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## Research Update:

# Ratings On Indonesia Raised To 'BBB-/A-3' On Reduced Fiscal Risks; Outlook Stable

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## Overview

- In our view, the Indonesian authorities have taken effective expenditure and revenue measures to stabilize the country's public finances despite the terms of trade shock.
- As a result, we expect net general government debt will stabilize near the current low levels while the budget deficit will gradually decline.
- We are therefore raising our long-term sovereign credit rating to 'BBB-', from 'BB+'. We are also raising our short-term sovereign credit rating to 'A-3' from 'B'. In addition, we are raising our ASEAN regional scale long-term rating to 'axA-' from 'axBBB+' and affirming our short-term rating at 'axA-2'.
- The outlook on the long-term rating is stable because we see upside and downside risks to the ratings are broadly balanced.

## Rating Action

On May 19, 2017, S&P Global Ratings raised its long-term sovereign credit ratings on the Republic of Indonesia to 'BBB-' from 'BB+'. The outlook is stable. We also raised our short-term sovereign credit ratings on Indonesia to 'A-3' from 'B' and our ASEAN regional scale long-term rating to 'axA-' from 'axBBB+'. In addition, we affirmed the short-term ASEAN regional scale rating at 'axA-2'.

## Rationale

We raised the ratings to reflect our assessment of reduced risks to Indonesia's fiscal metrics. We believe the government's increased focus on realistic budgeting has reduced the likelihood that a shortfall in future revenue would widen the general government deficit significantly beyond what we expect now. This also reduces the risk of a rising net general government debt ratio and debt servicing burden. Instead, we now anticipate that net debt will remain at the moderate levels of below 30% of GDP.

The government's new focus on realistic budgeting has lowered the risks that budget deficits will widen significantly when government revenue disappoints. Generating revenue from Indonesia's tax system has been a structural challenge confronting successive Indonesian governments. The ratio of general government revenue to GDP in Indonesia is the second lowest of all 67 investment-grade sovereigns, higher only than that of the Emirate of Sharjah. This leads to high interest burdens as a share of revenues, despite Indonesia's relatively low government debt stock (see: Sovereign Risk Indicators, an interactive version is available at www.spratings.com/sri).

Partly due to weaker commodity prices, tax receipts have been well below initial budget projections at least for the past three years. This had left the government having to cut spending toward the later part of the fiscal year (which runs from January to December) in order to keep the budget deficit within the legal ceiling of 3% of GDP. The 3% cap on the budget deficit written in Indonesia's State Finances Law 17 of 2003 has kept Indonesian governments focused on the fiscal balance. Consequently, the general government deficit in the five years to the end of 2016 averaged a modest 2.2% of GDP despite a sometimes challenging external environment.

In 2017, the government is projecting tax receipts that are lower than projections in the 2016 budget. Although this still represented an increase of more than 15% over realized tax collection a year earlier, the increase is significantly lower than those of earlier years. We expect this cautious stance toward budgeting fiscal revenue to persist over the next few years.

At the same time, we expect better revenue collection to result from the data collected during the just-concluded tax amnesty. We also expect increased control over fiscal spending with subsidy reforms being extended to electricity subsidies from 2017. These developments should ensure that the fiscal deficit remains below 2.5% of GDP over the next three to four years despite the government's intention to expand its infrastructure program to address the existing shortfall in infrastructure and basic services. Together with the greater focus on realistic budgeting, we believe that this will contain the risk of fiscal slippage leading to larger fiscal deficits than what we currently project. Despite the broader vulnerabilities of the economy to external shocks, we consider strong public finances a cornerstone of our investment-grade rating on Indonesia.

