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Macro Note

Indonesia: Unleashing The Power Of Consuming Class

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Key Summary

- Private consumption remains to be the most significant growth driver for Indonesia. In essence, to achieve higher economic growth, private consumption needs to increase significantly from hereon.
- Millennials, which represent one third of the total Indonesia population and will make up approximately 44% of Indonesia's productive age (15-64) in 2030, is one important force that may lift growth higher. They comprise as the largest workforce, command the largest portion of the income, and correspond to unique blend of higher value consumption; which more toward experiences rather than functional needs.
- Being a mobile first and mobile only generation, the combination of millennials' rising consumption pattern, increase in disposable income, and stellar rise of digitalization can provide further opportunity to raise Indonesia's overall private consumption growth.
- The results of our analysis suggest that on the back of potential rising purchasing power of the millennials, GDP growth could be boosted to around 6.5% by 2030.

A Snapshot Of Indonesia Economic Growth

- Indonesia's economic growth is respectable when compared to global growth, even during and after the 2008's global financial crisis. However, growth has been noticeably slowing, from around 6% in 2010 to around a low 5% today (Figure 1). As much as the end of the commodity super-cycle is somewhat responsible for that downtrend, the key engine of Indonesian economic growth (the private consumption) has been losing steam.
- Private consumption makes up more than 50% of the nation's GDP, but its growth has been gradually declining to its 5% mark. This begs the question of why there is such a secular declining trend and whether one should be duly worried about it. Despite the government trying to beef up higher headline growth by increasing investment expenditure, the resulting impact will take quite a while before it can be seen materially increasing the overall growth figure.
- With this big challenge in mind, it is precisely the time that Indonesia must refocus its efforts to revive the power of its domestic consumption and to leverage on its domestic market. The role of private consumption, especially consumption of the millennial generation consumption, if managed and supported appropriate and strategically, will be able to lift headline growth higher. This coupled with the fact that the realized impact of infrastructure investment, may add further to headline growth in due time.

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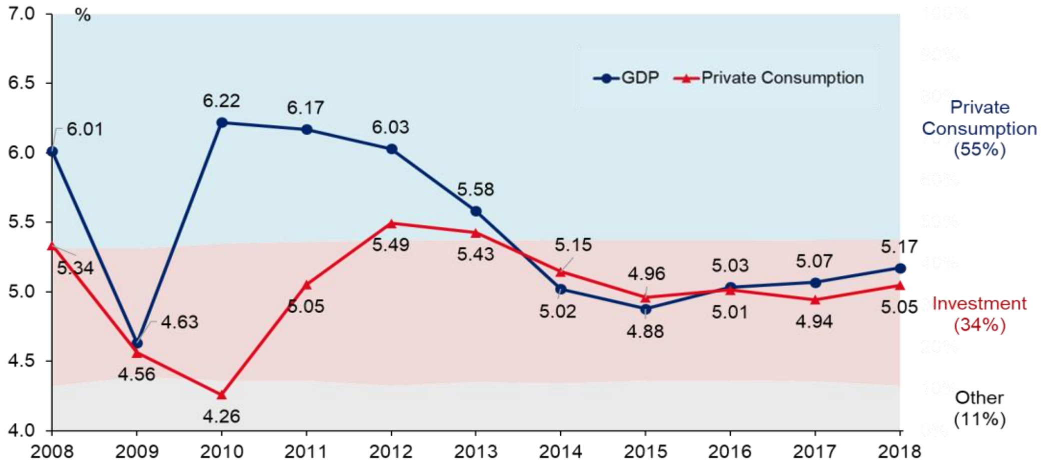
Figure 1. Indonesia's GDP Contribution

Source: Bloomberg, UOB Global Economics Research



The Importance Of Millennials: Understanding Indonesia's Demography

- Indonesia's population was 268 million in 2019 (Figure 2), an increase of 1.2% compound annual growth rate (CAGR) since 2000. The median age in 2019 was estimated at 28.8 years. The population will reach 269 million in 2030, an increase of 0.9% CAGR from 2019. Those typically not in the labor force (*the dependent*), ages 0-14 and 65+, will reach 22.9% and 9.0% of the population respectively, while *the productive* age of 15-64 will comprise of 68.1% of the population. As illustrated by Figure 3, the productive age group will be mostly dominated by the millennials, who are born on 1980 – 2000 period and reaching the age of 30-49 in 2030. These millennials composition is one of the important strengths to Indonesia's economy, which implies the largest workforce; thus, represent the largest portion of the income as well as the consumption.

