Navigator

Now, next and how for business

Indonesia report

Indonesia

Resource-heavy exports pay for value-added imports

A healthy global economy should support rising commodity prices and robust trade volumes for Indonesia in 2018. However, sustainable growth over the long term is contingent on the government fulling commitments to boost infrastructure investment, and reduce the cost of doing business. Authorities recognise the importance of reducing trade costs despite choosing not to join the CPTTP, with a number of ongoing initiatives on the table. But a rich supply of natural resources will remain key to driving export growth – both goods and services – over the long term.

Short-Term Snapshot

Indonesia's relatively-closed economy did not reach the lofty heights of many neighbouring markets in 2017 as weak household spending held back overall domestic demand. However, growth should pick up in 2018, underpinned by a more favourable outlook for private consumption, and continued strength in investment spending, as the government commits to resources to improving infrastructure.

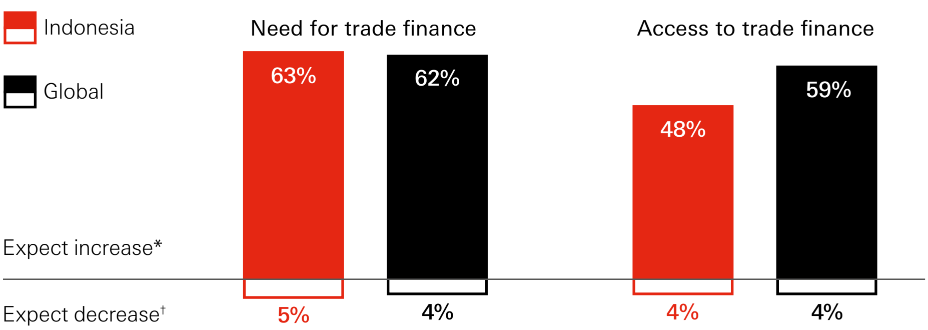
With the global economy expected to sustain solid growth, export growth is expected to remain robust in 2018, with rising commodity prices supporting increased export receipts. According to our survey, this view is shared by Indonesian businesses, with nearly three-quarters of firms expecting trade volumes to rise in 2018, a similar level to the global average.

Alongside being encouraged by the underlying strength of the global economic environment, respondents also view supply-side developments as a key opportunity to increase competitiveness and exports. This includes improvements in both the quality and quantity of labour inputs, quoted as the top two factors driving trade growth this year. As such, firms expect to increase export penetration via improved competitiveness in more developed markets, with Singapore, Malaysia and Japan providing the most opportunity for growth in 2018.

Action points for business

- Supply-side developments are expected to improve export competitiveness in 2018, and firms should be encouraged to not only build on existing relationships, but also expand into new markets.
- Although our survey reports a disconnect between demand and supply of finance, firms should not be discouraged in seeking finance. Healthier bank balance sheets should facilitate stronger credit growth in 2018.

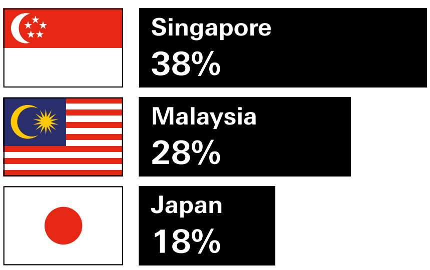
Outlook for trade finance need and access in the next 12 months



*Expect increase = Increase significantly + Increase slightly
†Expect decrease = Decrease significantly + Decrease slightly

Source: TNS Kantar

Which are the top 3 markets where your business will look to expand in the next 3-5 years?



