prabowo Subianto, a former lieutenant general and losing candidate in the last two elections, is of equal importance. Like Jokowi, Prabowo remains utterly silent about his choice of running mate. Nevertheless, several leading figures are rumored to be Prabowo's preferred vice presidential candidates, with each providing different political leverage that could increase his electability. If Prabowo manages to read Indonesia's political atmosphere correctly and choose the most suitable running mate, he may find that the third time is the charm.

Background: With Jokowi again standing between him and the presidency, Prabowo's game plan has come under widespread public scrutiny. However, it is even more difficult to predict Prabowo's possible moves than Jokowi's considering that Prabowo has not even built a solid alliance with other parties. While the Prosperous Justice Party (PKS) has expressed its support for Prabowo, on numerous occasions leaders of the Islam-based party have acknowledged the possibility of switching sides if Prabowo picks a running mate who is incompatible with the PKS' agendas. Consequently, as of today, the Gerindra Party, which Prabowo founded, remains the sole supporter of the party chairman's presidential bid.

Despite the absence of the PKS' official support, it was previously believed that Prabowo's running mate would be a figure from the PKS. Such an assumption surfaced because of the PKS' persistence in nominating a number of its leading cadres as Prabowo's vice-presidential candidates. Appointing a figure from the PKS, his strongest possible ally, might be Prabowo's most attractive option as it could serve as the final push for the PKS to officially pledge its allegiance to Prabowo.

However, the latest developments appear to indicate that the list of Prabowo's potential running mates has expanded. With the National Mandate Party (PAN) and the Democratic Party reportedly moving closer to joining Prabowo's coalition, plus the recent closed-door meeting between Prabowo and Puan Maharani, the daughter of Indonesian Democratic Party of Struggle (PDI-P) chairwoman Megawati Soekarnoputri, Prabowo, things may yet move in another direction.

Insight: The limited political support for Prabowo curbs the list of his potential vice-presidential candidates. In addition, rejecting candidates the PKS, his closest ally, recommends may lead the PKS to make a U-turn. On the other hand, the candidates recommended by the PKS may prove incompatible with Prabowo's agenda or unable to compensate for his shortcomings. This is the political dilemma Prabowo faces, and must put to an end to.

Nonetheless, a number of major events that could help rebuild Prabowo's political prospects, have occurred. First, Prabowo held a meeting with Puan, widely tipped as Megawati's heir apparent, earlier this week. Furthermore, Prabowo was slated to hold a key encounter with Democratic Party chairman Susilo Bambang Yudhoyono. The meeting was canceled, or delayed, as SBY was rushed to the hospital for fatigue. Previously PKB chairman Muhaimin Iskandar announced the party's "unconditional support" support for Jokowi, dashing Prabowo's hopes of pulling the PKB into his coalition.

These developments could affect Prabowo in several ways. First, any plans to forge a third coalition comprising the PKB, PAN and the Democratic Party are now over following the PKB's pledge to support Jokowi. Now PAN and the Democratic Party must choose between Prabowo and Jokowi, and rumors have it that both parties are moving closer to declaring their support for Prabowo. If that happens, it will impact Prabowo's coalition tremendously and alter its dynamics.

Welcoming new coalition members will create new opportunities for Prabowo. First, he will have more choices of vice-presidential candidate. In regards to the Democratic Party, for instance, SBY's eldest son and party top executive Agus Harimurti Yudhoyono (AHY) has widely been touted as the party's preferred vice-presidential candidate. AHY is also perceived by the public as one of Prabowo's most ideal vice-presidential candidates. Likewise, PAN will probably nominate its chairman Zulkifli Hasan as Prabowo's vice-presidential candidate.

Second, with new parties joining Prabowo's coalition, the PKS' leverage over Prabowo's future will decline, increasing Prabowo's flexibility in choosing his running mate.

Nevertheless, the emergence of new candidates such as AHY and Zulkifli may spark internal rivalry within Prabowo's coalition. Unlike PAN, which is willing to negotiate its position on the vice-presidential candidacy and reshape its political agenda, the PKS has threatened to quit the coalition if Prabowo picks the wrong vice-presidential candidate. PKS executive Suhud Alynudin said his party, the PKB and the Golkar Party had adopted the same guerrilla tactic to win the vice-presidential nomination. Indeed, the chances of the PKS, the PKB and Golkar forming a new coalition is very unlikely, yet Suhud's statement demonstrates the PKS' serious quest to increase its bargaining power in the upcoming presidential election. Furthermore, any meeting between Prabowo and SBY may force the PKS to take radical measures.