Figure 2. Indonesia Generation (2019) - Total 268 mn

Source: Statistics Indonesia, UOB Global Economics & Markets Research

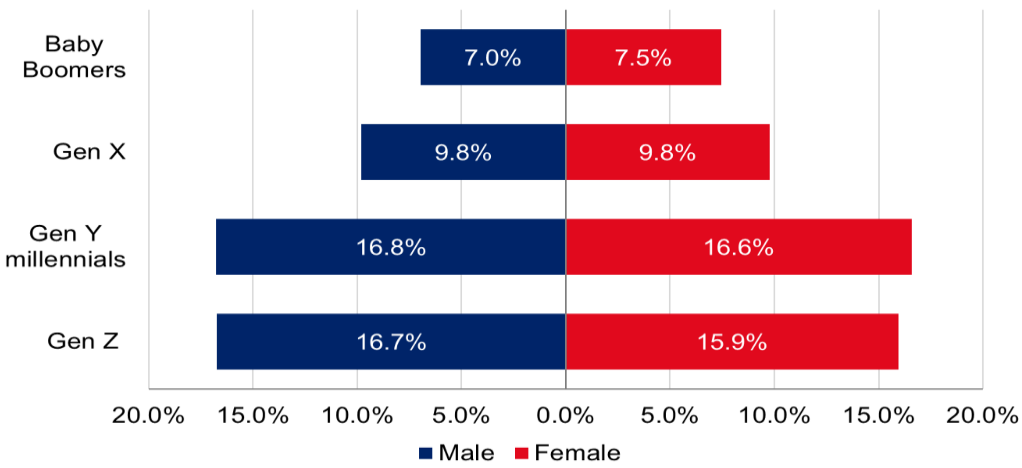
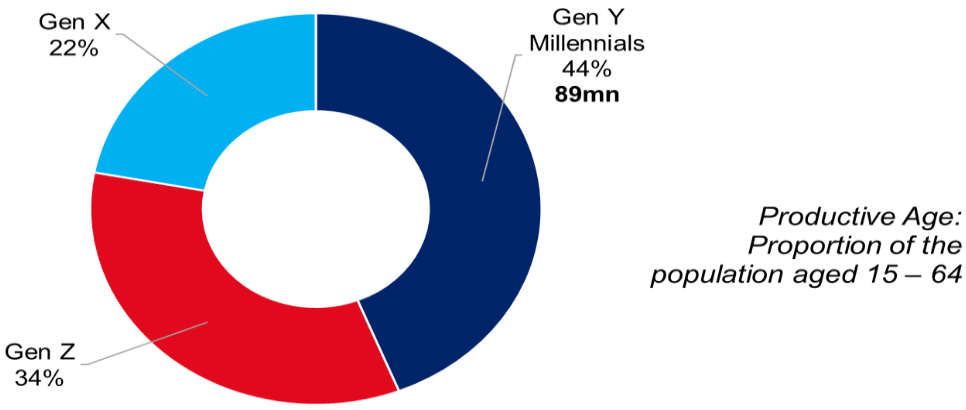


Figure 3. Productive Age Population 2030 - Total: 202mn

Source: Statistics Indonesia, UOB Global Economics & Markets Research

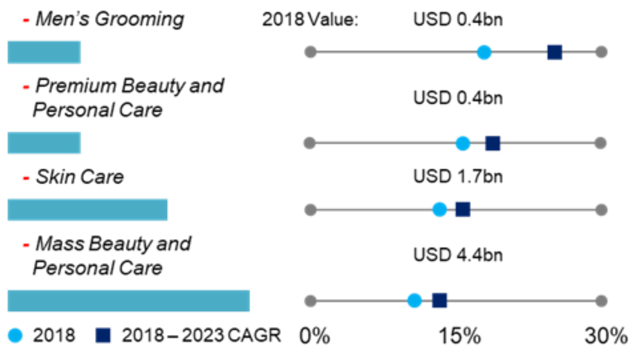
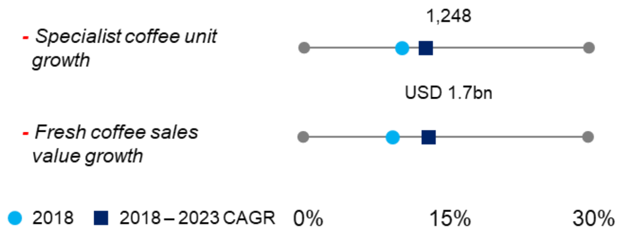
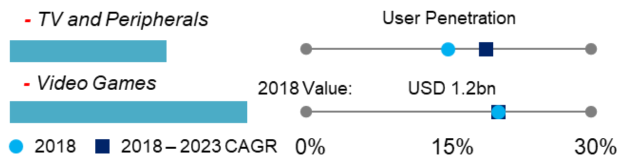