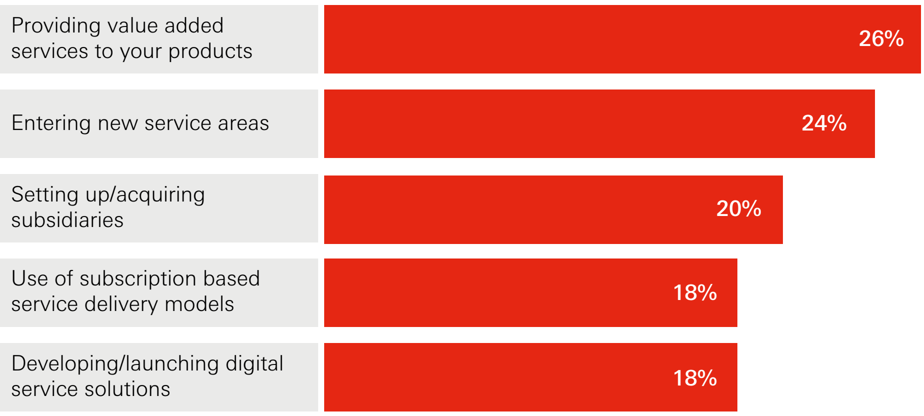
Source: TNS Kantar

Over 60% of businesses expect an increase in the need for trade finance in 2018, again similar to the global average. However, less than half of firms expect an increase in the ability to access finance, highlighting an ongoing concern over relatively weak credit growth in Indonesia. This should however be somewhat mitigated by better monetary policy transmission and improving banking sector balance sheets, with authorities anticipating accelerated credit growth this year.

Indonesian firms expect supply-side developments to boost international competitiveness in 2018.

Services account for just over 10% of total exports, with the travel & tourism accounting for around 50% of total services receipts. Overall, Indonesian firms are optimistic for near term prospects in services growth, with 61% of survey respondents expecting an increase in 2018. This buoyant mood is supported by expectations that major public infrastructure programs will ease bottlenecks in the important tourism sector. The government is aiming to attract over 20 million international tourists by 2020, up from 11.5 million in 2016. However, infrastructure in major hotspots such as the island of Bali is already overstretched, so authorities are looking make improvements to accommodate continued strong growth. In terms of growth strategies, respondents in the sector most commonly identified the addition of value-added services to existing products, as well as entering new markets.

How do you plan to grow your services business?



Source: TNS Kantar

Both businesses and the government agree that improving infrastructure is key to sustaining strong growth in tourism receipts.

Trade Policy Developments

Indonesia is not party to the recent Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) agreement, having expressed a lack of interest following the withdrawal of the US in early 2017. However, the government remains committed to ongoing negotiations of the pan-Asian Regional Comprehensive Economic Partnership (RCEP) deal, and an FTA with Australia is in the final stages of agreement, despite missing a deadline of end-2017 for completion.

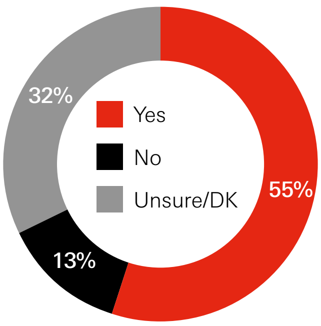
Furthermore, the trade ministry recently outlined plans to initiate negotiations with other potential partners in a bid to support export growth, particularly in the non-oil and gas sectors. Peru, Kenya, Mozambique, South Africa, Morocco and the GCC are all key targets in the near-term. EU plans to ban the use of palm oil in motor fuels by 2021 is a concerning development however, as this will impact a key export commodity and hit rural incomes.

The majority of Indonesian firms believe that governments are becoming more protective of their domestic businesses, according to survey respondents. In turn, increased protectionism is expected to increase the cost of doing business abroad and potentially lead to changes in future trading patterns. On the whole, recent trade initiatives are expected to have a neutral or positive impact on Indonesian firms. Unsurprisingly, ongoing ASEAN integration is viewed with the most optimism in terms of potential over the next few years.

Action points for business

- Businesses should be encouraged by the proactive nature of the governments approach to negotiating trade deals, and be ready to exploit opportunity's that may arise following their conclusion.
- Diversification and flexibility remain key in light of rising global protectionism, to avoid vulnerability to targeted measures such as the recent EU ban on palm oil.

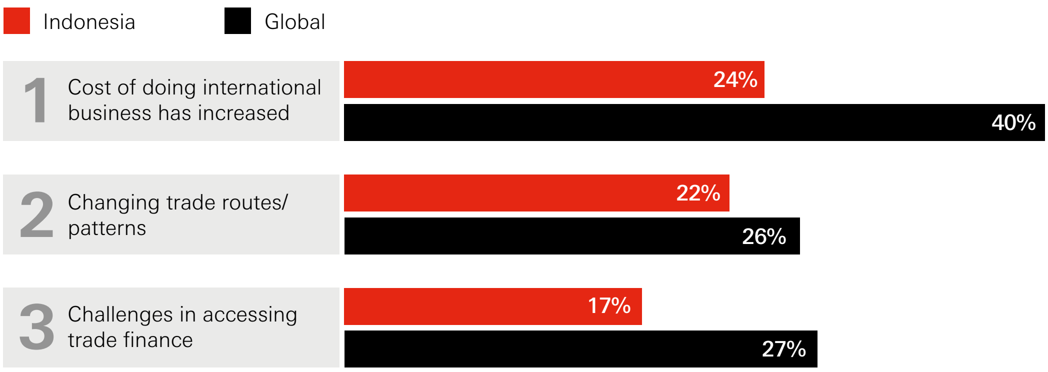
Are governments becoming more protective of their domestic business?



