

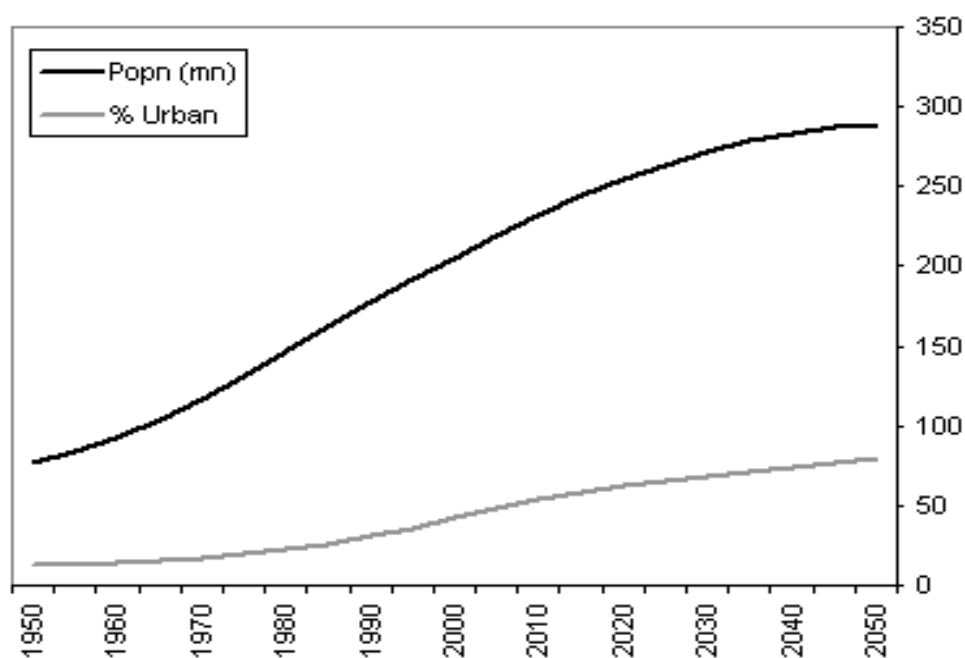
Indonesia As A BRIC Country? Maybe...

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Following the re-election of President Susilo Bambang Yudhoyono on Wednesday, arguably the biggest question is whether Indonesia can join the BRIC (Brazil, Russia, India, China) league and make the group 'BRIIC'. Goldman Sachs identified Indonesia as one of the 'Next 11' big emerging markets in 2005, and Morgan Stanley recently suggested that Indonesia should be considered a BRIC country. In Indonesia itself, a group of business leaders and politicians have initiated a Vision 2030 plan to raise GDP per capita to US\$18,000 by 2030 and have 30 companies in the Fortune 500 list, among other things. My own feeling is somewhat more cautious.

Indonesia's Strengths As A BRIC Contender

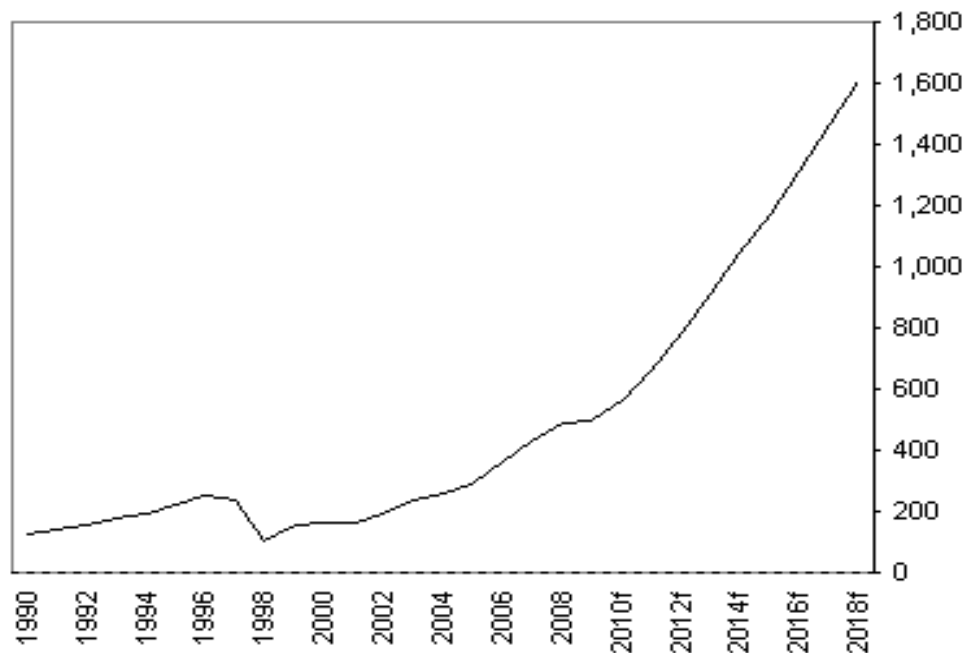
- **Demographics:** Indonesia is the world's fourth most-populous country, with 230 million people, and this will rise to 288 million by 2050. Indonesia also has a youthful population, with the working-age cohort (those aged 15-64) not due to peak until 2025, and remaining high at 64% in 2050. Like China and India, Indonesia is also urbanising rapidly, and is further ahead of both countries with 54% of its population already living in towns and cities – a figure which will rise to 79.4% by 2050. (All projections are derived from the UN World Population Prospects website.)