Millennials Unique Consumption Behavior: Anecdotal Evidences

- Indonesia's consumer market is set to witness a steady rate of expansion, driven by strong economic development, increase in disposable incomes, and most importantly the unique consumption pattern of millennials.

- According to various salary survey and our estimation, the portion of millennial real income growth experienced an increase at 8.6% CAGR during 2010-2019 period, which bigger than the average real income growth of all population at 3.0% - 4.0%. Moreover, the millennials have unique consumption behavior, which differs from their preceding generations. We observe some anecdotal evidences and important shift of their spending behavior. Overall, millennials could spend up to 50% (vs. the preceding generation, up to 30%) of their disposable income towards the so-called 4S: Skin, Sugar, Sun, Screen as exhibit in Figure 4. Businesses in a wide range of industries can expect to capitalize the millennials' strong purchasing power and the spending behavior and to invest further in providing the platform for the biggest consumption-driven in Southeast Asia.

Figure 4. Millennials Spending Behavior: 4S

4S	Description	Anecdotal Evidence
1. Skin	Spending related to fashion, mass beauty and personal care	*Source: APLI, Indonesian Business Megazine, Soap Perfumart & Cosmetic, UOB Global Economics Research* *"Based on interviews popular micro-loan (such as P2P lending and micro-loan financial systems) providers, most loans are taken by women to enable them to purchase premium skin care and beauty products."* 
2. Sugar	Spending related to F&B, especially premium and outside basic F&B need	*Source: Statistics Indonesia, Trade Resources, UOB Global Economics Research* *"The emerging of many of the coffee start-ups backed by international venture capital have shown how interesting the consumer domestic market is."* 
3. Sun	Spending related to travel, attraction, as well as leisure activity	*Source: Google, Temasek, UOB Global Economics Research* *"Increasing trend of travel both domestically and abroad where attractions and recreation are the main reasons."* 
4. Screen	Spending related to cinema, internet, digital tv, and video games	*Source: Statista, UOB Global Economics & Markets Research* *"Rising consumption of internet data, digital tv channel (Netflix, etc), and video games; due to era of computer generated effects"* 

The Potential Of Indonesia's Online Economy

- Being the mobile first and mobile only generation, the rising consumption pattern by the millennials and stellar rise of digitalization can provide further opportunity to raise private consumption growth.

- The main reason to be more sanguine on Indonesia's online/digital economy potential is attributed to its massive population and the stellar rise of online platforms in facilitating millennials' consumption growth. In addition, another support i.e. internet penetration has also been identified as one of the key factors in the rapid monetization of the online economy. China, for example, with population around 1.4 billion and internet user penetration rate of 57% in 2019 has been able to support the growth of companies such as Alibaba and Tencent. Indonesia, at the same time, has reached 56% internet user penetration rate from around 28%

in 2015 (Figure 5); providing digital players a large consumer base to market their services as well as drive marginal costs lower through economies of scale. As an evidence of advantage in both the population and rapid internet penetration, Indonesia has managed to produce the largest consumer based in Southeast Asia despite recording the lowest internet and e-commerce penetration among country peers (Figure 6).

