

Highlights of the week



Jokowi, Ma'ruf clinch victory: What's next?

Quick counts conducted by several pollsters indicate that Joko "Jokowi" Widodo and Ma'ruf Amin swept to victory in the 2019 general elections. Not only has the pair secured the presidential and vice-presidential seats, their coalition parties also reportedly managed to dominate the legislative elections, winning the majority of seats in the House of Representatives. Following Jokowi and Ma'ruf's crushing victory, it is very likely that the constellation of power in domestic politics would shift considerably.



KPU's professionalism at stake after overseas vote

A week prior to the 2019 general elections, Indonesian citizens living overseas went to polling stations for early voting. However, a considerable number of voters in various cities around the world reportedly could not exercise their right due to technical constraints. Overseas Elections Committees (PPLNs) could not accept many unregistered voters due to the time limit allowed by the law for them to vote.



Mandiri's high-risk plan to acquire Permata

After completing a due diligence process several weeks ago, Bank Mandiri is moving forward with the acquisition of Bank Permata. The negotiation with Bank Permata shareholders has reportedly begun this week. Although the plan can help the state-owned lender to become the biggest bank in Indonesia again, it poses several risks that so far, the State-owned Enterprise Ministry has been silent on the plan.



Economic challenges await president elect

Business associations ranging from the Indonesian Employers Association (Apindo) to the Indonesian Young Entrepreneurs Association (Hipmi) have expressed hope that the new administration will eliminate more business barriers to improve the ease of doing business. They highlighted six issues namely taxation, investment, exports, energy, industry and labor; which should be prioritized by the new administration.

POLITICS

Jokowi, Ma'ruf clinch victory: What's next?

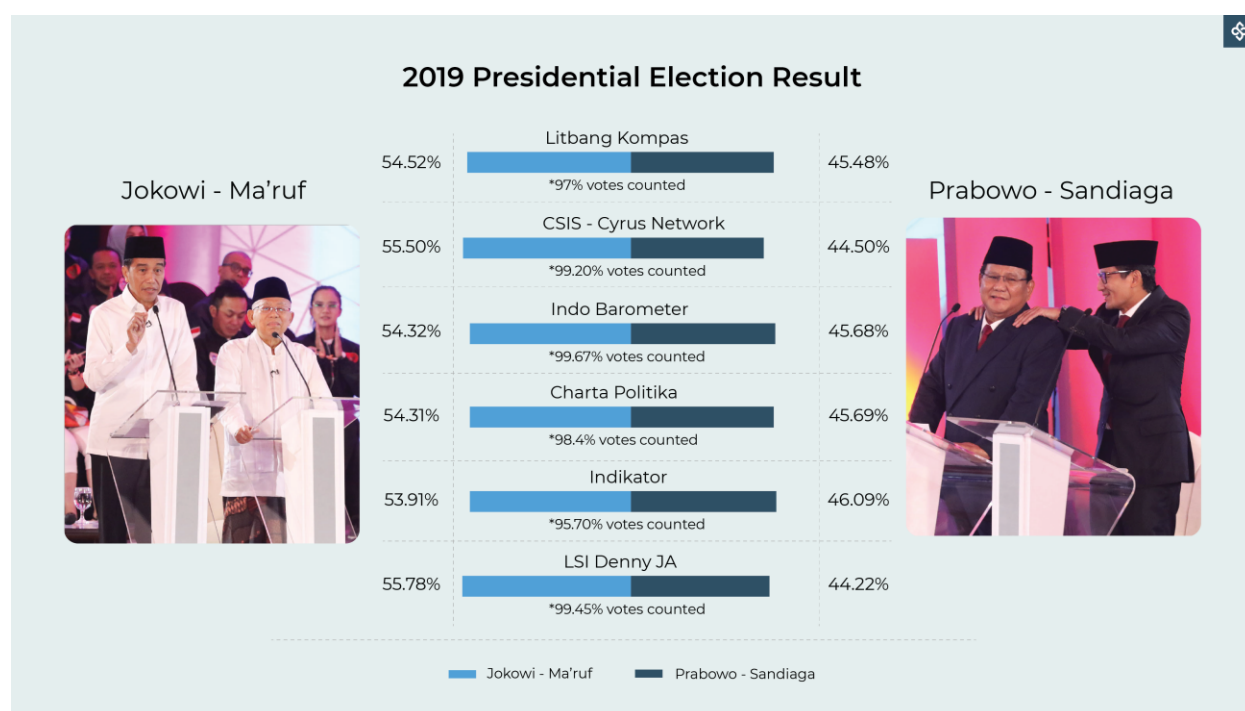
Quick counts conducted by several pollsters indicate that Joko “Jokowi” Widodo and Ma'ruf Amin swept to victory in the 2019 general elections. Not only has the pair secured the presidential and vice-presidential seats, their coalition parties also reportedly managed to dominate the legislative elections, winning the majority of seats in the House of Representatives. Following Jokowi and Ma'ruf's crushing victory, it is very likely that the constellation of power in domestic politics would shift considerably.

Takeaways:

- Winning both the presidential and legislative elections would assist Jokowi considerably to consolidate his power. Unlike after the 2014 legislative elections, it is very likely that now Jokowi and Ma'ruf's coalition parties would lead the House.
- Prabowo and Sandiaga's camp, however, may not lose without a fight. Until the KPU releases its official vote calculation in May, attempts to delegitimize several pollsters' findings on the election results would be numerous.

Background: Now that Jokowi and Ma'ruf have secured the presidential office and consolidated their power in the House, future actions might be easier to formulate and implement as most of the people are on the “same side”. Unlike after the 2014 general elections, when Jokowi won the presidential seat but lost the legislative elections to challenger Prabowo Subianto's coalition parties, now the incumbent has clinched victory in both the presidential and legislative elections, according to several quick counts.