Like Jokowi, Prabowo remains tight-lipped when it comes to his choice of vice-presidential candidate. This might be because he himself is still uncertain or he wants to avoid cracks within his coalition that may lead to its collapse. If the latter is true, then we may not get any official announcements from either Prabowo or Jokowi about their vice-presidential candidates any time soon.

What we've heard: Prabowo is still preparing different scenarios ahead of the Aug. 10 deadline for registration for the presidential election. There are currently two scenarios that Prabowo is seriously assessing, according to stories from his inner circle. First, he is considering to join next year's presidential race with PAN chairman Zulkifli Hasan. This plan is aimed to advantage both Gerindra and PAN in the legislative election that will take place simultaneously with the presidential race because it is believed that endorsing both leaders will strengthen the coattail effect for their parties although the pair might lose the presidential competition. Gerindra, in particular, is working all out to ensure that Prabowo will contest the race despite a predicted lose for the sake of the coattail effect on the party. The first scenario will lead to the exist of PKS from Prabowo-led coalition. PKS is said to join a third-axis coalition, which, according to sources, will be intentionally set up to later support Jokowi.

At the same time, Prabowo is also approaching PDI-P matron Megawati to assess the possibility of securing her support for a Prabowo-Budi Gunawan ticket. The discussion emerged during the recent closed-door meeting between Prabowo and Puan; a meeting that was facilitated by Budi Gunawan. It is said that Prabowo has promised to instruct Gerindra's representatives at the DPR, to pave the way for Puan to become the next House speaker in exchange of PDI-P support for him through a revision of the MD3 law that regulates the legislative institution. Gerindra was part of the coalition that changed the mechanism to elect House leaders in 2014 in order to hamper PDI-P secure the House's top chairmanship as winner of the 2014 legislative election.

Jokowi, the Army and the election

The recent installment of Lt. Gen. Andika Perkasa, President Joko 'Jokowi' Widodo's former Presidential Security Detail (Paspampres) commander, as the new Army Strategic Reserves commander (Pangkostrad) has been seen as a strategic decision ahead of the 2019 presidential election. Andika's reported close links with Jokowi may strengthen the President's control over the Army as the election looms.

Background: Lt. Gen. Andika Perkasa's appointment as the new Pangkostrad is not surprising given his alleged closeness with Jokowi. In fact, Andika, whose father-in-law A.M. Hendropriyono played a pivotal role in helping Jokowi win the presidency in 2014, has emerged as a rising star in the Army, and is billed as a potential candidate for the Army chief of staff post. Previous Kostrad commanders promoted to Army chief include the incumbent Gen. Mulyono, who will enter retirement age next January. Therefore, Jokowi's approval of Andika's nomination as Pangkostrad is seen as part of Jokowi's political planning.

Indeed, Jokowi may reap a number of political advantages from the installment of Andika as Pangkostrad. As the commander of the Army's pivotal strike force, Andika is a considerable asset to Jokowi for ensuring the loyalty of the entire Army and dampening the influence of former Indonesian Military (TNI) chief Gatot Nurmantyo, who is also a possible ally of Jokowi's arch rival Prabowo Subianto.



Lt. Gen. Andika Perkasa, S.E., M.A., M.Sc., M.Phil., Ph.D.



Academic Background

- Military Academy (Akml)
- Army Staff and Command School (Seskoad)
- The Military College of Vermont, Norwich University
- National War College, National Defense University
- Harvard University
- The Trachtenberg School of Public Policy and Public Administration, the George Washington University

Professional Background

Lieutenant Colonel

2002 - Intelligence Chief, Military Resort Command (Korem) 051/Wijayakarta, Jakarta Military Command (Kodam Jaya)/Jayakarta

2009 - Planning Department Chief, Sdirum, Indonesian Army's Military Command and Training Center (Kodiklat)

Colonel

2011 - Head Regiment Commander (Danrindam), Jakarta Military Command (Kodam Jaya)/Jayakarta

2012 - Military Resort (Korem) 023/Kawal Samudera Commander, Jakarta Military Command (Kodam) I, Bukit Barisan

Brigadier General

2013 - Information Department Commander (Kadispen), Indonesian Army

Major General

2014 - Presidential Security Detail (Paspampres) Commander

2016 - Military Commander (Pangdam) XII/Tanjungpura

Lieutenant General

2018 - Indonesian Army's Military and Training Center Commander (Dankodiklat)

2018 - Army Strategic Reserves Commander (Pangkostrad)



TENOGARA
STRATEGICS

Insight: Having graduated from the Military Academy (Akmil) in 1987, Andika is the only officer in his batch to enjoy promotion twice in the span of six months. In early January he was appointed the Army Education and Training Center (Dankodiklat) commander, which earned him a three-star military ranking.