Figure 5. Indonesia Internet Penetration

Source: We Are Social - Hootsuite, UOB Global Economics & Markets Research

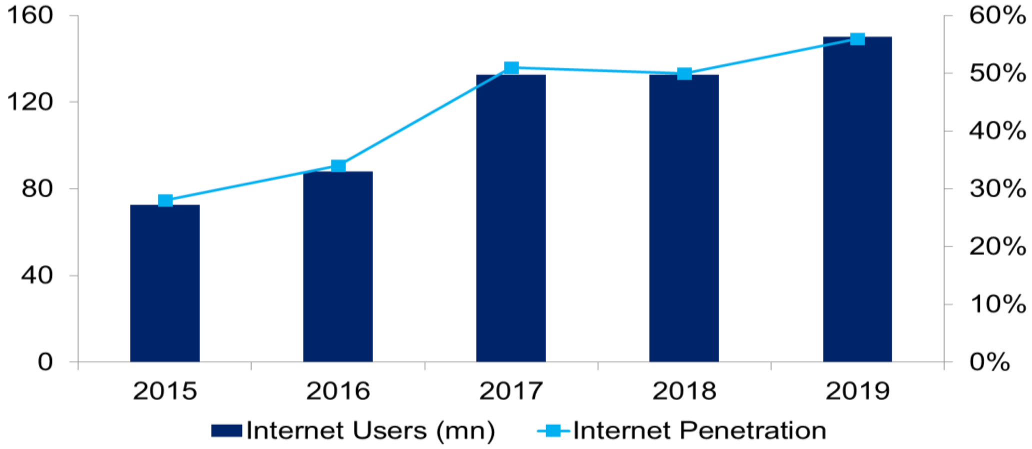
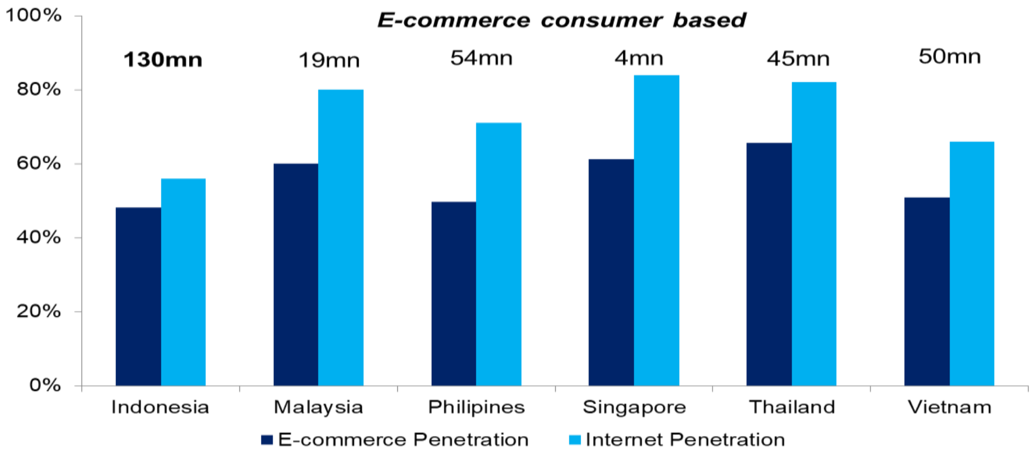


Figure 6. E-commerce and Internet Penetration

Source: We Are Social - Hootsuite, UOB Global Economics & Markets Research



- If we take a look at the overall potential of Indonesia's online economy, Google and Temasek has calculated that the value of Indonesia's online economy hit USD27bn in 2018 and is expected to reach USD100$ in 2025 (Figure 7), which is the highest compared to other country peers. Among those online economy, e-commerce, online travel, and transport-food-delivery holds the biggest share as shown by Figure 8, 9, and 10 respectively.

- Nevertheless, it is important to take note that, those potentials are accompanied with challenges. One of the key challenges is to capture the full potential of the consumer based by increasing the internet penetration rate. As mentioned above, Indonesia internet user penetration rate is the lowest as compared to other country peers. This due to the fact that Indonesia is comprised of archipelago, therefore, making the network infrastructure the biggest hurdle to beat (Figure 11).
- Another challenge lies within how to fully capture the online economy to measure the GDP. As revealed by Tapscott (1994) in his best-seller *The Digital Economy*, advancement of internet has dramatically changed the way of how business is conducted as well as provided an extraordinary services and welfare never anticipated before. However, productivity in the business and industries now confronts an apparent decline despite the accomplishment if the digitalization, which led to a possible productivity paradox and the limitations of gross domestic product (GDP) statistics in measuring online economy. While the ICT and comprehensive data management are still lacking, especially in emerging countries such as Indonesia, it will be a quite hard to properly measure the massive quality gains and benefits from the online economy.