Note: may not total 100% due to rounding

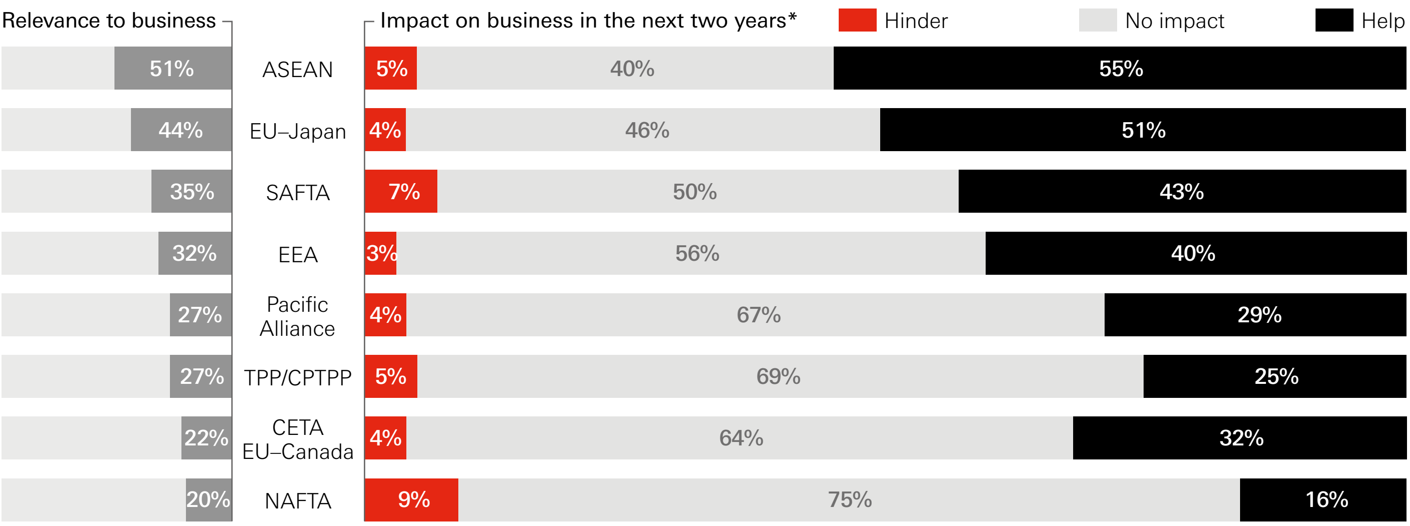
Source: TNS Kantar

Top 3 impacts of protective policies on my business



Source: TNS Kantar

Relevance and impact of trade agreements



Source: TNS Kantar

*May not total 100% due to rounding

Long-Term Outlook for Trade

Although Indonesia is not plugged into the tech cycle that has provided a strong recent stimulus for other economies in the region, the strengthening global economy bodes well more generally for Indonesia and its commodity-heavy export mix. And a rich base of natural resources will continue to drive export growth in the future, even though government initiatives will support growth in higher value-added production in the future. Indonesia is also exploiting a different natural resource base via the large tourism sector, however future growth is contingent on improving infrastructure to accommodate rising visitor arrivals.

Infrastructure is also important as a facilitator of growth in other sectors, including the B2B and other services sector, and therefore represents both an upside and downside risk to the growth forecasts. The government has ambitious plans in this respect, but with a reliance on private funding, given constraints over public expenditure. To date progress has been patchy, but there are a number of projects in the pipeline, and authorities have had some success in attracting Chinese finance to support investment.

