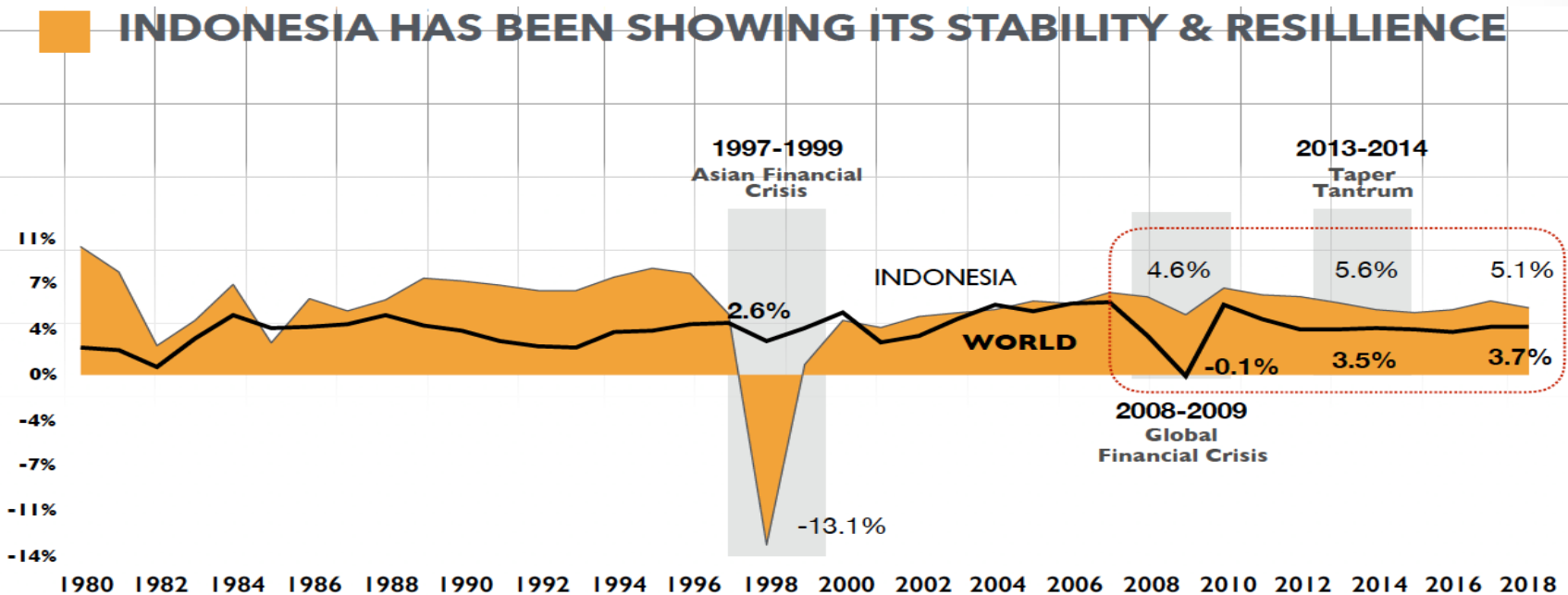


INDONESIA ECONOMY 2019

What to expect in a political year



INDONESIA HAS BEEN SHOWING ITS STABILITY & RESILIENCE



Source: BPS & IMF

Outline

- Global Economy issues and implication to Indonesia
- Domestic economy
- Risk, opportunities, trend and macro policy response 2019
- Conclusion

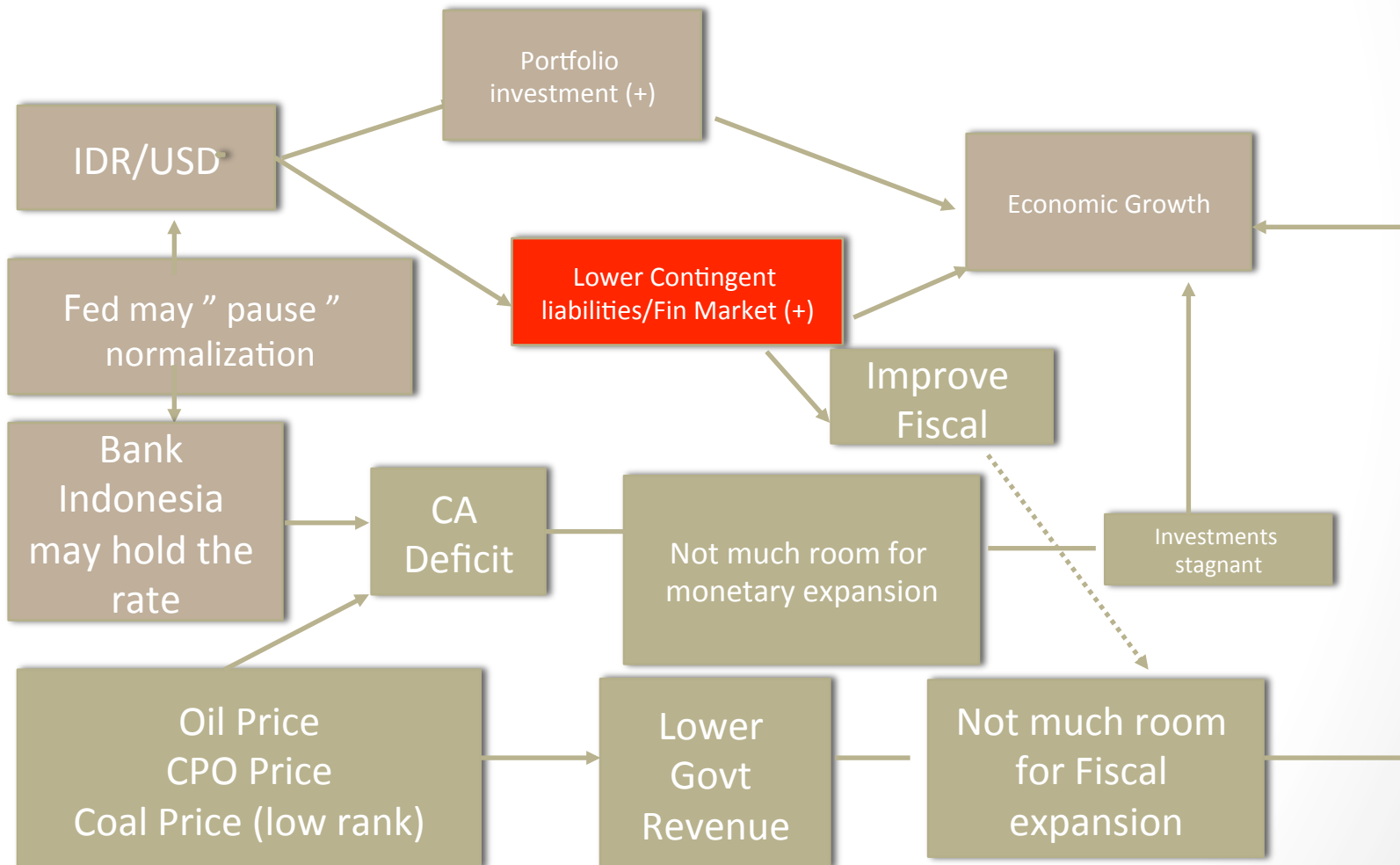


Global Economy

Living in a very uncertain world

- Synchronized expansion (2017) → unsynchronized growth (2018) → Synchronized global deceleration (2019)
- Trajectory path of Fed Fund Rate (more dovish)
 - Despite unemployment rate falling, inflation rate remain under-control and even declining recently as wage growth remain flatt
 - The fed take a more dovish stance, with fed fund rate may only increase at most 25 bps in 2019
- Oil price and commodities price (flat or trending down)
- Trade war is just one piece of a much bigger problem between the current leader of the world versus the emerging leader of the world.

