

Highlights of the week



Mid-sized Islam-based parties: Where will they go?

Latest surveys forecast that the majority of mid-sized Islamic parties will not pass the 4 percent parliamentary threshold in the upcoming legislative election. Looking at the implications carried by the decrease of the Islamic parties' electability rates, strategies to avoid further decline could be formulated.



Paradox of Plenty in Indonesia: Unhealthy lifestyle

The latest Health Ministry report on the state of the health of the nation shows many remarkable improvements that can be attributed to the policies of the government of President Joko "Jokowi" Widodo, but it also reveals one disturbing fact: that increasing prosperity does not automatically guarantee better health for some people. Some old health problems remain, and new ones are emerging, reflecting poor eating habits and lifestyle choices.



Lion Air crash raises questions on passenger safety

The Lion Air plane crash that killed all 189 people on board in late October has revealed some technical problems in the brand-new jet as well as problems in the airline's operations and management and in governance and control. The accident raises questions about the airline's safety standards and the government's oversight on the operations of low-cost carriers.



Meikarta may only be the first domino to fall

Lippo Group's credit rating downgrade by Moody's Investor Services and Fitch Ratings were a surprise, even for Lippo. However, business climate lethargy that is combined with series of "unwanted" events have dragged the group's general profitability down. With potential cash shortage to meet its liabilities, it is then reasonable why these credit rating agencies lowered their assessment despite the good news about their profit achievement.

POLITICS

Mid-sized Islam-based parties: Where will they go?

The latest surveys forecast that a substantial number of mid-sized parties will not pass the 4 percent parliamentary threshold in the upcoming legislative election. Considering that these parties are mostly Islam-based, what implications do the decrease of the parties' electability bear? Most importantly, how can these Islam-based parties avoid further decline?

Takeaway: Islam-based parties' declining electability, which is to certain extent caused by external and internal factors, inevitably requires these parties to rethink their political strategies in order to pass the parliamentary threshold. Inability to adjust to the current political environment may jeopardize further the existence of mid-sized Islamic parties' in the country.

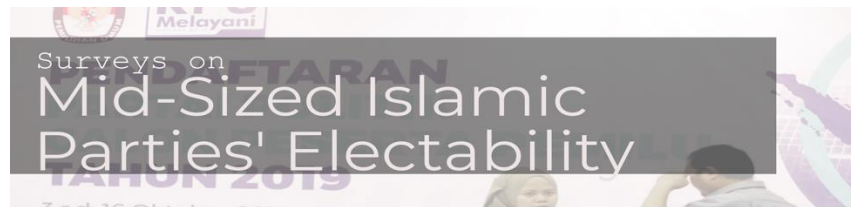
Background: Out of the 16 parties competing in the upcoming 2019 legislative election, most surveys reveal that only 5 parties will beat the parliamentary threshold. Surveys, however, differ in determining which parties will meet the threshold. A survey conducted by *Kompas*, for instance, identified the parties that top the threshold as the Indonesian Democratic Party of Struggle (PDI-P), Gerindra Party, Golkar Party, Democratic Party and National Awakening Party (PKB).

Despite their differences in the exact figures of Islam-based parties' electability rates, the surveys bear one similarity: only one Islam-based party will pass the parliamentary threshold. Currently, there are 6 registered parties that are Islam-based, namely the PKB, PKS, National Awakening Party (PAN), United Development Party (PPP) and Crescent Star Party (PBB). Other than the PKB and PKS, these parties' electability ratings remain below the parliamentary threshold.

Two major questions arise following the gradual decrease of Islam-based parties' influence in domestic politics: what are the possible causes of the decline? To maintain their influence in national politics, what strategies can be taken?

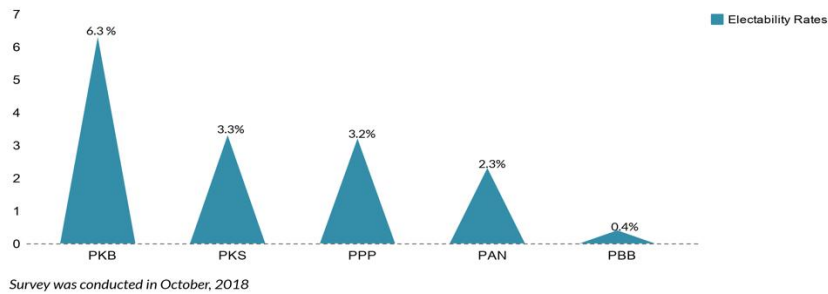
Insight: There is nothing new in the use of religion for achieving political goals in Indonesia. The 2017 Jakarta gubernatorial election, which resulted in the defeat of the incumbent, Basuki "Ahok" Tjahaja Purnama, who is a Christian of Chinese descent, is a glaring example. Months before the 2019 general elections, however, the influence of Islam-based parties is steadily weakening, as illustrated by their decreasing electability. What possibly happened?

Both external and internal factors play a considerable role in diminishing Islam-based parties' presence in the country. In terms of external factors, the rise of political pragmatism and nationalist rhetoric in presidential campaigns, to a certain extent, muffle the outcry of religious issues previously used. Both the incumbent President Joko "Jokowi" Widodo and his challenger Prabowo Subianto have frequently championed pragmatic issues, mostly surrounding the economy.



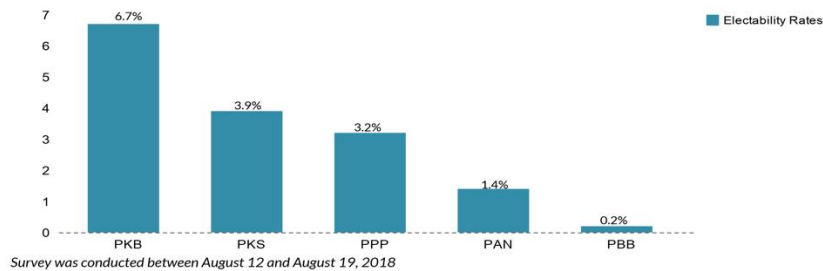
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Kompas