Speculation about the political motives behind President Jokowi's endorsement of Andika's new posting as Pangkostrad has been fueled by a number of figures who have opined that Andika's career progression has been way too fast. This includes his appointment as the Presidential Security Detail commander, which is the President's prerogative. According to Moeldoko, the current presidential chief of staff and former TNI chief, before an officer is installed in a strategic position he has to have held at least two comparable posts. As Andika had previously served as the Army spokesman with a rank of brigadier general, Jokowi's decision to assign him as the Presidential Security Detail commander in 2014 came as a surprise.

Indeed, promotion in the military is unpredictable. One may attend the military's Staff and Command School (Sesko) and secure a position as regional military commander (Danrem), but that does not necessarily qualify them for promotion to the rank of brigadier general.

Andika's success could be explained as simple luck. Nevertheless, this does not stop many from speculating about Jokowi's motives in promoting Andika.

As one of TNI's Main Command Forces (Kotama), Kostrad shoulders great responsibilities. The main responsibility of this elite force is to assist the Army in both Combat Military Operations and Non-Combat Military Operations. In fulfilling its responsibilities, Kostrad has the authority to gather intelligence, carrying out civic and military operations and manage the logistics, planning and monitoring of operations.

How does the appointment of Andika assist Jokowi's political campaign? First, their steady relationship ensures Andika's loyalty to the President. Being a son-in-law of Hendropriyono, a former State Intelligence Agency (BIN) chief and advisor to Jokowi's transition team in 2014, it is not surprising that Andika is part of Jokowi's inner circle. Appointing someone from his inner sanctum to one of the highest military positions in the country will enable Jokowi to oversee the military's conduct and suppress even the merest hints of opposition from the military. Plus, being the Pangkostrad will give Andika the authority to instigate grass-roots movements to amass public support for Jokowi in the upcoming presidential election.

Second, installing Andika as Pangkostrad may facilitate Jokowi's attempt to tame sympathizers of former TNI chief Gatot inside the military. This is exceptionally important for Jokowi, considering the high possibility of Gatot competing against Jokowi or supporting Jokowi's rival Prabowo in the upcoming presidential election.

Although Jokowi's motives for Andika's appointment remain unclear, having a trustworthy figure holding one of the most important military positions in the country will without doubt benefit him, especially as Indonesia's political sphere ahead of the upcoming presidential election remains uncertain. The advantages for Jokowi will multiply if he picks Andika as the Army chief next January. It is indeed safe to say that Andika is the front-runner in the race for the Army chief post, among seven other three-star generals available.

What we've heard: Despite his links to Jokowi, Andika will find it difficult to secure the Army chief post. Currently, there are eight three-star Army generals, but only six stand a chance of succeeding Gen. Mulyono. In addition to Andika, his successor as Dankodiklat Anto Mukti Purwanto, secretary general of National Resilience Council (Wantannas) Doni Monardo, deputy Army chief Tatang Sulaiman and TNI inspector general Muhammad Herindra have been tipped as contenders for the Army's top job. At 53 years of age both Andika and Herindra hold an age advantage over the other lieutenant generals.

A source close to TNI commander Air Chief Marshal Hadi Tjahjanto, however, has said the race to become the Army No. 1 remains wide open. Hadi is reportedly poised to promote his Military Academy classmate of the 1986 batch, Jakarta military commander Maj. Gen. Joni Supriyanto, to the Army chief job, as he does not trust the three-star generals the way he has faith in Joni. For that purpose Hadi has to assign Joni to a post available to a three-star general, which means another TNI reshuffle is imminent. In fact, there are currently two posts reserved for three-star generals vacant: secretary to the coordinating political, legal and security minister and rector of the Indonesian Defense University.

When it comes to nominations for the Army chief post, the TNI chief, after consultation with the Rank and Promotion Council for High-Ranking Officers (Wanjakti), proposes several candidates to the president, who then picks one of them. In many cases the TNI chief reveals his preference to the president.

Andika's appointment as Pangkostrad could also be seen as a fair deal if Jokowi eventually does not entrust him to hold the Army chief post. There have been reports of Jokowi's dislike with his own bodyguard Andika, which prompted the President to move from the Merdeka Palace in Jakarta to Bogor Palace late in 2017.

BUSINESS & ECONOMIC POLICY

PLTU Riau-1 corruption case reveals dark side of electricity business

A corruption case revolving around the steam power plant (PLTU) Riau-1 project has resulted in the arrest of House of Representatives (DPR) member Eni Maulani Saragih and an investigation of Social Affairs Minister Idrus Marham.