MAJOR ISSUES AND Implication to INDONESIAN ECONOMY

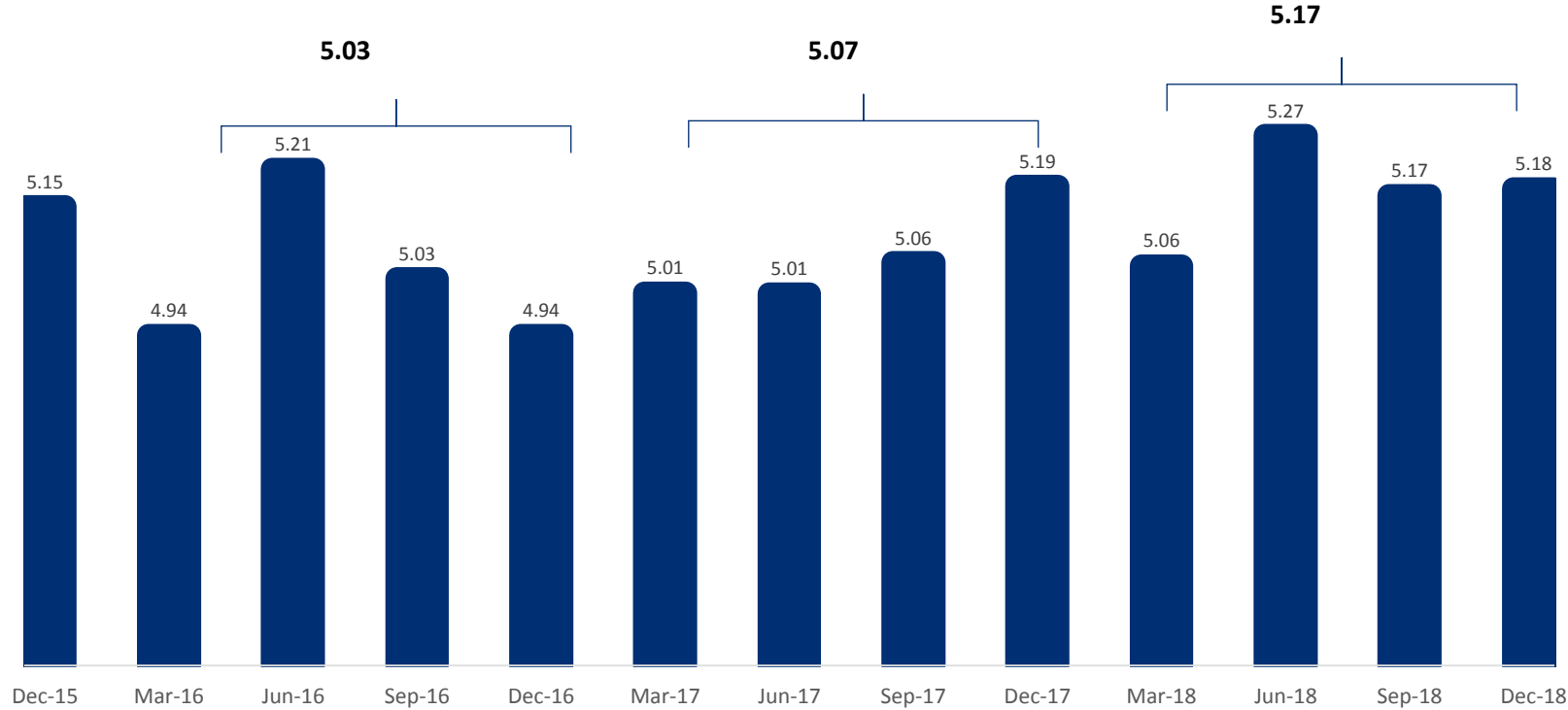


Domestic Economy

- Indonesia economy continue to hover at 5% although slightly increase from 5.07% in 2017 to 5.17% in 2018
- Consumption remain defensive (5.09% YOY) while investment (gross fix capital formation) contribute mostly to GDP expansion (6.67% YOY).
- Retail sale remain stagnant, while consumer confident remain strong
- Meanwhile export grew at 6.48%, import grew more rapidly at 12.04%. This is also explain a strong relation between investment (gross fix capital formation) and machinery and equipment imports. A very high elasticity of machinery and equipment import to GDP in Indonesia.
- Major sectors, Agriculture, Mining, Manufacturing and real estate are all grew at below GDP growth, while service sectors continue to grow more rapidly than average GDP. This trend has been continue for several years. (Disconnection between riel sectors and service sectors)

The economy is Gradually expanding

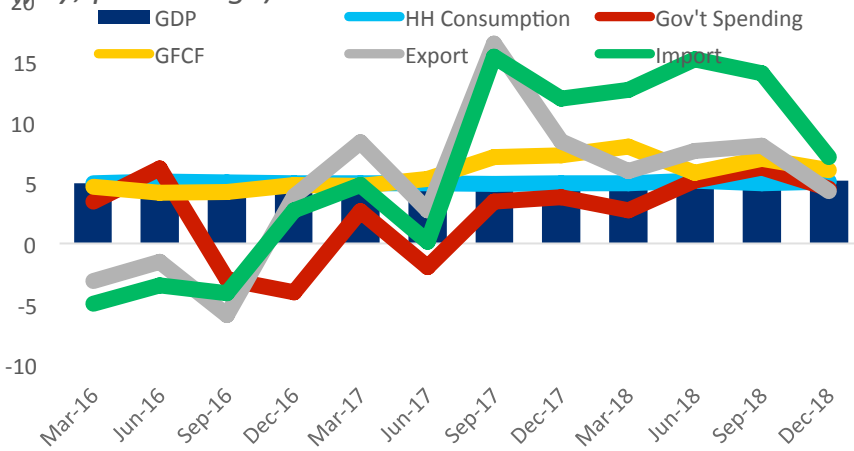
Indonesia GDP Growth
(% of GDP)



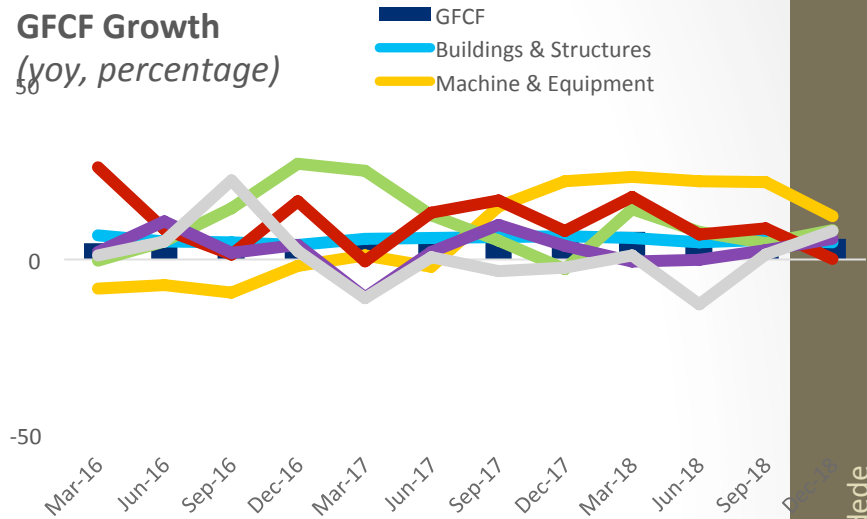
Source: BPS, CEIC (2018)

mostly driven by investment

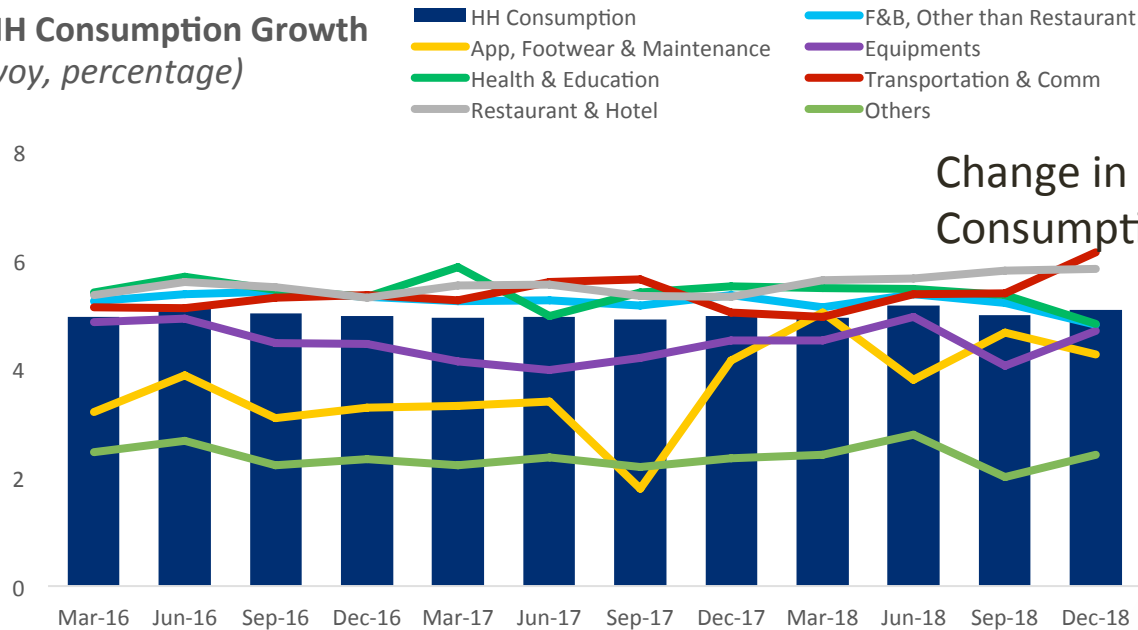
GDP Expenditure Growth
(yoy, percentage)



GFCF Growth
(yoy, percentage)



HH Consumption Growth
(yoy, percentage)

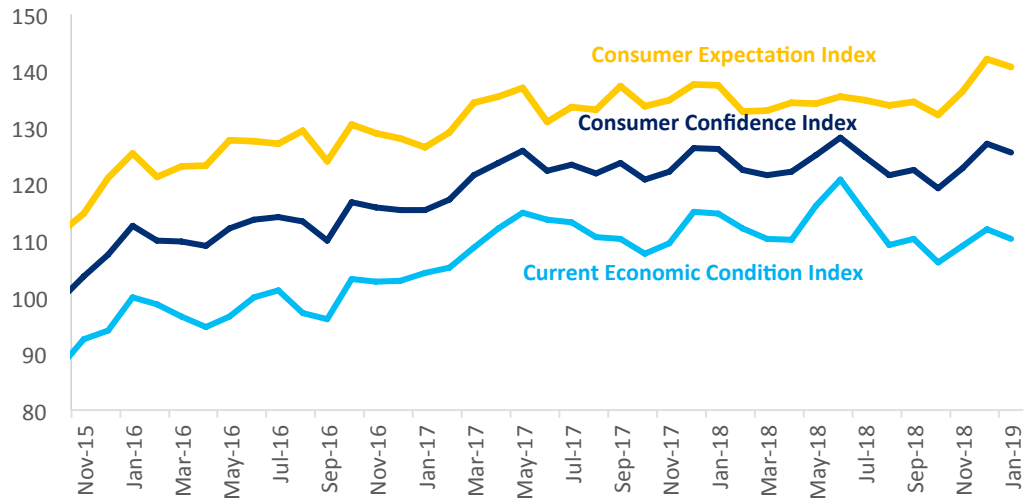


Change in the structure of Consumption => Life style

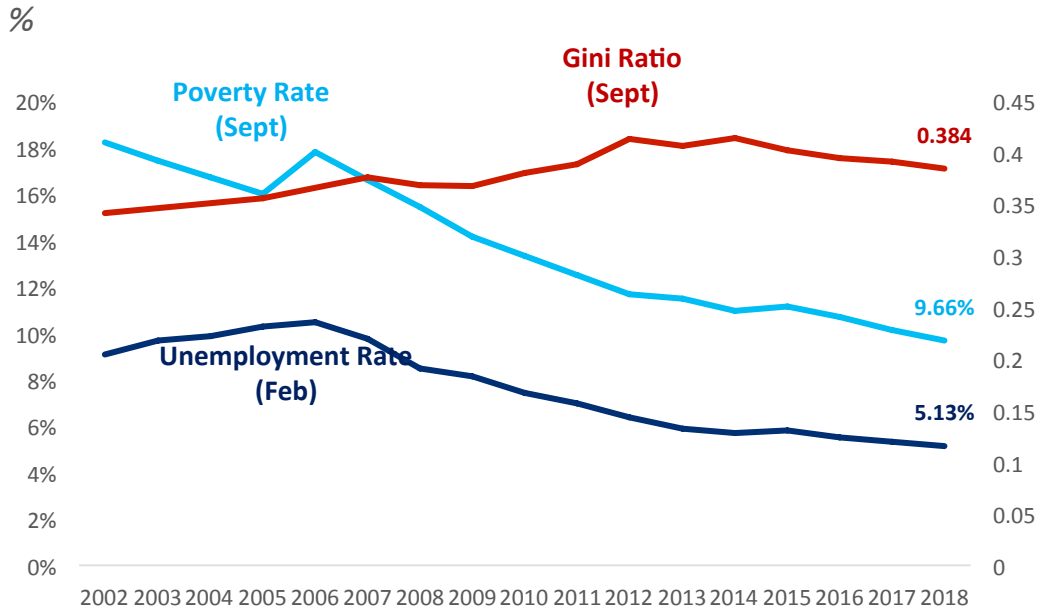
Welfare improvement

- Gini ratio (income distribution), poverty rate and unemployment improved, with some caveat
- Consumer confidence remains strong
- Total youth unemployment rate decline but, the unemployment among SMK and College graduate increase sharply (2014 => 2018)
- A steady unemployment rate among college graduate since 2014.
- We suspect job creation mostly in low productivity service sector (such as gojek and grap) and informal sector, where college graduate refuse to accept lower wage and less prestigious jobs
- This trend could potentially dissatisfaction toward government as many political survey result seen

