Indonesian economy faces continuing economic turbulence

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On Wednesday, the US Federal Reserve announced that its “quantitative easing” (QE) policy of pumping $US85 billion a month into financial markets would continue. The decision was greeted with sighs of relief among the South East Asian finance ministers gathered at the Asia Pacific Economic Cooperation (APEC) meeting in Bali, Indonesia.

No national delegation was more pleased than that of the host country Indonesia, where the expectation that the Fed would begin “tapering” its quantitative easing has hit the currency, shares and financial markets. On Wednesday’s news, the Jakarta stock exchange rose almost 5 percent and the embattled rupiah gained 4 percent.

The QE decision was unexpected. On May 22, when Fed chief Ben Bernanke hinted that tapering would start, Indonesian shares and the rupiah suffered. Indonesia had been a significant recipient of short term capital inflows spurred by the QE funds in the US. According to International Monetary Fund estimates, around $1.1 trillion has flowed into so-called emerging economies.

Indonesia is among the most vulnerable to changes in global capital flows because of its relatively high current account deficit. In the June quarter, the deficit was 4.4 percent of gross domestic product. In July, its trade deficit reached $2.3 billion. Net oil imports contributed to 83 percent of the deficit. The inflow of funds generated by the QE policy covered Indonesia’s trade deficit and the interest on its foreign borrowing.

However, Bernanke’s hint in May sent capital flying out of Indonesia. Since July, Indonesian foreign currency reserves have fallen by around $20 billion. Morgan Stanley has identified Indonesia, along with Brazil, India, Turkey and South Africa, as the “fragile five” with a common dependence on large capital inflows to cover high current account deficits.

Since May, the Indonesian stock market has been hit by a large outflow of portfolio investment that wiped out big gains made in the previous five months. In the month from July to August, share values fell 11.6 percent.

The decline of the rupiah only compounded the capital outflow, at the same time fuelling inflation that is already running nearly 9 percent. The falling rupiah also puts further pressure on the current account deficit that has developed since 2012—a product of declining international demand and lower commodity prices.

Indonesia has benefited from large direct foreign investment inflows, with this realised investment hitting a record of $32.4 billion on 2012. However, the government of President Susilo Bambang Yudhoyono has predicted a fall in foreign investment, pointing to a decline in capital-goods imports in the last quarter by 16.3 percent year-on-year.

The Bank of Indonesia has been forced to defend the rupiah. The currency has declined 18 percent against the US dollar since May. Its fall in the June quarter was the worst of the 24 emerging markets, and nearly seven times that of the Philippines peso.

On September 12, the Bank of Indonesia raised its key interest rate by 0.25 percent to 7.25 percent. This was the highest level since 2009, and marked the fourth increase this year. The central bank had previously lifted the rate by 0.5 percent just a fortnight ago. In its statement, the bank also revised estimated gross domestic product growth for the year down from 5.8 to 6.2 percent, to the range of 5.5 to 5.0 percent.

Only a year ago, Indonesia was touted in the international financial press and among investment fund managers as an example of how emerging economies would counteract economic stagnation in

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Europe and the US and the developing slowdown in China. The main factor, however, was the large inflow of speculative, short-term funds.

From 2000 to 2012, according to a *Bloomberg* report published in the *Jakarta Globe* on September 11, the emerging economies grew at an annual rate of 5.9 percent, compared with 1.8 percent for the US. Speculative capital also helped keep commodity prices high until 2012.

The *Bloomberg* report noted: “This led many people to declare the victory of the emerging economies over the West. But the high levels of emerging market growth were artificial, caused by the global capital boom … and then huge credit transfers from the West.”

This week’s Fed decision is not an indication of the strength of the US economy and financial system. The opposite is the case. Wall Street is addicted to the infusion of Fed funds to maintain an orgy of speculation and paper profits that can only be realised by driving up the rate of exploitation of the working class.

Finance ministers at this week’s APEC meeting signalled their own onslaught on the working class. South Korean finance minister Hyun Oh-seok told the meeting that major structural reforms were needed in emerging economies to prepare for future Fed action. Former Indonesian Finance Minister Sri Mulyani Indrawati declared: “We at least know how the market will react (to tapering if that happens)... so they can have six months to prepare.”

On Friday, Bank of Indonesia governor Agus Martowardojo warned that Indonesia must prepare. “We must be able to use the time frame provided by the Fed’s tapering delay to conduct structural reforms of monetary and fiscal aspects,” he said. One of the areas for “reform” he targeted was labour costs. The central banker’s comments foreshadow further deep inroads into the living standards of working people, with cuts to real wages and food subsidies in particular.

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