

HIGHLIGHTS OF THE WEEK

POLITICS

Can Constitutional Court end electoral dispute?

The Constitutional Court is to start hearings on Friday to settle a dispute over the presidential election. It has until June 28 to decide, but it remains unclear whether its verdict would put an end to the row and the current political uncertainty. Much depends on the court's ruling being accepted by the two contenders and their supporters.

Democratic Party eyes ministerial seat

The Democratic Party is moving closer to joining the ruling coalition after Susilo Bambang Yudhoyono's (SBY) eldest son and Democratic Party executive Agus Harimurti Yudhoyono (AHY) paid a visit separately to President Jokowi and Indonesian Democratic Party of Struggle (PDI-P) chairwoman Megawati Soekarnoputri on Idul Fitri. The visit is seen as the Democratic Party's maneuver to offer AHY as a member of Jokowi's Cabinet, in exchange for the party's switch of loyalty to the coalition.

Controversy over Tim Mawar's role in May riots

An investigative report by *Tempo* recently linked several former members of the Army's elite Special Forces' (Kopassus) Tim Mawar, notorious for its involvement in forced disappearances and the abduction of prodemocracy activists in 1997-1998, and last month's riots in Central Jakarta. – where eight people reportedly dead while hundreds are injured.

BUSINESS & ECONOMY

Weak global growth sparks rate cuts

The global economy has been weak in 2019. Investment is slowing and there is substantial risk for the escalation of a trade dispute that has spooked investors around the globe. Under such pressure, some central banks in the region namely Bank Negara Malaysia, Philippine Central Bank, Reserve Bank of India and Reserve Bank of Australia have decided to cut their benchmark interest rates.

After QRIS launching, more works still need to be done

Bank Indonesia has worked together with the Indonesian Payment Systems Association (ASPI), banks, credit card companies and online payment service providers to develop Quick Response Indonesia Standard code system (QRIS) since the middle of last year. Nevertheless, QRIS development is still unfinished. BI is still working on QRIS interoperability and interconnectivity QRIS is expected to be fully operational in the second half of 2019.

Red carpet for foreign carriers: Gimmick or solution?

Soaring operational costs for Indonesia airlines has penalized customers dearly with rising airfares and this eventually boosts inflation rates. The government has tried to bring down prices by lowering the fare ceiling but to no avail. Responding to the persistently high airfares, President Joko "Jokowi" Widodo suggested that the government would open Indonesia's sky to international air carriers. Their entry is expected to push up competition in the local aviation industry, currently dominated by state-owned carrier Garuda Indonesia and private Lion Air Group.

POLITICS

Can Constitutional Court end electoral dispute?

OVERVIEW

The Constitutional Court is to start hearings on Friday to settle a dispute over the presidential election. It has until June 28 to decide, but it remains unclear whether its verdict would put an end to the row and the current political uncertainty. Much depends on the court's ruling being accepted by the two contenders and their supporters.

At stake is the decision by the General Election Commission (KPU) to give incumbent president Joko "Jokowi" Widodo victory by an 11-percent margin. Challenger Prabowo Subianto rejects the result and is ready to prove in court that "massive, structured and systematic" electoral fraud denied him the presidency. He is asking the court to overrule the KPU and either declare him the winner, or order a rerun of the election.

The election outcome is now in the hands of the court's nine members. They are to face pressure inside and outside the court. The May 21 riots that erupted outside the offices of the KPU and the Elections Supervisory Agency (Bawaslu) serve as a reminder. Individual judges may already be receiving death threats. Court chief Anwar Usman says the panel would not bow to any pressure. "We only fear Allah," Anwar said.

Negotiations are taking place behind closed doors between Prabowo and Jokowi for a political deal. The President has offered Prabowo and his Gerindra Party a place in the coalition government. Two political parties that supported Prabowo in the election, the Democratic Party of former president Susilo Bambang Yudhoyono and the National Mandate Party (PAN), have begun talks about joining the government.

With the claim of massive fraud already having been dismissed by Bawaslu, it would be hard for Prabowo to prove his case, but at this stage anything is possible. There are three possible outcomes:

- The court confirms Jokowi's victory and Prabowo accepts the result. This would be a repeat of what happened after the 2014 election.
- The court confirms Jokowi's victory but Prabowo rejects the ruling, raising the spectre of more violence, perhaps worse than what we saw in May.
- The court agrees with Prabowo's claim and orders a rerun of the entire election or in selected districts where cheating occurred.

