Global Asset Management

Indonesia and Vietnam: writing their own stories

Notes from the road

Veronique Erb
EM Equity Portfolio Manager

Published December 2024

As we arrive in Jakarta, the mood feels downbeat. A Trump 2.0 victory has seen all ASEAN currencies take a hit. Meanwhile, Indonesia is transitioning to a new government under President Prabowo Subianto, and the jury is out. One thing is clear: Prabowo has some big shoes to fill.

The fact that we arrive in the middle of rainy season doesn't help. There is flooding in Jakarta, and when the concierge tells me he has spent most of the night clearing two feet of water from his flooded home, I remember that Jakarta is quite literally sinking, at an alarming rate of up to 11 inches annually in some parts. This explains why – despite attracting criticism – the main project of former President Joko Wibowo ("Jokowi") revolved around shifting the capital away from Java towards a new capital called Nusantara on Borneo island. It seems quite a drastic decision, and a very costly one at that, but in the meantime a giant sea wall is being built to try to protect the city from rising seawater. Still, after hearing the concierge's story, I feel like it might be too little, too late.

In the decade that Jokowi governed the country, Indonesia benefitted from significant infrastructure investment. This has translated into the removal of historic bottlenecks and improved the ease of doing business in the country. It also had the effect of structurally lowering inflation, given that Indonesia's archipelagic status and length of 5,100km has presented a natural impediment to moving goods cheaply. In 2015, Jokowi's much contested decision to 'downstream' commodities, which forced commodity producers in the nickel space to set up processing and smelting capacity rather than purely mining the ore, turned out to be a momentous turning point in Indonesia's economic development. This downstreaming had a considerable multiplier effect as during the shift from unprocessed to processed nickel, the selling price rose six-fold and the benefits felt by the economy were significant.

"In the decade that Jokowi governed the country, Indonesia benefitted from significant infrastructure investment. This has translated into the removal of historic bottlenecks and improved the ease of doing business in the country."

Indonesia, with a Gross Domestic Product (GDP) per capita of circa USD5,000[1], is just entering the phase where discretionary consumption meaningfully picks up, as individuals feel they have money to spend. It is a populous nation with over half of the population (approximately 150 million people) below 30 years of age. This makes for a very exciting demographic. Moreover, given its large and accessible labour force, Indonesia is a key beneficiary of supply chain diversification, as multinational companies look for a China+1 alternative.

Rich in culture and biodiversity, and with a strategic sea-lane position, trade has fundamentally shaped Indonesian history, making it a target for many nations colonial aspirations. The Dutch ruled Indonesia from 1816-1941 but some parts were colonised for much longer – as much as three and a half centuries. No wonder, given Indonesia's abundance of commodities and spices ranging from nickel, gold, palm oil, and timber, to coffee, cloves, ginger, and turmeric, to a variety of exotic fruits. This made for rich pickings for any colonial power over the centuries.

Today, however, Indonesia is an independent democracy and the largest Muslim nation on earth, with nearly 240 million out of its total 270 million population being Muslim[2].

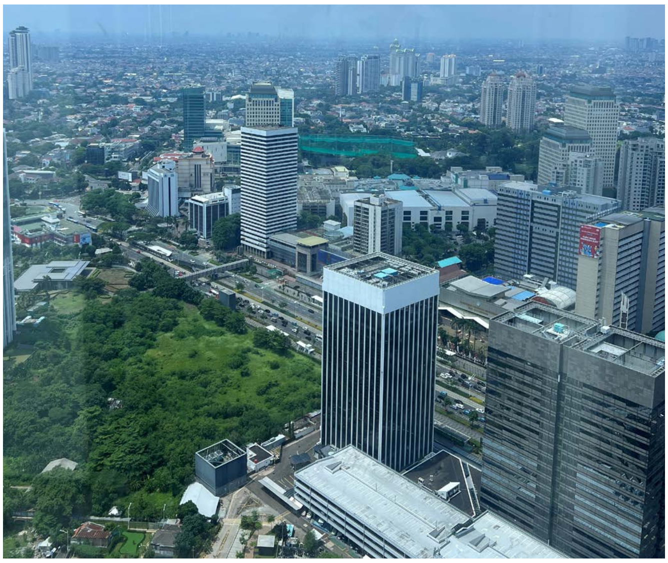
Our company visits tell a more upbeat story than our first impressions. This story is that the rise of Islamic banking and increasing financialisation offer significant opportunities to the population. Domestic consumption is also about to witness some fresh impetus, as President Prabowo's election promises focus on 'free school lunches for all kids in education', 'free healthcare', and 'access to affordable housing'.

Indonesia is a nation where both China and the U.S. have been looking to establish manufacturing facilities. China, in particular, has been actively setting up EV battery and vehicle facilities. In fact, whilst we were visiting Jakarta, President Prabowo was on a global whirlwind roadshow to try to attract further investment into his country.

"Indonesia is an independent democracy and the largest Muslim nation on earth, with nearly 240 million out of its total 270 million population being Muslim."

Some talking points that come to mind, following our company visits, are 'localisation' and 'swifter advertising & promotion capabilities'. These are key in Indonesia, given its young, digitally-savvy population, who can be easily won over by the newer, social media-driven brands. Post-Covid, there has been a concerted move away from general trade and mom-and-pop 'warung' type stores, towards modern retailing[3].

