COUNTRY RISK CATEGORY

3

OF 7

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Indonesia

COUNTRY ANALYST

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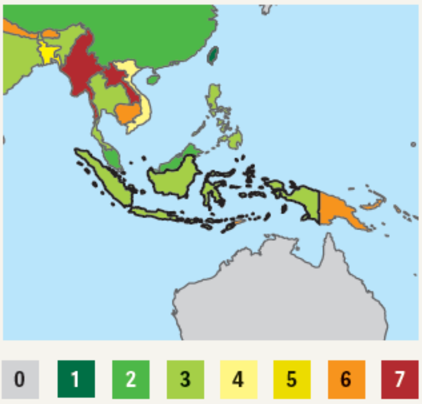
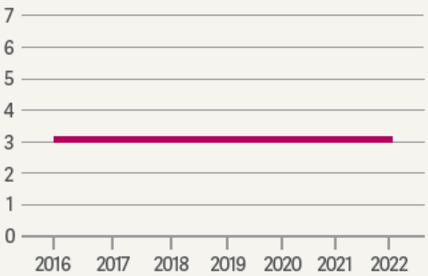
Basic facts (2021)

Population: 272 million
GDP, nominal: USD 1 186 billion
GDP/capita: USD 4 357



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 along with a large domestic market and good growth prospects
+ Relatively stable banking system
+ Moderate external debt and robust foreign exchange reserves

Weaknesses

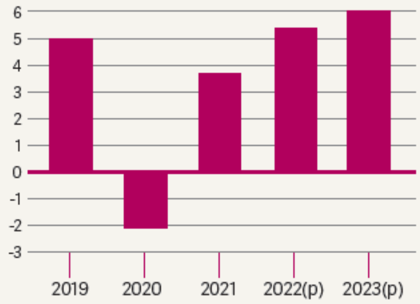
– Low levels of government revenues and growing levels of public sector debt
– Limited capital markets mean the country is occasionally exposed to shifts in foreign portfolio capital
– Raw materials-dominated exports expose the country to the commodity price cycle
– Exposure to transition risks in the context of climate change and the effects of climate change via the occurrence of natural disasters

Structural reforms strengthen the prospects

Indonesia is the 16th largest economy in the world (7th in terms of purchasing power parity), with the world's fourth largest population of 276 million where 44% are under the age of 25. Since the fall of the authoritarian Suharto regime in 1998, a series of peaceful elections and the transfer of power indicate increasingly entrenched democratic settings. Robust economic growth (5.4% per year during 2010-2019) has halved the poverty rate over the past 20 years, and more people are joining the growing middle class, even considering the setbacks caused by the Covid pandemic. The economy is relatively diversified. The growth is primarily driven by private consumption (54% of GDP) along with high levels of investment. The export sectors and manufacturing industries each amount to roughly 20% of GDP. With a foundation in abundant natural resources, goods exports are the country's largest foreign exchange earner with raw material-based exports including fossil-fuel based, metals, rubber and palm oil exports accounting for over 55%. This exposes the country to commodity price swings and economic developments in China. The country is also exposed to long-term transition risks given the country's energy mix and the importance of fossil fuels for exports. Another vulnerability lies in a low level of revenues from tax collection. With shallow financial markets, this makes the country at times reliant on on external financing, which exposes the economy to shifts in capital flows. Declines in raw materials prices, capital outflows, and the currency turmoil during the years 2013-2015, highlighted these shortcomings in the country's growth model.

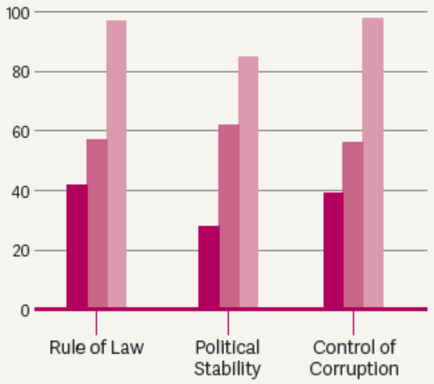
Following the inauguration of the reform-oriented President Joko Widodo ("Jokowi") in 2014, policies have been pursued to raise the country's growth potential, generate employment opportunities and strengthen the business environment and competitiveness for attracting foreign direct investment (FDI). Energy subsidies have been reduced, freeing up funds for investment in infrastructure and human capital. Governmental regulations aimed at reducing exports of unprocessed metals started to be introduced from 2009. This has contributed to increased FDI and diversification of exports, as the country has become a leading exporter of stainless steel. With one of the world's largest reserves of the type of nickel used in batteries for electric vehicles, it is hoped that ongoing investments will increase value added and generate new export niches. In his final term in office (2019-2024), Jokowi has continued reform policies despite the coronavirus pandemic. A major liberalisation reform was adopted in autumn 2020 which, if implemented, has the potential to boost the economy's potential growth . Structural reforms also affect government finances, where a major tax reform in 2021 is expected to gradually boost tax revenues. Steps have also been taken towards a more active climate policy. In 2022, legislation is being prepared to deepen financial markets and strengthen the financial sector. Eventually, the pace of reform should slow down as the "super-elections" to be held in February 2024 approach.For the first time the President and representatives for the Parliament and Regions will be elected simultaneously. However, the likelihood of major shifts in the broad macroeconomic policy direction beyond the elections appears contained.