Figure 7. Southeast Asia Internet Economy (USD bn)

Source: UOB KayHian, Google, Temasek, UOB Global Economics & Markets Research

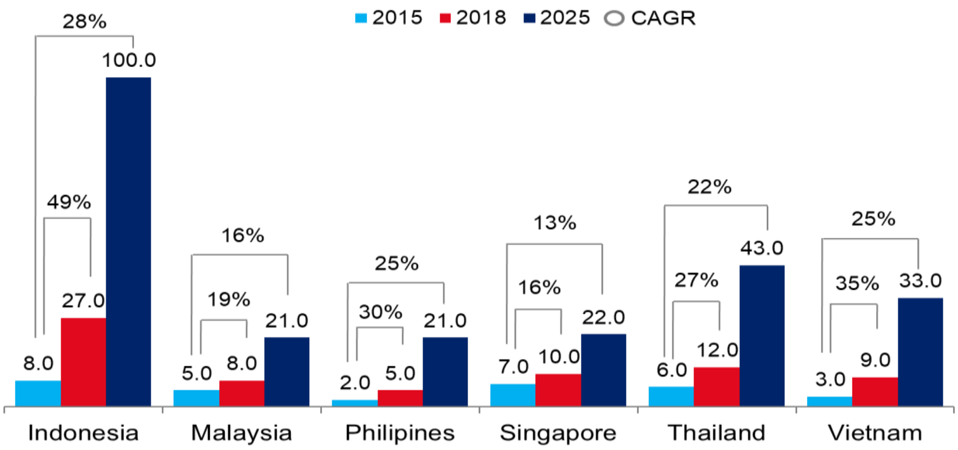


Figure 8. Southeast Asia E-Commerce Market (USD bn)

Source: UOB KayHian, Google, Temasek, UOB Global Economics & Markets Research

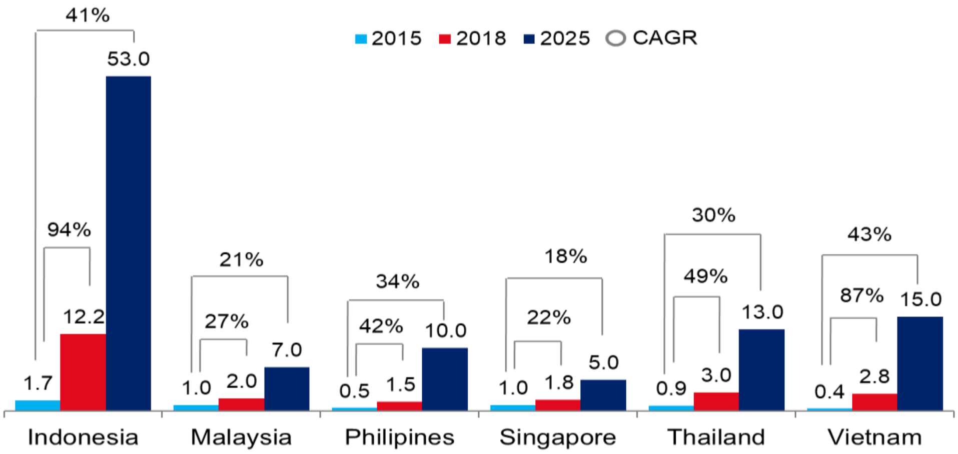


Figure 9. Southeast Asia Online Travel Market (USD bn)

Source: UOB KayHian, Google, Temasek, UOB Global Economics & Markets Research

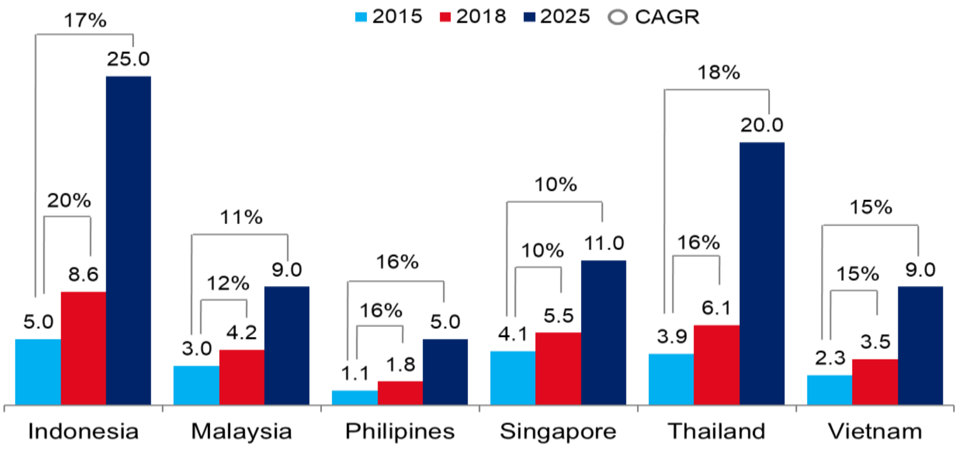


Figure 10. Southeast Asia Transport and Food Delivery Industries (USD bn)