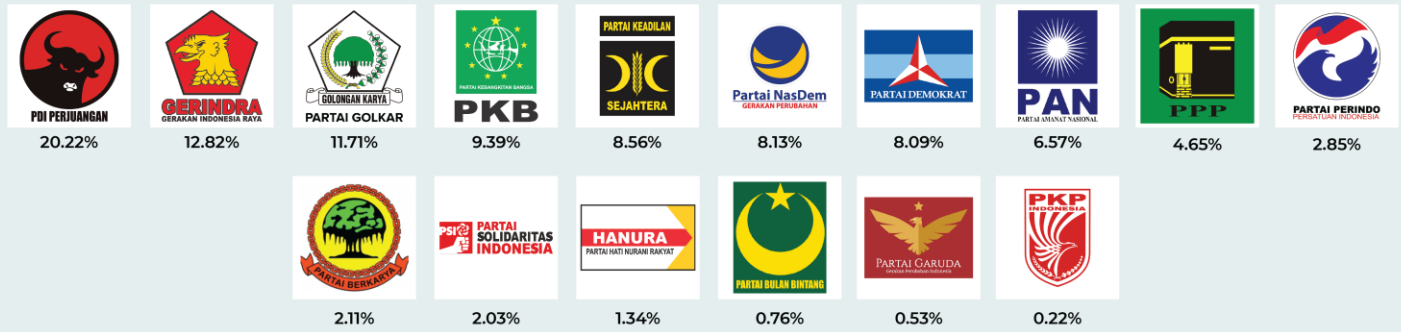
While it is too soon to predict what policies the newly elected officials will pursue, it is likely that they would take two immediate actions, namely allocating seats in the House and establishing a new Cabinet. With stronger and more consolidated power, it would be no surprise if Jokowi's political presence heavily imbues the two actions.