WHAT'S MORE

The real question is how far Prabowo will push before he knows that he has reached the limit. In 2014, he pulled the same trick, threatening not to accept the result. Once the court confirmed the KPU results that gave Jokowi a 5 percent lead, Prabowo called Jokowi to congratulate him.

The conditions today are different from 2014, so making a comparison can be misleading.

Five years ago, Prabowo won control over the House of Representatives, with his supporting coalition winning more seats, making him able to exert some influence on the government. Gerindra led the coalition, winning battle after battle in the House against the coalition government dominated by Jokowi's Indonesian Democratic Party of Struggle (PDI-P), taking all the key appointments of the House's leadership and controlling the legislative agenda. This situation, however, did not last. Within a year, three members of the opposition coalition abandoned Gerindra and gave Jokowi controlling majority.

This time, Jokowi already has a controlling majority in the House with the coalition of the PDI-P, Golkar, Nasdem, PKB and PPP. The opposition coalition would be further weakened if PAN and the Democratic Party join the ruling coalition. Jokowi gave a standing invitation to Gerindra. If you can't beat them, join them. Most everyone else is already preparing for the 2024 election and being part of the ruling coalition gives access to power and money. Prabowo and Gerindra have every reason to join the coalition.

Prabowo softened his stance when he decided to take his protest about electoral cheating to the Constitutional Court and off the streets. Early this week, he made an appeal to his supporters not to assemble outside the court building during the hearing. "Trust the court," he said.

The hardliners in his campaign team, however, continue with their strong and often violent rhetoric and said they would not accept the court's verdict if it does not give Prabowo victory. Some went overboard with their statements and are now under police investigation for possible treason.

At least two constituents in the Prabowo camp will not accept anything less than a victory: the Soeharto clan and the Islam Defenders Front (FPI).

Police investigations found that money to finance the violent May 21 protests, as well as the assassination plots, to create massive chaos was traced to Hutomo Mandala Putra, the son of former president Soeharto. His own Berkarya Party failed to win seats in the House, but the all his siblings have thrown their support behind Prabowo.

More than 21 years after their father was forced to step down, the Soeharto clan has escaped prosecution for the wealth they had amassed during his reign. This may change soon with the government now empowered under international agreements to chase down the massive amount of corrupt wealth stashed anywhere in the world, including Switzerland.

The FPI has its own reason for not accepting Jokowi's reelection. Their leader Rizieq Shihab has been in self-imposed exile in Saudi Arabia because of pornography charges. Sooner or later, his passport will be up for renewal.

The FPI has been the most vocal in spreading hate speeches against Jokowi. A few other FPI ulema are under investigation for possible treason. The FPI's permit as a mass organization is expiring soon and there are two petitions at change.org, one urging the government not to renew it and another demanding that the government strip Rizieq of his Indonesian citizenship.

Whether Prabowo will accept the election results and whatever incentives Jokowi may offer, first he has to cut his ties with the Soeharto clan and the FPI.

Democratic Party eyes ministerial seat

OVERVIEW

The Democratic Party is moving closer to joining the ruling coalition after Susilo Bambang Yudhoyono's (SBY) eldest son and Democratic Party executive Agus Harimurti Yudhoyono (AHY) paid a visit separately to President Jokowi and Indonesian Democratic Party of Struggle (PDI-P) chairwoman Megawati Soekarnoputri on Idul Fitri. The visit is seen as the Democratic Party's maneuver to offer AHY as a member of Jokowi's Cabinet, in exchange for the party's switch of loyalty to the coalition.

Such a move is understandable as the Democrats want to regain ground in politics after suffering a downfall in the last two elections. From the peak of 21 percent legislative votes in 2009 when SBY won his second term, the Democrats' political fortune has since nosedived. It managed only 10.2 percent of the vote in 2014 and further down to 7.3 percent in the April 17 election.

In this sense, preparing a proper stage for AHY as the future leader of the party is inevitable if it wishes to come back strongly in 2024, especially if AHY is to contest the presidential race.