Background: The Corruption Eradication Commission (KPK) arrested Eni and Johannes Budisutrisno Kotjo, one of the shareholders of Blackgold Natural Resources, as graft suspects last weekend. The KPK believes Eni received Rp 4.8 billion in kickbacks from Johannes for two services: lobbying for his company Samantaka Batubara to become a PLN Batubara supplier and for Blackgold Natural Resources to be appointed as the contractor for the PLTU Riau-1 project, in partnership with Pembangunan Jawa Bali Company (PTPJB).

Eni's arrest has implicated Social Affairs Minister and senior Golkar Party politician Idrus Marham. The KPK suspects Idrus may be involved in this project. PLTU Riau-1 is known as one of Setya Novanto's pet projects. As his close ally, Idrus is believed to have taken over the project when the KPK indicted Setya in the high-profile e-ID corruption case last year.

Insight: It is an open secret that Indonesian politicians use state-owned enterprises as their cash cows.¹ However, the extent of this grey area is obscure to the eye of the public, and the typical modus operandi differs from one sector to another.

In the electricity and power plant business, the Kalla family is well known as one of the major players,² but in recent years, many politicians have begun to make inroads into the business. One of them is Setya Novanto alongside his clique, another is Coordinating Maritime Affairs Minister Luhut Pandjaitan. Their involvement does not mean that all of the projects they obtained are questionable. The point is that it is quite common in Indonesia for politicians to have business interests in government-related projects.

The takeaway: The case of PLTU Riau-1 is one of few corruption cases involving the massive infrastructure budget of billions of dollars. This case indicates that vested interests could undermine the government's push for infrastructure development. What we fear is that this could be just the tip of the iceberg.

What we've heard: The allegations of corruption surrounding the development of steam power plant (PLTU) Riau I can be traced back to PT Samantaka Batubara's appointment as the project developer by state-owned electricity company PT PLN. Several sources have alleged that Johannes Budisutrisno Kotjo, as a shareholder in Blackgold Natural Resources, the holding company of PT Samantaka Batubara, bribed House of Representatives

¹ Beritasatu.com, "DPR: BUMN jadi sapi perah bukan cerita baru", 1 November 2012 <https://tinyurl.com/ycvxa4h9>

² Jamie Seith Davidson from National University of Singapore has two interesting papers that record Kalla family's business in toll road sector during the Yudhoyono Era. One is "Driving growth: regulatory reform and expressway in Indonesia"; another is "How to harness the positive potential of KKN: Explaining variation in the private sector provision of public goods in Indonesia".

Commission VII deputy chairman Eni Maulani Saragih to ensure Samantaka's appointment to the project.

The coal mining company is said to own a mining concession over 15 hectares of land under which a reserve of 147 million tons of coal is reportedly deposited. However, reports suggest that Samantaka's exploration and mineral data, recorded by its Joint Ore Reserves Committee (JORC), is inaccurate. Experts consider the coal extracted from Samantaka's field to be lower in quality and uncompetitive compared to other mines in Sumatra.

Samantaka's appointment led to the establishment of the Independent Power Producer (IPP) consortium, through which Eni reportedly lobbied PLN to include Blackgold as PLN subsidiary PT Pembangunan Jawa-Bali's (PJB) partner in the development of PLTU Riau I. Eni was also reportedly involved in pushing for the Riau I project to be included in the 2018-2027 State Electricity Procurement Business Plan (RUPTL). Blackgold previously teamed up with China Huadian Corporation long before Riau I was put on the RUPTL.

The Rp 4.8 billion kickback Eni allegedly received was her suspected payoff after paving the way for Samantaka and Blackgold to take part in the government-led project. The alleged graft was identified as part of the "initially set" Rp 307 billion project fee, or 2.5 percent of the project's Rp 12.28 trillion value.

The Riau I corruption case has also implicated another Golkar Party elite. Some sources have said that Riau I was one of Setya Novanto's power plant projects. Setya is reported to have a close relationship with Johannes Kotjo. Following Setya's conviction in the e-ID graft case, senior Golkar politician and the current Social Affairs Minister Idrus Marham allegedly took over the handling of the Setya's power plant project legacy, as the two are known to be old friends. Marham has known Eni since 2002 during his chairmanship at the National Committee of Indonesian Youth (KNPI), where Eni was his treasurer from 2002 to 2005. Eni, Johannes Kotjo and Idrus Marham are said to have met PLN president director Sofyan Basyir, possibly to discuss the size of the Riau I project fees.

A number of energy industry players have said that Riau I was unnecessary and non-urgent. To fulfill Riau's electricity demand, PLN already owns three gas power plants (PLTMG): PLN Payo Selincih, PLN Duri and PLN Rengat. They also receive 60 million standard cubic feet per day (MMSFCD), capable of producing 300-megawatts of electricity, from a swap agreement between Pertamina Jambi Merang and American oil and gas giant ConocoPhillips. The agreement obliges ConocoPhillips to supply PLN's gas needs from Grissik field in exchange for Pertamina's support supplying American oil and gas giant Chevron Pacific Indonesia's power plant that operates nearby.