Rich natural resource base will continue to drive export growth in the future
Indonesia is a large commodity exporter, benefitting from a rich natural resource base of minerals and fuels including coal, crude oil and copper. Furthermore, agriculture plays an important role in exports. Indonesia is one of the world's largest players in both palm oil and natural rubber production for example. As such, the two most important sectors – animal & vegetable oils and other minerals fuels – are expected to remain vital in driving export growth in the future. In the decade 2021-2030, these two sectors are expected to contribute nearly one-third of total export growth alone.

Authorities are trying to encourage more diversification and increased value-added production and exports however. This includes measures to support the automotive industry and specifically the production of 'low-cost green cars', while a well-publicised mineral export ban was implemented in 2014, with the aim of encouraging investment in higher value-added processing facilities (the ban was later relaxed in 2017).

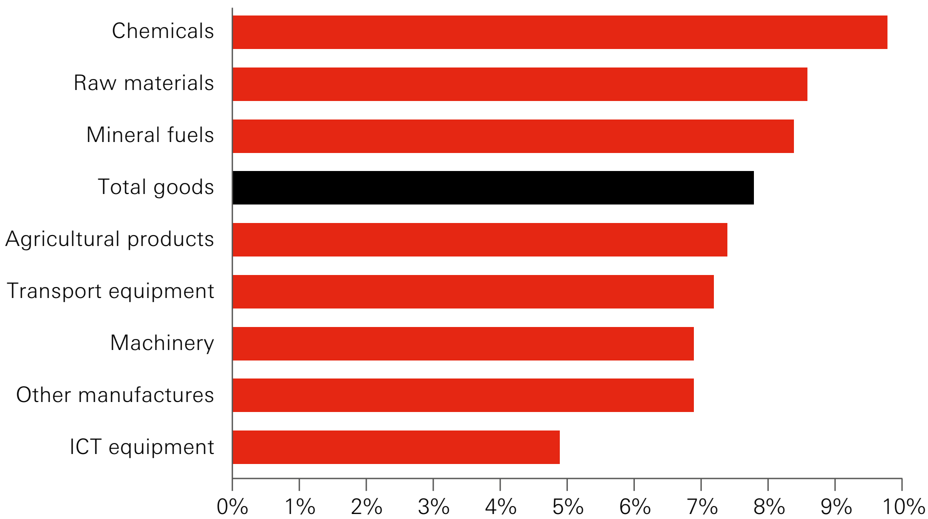
The government is simultaneously trying to improve the environment for businesses and encourage greater FDI. However, such measures have had little impact, and will take time to materialise. And in the meantime, growth in manufacturing, ICT equipment and machinery are all expected to lag aggregate export growth over the long term.

Action points for business

- While natural resources remain fundamental to future export growth, a move up the value chain is important to ensure ongoing economic development in Indonesia, and government investment should be match with business investment in product and/or process upgrades.
- Businesses should continue to help the government identify infrastructure priorities – both in terms of traditional investments in transport, as well as ICT and connectivity.

Despite attempts from authorities, Indonesia's exports are dominated by low value-added mining and production activities.

Exports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist destinations of goods exports

Rank	2016	2030
1	China	China
2	USA	India
3	Japan	USA
4	Singapore	Japan
5	India	Singapore

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Indonesia's export destinations are shaped by its reliance on natural resources and raw materials. The fastest-growing export markets are dominated by resource hungry emerging markets, including China and India, which are expected to be the largest export destinations by 2030, as well as Vietnam, the fastest growing export market over the long term. The US will also remain an important destination for Indonesian exports, particularly in clothing & apparel, despite the US withdrawal from the Trans-Pacific Partnership (TPP).

Other developed markets with a lack of natural resources will continue to be an important source of demand, including Singapore, Japan and Hong Kong. And in the case of Singapore – as well as Malaysia – petroleum products are exported from Indonesia for processing and onward shipment, a process that authorities would like to internalise in the future.

Infrastructure spending is expected to shape import demand, with industrial machinery dominating Indonesia's import mix.