2019 Legislative Election Result

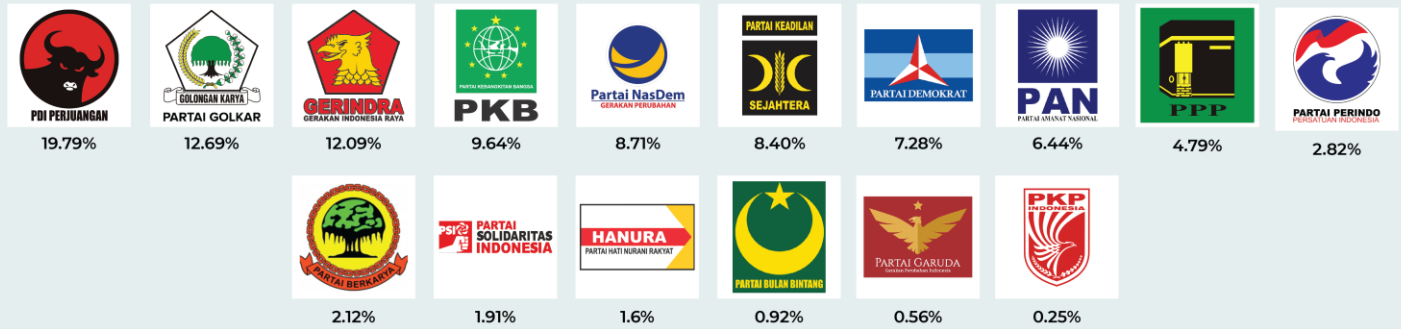
Litbang Kompas

87% votes counted



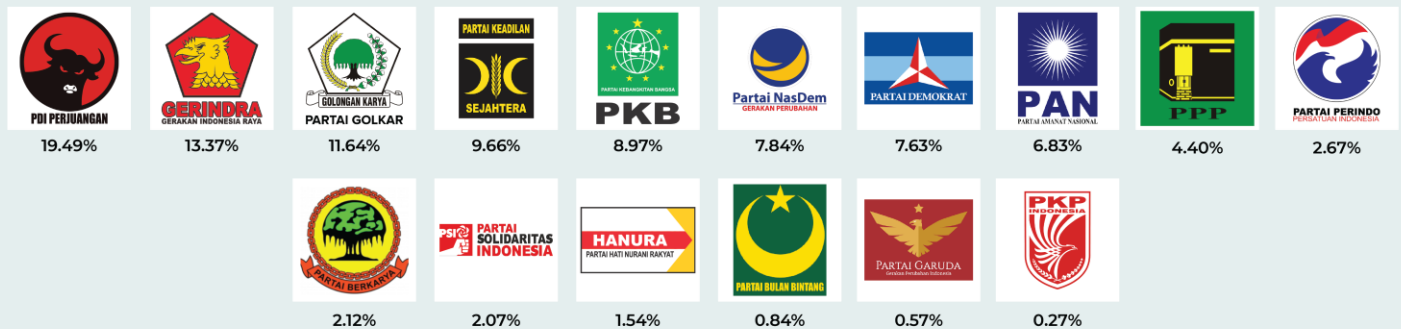
CSIS - Cyrus Network

99.2% votes counted



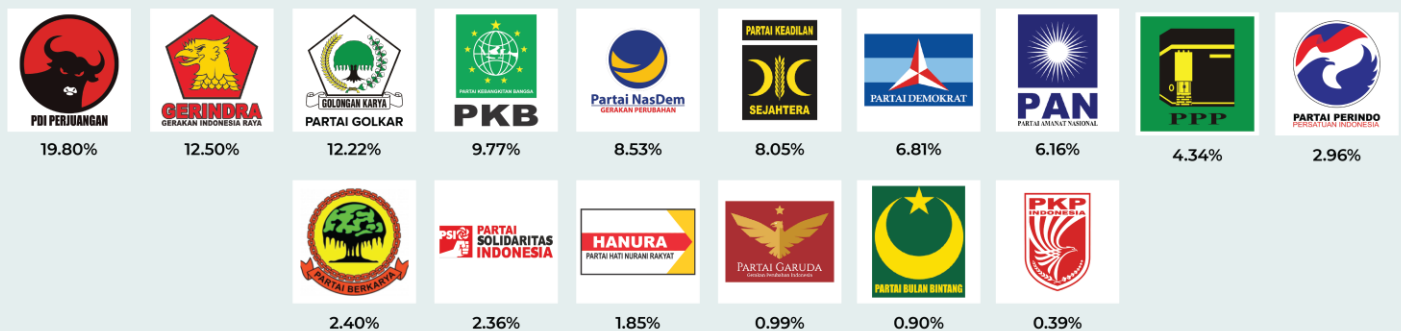
Indo Barometer

91.58% votes counted



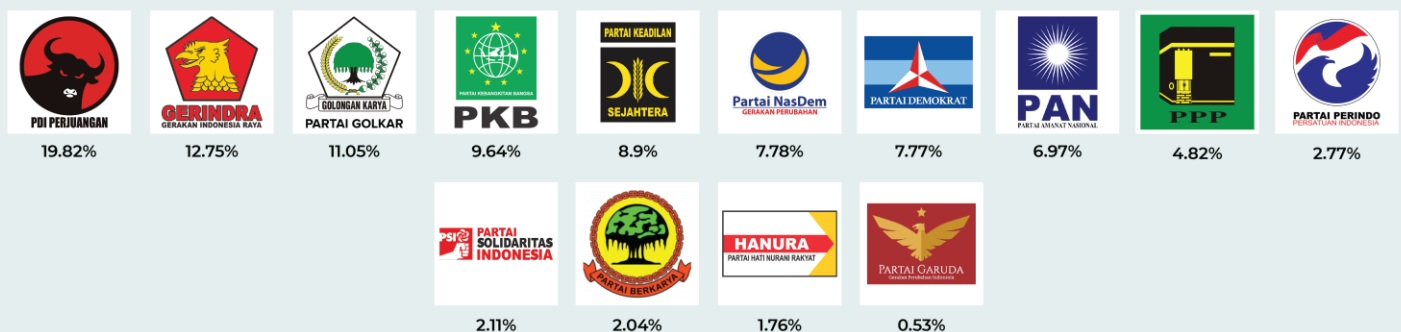
LSI Denny JA

98.40% votes counted



Charta Politika

92.8% votes counted



Insight: Compared to the 2014 presidential and legislative elections, the results of the 2019 general elections are more promising for President Jokowi. Indeed, in 2014, Jokowi's failure to seize a consolidated power in the House sent his coalition parties, which consisted of the Indonesian Democratic Party of Struggle (PDI-P), the NasDem Party, the National Awakening Party (PKB) and the Hanura Party, into secondary positions in the House. While at the time Jokowi's coalition parties in total only obtained 39.97 percent of the votes (207 seats), Prabowo's coalition parties, consisting of the Gerindra Party, the Prosperous Justice Party (PKS), the National Mandate Party (PAN), the Golkar Party, the United Development Party and the Crescent Star Party (PBB), managed to clinch 48.9 percent of the votes (292 seats).

The significant disparity of votes secured by Jokowi's and Prabowo's coalition parties manifested in the House formation following the 2014 elections. Not only was the House led by a Golkar executive, but almost all of the House's commissions were chaired by Prabowo's coalition parties as well, with only Commission IX and Commission X led by the neutral Democratic Party.

The lack of strategic positions held by Jokowi's coalition parties was reportedly orchestrated by Prabowo's camp.¹ According to a circulated letter signed by the heads of the Golkar, Gerindra, PKS, PPP and PAN factions, Prabowo's coalition parties had reached an agreement in appointing positions in the House and People's Consultative Assembly (MPR). The carefully deliberated appointment of positions was allegedly aimed at undermining the political clout of Jokowi's PDI-P. It took Jokowi more than one year to consolidate power in the House by enticing some political parties in the opposition to join his government. Those that eventually joined Jokowi's administration included Golkar, PPP and PAN.

Now that Jokowi's coalition parties have won the majority of votes in the 2019 legislative elections, it becomes very likely that the House and its commissions would be led by Jokowi's coalition parties, providing the President more space to maneuver.

It remains to be seen whether Jokowi would entice any political parties in Prabowo's camp to join his government, like he did in the past. At least the Democratic Party and, to a lesser degree, PAN joined Prabowo's coalition only half-heartedly. Moreover, the Democratic Party, which has hinted at its political flexibility in the past weeks, might even leave Prabowo's coalition altogether to join Jokowi's. After all, joining the winning side would benefit the alleged ambition of Susilo Bambang Yudhoyono, the patron of the Democratic Party, to have his eldest son, Agus Harimurti, be a presidential candidate in the 2024 election.

The end of the 2019 general elections, however, does not necessarily mean the end of political quarrels. While several quick counts have declared Jokowi and Ma'ruf the victors, the only calculation that counts is the General Elections Commission's (KPU). Regardless, the KPU is to only disclose its vote tabulation on May 22, a month after the election. Anything is possible in one month.

Although the vote gap between the Jokowi-Ma'ruf and Prabowo-Sandiaga tickets is considerably wide, about 10 percent, it is likely the opposition would try any possible means to delegitimize the quick count results in the upcoming weeks. After losing the 2014 presidential election by approximately 7 percent, Prabowo refused to accept the KPU's calculations and decided to file a report against it, the government and Jokowi's camp with the Constitutional

¹ Liputan6.com, "PerjanjianRahasiaMerontokkanBanteng di Parlemen" 01 October 2014
<https://tinyurl.com/y5geg7cb>

Court.² Now, after several pollsters released their calculations and declared a Jokowi-Ma'ruf victory, Prabowo and Sandiaga offered an alternative fact, claiming that the pair won by 62 percent of the votes according to its internal “real” counts.³ In his first statement following the release of the quick count results, Prabowo encouraged his supporters to “safeguard” ballots and his victory at the polling stations, as well as to take heed of the alleged biases of certain pollsters.

It is possible, regardless, that Prabowo would take even more drastic measures this year, at least based on previous statements made by several members of the ticket’s national campaign team. A member of the Prabowo-Sandiaga campaign team, Amien Rais, for instance, claimed that instead of lodging a report with the Constitutional Court, he would mobilize supporters and rely on “people’s power” if he detected any hints of election fraud.⁴ Indeed, following the release of the quick count results indicating Jokowi and Ma'ruf’s victory, the *#IniCurang* (this is cheating) hashtag appeared and gained popularity on Twitter.⁵ If it is any indication, it appears that mobilization, at least on online platforms, is already taking place.

