

**Research Report July 2019**

# **INDONESIA INVESTMENTS**

**“The Future of Biodiesel”**





# Indonesia Investments Research Report

## *Future of Biodiesel*

July 2019



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## Preface

Indonesia Investments' monthly research report is written and published by Van Der Schaar Investments B.V. - located in Delft, the Netherlands. The report aims to inform the reader of the latest, most relevant political, economic and social developments in Indonesia as well as those key global developments that are impacting on the Indonesian economy or politics.

Our research reports are intended for a wide audience, including both individual and corporate investors, financial market participants, policy makers, journalists, academics, and analysts.

The website Indonesia Investments is the reference and access point for gaining knowledge about Indonesian markets, the economy and cultures. The website is owned by Van Der Schaar Investments B.V., a privately-held investment company (Ltd.) which was established in 2009 but stands in a tradition that stretches back to urban development in the Dutch capital city of Amsterdam in the early 20th century. For information about Indonesia Investments, please visit: [www.indonesia-investments.com](http://www.indonesia-investments.com).



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Lastly, we would like to emphasize that although we strive to present accurate, up-to-date, and objective information to the reader, Indonesia Investments cannot guarantee the accuracy of all data that is included in this report.





## Introduction

With reform-minded Joko Widodo, often called “Jokowi”, in office for another five-year term, we hope to see more structural reforms that will strengthen the Indonesian economy, and turn it into a stronger player on the international scene. During his first term we already witnessed a couple of gutsy decisions that will surely impact positively on the country, albeit some take time before their impact can be felt. Massive infrastructure development, for example, is something that cannot be done overnight. It takes a number of years to build these projects, and it needs some more years to feel the multiplier effect (when various other projects are realized near an infrastructure project, such as property construction, that give rise to more economic activity).

But although we saw several positive developments related to structural reforms in the first term of Widodo (2014-2019), there is plenty left that needs to be done. Indonesia’s economy has been growing at a solid level around 5 percent each year supported by healthy macroeconomic fundamentals, including low public debt and low inflation (by Indonesian standards) as well as a favorable demographic structure (with the country being home to a young and big population). However, recent global economic turmoil has exposed a number of Indonesia’s vulnerabilities.

After commodity prices collapsed from their 2011 peaks, Indonesia’s economic growth slowed considerably before finally starting to accelerate modestly again from 2016 onward. This shows that, in terms of exports, Indonesia is highly dependent on natural resources or commodities (such as palm oil, coal, gas, copper, and rubber). But besides dropping exports in times of low commodity prices, there also seems to exist a major link between subdued commodity prices and non-optimal investment realization in Indonesia. Or, in other words, a major chunk of direct investment realization in Indonesia is related to the nation’s natural resources; when the outlook of specific commodities improves, many new investors arrive while existing investors become eager to spend on business expansion. Anecdotal evidence indeed suggests that rebounding direct investment in Indonesia in Q4-2018 and Q1-2019 is highly related to strongly recovering coal prices in the second half of 2018 (and this surge in coal-related direct investment also led to a jump in imports of capital goods, thereby putting some additional short-term pressures on Indonesia’s trade balance and current account balance).

The crucial task for the Indonesian government now, in the next five years, and beyond, is to reduce Indonesia’s traditional dependence on international commodity prices. Subdued or non-optimal investment realization and exports not only undermine the nation’s competitiveness in the international economy and put the country in jeopardy of falling victim to the middle-income trap but they also make Indonesia too reliant on volatile (short-term) portfolio capital inflows to finance its current account deficit. The country’s current account deficit has been widening in recent years and makes the country a particularly risky option in the eyes of foreign investors in times of global turmoil (thus resulting in heavy capital outflows in times of sudden turmoil).

Although it is important for Indonesia to reduce its dependence on (raw) commodities, it does have opportunities to make more efficient use of its existing commodity assets, specifically by turning them into value-added products that can be exported abroad or consumed domestically.

In this report we highlight the case of biodiesel. Biodiesel can become a real problem-solver for Indonesia in several ways: it is less harmful to the environment, Indonesia has (potentially) ample supplies of fatty acid methyl esters (FAME) made from palm oil (being the world's biggest palm oil grower), while a successful biodiesel program will surely lead to the need for fewer oil and fuel imports (impacting positively on the current account). More domestic consumption of palm oil is also important as there is uncertainty about (future) global palm oil demand.

Moving to a different topic, at the start of August 2019 (when finalizing this July report) we also experienced two matters that are somewhat characteristic of Indonesia. Firstly, on 2 August an earthquake struck not too far from Jakarta that caused quite some panic in the capital city and other parts on the western part of Java. Being located on the Pacific Ring of Fire, while most of its geographical space consists of water, Indonesians have to live with the constant risk of some form of (potentially deadly) natural disaster, such as earthquakes, tsunamis, volcano eruptions and floods. Moreover, the weak state of some of the nation's infrastructure and property in fact increases risks when disasters strike.

Secondly, on Sunday 4 August and Monday 5 August West Java and the Greater Jakarta area experienced the worst blackouts since 1997. On Sunday there was no electricity available from around 11:00 am to 21:00 pm, followed by 'managed blackouts' (because state-owned utilities company Perusahaan Listrik Negara, or PLN, worked on disruptions in several plants) on the following day from 10:00 am to about 16:00 pm. The massive blackouts caused the capital and other urban centers in the region to experience worsened traffic congestion (as all traffic lights were down). Meanwhile, the blackouts caused disruption to businesses and communications (which was also experienced by Indonesia Investments and led to a delay in the release of this July 2019 edition).

These two matters - natural disasters and blackouts - are among the risks that investors need to face when doing business in Indonesia, and therefore it is always good to think about these issues when making a business plan (especially when determining a location for the business).

Lastly, we would like to take this opportunity to thank you for purchasing this July 2019 edition of our report, titled '**The Future of Biodiesel**'. We hope it contains valuable information for you!

Indonesia Investments

**Research Department**

Jakarta, Indonesia - 5 August 2019



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