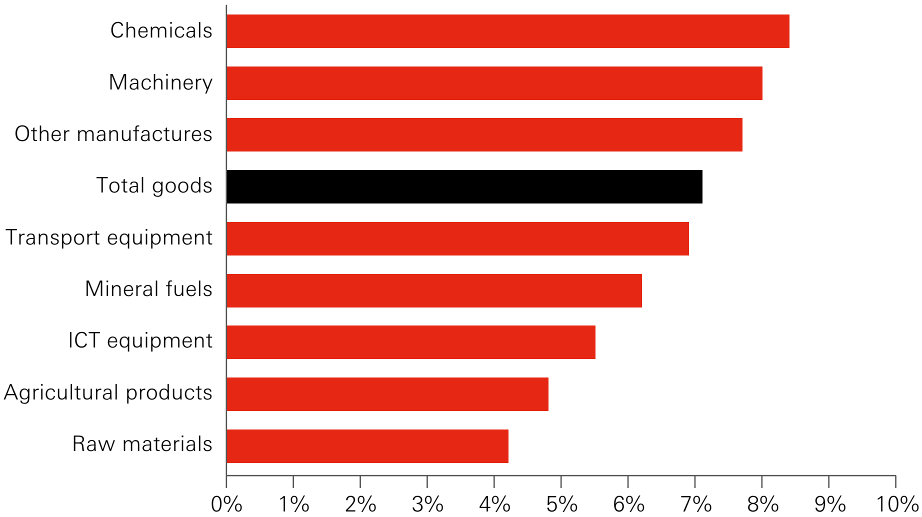
Infrastructure spending driving import growth

Despite modest beginnings, the incumbent government remains committed to boosting infrastructure spending in Indonesia. And there is plenty of scope for improvement, with the World Bank estimating that the infrastructure deficit stands at around $1.5 trillion compared with other emerging economies.

With many projects in the pipeline and expected to kick off in 2018-19, infrastructure spending is likely to shape import demand over the long term. Industrial machinery, the largest import sector, is anticipated to contribute nearly one-quarter of total growth in imports in 2017-2030.

Elsewhere, Indonesia will continue to import higher value-added goods from abroad to compensate for a lack of domestic production. This includes refined petroleum products, chemicals, transport equipment, ICT equipment and other manufactured goods.

Imports of goods by sector, 2017-30 (average annual growth)



Source: Oxford Economics

Top 5 Hotlist origins of goods imports

Rank	2016	2030
1	China	China
2	Singapore	Singapore
3	Japan	Japan
4	Malaysia	Malaysia
5	Korea	Korea

Note: Ranking among the 24 trade partners covered in the forecast

Source: Oxford Economics

Indonesia's demand for high value-added imports is reflected in the list of their most important import origins, both now and in the future. China and Singapore are expected to retain first and second place respectively by 2030, while Japan and Korea's presence reflect the importance of the industrial machinery and transport equipment sectors in import demand. Furthermore, countries such as the US, Canada and France all appear in the list of fastest growing import markets in the decade 2021-2030.

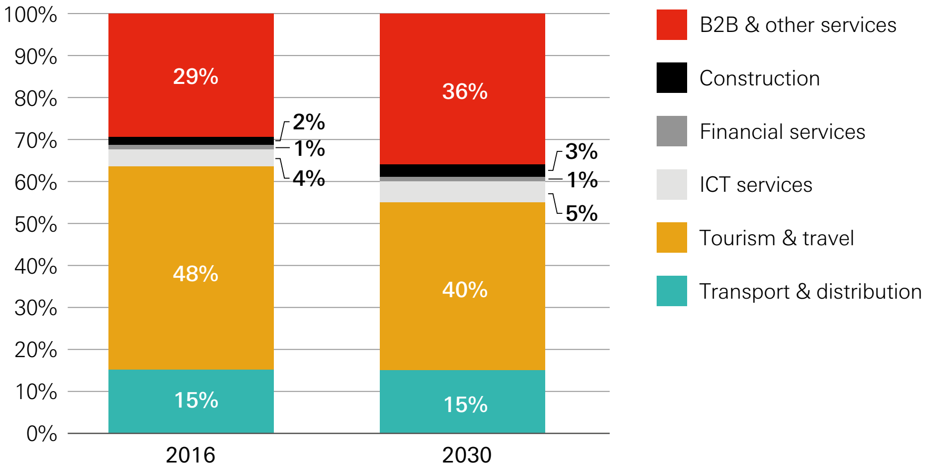
Infrastructure upgrades to boost competitiveness of tourism and B2B service exports

The story of Indonesia's service sector is one of unrealised potential, held back by poor infrastructure and overly-restrictive regulations. The exception is the travel & tourism sector, where Indonesia's reputation as a world class tourist destination has endured, leading to a rapid rise in visitor arrivals, particularly from China. However, here too infrastructure is becoming a problem, as highlighted by concerns of the sustainability of the Bali amid a rapid rise in visitor numbers. Nevertheless, tourism is expected to remain the most important export sector by 2030, contributing as much as 38% in total services export growth in 2021-2030.

