Research Update:

Indonesia Ratings Affirmed At 'BBB/A-2'; Outlook Stable

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PRIMARY CREDIT ANALYST

KimEng Tan
Singapore
+ 65 6239 6350
kimeng.tan
@spglobal.com

SECONDARY CONTACTS

Andrew Wood
Singapore
+ 65 6239 6315
andrew.wood
@spglobal.com

Rain Yin
Singapore
+ (65) 6239 6342
rain.yin
@spglobal.com

Overview

- We expect annual general government deficits of close to 3% of GDP over the next two to three years.
- The continued development of Indonesia's commodity-related industries should help maintain stable external metrics.
- We affirmed our 'BBB/A-2' sovereign credit ratings on Indonesia.
- The outlook remains stable.

Rating Action

On July 30, 2024, S&P Global Ratings affirmed its 'BBB' long-term and 'A-2' short-term sovereign credit ratings on Indonesia. The outlook on the long-term rating is stable.

Outlook

The stable rating outlook reflects our expectation that annual general government deficits will stay close to 3% of GDP over the next two to three years. The continued development of Indonesia's commodity-related industries should also help maintain stable external metrics.

Downside scenario

We may lower the ratings if we believe that one or more of the following developments will happen:

- Net general government debt rises at an annual rate of more than 3% of GDP persistently;
- General government interest payments surpass 15% of revenues on a sustained basis; or
- A structural slowdown in export receipts occurs, which drives annual gross external financing needs consistently above levels equivalent to the sum of current account receipts and usable reserves in that year.

Upside scenario

We may raise the ratings if material improvements in Indonesia's external metrics lead to net narrow external indebtedness falling below 50% of current account receipts and gross external financing needs going below 50% of the sum of current account receipts and usable reserves.

Rationale

Our ratings on Indonesia reflect the economy's sound growth prospects, prudent fiscal policy settings and relatively light net external and government debt burden. Balancing these strengths are low GDP per capita, narrow export and fiscal revenue bases as well as a domestic financial sector that is less deep and diversified than peers.

Institutional and economic profile: New government's fiscal plans introduce policy uncertainty

- The incoming government has signaled that it intends to raise public spending, with funding coming from an increase in government debt.
- Investors are likely to focus on whether the incoming government will continue to observe the legal restriction on fiscal deficits--an important policy anchor in Indonesia.
- Indonesia should maintain steady growth prospects over the next two to three years, with real per capita GDP growth of above 4% in the next three to four years.

Some media reports suggested that the incoming Prabowo administration may allow the government debt level to rise to 50% of GDP. This increase, from the current 39% of GDP, still leaves the debt ratio below the legal limit of 60% of GDP. However, it could be interpreted to mean that the government will run annual deficits above the legal limit of 3% of GDP.

The legal restrictions on Indonesian fiscal deficits and government debt ratios have served as a policy anchor for 20 years. The law was implemented in 2003, following the turmoil of the Asian Financial Crisis. It has been observed consistently, except during the severe economic disruptions of the COVID-19 pandemic. Investors could perceive heightened policy uncertainty if the law is changed.

The incoming administration's early communication of its intentions suggests that it is aware of this risk. It has stressed that a 50% debt ratio remains within the current legal limits. And it indicated that the debt increase is conditional on the new government's ability to increase revenue and that the debt ratio will be little changed in the next fiscal year. Recent media reports also cited an official close to the President-elect denying that the new government will change the law to allow larger fiscal deficits. Despite these assurances, policy uncertainty is likely to remain until the next government unveils its plan in detail.

The higher debt level will help fund the President-elect's policy priorities. He aims for these initiatives to raise real GDP growth to 8% annually. The most important of his plans is a "free nutritious meal" program targeting children and pregnant mothers. News reports put the annual cost for the scheme at approximately Indonesian rupiah (IDR) 450 trillion (US$28 billion; 2% of GDP in 2024) when it is fully implemented. The President-elect's other plans included larger investment in housing, power plants, and refineries, as well as increasing food production.