However, the Democrats' bid for a ministerial post will face an uphill battle. Although the latest Idul Fitri meeting with Jokowi and Megawati signaled the two most powerful figures' full acceptance of AHY, other parties in Jokowi's coalition can completely reject the Democrats' entry because the party was part of the rival camp. Accepting the Democrats will also reduce chances of the respective parties to secure ministerial posts, albeit the decision is in the hands of the President.

The possibility of AHY to emerge as a strong candidate – and rival – in the 2024 presidential election is another motive of the parties to undermine the Democrats' maneuver.

Likewise, the Democrats must think of the most strategic ministerial position that can give AHY a red carpet for 2024. The portfolio should give AHY both access to financial resources and publicity particularly among people in the grassroots.

Of course, parties and those who have contributed to Jokowi's victory will vie for the same luxury. Therefore, the Democrats must offer a robust political bargain to Jokowi and the coalition to secure at least one ministerial seat.

WHAT'S MORE

The absence of an incumbent in the 2024 presidential election will level the playing field. Indeed, it will encourage parties to groom their best members to be offered to the voters. A ministerial post is an ideal platform for the Democrats and AHY in the face of the 2024 elections.

Considering his background as a retired army officer, his overseas education and exposure to politics, AHY might be qualified for the defense, youth and sports or social services

ministerial post. However, he stands a realistic chance of winning the youth and sports ministerial post only because the other two portfolios will be highly contested.

The defense ministerial post Cabinet. Lawmaker Asrul Sani from the PPP said the Islamic-based party should get more than one seat.

Therefore, it is important for the Democrats to consolidate with not only Jokowi and the PDI-P but also the other coalition members. Failure to bridge communications with the coalition members will cost the Democrats their bid for seats in the Cabinet.

WHAT WE'VE HEARD

Agus Harimurti Yudhoyono (AHY) is moving closer to realizing his bid for a ministerial post since Megawati Soekarnoputri, chairwoman of the Indonesian Democratic Party of Struggle (PDI-P) and one of the country's most influential power brokers today, has reportedly given her approval to his entry into the Cabinet. President Joko "Jokowi" Widodo had earlier agreed to pick AHY as one of his ministers in the second term.

AHY's portfolio, however, remains undecided and difficult to assign, given that he is not alone in the competition. Megawati considered several potential ministerial candidates. Daughters of former president and Nahdlatul Ulama (NU) leader Abdurrahman "Gus Dur" Wahid, Zanubba "Yenny Wahid" Chafsoh and Alissa Qotrunnada "Alissa" Wahid Munawaroh Rahman are to be AHY's rivals if Jokowi is to appoint him to be the social services minister. Meanwhile, a son of former State Intelligence Agency (BIN) AM Hendropriyono, Diaz Faisal Malik Hendropriyono, now on Jokowi's expert staff, would stand between AHY and the sports and youth affairs ministerial job.

SBY's lukewarm conflict with Megawati, however, will no longer be a stumbling block for AHY's political venture since relations between his father and the PDI-P chairwoman are completely separate. AHY's visit to Megawati on the Idul Fitri holiday, seen as a humble and polite gesture, has managed to build amity between him and Megawati's family.

Controversy over Tim Mawar's role in May riots

OVERVIEW

The protests held by supporters of losing presidential candidates Prabowo Subianto and Sandiaga Uno turned violent on May 21, leaving eight people dead and hundreds of others injured. ¹ Following the unrest the police detained a number of key figures from Prabowo's campaign team, two of them being United Development Party (PPP) politician Habil Marati and former Army general Kivlan Zein, for allegedly funding the riot and plotting the assassination of four national figures.² An investigative report by *Tempo* recently linked several former members of the Army's elite Special Forces' (Kopassus) Tim Mawar (Rose Team), notorious for its involvement in forced disappearances and the abduction of prodemocracy activists in 1997-1998, and last month's riots in Central Jakarta.