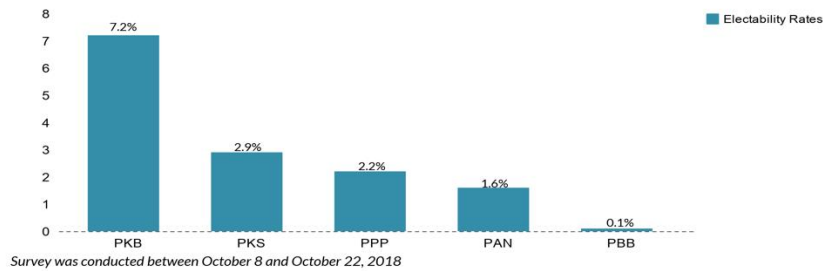
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The Indonesian Survey Institute (LSI)



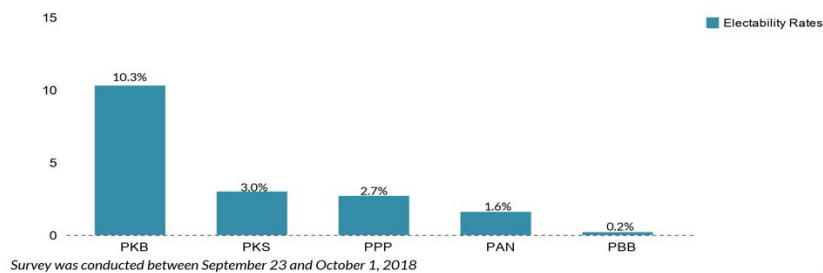
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Alvara Research Center



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Populi Center



The candidates' shift toward pragmatic issues might be due to several considerations. First, in regard to Prabowo and Sandiaga, contending religious issues may not be as effective as during the 2017 Jakarta gubernatorial election. It may even backfire on them. Jokowi's choice of Ma'ruf, the nonactive leader of the Islamic Ulema Council (MUI) and a respected cleric in Indonesia's largest Islamic organization Nahdlatul Ulama (NU), will undoubtedly protect Jokowi from attacks based on religious matters. Hence, Prabowo and Sandiaga have steadily gravitated toward economic issues, particularly as some perceive Jokowi's administration inept in regard to the economy. Meanwhile, having largely secured Jokowi's Islamic credentials, Jokowi – Ma'ruf now have to counter Prabowo – Sandiaga's incessant economic attacks. Inevitably, Jokowi has to employ defensive measures to address his alleged economic incompetence.

The rising use of pragmatic issues curtails the political significance of Islamic bodies, including the use of religion-based issues. In championing their objectives, Islam-based parties are often divided into two, a division illustrated by the *tauhid* defense movement last month and the concept of moderate Islam Nusantara. Parties categorized as *tauhid* defenders (Bela Tauhid) are the PKS and PAN, while Islam Nusantara is often affiliated with the PKB, PPP and PBB. Ideologically speaking, *tauhid* defenders are often those who are more conservative in nature, while Islam Nusantara generally promote a more moderate message.

The predilection toward political pragmatism and the abovementioned binary system limits the scope of mid-sized Islam-based parties in accomplishing their political objectives. Pursuing their preferred religious narrative, on the one hand, is not feasible and in line with the current political environment because of the shift toward political pragmatism. Regardless, for Islam-based parties to suddenly espouse pragmatic politics would be unlikely as well, as these parties do not have the required political footing but also lack the credibility. To put it bluntly, these Islam-based parties are two steps behind original nationalist parties such as the Indonesian Democratic Party of Struggle (PDI-P) or Golkar Party that have pursued pragmatic issues since they were first established.

Besides the rise of political pragmatism, internal factors within the parties themselves may also play a considerable part in mid-sized Islam-based parties' declining dominance. These factors include political scandals involving the parties, parties' negative role, or lack thereof, in presidential candidates' coalitions and internal discord.

The first internal factor, political scandals, has occurred in PAN, the PKS and PPP. The recent spread of fake news by government critic Ratna Sarumpaet has damaged the credibility of two Islam-based parties, PAN and the PKS. PAN founder Amien Rais' involvement in Ratna's viral hoax resulted in Amien being summoned by the police for questioning. Similarly, PKS' enthusiastic endorsement for Ratna provoked a backlash after the uncovering of the truth.

Other than involvement in the hoax case, the parties' involvement in corruption and transactional politics has also jeopardized their electability. The recent arrest of PAN politician and former House deputy speaker Taufik Kurniawan for alleged graft, for instance, may undermine the public's trust in the party. Likewise, the recent discovery of a political dowry amounting to Rp 500 million demanded from each PPP legislative candidate has raised speculation that the Muslim-based party practices transactional politics.

As the legislative election will be held simultaneously with the presidential election, it is expected that the parties will ride the presidential candidates' coattails and increase their own popularity by joining a coalition. This is not the case, however, in terms of the PBB, which informally supports Prabowo, but its charismatic founder Yusril Ihza Mahendra has accepted

an offer to serve as a lawyer for the incumbent candidate. In explaining its decision, party figures said the PBB would choose to align itself to Islamic clerics rather than the presidential candidates. Regardless, such a decision prompted speculation on whether the PBB had lost its political leverage that coalitions paid no heed to its neutrality. This is slightly different from the PKS, which joined the Prabowo-led coalition but has often been embroiled in disputes with Gerindra as in the case of the Jakarta deputy governor post. These disputes potentially paint the PKS as the black sheep of the coalition.

The final internal factor, parties' internal discord, may have the most profound impact upon mid-sized Islam-based parties' decline. Without a united front, internal schisms within parties are often sniffed out. The PKS is one of the parties most often rumored of experiencing disintegration. Soon after Sohibul Iman replaced Anis Matta as the party's chairman, a purge of Anis' loyalists began. This resulted in Anis' establishment of Indonesia's New Direction Movement (Garbi). The internal conflict has intensified with Garbi rumored to be moving closer to Jokowi. This disunity potentially diminishes the PKS' political standing as not only has it divided the party's supporters, it has also marred the credibility of the party's support.

In spite of mid-sized Islam-based parties' declining electability and the abovementioned external and internal factors, however, some believe that mid-sized Islam-based parties should pay no heed to popular political narratives, either the one based on religion or pragmatic issues, as they face a more pressing matter, namely the high parliamentary threshold. Regardless, parties may disregard the popular narrative if they possess particular capabilities. First, these parties should have a strong internal mechanism that enables them to employ effective strategies with maximum capacity at the grassroots level. Second, parties should have proven logistical capabilities to fund and mobilize their members in championing their objectives. Without these capabilities, they will gradually lose their political standing at the grassroots level. In this situation, it is inevitable for these parties to return to the national level and adhere to popular narratives, which may not be easy for them.

