

Indonesian President Widodo under pressure as economy slides

John Roberts
29 July 2015

Indonesian President Joko Widodo is facing increasing calls to reshuffle his cabinet as the country's economy slows amid falling investment, declining Chinese demand for resources and other global pressures.

Despite calls from Indonesian business circles and within his own governing coalition, as well the international financial press, Widodo has still not announced promised cabinet changes. Big business is demanding an economic team not tied to the country's oligarchic political parties and better able to serve its interests.

When Widodo was elected last October, the international media lauded his supposed independence from the traditional political establishment and his promises of pro-business economic "reforms" and multi-billion spending on Indonesia's economic infrastructure. The poor quality of roads, ports and high internal transportation costs has hindered exploitation of the country's cheap labour and natural resources by foreign and domestic capital.

Widodo's promises, however, have not been implemented. Apart from his abolition of the fuel subsidy, Widodo has not met business expectations. The government has only spent 8 percent of its \$21.8 billion infrastructure budget in the first half of the year; Bank Indonesia has announced that it will prohibit foreign currencies from being used in domestic transactions; and no major changes have been made to the Negative Investment List which denotes economic sectors where foreign investment is banned or severely restricted.

An op-ed comment last month in the *Wall Street Journal* entitled "Indonesia's Presidency Needs a Reboot" bluntly declared that Widodo's administration was "turning out to be a tale of misplaced

expectations." The president, it said, should "submit to demands for a cabinet shuffle" in order to regain "the confidence of investors needed to keep the Indonesian economy on a steadier footing." Early this month, the *Diplomat*, a US-based journal, said the Indonesian government had a "rudderless economic policy."

The Indonesian Democratic Party-Struggle (PDI-P) of former President Megawati Sukarnoputri, which backed Widodo, still continues to exercise power over the cabinet. A section of the divided Golkar Party, the political instrument of the Suharto dictatorship until its collapse in 1998, has also shifted its support from the parliamentary opposition led by Prabowo Subianto, and could enter Widodo's administration. This is raising further concerns in business circles that cabinet posts might go to Golkar which will favour its cronies.

Widodo's administration has also been publicly criticised by a senior minister. State-Owned Enterprises Minister Rini Soemarno, a close confidant of Megawati and former trade and industry minister in her administration, publicly declared recently that Widodo "knows nothing" about economics.

Driving this conflict is Indonesia's deteriorating economic position.

In the first six months of this year, Gross Domestic Product growth slowed to 4.9 percent, down from 5.3 percent in the first six months of 2014. The World Bank and the International Monetary Fund have lowered Indonesian growth forecasts for 2015 to 4.7 percent, down from 5 percent in 2014. The lower forecast follows similar downward revisions by various international investment banks.

The current account deficit, which is hovering at around two to three percent of GDP, a position that has persisted since 2011, is also a concern for investors and Bank Indonesia.

International prices for commodities, which make up two-thirds of exports and provided 21 percent of fiscal revenues in 2014, are in sharp decline, due in part to falling Chinese demand, recent increases in the US dollar and possible increases in US interest rates later this year. Commodities are often priced in US dollars, the higher dollar making these more expensive for foreign buyers.

Indonesia's trade balance has remained in surplus, primarily because of the slowing economy and lower imports. In June Indonesia exported goods worth \$US13.4 billion, 13 percent down on a year ago. However, imports for the month dropped 17 percent to \$12.9 billion.

China is now Indonesia's largest single export market, taking 11 percent of exports. Coal and crude palm oil make up the largest part and Indonesia is China's biggest supplier of rubber. In 2014, overall exports to China fell 22.5 percent and in the first quarter this year fell by 34 percent.

The change on coal exports is dramatic. In 2010, coal exports to Indonesia rose by 92 percent and in the following year China surpassed Japan as the biggest importer of Indonesian coal. In 2013, however, coal exports to China only increased by 12 percent and since then have quickly fallen. In the past year China's global coal imports declined by 37 percent with imports of Indonesian coal down by 64.9 percent in February, compared to the same month in 2014.

Underlining the fragility of the economy is the weakness of the rupiah, which in the past week reached 13,500 to the US dollar. Bank Indonesia has maintained a high benchmark interest rate of 7.5 percent to defend the currency and on July 1 activated a law forbidding transactions inside Indonesia using foreign currencies. Until then such transactions were running at \$US73 billion a year because large investors do not want to hold large sums valued in the weakening and volatile rupiah.

High interest rates have fuelled increased investment flows during the last year, aided by investor speculation related to the commencement of the Association of South East Asian Nations integrated economic community scheduled for later this year.

If the rupiah continues to decline, however, this could create a debt crisis and major capital outflows. All eyes will be on US interest rates and any movement by the

US Federal Reserve. A collapse of the value of the rupiah will undermine government plans to borrow \$38 billion over the next five years to part-finance its infrastructure program.

Indonesian think tank Indonesian Public Institute analyst Karyono Wibowo recently warned that if the rupiah hit 15,000 to the US dollar a meltdown on the scale of the 1998 Asian financial crisis was possible.

Job shedding has already begun amid signs of declining domestic consumption, with tens of thousands of footwear and textile manufacturing workers sacked in May. About 40,000 footwear jobs were eliminated in Tangerang, Bandung and Surabaya and at least 6,300 textile jobs.

The Indonesian Footwear Association said sales had dropped by nearly 50 percent in the first quarter of 2015, due to falling domestic demand, with "no signs of recovery" in the coming months.

Indonesian Textile Association chief Ade Sudrajat said sales had slumped by more than 40 percent in the January–April 2015, compared to the same period in 2014. "We are really shocked by this situation. Our warehouses are full because we cannot sell," he said.

Whatever the future make-up of Widodo's cabinet, his government is on a political collision course with the Indonesian working class.



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