



Indonesia: a crown jewel

Notes from the road

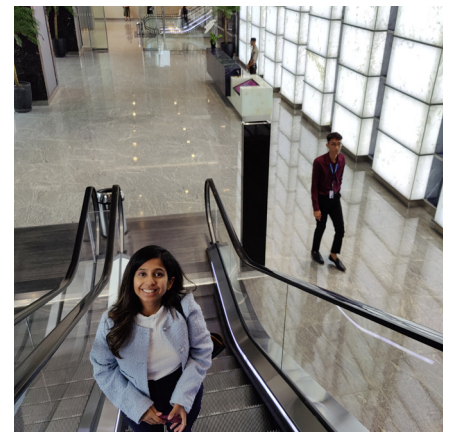
Emerging Markets Equity team

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“Indonesia is now one of the fastest-growing and strongest economies, not only in Southeast Asia but also in emerging markets. GDP growth in 2022 was 5.3% and a similar number is expected for 2023.”

During our three-day trip to Jakarta, the transformation of Indonesia was immediately apparent. Our arrival at the recently-opened international airport, built to welcome 25 million visitors, was followed by a swift transfer in Hyundai’s flagship EV, the Ioniq 5, to a newly-inaugurated luxury hotel. It is clear that after nine years in power, President Joko Widodo (popularly known as ‘Jokowi’) has changed the country.

Indonesia is now one of the fastest-growing and strongest economies, not only in Southeast Asia but also in emerging markets (“EM”). GDP growth in 2022 was 5.3% and a similar number is expected for 2023¹. The focus on attracting foreign investment, notably by developing infrastructure, is visible in the city centre which is modern, easy to drive around (traffic has been reduced by the recent opening of the first MTR line, an ultra-modern underground train) and buzzing with activity.



The majority of our meetings took place in Jakarta’s newly-developed and vibrant CBD.

¹ Statistics Indonesia, March 2023.

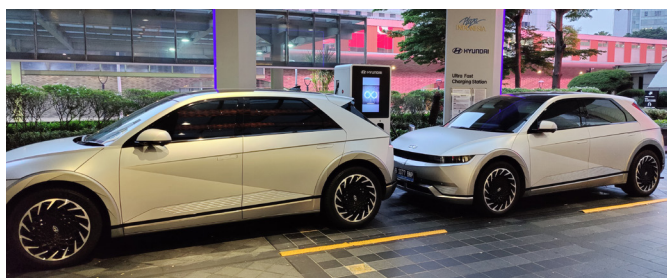
Indonesia tends to be seen as a commodity play, as the country is blessed with huge reserves, notably of coal, nickel and copper. However, for many years, and like many other commodities in rich EM countries, only low value-added products were exported to be transformed in other countries. This led to a negative current account, due to strong imports from a growing large population.

Indonesia was one of the “fragile five” back in 2013, as the reliance on the US dollar was strong, and so every time the Fed tightened, the country would be negatively impacted. This time is different, as the country has now moved to a current account surplus (Exhibit 1), thanks to the focus on downstream products exports. For instance, for iron and steel exports, the policy led to a jump from USD1.1 billion exports in 2014 to USD27.8 billion in 2022 (Exhibit 2)².

With the government ban on nickel ore exports in 2019, a large number of smelters are being built in the country, increasing the value of exports. The focus now is on battery materials, which will likely add even more value, and all the big electric vehicle (“EV”) battery makers are present in the region to benefit from the large nickel ore deposits. Not only will the country benefit from higher value exports but in line with its transition to a low carbon economy and target to halve carbon emissions by 2030³, it is incentivising the switch to EVs.

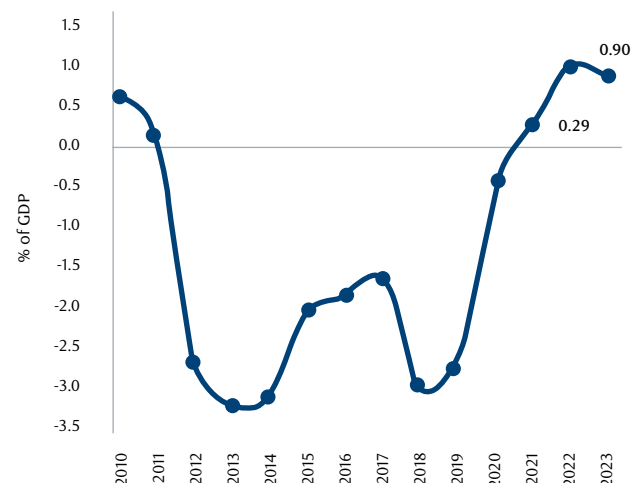
The high number of blue plates for EVs in Jakarta is a good indication that the government’s push to electrification is gaining traction with the population, at least in the big cities. Fitch anticipates that 50,000 EVs will be sold in the country in 2023⁴. The appetite for EVs is so large that the Hyundai Ioniq 5 is now a best seller and has replaced the BMW as the first choice of luxury car.