Paradox of plenty in Indonesia: Unhealthy lifestyles

The latest Health Ministry report on the state of the health of the nation shows many remarkable improvements that can be attributed to the policies of the government of President Joko "Jokowi" Widodo, but it also reveals one disturbing fact: that increasing prosperity does not automatically guarantee better health for some people. Some old health problems remain, and new ones are emerging, reflecting poor eating habits and lifestyle choices.

Takeaway: Remarkable policy reform does not necessarily improve the health and life quality of the public. The latest report from the Health Ministry suggests that Indonesia continues to face classic emerging economy problems such as undernourishment, malnourishment and stunting, and unhealthy lifestyles. Without a serious governmental approach, the problems will be a time bomb for the country's future generation. Improving the people's awareness on healthy lifestyles and eating habits are the most feasible solutions to these problems.

Background: The report by the ministry's research and development agency was based on a nationwide survey, with a sample of 300,000 people, and compared the results with a similar survey conducted in 2013. The timing of the release, six months before Jokowi seeks reelection, may have raised suspicions about its motive. The Health Ministry, for example, in its press release, highlights achievements. A closer look at the report, however, shows all is not that well. Rather than using it for chest thumping the achievements of the last five years, the report defines the challenges for the next president, whether it is Jokowi or his challenger Prabowo Subianto.

Insight: The report says anemia among expecting mothers has increased to 48.5 percent in 2018 from 37.1 percent in 2013, meaning that nearly half of pregnant women in Indonesia have anemia, a condition of a deficiency in healthy red blood cells in their body. This will have consequences on the babies, with the likelihood many will be born underweight and shorter than normal.

Without remedial action during pregnancy or after birth, these babies will likely grow up undernourished and malnourished, another major problem identified in the report that Indonesia has been struggling with: stunting.

The report says there have been improvements in fighting malnourishment and undernourishment for under-5s, falling to 17.7 percent from 19.6 percent five years ago. Stunting has also fallen to 30.8 percent from 37.2 percent, indicating that Indonesia is gaining in its fight.

	2018	2013
Anemia among expecting mothers	48.5%	37.1%
Stunting	30.8	37.2
Diabetes	8.5	6.9
Hypertension	34.1	25.8
Obesity	21.8	14.8
Smoking among 10-18 year olds	9.1	7.2
Lack of exercise	33.5	26.1

But Indonesia is still far from meeting the target to bring down the stunting rate to 20 percent set by the World Health Organization. The current rate puts Indonesia, a middle-income country by World Bank classifications, more or less on par with the poorest of African nations.

By regions, the poorest provinces in Indonesia, mostly to the east of Bali, like West Nusa Tenggara, East Nusa Tenggara, Gorontalo and Maluku, have the highest rate of malnourishment and undernourishment, as well as stunting. But stunting is also found in rice-producing regions like Tasikmalaya in West Java, the country's rice barn, suggesting that poverty is not the only cause of malnourishment and undernourishment, and hence stunting.

Studies have found that malnourishment and undernourishment not only have an impact on the physical growth of children, but also affects intellectual development. Many studies show that stunted children tend to perform poorer in school compared to their healthier peers.

The problem of stunting has been with Indonesia all these years, but only officially recognized this year when President Joko "Jokowi" Widodo made it a national issue. In the past, there was recognition of the problem of malnourishment and undernourishment, but not the impact it has on how children grow up.

Official recognition of the problem may be late, but it is still better than never. The demographic dividend that Indonesia is currently experiencing will be squandered if it raises children with health and intellectual problems.

Unaddressed, the problem of malnourishment and undernourishment, and the consequences to health and the intellectual development of children, will accentuate the gap between wealthy west Indonesia and the poor east. And any fight to narrow the wealth gap between the rich and the poor, in both urban and rural Indonesia, will be that much harder as the poorest of the poor would have little capacity to lift themselves out of their predicament.

Part of the problem is the people's poor eating habits that have barely changed for many, even as they earn more money with the economic progress of the last 20 years. In fact, going by the report, any change in eating habits or lifestyle tends to go in the wrong direction.

In the last five years, cases of diabetes increased to 8.5 percent from 6.9 percent, hypertension rose to 34.1 percent from 25.8 percent, and obesity among adults (18 years and above) jumped to 21.8 percent from 14.8 percent.

On poor lifestyle and eating habits, the survey finds that 95.5 percent are not eating the minimum amount of vegetables they need, and 33.5 percent are not doing enough exercise, up from 26.1 percent.

Indonesia is also losing the fight against the big and powerful tobacco industry, which has been aggressively targeting young people. The survey found an increase in the number of smokers in the 10 to 18 year old age group to 9.1 percent, compared with 7.2 percent in 2013. With the trend going the opposite way, the Health Ministry, fighting almost a lone battle in the Cabinet, can forget about its target to bring it down to 5.4 percent. Ironically, though not surprisingly given the power of the tobacco lobby, the health report was released around the same time that the Finance Ministry announced it was postponing an earlier plan to hike the tobacco excise.

BUSINESS & ECONOMIC POLICY

Lion Air crash raises questions on passenger safety

Lion Air flight JT610, heading from Jakarta to Pangkal Pinang, crashed into the Java Sea on Monday (29 October), just 13 minutes after takeoff, killing all 182 passengers and seven crew members on board.

Takeaway: The Lion Air plane crash that killed all 189 people on board in late October has revealed some technical problems in the brand-new jet as well as problems in the airline's operations and management and in governance and control. The accident raises questions about the airline's safety standards and the government's oversight on the operations of low-cost carriers.

Background: Indonesia's National Transportation Safety Committee has found that the ill-fated brand-new Boeing 737 MAX 8 jet had faulty airspeed readings during its last four flights before crashing into the sea.¹ The night before the crash, the three-month-old aircraft flew from

¹ The Jakarta Post, "Crashed Lion Air jet had faulty speed readings on last four flights," 6 November 2018 <https://tinyurl.com/y93y4a5r>

Denpasar to Jakarta in an erratic flight, rising and falling repeatedly and at one point dropping down 267 meters.²

Prior to takeoff from Bali, the plane was on the ground for less than 30 minutes after landing on a flight from Manado³ and was authorized to fly with the issuance of the flight release certificate (FRC) by the airline's aircraft maintenance engineer (AME)⁴. Lion Air CEO Edward Sirait stated that the airline's engineers in Bali had conducted repairs of the reported technical problem according to an aircraft maintenance manual from Boeing.

