Withdrawal of The United States’ Generalized System of Preferences Facility

Preliminary

In early March 2019, the US government retracted the Generalized System of Preferences (GSP) facility for India and Turkey as a result of its evaluation of the two nations. India’s GSP facility was retracted due to unnecessary trade barriers between the two, while Turkey’s import facility was withdrawn as the US felt its economy had grown and diversified. This must be a concern to the Indonesian government as the US’ GSP facility for the nation can also be retracted by President Donald Trump’s administration. The potential withdrawal was triggered by the US trade deficit with Indonesia, but according to Indonesian Minister of Trade Enggartiasto Lukita, this is only temporary. Indonesia can still benefit from the facility while the US government evaluates whether to continue the arrangement, and the Indonesian government improves trade policies with the US.

The US Generalized System of Preferences

The Generalized System of Preferences (GSP) is a US government program to develop the economic growth of emerging markets through the provision of a free import duty facility for the products of a beneficiary developing country (BDC). Articles eligible for GSP need adequate qualifications, such as being directly imported from BDCs, being an original product of the BDC or manufactured there, and the importer has to request free duty under GSP by placing a special program indicator (SPI) (A, A+, or A*) on articles to be imported. BDC products that receive the facility will be removed if they exceed the set competitive need limitations (CNL), i.e. worth USD 185 million, or the quantity is more than or equal to 50% of the total US import value for those products. The GSP facility will be terminated if: the BDC is considered to have become a high-income country (GDP per capita at least USD12,235); a review of the BDC shows the development of its economy and trade competitiveness; or if the US experiences a large trade deficit with the BDC.

Figure 1. US trade deficit with Indonesia (USD billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade Deficit (USD billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>8.36</td>
</tr>
<tr>
<td>2015</td>
<td>8.37</td>
</tr>
<tr>
<td>2016</td>
<td>8.65</td>
</tr>
<tr>
<td>2017</td>
<td>9.00</td>
</tr>
<tr>
<td>2018</td>
<td>8.40</td>
</tr>
</tbody>
</table>

Source: Indonesia Central Bank

Continued to page 2
Indonesia receives the GSP facility, and is one of the US' trade partners in Southeast Asia. Over the last five years, the average of Indonesia’s exports to the US was USD16.96 billion, and the average of its imports from the US was USD8.28 billion. During that period, the US experienced an average trade deficit with Indonesia of USD8.68 billion. The US government believes GSP caused the trade deficit, so it plans to retract GSP. But with Indonesia’s GDP per capita of USD3,927 (IDR56 million) according to Indonesia Statistics (BPS), it still meets US criteria to receive GSP.

Though Indonesia’s GSP status is still undecided, the threat of it being withdrawn will impact market players whose products have GSP status. Based on US International Trade Commission data, Indonesian goods imported under GSP in 2018 had a total value of USD2.13 billion from 72 classifications (based on two digits of the Harmonized System—HS). Of the 72, 20 dominated the imports with a value of USD1.94 billion—or 91.10% of the total. Although this is a relatively small proportion of Indonesia’s total exports to the US in 2018, the government should immediately find alternative markets for those products to anticipate US’ decision to withdraw the GSP facility from Indonesia.

Some 12 countries can be alternative export markets for the 20 products with GSP, based on their currently large import value. Of the 12 countries, Japan is the biggest importer of Indonesian goods with a GSP facility, with an import value of USD6.55 billion in 2018, followed by Singapore and China, which imported USD5.46 billion and USD3.64 billion, respectively. However, the shift in export destinations should only be temporary, and only if the US government actually withdraws Indonesia’s GSP facility. The search for new markets for these products has to be conducted to maintain domestic export performance. In 2018, Indonesia experienced a serious current account deficit problem. Its increasing deficit due to world oil price hikes saw an import value spike, but this was not compensated by an increase in export performance.