The threat of mass mobilization only jogs memories about Jakarta’s 2017 gubernatorial election, when mass mobilization, known as the 212 rally, also occurred. Considering how Prabowo and Sandiaga’s supporters are often affiliated with the rally and the particular groups that supported it, it is very likely that similar mobilizations and street demonstrations would occur. However, it is doubtful if such a rally would draw a bigger crowd this time, as there would be no religious grounds to bolster the cause. Also, National Police chief Tito Karnavian has stated that any mass gathering to celebrate early any claimed victory or display any disappointment over the election results would be dispersed.⁶

For many, Prabowo has now become irrelevant. It is questionable if any businessperson or political leader would risk investing any loyalty to defend his hollow claimed victory.

What we’ve heard: Vice presidential candidate Sandiaga’s whereabouts has been questioned following his and Prabowo’s defeat in the presidential election. Members of the public speculated why Prabowo appeared alone while giving his first response to the quick counts that declared his defeat. While it was reported that Sandiaga was prevented by fatigue from appearing in public, the vice presidential candidate allegedly did not appear with Prabowo as the pair had been quarreling following the release of the quick counts. Sandiaga reportedly had disagreed with Prabowo’s refusal to admit the pair’s defeat and advised Prabowo to refrain from claiming victory until the KPU announced its results, leading to a falling-out between the two.

However, official statement from Prabowo-Sandiaga’s camp insists that Sandiaga has been sick since the election day. Sohibul Iman from PKS, for instance, denied allegations of tensions between Prabowo and Sandi, stating that Sandiaga was resting due to sickness when Prabowo was giving his statement.

² Merdeka.com, “Gugat KPU ke MK, Prabowo-Hatta kerahkan 95 pengacara” 27 July 2014 <https://tinyurl.com/y2n3u5wz>

³ Thejakartapost.com, “‘We have already won,’ Prabowo claims,” April 17, 2019. <https://tinyurl.com/y5zmuh3z>

⁴ Jakartaglobe.id, “AmienRais Threatens ‘People Power’ at Slighets Hint of Voter Fraud” 03 April 2019 <https://tinyurl.com/yxw2y8lh>

⁵ Tirto.id, “Merespons Quick Count, Tagar #IniCurangMenggema di Twitter” 17 April 2019 <https://tinyurl.com/yyfv2gsk>

⁶ Detik.com, “Kapolri: Mobiliasikemenanganatauketidakpuasan, semuakamibubarkan,” April 18, 2019. <https://tinyurl.com/y6jvuyk6>

2019 Legislative election result: Parties exceed surveys' expectations

Several pollsters announced that nine of 16 parties contesting passed the parliamentary threshold. They are the Indonesian Democratic Party of Struggle (PDI-P), Gerindra Party, Golkar Party, the National Awakening Party (PKB), NasDem Party, the Prosperous Justice Party (PKS), Democratic Party, National Mandate Party (PAN) and United Development Party (PPP). Of the nine parties, five are from Joko "Jokowi" Widodo-Ma'ruf Amin's coalition. A number of quick counts announced that the coalition parties had secured more than 50 percent of the vote, ensuring the much-needed outright majority in the House of Representatives.

Newcomers, namely the United Indonesia Party (Perindo), Berkarya Party, the Indonesian Solidarity Party (PSI) and Garuda Party, and old timers the Indonesian Justice and Unity Party (PKPI), Hanura Party and Crescent Star Party (PBB), failed to beat the 4 percent threshold.

Insight: The quick counts conducted by several pollsters for the 2019 legislative election sprung surprises. First, while predictions of the PDI-P, Gerindra and Golkar dominating the top three were proven, it appears that Gerindra's predominance in Prabowo Subianto-Sandiaga Uno's coalition had been overestimated. Indeed, it has been frequently argued that Gerindra would win big in the legislative election due to the coattail effect that it reaped from its patron Prabowo's presidential nomination.

Meanwhile, the surprisingly huge number of votes reaped by PAN and the PKS, other Prabowo-Sandiaga coalition parties, indicate that most of Prabowo-Sandiaga's supporters did not necessarily vote for Gerindra as predicted. The Centre for Strategic and International Studies' (CSIS) survey in March, for instance, found that PAN and the PKS' electability merely stood at 2.5 percent and 4.6 percent respectively. [Quick counts conducted by the CSIS](#) after the April 17 elections, however, found that PAN and the PKS won 6.44 percent and 8.4 percent of the vote respectively based on 99.2 percent of samples collected. This might imply that despite the coattail effect, PAN and the PKS, which are known for their Islamic credentials, preserved their popularity among Prabowo-Sandiaga's Islamist supporters. This is important as Prabowo-Sandiaga's supporters have often been affiliated with Islamist groups such as the Islam Defenders Front (FPI) and the 212 Movement alumni, which are reportedly affiliated with PKS in particular.

Similarly, several surveys also overestimated the electability of PDI-P, Jokowi's party. While PDI-P has now won the most votes in two consecutive legislative elections, its electability had been overrated. Kompas and the CSIS, for instance, both predicted in March that the party would reap more than 25 percent of the vote, mainly due to the coattail effect from Jokowi's presidential candidacy. The two found in their quick counts, however, that the PDI-P only won approximately 20 percent of the vote.

It appears that the PKB has risen to stardom in Jokowi-Ma'ruf's coalition. The Islamic party surpassed its performance in 2014, when it won 9 percent of the vote. Several surveys had predicted the party to win up to 6 percent of the vote.

KPU's professionalism at stake following overseas vote

A week prior to the 2019 general elections, Indonesian citizens living overseas went to polling stations for early voting. However, a considerable number of voters in various cities around the world reportedly could not exercise their right due to technical constraints¹.

Overseas Elections Committees (PPLNs) could not accept many unregistered voters due to the time limit allowed by the law for them to vote.

