Economic Analysis

Will Indonesia’s new stimulus hit the right note?

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Over the past month until yesterday, Indonesia’s Jokowi administration in coordination with Bank Indonesia and the Financial Services Authority (OJK) has announced a spate of measures that were rolled out in four batches for reviving the flagging economy. Indonesia grew at its slowest pace in 6 years during H1 2015 at 4.7% y/y (See Figure – 1). In this flash, we take a close look at the entire new economic package to examine its effectiveness in reversing the ongoing erosion in consumer purchasing power, rekindling a flagging investment cycle, boosting industrial competitiveness, and improving governance standards.

A two-pronged focus: Broadly, Indonesia’s latest economic package encompasses a two-pronged strategy - 1) Aiding consumer purchasing power and 2) Rekindling a flagging investment cycle (See Table – 1). While the former has eroded significantly amid high interest rates, elevated inflation, and rising unemployment, the latter is dragged by unwinding of the global commodity super cycle, a slowing Chinese economy and a delayed reform momentum at home (See Figure – 2). Measures to boost consumption demand span from expanding the rice subsidy scheme to ease consumer budget constraint, revising wage setting regulations to upkeep real income levels, tax concessions to boost housing demand, insurance protection for small rice farmers and encouraging entrepreneurship by providing subsidized loans. Meanwhile, the new set of investment and industry related policy actions range from providing working capital funds and lower interest rates on loans to small businesses, particularly in the export oriented sectors, simplifying procedures to obtain business permits, land acquisitions and energy sectors, easier import regulations, steps to promote special economic zones, electricity and energy price subsidies, wide ranging tax concessions for key sectors, and greater devolution of funds from the center to local governments to boost infrastructure development.

The new Jokowi administration has delivered sub-par economic performance in its first year at helm: The pace of investment reforms have disappointed and policy uncertainty has increased as investors are stymied by sudden and unfavorable shifts in regulations. Foreign investors fret over several policy miss-steps (See Figure - 3). The subdued business confidence is coupled with waning popular support for Jokowi amid rising unemployment, high inflation, a rapidly depreciating rupiah and a failure to fight corruption. More than 62000 people have lost their jobs in Indonesia during the first nine months of 2015 while public satisfaction with President Jokowi has dropped to just 46% in September from 57.5% in March 2015. September consumer confidence index fell to its lowest reading since February 2009.

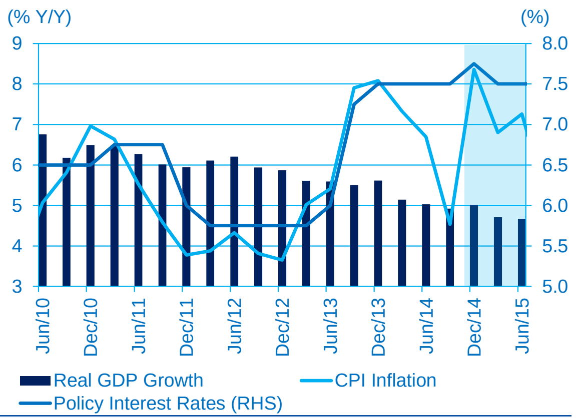
Will the new measures be effective? A turnaround in sentiment can trigger a virtuous cycle: Set against a backdrop of downbeat business and consumer sentiment, the latest booster dose from Jokowi is incremental but progressive and wide ranging. The package lacks bold and hard legislative reforms aimed at making rigid labor laws more flexible, directly tackling red tape, and narrowing the large negative investment list that restricts foreign investments across key sectors. Also, the success of these measures would depend on the government’s ability to ensure regulatory certainty and effective coordination amongst authorities to make land acquisition easier and enforce the new legal framework that supports public private partnerships. That said, on a positive note, the newly announced measures, if implemented effectively, should help release the economy’s animal-spirits. In addition, the new measures would be augmented by a pick-up in productive public spending in 2H 2015. Only 11% of $21bn allocated for infrastructure spending in 2015 was spent in the first 7 months of 2015 (See Figure – 4). Against this backdrop, the latest set of economic stimulus measures coupled with higher productive capital spending should provide an impetus to final demand and crowd in private investments, in turn aiding Indonesia’s growth prospects. We maintain our full year 2015 GDP growth estimate for Indonesia’s at 5.0% y/y, a pace similar to that seen in 2014.