Source: UOB KayHian, Google, Temasek, UOB Global Economics & Markets Research

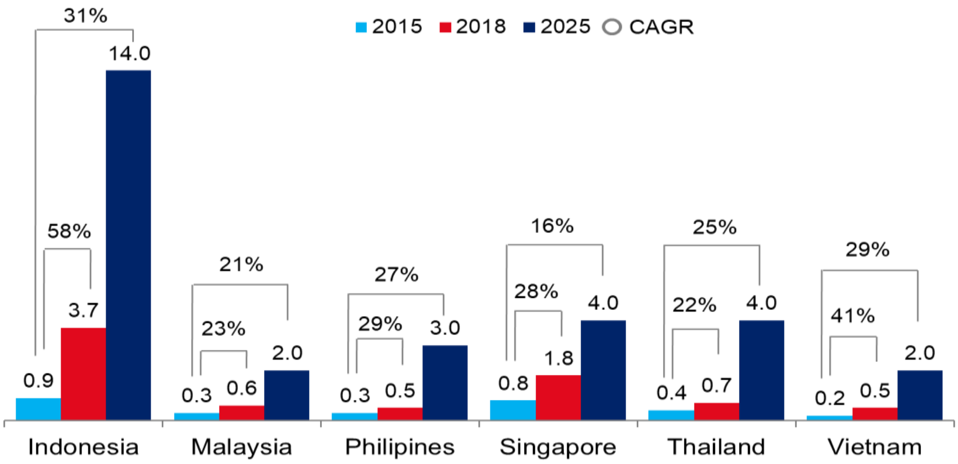
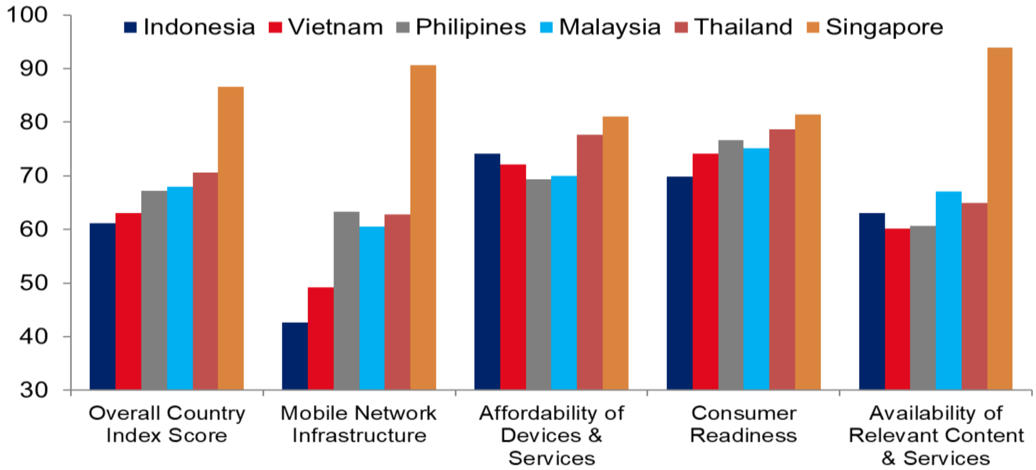


Figure 11. Mobile Connectivity Index Comparison 2019 (max. 100)