Consumer Confidence Index
(Index, Weighted average of 18 cities)



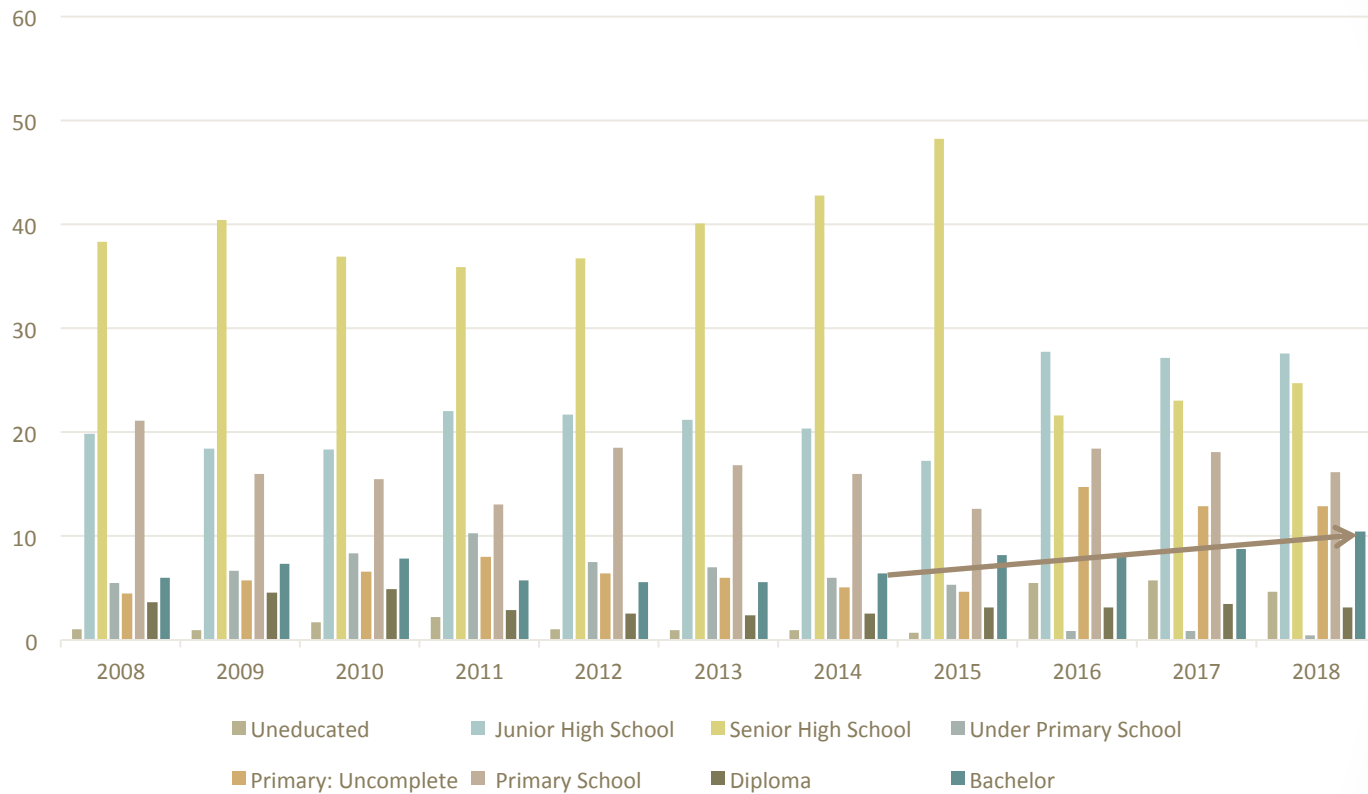
Poverty and Unemployment Rate



Source: BI, BPS, CEIC (2018)

A steady rise in college graduates unemployment

Youth Unemployment by Education



Dissatisfaction among College graduates

Q : Seandainya pemilihan Presiden Indonesia dilaksanakan hari ini, menurut Ibu/Bapak, Dari 2 pasang nama berikut, mana yang Ibu/Bapak pilih untuk menjadi Presiden dan Wakil Presiden Indonesia?

Kategori	Base	JOKO WIDODO (JOKOWI) – MA'RUF AMIN	PRABOWO SUBIANTO – SANDIAGA UNO	Rahasia/Belum Memutuskan/TT/TJ
Pendidikan (%)				
Pernah Kuliah atau di atasnya	11,5%	37,7%	44,2%	18,1%

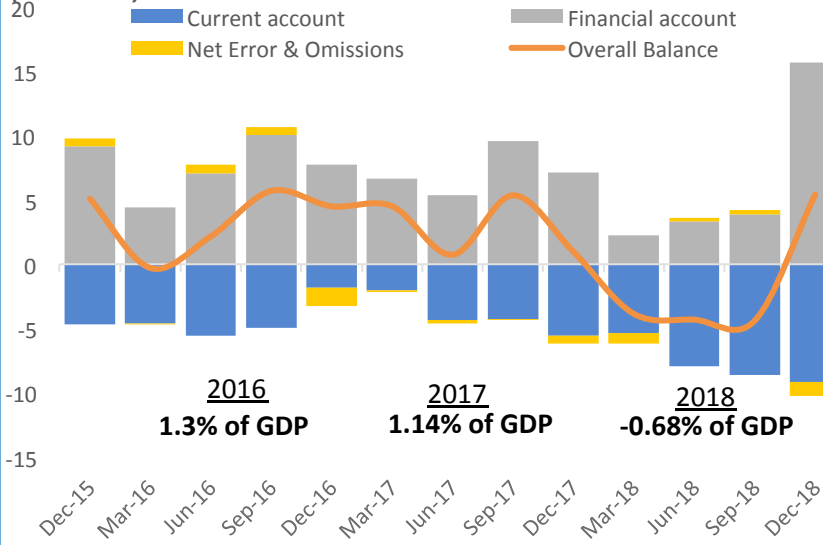
Prabowo Subianto – Sandiaga Uno unggul di pemilih Terpelajar.

BOP

- After suffer with negative balance Q1-Q3, turn to positive balance in Q4. this also reflected in rupiah movement
- CAD deteriorate from -1.60% of GDP (-17.3B) in 2017 to 2.98% of GDP (-31.7B) in 2018. This number also reflected the important of foreign saving to finance investment in Indonesia.
- Non oil and gas balance performance persistently declined, while oil and gas continue in negative territory.
- Both FDI and Portfolio investment declined, with the latter fall sharply until October 2018 and only revive after The fed, reverse her interest rate stance (from hawkish to dovish).
- However FDI also trending down

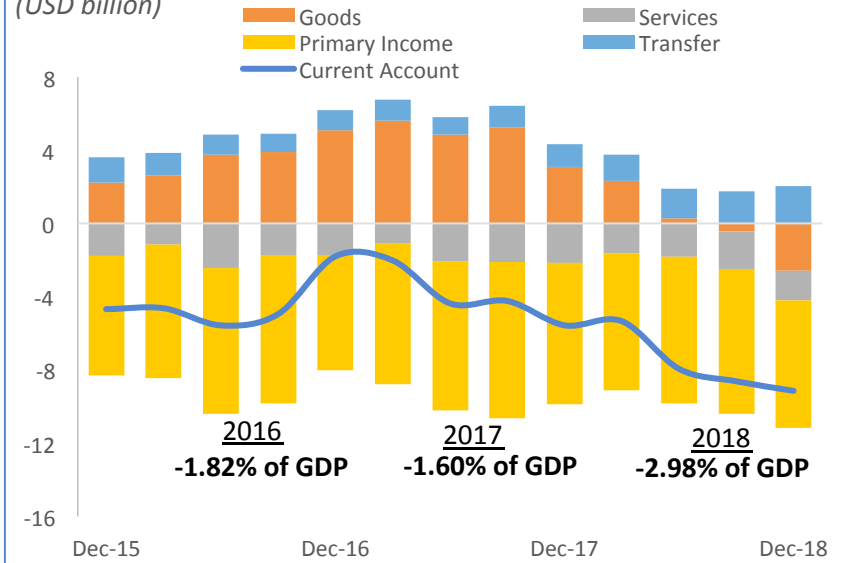
Balance of Payment

(USD Bn)



