Election Results Bring Hope for Significant Changes in India and Indonesia

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This past year brought important political changes for the two largest economies in South/Southeast Asia. Although significant challenges remain, the election of a new government in India and a new president in Indonesia have been met with optimism by many participants in those countries' markets.

India

In May, financial markets and the Indian business community reacted positively to Narendra Modi's landslide victory in the Indian elections. Foreign investors, who have experienced years of uncertain governmental regulation, grindingly slow bureaucratic processes and underdeveloped infrastructure, have shown cautious optimism. The hope of Indian and foreign investors alike is that Modi's decisive style, together with his party's outright majority in the lower house, can finally allow real, significant change to occur. Modi's government already has raised the foreign investment cap in the defense and railways sectors from 26 percent to 49 percent and shaken up the governmental bureaucracy — which reportedly has resulted in dramatically reduced turnaround times for many governmental approvals and licenses. Modi's government plans to implement additional proposals, including:

- raising the foreign investment cap in the insurance sector from 26 percent to 49 percent;
- easing regulations on the purchase and development of land for infrastructure projects;
- reforming the labor market (though substantial resistance is expected from India's trade unions);
- implementing a nationwide goods and services tax; and
- implementing government asset sales, including in the coal and energy sectors.

Modi faces significant challenges in carrying out these proposals, including that his Bharatiya Janata Party does not control the upper house of Parliament and is likely to encounter difficulties pushing through the entirety of his proposed agenda.

Growth in M&A

In terms of deal activity, the aggregate value of cross-border mergers and acquisitions involving Indian companies in 2014 remained subdued, at around half the 2007 levels. Unlike many Asian markets, which quickly recovered in the second half of 2009 on the back of the massive monetary stimulus in China, Indian inbound and outbound deal activity has not yet recovered to precrisis levels — in part because of a number of very large outbound acquisitions by major Indian corporations in 2006 and 2007 that resulted in massive write-downs. However, domestic M&A activity, particularly among midmarket companies, recovered strongly in 2014 and now exceeds precrisis levels. Some signs indicate that the change in government, including several of the initiatives mentioned above, are spurring greater interest in Indian targets from foreign strategic and financial investors, particularly in the health care/pharma, technology, manufacturing and consumer products sectors, all of which augur well for an increase in inbound M&A activity in 2015.

Increase in Equity Offerings

Following a significant recovery in equity markets in 2014 — largely on the back of Modi's election victory — an increase in equity offerings, including initial public offerings, by Indian companies is expected in the coming year. Recent regulatory changes by the Securities and Exchange Board of India (SEBI), including allowing Indian companies to list depositary receipts on overseas stock exchanges without first listing their shares on an Indian stock exchange, should open up capital raising opportunities for Indian companies.

The market for offerings of foreign currency-denominated debt securities by Indian companies has previously faced significant hurdles, including a very active local bank-lending market, high withholding tax rates on offshore interest payments and restrictions imposed by the Reserve Bank of India's (RBI) External Commercial Borrowing (ECB) guidelines. The guidelines are designed to manage the Indian economy's exposure to short-term or high-cost foreign currency-denominated debt by imposing restrictions on the use of proceeds of foreign currency-denominated borrowings in noncapital-related activities and certain sectors, as well as an all-in cost ceiling (known as the "interest rate cap") on such borrowings of between 350 bps and 500 bps above six-month LIBOR, depending on tenor.

In 2014, the government announced a temporary reduction in withholding tax on interest payable to foreign institutional investors, from 20 percent to 5 percent until May 2015, which spurred significant debt issuance by well-known, higher-rated Indian corporations and banks. However, the strict enforcement of the ECB guidelines by the RBI, including with respect to recent offerings that used an offshore issuer structure to fund Indian operating affiliates, have prevented the development of a more robust foreign currency debt market for lower-rated Indian corporates.

Indonesia

Indonesia's July 2014 presidential election was in many ways a watershed moment for the country, the fourth most populous in the world. Joko Widodo's (Jokowi) win is considered a victory for the common man over the establishment — all prior presidents since Indonesia's democratization following the downfall of the Suharto regime in 1997 have been from the military or political elite.

That said, the break from the old guard has not been complete. Jokowi was handpicked to lead his party by former President Megawati Sukarnoputri, the daughter of Indonesia's first President Sukarno. The new president's coalition is a minority in the Indonesian parliament (known as the People's Representative Council); the majority coalition consists of parties that supported Jakowi's competitor in the presidential election runoff, former Gen. Prabowo

Subianto.

The new government faces several challenges. While Indonesia's economy, the largest in Southeast Asia, continued to grow in 2014, the pace of growth was slower than in previous years. The decreasing rate of expansion largely was driven by a significant slowdown in commodity exports, which in turn was due to falling Chinese demand and the related decrease in global commodity prices. Nevertheless, consumer demand continues to grow, which benefits the manufacturing, retail, real estate and leisure sectors, among others. Indonesia has long been attractive to investors due to its appealing demographics — *i.e.*, its young population — its natural resources and, compared to the past, its relatively stable political environment.

As for deal activity, the Indonesian M&A and equity markets were relatively subdued in 2014 compared to prior years. The slowdown was driven in part by the prospect of a presidential election, which historically has placed a damper on strategic corporate action, but also by the emerging markets sell-off in the early part of the year and the refocus by global investors on developed markets.

For inbound investment into Indonesia, regulatory concerns remain. For example, in January 2014 the government implemented a law prohibiting the export of unprocessed mineral ores in an effort to boost investment in smelters and ore processing plants. While the law has the potential to move Indonesia up the commodities value chain, it also risks a pullback in production by some miners and the scrapping of new projects by investors.

In 2014, U.S. dollar debt issuance by Indonesian corporations was robust, particularly in the real estate sector. However, late in the year, the central bank expressed significant concern about Indonesian corporations' exposure to foreign currency-denominated debt. These concerns date back to the Asian financial crisis, when the substantial exchange rate devaluation was the driver for massive foreign-currency debt defaults. What has followed is a new Bank Indonesia regulation that requires nonbank entities incurring offshore borrowings to hedge a portion of the foreign currency exposure, maintain minimum liquidity levels as they approach payment dates and, beginning on January 1, 2016, have a minimum "BB" credit rating from an Indonesian or international rating agency. A significant amount of foreign currency debt of Indonesian corporations comes due in the next couple of years, and it remains to be seen how this new regulation will affect the refinancing of this indebtedness.