

# INDONESIA – WAITING FOR THE BOOM?

Ewan Markson-Brown, Investment Manager. First Quarter 2018.



Investors should carefully consider the objectives, risks, charges and expenses of the fund before investing. This information and other information about the Fund can be found in the prospectus and summary prospectus. For a prospectus or summary prospectus please visit our website at <https://usmutualfund.bailliegifford.com>. Please carefully read the Fund's prospectus and related documents before investing. Securities are offered through Baillie Gifford Funds Services LLC, an affiliate of Baillie Gifford Overseas Limited and a member of FINRA.

## RISK FACTORS

This article contains information on investments which does not constitute independent research. Accordingly, it is not subject to the protections afforded to independent research and Baillie Gifford and its staff may have dealt in the investments concerned.

Any stock examples, or images, used in this article are not intended to represent recommendations to buy or sell, neither is it implied that they will prove profitable in the future. It is not known whether they will feature in any future portfolio produced by us. Any individual examples will represent only a small part of the overall portfolio and are inserted purely to help illustrate our investment style.

As with all mutual funds, the value of an investment in the fund could decline, so you could lose money. International investing involves special risks, which include changes in currency rates, foreign taxation and differences in auditing standards and securities regulations, political uncertainty and greater volatility. These risks are even greater when investing in emerging markets. Security prices in emerging markets can be significantly more volatile than in the more developed nations of the world, reflecting the greater uncertainties of investing in less established markets and economies.

Currency risk includes the risk that the foreign currencies in which a fund's investments are traded, in which a fund receives income, or in which a fund has taken a position, will decline in value relative to the U.S. dollar. Hedging against a decline in the value of currency does not eliminate fluctuations in the prices of portfolio securities or prevent losses if the prices of such securities decline. In addition, hedging a foreign currency can have a negative effect on performance if the U.S. dollar declines in value relative to that currency, or if the currency hedging is otherwise ineffective.

For more information about these and other risks of an investment in our mutual funds, see "Principal Investment Risks" and "Additional Investment Strategies" in the relevant prospectus.

The undernoted table shows which examples from this paper were held by Baillie Gifford at 31 January 2019.

Company	Baillie Gifford Share Holding in Company
SEA Ltd ADR	2.20%
PT Vale Indonesia	1.39%

The funds are distributed by Baillie Gifford Funds Services LLC. Baillie Gifford Funds Services LLC is registered as a broker-dealer with the SEC, a member of FINRA and is an affiliate of Baillie Gifford Overseas Limited.

*Fishing boats and the illuminated Suramadu (Surabaya - Madura) bridge at dusk.*

---

## **EWAN MARKSON- BROWN**

### ***Investment Manager***

---

Ewan has co-managed the Pacific Fund since May 2014 and has managed Pacific Horizon Investment Trust PLC since March 2014. He is an Investment Manager in the Emerging Markets Equity Team. Prior to joining Baillie Gifford in 2013, he was a Senior Vice President in Emerging Markets at PIMCO. Ewan previously worked at Newton for five years most recently as lead portfolio manager on an Asia Pacific equity strategy, as well as segregated Asian income and Japanese equity strategies. He also previously worked for Merrill Lynch Investment Managers as a portfolio manager in the Asia-Pacific region for six years. Ewan graduated MA in Politics, Philosophy and Economics from Oxford University in 2000.





---

# INDONESIA – WAITING FOR THE BOOM?

---

BY EWAN MARKSON-BROWN





*The potential for Indonesia to be one of the better-performing economies and markets in the next decade is growing.*

*If President Jokowi wins again in the 2019 election, a growth and anti-corruption agenda could spark change.*

*Technology may weaken the control of vested interests, breaking barriers to entry, lowering prices and creating jobs.*