Indonesian policymakers prioritize economic and financial stability. Over the years, they have made constant efforts to increase transparency through regular interactions and information-sharing with financial market participants. They have been willing to be flexible in making policy adjustments when circumstances require them. The current government had also been quick to rein in its budget deficit below 3% of GDP once the economic pressures of the pandemic receded.

Although a new government will inevitably bring changes, President-elect Prabowo had served in past governments. Consequently, we believe there will be significant policy continuity. When policymakers implement new initiatives, we also expect they will seek to avoid serious economic or financial disruptions.

We forecast Indonesia's economy will continue to grow at close to 5% annually over the next three to four years. We expect domestic demand to provide much of the growth momentum during this period. With the uncertainty of the elections out of the way, private investment should pick up from the slowdown in 2024. The incoming government's pro-growth focus should also see increased public spending in the next few years.

Average income in Indonesia remains lower than most other investment-grade sovereigns but is rising faster. We estimate GDP per capita this year at US$5,000, marginally above that in 2023. The small increase this year, despite much stronger growth in local currency terms, reflects our expectation of a depreciation of the rupiah. Trend economic growth, however, is better than most economies of similar income levels.

Flexibility and performance profile: New government's fiscal orientation to come into focus following a period of powerful consolidation

- We project Indonesia's fiscal deficit at close to 3% of GDP in the next three years.
- We don't expect forecasts of current account deficits in the next three years to materially weaken the narrow net external debt ratio.
- Consumer price inflation should come in within the government's target range in the next two years.

We expect budget deficits in the next three years to be higher than those in 2022-2024. The incoming government has indicated that it does not intend to make legal changes to allow for higher deficits. However, given its spending plans, it would likely aim for budget shortfalls close to the legal limit of 3% of GDP.

The revenue-to-GDP ratio in the next few years should stabilize at slightly below 15% of GDP, falling slightly from levels in the past two years. The recent sharp correction in nickel prices globally is likely to affect miners and manufacturers negatively in the near future. The government's expansion of bans on ore exports could also dent export earnings.

In mitigation, new nickel smelters and factories for electric vehicle batteries have, or are likely to, begin operations in the near future. While they enjoy income tax holidays, they will support demand for miners and related industries. At the same time, the incoming government also intends to raise revenue by focusing on improving tax compliance.

Based on the above assumptions, net general government debt should rise marginally to 36.3% of GDP at the end of 2027, from 35.7% in 2023. With interest rates likely to decline in the near future, interest payments in the next few years should stay close to 14% of general government revenue.

The government fiscal trajectory appears more uncertain than usual. Our projections are in line with the incoming government's stated commitment to the legal limits on budget deficits. However, this would put our gross government debt projections in the next few years well below the 50% level that it is reported to be comfortable with. Future policy changes could cause the path of fiscal indicators to deviate from our projections.

We expect limited contingent liabilities to the government from the financial system. This is based on our assessment of Indonesia's banking industry country risk at '6' and the banking sector's balance sheet size of less than 60% of GDP.

Indonesia's external metrics should remain relatively stable in the next three to four years, despite our expectations of a return to current account deficits. We believe exports will continue to grow in the next few years, with new smelters and factories coming onstream. However, the growth rate will likely be weighed down by weak nickel prices and the renewed ban on ore exports.

In the next few years, we expect continued foreign investment in the industrial sector to sustain moderate import growth. Gross external financing needs should remain a little above 90% of the sum of current account receipts and usable reserves.

Narrow net external debt should fall to about 55% of current account receipts in 2027, from nearly 70% this year. In recent years, gross external debt had declined modestly. This reflected net repayment of foreign debts by nongovernment borrowers as global interest rates rise and the U.S. dollar strengthened. Although we project a recovery in external borrowing, it is likely to be a modest pick-up owing to foreign interest rates remaining elevated. We expect exports and higher external interest earnings to keep growth of current account receipts in line with that of nominal GDP.

We view Bank Indonesia as possessing significant operational independence since July 2005, when it formally adopted the inflation-targeting framework. The central bank has since managed inflation roughly in line with that of its regional peers; in particular, price pressures have been generally well contained since the early 2010s. Indonesia's 2024 inflation target is 1.5%-3.5%, and we forecast consumer price inflation to average 2.8% in 2024, and 3.0% in 2025.