Elsewhere, the outlook for services exports is encouraging. Major investments in ICT and related infrastructure, as well as continued efforts to reduce the cost of doing business in Indonesia, should boost the attractiveness of Indonesia as a destination for B2B and other services such as business process outsourcing, and help domestic firms compete with the likes of India and the Philippines in this area. Indonesia's large domestic market and a rich pool of skilled urban labour provides a solid base from which to grow, with over one-third of services export growth expected to come from the B2B and other services sector in the decade 2021-2030.

B2B services represents a significant opportunity for growth if improvements can be realised in ICT and related infrastructure.

Sectoral shares in total services exports



Source: Oxford Economics

Top 5 Hotlist destinations of services exports

Rank	2016	2030
1	Australia	China
2	Japan	Australia
3	Singapore	Singapore
4	China	Malaysia
5	Malaysia	Japan

Note: Ranking among the 23 trade partners covered in the forecast

Source: Oxford Economics

Indonesia's largest export destinations for services are dominated by regional markets, and particularly the major tourism markets. China, Australia, Singapore and Malaysia accounted for more than half of all visitor arrivals in 2016, and a combination of geographical proximity and China's burgeoning middle class is likely to ensure these markets continue to grow in the long term. Elsewhere India, one of the fastest growing export market for goods, is the fastest growing market for services over 2017-2030. This indicates the significant opportunity in expanding ties with firms in India.

About the HSBC Navigator

The HSBC Navigator presents a blend of survey evidence, policy analysis, and economic modelling to generate unique and timely insights into the changing landscape for global trade.

The business survey is a quantitative indicator of the short-term outlook for global trade. The survey, which is the largest of its kind, is conducted on behalf of HSBC by Kantar TNS. It is compiled from responses by decision-makers at over 6,000 businesses – from small and mid-market to large corporations – across a broad range of industry sectors in 26 markets. Interviewees were polled on a range of questions including expectations around future growth in trade, trade finance needs, attitudes toward trade policy developments and strategic business plans.

The survey represents a timely source of information on the fast-evolving trade environment. And it can provide a useful contextual setting for interpreting developments in official data. In this way, economists at Oxford Economics are able to blend insights from the survey with their own analysis and modelling of developments in trade.

Oxford Economics has tailored a unique service for HSBC which forecasts bilateral trade in goods and services, in part based on HSBC's own analysis and forecasts of the world economy. A top-down approach is employed, with Oxford Economics' suite of models used to ensure consistency between HSBC's forecasts for economic growth and exchange rates in key countries and the more granular projections for bilateral trade flows presented here.

Oxford Economics employs a global modelling framework, with headline bilateral trade forecasts constructed as a function of demand in the destination market and the exporter's competitiveness (as measured by unit labour costs in nominal USD terms). Exports, imports and trade balances are identified, with both historical estimates and forecasts for the periods 2017-20 and 2021-30.

These headline bilateral trade forecasts for goods and services are also disaggregated by sector, using Oxford Economics' Industry forecasts to inform future production trends and taking into account the historic relationship between output and exports in each sector, by market:

- For trade in goods, sectors are classified according to the UN's Standard International Trade Classifications (SITC) system at the two-digit level and grouped into 30 sector headings.
- For trade in services, we identify five broad sectors: B2B and other services, tourism & travel, transport & distribution, financial services, ICT services and construction.

Drawing on the Kantar TNS survey results and Oxford Economics' long-term forecasts, Oxford Economics produces in consultation with HSBC a global report and specific reports on the following 23 markets: Argentina, Australia, Bangladesh, Canada, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Japan, Malaysia, Mexico, Poland, Saudi Arabia, Singapore, Turkey, UAE, UK, USA and Vietnam. The analysis of trade in goods also includes trade with Brazil and Korea for a total sample of 25 key trading markets; for trade in services the analysis also includes Korea for a total sample of 24 key trading markets.

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