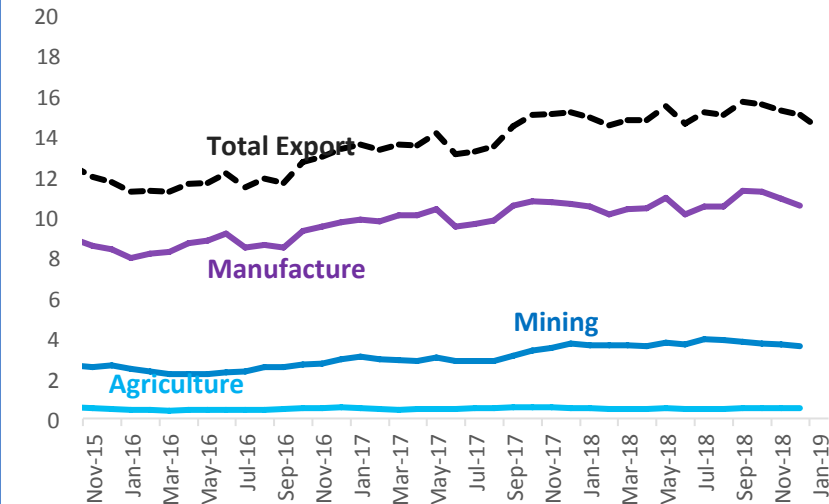
Current Account

(USD billion)



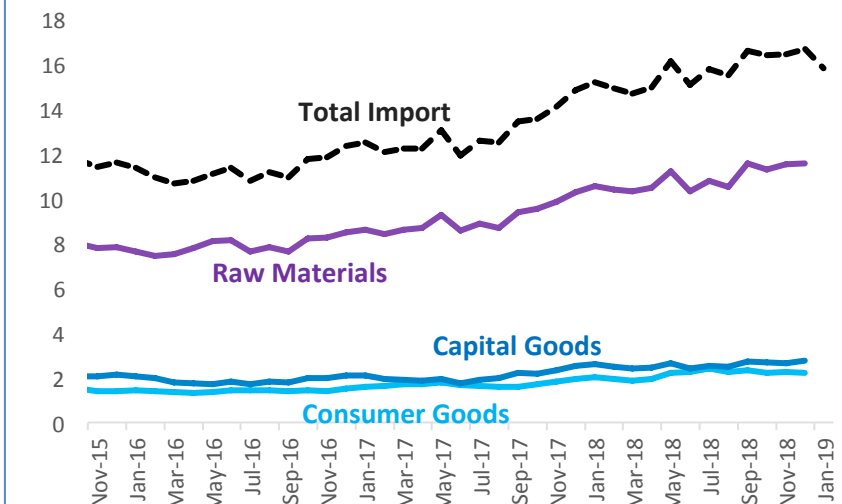
Export of Goods

(3-months moving average, USD Billion)



Import of Goods

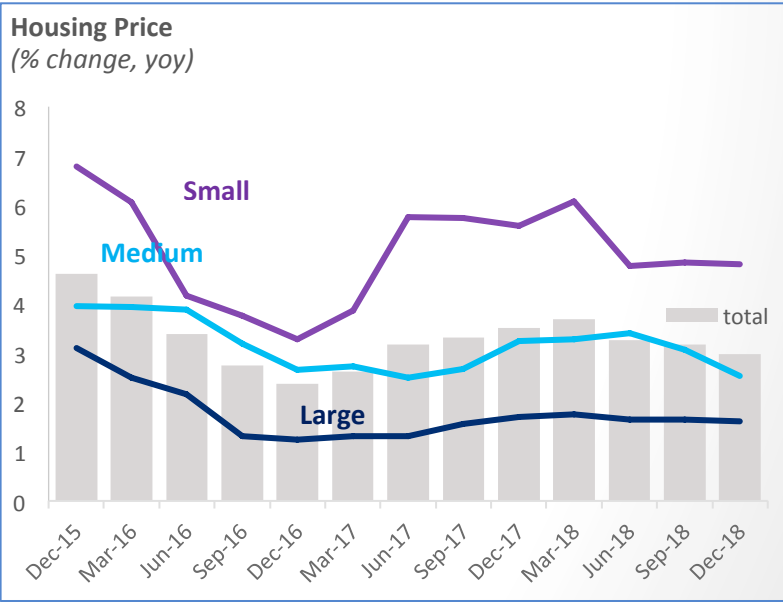
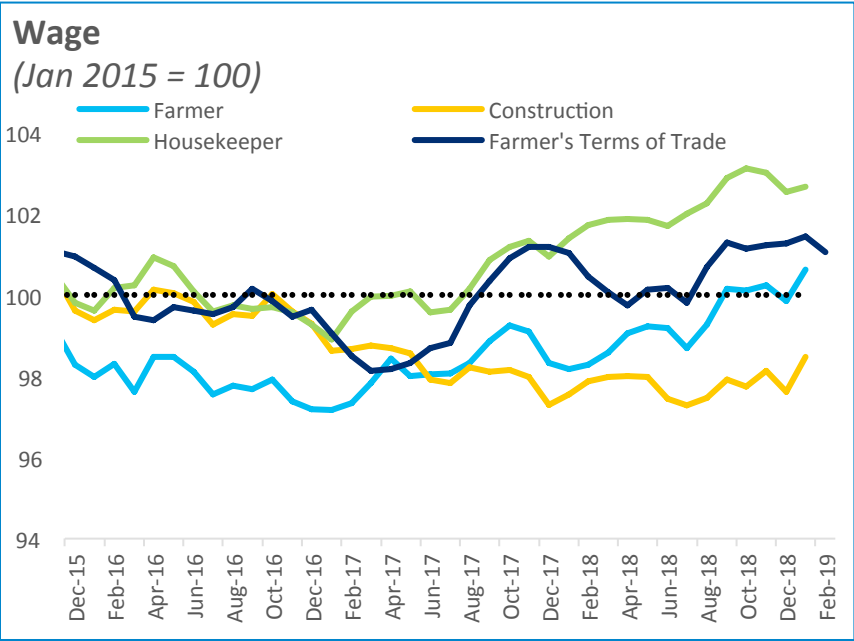
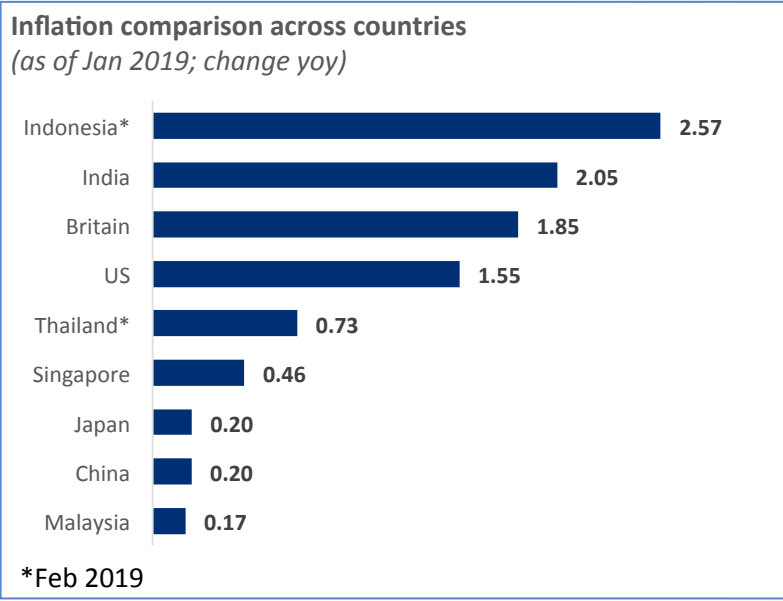
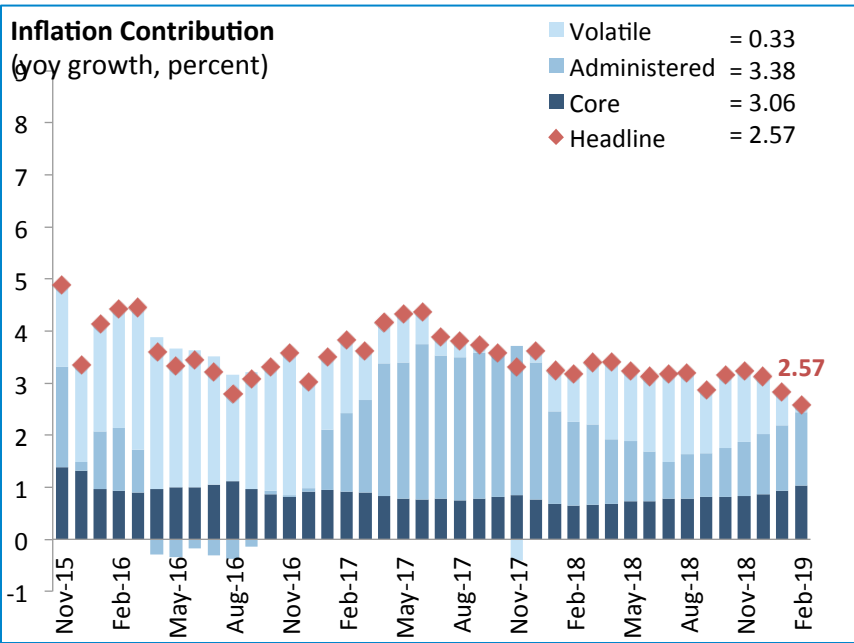
(3-months moving average, USD Billion)