A polling station at Sydney Town Hall could not stay open late due to the venue's limited rental time, resulting in a petition demanding a revote. Meanwhile in Tokyo, at least 300 people queued two hours past the station's closing time. Unused returned postal ballots had to be used to accommodate some voters as the PPLN in Tokyo did not have extra ballots. The same chaos happened in San Francisco, where people had to wait for hours amid the uncertainty about the availability of ballots.²

Insight: The fact that the PPLN – the representative of the KPU abroad – was surprised by the huge turnout implies the commission's miscalculation of overseas voters', even the unregistered ones, enthusiasm, and its unpreparedness in anticipating unforeseen difficulties. The furor came as the KPU acted slowly against the findings of punched postal ballots Selangor, Malaysia. The KPU ignored advice from the Elections Supervisory Agency (Bawaslu) to postpone the vote pending settlement of the issue.

The KPU's last resort to restore credibility came on April 17, although some parties might attempt to delegitimize undesired election results. Some technical issues during voting day, such as shortage of ballots, delayed voting. This may provide leeway for certain actors to scapegoat the KPU for their defeat.

KPK still targeted

The Corruption Eradication Commission (KPK) has been targeted by terror attacks, including death threats, arrests, tortures and even an acid attack on KPK senior investigator Novel Baswedan. Earlier this year, KPK chairman and deputy chairman Agus Rahardjo and Laode M. Syarief faced a terror attack as Molotov cocktails were thrown at their residences. It is strongly implied that the investigators have been working in unfavorable, even deadly environment as a consequence to their commitment to anticorruption, resulting in the delay of investigations or even failure in uncovering corruption cases.

One-hundred-and-fourteen investigators of the commission have filed a petition to the commission's leaders, protesting the obstructions they faced while on duty. Five points were raised in the petition, including leakage of confidential information on covert operations, special treatment of witnesses and internal attempts to hinder investigations.

Insight: In discussing corruption eradication, external threats against the KPK have often been assumed the main culprit behind the commission's lackluster anticorruption operations. Starting from vengeful politicians or businesspeople to alleged inadequate protection from the government, external factors have often been highlighted. The government and other state organizations' commitment, for instance, has often been doubted. A rally marking two years of the futile investigation into Novel's acid attack demanded the government to establish an independent joint fact-finding team to conduct a more impartial investigation.

Regardless, the newest petition on alleged attempts of several KPK members to obstruct the commission's investigation indicates that a much more complicated internal issue might be at play. Claims about certain groups within the KPK obstructing investigations reaffirm allegations about the antigraft body being divided into factions. If such is the case, the KPK thus not only needs more external support, but also thorough internal reform to ensure better measures are taken in the future. Such reform, however, will not be easy.

BUSINESS & ECONOMIC POLICY

Bank Mandiri's high-risk plan to acquire Bank Permata

After completing a due diligence process several weeks ago, Bank Mandiri is moving forward with the acquisition of Bank Permata. The negotiation with Bank Permata shareholders has reportedly begun this week.

Takeaways:

- Bank Mandiri's planned acquisition of Bank Permata is likely to be costly at Rp 35 trillion to Rp 37.5 trillion.
- Besides buying the shares from SCB and Astra International, Bank Mandiri might also need to inject fresh capital into Bank Permata.
- An acquisition of Bank Permata by Bank Mandiri looks risky, and, so far, the State-owned Enterprise Ministry has been silent on the plan.

Background: Bank Permata, formerly PT Bank Bali Tbk, was one of the ten biggest Indonesian banks in terms of assets. In 2018, Bank Permata's assets amounted to Rp 155.7 trillion.

Following the end of the commodity price boom in 2014, Bank Permata fell into financial turmoil. In 2015, it suffered a Rp 6.5 trillion loss. Seeing this turmoil as an opportunity, British Standard Chartered Bank (SCB) and Indonesia's conglomerate Astra International acquired 90 percent of Bank Permata shares, worth Rp 13 trillion.

Under SCB's supervision, Permata underwent a loan restructuring program, removing nonperforming loans (NPL) and bad assets from its books. Bank Permata's financial condition improved. In 2019, Moody's Investor Service raised Bank Permata's currency deposit rating to Baa3 and its baseline credit assessment to ba1.⁷

However, the bank's overall financial performance, specifically its loan and credit assessment system, is still problematic. In 2016, Garasindo, one of Bank Permata's biggest borrowers, defaulted on a Rp 1.2 trillion loan.⁸ The restructuring process ended with a decision to sell parts of Garasindo's defaulted loan bundled with defaulted loans from other borrowers worth Rp 1.5 trillion.⁹

Bank Permata's poor performance has disappointed its shareholders. The SCB included Bank Permata into its list of nonperforming assets in 2018 and decided to divest its stake. SCB Group chief executive officer Bill Winters mentioned in an interview with CNBC Indonesia that SCB faced too many challenges in Bank Permata, without elaborating further, and called the investment "undeserving".¹⁰

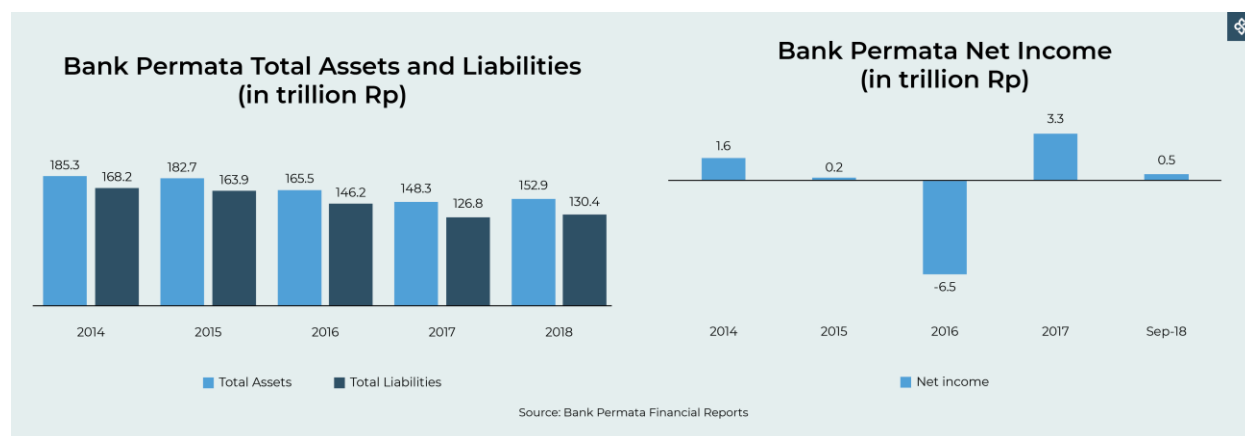
⁷ The insider stories, "Moody's affirms Bank Permata's Baa3 Ratings with a stable outlook," March 14, 2019. <http://tinyurl.com/y6ra8ayj>