The JT043 Denpasar-Jakarta flight started the rollercoaster ride only a few minutes after takeoff. The plane felt like it was losing power and unable to rise several times during the flight. The pilot made a return-to-base (RTB) request only five minutes after takeoff, before which they said the problem had been resolved and went ahead to Jakarta flying manually.⁵

The pilots were recorded to have issued a "PAN, PAN" call (from the French word *panne*, meaning "breakdown"), the code for when the safety of an aircraft or the people on board is in jeopardy with no immediate danger, a situation that could easily escalate to "mayday" (French *m'aider*, meaning "help me").

William Martinus, the pilot for the flight, reportedly banged his head against the plane's partition wall out of frustration immediately after landing. He submitted a report that the aircraft had experienced faulty altitude and speed readings after takeoff.

The next morning, the aircraft was flown from Jakarta to Pangkal Pinang as flight number JT610 and experienced the same instrument malfunction, before losing contact only 12 minutes after takeoff. Data show that it made a sudden dive at 500 kilometers per hour into the sea, killing all 182 passengers and 7 cabin crew members. With the latest fatal crash, Lion Air has had 15 serious incidents since launching operations in June 2000, some fatal and others resulting in injuries and aircraft losses.

Insight: The latest plane crash, involving the brand-new Boeing 737 MAX 8 belonging to the country's largest airline in terms of routes served, calls for greater attention on air passenger safety. Three aspects are essential to passenger safety in air transportation: engineering and design, operations and management, and governance and control.⁶

With regard to engineering and design, early investigation results indicate there were technical problems with the ill-fated aircraft. The National Transportation Safety Committee (KNKT) has asked the US National Transportation Safety Board and Boeing to take necessary steps to prevent similar incidents, especially on the Boeing 737 Max 8, a fuel-efficient update of the bestselling short-haul Boeing 737. Boeing Co. responded by issuing a bulletin advising airlines on procedures to deal with false readings from a 737 MAX plane sensor.

After the crash, the KNKT reviewed all Boeing 737 MAX 8 planes belonging to Lion Air and found defects on two of them. The faults did not appear to be related to the accident and were left to Boeing to resolve.

² The Guardian, "Lion Air plane flew erratically day before it crashed," 30 October 2018 <https://tinyurl.com/yaju62ox>

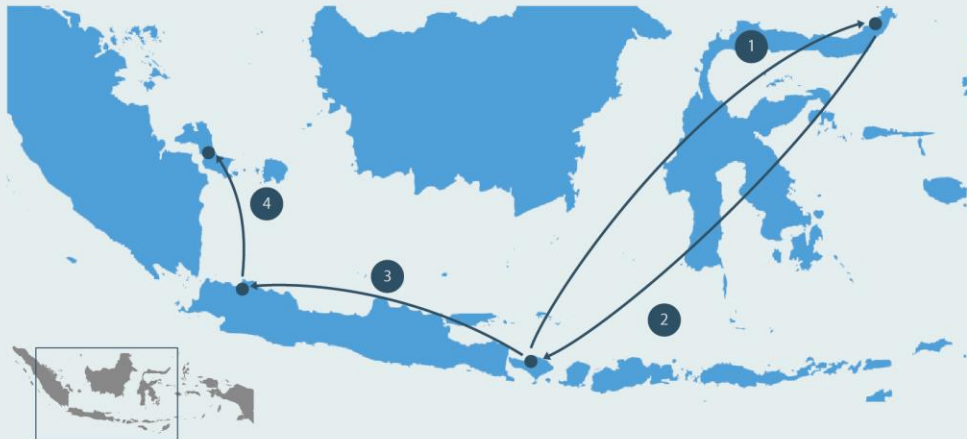
³ Koran Tempo, "KNKT: PK-LQP bermasalah sejak tiga rute sebelumnya," 6 November 2018 <https://tinyurl.com/ycbnas43>

⁴ Majalah Tempo, "Singa Merah terbang buta," 2 November 2018 <https://tinyurl.com/ycqgd6nr>

⁵ News.com.au, "Lion Air crash: Pilot on previous flight made distress call before continuing to fly," 2 November 2018 <https://tinyurl.com/ybkgirl7>

⁶ The Jakarta Post, "Lesson from Air France crash in Lion Air Probe," 7 November 2018.

Lion Air Had Faulty Airspeed Readings on the Last 4 Flights



1 JT 776
 Denpasar - Manado
 27 Oct 2018
 Take off : 09.55 WITA *
 14.34 WITA
 Landing : 16.41 WITA
 Issues :
 1. Faulty airspeed reading
 2. Flight delay for 4 hours 39 minutes

2 JT 775
 Manado - Denpasar
 28 Oct 2018
 Take off : 18.40 WITA*
 19.51 WITA
 Landing : 22.00 WITA
 Issues :
 1. Faulty airspeed reading
 2. Flight delay for 1 hour 11 minutes

3 JT 043
 Denpasar - Jakarta
 27 Oct 2018
 Take off : 19.30 WITA*
 22.21 WITA
 Landing : 22.56 WIB
 Issues :
 1. Faulty airspeed reading
 2. Flight delay for 2 hours 51 minutes
 3. Plane was on the ground for only 21 minutes
 4. "PAN, PAN" urgency signal was made
 5. Plane flew erratically

4 JT 610t
 Jakarta - Pangkal Pinang
 29 Oct 2018
 Take off : 06.10 WIB
 Landing : (-)
 Issues :
 1. Plane was repaired overnight
 2. Faulty airspeed reading
 3. Plane lost contact 13 minutes after takeoff
 4. Plane crashed into water, killing 182 passengers and 7 crews

*Takeoff schedule prior delay

Source:
 Various sources

Nevertheless, a recurring technical issue should have called for greater attention, especially on the airline's operation and management. This raises questions with regard to Lion Air's commitment to passenger safety.

Airlines in the low-cost-carrier (LCC) category are known for reducing costs in aspects of services, but not in safety. The LCC business strategy widely known to make low airfares possible is the absence of frills in their service – no free food and beverages, no assigned seats, no free in-flight entertainment and no ticket refund. People do not expect an amazing in-flight experience on a budget airline, but they do expect to arrive safely in their destination.