We also forecast a stable general government debt ratio over the next few years, reflecting the relatively stable projected fiscal balance. In some recent years, general government debt had increased significantly more than the size of the budget deficit. In the five years to 2016, for instance, the average increase was 3.2% of GDP annually. This was due to the impact of the depreciation of the Indonesian rupiah during this period on the size of the government's foreign currency debts as measured in local currency terms. More than 40% of government debt is denominated in foreign currencies at the end of 2016. We expect the change in government debt to be more in line with the fiscal deficit over the next few years, given our relatively stable outlook for the rupiah exchange rate. We project net general government debt to remain well below 30% of GDP. On top of this relatively moderate debt burden, we expect limited contingent liabilities facing the government over the next few years. That said, Indonesia continues to display an elevated interest burden relative to revenues, a reflection of the aforementioned difficulties of boosting tax revenues. We now consider the fiscal factors to be a rating strength, while institutional, monetary, and external factors are considered neutral.

Indonesia has exhibited effective policymaking in recent years to promote sustainable public finances and balanced economic growth. Political and policy institutions in Indonesia are generally stable and free of challenges to their legitimacy. The Indonesian society is generally cohesive despite the expanse of the country over many islands. News and information generally flow freely in Indonesia, with key policy and other changes well publicized and debated. Indonesia publishes timely economic, fiscal, and financial statistics in great detail. At the same time, Indonesia continues to trail many similarly rated sovereigns in perceptions regarding governance issues, such as control of corruption. We believe this has stunted growth-enhancing, inward foreign direct investment.

We believe economic and financial policy settings have become more predictable recently. The government has built a political coalition with a parliamentary majority. Despite the government having a greater number of political parties, it has managed to appoint individuals who are generally viewed as competent to the key economic ministerial positions.

Bank Indonesia, the central bank, has been an important institution in Indonesia's ability to sustain economic growth and attenuate economic or financial shocks. Over the past decade or so, inflation in the country has been broadly in line with those of its major trading partners. The central bank has had significant operational independence to pursue its monetary policy target since July 2005, when it formally adopted the Inflation Targeting Framework. It relies increasingly on market-based instruments in implementing monetary policy in a financial system that has grown steadily in recent years. Monetary flexibility has been augmented in recent years by the increasing flexibility of the rupiah, a floating currency.

Indonesia's external debt burden has risen over the past five years. External debts amount to a little above one-third of GDP at the end of 2016. The country's current account receipts (CAR), however, are small in relation to the size of the economy and have fallen relative to economic output over the past five years. Partly reflecting this decline, total external debt--net of liquid assets held by the public and financial sectors--has risen to just below annual CAR in 2016 from less than half in 2011.

The greater flexibility of the rupiah since 2013 should benefit the external metrics over the next three to five years. The current account has narrowed with the rupiah depreciation since 2013. At the same time, the rupiah flexibility has allowed the central bank to increase its foreign exchange reserves. Together with policy measures to discourage short-term external borrowing, gross external financing needs (current account payments plus short-term external debt) have declined to 94% of CAR in 2016 from almost 100% in 2014. We expect this external liquidity ratio to continue to decline (in other words, improve) in the next three years. This should go some way toward mitigating the risk of marked deterioration in the cost of external financing that we believe Indonesia continues to face in times of volatility in international financial markets.

The main weakness remains the economic risks facing the country, where the economy is still considered lower middle-income and, as a commodity exporter and capital importer, subject to external shocks. A key rating constraint is Indonesia's GDP per capita, which we estimate at US$3,800 in 2017. We estimate the trend growth rate of GDP per capita to be slightly above 4% per year. Growth of the Indonesian economy is largely dependent on domestic demand in recent years while exports have diminished in importance due to the decline in commodity prices. Improved global demand and stabilizing prices, however, have contributed to a strong rebound in exports early in 2017.

## Outlook

The stable outlook reflects our view that the policy environment and economic conditions will keep external and fiscal metrics close to current levels over the next one to two years. We could raise the long-term ratings if external and fiscal balances significantly outperform our current expectations.

Conversely, downward pressure on the rating could emerge if we expect trade and fiscal balances over the next three to five years to be materially worse than our current projections. Indications of pressure on the rating are net general government debt and budget deficits surpassing 30% and 3% of GDP, respectively, in a sustained way; or external liquidity (gross financing requirements as a percentage of current account receipts and foreign exchange reserves) consistently surpassing 100%, which could be triggered by another negative terms of trade shock.

