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ICP MONTHLY ALERT

POLITICAL & POLICY ISSUES TO WATCH

Jokowi off to a really rough start...

The first term of President Jokowi (inaugurated 20 Oct) and the nation's new DPR (installed 1 Oct) starts this month. There was never any doubt that the new president would face significant challenges from the political establishment right from the start. Nonetheless, the worst that could have happened to Jokowi at this early stage of his presidency has, in fact, occurred. Prabowo's Merah Putih coalition (KMP) now holds all the leadership posts in the DPR. (The speakership went to Golkar: Setya Novanto - party treasurer and one of the richest lawmakers in the country, but who is also a person of interest for the KPK in a number of cases. Four deputy speakerships also went to the KMP.) For the first time ever, the president's party and administration will be largely a spectator in defining legislative priorities. The PDIP coalition's efforts to challenge the law that allowed this to happen (the so-called MD3 law, passed by the previous DPR in its lame duck session earlier this year) with the Constitutional Court, was quickly rejected by the court. The KMP was also successful in passing controversial legislation to abolish direct local elections, replacing it with a Soeharto-era system whereby local legislatures appoint their local leaders. This could strengthen the KMP's political base significantly in the regions. Meanwhile, PDIP and particularly Party Chair Megawati with her stubborn unwillingness to pursue rapprochement with SBY have so far proven inept in providing Jokowi with strong political support in the legislature. In contrast, the KMP has so far completely outmaneuvered and out-muscled PDIP and Jokowi every step of the way while maintaining a significant degree of unity. Jokowi needs a win, badly, but right now the KMP has all the momentum.

...a primer to policy gridlock, political showdowns?

What does this mean for the political and policy outlook? There will be a lot of tension and a lot of gridlock. Perhaps more importantly, what the KMP wants in terms of policy will be just as important as initiatives proposed by Jokowi's administration. (Bakrie and others in the KMP have previously stated they want to make revisions to legislation regulating the telecoms and mining sectors as well as legislation governing the anti-corruption agency KPK. Although details of their specific aims with respect to these revisions are unclear, the public's interest has not been mentioned.)

Will Jokowi compromise with cabinet?

The political drama of the past month has overshadowed the discourse on Jokowi's cabinet, which he will be announcing over the coming weeks. The president has made clear that key posts like finance, transportation, public works, trade and industry will be allocated to professionals. However, perhaps more importantly within the context of the current political environment is whether Jokowi and PDIP are willing to compromise and provide enough ministerial slots, not only to members of their coalition, but also to members of the KMP (particularly Golkar) to entice them to jump ship and blunt the KMP's momentum.

Golkar will be key to effective Jokowi government

Meanwhile, in the mid-term perhaps the key political event to watch will be Golkar's congress, which will likely be held early next year. If JK can get his man to lead Golkar and have the party join Jokowi's government, this would go a long way to providing the necessary support in the DPR for the president to pursue his reform agenda. (This scenario has played out before in 2004 – SBY faced a dysfunctional and disruptive DPR for the first six months of his first term, right up until JK secured Golkar's chairmanship and brought the party into the government.) If JK fails and, with the KMP functioning as a disruptive force over the next five years, there will be little reason to be confident of an effective Jokowi administration, and little reason to be optimistic about Indonesia's prospects.



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Key Risks

- PDIP fails to secure more political support while KMP continues on aggressive path to block every Jokowi effort to govern, creating major political and policy uncertainty

MARKET OUTLOOK

Economic outlook increasingly dim

The September Alert portrayed an increasingly grim outlook for the Indonesian economy. Nothing has changed. The macroeconomic challenges arising from external factors remain, with a deterioration in global liquidity due to U.S. monetary tightening continuing to drive BI's hawkish stance and eliminating any chance for lower interest rates despite low inflation and slowing economic growth. Meanwhile, China's structural economic downturn continues, pushing down the price of coal and palm oil – which account for around a quarter of Indonesia's export earnings (double the levels before the 2008 global financial crisis) – to levels not seen since 2008. This is driving down local income, negatively impacting consumption and slowing bank deposit growth amid still relatively high credit growth, which in turn is forcing many local banks to hike rates to attract new depositors. This is exacerbating the tight liquidity in the domestic market, significantly curtailing fixed investment growth and further weakening the economy.

Domestic engine losing steam while political uncertainty continues to hit investor confidence

Meanwhile, the prospect of any domestic growth engine to offset these negative factors appears to be increasingly limited. Creating fiscal space for government development spending by biting the bullet on fuel prices and attacking bureaucratic excesses has become a top priority for Jokowi. Nevertheless, the rise of the KMP after initial expectations that many of the major parties would jump ship and back a Jokowi administration has raised significant questions about the potential effectiveness of the new government. The local stock exchange (IDX) plunged 2.7% a day after the KMP's complete takeover of the DPR leadership, the sharpest drop since April. The bourse saw similar declines a week earlier in the days following the KMP's successful attempt to enact legislation abolishing direct local elections. In total, September saw foreign investors pull out more than US\$600 million from Indonesian stocks, the largest outflow since June 2013. The IDX is still up around 17% for the year, but this has largely been based on investor expectations of a smooth political transition. This now looks increasingly unlikely.

Downward spiral to continue

As prominent businessman and acting coordinating minister for economic affairs Chairul Tanjung described the situation recently, the current political dynamics could have a profound effect on entrepreneurs, businesses and ultimately the economy. Unless Jokowi and PDIP can shore up their political support, the KMP's aggressive, disruptive actions will be a major threat to the economy and Indonesia's slow decline over the past 16 months will probably accelerate. .

Key Risks

- Political uncertainties prompt major capital outflows that forces BI to hike rates dramatically, further curbing economic growth

	2012	2013	2014*	2015*
GDP Growth (real)	6.26%	5.78%	5.25%	5.40%
CPI yoy	4.30%	8.38%	5.00%	10.00%
X-rate to US\$, year end	9,670	12,189	12,000	12,500
SBI (one-month), year end	5.75%	7.50%	7.50%	7.75%

Source: *CastleAsia, PT Jasa Cita, Jakarta, Indonesia



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