Indonesia Construction Sector

Sector Focus May, 2022

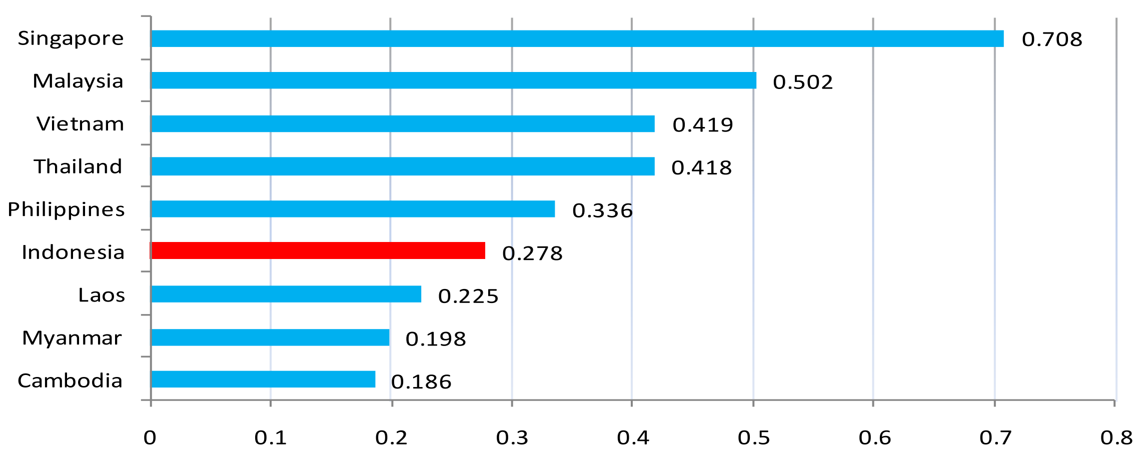
Expect a recovery growth

The construction sector growth in Indonesia has been grew decently for the last 5 years. This was on the back of several government investments in infrastructure budget, acceptable interest rate, supportive banking liquidity, quite stable GDP growth despite there was an external challenge that have increased the rupiah exchange rate volatility and also the pandemic covid-19 that has dragging down the economic capacity to grow further. The hawkish tone in the global monetary policy stance would provide a challenge due to the higher borrowing cost that could be transmitted to the domestic interest rate. However, the higher vaccination rate is a positive factor or to be the precondition to expect the normalizing growth ahead.

Government of Indonesia is on the pace of accelerating its infrastructure development to spur the growth by developing the connectivity, lowering logistic cost, developing the energy supply to support the industry as the basis to increase its competitiveness amid the challenges it has steaming from the current account deficit. More foreign direct investment and export is necessary to reduce the vulnerability toward the external challenges that would deteriorate the rupiah stability

The quality of the physical access for infrastructure in Indonesia is lacked behind several Southeast Asia countries as recorded by UNESCAP. The Indonesia's access to physical infrastructure index (APII) score was at 0.278 or lower than Philippines (0.336), Thailand (0.418), Vietnam (0.419), Malaysia (0.502), and Singapore (0.708). Port and road contributes to the lowest score, which implying the lower competitiveness in the logistic and supply chain. The acceleration of the public spending in the infrastructure thus remains the government priority in the near future to support the GDP growth that currently trap at 5.2% or below its historical level at beyond 6%.

Access to physical infrastructure Index. Indonesia still lagging behind



Source: UNESCAP

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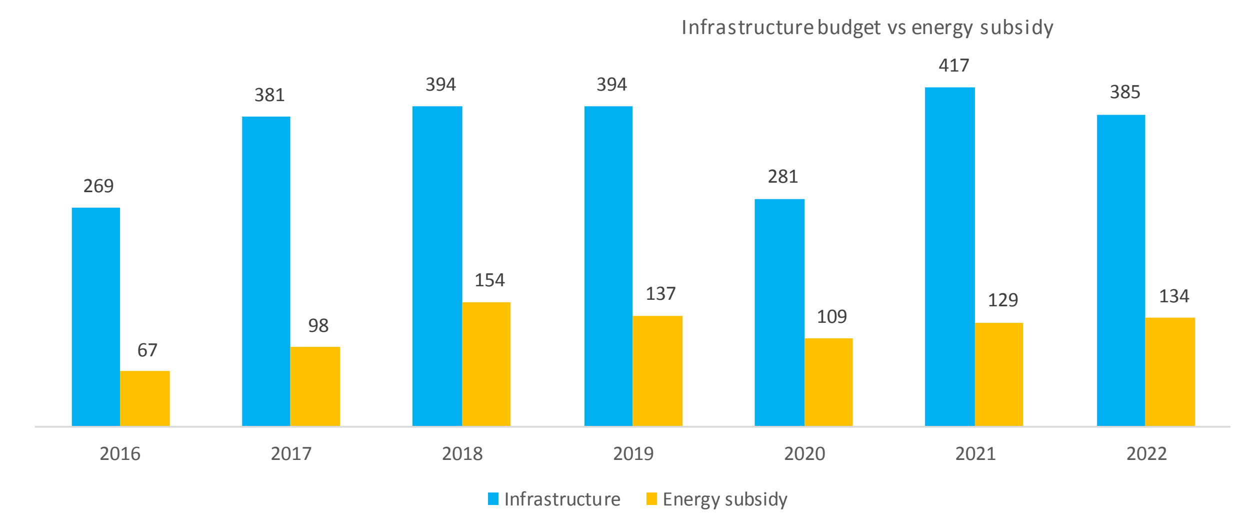
The improvement of government spending in the infrastructure has been shown through the structural reform in fiscal side by cutting the energy subsidy and reallocate it to the infrastructure spending since 2015. However, the Covid 19 has postpone the private and also government projects due to the budget reallocation or rearrangement of the priority for the health and social spending. This made the revenue on the construction company lower. However, the sign of the economic recovery has been seen in the economic activity and also the business sector. The higher degree of vaccination as the precondition to expect the strong economic growth due to the lower possibility of the social restriction going forward. The higher people mobility, the pent up demand and strong global economic demand will have a positive impact on the GDP. Government has adjusted the infrastructure spending and the portion of the infrastructure spending in the budget that has gradually restored. This would be the growth driver for the construction company especially State Owned Enterprise (SOE) that mandated to accelerate the government program.