In the technical operation, common practice among LCCs is the use of a single type of aircraft and high aircraft utilization.⁷ The need for high aircraft utilization pushes airlines to achieve a fast turnaround (the time an aircraft spends on the ground before embarking on the next flight) and excessive staff working hours. Fourteen ex-pilots of Lion Air shared their experience of working at the airline in a book titled *Flight Insight: Buruk Maskapai, Pilot Dibelah* (Flight Insight: Bad Airline, Pilots Split).

Having only a single type of aircraft means airlines do not have to maintain stocks of spare parts for different types of aircraft, and it helps them ensure that all their staff – pilots, flight attendants, engineers, mechanics, and operational personnel – can implement their best competency in all flights.

Lion Air is no exception. The airline operates mostly Boeing 737 jets – 38 Boeing 737-800 aircraft, 63 Boeing 737-900 and 10 Boeing 737 MAX 8. In addition, Lion Air has three Airbus A330-300 and one Boeing 747-400 plane.

The ill-fated Boeing 737 Max 8 aircraft had only been in service since August but had amassed hundreds of hours of flight time. Again, it's normal for an LCC to maximize aircraft utilization. An issue arises when recurring technical problems are not addressed properly, simply to pursue aircraft utilization. That would mean the airline cares less about safety than profitability.

In an interview with *Kompas* daily in 2015, Lion Air founder Rusdi Kirana, now Indonesia's ambassador to Malaysia, notoriously said, "my airline is the worst in the world, but you have no choice".⁸

That's the result of Lion Air's monopoly in the country's air travel. Together with Batik and Wing Air, the Lion Group controls more than 50 percent of air travel.⁹ When one business group monopolizes air travel, it is hard to expect regulators to get tough with the group. Then comes the issue of governance and control, which is problematic in terms of air transportation. Indonesian airlines were for a long period banned from European skies. The European Union was especially concerned about the Indonesian Directorate General of Civil Aviation's ability for proper regulatory oversight of the country's airline industry. EU regulators only lifted the prohibitions on some carriers – including Lion Air – last June. The last accident could prompt the EU to review its decision.

⁷ Airasia, "What's LCC?" accessed on 6 November 2018 <https://tinyurl.com/y77a94tp>

⁸ Kompas.com, "Rusdi Kirana dibalik Lion Air (3): Maskapai saya paling buruk di dunia, tetapi anda tak punya pilihan," 21 February 2015 <https://tinyurl.com/ydf9tv2o>

⁹ CNN Indonesia, "Operasikan Tiga Maskapai Lion Group Dituding Monopoli," 21 January 2015 <https://tinyurl.com/y9rb6z6e>

The government – in this case the Transportation Ministry – has sanctioned Lion Air after the crash by ordering the removal of Lion Air’s technical director Muhammad Asif, the quality control manager and the fleet maintenance manager to ensure impartiality in the ongoing investigation into the crash.¹⁰

The ministry’s Aircraft Airworthiness and Operation Directorate has also conducted an evaluation and special audit on Lion Air. Findings from the probe would be submitted to the KNKT, which has conducted its own investigation.

That sanction and ensuing investigation are the logical consequence of a fatal crash like that of JT610. The question is, where were the regulators before the accident, when people kept complaining about Lion Air’s bad customer services, such as long flight delays and unfriendly crews.

It remains to be seen whether the government can get tough on Lion Air if the investigation reveals negligence on the part of the company, considering that its owner has a close connection with the country’s top political leader.

What we’ve heard: Sources have said that the Boeing 737 MAX 8 jet that crashed into the Java Sea on Oct. 29 should have been grounded for at least 12 hours before embarking on the next flight to Pangkal Pinang, following the technical problems encountered during the previous flight from Denpasar to Jakarta.

The sources said a flight test without passengers should have been conducted after the plane underwent maintenance on the night before the accident. But Lion Air did not do that.

Lion Air also reportedly skipped some tests for its Boeing 737 MAX 8. Sources said Lion Air’s Boeing 737 Max 8 had not undergone a complete flight, equipment and aircraft evaluation, although regulations require a new commercial airplane to pass certification tests and demonstration flights.

The government, in this case the Transportation Ministry, is seen as giving preferential treatment to Lion Air. Lion Air, for example, was the only airline that did not have its own fleet, instead leasing all of its aircraft, while the rules oblige airlines to own commercial planes. When protest emerged, a Transportation Ministry director backed Lion Air’s position by raising the question of who would replace the airline’s function if it were grounded.

All of this happened because of the Lion Group’s monopoly in domestic air travel as well as its strong political clout. Lion Air management’s close relationship with regulators is an open secret.

The same source said Lion Air maintained relations with several high-level officials at the Transportation Ministry, in particular those in the Air Transportation Directorate General.

Despite its strong relations with the regulators, Lion Air did not always get what it wanted. For example, a few years back, Lion Air wanted to build a new airport in Lebak, Banten, but the lobbying effort stopped when Ignasius Jonan became the transportation minister.

¹⁰ Tempo.co, “Govt suspends licenses of Lion Air Director, Managers,” 1 November 2018
<https://tinyurl.com/y7un5mt7>

Meikarta may be first domino to fall over in Lippo Group's businesses

On Nov. 2, Fitch Ratings downgraded Lippo Karawaci's long-term foreign- and local currency issuer default rating (IDR) from B to CCC+, followed by Fitch Ratings Indonesia's decision to downgrade the group's national long-term rating from BBB+ to BB- with negative outlook.¹¹

Takeaway: Having seen general profitability decline within Lippo Group's major business lines, it is no surprise that Fitch Ratings sees a potential cash shortage at Lippo Karawaci and an inability to meet liabilities. Worse, there is a possibility that Lippo Karawaci and Lippo Group as a whole would not be able to finish the Meikarta project.

Background: This is a tough time for Lippo Group. Before Fitch Ratings' announcement, Moody's had already downgraded Lippo Karawaci's credit rating from B1 to B2 on April 25¹² and from B2 to B3 on Sept. 18¹³, citing liquidity problems and the company's ability to meet its debt servicing obligations.

The recent Meikarta permit graft case has exacerbated Lippo Karawaci's liquidity and cash flows problems. Many buyers have requested to cancel their down payment for Meikarta's project. Facing a high degree of uncertainty over the legality of Meikarta, Bank Muamalat and BNI have decided to stop their mortgage services.¹⁴ Moreover, the investigation has raised questions among foreign investors over Lippo Karawaci's internal corporate governance.¹⁵ Poor corporate governance would make many investors feel hesitant to finance not only the Meikarta project, but also other Lippo Karawaci business ventures.