Source: We Are Social - Hootsuite, UOB Global Economics & Markets Research

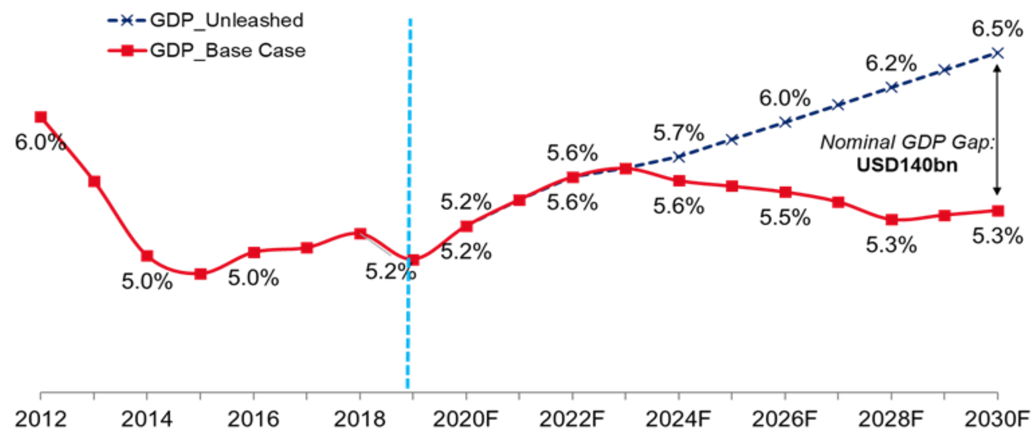


GDP Projection: Unleashing the Power of Consuming Class

- Our analysis, also supported by anecdotal evidences, suggest that the unique consumption of the millennials, along with their rising purchasing power, will be able to boost Indonesia economic growth to around 6.5% in a period of approximately a decade (Figure 12). Our assumptions are strongly based on the view that millennial generation has not fully reached their consumption potential as their earning will significantly grow in the next 10 years. Nevertheless, we should take caution that the appropriate strategy must be put in place for us to reach a higher and more sustainable growth, capitalizing on millennials' rising consumption. That is, Indonesia must look more towards its domestic resources rather than importing most of its consumption goods. In the current and potentially prolonged periods of rising nationalism in the world, actually most millennials are nowadays less brand-conscious and at the same time placing a much greater important towards experiential and self-actualizing consumption behavior (exactly the 4S consumption that we refer to in the above).

Figure 12. Real GDP Growth (%) Projection

Source: Bloomberg, UOB Global Economics & Markets Research



Attracting Foreign Investment Strategically

- Our observation also suggests that foreign investors are also eyeing on Indonesia consumer market. We gathered data from the positioning of private equity (PE) and venture capital (VC) dedicated to invest into Indonesian consumer-focused sectors. The data shows that offshore foreign investors are currently halfway through in raising their collective targeted capital of USD6.6bn in order to invest in Indonesia's consumer market (Figure 13). In comparison, this value is almost equal to quarterly Indonesian FDI for all sectors (Figure 14). On top of that, anecdotal evidence mentioned in Figure 4 above is also provided the supporting evidence. This is another reason for us to ensure that we must partner with the foreign investors in raising the much-needed financial capital to unleash the great consumption potentials in Indonesia. It is also a good diversification of sectors from the usual ones such as mining, electronics, and transportation. Furthermore, if we could induce and strategically entice more of these foreign investments to use more and more local factor of productions and local resources, then the acute problems of having persistent current account deficit could be mitigated (see next section).

Figure 13. Foreign Investors Collective Targets to Indonesia Consumer Sector

Source: Bloomberg, UOB Global Economics & Markets Research

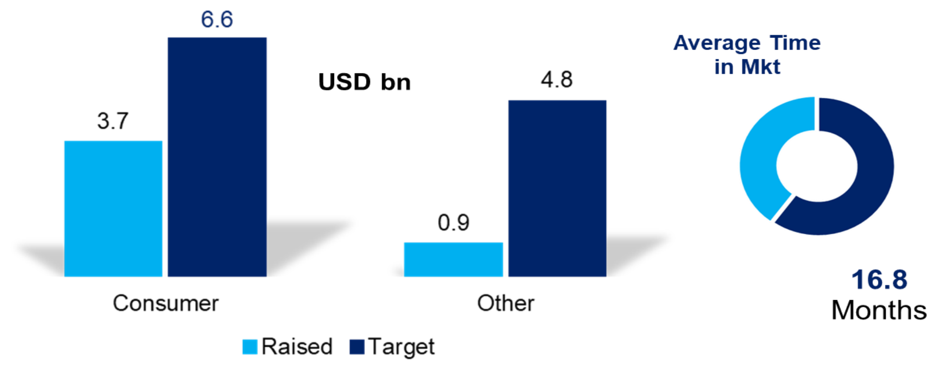
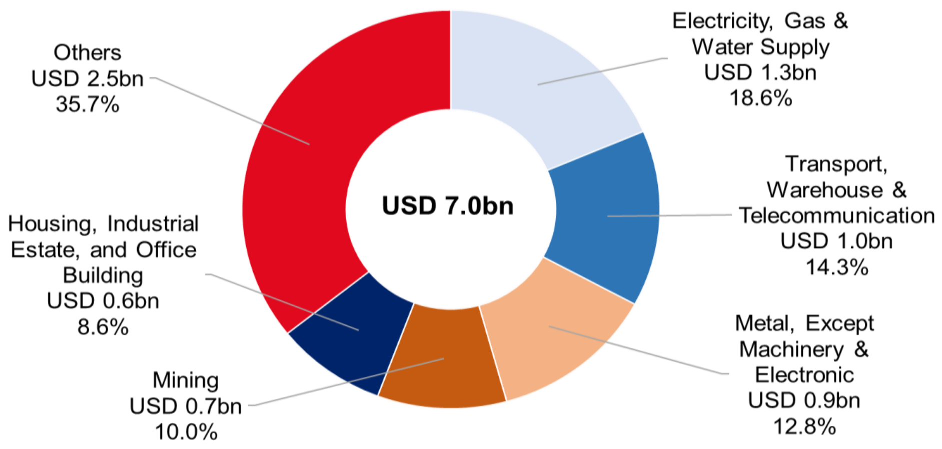