¹ Thejakartapost.com, "Terror groups 'may seize on unrest'" 24 May 2019

<https://tinyurl.com/yyos6ml3>

² Koran.tempo.com, "Polisi duga eks Tim Mawar dalangi kerusuhan" 12 June 2019

<https://tinyurl.com/y2nnv4yl>

According to *Tempo*, to which the police gave access to the transcript of phone conversations between suspects, former member of Tim Mawar Fauka Noor Farid, who is also a member of the Gerindra Party, allegedly directed the rioting. The transcript also revealed a conversation between Fauka and fellow Prabowo supporter Dahlia Zein, in which Fauka said he would like to see chaos that claimed lives.

Although Prabowo's connection with Kopassus, especially Tim Mawar, in the past has sparked speculation about the team's involvement in the recent unrest, there is no specific link that could connect the conversation transcript and the funding and strategies to be used in the assassination plot.

WHAT'S MORE

Both Fauka and Dahlia deny any role in the riot. Likewise, former head of Tim Mawar Maj, Gen, (ret) Chairawan rejected *Tempo*'s claims about the team's role in the riot, saying the team had disbanded in 1999.³ National Police spokesperson Insp. Gen. M. Iqbal also declined to confirm Tim Mawar's involvement in the postelection riot. He, however, acknowledged that Fauka was named during the questioning of another suspect.⁴ Despite the denials about Tim Mawar's alleged involvement in the riot, its involvement with presidential candidate Prabowo is undeniable. Prabowo is a former commander of Kopassus when Tim Mawar is believed to have kidnapped prodemocracy activists back in 1998. It is no surprise that ever since, the team has always been associated with unrest. Moreover, Chairawan was a member of the Prabowo-Sandiaga campaign team, meanwhile Fauka founded and heads a Prabowo support group, Garda Prabowo.

However, a key point that would undermine the charges against Tim Mawar is that the assassination targets, namely Coordinating Political, Legal and Security Minister Wiranto, Coordinating Maritime Affairs and Fisheries Minister Luhut Pandjaitan, State Intelligence Agency (BIN) chief Budi Gunawan and presidential special staff for intelligence affairs and the man behind the Densus 88 counterterrorism squad Gorries Mere, are all high profile figures holding defense and security positions.

Their security and protection procedures must always be maintained at the maximum level, which is why it would be extremely difficult for any potential assassin to get close to them. Furthermore, the money provided for the putative assassinations and weaponry of S\$15,000 and Rp 60 million, respectively, allegedly provided by Kivlan and Habil, would be far too low for such high-value targets.⁵ The report originates from an undisclosed transcript provided by the police, which casts doubt on the reliability of the information. It is important, therefore, for the police to maintain their accountability and transparency in their investigation into the case.

³ Koran.tempo.com, "Tempo hargai laporan Chairawan ke Dewan Pers" 12 June 2019 <https://tinyurl.com/y5ga33t7>

⁴ Thejakartapost.com, "'Tim Mawar' back in spotlight" 12 June 2019 <https://tinyurl.com/yxhddjt>

⁵ Koran.tempo.com, "Polisi duga eks Tim Mawar dalangi kerusuhan" 12 June 2019 <https://tinyurl.com/y2nnv4yl>

BUSINESS & ECONOMIC POLICY

Weak global growth sparks rate cuts

OVERVIEW

The global economy has been weak in 2019. Investment is slowing and there is substantial risk for the escalation of a trade dispute that has spooked investors around the globe. Under such pressure, the Monetary Policy Committee of Bank Negara Malaysia decided to cut the overnight policy rate (OPR) by 25 basis points (BPS) to 3 percent last month.⁶ The Bangko Sentral ng Pilipinas or the Philippine central bank followed its neighbor's policy by cutting its overnight borrowing rate to 4.5 percent from 4.75 percent and the corresponding lending rate to 5 percent from 5.25 percent.⁷ Early this month, the Reserve Bank of Australia (RBA)⁸ and the Reserve Bank of India (RBI)⁹ cut their policy rate by 25 bps to 1.25 percent for the former and 5.75 percent for the latter.