## Key Statistics

**Table 1**

**Republic of Indonesia--Selected Indicators**

| ECONOMIC INDICATORS (%) | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| Nominal GDP (bil. LC) | 7,831,726 | 8,615,705 | 9,546,134 | 10,569,705 | 11,531,717 | 12,406,810 | 13,645,346 | 14,818,692 | 16,129,654 | 17,621,041 |
| Nominal GDP (bil. $) | 893 | 918 | 913 | 891 | 861 | 932 | 1,014 | 1,081 | 1,162 | 1,277 |
| GDP per capita (000s $) | 3.6 | 3.7 | 3.6 | 3.5 | 3.3 | 3.6 | 3.8 | 4.0 | 4.3 | 4.7 |
| Real GDP growth | 6.2 | 6.0 | 5.6 | 5.0 | 4.9 | 5.0 | 5.3 | 5.4 | 5.6 | 5.7 |
| Real GDP per capita growth | 4.8 | 4.6 | 4.2 | 3.7 | 3.6 | 3.8 | 4.0 | 4.2 | 4.4 | 4.4 |
| Real investment growth | 8.9 | 9.1 | 5.0 | 4.4 | 5.0 | 4.5 | 5.5 | 5.5 | 5.4 | 6.2 |
| Investment/GDP | 33.0 | 34.8 | 34.4 | 34.2 | 32.5 | 32.1 | 35.9 | 35.6 | 35.5 | 35.1 |
| Savings/GDP | 33.2 | 32.1 | 31.3 | 31.1 | 30.5 | 30.4 | 34.7 | 33.7 | 33.0 | 32.7 |
| Exports/GDP | 24.1 | 22.3 | 21.4 | 21.0 | 18.5 | 16.4 | 16.8 | 16.3 | 15.7 | 15.0 |