<table>
<thead>
<tr>
<th>No</th>
<th>Export Destination</th>
<th>Commodity (two digits of HS)</th>
<th>Export Value (US Dollar)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Japan</td>
<td>16, 29, 39, 40, 44, 69, 71, 76, 84, 85, 92, 94</td>
<td>6,554,765,940</td>
</tr>
<tr>
<td>2</td>
<td>Thailand</td>
<td>16, 73, 87</td>
<td>1,256,681,237</td>
</tr>
<tr>
<td>3</td>
<td>Philippines</td>
<td>17, 87</td>
<td>1,984,857,953</td>
</tr>
<tr>
<td>4</td>
<td>Vietnam</td>
<td>17</td>
<td>22,082,731</td>
</tr>
<tr>
<td>5</td>
<td>Netherlands</td>
<td>20, 38, 42, 94</td>
<td>827,156,646</td>
</tr>
<tr>
<td>6</td>
<td>Spain</td>
<td>20</td>
<td>22,033,443</td>
</tr>
<tr>
<td>7</td>
<td>China</td>
<td>29, 38, 39, 40, 44, 92</td>
<td>3,643,563,355</td>
</tr>
<tr>
<td>8</td>
<td>Belgium</td>
<td>42</td>
<td>35,415,733</td>
</tr>
<tr>
<td>9</td>
<td>Malaysia</td>
<td>69, 76, 96</td>
<td>139,422,945</td>
</tr>
<tr>
<td>10</td>
<td>Singapore</td>
<td>71, 73, 84, 85, 90</td>
<td>5,457,371,218</td>
</tr>
<tr>
<td>11</td>
<td>Switzerland</td>
<td>90</td>
<td>65,398,645</td>
</tr>
<tr>
<td>12</td>
<td>India</td>
<td>96</td>
<td>33,578,662</td>
</tr>
</tbody>
</table>

Source: United Nations Comtrade Database
EFINDO is of the view that the risk profile of the life insurance industry is moderate, with a stable outlook. Amid the continuing macroeconomic slowdown, we project the industry to slightly grow by around 2%-7% in the next 12-18 months. The industry growth is supported by low insurance penetration, Indonesia’s large population, high consumption and growing middle class, as well as improving market awareness. Low penetration indicates the potential of untapped business, although at the same time also reflects lack of insurance literacy in communities. The industry growth is also constrained by intense competition led by its largest players, as well as closer supervision by the regulator. Moreover, life insurance companies are constantly exposed to capital market volatility particularly the ones with high portion of guaranteed products. Given their business nature that enable the players to enjoy adequate underwriting result, life insurers are more aggressive in their investment activities to pursue higher yield. Unfavorable macroeconomic condition may affect investment performance and this could lead to liquidity pressure if it need to be monetized to repay the liabilities to the policyholders.

**Market overview: products and distribution channels**

The life insurance industry is relatively concentrated among 10 large insurers, which dominate in the market is unlikely to change in the medium term. The top 10 insurers controlled more than 60% of total assets and premiums as of December 31, 2018 (FY2018).

In terms of product, investment linked products dominated the market, at around 60% of the industry’s total GWP. The products offer investment savings with valued protection benefits, where protection products such as life, personal accident, and health are sold as riders. Product demand is also affected by stock market performance, which often yields in favorable investment returns during a bullish stock market, but may trigger redemption during negative investment returns amid a bearish stock market. At such time, insurers can anticipate the conditions by expanding traditional protection products, which are not as cyclical as investment linked products.

In terms of distribution channel, life insurance products are sold predominantly through the bancassurance channel and agency forces, at around 43% and 39% of the industry’s total premium income, respectively. We are of the view that bancassurance will continue to make a significant contribution, with insurers’ efforts to increase productivity, particularly due to their sizable spending in the partnerships, where face-to-face interaction may still be most consumers’ preferred way to take up life insurance. As such, we project agencies will not necessarily shrink, while the digitally growth, along with its increased role to complementing the traditional agency channel, but its share is likely to remain insignificant in the near to medium term.

**Exposure from capital market volatility to financial profile**

PEFINDO notes that life insurance companies are continuously exposed to capital market volatility, and this may affect their overall financial indicators. Given the long tenor and competitive nature of the industry, the overall loss ratio and combined ratio would rise to around 100% and 120%, respectively, and therefore life insurers are depending on investment results to fund their operations. As mortality and morbidity statistics are well maintained, the loss ratio is more predictable, life insurers are more aggressive in their investment activities to pursue higher yield. Unfavorable macroeconomic condition may affect investment performance and this could lead to liquidity pressure if it need to be monetized to repay the liabilities to the policyholders.