⁸ Katadata.co.id, "Bank Permata terbebani kredit macet Garasindo Rp 1.2 triliun." 25 March, 2017 <https://tinyurl.com/yxzdutuv>

⁹ Kompas.com, "Bank Permata akan jual kredit bermasalah Garasindo?" 15 May 2018 <https://tinyurl.com/y6l79ntz>

¹⁰ CNBC Indonesia, "Buka-bukaan Bos Stanchart soal kondisi bisnis Bank Permata," Nov. 23, 2018. <https://tinyurl.com/y2ptknnn>

By contrast, Astra International has asserted that it will keep its ownership of Bank Permata. The official statement stressed that Astra would commit to supporting Permata's business plan, believing that the bank could still contribute to Astra's long-term prospects.¹¹



Insight: SCB's divestment announcement has attracted potential buyers, domestic as well as foreign. Reports suggest that several Japanese Banks, namely Bank Mizuho, Mitsubishi UFJ Financial Group, Japan Post Bank and Mitsui Financial Group, have negotiated with SCB over potentially buying Bank Permata's shares. Mizuho was rumored to be the most prominent potential buyer due to its previous attempt to acquire a stake in Panin Bank in 2015 and the fact that other lenders have already merged with several local banks.¹²

In March 2019, state-owned Bank Mandiri leapfrogged everyone and expressed its interest to buy Bank Permata. By early April, Bank Mandiri completed the due diligence process, and it started negotiations with Bank Permata's shareholders on April 10.¹³

An acquisition of Bank Permata make Bank Mandiri the bank with the largest assets in Indonesia, surpassing state-owned lender Bank Rakyat Indonesia (BRI)'s Rp 1,296.89 trillion in assets. Bank Mandiri's assets would grow to Rp 1,355 trillion if it acquired Bank Permata's Rp 153 trillion assets.¹⁴ Besides boosting its assets, Bank Mandiri also aims for obtaining Bank Permata's network of retail debtors.

	2014	2015	2016	2017	Sep 2018
Interest income (in trillion Rp)	15.5	16.1	14.4	11.2	8.2
EPS (Rp)	133.54	20.79	-290.20	118.96	17.62
Book Value (Rp)	1,438.47	1,583.06	863.46	767.07	777.56

Source: Bank Permata Financial Reports, Indonesia Stock Exchanges

¹¹ CNBC Indonesia, "Astra kekeh tak mau jual saham Permata," Jan. 21, 2019. <https://tinyurl.com/y24mcscy>

¹² CNBC Indonesia, "RHB: Mizuho jadi candidate potensial caplok Permata," Jan. 21, 2019.

¹³ Investor Daily, "Bank Mandiri segera negosiasi dengan Stancart dan Astra," Apr. 10, 2019. P. 24

¹⁴ Bisnis Indonesia, "Aset Bank Mandiri lampau BRI bila akuisisi Bank Permata terealisasi," Apr. 10, 2019.

<http://tinyurl.com/y5k8vxyg>

Nevertheless, this acquisition is not without risks. Bank Mandiri still needs to deal with the challenges of restructuring Bank Permata's Rp 4.7 trillion worth of nonperforming loans. SCB had restructured Rp 4.9 of 9.6 trillion of the nonperforming loans since its investment in Bank Permata in 2015. In the end, SCB gave up mid-way. Continuing what SCB started, there is high possibility that Bank Mandiri needs to inject fresh capital.¹⁵

	2014	2015	2016	2017	2018
Gross NPL (%)	1.7	2.74	8.83	4.6	4.36
Net Non-Performing Loan (NPL)					
Percentage	0.63	1.4	2.24	1.67	1.73
Value in trillion Rp	2.3	3.6	9.6	4.5	4.7

Samuel Sekuritas Indonesia head of research Suria Dharma said Bank Permata's acquisition would not come cheap. According to his calculation, Bank Permata's price-to-earnings ratio is 30 times its true value, and the price-to-book value (PBV) is estimated to be 1.2 times higher. Considering SCB and Astra International's valuation of Bank Permata, he speculated that Bank Mandiri would need to pay up to 2 times the PBV, which is worth Rp 35 trillion to Rp 37.5 trillion at an average share price between Rp 1,400 and Rp 1,500.¹⁶ Meanwhile, Bank Permata's share price in the Jakarta Composite Index (JCI) is around Rp 950 per share.

What we've heard: A source at the State-Owned Enterprises Ministry said Bank Mandiri wants to acquire Bank Permata to surpass Bank Central Asia (BCA) and Bank Rakyat Indonesia's (BRI) in assets and performances.

According to the source, the gap between Mandiri and BRI's assets have widened during the past two years. Last year, its assets reached Rp 1,202.25 trillion, Rp 94 trillion lower than BRI's. Mandiri's reputation as the bank with biggest assets is now at stake.

Not only is it losing the competition in asset size, it is also falling short of BRI in terms of net profit. Mandiri's efforts to obtain more income by disbursing micro loans and credits excessively to the retail sector have been counterproductive. Its current net profit is only Rp 25.02 trillion, lower than BCA which booked Rp 25.86 trillion and BRI which raked in Rp 32 trillion.

The source also revealed that Mandiri had been lobbying State-Owned Enterprises Minister Rini Soemarno since last year, adding that the board of directors had been tirelessly trying to convince Rini that the Permata acquisition plan was important because it would make Mandiri the biggest bank in Indonesia again. The board argued that Mandiri could acquire it at a lower price due to its high number of non-performing loans (NPL).

However, Permata's poor performance is creating a dilemma for Mandiri's board during discussions with the ministry. If Mandiri cannot solve Permata's NPL problem, it could drag Mandiri's performance down. Moreover, there is a risk that Astra -- one of Permata's main shareholders -- would make a unilateral decision to cut its business partnership in automotive retail with Permata.