However, some central banks beg to differ. They have not responded to the weak global economy by cutting rates, but rather by maintaining policy rates. For instance, Bank of Korea decided to maintain its rate at 1.75 percent due to South Korea's heavy household debt and real estate prices volatility.¹⁰ Likewise, the Turkish central bank kept its one-week repo rate unchanged at 24 percent, prioritizing macro financial stability over short-term growth.¹¹ The Bank of Thailand also left its policy rate unchanged at 1.75 percent due to fears over financial instability, despite strong signals of slowing economic growth.¹²

In Indonesia, where the current account and trade deficits have stifled the economy, the central bank faces growing pressure from the business community to cut interest rates to stimulate short-term growth.¹³ The Financial Services Authority (OJK)¹⁴ and Finance Minister Sri Mulyani Indrawati¹⁵ support the idea and have told the media that rate cut was possible. They reasoned that Bank Indonesia (BI) should take the possibility of a future Fed rate cut into account.¹⁶

⁶ Thestar.com.my, "Bank Negara lowers OPR by 25bps to 3%." 7 May 2019 <https://tinyurl.com/y6lng4w3>

⁷ WSJ.com, "Philippines central bank cuts rates." 9 May 2019 <https://tinyurl.com/y2mc6olz>

⁸ FT.com, "Australia cuts interest rate for first time in 3 years." 4 June 2019 <https://tinyurl.com/y2yb3t2p>

⁹ Hindustantimes.com, "RBI cuts rates to 9-year low in bid to spur growth." 6 June 2019

<https://tinyurl.com/y53yxha5>

¹⁰ Asiatimes.com, "Bank of Korea freezes interest rate at 1.75 percent." 31 May 2019

<https://tinyurl.com/yy4hq3g6>

¹¹ Ahvalnews.com, "Turkish central bank leaves interest rates on hold." 12 June 2019

<https://tinyurl.com/yx8nesr5>

¹² BOT.or.th, "Edited minutes of the Monetary Policy Committee meeting (No. 3/2019) 8 May 2019." 22 May 2019

<https://tinyurl.com/y5tvocl>

¹³ Bisnis.com, "Apindo dan Kadin dorong suku bunga turun." 13 June 2019 <https://tinyurl.com/y5l29sv9>

¹⁴ CNNIndonesia.com, "OJK nilai BI perlu turunkan suku bunga demi rangsang ekonomi." 12 June 2019

<https://tinyurl.com/y6cyeyzl>

¹⁵ Bloomberg.com, "Bank Indonesia may ease monetary policy, Finance Minister says." 12 June 2019