**Table 1**

| Republic of Indonesia--Selected Indicators (cont.) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **ECONOMIC INDICATORS (%)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
| Real exports growth | 14.9 | 0.8 | 3.8 | 0.8 | (2.5) | (2.7) | 5.0 | 2.5 | 2.5 | 2.5 |
| Unemployment rate | 7.5 | 6.1 | 6.2 | 5.9 | 6.2 | 5.6 | 5.3 | 5.0 | 5.0 | 4.9 |
| EXTERNAL INDICATORS (%) | | | | | | | | | | |
| Current account balance/GDP | 0.2 | (2.7) | (3.2) | (3.1) | (2.0) | (1.8) | (1.2) | (1.9) | (2.5) | (2.5) |
| Current account balance/CARs | 0.8 | (11.0) | (13.5) | (13.1) | (9.5) | (9.0) | (6.1) | (9.7) | (13.2) | (13.9) |
| CARs/GDP | 25.0 | 24.2 | 23.7 | 23.6 | 21.4 | 19.4 | 20.1 | 19.5 | 18.7 | 17.9 |
| Trade balance/GDP | 3.8 | 0.9 | 0.6 | 0.8 | 1.6 | 1.7 | 1.7 | 1.1 | 0.6 | 0.4 |
| Net FDI/GDP | 1.3 | 1.5 | 1.3 | 1.7 | 1.2 | 1.6 | 0.2 | 0.1 | 0.2 | 0.1 |
| Net portfolio equity inflow/GDP | 0.4 | 1.0 | 1.2 | 2.9 | 1.9 | 2.0 | 1.0 | 0.8 | 0.9 | 0.7 |
| Gross external financing needs/CARs plus usable reserves | 85.6 | 92.2 | 96.3 | 99.8 | 94.0 | 94.3 | 91.5 | 89.8 | 93.5 | 94.8 |
| Narrow net external debt/CARs | 48.4 | 58.9 | 72.6 | 81.6 | 104.3 | 99.0 | 91.6 | 93.9 | 94.6 | 96.7 |
| Net external liabilities/CARs | 155.1 | 177.3 | 187.2 | 201.2 | 226.1 | 199.7 | 183.0 | 186.1 | 192.4 | 196.0 |
| Short-term external debt by remaining maturity/CARs | 23.2 | 27.0 | 33.0 | 33.9 | 41.5 | 40.5 | 37.7 | 33.9 | 33.6 | 33.6 |
| Usable reserves/CAPs (months) | 5.2 | 5.4 | 5.5 | 5.0 | 6.6 | 6.4 | 6.5 | 6.6 | 6.0 | 5.9 |
| Usable reserves (mil. $) | 110,239 | 112,798 | 99,379 | 111,846 | 105,932 | 116,374 | 126,499 | 123,888 | 127,374 | 131,205 |
| FISCAL INDICATORS (%, General government) | | | | | | | | | | |
| Balance/GDP | (1.1) | (1.8) | (2.2) | (2.1) | (2.5) | (2.5) | (2.4) | (2.4) | (2.3) | (2.2) |
| Change in debt/GDP | 1.6 | 2.0 | 4.2 | 2.2 | 4.8 | 2.7 | 2.5 | 2.4 | 2.3 | 2.2 |
| Primary balance/GDP | 0.1 | (0.6) | (1.0) | (0.9) | (1.2) | (1.0) | (1.0) | (1.0) | (0.9) | (0.8) |
| Revenue/GDP | 15.5 | 15.5 | 15.1 | 14.7 | 14.8 | 14.1 | 14.5 | 14.7 | 14.9 | 15.0 |
| Expenditures/GDP | 16.5 | 17.3 | 17.3 | 16.8 | 17.4 | 16.6 | 16.9 | 17.1 | 17.2 | 17.2 |
| Interest /revenues | 7.7 | 7.5 | 7.8 | 8.6 | 9.1 | 10.4 | 9.9 | 9.7 | 9.6 | 9.5 |
| Debt/GDP | 23.1 | 23.0 | 25.0 | 24.8 | 27.6 | 28.3 | 28.2 | 28.4 | 28.4 | 28.2 |
| Debt/Revenue | 149.6 | 148.2 | 165.7 | 169.0 | 185.9 | 200.8 | 194.4 | 192.9 | 190.3 | 187.7 |
| Net debt/GDP | 21.0 | 21.4 | 23.2 | 22.9 | 25.3 | 26.2 | 26.3 | 26.6 | 26.7 | 26.7 |

**Table 1**

| Republic of Indonesia--Selected Indicators (cont.) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **ECONOMIC INDICATORS (%)** | **2011** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
| Liquid assets/GDP | 2.1 | 1.6 | 1.8 | 1.9 | 2.3 | 2.1 | 1.9 | 1.8 | 1.6 | 1.5 |
| MONETARY INDICATORS (%) | | | | | | | | | | |
| CPI growth | 3.8 | 4.3 | 8.4 | 8.4 | 3.4 | 3.0 | 4.7 | 4.7 | 5.0 | 4.7 |
| GDP deflator growth | 7.5 | 3.8 | 5.0 | 5.4 | 4.0 | 2.5 | 4.5 | 3.0 | 3.0 | 3.4 |
| Exchange rate, year-end (LC/$) | 9,068.0 | 9,670.0 | 12,189.0 | 12,440.0 | 13,795.0 | 13,436.0 | 13,563.9 | 13,812.1 | 13,842.5 | 13,786.1 |
| Banks' claims on resident non-gov't sector growth | 25.0 | 22.8 | 20.8 | 12.3 | 9.0 | 9.3 | 6.5 | 7.5 | 9.0 | 10.0 |
| Banks' claims on resident non-gov't sector/GDP | 30.2 | 33.8 | 36.8 | 37.3 | 37.3 | 37.9 | 36.7 | 36.3 | 36.4 | 36.6 |
| Foreign currency share of claims by banks on residents | 10.1 | 10.2 | 11.9 | 11.1 | 10.3 | 9.4 | 12.0 | 14.5 | 14.5 | 14.5 |
| Foreign currency share of residents' bank deposits | 14.6 | 15.5 | 18.4 | 17.1 | 17.3 | 15.7 | 16.4 | 16.4 | 16.4 | 16.4 |
| Real effective exchange rate growth | (1.1) | (5.3) | (11.5) | 10.0 | (1.6) | 6.8 | N/A | N/A | N/A | N/A |