Insight: Meikarta is a very ambitious project. The Lippo Group has invested Rp 7.3 trillion in PT Mahkota Sentosa Utama and PT Megakreasi Cikarang Permai, Lippo Cikarang and Karawaci's subsidiaries that are responsible for the execution of the development project. Besides direct investment, Lippo has also made significant indirect investment through PT Great Jakarta Inti Development and Peak Asia Investment Pte, Ltd amounting to Rp 2.23 trillion. In total, Lippo Group has invested Rp 9.53 trillion in this project.

Lippo Group Direct Investment in Meikarta, in trillion Rupiah	
PT Megakreasi Cikarang Permai, incl. investment at PT Mahkota	7.30
PT Mahkota Sentosa Utama	6.63
Lippo Group Indirect Investment in Meikarta, in trillion Rupiah	
PT Great Jakarta Inti Development	0.72
Peak Asia Investment Pte Ltd	1.51

Source: Lippo Cikarang Financial Statement 2017

¹¹ Fitchratings.com, "Fitch downgrades Lippo Karawaci to 'CCC+/BB-' (IDN)", Off RWN." 2 November 2018 <https://tinyurl.com/y9xr9x95>

¹² Moodys.com, "Moody's downgrades Lippo Karawaci to B2; outlook negative." 25 April 2018 <https://tinyurl.com/y7dy7u5s>

¹³ Moodys.com, "Moody's downgrades Lippo Karawaci to B3; outlook negative." 19 September 2018 <https://tinyurl.com/yaegv22g>

¹⁴ Tempo.co, "Proyek Meikarta bermasalah, sejumlah bank berhenti alirkan kredit." 25 October 2018 <https://tinyurl.com/y76a8c6a>

¹⁵ Bloomberg.com, "Indonesia corruption crackdown adds to strains on junk bonds." 19 October 2018 <https://tinyurl.com/y8no478h>

Despite the high investment, Lippo Group seems hard-pressed to finish the ambitious project. To make an assessment, we need to look at the financial health of the Lippo subsidiaries in charge of the Meikarta project, Lippo Karawaci and Lippo Cikarang.

Since 2013, Lippo Cikarang has suffered from a decline in profitability. Its profit-to-revenue ratio has dropped by half from 48 percent in 2014 to 23.5 percent in 2017. Meanwhile, its expense-to-revenue ratio has increased by more than 10 percentage points to 54.9 percent in 2017.

Lippo Karawaci, Lippo Cikarang's parent company, has similar problems. Its profitability has fallen by a third from 29.5 percent in 2014 to 10.7 percent in 2017.

In preparation for the Meikarta project, both Lippo Karawaci and Lippo Cikarang have improved the amount of cash held, from Rp 1.8 trillion in 2013 to Rp 2.5 trillion in 2017 for the former and from Rp 308 billion to Rp 578 billion for the later. Nevertheless, Lippo Karawaci's current liabilities have increased significantly, rising from Rp 4.8 trillion to Rp 8.7 trillion.

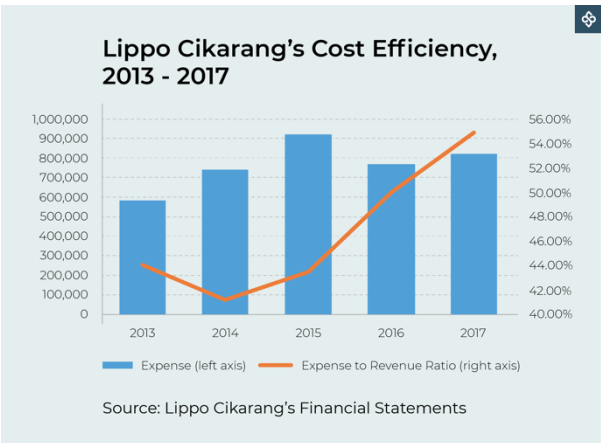
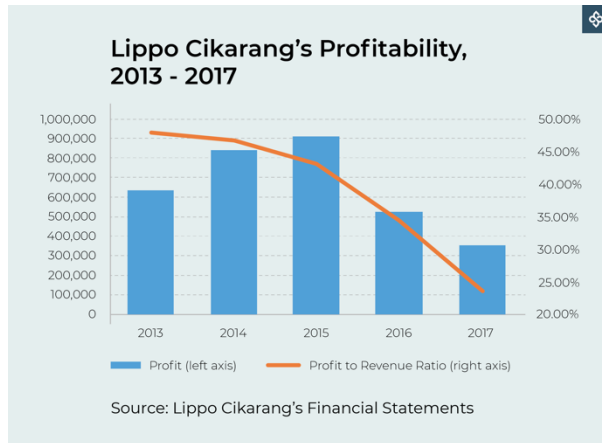
Although both Lippo Karawaci and Cikarang hold greater amounts of cash in preparation for the Meikarta project, both of them have negative net cash flows from operating activities due to the project. In fact, Lippo Karawaci has recorded a negative cash flow from operations since 2015. Based on the data, both companies will need outside financing not only to finish Meikarta project, but also to run their day-to-day business operations.

This raises the question as to whether Lippo Group, as a whole, has the means to finance the Meikarta project until completion. A look at the financial health of Lippo's retail (Matahari) and media (First Media) businesses, suggests that this is unlikely the case, because Lippo Group's other businesses have been losing money in this past five years.

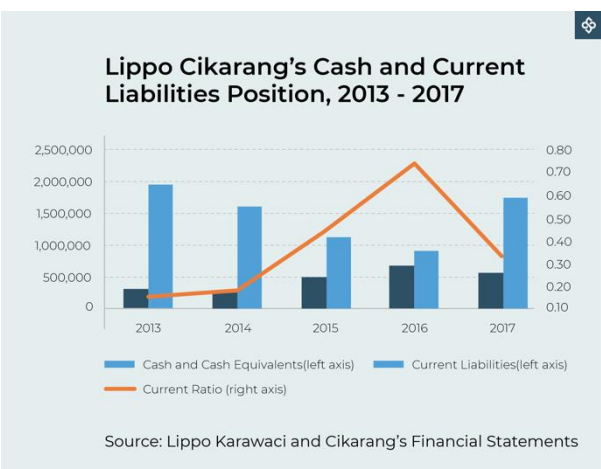
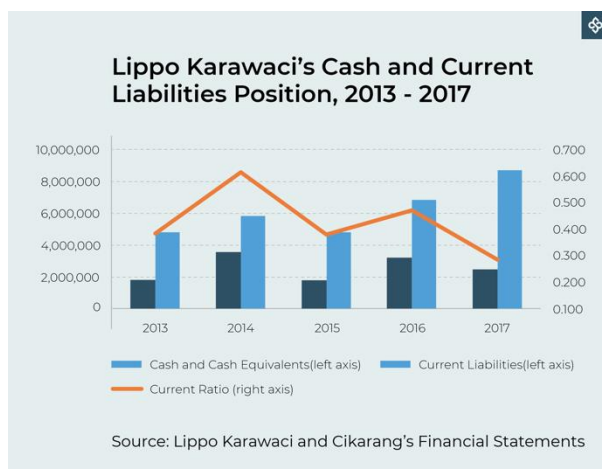
Net Cash Flows from Operating Activities, 2013 – 2017

