Economic Monthly [Asia]

# Hopes Indonesia will improve investment environment as well as curb COVID-19 cases and normalise economy

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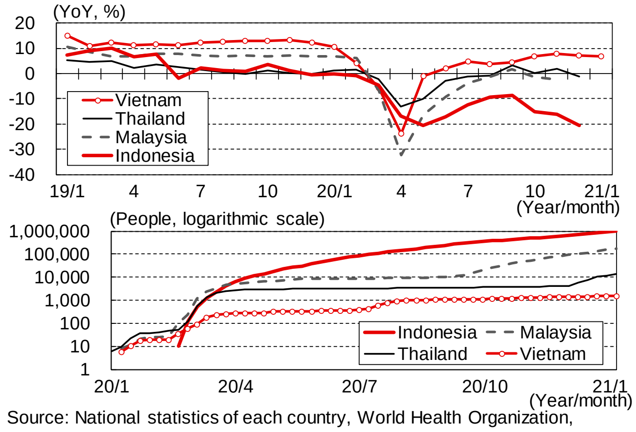
**22 FEBRUARY 2021**
(ORIGINAL JAPANESE VERSION RELEASED ON 29 JANUARY 2021)

It appears the Indonesian economy had been recovering gradually since the middle of last year but there are signs recently that it is deteriorating again: the pace of decline in retail sales year-on-year has accelerated for three consecutive quarters (Chart 1, upper). Looking at the background for this situation shows Indonesia has not been able to halt the spread of COVID-19 compared with other major ASEAN countries (Chart 1 lower), and the government tightened restrictions on movement once again on 11th January. Based on the above, it could be said that downside risks to the economy are rising again.

On the other hand, Indonesia's currency appears firm at present, unlike its real economy, despite its sharp depreciation in March last year caused by capital outflow (Chart 2, upper). An increase in risk appetite worldwide on the back of decreased uncertainty about the US political situation and expectations of a COVID-19 vaccine has affected the currency. In addition, a large decrease in imports due to a fall in domestic demand led to an improvement in the current account, and downward pressure on the currency is softening or shifting to upward pressure. In fact, Indonesia's current account recorded a surplus for the July-September quarter last year on a quarterly basis – the first surplus since July-September 2011 – owing to an increased surplus in the balance of goods brought about by a decrease in imports of goods. The overall balance also recorded an inflow for the second quarter in a row (Chart 2, lower).

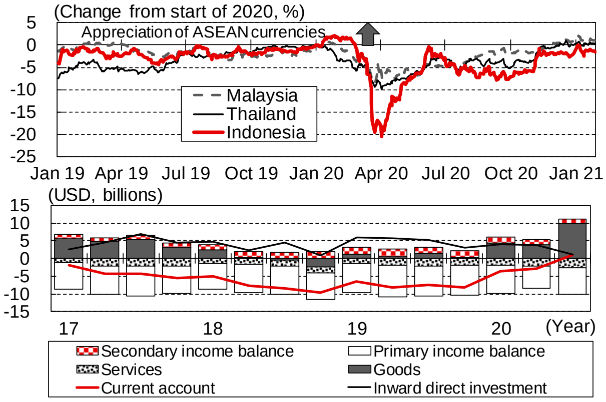
Nevertheless, except for the temporary factors caused by the COVID-19 pandemic, there has not been a change in the weak composition of Indonesia's external account, where capital inflow from inward direct investment cannot compensate for the deficit in the current account. Therefore, there are hopes that the government will not just deal with stopping the spread of infection but will also make a sustained effort to attract foreign investment by making improvements to its business environment, regardless of the COVID-19 situation. An example of this is the Job Creation Law was passed by parliament in October last year in response to issues highlighted by overseas companies operating in Indonesia (came into effect the following month). This law aims to attract foreign capital by easing or overhauling labour regulations, such as increases to the minimum wage, the upper limit for severance pay and the requirements for dismissal, as well as regulations related to investment and land acquisition. It will be important to keep an eye on the viability of such laws as a steppingstone to improving the fundamentals of the Indonesian economy after the COVID-19 pandemic comes to a close.

Chart 1: Retail Sales and Total COVID-19 Cases in Major ASEAN Countries




Source: National statistics of each country, World Health Organization, MUFG Bank Economic Research Office

Chart 2: Exchange Rate of Major ASEAN Currencies against USD and Indonesia's Balance of Payments




Source: National statistics of each country, Bank Indonesia, MUFG Bank Economic Research Office

Translated by Elizabeth Foster

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