Savings is defined as investment plus the current account surplus (deficit). Investment is defined as expenditure on capital goods, including plant, equipment, and housing, plus the change in inventories. Banks are other depository corporations other than the central bank, whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the prior year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus public-sector liquid assets held by nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. LC--Local currency. CARs--Current account receipts. FDI--Foreign direct investment. CAPs--Current account payments. The data and ratios above result from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.

## Ratings Score Snapshot

**Table 2**

| Republic of Indonesia--Ratings Score Snapshot | |
|---|---|
| **Key rating factors** | |
| Institutional assessment | Neutral |
| Economic assessment | Weakness |
| External assessment | Neutral |
| Fiscal assessment: flexibility and performance | Neutral |
| Fiscal assessment: debt burden | Strength |
| Monetary assessment | Neutral |

**Table 2**

| Republic of Indonesia--Ratings Score Snapshot (cont.) |
|---|
| S&P Global Ratings' analysis of sovereign creditworthiness rests on its assessment and scoring of five key rating factors: (i) institutional assessment; (ii) economic assessment; (iii) external assessment; (iv) the average of fiscal flexibility and performance, and debt burden; and (v) monetary assessment. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). Section V.B of S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 23, 2014 , summarizes how the various factors are combined to derive the sovereign foreign currency rating, while section V.C details how the scores are derived. The ratings score snapshot summarizes whether we consider that the individual rating factors listed in our methodology constitute a strength or a weakness to the sovereign credit profile, or whether we consider them to be neutral. The concepts of "strength", "neutral", or "weakness" are absolute, rather than in relation to sovereigns in a given rating category. Therefore, highly rated sovereigns will typically display more strengths, and lower rated sovereigns more weaknesses. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in assessment of the aforementioned factors does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the assessments. |

## Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, June 1, 2016
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology, Dec. 23, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

## Related Research

- Asia-Pacific Sovereign Rating Trends, January 2017, Jan. 10, 2017
- Sovereign Debt 2017: Asia-Pacific Borrowing Of US$2.6 Trillion Is Likely This Year, Feb. 24, 2017
- Asia-Pacific Credit Conditions Q2 2017: Top Risk Is Uncertain U.S. Trade Tax Policy, March 28, 2017
- Asia-Pacific Economies' Smooth Start To 2017: What Could Possibly Go Wrong?, March 30, 2017
- Emerging Markets Sovereign Rating Trends: First-Quarter 2017, April 12, 2017
- 2016 Annual Sovereign Default Study And Rating Transitions, April 3, 2017
- 2016 Sovereign Ratings Update: Outlook and CreditWatch Resolutions, April 18, 2017
- Sovereign Ratings History, April 11, 2017
- Sovereign Debt 2017: Global Borrowing To Drop By 4% To US$6.8 Trillion, Feb. 23, 2017
- Global Sovereign Rating Trends: First Quarter 2017, April 10, 2017

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee agreed that the rating factors for fiscal flexibility and performance as well as the fiscal debt burden had improved.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

## Ratings List

Upgraded; Outlook Action; Ratings Affirmed

| | To | From |
|---|---|---|
| Indonesia (Republic of) | | |
| Sovereign Credit Rating | BBB-/Stable/A-3 | BB+/Positive/B |
| Senior Unsecured | BBB- | BB+ |
| | | |
| ASEAN Regional Scale | axA-/--/axA-2 | axBBB+/--/axA-2 |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.