	2014	2015	2016	2017
Lippo Karawaci	786.47	(2,834.95)	(408.63)	(4,507.22)
Lippo Cikarang	18.00	349.05	262.60	(3,427.30)

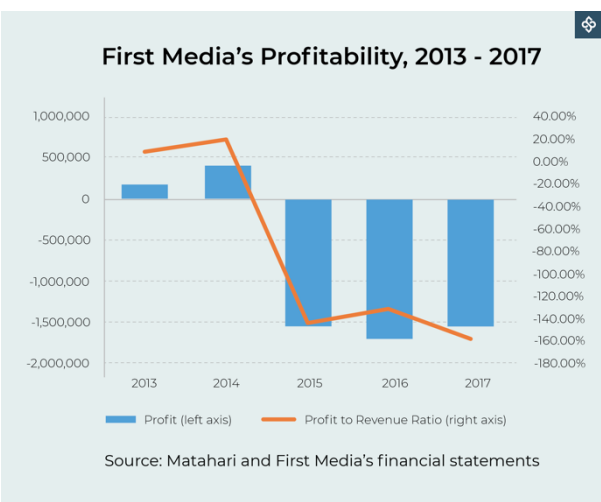
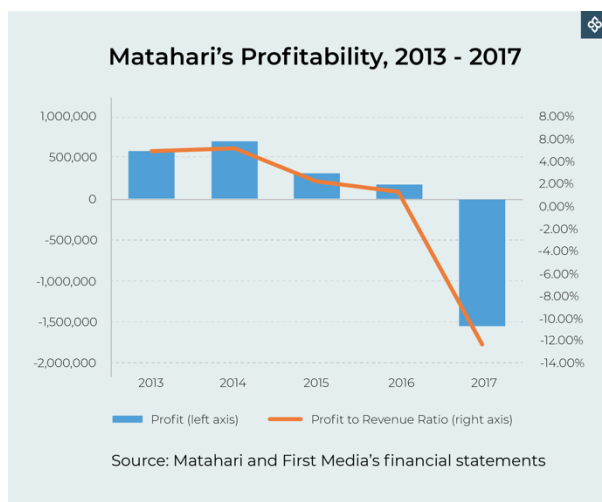
Source: Lippo Karawaci and Cikarang's Financial Statements



Source: Lippo Cikarang's Financial Statements



Source Lippo Karawaci and Cikarang's Financial Statements



Source: Matahari and First Media's financial statements

MACROECONOMIC UPDATE

Strong sign of economic recovery in Q3.2018, amid external economic risks ahead

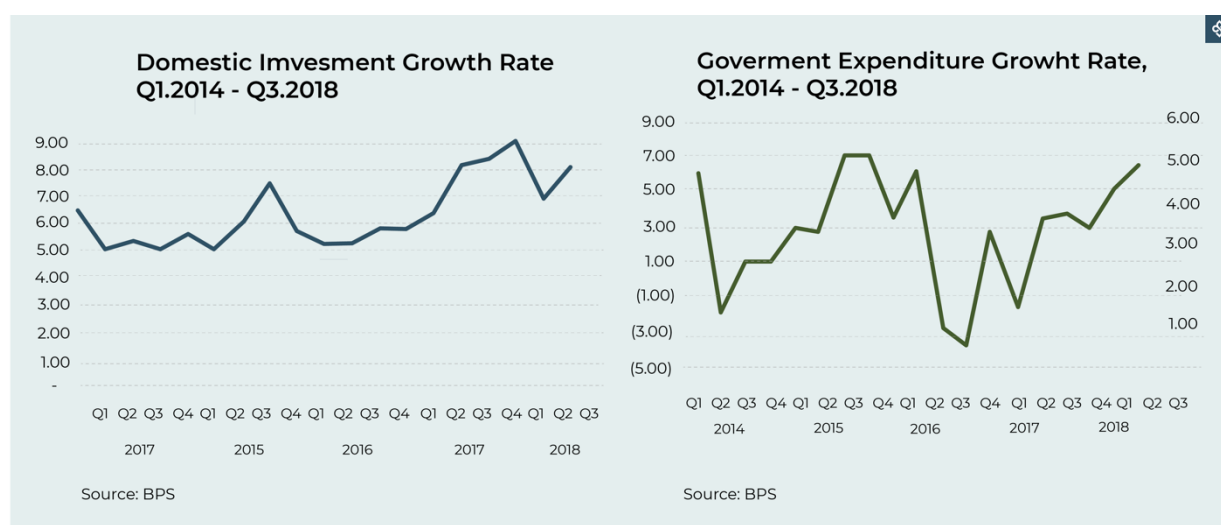
On November 5, Statistics Indonesia (BPS) announced that the economy recorded 5.17 percent year-on-year (y-o-y) real economic growth in the third quarter of 2018, higher than the same period last year at 5.06 percent.

Background: Investors in the financial market responded to BPS' announcement with optimism and joy, as reflected in sharp Rupiah appreciation from Rp 15,128 per dollar on November 1 to Rp 14,540 per dollar on November 8.

This year's strong third quarter GDP growth was driven by 6.96 percent y-o-y growth in domestic investment and 6.28 percent y-o-y expansion in government spending. Bank Indonesia's pro-stabilization monetary policy, by hiking the 7-Day Reverse Repo Rate (7DRRR) by 150 basis points to 5.75 percent between May and September 2018 to stabilize the Rupiah, has not dampened domestic businesses' appetite for investment.