In the last two years, PLN has reduced its gas consumption, arguing that Riau's electricity demand has been met. Chevron has also abated its daily gas needs by half as oil lifting decreases. However, according to a source from the Energy and Mineral Resources Ministry, PLN is reluctant to utilize the abundant gas reserves to develop clean energy, even though the government has pledged to reduce its carbon emissions by 29 percent by 2030. One reason: coal is cheaper than gas.

Muhammad Jusuf Kalla

Vice President 2004-2009; 2015-2019

Kalla family, through their holding company the Kalla Group, owns many power plants across Indonesia. The group made their fortune by winning numerous power plant projects in 2004-2009. The group also has an electrical engineering manufacturing company that works as the group main supplier. Kalla Group is closely connected with Intim Group, owned Jusuf Kalla's brother Halim Kalla, and Aksa Mahmud's Bosowa Group. In 2013, Kalla Group announced their intention to dominate Indonesia's hydro power plant markets.

- Kalla Group (Hydro power plants in Jambi, Mamuju)
- PT Poso Energy (Hydro power plants in Poso)
- Bukaka Group (Extra High Voltage Air Duct producer, Hydro power plants in Ussu, Pinrang, Asahan, Sarulla, Batam)
- PT Kalla Electrical System (Transformers supplier for Kalla and Bosowa Group)
- PT Malea Energy (Hydro power plants in Toraja)



Aksa Mahmud

People's Consultative Assembly Member 1999-2004;
House of Representatives Member 2004-2009

Aksa Mahmud is Jusuf Kalla's brother in law and the owner of Bosowa Group from South Sulawesi. Although Bosowa is not part of Kalla Group, in practice it has close ties with Kalla Group's members.

- PT Bosowa Energy (Steam power plants in Jeneponto)



Halim Kalla

Businessman, Jusuf Kalla's brother

Besides holding Commissioner position in the Lion Group, Halim Kalla is a member in Kalla and Bosowa conglomerate. He is also the owner of energy focused enterprise, Intim Group.

- Intim Group (Steam power Plants in Cilacap)



Setya Novanto

House of Representatives Speaker 2014-2017

Prior to his entry in politics, Novanto was a businessman in energy and mining sectors. He owns a steam power plant in East Nusa Tenggara. Now, he is a corruption convict, held at Sukamiskin Prison in West Java,

- Steam power plant in Bolok Industrial Complex, East Nusa Tenggara



Sandiaga "Sandi" Uno

Jakarta's current Deputy Governor

A politician affiliated with Gerindra Party, previously Sandi was known as a successful businessman under Saratoga Group. He is reported as a shareholder in Paiton Energy consortium.

- Saratoga Group is a member of Paiton Energy consortium, which operates three major steam power plants in East Java



Luhut Binsar Panjaitan

Coordinating Maritime Affairs Minister

Previously, Luhut held the majority ownership of coal mining company PT Toba Bara Sejahtera, which owns several power plants in Kalimantan and Sulawesi. In 2016, he sold most of his shares to Singaporean holding company Highland Strategic. However, some reports suggest that this company is just a cover for Luhut's business interest to participate in government electricity tenders.

- PT Minahasa Cahaya Lestari (Steam power plants)
- PT Gorontalo Listrik Perdana (Steam power plants)
- PT Pusaka Jaya Palu Power (Steam power plants)
- PT Kartanegara Energi Perkasa (Gas power plant)



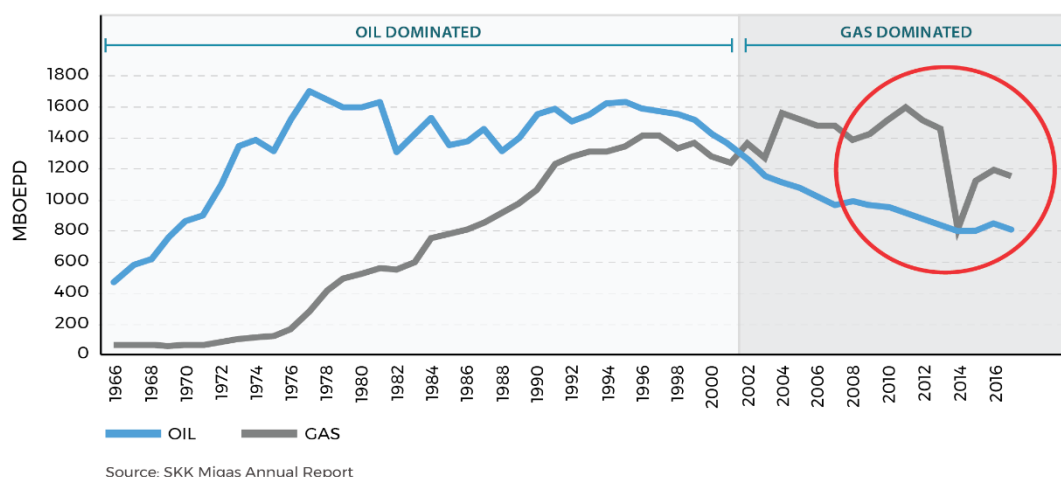
Investors show lack of interest in latest oil and gas auction