**Stable Outlook for PEFINDO’s rated portfolio**

As of March 31, 2019, PEFINDO published the financial strength ratings of four life insurance companies: PT BNI Life Insurance (AA+/stable), PT Asuransi BRI Life (AA/stable), PT Asuransi Jiwa Taspem (A+/stable), and PT Helksa Solution Insurance (BBB+/stable). The number of rated life insurance companies is smaller than general insurers (12 published ratings), due to different business models as there are fewer life insurers who directly conduct partnerships with banks - who require a ratio to reduce the risk weighted assets for their insured loans, compared to the general insurers.
the contingent liability is one of the indicators analyzed by PEFINDO to determine the credit rating of local governments in Indonesia. The contingent liability analysis describes the material liabilities that could affect the local government’s financial performance, which was not stated as “Liabilities” in the Balance Sheet. The analysis can also minimize external risks that might occur and can indicate the local government’s plans and preparedness to mitigate these risks.

In brief, the Government Accounting Standards (Standar Akuntansi Pemerintahan/SAP) define contingent liabilities as 1) potential liabilities arising from past events that have or do not have a future impact that is not fully within the entity’s control; or 2) current obligation arising from past events, but were not recognized because there is no probability that the entity will spend its resources to complete its obligations or the amount of the liability cannot be measured reliably.

The contingent liability analysis is measured qualitatively, focusing on the type and the materiality. The analysis is carried out on contingent liabilities from local-owned enterprises (Badan Usaha Milik Daerah/BUMD), public-private partnership (PPP), securitization and litigation, and other contingent liabilities.

SAP requires disclosure of contingent liabilities and other commitments in the notes to the financial statements (Notes) as a requirement for fair financial statements. In the following analysis, we will use several examples of contingent liabilities disclosed on the Notes of several provincial governments in 2017.

**Contingent liabilities from BUMD**

We analyze the potential exposure of BUMD’s business and financial profiles to local government’s finances, which consist of business scale, business sector, financial performance, credit profile, and risk profile. We also analyze the strategic value of BUMD both politically and economically, and also the presence/absence of support from the local government with the additional capital injection, guarantees, or other parent supports.

We also assess whether there is a possibility of privatization. For BUMD that is also owned by other local governments or other shareholders, we also consider the presence/absence of additional support from other shareholders.

Based on the 2017 Notes, several contingent liabilities from BUMD have been disclosed are BUMDs in liquidation process, poorly performed BUMDs, and BUMDs in capital disputes with other shareholders. These types of contingent liabilities have the potential to inflict future obligations for the local governments.

**Contingent liabilities from PPP**

There are two types of PPPs in Indonesia, PPPs projects partially funded by the government and PPPs projects initiated by private entities. Of these two, the central government and the local government can act as the guarantor. In addition to PPP, there are other schemes of utilization of state/local assets, through rent, lease, utilization cooperation, build-operate-transfer/built-transfer-operate, and infrastructure cooperation.

Although in general the inherent risk of the PPP project is a risk of the private entity, there is still a possibility of risk exposure to the local government. It is especially for PPP projects that have a political and economic exposure, considering currently the infrastructure development is a priority of the central government and regional governments.

Based on the 2017 Notes, several contingent liabilities from PPPs that have been disclosed are disputes over asset utilization, especially for contracts carried out before the reform era (before the year of 2000), which did not have a strong regulation basis regarding PPP/asset utilization. Some local governments have the potential to lose ownership of their assets on this matter.

**Contingent liabilities from securitization and litigation**

In Indonesia, the practice of securitizing assets or revenues of the local governments is not yet common. However, if it can be realized, we will analyze the inherent risks, especially those that occur off-Balance Sheet. Meanwhile, local governments may encounter several litigation cases. The litigation is a part of contingent liabilities because the impact of the obligations depends heavily on the court verdict. We also add the assessment on litigation risks based on discussion with the local government management and documents that could confirm the legal position of the local government.

Based on the 2017 Notes, several contingent liabilities from litigation that have been disclosed mostly come from disputes over ownership of land and other assets. Other litigations are detention of assets that currently become evident in criminal cases, and also disputes over completed work by the provider but has not been paid.