Figure 14. Top 5 FDI Realization 2Q19: Sector (USD bn)

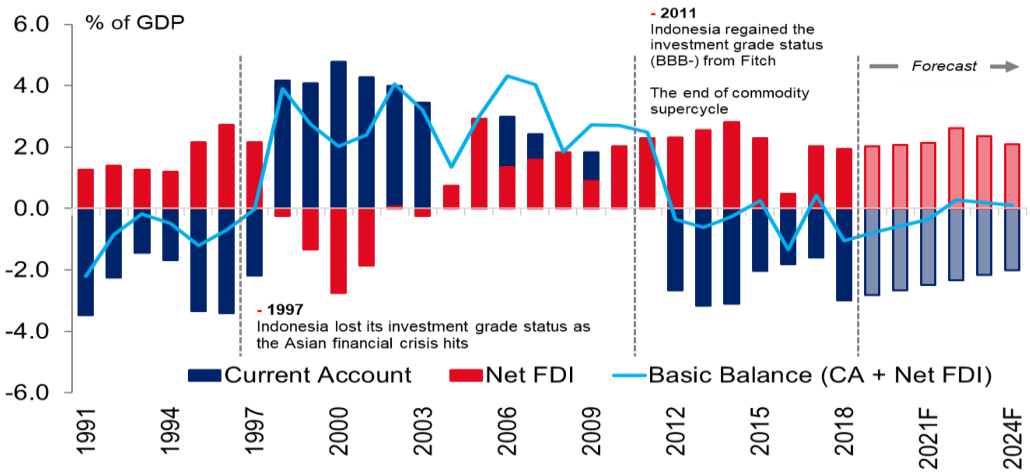
Source: Investment Coordinating Board Indonesia, UOB Global Economics & Markets Research



- The high inclination of investors wanting to enter into Indonesia's consumer market may introduce a key issue: Would further exposing ourselves more from external financing to drive growth higher a cause for concern? Not necessarily in our view, as long as strategy and clear rule of investments are put in place such as using more and more local resources rather than importing (as argued previously). Macro-fundamentally, our external sector does need external financing, which is far better considering the funding is FDI; long-term and non-hot money. The advantage of having this increase in FDI can be explained from the concept called basic balance, where the incoming FDI is expected to be able to cover the deficit in Indonesia's current account balance and ultimately stabilize IDR exchange rate. Given the government efforts in narrowing the current account deficit along with further FDI prospects from PE and VC, Indonesia is expected to record a positive basic balance in 2022 (Figure 15).

Figure 15. Indonesia Basic Balance

Source: Bloomberg, OECD, UOB Global Economics & Markets Research



Conclusion

- In conclusion, amidst the concern of global growth slowdown and rising market uncertainties, we may take comfort (yet, not being complacent) in the promising consumption power of the Indonesian economy due to its large potential of the domestic market, especially with the unique consumption of the millennial generation in the era of digitalization. Strategically, it would also be much more desirable should the focus of such rising consumption to be supported by increasing use of domestic sources, i.e. local raw materials and factor production factors; better still if we could export the mainly local-based and value-added products to international markets. In addition, with the expected improvement in the current account position and possibly more entry of longer-term foreign investment, the rupiah will tend to be more stable. This may also have a positive impact on the magnitude of the opportunity to reduce interest rates to a lower level and at the same time support a higher quality economic growth in Indonesia.

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