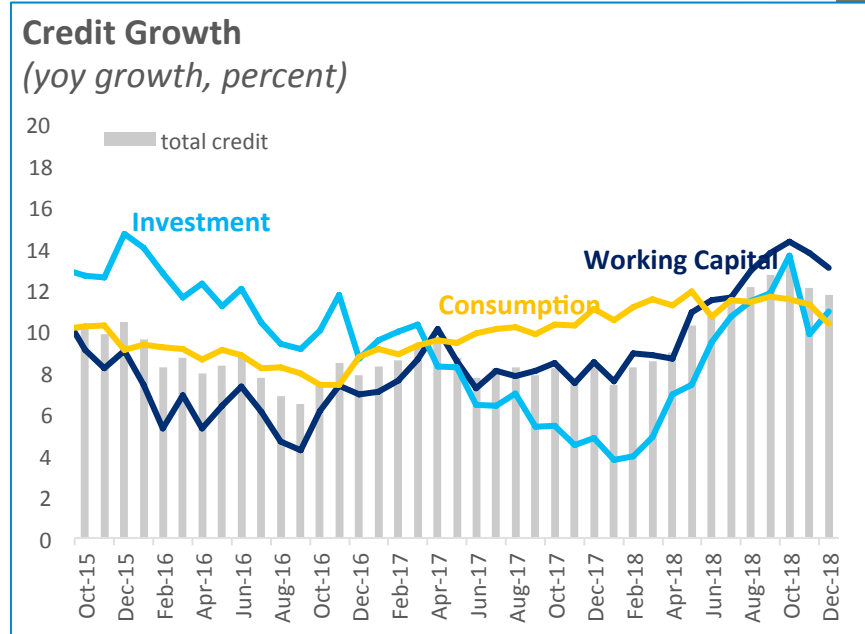
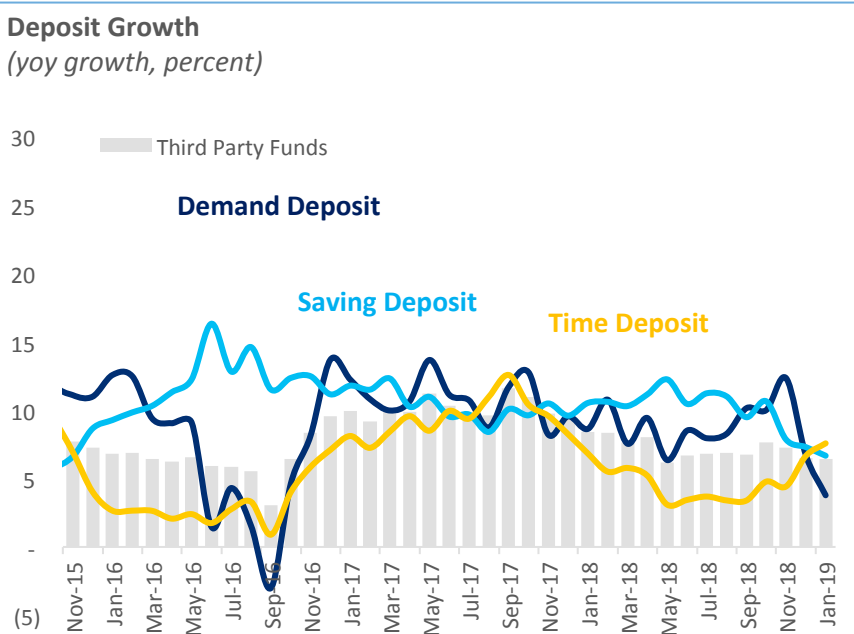
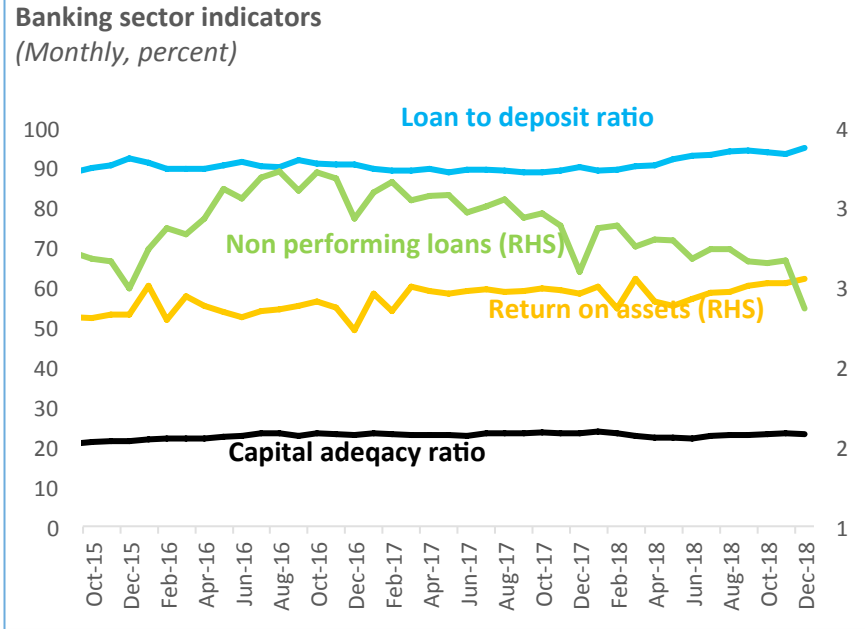
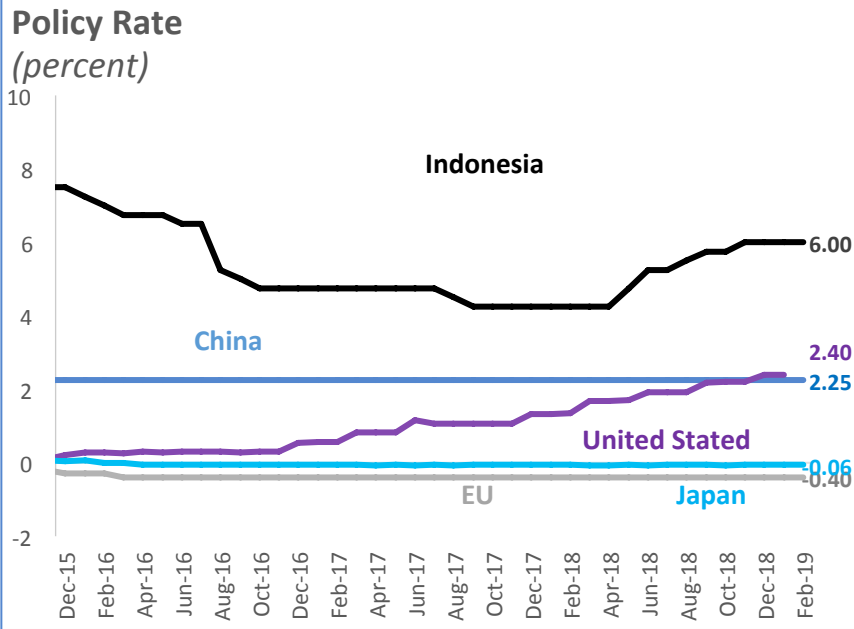
Source: CEIC (2018)

Prices, policy rate and bank condition

- Prices remain subdued: Inflation rate declines and stable, despite low skill wages increase
- Housing price remains weak, except small size housing
- As such policy rate stay at 6%, with no sign of hike
- Banking credit back to normal 10% in early January 2019, after accelerating in the second half of 2018. While third party fund grew at lower rate than credit, lead to higher loan to deposit (94%).
- NPL still under control at low rate, while bank well capitalized
- **We do not see any signal that lead to financial system pressure in the near to medium term, as long as OJK and banking sector continue to take prudent approaches**



Source: CEIC (2018)



Source: CEIC (2018)

*from Aug 2016 Bank Indonesia adopt 7-days repo rate as new benchmark of monetary tool

Financial market and government budget

- The flows of foreign capital play a dominant role in Indonesia financial market
- When the foreign capital flow in to the country, performance of rupiah, bonds and equities improved
- So far so good but never taking for granted, external factors play a dominant role.
- In addition government budget solid management has also contributed to investor confidence
- However Indonesia may face some challenges: tax target in 2019 much higher than actual tax revenue in 2018. More over, the decline of commodities' prices could also pose some risk.
- Hence we may have some fiscal constraint to stimulate the economy

Stronger revenue and fiscal management improved but there is a fiscal risk for 2019 due to decline of oil, energy and commodity prices

Govt. Budget
(IDR Tn)

Post	2018 Budget	2018 Actual	2019 Budget	2019-2018 Budget to Budget (%)	2019-2018 Budget to Actual (%)
A. Revenues	1,895	1,942	2,165	14.2	11.5
1. Tax Revenues	1,618	> 1,521	1,786	10.4	17.4
Income tax	855	751	894	4.6	19.0
Oil&Gas	38	65	66	73.7	1.5
Non Oil&Gas	817	687	828	1.3	20.5
VAT	542	538	655	20.8	21.7
Land,Building& other taxes	27	26	28	3.7	7.7
Excises	155	160	166	7.1	3.8
International Taxes	39	46	43	10.3	-6.5
2. Non-tax Revenues	275	< 407	378	37.5	-7.1
Natural Resources	104	181	191	83.7	5.5
Oil&Gas	80	143	160	100.0	11.9
Non Oil&Gas	23	38	31	34.8	-18.4
Other Non-Taxes	172	226	188	9.3	-16.8
3. Grants	1	14	0		
B. Expenditures	2,221	2,202	2,461	10.8	11.8
1. Central Government	1,454	1,444	1,634	12.4	13.2
Personnel	366	347	382	4.4	10.1
Material	340	337	345	1.5	2.4
Capital	204	185	189	-7.4	2.2
Interest Payment	239	258	276	15.5	7.0
Subsidies	156	217	224	43.6	3.2
Social	81	84	102	25.9	21.4
Other	67	16	116	73.1	625.0
2. Transfer To Regions	766	758	827	8.0	9.1
General Transfer	706	698	757	7.2	8.5
Village Funds	60	60	70	16.7	16.7
C. Overall Balance	-326	-260	-296	-9.2	13.8
<i>Overall Balance (% of GDP)</i>	-2.2	-1.76	-1.8	-18.2	2.3

Trend, Risk and opportunities

- Global trends (medium term): anticipate and response
 - The battle of technology supremacy
 - The rise of indo-pacific
 - The generation of fake news
 - Job destruction and technology change
- Risks
 - Economic and political confrontation among major power
 - Erosion of multilateral trading rules and agreement
 - Populist policy, SOE domination (heavy involvement)
 - Nationalist and protectionism
- Opportunities
 - Demographic (young milenial bonuses) with rapid technology adoption
 - Right policy direction
- Political development
 - Political Survey : Trend narrowing between no1 and no2 (15-20%), and economic performance matter the most
 - **Winning a wide margin is necessary for tough reform**

Domestic risks

- Capital flows volatility (to BOP, Rupiah)
- Populist policy and political promised
- Contingent liabilities (SOEs, Pertamina, PLN, SOEs infrastructure, national social programs)
- Heavy involvement of SOE and government (+/-)

Main Government Policies in 2019

Monetary

- Pre-emptive and ahead of the curve policy stance
 - Use calibrated policy rate to ensure inflation under control and rupiah in line with fundamental value
 - Maintaining adequate liquidity in money market and banking
- Accommodative macro-prudential policy to support financial stability and stimulate banking intermediation
- Accelerating financial market deepening (FX and money market)
 - Encourage use of spot, swap and DNDF instruments to increase transaction volume
 - Use repo instrument and interest rate swap to augment liquidity
- Efficient payment system