The Ministry of Energy and Mineral Resources (MEMR) is surprised by investors' lack of interest in the latest oil and gas auction.

Background: There were only seven participants at the auction, and none of them followed through on their promise to submit work proposals by the deadline of July 3. Chevron announced its decision to pull out from Makassar Strait offshore gas drilling project last week (July 11), citing negative net present value (NPV) and the MEMR's refusal to add its production share under the new gross split scheme. Chevron's decision has cast uncertainty on the development of the Rapak and Ganai offshore gas drilling projects.³ In similar circumstances, Shell exited the Moa Block project in Maluku.⁴

This development could jeopardize the government's plan to boost oil and gas production as well as new upstream investment this year to reverse the downward trend seen since 2014 amid a sharp fall in global oil prices at the time (see the figures below).

Indonesia's Oil and Gas Production Profile in million barrels oil equivalent per day (MBOEPD), 1966 – 2017



Insight: A lot of controversy surrounds the new gross split scheme, but the most important question is how it will affect project profitability. According to a calculation made by Pinsot Manson and Wood MacKenzie (see tables below),⁵ gross split may result in lower NPV and internal rate of return (IRR) for contractors than the previous cost recovery production sharing contracts (PSCs). But if the contractors were able to significantly reduce costs, the gross split scheme could be an attractive option, specifically for offshore oil drilling project, less so for offshore gas drilling project.

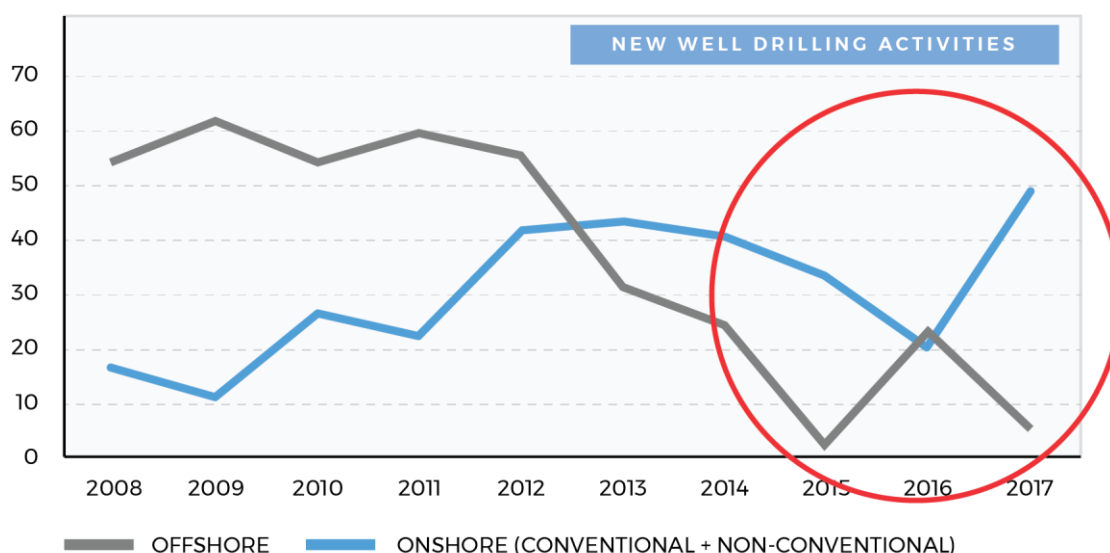
³ Kontan.com, "Chevron henggang dari Blok Makassar Strait", 12 July 2018 <https://tinyurl.com/y92f3a2a>

⁴ Kontan.com, "Tidak ekonomis, Shell berniat kembalikan Blok Moa ke pemerintah", 15 July 2018 <https://tinyurl.com/y7ug6rhc>

⁵ Pinsot Manson and WoodMacKenzie calculation assumes 2 percent interest rate, an oil price US\$ 60/bbl, a gas price US\$ 6/mcf.