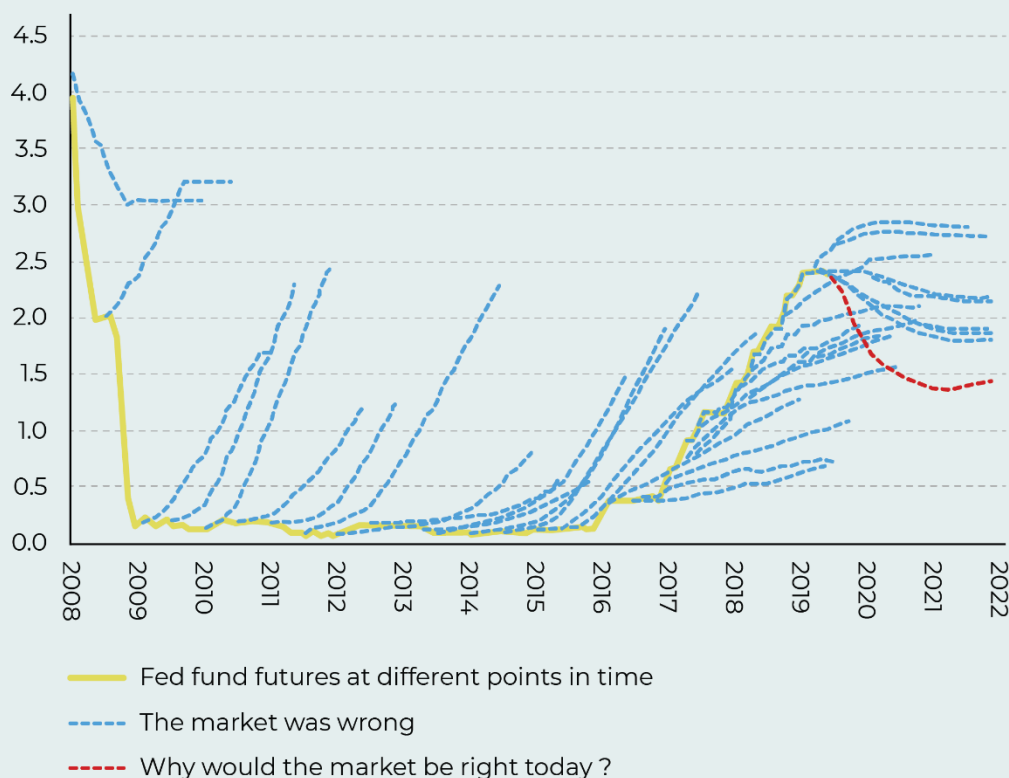
<https://tinyurl.com/y4g5mmv5>

¹⁶ CNNIndonesia.com, "Kadin minta BI mengacu the Fed untuk turunkan suku bunga." 13 June 2019

<https://tinyurl.com/y6brsy4s>

Following a signal from the chairman of the Federal Reserve, Jerome Powell, about the possibility of cutting interest rates in the face of an escalating United States-China trade war and weak US employment report last week, Wall Street financial gurus have speculated over the possibility of a Fed rate cut.¹⁷ Nevertheless, Reuters' poll of 100 economists conducted over six days until June 12 suggests otherwise. Economists expect the Fed to maintain interest rates at 2.25 – 2.50 percent until the third quarter of 2020.¹⁸

The Market is Almost Always Wrong About What The Fed Will Do



Sources: FRB, Bloomberg Finance LP, Haver Analytics, DB Global Research

WHAT'S MORE

Predicting the Fed's monetary policy is big business in the United States. All banks and financial companies on Wall Street have their own Fed watchers, finance and economic professionals who specialize in monitoring the Fed's future direction in regard to monetary policy.

At the Chicago Mercantile Exchange, financial contracts named Federal Funds Futures, which represent market opinion of federal funds rate at the date of contract expiry, have been

¹⁷ NYTimes.com, "Wall Street asks when, not if, the Fed will cut interest rates." 9 June 2019

<https://tinyurl.com/yxskjb8j>

¹⁸ Reuters.com, "Trade war risks forcing Fed rate cut this year, say economists: Reuters poll." 13 June 2019

<https://tinyurl.com/y2x8x2ja>

traded since 1988. The Fed has regarded this market as a tool to improve monetary policy transparency, helping traders and other market participants obtain information that had previously only been available to specialized Fed watchers.¹⁹

However, empirical evidence suggests the market is a poor, if not terrible, user of such information. Deutsche Bank chief economist Torsten Slok and his team summarize this issue in a graph, showing that traders on Wall Street (the market) have been systematically wrong in predicting what the Fed will do with data from the Federal Funds Futures. Their conclusion over speculation on the Fed rate cut is “not so fast”.²⁰

After QRIS launching, more works still need to be done

OVERVIEW

At the end of May, Bank Indonesia (BI) launched its long-awaited Quick Response Indonesia Standard (QRIS) code system that facilitates users from one payment service (e.g. GoPay or OVO) to transfer funds to a shopkeeper using another payment service (e.g. Dana or LinkAja).

The central bank has worked together with the Indonesian Payment Systems Association (ASPI), banks, credit card companies and online payment service providers to develop QRIS since the middle of last year. Nevertheless, QRIS development is still unfinished. BI is still working on QRIS interoperability and interconnectivity (see **What We’ve Heard for details**). QRIS is expected to be fully operational in the second half of 2019.

In addition to the technical development of QRIS by BI, there are two other issues that need to be addressed by providers: namely marketing of a QR-based cashless payment system and management of complaints from their respective users under QRIS. (see **What’s More for details**.)

WHAT’S MORE

From the QR-based online payment service providers’ perspective, the launch of QRIS opens opportunities and provides challenges to nurturing industry-wide collaboration. According to our interview with GoPay, there are two important areas for collaboration.

One area of collaboration is in marketing to promote the use of a QR-based cashless payment system, especially to micro- and small-sized merchants. Before QRIS, QR-based online payment service providers focused their marketing efforts on acquiring access to the same merchants. For example, OVO and LinkAja would aim their marketing efforts at Warung Nasi Uduk Ibu Jum, which was already registered as a GoPay merchant, so Warung Ibu Jum would display OVO and LinkAja’s QR codes for their users.