Indonesia Population Profile

- **Consumption potential:** With a per capita GDP of US\$2,000, Indonesia is already twice as rich as India, which investors are so excited about. In addition, private consumption as a percentage of GDP in Indonesia is around 65%, which is greater than in India (around 60%). Moreover, Business Monitor International (BMI) forecasts Indonesia's per capita GDP rising to around US\$6,200 by 2018.

- Absolute GDP: Owing to its vast population, Indonesia's total GDP, at US\$500bn, is already the 19th biggest in the world, and the fourth-largest in Asia ex-Japan and Australia. BMI forecasts nominal GDP to more than treble to US\$1.6trn by 2018.



Indonesia – Nominal GDP, US\$bn. f=BMI forecasts

- Commodity resources: Indonesia is rich in a variety of commodities, ranging from agricultural produce to metals and natural gas.
- Strategic location: Indonesia lies at the key geographical intersection of the Pacific Ocean and the increasingly important Indian Ocean. It abuts the crucial Malacca Straits, the main shipping route between East Asia, the Middle East, and beyond. To its south lies a prosperous market in the form of Australia.
- Political stability: Indonesia's politics has become a lot more stable in recent years, as evidenced by the smooth passage of 2004 and 2009 elections. The terror threat of the early 2000s may linger, but the government has cracked down hard on extremism. Separatist and sectarian conflicts which threatened to tear the country asunder have also abated.
- Islamic ties: Indonesia is the world's most populous Muslim country, and a moderate one at that. A breakthrough by Islamist parties has largely failed, and Indonesia could thus seek to portray itself as a successful Muslim democracy. At the same time, the government is increasingly seeking to develop Islamic financing at home through closer ties with the Gulf states.

So far, so good. However, the following weaknesses also need to be considered:

Indonesia's Shortcomings

- Weak growth: Although Indonesia is set to outperform most other Asian economies in 2009-10, due to high private consumption, real GDP growth has been somewhat disappointing, considering the positive factors at work. Growth in the final years of the Suharto era (1966-98) was in the 7.0-9.0% range, but has never recovered from the chaos that followed his downfall. Indonesia's best performance in recent years was 6.3% in 2007, which was also a very strong year for the

global economy. For the 'Vision 2030' goals to be achieved, Indonesia needs to attain 8.5% real growth – which, frankly, I believe is beyond its speed limit for the foreseeable future.



Indonesia – Real GDP Growth (%). f=BMI forecasts.

- Corruption and red tape: Indonesia remains among the most corrupt countries in the world, according to Transparency International. Indeed, two successive former central bank governors have been convicted of corruption in recent years. In addition, extensive red tape makes it very time-consuming to set-up a business in Indonesia. Labour laws are also tough. The poor business environment acts as a major constraint on foreign direct investment (FDI) and thus growth. Although Indonesia drew in a record US\$8.3bn in FDI in 2008, China received US\$92bn and India US\$33bn.
- No longer in OPEC: Indonesia was forced to quit OPEC in January 2009 as it is no longer a net oil exporter. Stagnant domestic demand for oil, combined with falling domestic production (due to under-investment), mean that Indonesia is now a net crude importer. This makes Indonesia vulnerable to oil price spikes.
- Lack of value-added industries: Unlike China or India, Indonesia is not famous for its manufacturing or globally-oriented service industries. There are no internationally acclaimed Indonesian multinational companies in the Fortune 500 as there are for China, India, Brazil, and Russia.
- Fragmented geography and centrifugal forces: Indonesia's archipelagic nature (consisting of 17,500 islands) makes it difficult to develop a comprehensive national infrastructure. Although more than 50% of the population is concentrated on the main island of Java, there has been significant migration to the outlying islands. In addition, while the separatist conflicts of the late 1990s/early 2000s have subsided, they could resurface at some future date.
- Volatility of the rupiah: Indonesia's rupiah is the most volatile currency in Asia, making its trajectory difficult to predict. This volatility reflects high degrees of speculative capital inflows and outflows, and by extension rapidly-changing investor sentiment towards the country. The rupiah has struggled to rise beyond the IDR8,700-9,000/US\$ range in recent years, and it is difficult to

see a sustained break of this area. Overall, investors still perceive Indonesia as a very risky destination.



Indonesia – Exchange Rate, IDR/US\$

On Balance, Much Work Needs To Be Done

The bottom line is that while the positives seem to outweigh the negatives, it is evident that Indonesia has much work to do to before it can achieve the same investor enthusiasm that BRICs – and several others for that matter – have generated. All of the negatives act as constraints on the positives. Unless Yudhoyono can make a big breakthrough and implement reforms, Indonesia will maintain respectable growth of around 5% over the coming years (which is BMI's core scenario out to 2018), but fail to achieve take-off and ascent to a higher growth plane.