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01

ELECTION SPECIAL

Act or react

What can the oil and gas industry expect from Indonesia's new president?

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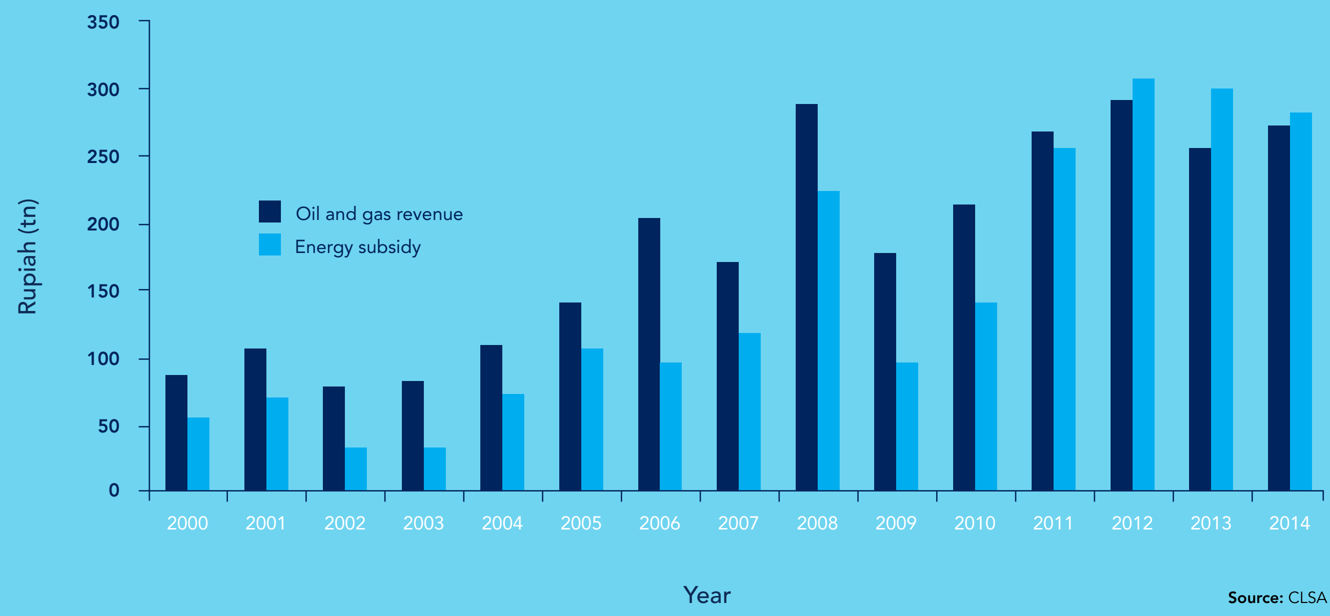
On October 20th, Jakarta Governor Joko Widodo ("Jokowi") will be inaugurated as Indonesia's seventh president, having secured an absolute majority in the world's biggest direct presidential election in July. To help inform debate about the election and its impact on the energy industry, we asked two independent experts, in Indonesian politics and investment respectively, for their views on the president-elect's policies and ability to affect the country's oil and gas future.

A critical element to Jokowi's campaign is Indonesia's ongoing economic prosperity and increased growth rate targets. Indonesia's energy sector is a significant economic constituent, representing 15.6% of GDP in 2012 with oil and gas alone providing 16% of state revenues. However, production in ASEAN's historically dominant oil and gas producer is stagnating in the face of soaring demand, prompting an ever-expanding deficit gap currently being filled by imports. Imports have fuelled pressure on the country's current and trade accounts, which will only increase without increased oil and gas production. This pressure is exacerbated by fuel subsidies dating back to Indonesia's OPEC membership (it exited in 2009), which currently cost the government more than oil and gas revenues.

In his analysis for Risco, Indonesian political expert and commentator Kevin Evans highlights the unique nature of the president-elect as Indonesia's democratic evolution continues. For the first time, Indonesia will have a president who doesn't hail from a traditional elite – the former furniture maker, and subsequently mayor of both Solo and Jakarta, entered local politics less than a decade ago.