Despite its potential benefits, the gross split scheme is out of touch with the existing environment, as the industry trend has shifted from oil-dominated to gas-dominated since 2002. To make the gross split scheme successful, the MEMR might need to exercise its discretionary authority more often to provide a more attractive production split for the contractors. However, the latest Chevron and Shell cases suggest that the MEMR is unwilling to take such action.

Indonesia's New Well Drilling Activities, 2008 – 2017



Source: SKK Migas Annual Report

The takeaway: Oil and gas contractors are skeptical about the new gross split scheme, because by calculation it offers less profitability than the previous cost recovery PSCs. The MEMR needs to address this problem, but it seems the Ministry is still struggling to devise workable gross split contracts.

PSC Contractor NPV10 comparison: Gross split PSC vs. Cost recovery PSC, for exploration prospects

PSC Contractor NPV10 (US\$ millions)						
PSC type and cost reduction (if any)	20 mmbbl onshore oil	100 bcf onshore gas	20 mmbbl shelf oil	200 bcf shelf gas	400 mmbbl deepwater oil	2 tcf deepwater gas
Cost recovery PSC	188.9	79.5	128.9	14.8	1,346.3	259.6
Gross split PSC	142.5	30.9	101.6	-26.2	1,049.5	-10.9
Gross split PSC, 10% cost reduction	154.2	42.0	122.5	-6.3	1,410.2	176.9
Gross split PSC, 20% cost reduction	165.9	53.1	142.9	13.2	1,766.4	363.3

Source: Pinsent Masons and Wood Mackenzie

PSC Contractor IRR comparison: Gross split PSC vs. Cost recovery PSC, for exploration prospects

PSC Contractor IRR, %						
PSC type and cost reduction (if any)	20 mmbbl onshore oil	100 bcf onshore gas	20 mmbbl shelf oil	200 bcf shelf gas	400 mmbbl deepwater oil	2 tcf deepwater gas
Cost recovery PSC	60.2%	31.9%	27.8%	11.7%	17.9%	11.4%
Gross split PSC	47.2%	19.7%	24.0%	5.5%	16.5%	9.9%
Gross split PSC, 10% cost reduction	53.8%	24.2%	28.3%	8.8%	19.4%	11.5%
Gross split PSC, 20% cost reduction	61.8%	29.5%	33.3%	12.7%	22.8%	13.3%

Source: Pinsent Masons and Wood Mackenzie

EXTRAS: MACROECONOMIC UPDATE

June trade surplus eases worry over current account deficit

The Central Statistics Agency (BPS) announced a trade surplus of US\$1.74 billion in June, cutting the year-to-date (YTD) deficit to \$1.02 billion.

Background: The Central Statistics Agency (BPS) announced a trade surplus of US\$1.74 billion in June, cutting the year-to-date (YTD) deficit to \$1.02 billion. The surplus was not caused by an improved export performance. Rather, it is the result of a decline in month-to-month imports from \$17.6 billion in May to \$11.2 billion June, which reflects a decline in general economic activity due to the 12-day-long Idul Fitri (Eid al-Fitr) holiday.

Indonesia's Trade Balance

	2018		
	Total Exports	Total Imports	Surplus/Deficit
January	14,553.40	15,309.40	(756.00)
February	14,132.60	14,185.50	(52.90)
March	15,586.90	14,463.60	1,123.30
April	14,537.20	16,162.30	(1,625.10)
May	16,209.30	17,662.90	(1,453.60)

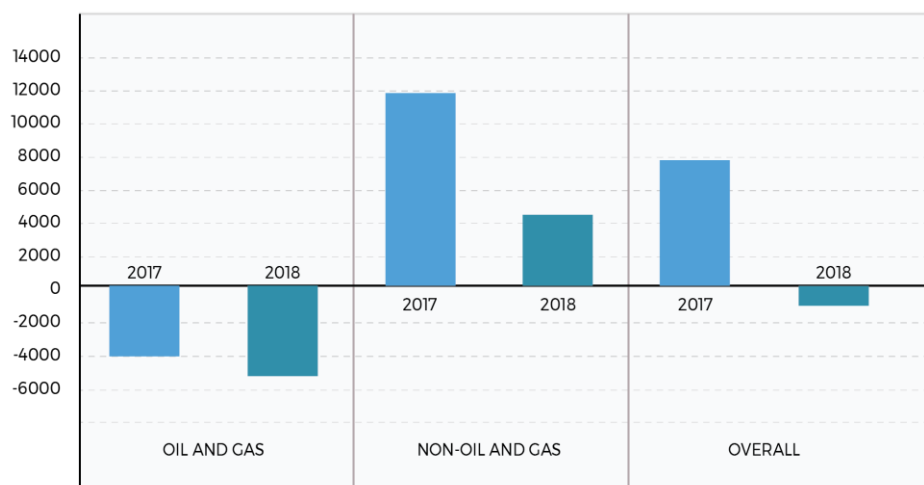
June	12,999.20	11,256.60	1,742.60
Total	88,018.60	89,040.30	(1,021.70)

Source: Central Statistics Agency (BPS).