**Other contingent liabilities**

Other contingent liabilities are employees compensation and insurance, extraordinary support to lower levels of the governments, and natural catastrophes. These types of contingent liabilities have been mitigated through several acts and state regulations. Meanwhile, the mandated commitment for local governments also becomes other contingent liabilities. Based on the 2017 Notes, the contingent liabilities that have been disclosed are commitment to grant scholarship and commitment to reclamation contributions.
On Wednesday, April 10, 2019, the Annual General Meeting of Shareholders (AGMS) of Fiscal Year 2018 was held by PT Pemeringkat Efek Indonesia (PEFINDO) at the Ayana Midplaza hotel ballroom in Jakarta. The meeting was attended by the holders/owners of 94,897 shares, representing 94.897% of total paid up capital. The AGMS has approved and made a meeting decisions on Agenda 1 through Agenda 5, except for Agenda 6 (miscellaneous agenda).

PT Pemeringkat Efek Indonesia (PEFINDO) in collaboration with the Indonesia Stock Exchange (IDX) held a seminar with the theme of “The Role of the Stock Market and Debt Market to Support The Company’s Growth” on Thursday, April 25, 2019 at Seminar Room - Tower II of Indonesia Stock Exchange by inviting approximately 80 PEFINDO's clients that have not yet "go public" or listed on IDX.

The seminar began with speeches from Mr. Fithri Hadi as IDX Director and Mr. Salyadi Saputra, PEFINDO President Director, hosted by the moderator, Mr. Bima Ruditya (Head of the IDX Listed Company Development 2). The presentations were delivered by Ms. Vonny Widjaja (PEFINDO Rating Director) with the title of "Debt / Innovative Financial Instruments", Mr. Poltak Hotradero (IDX Senior Development Specialist) titled "Potential Growth of the Company through Go Public", and Mr. Nelwin Aldriansyah (Director of PT Bahana Sekuritas) titled "Preparation and Benefits of Go Public". Mr. Haris Gunawan (Director of Finance & Strategy of PT Waskita Karya (Persero) Tbk.) also presented a success story about challenges and benefits of going public experienced by PT Waskita Karya (Persero) Tbk, received enthusiastic responses by the seminar participants.

By holding this seminar, it is expected that the participants representing could that will strengthen the management’s consideration to immediately execute their plans to become a go public and debt issuers listed on IDX.
Financing needs of finance companies are still quite large. Based on data from the Indonesian securities custodian, the debts securities that will mature from finance companies in 2019 will reach IDR37.9 trillion. So, not surprisingly, the need for issuance of debt instrument from finance companies will still be large this year, despite recording low growth.

Towards the end of the third quarter, momentum was quite good for bond issuance. Bond yields have begun to move down along with interest rates and the rupiah is relatively more stable compared to the beginning of last year. Government bond yields for 3 years and 5 years tenors have dropped from 7.905% and 7.907% at the end of last year to 7.048% and 7.168% as of April 24, 2019, respectively. In addition, even though it is still overshadowed by high oil prices, there is an opportunity for policy rates to fall along with inflation maintained at the lower level of the central bank’s target.

For the next few months, we expect the debt securities issuance from those two sectors will still be quite large. In total there are IDR52.3 trillion debt securities that will mature throughout May-December 2019, of which around IDR26.8 trillion are from finance companies and the rest are from the banking industry.

Unlike banking, finance companies are quite significantly depending on funding from the debt market. Funding from debt instrument covers around 22.6% of total funding. In addition to working capital, the

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**Figure 1. Bond Issuance During The First Quarter (IDR Trillion)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank</th>
<th>Financing companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2015</td>
<td>10</td>
<td>5</td>
</tr>
<tr>
<td>2016</td>
<td>15</td>
<td>10</td>
</tr>
<tr>
<td>2017</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td>2018</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td>2019</td>
<td>30</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: PEFINDO Database

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**Figure 2. Growth of Outstanding Loans and Financing Receivables (% YoY)**

- Financing receivables
- Bank loans

Source: OJK
### Companies & Bonds Rated by PEFINDO

#### Shelf Registration Bond Year 2016 and 2018
- **45** Bank Pembangunan Daerah Sulawesi Barat (Bank Nagari) & Bank Pembangunan Daerah Sulawesi Selatan (Bank Pembangunan Daerah Sulawesi Selatan) & Bank Syariah Mandiri (Bank Syariah Mandiri) & Bank Pembangunan Daerah Jawa Timur Tbk. (Bank Pembangunan Daerah Jawa Timur Tbk.)
  - **A-** Stable
  - **A-** Stable
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