A source at Astra said Astra International was unwilling to inject additional capital into Permata. Compared to other Astra subsidiaries in the financial industry, such as Astra Credit Companies

¹⁵ See note 1

¹⁶ Bisnis Indonesia, "Samuel Sekuritas: harga Saham Bank Permata sudah tinggi," Apr. 10, 2019. <http://tinyurl.com/y4cdlus5>

(ACC) and Toyota Astra Financial Services (TAF), Permata's performance in the last two years was very disappointing. Despite Astra and Standard Chartered's Rp 13 trillion investment, Permata failed to improve its loan and credit assessment system.

A senior banker said Permata kept making reckless loans. Failing to learn from Garasindo's Rp 1.2 trillion default, Permata loaned money to Yohanes Chandra Ekajaya, an oil and gas businessman whose name emerged in the corruption case of Rudi Rubiandini, the former head of the Upstream Oil and Gas Regulatory Special Task Force (SKK Migas). Permata's decision to disburse massive loans to various corporations in the coal industry is also flabbergasting.

A government source said the Financial Services Authority (OJK) was worried and opined that Permata should be rescued immediately because of its NPL issue. When Mandiri communicated its acquisition plan, the OJK seized the momentum immediately, giving Mandiri permission to acquire Permata.

Economic challenges await president elect

Business associations ranging from the Indonesian Employers Association (Apindo) to the Indonesian Young Entrepreneurs Association (Hipmi) have expressed hope that the new administration will eliminate more business barriers to improve the ease of doing business.

Background: Based on separate interviews by the *Kontan* economic daily newspaper,¹⁷ Apindo and Hipmi highlighted several issues for whoever is elected president. They include:

1. Taxation

Simplifying tax regulations, forming a separate tax body from the Finance Ministry, expanding tax data (especially in the informal sector) and improving public awareness about taxes.

2. Investment

Implementing a one-stop service center between the regional and central government as well as providing tax incentives and allowances.

3. Exports

Creating new markets, reducing export taxes and providing more access to funding for exporters to grow.

4. Energy

More consistency when planning and implementing regulations, fixing overlapping regulations and ensuring that all energy sources are used to maintain national energy security.

5. Industry

Improving permit handling procedures, eliminating unofficial fees and allowing for the import of capital goods that are unavailable at home.

6. Labor

Increasing productivity through a more productive wage policy and improving manpower regulations for national competitiveness.

Insight: The six issues highlighted by the associations were impediments in doing business in the past four-and-a-half years under the administration of President Joko "Jokowi" Widodo. Here is our take on the six issues:

¹⁷ *Kontan*, "Tantangan ekonomi menanti presiden terpilih," Apr. 12, 2019. P.1

Taxation

Expanding the tax base has been the government's long-standing objective to increase the tax ratio, but it is easier said than done. Indonesia's tax ratio of below 11 percent is way below the 15 percent threshold needed to stimulate growth. According to government data, only 10.6 million taxpayers filed their tax returns for 2017, or 66 percent of the total registered 16.5 million taxpayers. As a result, personal income taxes contribute only 10 percent of tax revenues, with the other 90 percent coming from corporate and indirect taxes. In most other countries, personal income taxes contribute to the bulk of revenue.¹⁸ But increasing income tax -- and thus increasing the tax ratio -- is not an easy proposition considering that more than 50 percent of the country's workforce is employed in the informal sector. And taxing those in the informal sector is precarious because they earn a much lower income than their peers in the formal sector. So, work needs to be done to improve the income of those in the informal sector.

Investment

The government has launched the online single submission (OSS), with President Jokowi boasting that it could issue licenses in a matter of hours, not days, weeks or months. However, businesses have complained that the OSS has not produced the intended results as yet because of the conflicting regulations among the ministries and between those of the central and local governments. The issue is how to harmonize the regulations at various levels of the government.

Exports

Exports have been declining in proportion to the gross domestic product (GDP), from 35 percent in the 1990s to around 20 percent now. Slowing exports have also lowered economic growth in the past years as household spending and investment continue to grow above 5 and 6 percent, respectively. The problem is that Indonesia still relies too much on resource-based commodity exports. The government imposes levies on resource base exports to encourage more downstreaming and industrialization and therefore improving value added. As downstreaming is still slow, such export levies burden exporters making them less competitive, which slows down exports. The challenge is how to stop resource-based exports and expand the export of manufactured products and services.

Energy

Indonesia still relies on petroleum, coal and natural gas to meet the country's energy demand, with fossil fuels supplying 40 percent, coal 30 percent, and natural gas 23 percent, according to 2017 official data.¹⁹ It means 7 percent of energy supply comes from renewable sources, including hydro and biofuels. As the country suffered from a huge deficit of over US\$12 billion in the oil and gas trade last year, it needs a lot of investment to boost oil and gas production and move into renewable electricity generation. Industry players say Indonesia suffers from policy deficits and therefore investment into finding new oil and gas reserves as well as renewable electricity generations has been declining over the past few years. The challenge is to find a good energy and mineral resources minister to reverse this trend.

Industry

Indonesia has experienced de-industrialization in the past decade, with declining industrial contribution to the country's GDP, from 26 to 20 percent.²⁰ Another problem is that its industries or manufacturing plants have been reliant on imported raw materials and capital goods. When the government imposes limitations on imports, the manufacturing sector is hit particularly hard.

¹⁸The Jakarta Post, "Indonesia's low tax-to-GDP ratio," Oct. 11, 2019

¹⁹Ministry of Energy and Mineral Resources, "Handbook of energy and economic statistics of Indonesia," 2017.

²⁰Republika.co.id, "Indonesia experiencing de-industrialization: INDEF", June 20, 2018.

<https://tinyurl.com/y3x6bjvb>

Industry players know that Indonesia needs to build industries that process home-grown raw materials, such as those processing mining products.