The good economic performance and confidence in the current administration has translated into strong investments in the country, and we saw those in offices and retail buildings. All the companies we visited had recently moved into brand new, super modern offices. They are surrounded by shiny new malls, many focusing on lifestyle, with dozens of restaurant choices and trendy coffee shops. We also spoke to young Indonesians who, after studying in the US or Australia, are coming back to work in the capital and enjoying the attractive opportunities available to them.



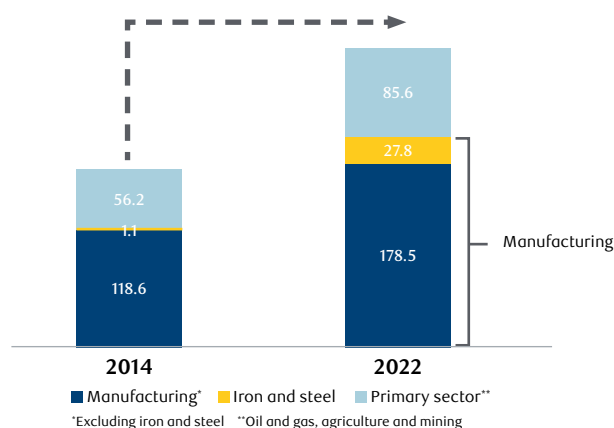
Hyundai is an EV pioneer in the Indonesian market.

Exhibit 1: Current account balance (% of GDP)



Source: Statistics Indonesia, Bank Indonesia, March 2023.

Exhibit 2: Comparison of 2014 and 2022 exports (USD billion)



Source: Statistics Indonesia, Bank Indonesia, March 2023.

Politics was a topic of discussion but local people seem relaxed about the outcome of the upcoming 2024 general elections. The expectation is that we will likely see a continuation of current policies which have been very beneficial for the country so far.

One challenge is that the growth benefits the entire population and not only a small percentage, as we have seen in many other emerging countries. We know that if this is the case, unrest may quickly follow and more populist candidates could emerge and slow down the pace of reforms.

When we talked to the Ministry of Finance, it was clear that government focus is to have strong and sustainable economic growth, with limited deficits and a reduction in poverty.

² Statistics Indonesia, Bank Indonesia.

³ [Indonesia optimistic of reaching net zero emissions by 2060 or earlier | Reuters.](#)

⁴ [Indonesia's Annual EV Sales to More than Double to 5% in 2023 \(fitchratings.com\).](#)

Fiscal deficits were controlled notably during the Covid-19 pandemic, meaning that the country is now within its target of 3% deficit, with 2.4% achieved in 2022 (Exhibits 3 and 4). The situation has helped to keep government debt to a relatively low level, especially compared to other countries.

The country could really be one of the largest success stories in EM. It has a diversified economy, with both domestic consumption (53% of GDP) and exports of downstream commodities products helping to generate a strong current account.

This dual engine of growth could lead to high and sustainable growth for years to come. The government has set up 'Vision Forward Indonesia 2045' with targets of 6-7% GDP growth which will be delivered thanks to structural reforms⁵. This includes strengthening the quality of human resources to encourage an economic structure that has high added value, is environmentally friendly and is inclusive to realise.

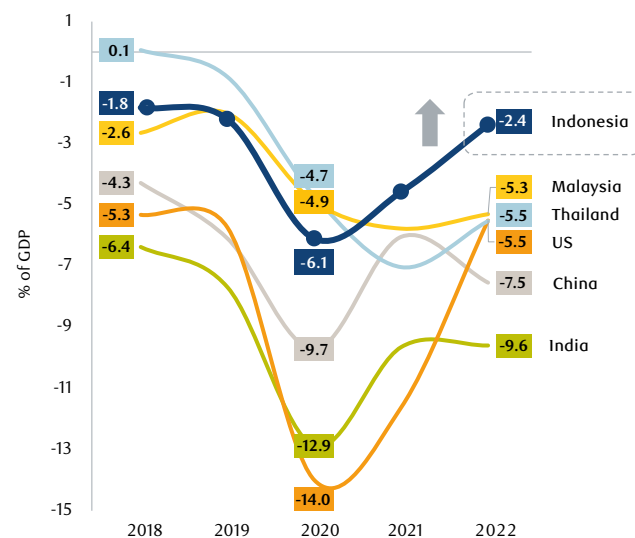
“One challenge for investors is that the stock market in the country is small and there are not many large and liquid enough listed companies outside banks, telcos and materials names.”

