COUNTRY RISK CATEGORY
3
OF 7

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Indonesia

COUNTRY ANALYST
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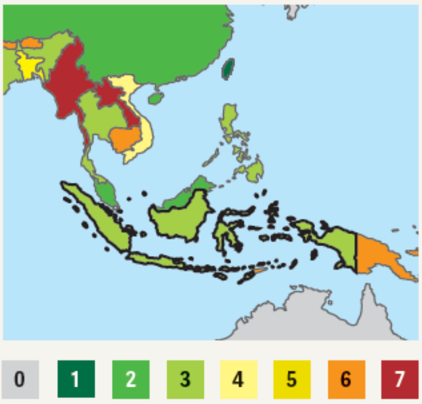
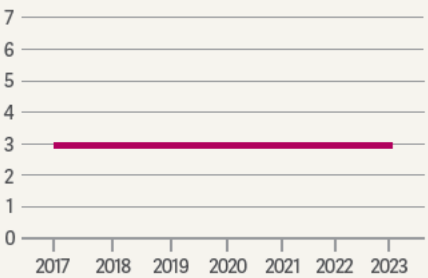
Basic facts (2022)

Population: 275 million
GDP, nominal: USD 1 318 billion
GDP/capita: USD 4 798



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 prospects with a large domestic market
+ Growth oriented reform policies and a history of prudent fiscal policy
+ Relatively stable banking system
+ Moderate external debt and robust international reservesand flexible currency

Weaknesses

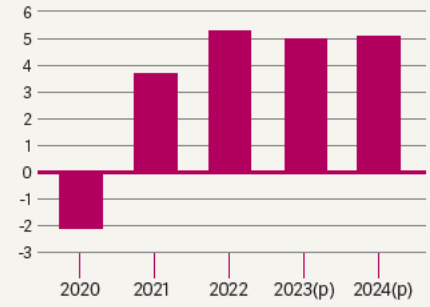
– Low levels of government revenues and growing levels of public sector debt
– Shallow capital markets mean exposure to shifts in portfolio capital
– Raw material-based exports expose the country to the commodity price cycle
– Vulnerability to climate change via natural disasters and transition risks

Structural reforms and export diversification strengthen the outlook

Indonesia is the world's 16th largest economy with the fourth largest population at 275 million, of which 42 per cent are under the age of 25. Since the fall of the Soeharto regime in 1998, a series of peaceful transfers of power through elections show democratic achievements, and serious threats to political stability are difficult to discern. Robust economic growth (5.4 per cent per year in 2010-2019) has led to the poverty level halving in 20 years and a growing middle class, although the pandemic has been a setback. The economy is relatively diversified. The growth is primarily driven by private consumption (53 per cent of GDP) along with high levels of investment. The export sector and the manufacturing industry both amount to about 20 per cent of GDP. With a base in large natural resources, the country's biggest currency earner is goods exports, where raw material-based sectors account for over 55 per cent, for example gas, coal, metals, rubber and palm oil. This exposes the country to the commodity price cycle and developments in China. Another vulnerability is low government revenues (12 per cent of GDP). With shallow financial markets, this at times creates a reliance on external financing, which exposes the economy to shifts in capital flows. In the long term, the country is exposed to transition risks given the importance of fossil fuels for the country's exports and energy mix and given the risks that climate change entails for the agricultural and plantation sector.