Labor

Productivity is a big issue for Indonesia labor, not in the formal sector but more in the informal sector which employs 70.5 million people, or 53 percent of the total employed workforce. Of those working in the informal sector, 28 million are underemployed, working less than 35 hours a week; of whom, 8 million work less than 15 hours a week.²¹ Thus improving the productivity of those in the informal sector could improve their welfare. Jokowi's planned pre-employment card that offers various training benefits would likely help upgrade the skills of those working in the informal sector, in addition to the new graduates, and thus improve their productivity.

Macroeconomic Update: The President's post-election priorities

On April 15, Statistics Indonesia (BPS) said the country had recorded another trade surplus in March of US\$540 million, larger than last month's surplus of \$330 million. Just a few days earlier, Bank Indonesia recorded Rp 91 trillion (\$6.4 billion) of capital inflows this year to date.²²

Takeaways:

- The election has closed; President Jokowi now has the energy to focus on improving Indonesia's trade position.
- Weakening export performance and the country's dependence on natural resource-based exports are a cause for concern.
- Indonesia needs to reorient its economy toward manufacturing exports through new export and supply chain strategies.

Background: The reported trade surplus and capital inflows are good news for President Joko "Jokowi" Widodo's reelection bid. The Jokowi administration has been pursuing import restriction policies since mid-2018 to combat the trade deficit and stabilize the economy. For example, the mandatory 20 percent biofuel-mix (B20) policy it introduced has succeeded in reducing energy imports. The oil and gas import volume dropped from 4.6 million tons in November 2018 to 2.7 million tons in March 2019. Consequently, the oil and gas trade deficit narrowed to \$1.3 billion in the first quarter of 2019, a year-on-year decline of more than 50 percent from \$2.7 billion in 2018.

Other import restriction policies, such as the new import levy and several import substitution incentives, have also succeeded in reducing non-energy imports. BPS reported that non-oil and gas imports dropped to \$35.9 billion in the first quarter of 2019 from \$37.2 billion in the first quarter of 2018, and that total imports declined from \$44 billion to \$40.7 billion.

Despite its success in reducing imports, the administration is still struggling with Indonesia's dwindling exports. Driven by the \$3 billion decline in non-oil and gas exports, total exports in the first quarter of 2019 fell to \$40.5 billion, from \$44.2 billion in the first quarter of 2018.

²¹Statistics Indonesia. "Survei Angkatan Kerja Nasional (SAKERNAS) 2018."

²²The Jakarta Post.com, "Bank Indonesia records Rp 91 trillion of capital inflows." 13 April 2019

<https://tinyurl.com/yxet23an>

Meanwhile, capital inflows have neutralized the negative impacts on the rupiah exchange rate from last year's capital outflow. Capital outflows caused the rupiah to depreciate from Rp 13,542 per US dollar on Jan. 2, 2018 to Rp 15,233 per US dollar on Oct. 9, 2018. Capital started flowing into the country in the fourth quarter of 2018, which resulted in the rupiah appreciating to close at Rp 14,085 per US Dollar on Tuesday (April 16, 2019).

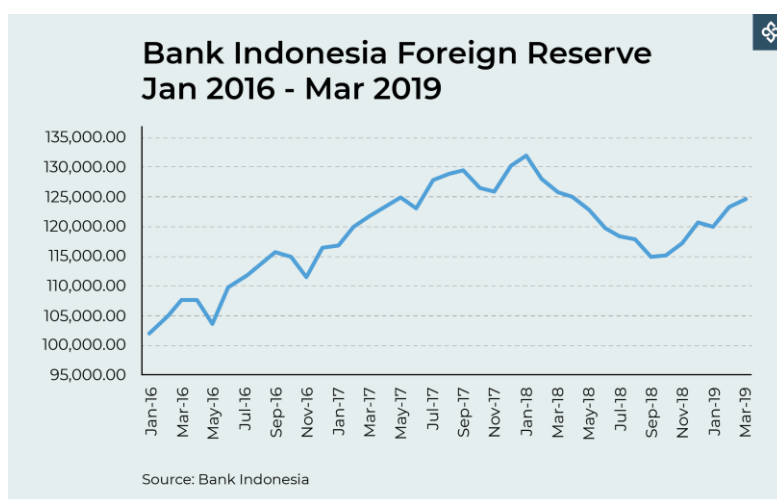
Capital inflows have also boosted the performance of Indonesia's financial market, with the Jakarta Composite Index (JCI) increasing from 5,702.82 on Oct. 11, 2018 to 6,481.54 on April 16. The JCI is again expected to increase following the presidential election on April 17.²³ Capital inflows have ultimately improved Bank Indonesia's foreign exchange (forex) position, with the country's forex reserves increasing by \$9.7 billion to \$124.5 billion between in September 2018 and March 2019.



Insight: Early quick count results for the 2019 election place the incumbent in a comfortable lead of 8-10 percent against challenger Prabowo Subianto. If he wins a second term, reducing the current account and trade account deficits will remain President Jokowi's number one priority. He is likely to address the macroeconomic challenges by continuing to pursue his import restriction policy, which have proven successful so far.

Nevertheless, the weakening export performance is another obstacle. If Indonesia is able to maintain last year's export performance while reducing imports, it could record a trade surplus of \$3.5 billion. The question is whether it is able to

maintain last year's export performance through 2019, which would depend on Jokowi reorienting the economy from natural resource-based exports to manufacturing exports.



Boosting manufacturing exports is challenging: The government needs a clear strategy to improve the country's position in the global supply chain amid the competition of its Southeast

²³²³ Tempo.co, "Jokowi atau Prabowo pemenangnya, asing beli saham setelah Pilpres." 17 April 2019 <https://tinyurl.com/y46fddty>

Asian neighbours such as Singapore, Malaysia, Thailand and Vietnam. Most foreign investors do not see Indonesia as a potential production hub; rather, they are interested in the potential of its domestic market.

The Indonesia-Australia Comprehensive Economic Partnership Agreement (IA-CEPA), signed in early March, provides an opportunity to boost Indonesia's manufacturing exports. However, President Jokowi must focus on reorienting the economy toward manufacturing exports to take advantage of this opportunity. One of the first things he should do post-election is to come up with a clear supply chain strategy to convince foreign investors that Indonesia is a potential production hub.

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.



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