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OF 7

Indonesia

Johan Fredriksson

+46(0)8-788 00 30

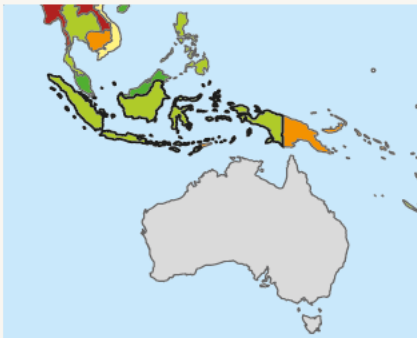
johan.fredriksson@ekn.se

Basic facts (2020)

Population: 270 million

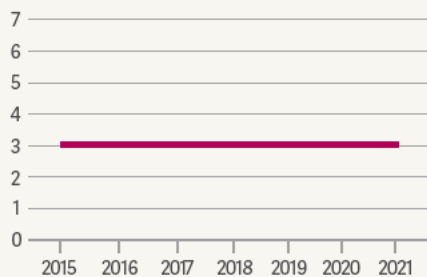
GDP, nominal: USD 1 060 billion

GDP/capita: USD 3 922



The country risk categories are arranged on a scale from 0 to 7. The lower the figure, the better the country's creditworthiness

Country classification history



Source: EKN

Strengths

- + Robust growth and good growth prospects.
- + Relatively stable banking system
- + Moderate external debt

Weaknesses

- Low levels of government revenues and growing levels of public sector debt.
- Limited domestic capital markets make the country dependent on foreign portfolio capital for budgetary and corporate financing.
- Commodity-dominated exports expose the country to the commodity price cycle.

Large domestic economy provides resilience

Indonesia is the 16th largest economy in the world (10th in terms of purchasing power parity), with the world's fourth largest population of 270 million where 44% are under the age of 25. Since the fall of the Soeharto regime in 1998, a series of peaceful elections and transfer of power indicate significant democratic achievements. Rising income levels via robust economic growth (5.4% a year in 2010-19) have halved the poverty level in 20 years and the country reached "Upper Middle Income Country" status in 2020. The economy is relatively diversified. The export and manufacturing sectors both amount to almost 20% of GDP. However the growth of the economy is primarily driven by domestic private consumption (55% of GDP) and high levels of investment. Based on extensive natural resources, goods exports are the country's main currency earner. Raw material-based exports including hydrocarbons, metal, rubber and palm oil account for almost 50% of exports. This exposes the country to commodity price fluctuations and developments in China. Another vulnerability lies in the fact that the low levels of tax collection and still-shallow financial markets make the country reliant on external financing of budget and current account deficits. About 60% of the public debt is external, of which 40% is in foreign currency. This exposes the economy and currency to shifts in capital flows. However, the country has a track record of prudent and cautious macro-policies, which have built up buffers in the form of moderate government and foreign debt levels, and relatively large international reserves. The large domestic economy and these buffers provide resilience to external disruptions.

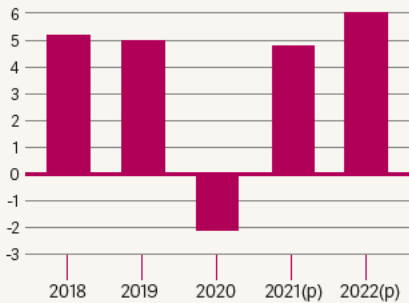
Declines in commodity prices, capital outflows, and currency turmoil in 2013-2015 pointed to shortcomings in the country's growth model. Since the cautiously reformist President Joko Widodo ("Jokowi") began his first term in office in 2014, policies have been pursued to strengthen the country's growth potential over the long term, create jobs, and strengthen the country's foreign direct investment (FDI) competitiveness. Energy subsidies have been reduced and released budgetary resources for increased investments in infrastructure and human capital. In addition, gradual reform processes to strengthen the business environment are being conducted. Government regulations designed to reduce exports of unprocessed metals were introduced starting in 2009 and have led to increasing FDI and export diversification in recent years. The country has become a leading exporter of stainless steel and there are hopes that investments will continue to increase the value added from the assets and create new export niches e.g. in the emerging battery industry.

Strong buffers offset the weakening of public finances

The effects of the coronavirus pandemic, not the least on key growth engines such as household consumption and the service sector have weakened both economic growth and public finances. While GDP declined in 2020 (-2.1%), for the first time since 1998, the decline was mild compared to several neighboring countries. This is explained by the fact that the country's restrictions in response to the pandemic have so far been somewhat milder, with local restrictions instead of national lockdowns, plus a limited overall reliance on

Indonesia

GDP growth (fixed prices, % per annum)



Source: IMFWEO April 2021

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank

tourism revenues. The downturn has been countered with public stimulus, robust FDI inflows and a recovery in commodity exports, which benefited from China's recovery. However, the spread of infection is not yet under control and it is likely to take some time into 2022 before the vaccination cover in the population approaches levels that might yield some form of herd immunity. As a result, the pandemic and vaccination trends are the primary uncertainties over the next year, which may dampen the prospects for recovery. GDP growth in 2021 is likely to be in the range of 3-4.5%. A return to previous rates of growth, somewhat above 5% is not expected until 2022. The extent of damage to the balance sheets of the corporate and banking sectors is difficult to assess. However at the outset of the pandemic the indebtedness in the corporate and banking sectors was moderate, mitigating systemic risks.