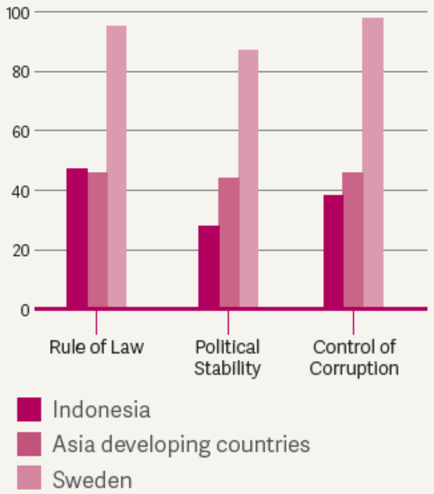
During President Joko Widodo's two terms in office from 2014 to 2024, economic policy has focused on raising the country's growth potential and creating jobs. One cornerstone is infrastructure expansion. Energy subsidies have been reduced to free up funds for investment and economic relations have deepened with China, which has provided significant flows of foreign direct investment (FDI) and loans. A second cornerstone is to promote the development of an industrial base to increase the added value from Indonesia's natural resources. Restrictions have been gradually introduced since 2009 to reduce exports of unprocessed metals. With one of the world's largest nickel reserves and FDI, not least from China, the country has reached a leading position as both a stainless steel exporter and nickel producer. Increasing demand for refined nickel used in electric vehicle (EV) batteries is driving a wave of investment in refinery capacity. Expansion is also underway in the copper sector, another EV component. This development is increasing exports, especially to China, which is now the largest export market (over 20% of exports). However, export restrictions on certain raw materials are creating trade friction with the EU and the US. With growing interest from Chinese and Western vehicle manufacturers, there are opportunities, if the country manages to address regulatory and environmental factors, to establish the country as an industrial hub in the EV sector's value chains. A third cornerstone is reform policy. Tax reforms in 2021 are expected to strengthen government revenues. In 2022, legislation was adopted aimed at deepening capital markets and strengthening the financial sector. In the spring of 2023, the administration pushed through a major
liberalisation reform aimed at strengthening the business environment and competitiveness for FDI. Steps are also being taken towards a more active climate policy, with a view to expanding renewable energy and phasing out coal

Real GDP growth (constant prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Swedish export to Indonesia

	MSEK
2022	4 913
2021	3 362
2020	2 781
2019	3 570
2018	4 217

Source: SCB

EKN:s exposure

	MSEK
Guarantees	1 389
Offers	1 710

in the long term. However, more ambitious targets depend on external funding. The implementation of the reforms is gradual and the pace of reform is expected to slow down as the February 2024 super elections approach, when the presidential, parliamentary and regional elections will be held simultaneously for the first time. Radical changes in macroeconomic policy beyond the elections are considered less likely.

Growth normalising after the pandemic

GDP growth, which has normalised to pre-pandemic levels, is expected to remain relatively robust at around ±5 per cent in 2023-2024. This implies some slowdown after the recovery in 2022, which was driven by pent-up domestic demand and high commodity prices. Inflationary pressures are expected to continue to ease provided that there are no new disruptions, not least from the war in Ukraine. In the coming year, the lagged effects of the domestic interest rate hike cycle are expected to dampen domestic demand, which is also affected by the fact that the pandemic has weakened households' purchasing power. The growth impulse from China's opening-up may counteract the slowdown but will not fully compensate for weaker demand in the Western world and lower prices for commodity exports such as coal and palm oil.

Government finances are relatively sound, albeit somewhat weakened. The government's debt ratio, debt relative to GDP, increased during the pandemic years but is expected to stabilise around a moderate 40 per cent in the next few years. However, state-owned companies finance the country's infrastructure programmes to a large extent through loans in their own name. The total public debt ratio therefore likely exceeds 70 per cent, and limited transparency related to Chinese financing raises some uncertainty about its extent. The government may in some cases have to step in with financial support, which has reportedly begun to happen. In addition, the plans to start re-locating the capital to Borneo within a few years may entail significant expenses. The return to a tighter fiscal policy after the pandemic is therefore positive. In 2022, one year ahead of schedule, the central government budget deficit already returned to a level just below the statutory deficit ceiling of three per cent of GDP. On a positive note, the share of government debt that is denominated in foreign currency is moderate (around 39 per cent in 2022). Furthermore, the country has a track record of cautious macro policy with a relatively well-established macro-policy framework with deficit ceilings, inflation targets and flexible currency. This has helped to build up of buffers in the form of moderate public and external debt, as well as robust international reserves. No major current account deficits are expected, and the expanding export base may further reduce vulnerabilities in the country's external position. These buffers, combined with a large domestic economy, provide resilience to external shocks.

Business environment

The reform policies of the past decade have contributed to Indonesia's performance gradually improving in indices that measure business and investment climate. In the World Bank's Governance Indicators (WBGI), the performance of economic institutions has strengthened in most areas and is now slightly above the average for emerging and developing countries in Asia.