Fiscal policy

- Goals : healthier, more Equitable and self sufficient
- Lower deficit, toward primary surplus
- Strengthening decentralization and social protection program and focusing on **human capital quality**
- Increasing tax revenue, increasing the share of local currency in bond issuance, **driving export**

DOUBLE DEDUCTION INCENTIVE (PROPOSED)

would be used to increase the education quality, strengthen infrastructure budget, overcome poverty, increase export competitiveness and international engagement

VOCATIONAL	
SUBJECT	Corporate taxpayers providing practice and apprenticeship facilities
INCENTIVES	<ul style="list-style-type: none"> Reducing income by 100% real costs Additional deductions for net income of 100% real costs
SECTOR	Agribusiness, manufacturing; tourism; health care; e-commerce; labor export

R & D	
SUBJECT	R & D by Corporate Taxpayer
INCENTIVES	<ul style="list-style-type: none"> Reducing income by 100% real costs Additional deductions for net income of 100% real costs
THEME	The ability to engineer, innovate and / or diffuse technology in improving the performance of production and / or competitiveness of goods / services in the country, on certain themes

IMPORT | INVESTMENT | EXPORT



Budget 2019: social protection spending have a positive impact on necessity spending (lower income group)

2018 State Budget versus 2019 State Budget:

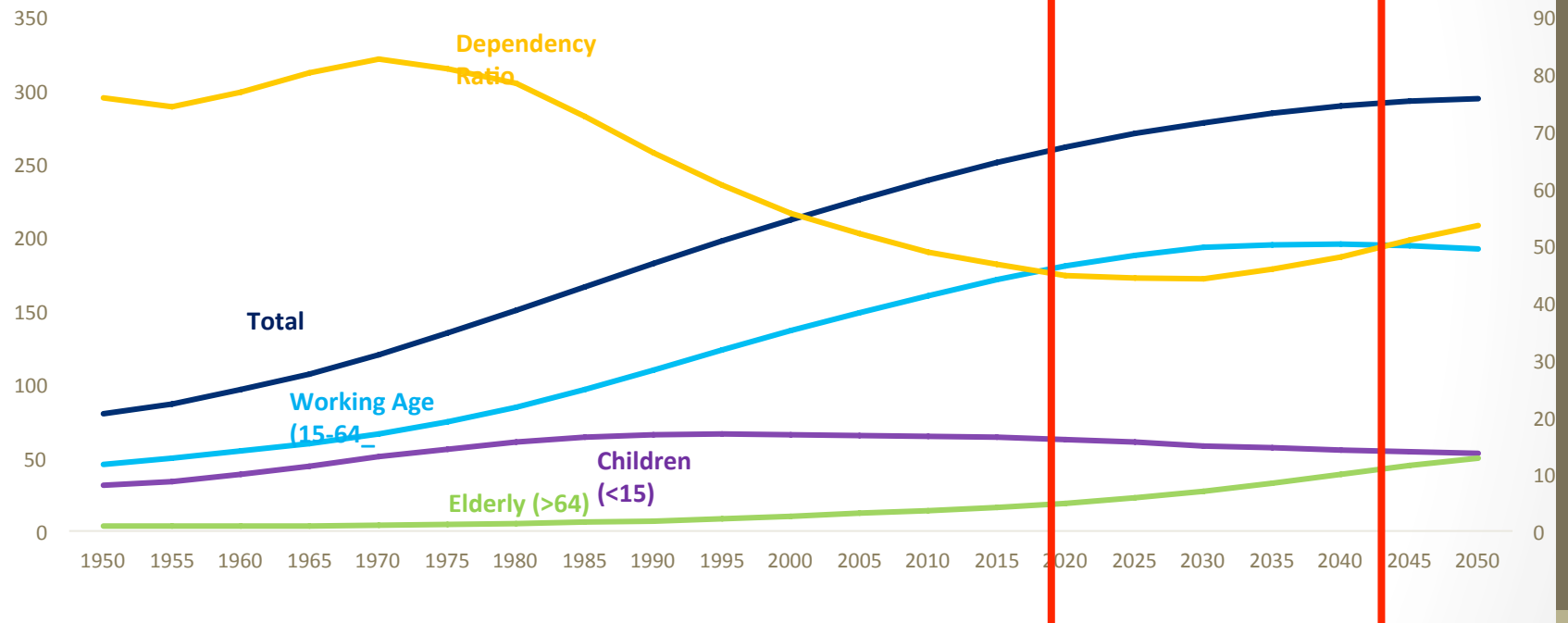
	State Budget 2018	State Budget 2019	Growth (%)
Government Revenue (in IDR Trillion)	1,942	2,165	11.48
Government Spending (in IDR Trillion)	2,202	2,461	11.76
Village Funds (in IDR Trillion)	60	73	21.67
Health Budget (in IDR Trillion)	107.4	122	13.59
Education Budget (in IDR Trillion)	434.6	487.9	12.26
Social Protection Budget (in IDR Trillion)	287	381	32.75

OPPORTUNITIES

- **DEMOGRAPHY**
- Young/millennial
- Expanding domestic consuming class
- Savvy technology and eager to learn (**rapid technology adoption**)
- In the center of global market growth
- Right policy direction, albeit still need to improve policy implementation
 - **Infrastructure**
 - **Human capital and technology**

Demographic Bonus

Population Projection
(Mn Person)



Source: Sri Moertiningsih Adioetomo (2012)

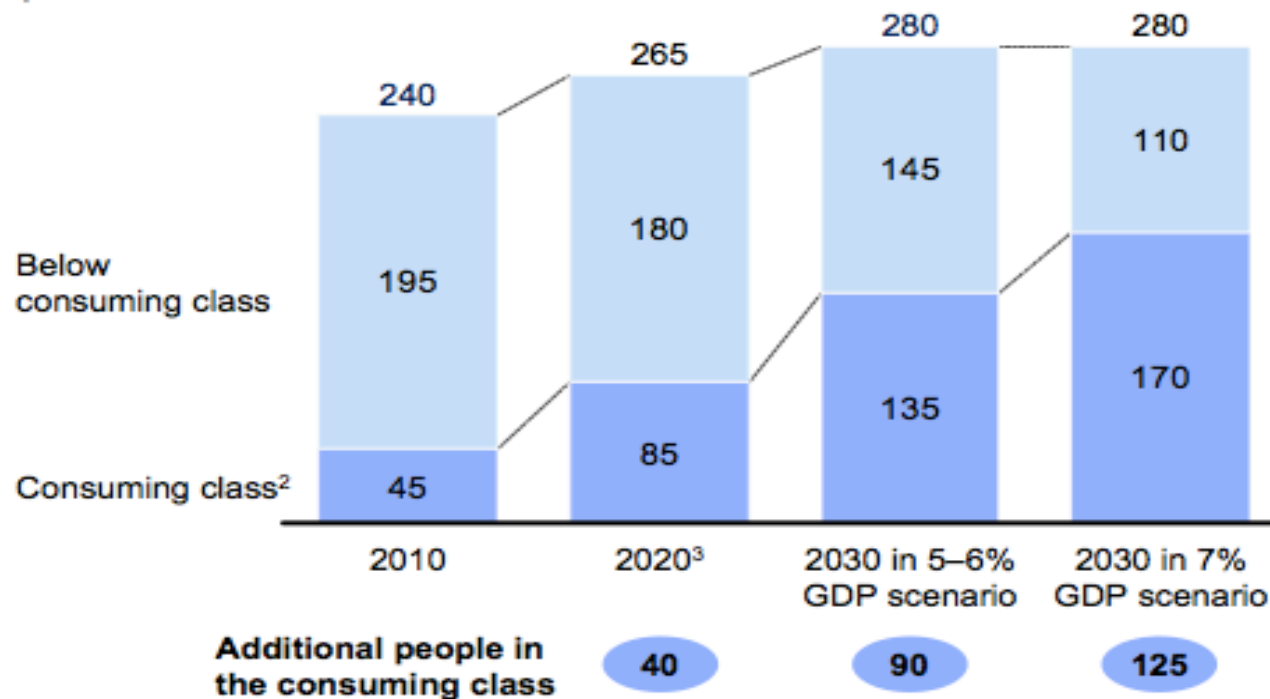
Window of Opportunity

Dependency ratio is at its lowest → Higher consumption; higher savings if the working age population are able to get a proper job and high productivity