GDP growth (fixed prices, % per annum)



Source: IMF WEO, Macrobond

Business environment



Ranking from 0 (worst) to 100 (best)

Source: The World Bank, Macrobond

Resilience from large domestic market and buffers

In 2022, the economic growth rate looks set to recover to levels around 5%. This follows a fall in GDP in 2020 (-2.1%) and a dampening effect from the pandemic waves in 2021 (+3.7%). With rising vaccination rates and the lifting of pandemic restrictions, private consumption and investment are expected to rebound. Damages from the coronavirus pandemic to corporate and banking sector balance sheets are difficult to assess, as regulatory relaxations for the classification of bank loans has been extended to 2023. However, prior to the pandemic, corporate sector indebtedness was moderate and the banking sector in good health, reducing systemic risks. Weaker external demand looks set to be offset by higher raw material export prices, strengthening the current account and generating increased government revenues. This should allow for more gradual adjustments to subsidised energy and electricity prices. This will mitigate the impact higher raw materials prices would otherwise have on household purchasing power, which will nevertheless be somewhat dampened by inflation and gradually rising interest rates going forward.

During the pandemic, central government debt increased to 43% of GDP in 2021 (31% in 2019). The stimulus measures were possible as two cornerstones of the country's fiscal policy framework – the statutory budget deficit ceiling (3% of GDP) and legal barriers to budget financing from the central bank – were temporarily suspended until 2022. The central government's debt is manageable, but part of the problem is that the country's infrastructure programmes are partly debt-financed via state-owned companies. Thus, total public sector debt is approaching 80% of GDP. In addition, plans to move the country's capital city to the island of Borneo in a few years' time could entail significant public expenditures. On the positive side, the proportion of sovereign debt that is external is gradually declining (55% of sovereign debt is external, of which 40% is in foreign currencies). Given economic recovery and an announced return to a traditional fiscal policy in 2023, along with a phasing out of the stimulus measures, the debt situation is stabilising and is expected to remain manageable.

The country has a history of prudent macroeconomic policies which have built up buffers. In addition to a moderate sovereign debt and a flexible currency, the country's good external buffers have been further strengthened as the country's current account is temporarily in surplus during the current commodity price cycle. Foreign exchange reserves are robust, covering more than 5.5 months of imports, and external debt is moderate. These buffers, combined with a large domestic economy, provide resilience to external shocks. The country is thus considered to be in a position to navigate the increasing uncertain global situation concerning raw materials-driven inflationary impulses, rising borrowing rates and weakening growth prospects in key export markets, provided that rising but still moderate inflationary pressures can be contained and no further severe pandemic shocks are experienced.

Business environment

The reform policies over the past five to six years have contributed to a gradual improvement in Indonesia's performance in indices measuring the business and investment climate. In the World Bank's Worldwide Governance Indicators (WGI),

Indonesia

Swedish export to Indonesia

	MSEK
2021	3 362
2020	2 781
2019	3 570
2018	4 217
2017	4 013

Source: SCB

EKN:s exposure

	MSEK
Guarantees	1 116
Offers	780

the performance of economic institutions has improved and now is slightly above the average for Asian emerging and developing economies. The reform process is expected to be pursued, not the least via the implementation of a major reform package, called the Omnibus Law on Job Creation enacted in 2020. This includes, among other things, liberalisation for foreign direct investment, streamlining and modernising legislation, and digitalising licence and permit applications. In addition, a sovereign wealth fund the Indonesia Investment Authority (INA), has been established, The fund aims at facilitating foreign direct investment and mobilising private capital for investment in public infrastructure, with the aim of eventually raising the equivalent of at least USD 110 billion (about 10% of GDP). The above reforms are in part a continuation of a long-standing effort to streamline and rationalise a growing patchwork of laws and regulations, and at the same time the aim is also to limit the regions' influence over the regulatory environment after almost two decades of decentralisation. However, the reforms are controversial and contested, due to a relaxation of requirements for environmental impact assessments and more "flexible" labour market legislation. With the reform on the books, much will remain in terms of implementation before a major impact on the business climate will be discerned. As the country's climate change and carbon policies evolve, regulatory changes, such as reforming energy and electricity subsidies, expanding the carbon tax and introducing emissions trading, can be expected in the short term.

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 debtors' business operations and in the country's legal and institutional environment that affect the position of lenders and creditors. According to the WGI, the quality of the regulatory environment is just above the average for 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 2020, the country's ranking in Transparency International's Corruption Perceptions Index slipped 17 notches to 102 (out of 180 countries). The trend reversal coincided with a weakening of Indonesia's Corruption Eradication Commission (KPK) after the Parliament passed legislative amendments in 2019 limiting its independence. The ranking improved slightly in 2021 to 96, in line with the regional average ranking . In Business Sweden's 2021 Global Business Climate Survey, aimed at Swedish companies engaged in business operations in the country, 42% of the respondents held the view that corruption had a significant impact on their business operations, in particular related to permits and licensing, and customs clearance issues.

The legal framework for civil law is based on the Dutch model although it has undergone a number of updates in recent decades. This includes statutory provisions for securities in moveable property (1999) and a more creditor friendly bankruptcy code (2004) The application and enforcement of the country's laws is reported to be uneven at times and the performance of the judiciary inadequate, while corruption can also affect the predictability and reliability of a judicial outcome. EKN has limited recent experience in recovering claims in Indonesia.

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 any specific requirements or preconditions.

EKN:s commitment and experience

EKN's exposure amount to SEK 1.9 billion, of which SEK 1.1 billion are issued guarantees. During the period 2017-2021, EKN issued guarantees corresponding to a total of SEK 6.3 billion in 68 transactions for a bit more than 20 different export companies. The dominant sectors in this flow were transport and construction equipment and telecoms. A bit over 20 transactions with SME exporters accounted for 1% of the issuance of guarantees. A characteristic of the flow is that more than 70% of the amounts relate to transactions with a credit term of one year or less. 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. Delays in payment are less common. Of the guarantees issued during 2017-2021, approximately 10 per cent were notified as being in arrears (as per June 2022). The average delay in payment was 110 days, but the Covid pandemic is expected to affect 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 8 million. The recovery rate varies, but has generally been very low.