Valuations are currently attractive compared to history, as worries about global growth mean that optimism about the country is offset by fear that commodity prices may weaken from here, negatively impacting the current account and fiscal outlook.

One challenge for investors is that the stock market in the country is small and there are not many large and liquid enough listed companies outside banks, telcos and materials names. However, we have seen many IPOs in the recent past and we expect this to accelerate as the private equity scene is vibrant, with hundreds of companies being currently funded. We have seen also a partial privatisation program which is very positive. The government wants more transparency and accountability for the state-owned sector, something we believe will lead to an overall re-rating.

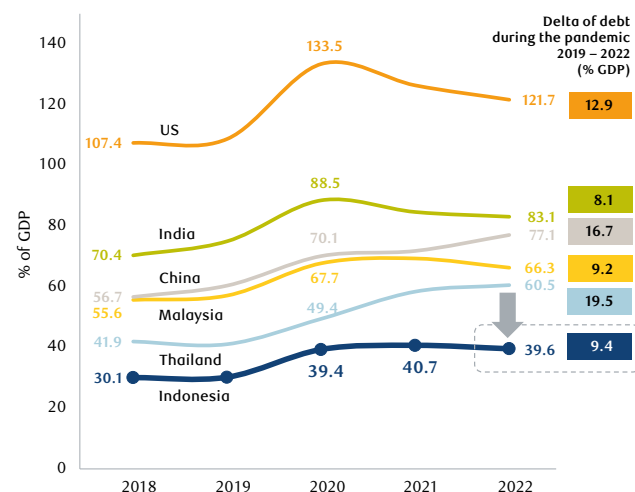
Indonesia Investment Authority (“INA”) is the newly-created sovereign wealth fund tasked with facilitating FDI in the country, not only in the materials sector but also in infrastructure (both physical and digital), logistics, green investing, and health care to name a few, by co-investing with foreign entities. We met a very dynamic and experienced team there, who were already managing USD6.2 billion⁶.

Exhibit 3: Fiscal deficit before and after the pandemic (% GDP)

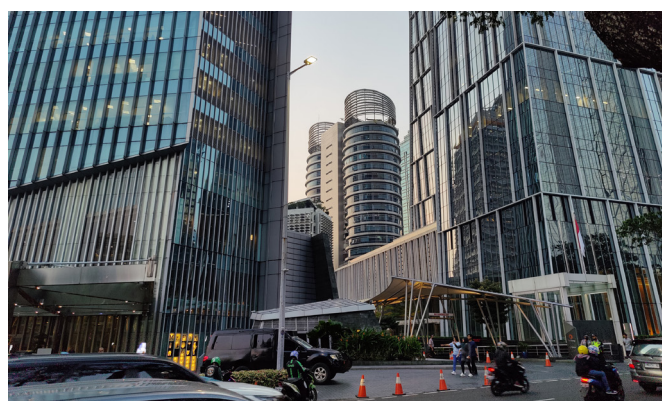


Source: IMF Database & MOF, processed.

Exhibit 4: Debt ratio before and after the pandemic (% GDP)



Source: IMF Database & MOF, processed.



Indonesia's economic planning follows a 20-year development plan (from 2005-2025).

⁵ Ministry of Finance, Republic of Indonesia, March 2023.

⁶ [Indonesia Investment Authority | Partner for Future Prosperity \(ina.go.id\)](https://ina.go.id).

We included many shopping malls in our visit, in order to get a pulse on domestic consumption. We visited the newly open Ashta District 8 in the CBD, a lifestyle hub with very few clothing retailers and a strong focus on experiences, with a bookshop, trendy coffee places, interior-designed restaurants and curated brands such as KitchenAid and Kitsune.

In another nearby mall, we witnessed that aspiration is the same in the country as everywhere in the world, and this giant LVMH store is a good illustration of the rise of the GDP per capita in the country and the appetite for luxury goods.

As we leave, we can only wish that Indonesia continues on this positive path; this should translate into strong equity returns for investors over the long term.



Indonesia's improving retail infrastructure reflects the appetite for the luxury sector in large cities.

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