The rise of consuming class

An estimated 90 million Indonesians could join the consuming class by 2030

Million people¹



1 Rounded to the nearest five million.

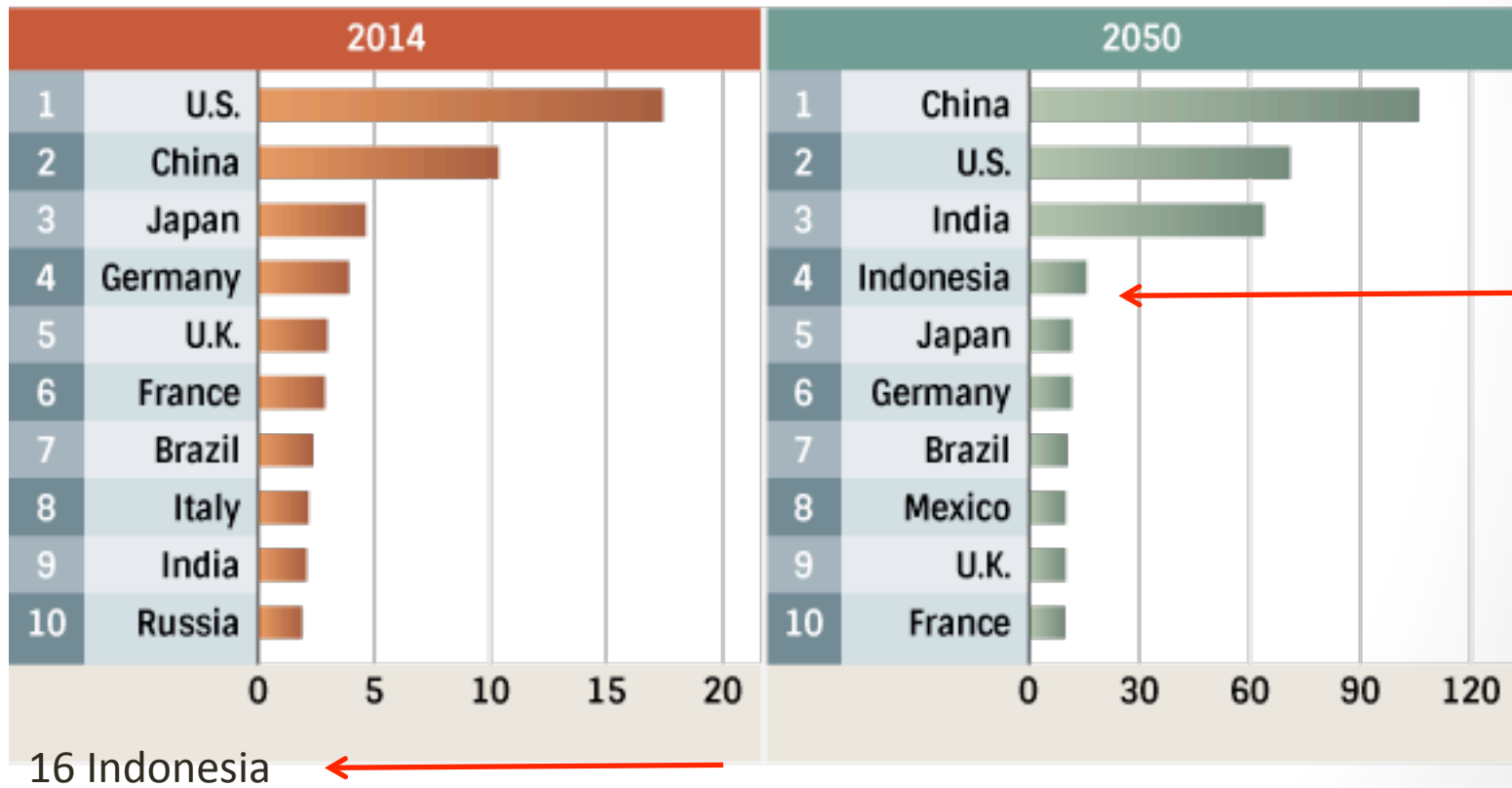
2 Consuming class defined as individuals with an annual net income of above \$3,600 at 2005 purchasing power parity (PPP).

3 Based on annual GDP growth of between 5 and 6 percent.

SOURCE: McKinsey Consumer and Shopper Insight (CSI Indonesia 2011); 2010 Population Census, Indonesia's Central Bureau of Statistics; Canback Global Income Distribution Database (C-GIDD); McKinsey Global Growth Model; McKinsey Global Institute Cityscope 2.0; McKinsey Global Institute analysis

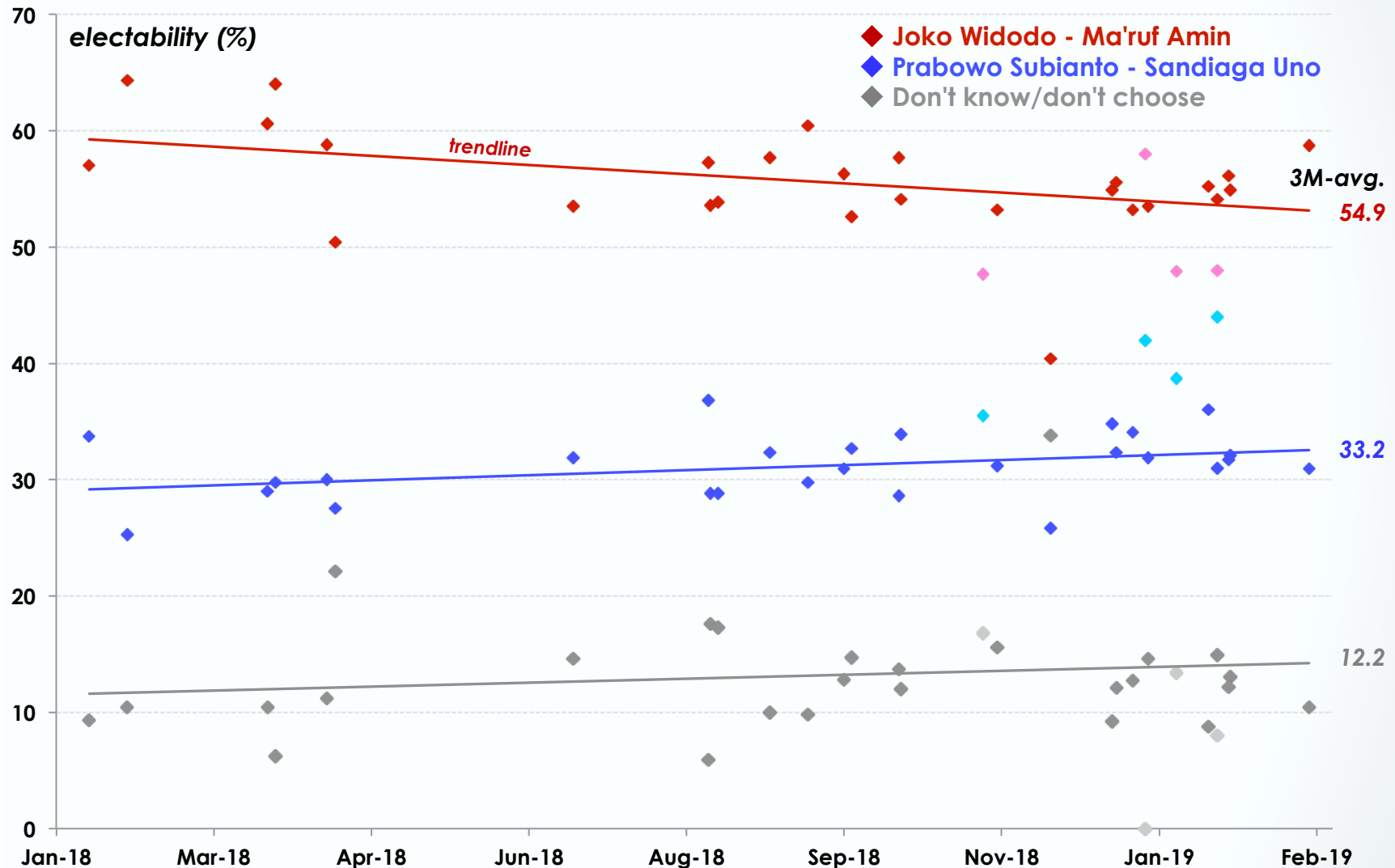
Potential But not easy ride, many home works to do

World's top 10 economies in 2050 at market exchange rates, nominal GDP; in trillions of U.S. dollars



Source: The Economist Intelligence Unit

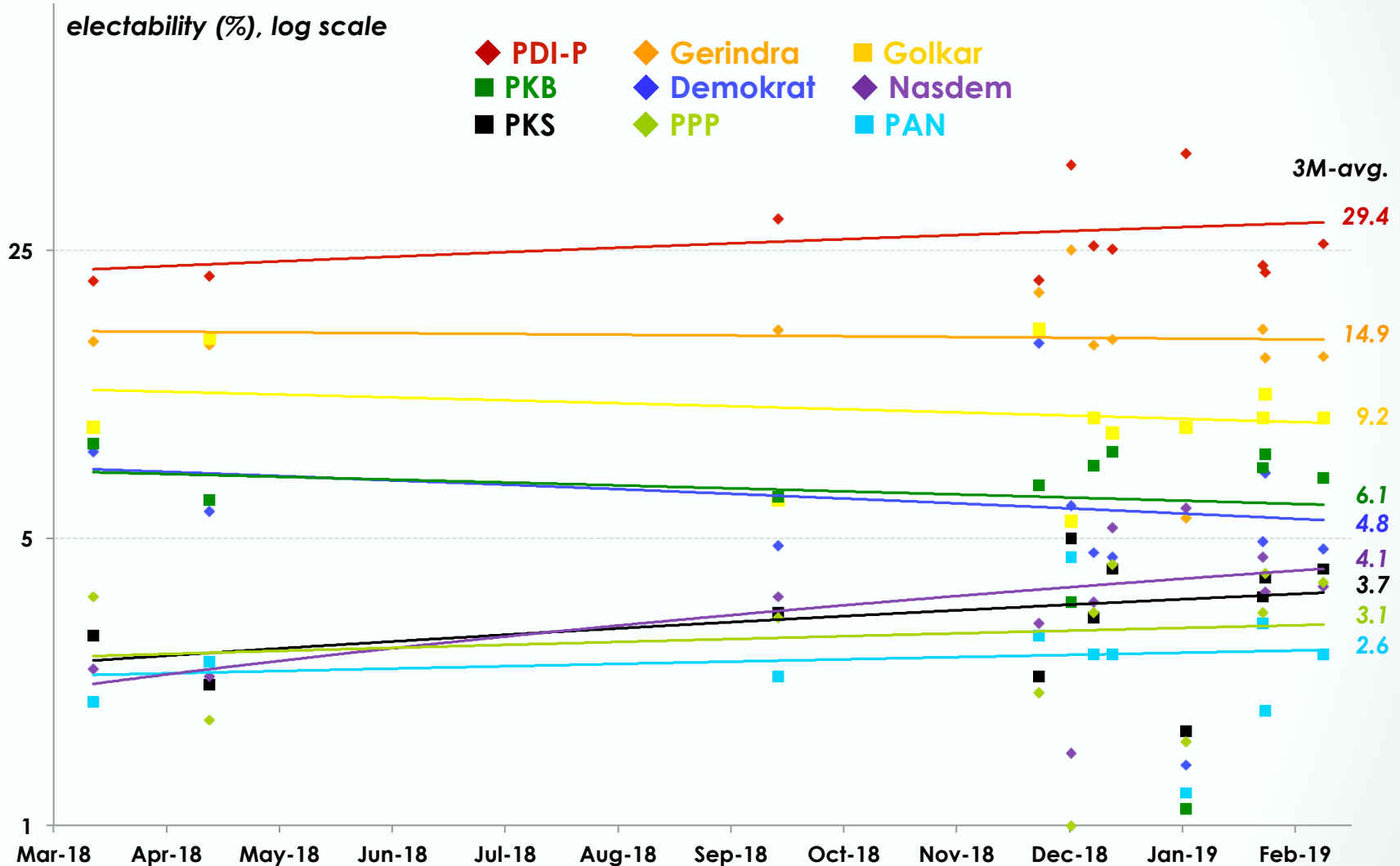
Presidential Election Polls: Jokowi leads Prabowo by a wide margin