In order to boost the economy, new stimulus packages have been launched, large infrastructure projects that slowed down in 2020 will resume, and the budget deficit will be substantially increased in 2021. Government debt is thus expected to increase to 43% of GDP in 2022 (31% in 2019). While these are still moderate levels, the infrastructure programs are financed in part via state-owned enterprises, which is why total public-sector debt is approaching 80% of GDP. The widening budget deficits are made possible by the government's implementation of a temporary suspension of both the statutory deficit ceiling (3% of GDP) in 2020 and of legal obstacles for the central bank to finance parts of the budget. The government has flagged its intention to return to the deficit target in 2023. The policy poses potential risks of currency turmoil, especially if the credibility of the pledges to return to traditional policies were to begin to be called into question. However good buffers remain in the form of limited and mostly FDI-funded current account deficits, moderate external debt (just under 40% of GDP), and robust international reserves. Furthermore, the conditions are considered good for further reforms with more than 2.5 years left until the 2024 super-election year, when the president, Parliament and regions are to be elected simultaneously for the first time. With the support of a strong parliamentary majority, albeit in coalition form, Jokowi has begun his second term with reforms. Indonesia has established a government fund (INA) to manage national investment which is dedicated to mobilising foreign and private capital for investment in public infrastructure with the aim of eventually raising over USD 110 billion (about 10% of GDP). A major liberalisation reform was also adopted in autumn 2020, which may eventually strengthen the growth potential of the economy.

Business environment

Reform policies over the past 5-6 years have contributed to a gradual improvement in Indonesia's performance in several indices measuring the business and investment climate. In the World Bank's Worldwide Governance Indicators (WGI), the performance of economic institutions has strengthened and is just above the average for Asian emerging and developing economies. In the World Bank's business climate (Ease of Doing Business Index (DBI)) ranking the country has climbed to 73 out of 190 countries (120 in 2015). However Indonesia ranks 116 in terms of time and costs associated with import and export procedures and logistics. The reform process is now expected to re-gain some momentum after a couple of years in which the pace of reforms was dampened by the political cycle (election year 2019) and the pandemic. In the autumn of

Swedish export to Indonesia

	MSEK
2020	2 781
2019	3 570
2018	4 217
2017	4 013
2016	2 991

Source: SCB

EKN:s exposure

	MSEK
Guarantees	1 319
Offers	836

2020, a major reform package was adopted, including gradual reductions in corporate tax rates, rationalization, and digitization of permit applications, and liberalization of the restrictive FDI regulatory framework. The reform is the result of a long-standing effort to rationalise a growing body of laws and regulations. To some extent the aim is also to limit the regions' influence over the regulatory environment, after almost two decades of decentralisation. The reforms are controversial and contested, due to a relaxation of requirements for environmental impact assessments and more flexible labour market legislation. However much remains in the implementation path before a greater footprint on the business climate can be discerned.

From EKN's credit risk perspective, important aspects of the business environment are related to the degree of predictability, stability and quality both in regulations that affect our obligors' business operations and, in the country's, legal and institutional environment that affect the position of creditors. According to the WGI, the quality of the regulatory environment is just above the average in the context of emerging and developing countries in Asia. Challenges can be found due to a large bureaucracy with some overlap in government mandates and statutes and regulations. The decentralisation process allows local authorities to have a substantial influence on regulations and supervision. In Business Sweden's Global Business Climate Survey (2020) aimed at Swedish companies engaged in business operations in the country, nearly one-half of the respondents considered that corruption had a significant impact on their operations, in particular related to licensing, customs clearance, and tax issues. In Transparency International's Corruption Perceptions Index, the country's ranking fell to 120 out of 180 countries (85 in 2019). That rank is weaker than the average ranking for emerging and developing countries in Asia (90). The break in the trend coincides with the adoption by the Parliament of legislative changes restricting the independence of the country's Corruption Authority (KPK).

The legal framework for civil law is based on the Dutch model although it has undergone several updates in recent decades. This includes a more creditor friendly bankruptcy code (2004) and provisions for securities in moveable property (1999). The application of the laws is sometimes reported to be uneven, and the effectiveness of the judiciary low. The DBI indicates that the cost of resolving a commercial dispute via the courts is burdensomely high. EKN has limited recent experience of debt recovery in Indonesia. However according to DBI, the recovery rate in company bankruptcies (for transactions with security provided) is estimated to be 65 per cent. This is better than the regional average (40%).

Financial reporting requirements for banks and listed companies have been strengthened, and the local standard applied to these companies (SAK) is approaching international standards (IFRS). For unlisted companies, an alternative standard (SAK-ETAP) is applied which is considered to provide significantly less transparency. Consolidation of accounting rules in new legislation has been on the reform agenda for several years.

EKN:s policy

EKN has placed Indonesia in country risk category 3 (out of 0 to 7) since 2012. Normal risk assessment applies to all debtor categories. This means that there

are no predetermined limitations in the issuance of guarantees and that the transactions are assessed on their own merits without specific requirements or preconditions.

EKN:s commitment and experience

EKN's guarantee commitment amounts to SEK 2.1 billion, of which SEK 1.3 billion are outstanding guarantees, the rest are pledges. During the period 2016-2020 EKN issued guarantees in 67 transactions for some 20 export companies totalling SEK 5.7 billion. The dominant sectors in this flow were transport and construction equipment and telecoms. About 25 transactions with SME exporters accounted for 1% of the issuance of guarantees. Characteristic of the flow is that more than 75% of the amounts relate to transactions with credit term up to one year. The dominance of short-term transactions may be a sign that demand for longer funding from Indonesian buyers is limited. EKN's payment experience has been good, with few losses due to claims. Delay in payment is however not entirely uncommon. In approximately 15 per cent of the guarantees issued during the period 2016-20, arrerars were notified (as per May 2021). The arrears lasted 70 days on average. Relatively few transactions have resulted in a claim loss. Over the past 5 years, EKN has settled claims in 5 transactions, for slightly over SEK 8 million. The recovery rate varies but amounts in total to a low 20%.