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Taking A Risk In Indonesia

By Mark Thompson, AsiaWise

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Indonesia's political stability improved by a couple of notches in October. So says the newly launched **Lehman Brothers** Eurasia Group Stability Index (LECSI), which aims to tell investors whether the political and social climate in a select group of volatile developing nations is getting better or worse.

In recent years, political stability has been the big question mark confronting foreign investors contemplating a dip into the tempting Jakarta stock market. Many of Indonesia's best publicly traded companies are cheaper than their peers in other countries in the region. Yet most foreign investors have looked askance at Indonesia's bargain stocks. Since 1998, foreign capital outflows have averaged \$10 billion a year, according to Anwar Nasution, a senior deputy governor of Indonesia's central bank.

But what if fears about impending political and social chaos in Indonesia prove to be unfounded? What if President Megawati Sukarnoputri shows a strong hand on the rudder and steers the tumultuous archipelago into smoother waters? Indonesian stocks could surge. But few foreign fund managers are banking on that.

A handful of emerging market funds, including two of the largest, have hefty stakes in a couple of Indonesian issues. But more mutual funds have shifted their Indonesian weighting from very light to still lighter in the past year, even as the political climate has arguably grown slightly calmer.

One fund that appears to have unusually high hopes for Indonesia, or at least for one particular company, is the \$900 million **GMO Emerging Markets Fund**. As of early October, its sixth largest holding was **Hanjaya Mandala Sampoerna**, a manufacturer and distributor of clove cigarettes. With a market capitalization of US\$1.4 billion, Sampoerna is one of Indonesia's top five publicly traded companies. It has made the GMO fund proud over the past year, gaining 22%.

Another large global fund, the \$1.5 billion **Templeton Developing Markets Trust**, has another Indonesian issue among its top 10 holdings: **Telekomunikasi Indonesia**, the nation's dominant telecom provider and largest publicly traded company with a market cap of \$2.7 billion. It has gained 23% over the past year.

The \$61 million **AIM Asia Growth Fund** is more typical in its treatment of Indonesia. As a regional fund, it has a much smaller universe of stocks to choose from than the GMO and Templeton funds. But it has a much lighter weighting in Indonesia -- a weighting that has gotten steadily lighter by the month, dropping from 1.8% last fall, to 1.6% last spring to less than 1% as of the first of November.

Some fears for the political future of Indonesia have actually subsided even as foreign investors have continued to pull out. Former President Abdurrahman Wahid was impeached on corruption charges without the widespread violent protests that

his followers had threatened to incite.

More recently, Wahid's successor, President Megawati, has successfully tiptoed through the minefield laid by the September 11 attack on the United States, a performance that earned her government an uptick in the stability index. By lambasting the U.S. bombing of Afghanistan even while unleashing security forces on Islamic protesters, she managed to "satisfy the dramatically opposite interests pressing upon her government," the LEGSI report for Indonesia in November noted.

John Green, the Eurasia Group's Indonesia expert, added in an interview with AsiaWise that the apparent success of the U.S.-led war in Afghanistan has served to discredit the Islamic extremists in Indonesia who vowed to drive Westerners out of the country. "The rhetoric was wholly disproportionate to the resources, the following and the potential for disruption that these radical Islamic extremists actually possess," he noted.


In another plus for political stability, potential rivals to Megawati's party were mired in woes of their own making. Wahid's party is split down the middle between his loyalists and supporters of Defense Minister Matori Abdul Djailil. And the Golkar party was dogged by a corruption investigation, the LEGSI report noted.


Still, the political situation isn't exactly rock solid. Of the 10 countries currently covered by LEGSI ratings (10 more will be added next year), Indonesia ranks eighth, below six former Soviet bloc nations, Turkey and Thailand and just ahead of Azerbaijan.


The recent slight turn for the better in Indonesia hasn't given the stock market much of a lift. The Jakarta Composite Index is down 15% in the year to date, which is better than many other national indexes can boast in this dismal year. Among the ASEAN nations, the Thai and Malaysian market indexes have performed better than their Jakarta counterpart but Singapore's STI and the Philippines' Composite index have done much worse. However, Indonesia, alone among its ASEAN neighbors, hasn't enjoyed a strong market rebound in the past month.

The trouble might be that while concerns about political stability aren't as much of a distraction as they used to be, that has allowed investors to focus more on Megawati's economic performance to date. And it's not a heartening sight. In one worrisome recent development singled out by the LEGSI report as a "dangerous precedent," the provincial government in West Sumatra blocked the sale of the Indonesian government's stake in a cement company to Mexico's Cemex. That doesn't bode well for other much-anticipated sales of underperforming government assets.

"If Megawati and her economic team turn on a dime and begin doing the things we all hoped they would have done in the first 100 days -- selling off assets, getting the assets back into productive hands, getting foreign investors back in, defending the personal security and the property rights of foreign investors -- that's the best case scenario for Indonesia economically," says Green. He's not holding his breath.

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