¹⁹ Owens, Raymond E. and Roy H. Webb. 2001. “Using the Federal Funds Futures Market to Predict Monetary Policy Actions.” *Business Economics*, Vol. 36 (2), pp. 44-48. <https://tinyurl.com/yxwqya3y>

²⁰ Bloomberg.com, “Don’t be so sure the Fed is cutting rates.” 11 June 2019 <https://tinyurl.com/y23drwyr>

With QRIS, QR-based online payment service providers could coordinate their marketing efforts toward penetrating new pools of merchants to expand the use of QR-based cashless transactions in Indonesia. However, such a coordinated marketing strategy does not occur automatically. It needs to be nurtured.

Another area of collaboration is in operational effort to ensure seamless experience for users and merchants. Cashless payment is a service based on trust, therefore, ensuring service excellence for users and merchants is priority. From merchant registration, payment settlements, to complaint handling, all procedures need to be carefully thought and prepared to maintain merchant's trust towards cashless payments. For example, for micro merchants, liquidity is priority, therefore, it is important for them to be able to access their income from cashless payments on the same day. Industry-wide collaboration is required to design a system to ensure that micro merchants's liquidity needs are still met under QRIS.

The next area of collaboration is in complaint management. Before QRIS, complaints were handled by each provider. Under QRIS, the questions that arise are: (a) Who should be responsible for responding to complaints of transaction failures from users of different providers? and (b) What should the standard of procedure be? The discussion with BI and among industry players is pointing toward the establishment of a centralized system, but the company that would be responsible has not been chosen yet. In the current testing phase, such an issue is handled by the National Electronic Transaction Operator company (PT PTEN).

WHAT WE'VE HEARD

Although Bank Indonesia has secured agreements from 16 QR-based online payment service providers to adopt the Quick Response Indonesia Standard (QRIS) in their systems, our source at BI said that QRIS is still in the testing phase. Currently, BI is pushing for acceleration of testing, aiming to make QRIS fully operational in the second half of 2019.

Our source told us that QR standardization comprises three phases. In the first phase, the central bank appointed the Indonesian Payment Systems Association (ASPI) to oversee the development of QRIS requirement specifications, which must adhere to the EMVCo's merchant presented QR code specification adopted in Singapore and Thailand. The development involved tech experts from existing QR-based online payment service providers, as well as from switching companies.

The requirement specifications regulate the information available in QRIS, such as merchant's identity, bank account, business category, country code and currency used, as well as its interoperability across various online payment service providers. By adhering to EMVCo's QR Code specifications, QRIS would also be connected to Visa, Mastercard and Union Pay systems and databases. EMVCo's specification has lower data-security risks compared to other QR Code specifications.

The second phase focuses on interconnectivity between QR-based online payment service providers. At this phase – which is currently progressing – QRIS should be functional and be able to replace different QR codes displayed at merchants.

The last phase focuses on operational stability, in which merchants and customers can use QRIS without facing technical difficulties.

Red carpet for foreign carriers: Gimmick or solution?

OVERVIEW

Soaring operational costs for Indonesia airlines has penalized customers dearly with rising airfares and this eventually boosts inflation rates. The government has tried to bring down prices by lowering the fare ceiling but to no avail. Instead, airfares have gradually increased and seemingly created a new normal.

Statistics Indonesia (BPS) recorded that airfares contributed 0.3 percent to year-on-year inflation of 3.32 percent as of May and the effect of higher airfares on inflation would continue in June, especially during the Idul Fitri holidays.

Rising airfares also prompted the public to resort to using private cars during the most recent Idul Fitri exodus. The Transportation Ministry noted that the number of people using public transportation dropped 17 percent to 11.53 million during the Idul Fitri holidays this year (May 30 to June 8), down from 13.92 million during the Idul Fitri holidays last year. The steepest decline was recorded in air transportation (33.9 percent year-on-year) and bus transportation (down 28 percent year-on-year). An improving network of toll roads on Java and Sumatra has also contributed to the drop in the use of public transportation.

Responding to the persistently high airfares, President Joko “Jokowi” Widodo suggested that the government would open Indonesia’s sky to international air carriers. Their entry is expected to push up competition in the local aviation industry, currently dominated by state-owned carrier Garuda Indonesia and private Lion Air Group.