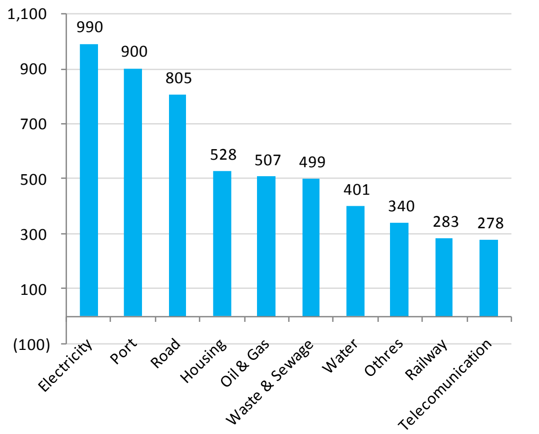
Reallocation from energy subsidy to infrastructure spending since 2015 (in IDR tn)



Source: Ministry of finance

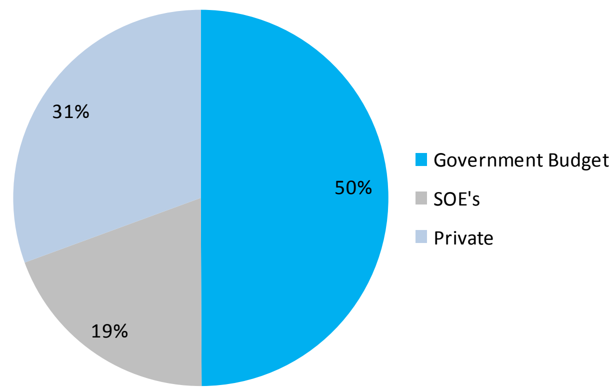
The Indonesia total infrastructure investment was about IDR5,529tn and the government and SOE dominates the total portion with 69% shares while the rest or 31% of the infrastructure project was owned by private sector. Electricity, port and road were the top three infrastructure investment that has been built in the last 3 years.

Infrastructure Investment



Source: RPJM

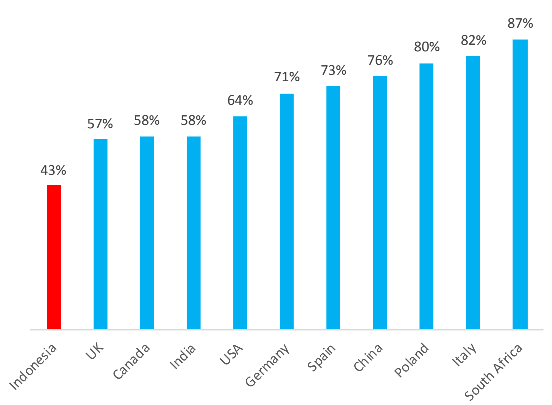
Project by ownership



Source: RPJM

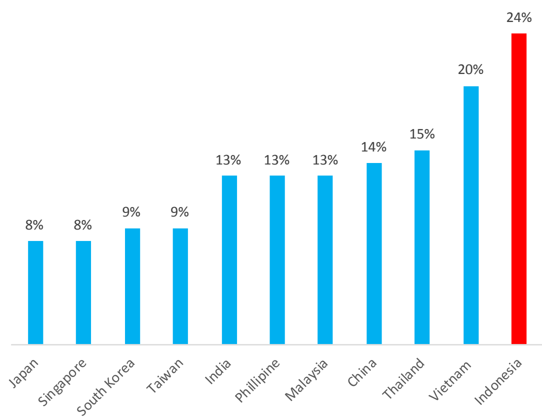
The infrastructure will remain the priority of the government spending due to the condition of the Indonesian infrastructure that would not favorable to support the strong GDP growth ahead. This is reflected in the lower infrastructure stock compares to its peer that at 43%. More infrastructure building is needed to support the capacity to cater the higher output that could generate higher GDP growth. **The lack of infrastructure stock is also seen in the higher logistic cost in Indonesia that is higher than the peer. The cost is about 24% of GDP compare to the other Asian countries at below 20%. The efficiency issue is the factor that burden the economic activity that obstruct the productivity to generate better inclusive growth.**

Indonesia Infrastructure Stock is below international infrastructure stock. More infrastructure building is needed



Source: ISER,World Bank

Logistic cost as % of GDP



Source: ISER,World Bank

The normalizing of the government allocation for infrastructure and the SWF (Sovereign Wealth Fund) that expected to increase the capacity of national funding for Infrastructure as the catalyst to expect the positive recovery in the construction sector amid a thought challenger amid the early stage of the recovery due to the negative impact of Covid-19. **This is estimated to provide the better new project for the construction sector especially for the state own enterprise company.** In term of revenue the state own enterprise such as WIKA , PTPP, ADHI, WEGE, WSKT dominates the total revenue or 85% of the total revenue share. The private construction revenue growth would rely on the private property and high rise building which exposed to the interest rate and economic cycle.

The construction of the new capital in Kalimantan will also be a catalyst for the construction sector to record performance growth in the future. SOE companies are likely to benefit from the government's planned project to build the new capital.

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