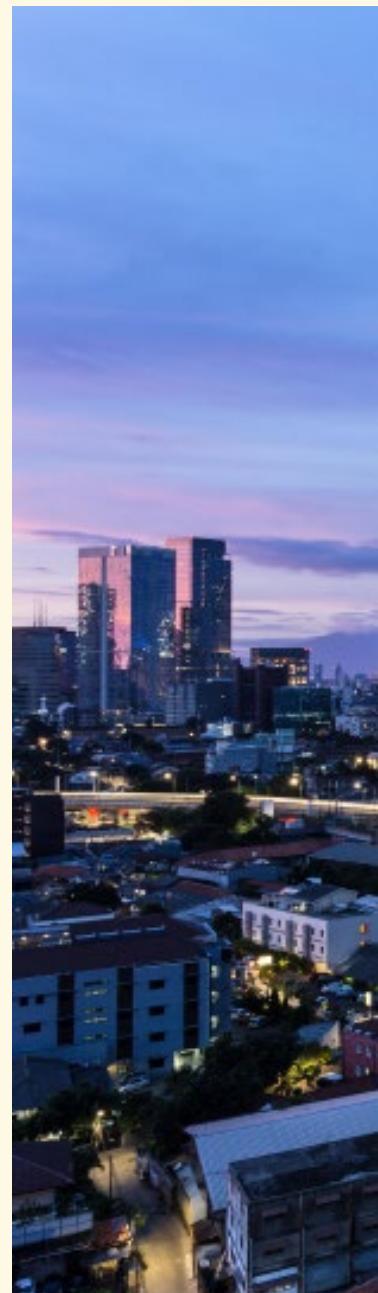
*The lapsing of negative short-term cyclical impacts (cuts to fuel and electricity subsidies, tax amnesty and falling commodity markets) suggests an economic rebound in 2019.*

This was my third trip to Indonesia. The last was in 2005 and back then I left feeling that, for various reasons, as a long-term stock picker the country was a dangerous arena for foreign investors. Indonesia suffered, and still does, from the hallmarks of a failing democracy; a model rentier society driven by policy paralysis and embedded competitive corruption at all levels of the state. It seemed to me back then that vested interests ensured that the currency was to be devalued, debt was to be defaulted and equity was an avenue to monetise assets for vested interests. Still, it was trading around with a commodity boom ahead, so there was money to be made.

The Jakarta skyline is different now; a few more glass buildings dot the urban sprawl. At the ageing airport, the ‘Visa on Arrival’ counter used by immigration officials to extract additional payments from tourists has gone. However, unlike elsewhere in ASEAN, there is no airport express or MRT (mass rapid transit). The 30 kilometres to the city centre still take one-and-a-half hours on weekdays. There has been less infrastructure change in Jakarta over the past 20 years than in any other Asian economy; 10% annual car growth over the last few years has been matched with 0.2% road building. Something, however, is changing. Many new projects are under construction, driven by the current government. They are scheduled to complete by 2018/19 and, despite my initial scepticism, most people on the ground think this will be achieved. Anecdotes suggest that, historically, road building plans would

be fully funded at the outset, 30% of the funds would then be taken by vested interests, leaving the project short of funding and unfinished waiting for the next government to bankroll it again. Hence the unwillingness of the private sector or the banks to fund and build infrastructure.

Jakarta is not an international city. For many, Indonesia has not been welcoming to either foreigners or, surprisingly, their money (at least not in the sense that it will be allowed to make a return). There are fewer foreign expatriate licenses now than in 1983 and a recent ruling trying to tax foreigners on all their worldwide income, an excuse for a shake-down, is unlikely to help the situation. The Chinese, however, are coming. Unlike western companies, they seem to be able to ‘play the game’. A smelter is being built with Chinese materials and labour (which I’m told is illegal). Country Garden, a Chinese property developer, is constructing apartments at twice the speed of competitors, despite denials surrounding the use of Chinese labour. Rumours suggest that the Chinese are being treated preferentially over Westerners. Freeport-McMoRan was concerned it would not be granted an extension to its copper licence expiring in 2023, despite demands by the government to undertake significant investments. Vale built a nickel smelter on the government’s orders, local peers dragged their feet on their own investment and the export ban on nickel ore was rescinded.





*The Jakarta skyline is different now;  
a few more glass buildings dot the urban sprawl.*



---

## THE RISE OF JOKO WIDODO

---

Megawati Sukarnoputri, the leader of the Indonesian Democratic Party of Struggle (PDI-P) and daughter of the founding president of Indonesia, having twice failed to win the presidential nomination due to perceived unpopularity, approached Joko Widodo (also known as ‘Jokowi’), the mayor of a small provincial town, who had achieved significant success in infrastructure building and reducing corruption, to stand for mayor of Jakarta (a position he was to hold from 2012 to 2014). In 2014, he was elected president of Indonesia, becoming the first non-military or political ‘outsider’ elected to the post.

It is assumed that Megawati had hoped that Jokowi would be her puppet. However, his anti-corruption stance led to the PDI-P withdrawing its support and Megawati openly trying to undermine him. This led to the president not having the full support of any major party within the government. The recent imprisoning of the ex-mayor of Jakarta, a former running mate and friend of Jokowi, on blasphemy grounds (he is Chinese and Christian), was seemingly driven to undermine Jokowi and indicates that the president’s influence is still constrained (seemingly, religion in Indonesia is increasingly being used as a political tool).