Indonesia's oil and gas revenue vs fuel subsidy cost

Structural change is needed



Source: CLSA

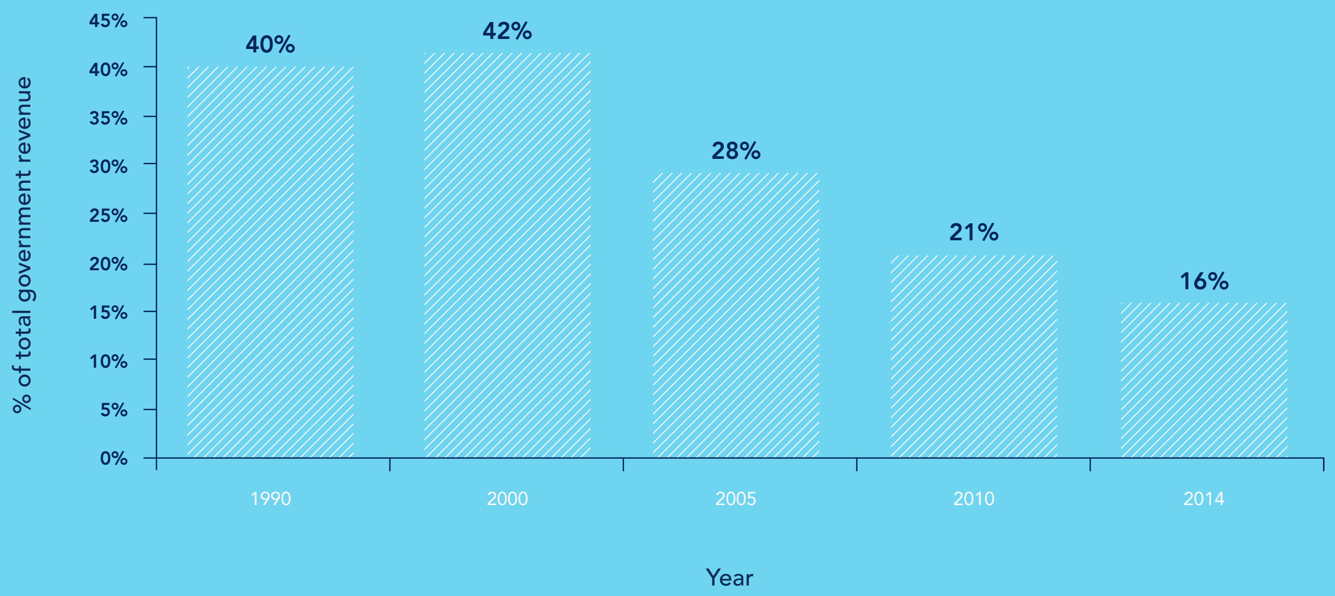
The cost of fuel subsidies wipes out revenue from oil and gas

Kevin observes key attributes engendering a strong ability to deliver results, absent of historical hang-ups and constraints. The question is the direction such execution will take. Kevin expects early action in reducing fuel subsidies and ultimately an incremental improvement in the investment attractiveness of upstream oil and gas for both domestic and foreign participants, recognising the significant execution hurdles for the latter. Where Kevin diverges from the currently accepted outlook of "positive expectation, questionable timing on delivery" is in Jokowi's ability to overcome these hurdles within a few years, aided by vice-presidential facilitator Jusuf Kalla.

Jayden Vantarakis, Deputy Head of Indonesian Research at CLSA, Asia's leading independent equity brokerage, sees change occurring more quickly. He views GDP growth of 7%+ pa as a priority for Jokowi. The current structural energy trade deficit and fuel subsidies represent significant barriers to achieving this and will have to be dealt with. Jayden believes this will compel the new president and his government to implement positive structural reform to encourage oil and gas investment to in turn stimulate higher production.

Oil and gas revenue as a proportion of total Indonesian government revenue

Oil and gas are material to Indonesia – albeit proportionately less than before



Source: CLSA

Both Kevin and Jayden see Indonesia's overall economic performance as a key motivator for action. History would support this view, expressed by the outgoing administration's articulate Minister of Finance as "good times lead to bad policy and bad times lead to good policy". Both expect a first step of subsidy reduction. The difference in their views lies in the implicit timing: Jayden is confident the next government's primary desire to protect targeted growth will quickly catalyse the creation of a more attractive oil and gas investment environment, while Kevin is quietly optimistic for improvement over the next few years.

One area of oil and gas investment that clearly seems set to receive greater support is domestic participants. This is potentially a welcome source of investment, although it is not a singular solution and is unlikely to make material impact on such a significant (and expanding) energy shortfall. Domestic oil and gas participants naturally face balance sheet, funding and skill constraints in an industry that is highly capital and skills intensive. For Indonesia, it is set to become even more so as the industry seeks resources in the more challenging eastern and deepwater areas of the country. The president-elect recognises the part global capital and skills have to play if Indonesia's oil and gas production is to be increased to deliver corresponding support to the country's economy. The issue is whether the hurdles can be overcome. The traditional comment on this would be "time will tell" but recent history of Indonesia's president-elect suggests that directional clarity will come quickly.

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Risco Energy is an investment company focused on upstream oil and gas in ASEAN

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