Nevertheless, experts perceived the idea negatively. University of Indonesia international law expert Hikmanto Juwana, for instance, has cautioned the government by referring to similar past experiences of inviting in foreign banks. He argued the idea would violate the principle of cabotage, by which foreign carriers can serve domestic routes only if domestic carriers lacked the capacity. Furthermore, he said that inviting in foreign carriers may cause future problems: Superior foreign carriers may acquire smaller local airlines in the process, just like the situation in the banking sector. Foreign banks were considered a solution of market liberalization in the past, but in the process, foreign banks acquired local banks because of their superior ability to withstand crisis.

Rather than inviting in foreign airlines, the government should investigate and penalize cartel-like practices between Garuda Indonesia and the Lion Air Group in setting prices and also their ganging-up to force ticket-booking companies to kick their competitor AirAsia off their apps for not joining forces to raise airfares.

WHAT WE’VE HEARD

Long before President Joko “Jokowi” Widodo floated the idea of inviting foreign airlines to partake in operating domestic routes, Transportation Minister Budi Karya Sumadi met with AirAsia CEO Tony Fernandes to ask that his airline serve more domestic routes.

In a meeting on May 15 in the Transportation Ministry, Budi requested Fernandes to increase the number of AirAsia’s domestic routes, particularly to serve less-crowded routes rather than

only major tourist destinations. The aim was to reduce airfares through more competition in the domestic market. AirAsia reportedly agreed to the request.

However, one AirAsia executive said the company would not enter routes already dominated by Garuda and Lion Air, arguing that the company is not going for a suicide. The source added that AirAsia would first increase its service frequency on existing routes and then focus on expanding its routes to popular tourist destinations such as Lombok. He said AirAsia was still awaiting government approval for its proposed new routes, namely Jakarta-Lombok, Yogyakarta-Lombok, Bali-Lombok and Singapore-Lombok.

Another source said that Jokowi's idea to invite foreign airlines into domestic routes was in line with the government's plan to relax the negative list of investment in the air transportation industry. The Office of the Coordinating Economic Minister proposed this idea after an internal coordination meeting after the government policy of lowering the airfare ceiling by between 12 to 16 percent failed to effectively reduce prices.

One of the foreign airlines that is said to be interested in entering the Indonesian market after the revision of the negative list is Singapore-based low-cost carrier Scoot. Unfortunately, Scoot was said to be only interested in serving popular tourist destination routes. Another Singapore-based airline, Silk Air, has also expressed interest in the plan.

Tenggara Strategics is a business and investment research and advisory institute established by the Centre for Strategic and International Studies (CSIS), The Jakarta Post and Prasetiya 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.



PT Trisaka Wahana Tenggara

The Jakarta Post Building
Jl. Palmerah Barat 142-143
Jakarta 10270

+62 21 5300476/8 ext. 2009

info@tenggara.id

www.tenggara.id

Board of Commissioners:

Jusuf Wanandi, Djisman S. Simandjuntak, Endy M. Bayuni

Board of Directors:

Riyadi Suparno, Phillips J. Vermonte,
Deddi Tedjakumara

Guarantor: Riyadi Suparno

Researchers & Writers:

Astria Zahra Nabila, Adinova Fauri, Benni Yusrizza,
Dwi Atmanta, Frans Surdiasis, Stella
Kusumawardhani, Lionel Priyadi, Vincent Lingga,
Yesaya Christianto, Yessy Rizky

Disclaimer:

Tenggara Strategics always aims to use reliable sources in providing our best analysis to our clients, and is not responsible for any errors, inaccuracies and/or viewpoints in the original source material upon which we have based our analysis. The analysis contained in this document is intended exclusively for our clients who have subscribed to this service, and is not for public consumption or dissemination.

Nothing contained herein shall to any extent substitute for the independent investigations and the sound technical and business judgment of the reader. In no event will Tenggara Strategics, including its employees, be liable for any decisions made or actions taken in reference to the information contained in these documents, or for any incidental, consequential, indirect, special or exemplary damages, including damages from loss of profits or opportunities, even if advised of the possibility of such damages.