Source: Katadata, Google News

*lighter dots represents surveys done by non-mainstream pollsters or unusual methodologies

Parliamentary Election Polls: PDI-P and Gerindra riding on coattail effects

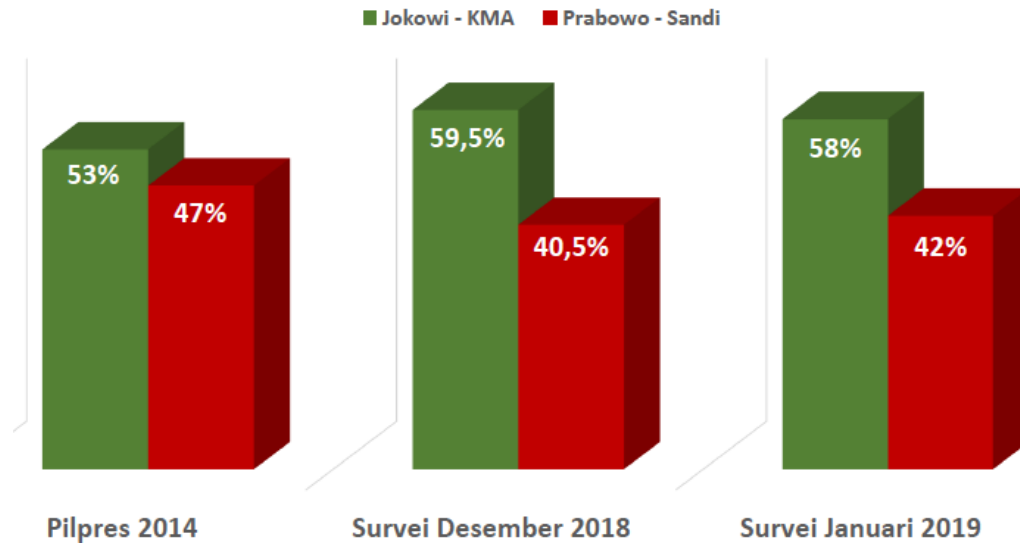


Source: Katadata, Google News

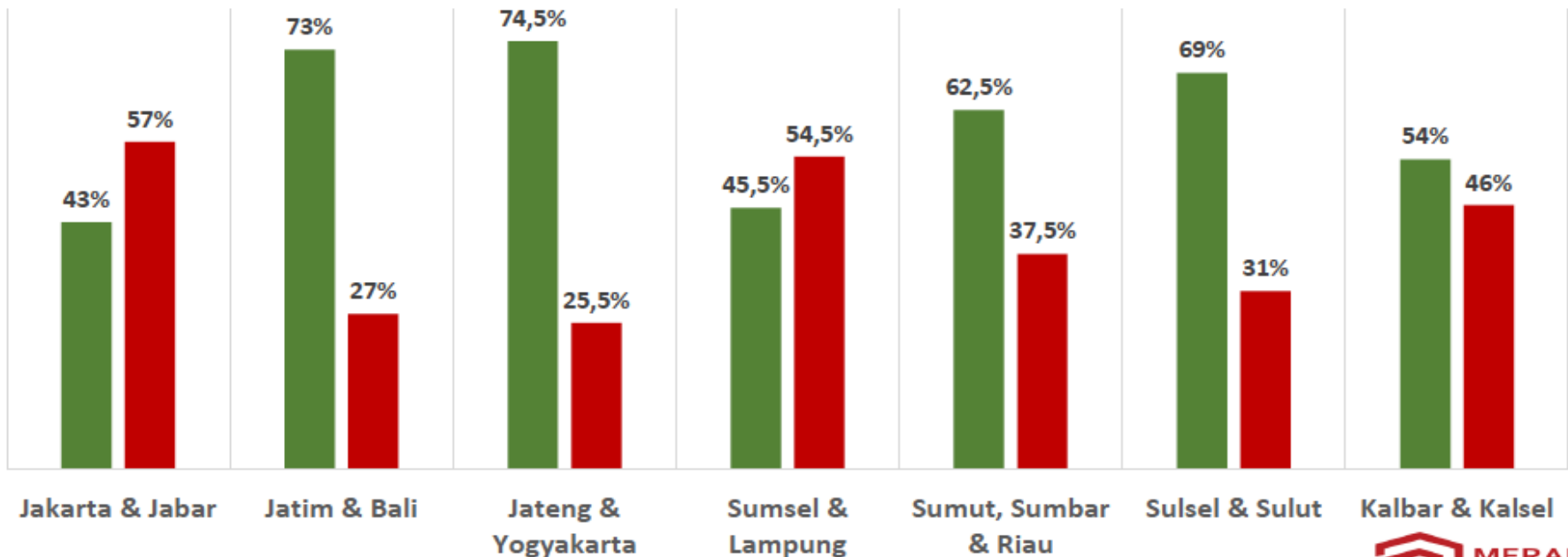
POLITICAL SURVEY

Trend Elektabilitas

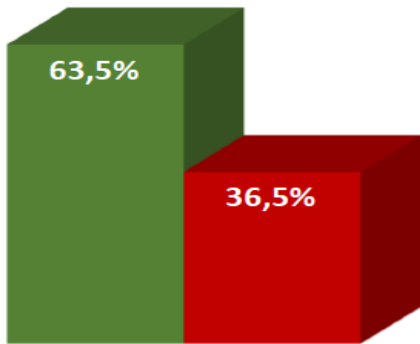
Source :
Roy Morgan



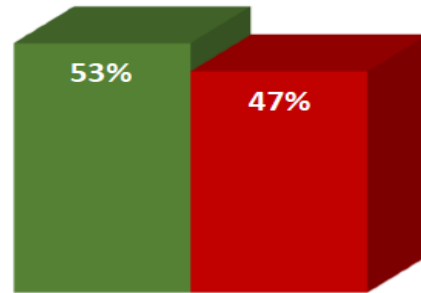
Legend: ■ Jokowi - KMA ■ Prabowo - Sandi



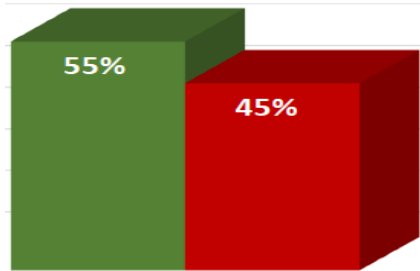
Raden Pardede



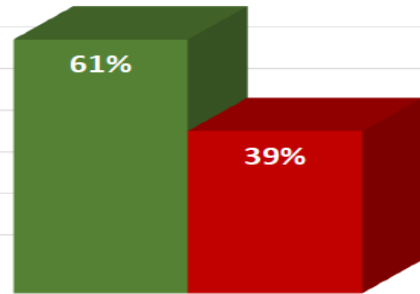
Rural



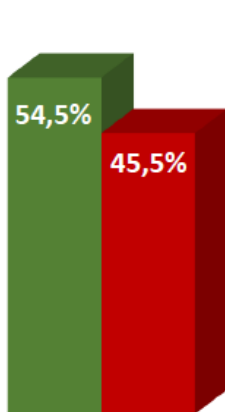
Urban



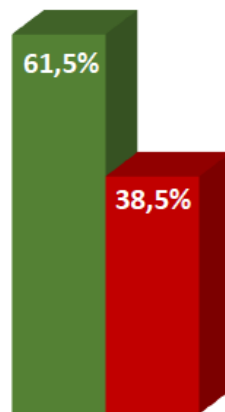
Laki-laki



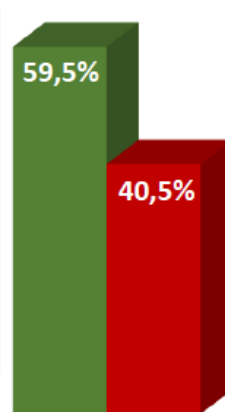
Perempuan



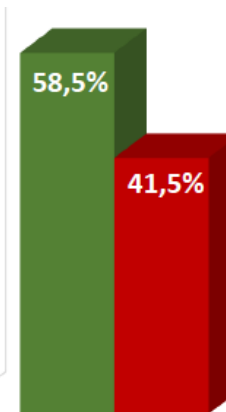
17-24



25-34



35-49



50+

***To benefit from :
Demographic Bonus and Technology
revolution***



Requires

***SERIOUS REFORM →
STRONG LEADERSHIP (consensus
builder) →
STRONG (legitimate) POLITICAL POWER
for institutional reform***

SCENARIO 1 : Jokowi – Amin

Low margin : BAU/gradual/Tough reform

Big margin : BAU/gradual/Tough reform

SCENARIO 2 : PBW – Sandi

Investor confidence

More Nationalistic view

More “religion” driven policy orientation

TOUGH REFORM :

- Investment (openness, attractive, certainty), Labor market and productivity, Infrastructure (core and connectivity), Human resources upskilling and adoption of new technology
- Riil sector policies (A, M, C, S), servicification, SME and global orientation
- Institutional (effective implementation)

Conclusion

- We are living in uncertain world, higher risk
- The fed taking a more dovish stance, and so major central banks and more favorable for Indonesia
- The economy only expand gradually and hover around 5%, with investment as the main driver
- Despite the overall welfare improvement and unemployment rate declined, dissatisfaction among college graduate heightened, as they seen more difficult to find the appropriate job (mismatch)
- We need to anticipate trend, challenges and risk and respond immediately. At the same time we need to capitalize all opportunities
- So far monetary and fiscal policies in 2018 have been able to navigate our economy through the choppy water, however riel sector policy (reform) remains key to move the economy forward. Tough reform is only possible if the president have a substantial political capital