So far, Jokowi has instigated \$22 billion of spending on infrastructure programmes, including a restarted light rail transport and MRT system for Jakarta and numerous toll roads across the country. According to Bank Negara, its infrastructure book is on schedule to complete in 2018/19. However, Jokowi has been hampered in his efforts by a political system not willing to forego its traditional emoluments.



© Bloomberg/Getty Images

On my trip, there was overwhelming support and expectation that Jokowi would win the 2019 presidential election, but he has lost the support of the PDI-P and cannot run unless he has a party backing him. With the nomination of Jusuf Kalla as vice president, Golkar (his political party) is the obvious choice. However, the current Golkar party chairman, Novanto, is being investigated for tax fraud, potentially leaving an opening for a pro-Jokowi supporter to take the helm. The recent appointment of Air Chief Marshall Hadi Tjahjanto as the new armed forces commander – he is both a Jokowi loyalist and a religious moderate, as is the president – is a strong positive sign. Although politics here is uncertain, at October 2017, Jokowi’s poll numbers show 60% support versus his rival, Prabowo Subianto, in a head-to-head, and a 76% approval rating.





*Joko Widodo, attends the Bloomberg Year Ahead Asia Conference in Jakarta*

Jokowi is not a strongman reformer, unlike Modi in India, and he also does not seem to be an idealist. He does, however, have a strong track record of building infrastructure, popularity, pragmatism and a can-do approach, coupled with a clean image and no family patronage. This makes it possible that a strong showing in 2019 could usher in a period of strong reforms and growth for the country.

Furthermore, the potential impact of technological change should not be forgotten. Indonesia has only partly participated in the global disinflationary boom. As evidenced by other emerging countries in recent years, the potential for technology to replicate or bypass infrastructure bottlenecks, vested interests and create wealth amongst the larger population is extremely high. For interest, since 2016, \$2.8 billion was raised in just four transactions by Indonesian technology private equity companies.

Grab, Uber and Go-Jek (motorbike transportation and delivery) have already revolutionised the transportation market in the country; Go-Jek itself has created 900,000 new jobs. E-commerce is pushing down consumer prices, giving access to a wider population and creating new small businesses. In addition, electronic wallets will challenge incumbent banks' dominance and margins.

Baillie Gifford has invested in Sea Limited, which runs Shopee, a leading third-party online marketplace in South-East Asia. The platform has grown rapidly since its launch in 2015 and its gross merchandise value reached \$1.1 billion at the end of 2017. Its Indonesian arm, where e-commerce penetration is only 0.4% versus 3.5% in the US or 3.1% in Taiwan, operates in a market worth \$3.6 billion today.

Shopee is allowing small businesses like to flourish by connecting them to willing consumers who have not been serviced by the existing infrastructure. The growth of online marketplaces like Shopee is creating demand from areas which traditionally had no access to these products or services, or where the cost of getting them was too high.







A high-angle photograph of a busy street in Indonesia. On the left, a large pile of trash, including plastic bags and cardboard boxes, is piled up on the side of the road. A yellow motorcycle is parked near the trash. In the foreground, a person wearing a blue helmet and a dark jacket is riding a black motorcycle. The street is lined with colorful umbrellas and awnings, and there are people walking and riding motorcycles in the background. A large tree is on the right side of the street.

# CONCLUSION

*I went to Indonesia sceptical about a country whose dollar GDP per capita has fallen since 2010 and is now close to half that of Thailand, and a stock market which in dollar terms has gone sideways for seven years. However, I feel that there is a possibility that Indonesia may emerge in the next few years as one of the most exciting growth stories globally. To achieve this, the stars have to align. An infrastructure and technology led disinflationary boom would create jobs and increase disposable incomes dramatically for a very young and growing population, a scenario not dissimilar to India in early 2013.*



# **CURIOUS ABOUT THE WORLD**

**[bailliegifford.com/thinking](http://bailliegifford.com/thinking)**

**Principal Office: Calton Square, 1 Greenside Row, Edinburgh EH1 3AN  
Telephone +44 (0)131 275 2000 / [www.bailliegifford.com](http://www.bailliegifford.com)**

**780 Third Avenue, 47th Floor, New York, NY 10017  
Telephone +1 (212) 319 4633 / [www.bailliegifford.com](http://www.bailliegifford.com)**