Even so, economic analysts consider last month's surplus a positive sign for the economy. For example, Bank Central Asia economist David Sumual lowered his current account (CA) deficit forecast from 2.8 percent to less than 2.5 percent because of the June trade surplus.⁶

Insight: The June trade surplus creates positive momentum for the economy, but turning the YTD trade deficit into a surplus will be challenging. According to the figures below, there are two factors behind the 2018 YTD trade deficit. One is a decrease in the non-oil and gas trade surplus. The other is an increase in the oil and gas trade deficit. To achieve a trade surplus by the end of 2018, the government needs to stimulate non-oil and gas exports, mainly from palm oil and manufacturing exports, while reducing domestic fuel consumption. However, President Joko "Jokowi" Widodo's decision to increase energy subsidies this year⁷ and next year⁸ does the opposite. This policy would stimulate consumers to keep their fuel consumption at 2017 the level or even higher amid rising global oil prices.

Indonesia's January – June Trade Balance, 2017 and 2018



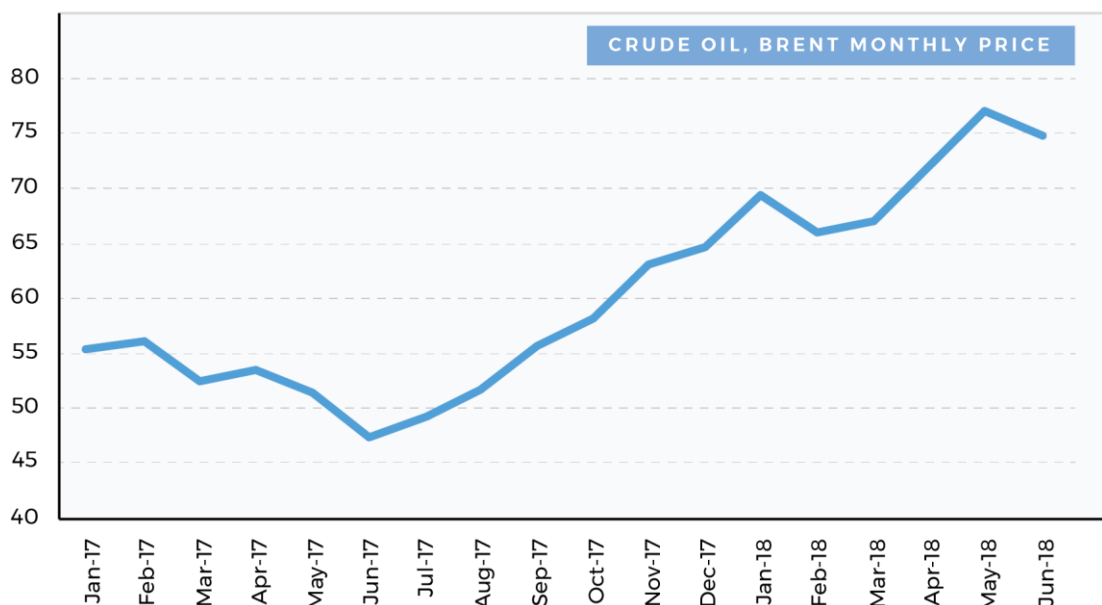
Source: Central Statistics Agency (BPS)

⁶ Bisnis.com, "Surplus Juni jadi momentum positif", 17 July 2018 <https://tinyurl.com/y8xfwdjs>

⁷ Kompas.com, "Subsidi energy sepanjang 2018 diprediksi bengkak 173 persen dari target APBN", 18 July 2018 <https://tinyurl.com/y8xufcd5>

⁸ Esdm.go.id, "Banggar DPR setuju anggaran subsidi energy RAPBN 2019", 3 July 2018 <https://tinyurl.com/ydz2rfqe>

Brent Monthly Crude Oil Price, January 2017 – June 2018



Source: Index Mundi

Even though President Jokowi's energy subsidy policy seems incoherent from an economic perspective, he needs this policy as a cover for his political failure, as he failed to achieve the 7 percent real economic growth rate in his first term that he promised in his 2014 presidential election campaign.⁹

The takeaway: President Jokowi's 2018 and 2019 energy subsidy policy is driven by political rather than economic rationale. As a consequence, it will hamper efforts to achieve a full-year trade surplus.

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⁹ Detik.com, "Pertumbuhan ekonomi 7 persen seperti janji Jokowi akan terwujud di 2017", 18 December 2014 <https://tinyurl.com/ybzubitt>