The Indonesia stock exchange, Jakarta.


Sudirman Central Business District, Jakarta.

A company store visit.

1 https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=ID
2 https://www.statista.com/topics/8377/demographics-of-indonesia/#topicOverview
3 A warung is a type of small family-owned business — small retail, eatery, or café — in Indonesia. It is an essential part of daily life in the region.

Although the basket size is still small, at only USD4[4], we see significant growth of the 'mini-market', a hybrid concept somewhere between the supermarket and convenience store formats. Meanwhile, at the high end, it is apparent that discretionary consumption is also alive and well, with areas such as premium sports brands selling very well in the shopping malls. There is robust demand for malls even in the lower tier 2 and 3 cities, and so there is clear bifurcation, where at the lower-end the consumer is downgrading but at the high-end, discretionary items remain in strong demand. We have observed that this trend is not unique to Indonesia.

Arriving in Ho Chi Minh, Vietnam feels very different to Jakarta. We are met with big boulevards, high rise buildings, and buzzing street life. Vietnam has a rich history and has historically been ruled by Chinese empires. However, more recently, it was colonised by France, as a rich source of raw materials, and a market for tariff-protected goods produced by French industries. Gaining back its independence from France in 1945, it quickly found itself entrenched in a bloody civil war – an ideological war between the communist north and the pro-capitalist south, which was supported by anti-communist allies during the Cold War. The winner of the war is disputed, however Vietnam remains a communist country and largely follows a Chinese planned system. Large scale, national champions in manufacturing have been created, and this is why Vietnam has been the recipient of so much foreign direct investment these last few decades. It is, for example, the largest employer for Nike in the world, and is moving up the value chain away from lower-end, textile-based manufacturing towards the higher-end tech supply chain.

"Large scale, national champions in manufacturing have been created, and this is why Vietnam has been the recipient of so much foreign direct investment these last few decades."

Ho Chi Minh City, also known as Saigon, bears its name from Vietnam's founder. Ho Chi Minh was a communist revolutionary who led Vietnam to freedom, first from the French and thereafter from the capitalist West. A remarkable man who was born in what was then known as France's Indochine, he received a French education and spent some time overseas in France, the U.S., and Great Britain.

One thing that is immediately apparent when we start our meetings is that diversity and inclusion is truly practised in Vietnam. Half of our meetings are with women, and they also fill many senior positions.

Circling back to its founding father, Ho Chi Minh, and the foundation of Vietnam, the country bears the incredible accolade of being one of the few in the world to win two wars without the use of arms.

A visit to a pharmaceutical company's distribution centre.

And the accolades don't end there. In November 2017, at an APEC conference at Danang in central Vietnam, the then U.S. President Trump said, "what the countries and economies represented here today have built in this part of the world is nothing short of miraculous." He described Da Nang as a city that was "once home to an American military base, in a country where many American and Vietnamese lost their lives in a very bloody war. Today we are no longer enemies, but we are friends."

Trump 2.0 is now on the horizon, and there is considerable uncertainty with regards to trade tariffs. Both governments consistently prioritised U.S.-Vietnam relations across administrations, and Vietnam has been instrumental for many of those multinationals looking for a China+1 strategy.

The country's economy has grown 30x since the early 1990s[5], and it has a young and educated population, of whom approximately one-third are below 30 years of age. However, Vietnam ranks only just behind Indonesia in terms of GDP per capita, and the country is still only in the frontier index, with potential FTSE inclusion into the EM index not until September 2025 (MSCI will be even later).

In terms of our meetings, we visit banks with various areas of focus, one with a mortgage niche and another specialising in SMEs. We visit logistics and port operators, retailers, condiment manufacturers, a property developer, and a high-end jewellery retailer, which gives us a good picture of the economy. With a closed capital account, foreign ownership limits, and a communist centrist government, there are definite roadblocks to contend with. An anti-corruption drive that has seen new property launches and decision making stall, and commercial decision making much more difficult, is the result of the USD12.5 billion property fraud scandal when Vietnamese property tycoon Truong My Lan, was sentenced to death earlier this year. The stuff of fiction, one story is that Truong's driver was caught driving a suitcase stuffed with billions of dollars. It is clear that, as the economy develops, lessons will be learned, laws will be streamlined, and loopholes will be plugged. For the moment, however, it remains an enticing story.

[4] Sumber Alfaria investor presentation.
[5] https://www.oxfordeconomics.com/resource/the-miracle-growth-story-of-vietnam-has-further-to-unfold/#:~:text=Thanks%20to%20its%20successful%20economic%20reform,%20Vietnam%E2%80%99s%20GDP,three%20decades,%20surpassing%20all%20its%20ASEAN%20regional%20peers.

Author

Veronique Erb

Portfolio Manager

Veronique is a portfolio manager on the RBC Emerging Markets Equity team at RBC GAM and focuses on research on Southeast Asia and Saudi Arabia. Prior to joining the firm in 2015, Veronique was at a large independent brokerage and investment group in Asia, where she was responsible for Asian ex-Japan equities for 15 years. During this time, she developed significant expertise in Asian equities, as well as a deep understanding of the region's corporate culture and economic development. Veronique began her career in the investment industry in 2000.

Published December 2024

RE/0167/12/24

Global Asset
Management