Meanwhile, President Joko "Jokowi" Widodo's populist economic policies, such as his fuels subsidy, village and sub-district funds, *etc.*, that were enacted in the face of 2019 presidential election have produced the intended effect on the whole economy, albeit the distortions it created have resulted in many economic maladies, like trade account and current account deficits as well as sharp Rupiah depreciation this year.

Although the current economy is driven by domestic factors, foreign trade is still important for Indonesian economy, as evidenced in high correlation between real GDP growth, and export and import growth. In the current economic situation, Indonesia needs strong export performance, particularly from the extractive sectors such as palm oil, coal, and minerals, to boost the economy further. Unfortunately, the world's demand for commodities is still weak, suggesting that it is unlikely for Indonesia to achieve high economic growth in the near future.





Insight: The 2018 third quarter economic data signals that Indonesian economy is on recovery track, and this news is important not only for investors and business community, but also for the two presidential candidates, especially the challenger Prabowo Subianto and Sandiaga Uno.

In his interview with Tempo magazine, Sandi stated that the 2019 presidential election is a referendum for the incumbent's economic policy.¹⁶ Recently, Sandi beefed up his rhetoric by rebranding the economic referendum into an economic jihad.¹⁷ Although this rhetoric is a good strategy to appeal for Islamic voters, Sandi's decision to double down on his economic referendum rhetoric could be a double-edged sword.

For President Jokowi, strong 2018 third quarter economic data is a good news. It can be used not only to counter Sandi's economic rhetoric – for example, “tempe setipis ATM” (tempeh as thin as an ATM card)¹⁸ – but also to cover for his own policy flip-flop such as the fuel prices hike reversal on October 11¹⁹. For the challenger, this good economic news is a bad news, because it weakens their main election strategy when they need it to cover Prabowo's public relation disasters, specifically after Ratna Sarumpaet's lies²⁰ and “tampang Boyolali” fiasco²¹.

Nevertheless, it does not mean that Prabowo and Sandiaga's election strategy is completely off the table. In fact, the incumbent's good economic achievement in the third quarter faces two external risks. First is the fight between the European Commission and Italy's right-wing government over the Italian government's budget.²² Another is the risk that Trump would escalate US-China trade war, if both countries could not agree on “a great deal” by early December.²³

¹⁶ Tempo Magazine, “Prabowo mewakafkan saya.” 13-19 August, Edition No. 4725.

¹⁷ Detik.com, “Sandiaga sebut Pilpres 2019 momentum jihad ekonomi, apa maksudnya?” 23 October 2018 <https://tinyurl.com/y9qxf4n>

¹⁸ Detik.com, “PDIP: Jokowi sebut tempe tebal pulihkan hoax ‘setipis ATM’ Sandi.” 1 November 2018 <https://tinyurl.com/ybja6shw>

¹⁹ Kompas.com, “Jokowi batalkan kenaikan harga premium, miskoordinasi atau cari simpati?” 11 October 2018 <https://tinyurl.com/y8xomcqy>

²⁰ TheJakartaPost.com, “Prabowo apologizes for Ratna Sarumpaet's lies.” 4 October 2018 <https://tinyurl.com/y8y66pkp>

²¹ TheJakartaPost.com, “Prabowo apologizes for controversial ‘Boyolali faces’ remarks.” 7 November 2018 <https://tinyurl.com/ybflrwhw>

²² Spiegel.de, “Italy double downs on threat to Euro stability.” 1 November 2018 <https://tinyurl.com/y7u576gk>

²³ StraitTimes.com, “Trump warns of more tariffs without ‘great deal’ with China on trade.” 30 October 2018 <https://tinyurl.com/y9c7m4do>

Gross Domestic Product (GDP) Growth 2016-2018 (YOY in percentage)



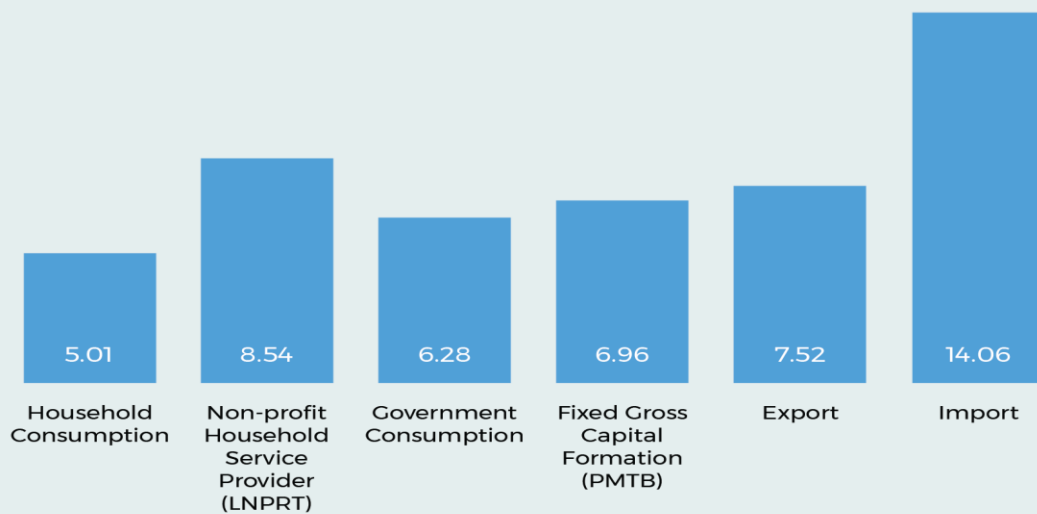
Source: Statistics Indonesia (BPS)

GDP growth by sector (YOY in percentage)



Source: Statistics Indonesia (BPS)

GDP growth by expenditure (YOY in percentage)



Source: Statistics Indonesia (BPS)

These external economic risks provide openings for the challenger to attack President's Jokowi on economic ground. Relying solely on external economic risks, however, is unwise because of its high degree of uncertainty. Rather, it is wiser for Prabowo and Sandiaga to complement their main election strategy with better policy alternatives to differentiate their economic brand from economic populism and nationalism championed by President Jokowi.²⁴

For the incumbent, good macroeconomic management is the key to face the two upcoming adverse economic risks. Nonetheless, employing good macroeconomic management requires strict policy discipline, the Achilles heel of President Jokowi.



²⁴ Katadata.co.id, "Comparing populist policy from Jokowi and Prabowo economic programs." 15 October 2018 <https://tinyurl.com/y9unjjsr>

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