From EKN's credit risk perspective, important aspects of the business environment are predictability and quality, partly in regulations that affect debtors' business operations, and partly in the country's legal and institutional environment, as these affect the position of creditors. Based on the WBGI, the quality of the regulatory environment has been strengthened and is above the average for the region. Challenges exist in an extensive bureaucracy with partially overlapping regulations, laws and government mandates. The decentralisation process allows local authorities to have a significant influence on regulations and supervision. In combination with the trends described below, the regulatory environment is assessed as having some uncertainty and variability, although with a positive trend. For the legal environment, the country's performance in the WBGI is in line with the average in the region and the trend is positive. The legal framework has been updated in recent decades. This includes a more creditor friendly bankruptcy code (2004) and statutory provisions for securities in moveable assets (1999). However, the application of the laws is reported as being inconsistent at times. The efficiency of the judiciary is low, while corruption can affect the predictability of judgments. EKN has limited recent experience in recovering claims in Indonesia. Corruption remains a challenge. This is reflected in the deterioration in Transparency International's Corruption Perceptions Index, with the country's ranking dropping to 110th out of 180 countries in 2022 (85th, 2019). This trend reversal coincided with the pandemic when a lot of public support was distributed, but also with legislative changes in 2019 that critics claim weakened the Corruption Eradication Commission (KPK) and increased the risk of political interference. Increased digitisation can over time reduce the scope for corruption, e.g., related to permits, licences and customs matters.

A cornerstone of the reform of the business environment will be the implementation of the Omnibus Law on Job Creation, a major reform package that was enacted in 2023. This includes, among other things, liberalisation of FDI, simplification of permit applications, reforms of corporate taxation and land acquisition. The package was launched in 2020 and several elements are in place. For example, several sectors were opened to FDI in 2021 and a development fund (INA) was established to mobilise co-investment in infrastructure, green energy and strategic industries in the country from donors and private capital with government seed capital. However, parts of the package are contentious, including relaxed requirements for environmental impact assessments and more flexible labour market legislation. The law may therefore be challenged in the Constitutional Court. Once the reform has been successfully completed, much remains to be done in terms of regulation and implementation before a major impact on the business environment can be seen. As climate policy develops, regulatory changes can be expected regarding energy subsidies, the extension of the carbon tax and the introduction of emissions trading. The digital economy (e-commerce, fintech, payment solutions, healthcare, education, etc.) is growing rapidly, and internet use rose to almost 75 per cent of the population during the pandemic. Changing regulations are expected in this area as well, as legislation is lagging behind. Another trend is the increasing use of so-called non-tariff barriers and local content requirements in public procurement. Business Sweden's Business Climate Study 2022 notes that the trend can make it more difficult for Swedish companies to sell, especially if there is no local operation/composition.

Financial reporting requirements have been strengthened with a gradual convergence towards international standards (IFRS). From 2023, banks and listed companies will have the choice between reporting fully in accordance with IFRS or applying the local standard (SAK IFRS Convergence) with certain adjustments relative to IFRS. For unlisted companies, a standard is applied that is considered to provide significantly less transparency (SAK-EP/ETAP).

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 any specific requirements or preconditions.

EKN:s commitment and experience

EKN's exposure amounts to SEK 3.1 billion, of which SEK 1.4 billion is in issued guarantees. Between 2018 and 2022, EKN issued guarantees in 66 transactions for some 20 exporting companies corresponding to a total of approximately SEK 6 billion. The dominant sectors in this flow were transport and construction equipment, as well as telecoms. Some twenty transactions with SME exporters accounted for approximately 1 per cent of the issuance of guarantees. Characteristic of the flow is that approximately 60 per cent of the amounts relate to short-term transactions with credit periods of up to one year. EKN's payment experience is relatively good with few claims. Delays in payment are less common. Of the guarantees issued during the period 2018-2022, approximately 11 per cent were notified as being in arrears (as per June 2023). The delays lasted an average of 120 days, but the pandemic has had an impact on the statistics. Relatively few transactions have resulted in a loss due to a claim. Over the past 5 years, EKN has settled claims in five transactions, corresponding to slightly more than SEK 21 million. Recovery rates vary but have generally been low.