

Global index provider threatens to cut Indonesia off from international investment

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The Indonesian stock market has been put on notice by the Morgan Stanley Capital Investment (MSCI) index that it could be virtually excluded from the international flow of investment finance unless it complies with its demands.

Last January the MSCI warned it could shift the designation of Indonesia from “emerging” market to “frontier” status because of what it considered to be major problems with the operation of the stock market which has enabled big companies and their owners, a tight-knit group of oligarchs, to manipulate it to enrich themselves.

That announcement sent a shock through the market because such a designation would cause billions of dollars to leave the country particularly because of withdrawals by passive investment funds which use index designations as a guide to where they direct their money. Such an outflow would produce major economic turbulence if not a financial crisis,

Earlier this month the MSCI upped the ante. It issued a warning that unless what it considered to be major problems were rectified by next June Indonesia could be removed from the index altogether, sending it to “standalone” status along with Argentina, Ukraine, Zimbabwe and others considered to be “uninvestible.”

This would be a major move because Indonesia is the world’s fourth largest country by population and ranks number 17 in terms of GDP and is the largest economy in south-east Asia. After the January warning Indonesian authorities said they were taking measures to address the concerns. But in the latest decision, the MSCI said reduction to “frontier” status would not address the depth of the problems.

“Sufficient progress has not been observed consistently across the Indonesian equity market,” it said. “Significant concerns remain around market

dysfunction, including continued suspected coordinated trading behaviour and lack of evidence of meaningful enforcement.”

The major issue is what are known as “deep-fried” stocks. These are thinly traded shares with heavily concentrated ownership in the hands of some of the country’s richest men who can engage in “pump-and-dump” schemes—inflating the price of a stock to realise major gains at the expense of investors who have been drawn in.

The threat of a reduction to “standalone” status resulted in the biggest fall in the Indonesian stock market since the so-called Asian crisis of 1998 when it plunged by 12 percent, triggering a 30-minute trading halt. So far this year the Indonesian market has dropped by 40 percent to place it in the ranks of the world’s worst performers.

It is estimated that international investors have withdrawn around \$5 billion so far this year. The Indonesian rupiah, which is Asia’s worst performing currency for 2026, also fell further taking its decline against the US dollar to 8 percent.

In response to the MSCI warning the Indonesian Financial Services Authority said it was “carefully reviewing and paying serious attention to MSCI’s assessments.”

Last week the Indonesian stock exchange said it would expel companies from the Jakarta Composite Index that had a tightly concentrated ownership structure following a meeting with MSCI officials. The removed companies make up about around one-fifth of the index’s combined market value.

They include Dian Swastatika Sentosa, a major energy and technology holding company and Barito Renewables Energy, two of the biggest firms by market value. Both companies said they respected the decision

and would seek to create a stronger investment climate in Indonesia. They will still be able to be traded but their price movements will not affect the Jakarta Composite Index.

An investigation into the lack of freely available shares in Barito Renewables found that 97 percent of shares were held by entities connected to the dominant shareholder.

The *Financial Times* (FT) reported that “Indonesia’s regulator said it had imposed fines on traders, underwriters, securities firms and beneficial owners of the two companies ‘who are proven to have violated the provisions of capital market regulations’ during the companies’ initial public offerings.”

But whether such a move will be enough to satisfy the MSCI is another question. According to an economist cited by the FT “removing the stocks from the composite index does not necessarily solve the issue” and the focus should be on reform to make information transparent.

The MSCI move has not been universally welcomed with some traders feeling they were blindsided.

Gary Tan, an emerging markets portfolio investments manager at the US-based firm Allspring Global Investments, told the FT the MSCI statement “came as a surprise” and that “standalone status to us seems a little far-fetched.”

But he went on to point to what well may be the underlying driving force of the decision. “The biggest thing that needs to change is the ownership structure. That’s the biggest bugbear.”

A recent comment by FT journalist Robin Wigglesworth noted the rise of a “new force” in financial markets, which he dubbed the “index vigilantes,” that were “scouring the world for countries behaving badly and threatening to cut off their access to international capital if they don’t shape up.”

The MSCI has framed its move in terms of securing the operation of a free market and protecting smaller investors against the actions of monopolies. That is a fiction.

A 2021 analysis of index providers, cited by Wigglesworth, pointed out: “Rather than a purely technical exercise, constructing indices is inherently political. Which countries are included into an index or excluded ... is based on criteria defined by index providers, thereby setting standards for corporate

governance and investor access.”

The key term here is “investor access.” Indonesia is a country rich in lucrative resources which are dominated by a local oligarchy. It has been estimated that the richest individuals in Indonesia control total wealth equivalent to 20 percent of the country’s GDP and that five tycoons alone control publicly listed companies accounting for 20 percent of the market value of the Indonesian Stock Exchange.

MSCI is not some neutral body laying down global standards. It plays a vital role in the organisation of the flow of funds from the major economies via so-called passive investment tied to indexes. But in Indonesia access to investment opportunities is being blocked by a local oligarchy which it is seeking to break up.

Indonesian president Prabowo Subianto, the foremost representative of the oligarchs, indicated the issues at stake when he declared that Indonesia “will not be intimidated” by the MSCI.



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