Table 1
Key measures outlined in Indonesia's latest economic stimulus package

	Measure	Details	Impact
	• Measures to enhance consumer purchasing power		
1	Rice subsidy scheme	• Expand existing rice subsidy scheme	• Ease consumer budget constraint
2	Aid to fisherman	• LPG to fuel convertor kits given to fishermen	• Make fishing more energy efficient
3	Stabilize food prices and anchor inflation	• In coordination with Bank Indonesia, food prices and overall inflation will be anchored through credible monetary policy and supply response	• Aid real income levels of consumers
4	Reduce beef import prices	• Indonesia to consider more countries to find competitive prices for beef imports	• Ease the price of beef in domestic markets
5	Wage setting regulations	• Periodic inflation linked revision of wages	• Upkeep real income levels
6	Raise threshold tax level to buy luxury apartment	• Cheaper luxury apartments will no longer be subject to luxury tax	• Boost domestic housing sector
7	Protect small rice farmers	• Insure small farmers against crop failure, government to pay 80% of the premium	• Protect the livelihood of farmers
8	Subsidised loans to salaried workers	• Salaried workers to get subsidised loans for opening small businesses – Widen eligibility list	• Encourage entrepreneurship and increase home based economic activity
	• Measures to boost investment activity and industrial competitiveness		
10	Low interest rate loans for micro, small, mid-sized firm	• Loan rates cut from 23% to 12% for labor-intensive small businesses, given by Exim bank • Provide working capital for export oriented SMEs	• Help sustain small businesses and avoid layoffs
11	Special Economic Zones	• New regulations to promote Special Economic Zones and two bonded logistic zones	• Boost industrialization & higher FX revenue
12	Easier import regulations	• Import regulations are eased for select agri products, textiles, cosmetics, tires and pearls	• Boost producer margins by reducing cost of imports
13	Simplifying and speeding up investment, land acquisition and business permit procedures	• Processing time for permits cut from 8 days to just three hours for specific companies, won't need to obtain environmental permits and location permits. • Fast-track permit allocation for mining sectors from up to 4 years to 15 days • Reduced time for investors to obtain land use certificates, provide greater legal certainty.	• Boost industrial activity and domestic private investments
14	Lower energy and electricity prices	• 30% discount to industries for electricity usage between 11pm and 8pm. • Allow delayed electricity bill payment for specific distressed industries • Lower price/subsidy for diesel & gas for industry	• Enhance operational efficiency by reducing costs, lower transportation costs, avoid distressed companies from going bankrupt and prevent layoffs
15	Tax sops and others	• Doubled the maximum length of tax holidays to 20 years while expanding eligibility of sectors • Corporate tax rate will be reduced next year from 25% currently to 18%-20%. • Scrapped VAT for imports of aviation products • Remove value added tax in transportation sector • Interest rate tax cuts for exporters • Greater devolution of central government funds to local governments	• Increase industry profitability, enhance competitiveness, Offer efficient industrial facilities for investors

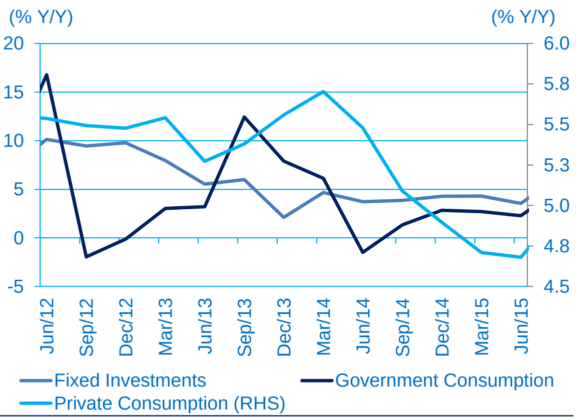
Source: BBVA Research, Indonesian Government official sources

Figure 1
Indonesia's GDP growth at 6 year low levels in Q2



Source: BBVA Research, CEIC

Figure 2
Growth slowdown has been broad-based



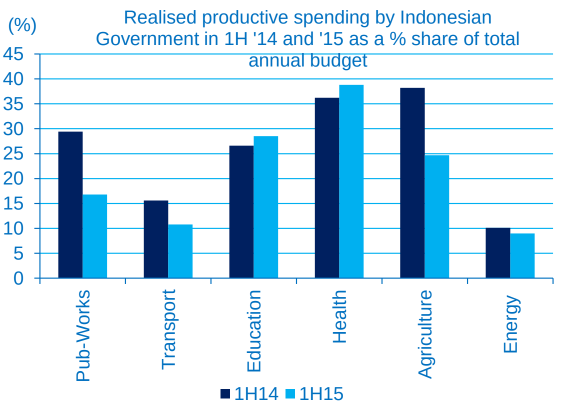
Source: BBVA Research, CEIC

Figure 3
Past policy hits and misses by the Jokowi administration

Past reforms actions by Jokowi administration	Policy measures by Jokowi that have upset foreign investors
Scrapping low octane gasoline subsidies and cap on diesel subsidy	Banning the use of foreign currencies for domestic transactions
Five year infrastructure development plan to boost rail, road, port and power sector	Forcing banks and companies to place their data centers onshore
Tax incentives to encourage foreign direct investments	Banning sale of beer in mini-markets
Establishment of one-stop service (PSPT) for project approval (Pelayanan Terpadu Satu Pintu)	Restricitons on foreigners to services Indonesian domestic sea lanes
New land acquisition law to facilitate infrastructure development	Limits to FDI in ports, warehousing and freight forwarding.
National broadband plan to make internet more accessible	Restrictions on export of minerals such as nickel and copper

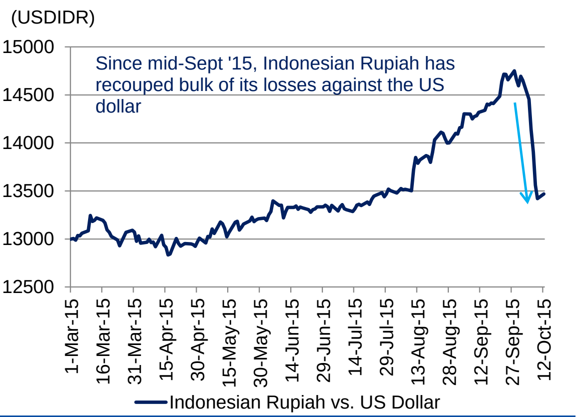
Source: BBVA Research, CEIC

Figure 4
Need to fast-track productive spending



Source: BBVA Research, CEIC

Figure 5
Announcement of stimulus measures have provided a fillip to the Indonesian rupiah



Source: BBVA Research, CEIC

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