Bank Indonesia is relying more on market-based instruments to implement its monetary policy, and the financial system has grown steadily in recent years. The increasing flexibility of the rupiah, a floating currency subject to intermittent intervention, augments monetary flexibility.

Bank Indonesia maintains a sizable portfolio of government debt on its balance sheet, in part as a legacy of the burden-sharing agreement it struck with the government during the pandemic. Much of this debt will mature over the next three to four years, but the central bank could step in to purchase longer-dated securities on the secondary market if it does not want to pare its balance sheet.

Key Statistics

Table 1

Indonesia--Selected Indicators

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Economic indicators (%)										
Nominal GDP (bil. LC)	14,838,756	15,832,657	15,443,353	16,976,751	19,588,090	20,892,377	22,484,219	24,369,397	26,324,687	28,451,050
Nominal GDP (bil. $)	1,042	1,119	1,059	1,187	1,319	1,371	1,404	1,529	1,653	1,781

Table 1

Indonesia--Selected Indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
GDP per capita ('000s $)	3.9	4.1	3.9	4.3	4.8	4.9	5.0	5.4	5.8	6.2
Real GDP growth	5.2	5.0	(2.1)	3.7	5.3	5.0	5.0	5.0	4.9	4.9
Real GDP per capita growth	4.0	3.9	(3.1)	3.0	4.6	4.3	4.2	4.2	4.1	4.1
Real investment growth	6.7	4.5	(5.0)	3.8	3.9	4.4	3.8	6.3	5.6	5.3
Investment/GDP	35.1	33.7	29.7	32.5	35.7	36.0	35.4	35.4	35.2	35.0
Savings/GDP	32.1	31.0	29.3	32.8	36.7	35.8	34.7	34.5	34.3	34.1
Exports/GDP	21.0	18.6	17.3	21.4	24.5	21.7	22.2	22.4	22.5	22.6
Real exports growth	6.5	(0.5)	(8.4)	18.0	16.2	1.3	4.8	5.0	4.8	5.1
Unemployment rate	5.3	5.2	7.1	6.5	5.9	5.3	4.8	4.7	4.7	4.7
External indicators (%)										
Current account balance/GDP	(2.9)	(2.7)	(0.4)	0.3	1.0	(0.1)	(0.7)	(0.9)	(1.0)	(0.9)
Current account balance/CARs	(13.1)	(13.8)	(2.3)	1.3	3.9	(0.6)	(2.9)	(3.9)	(4.2)	(3.8)
CARs/GDP	22.4	19.7	18.3	22.3	25.6	23.0	23.2	23.3	23.4	23.5
Trade balance/GDP	(0.0)	0.3	2.7	3.7	4.8	3.4	2.8	2.4	2.1	2.1
Net FDI/GDP	1.2	1.8	1.3	1.5	1.4	1.1	1.3	1.3	1.3	1.3
Net portfolio equity inflow/GDP	(0.5)	(0.1)	(0.5)	0.2	(0.1)	(0.1)	(0.3)	(0.3)	(0.3)	(0.3)
Gross external financing needs/CARs plus usable reserves	97.5	100.3	89.8	87.4	86.3	91.8	94.2	92.7	92.9	92.5
Narrow net external debt/CARs	100.9	115.6	132.6	90.4	66.9	72.1	69.7	63.7	59.2	55.2
Narrow net external debt/CAPs	89.2	101.6	129.6	91.6	69.6	71.6	67.8	61.2	56.8	53.2
Net external liabilities/CARs	153.3	171.5	164.3	117.3	84.1	93.4	91.2	85.2	80.8	76.9
Net external liabilities/CAPs	135.5	150.8	160.7	118.8	87.5	92.8	88.7	82.0	77.6	74.1
Short-term external debt by remaining maturity/CARs	36.3	38.3	45.2	33.0	27.2	28.9	29.7	25.7	24.1	22.7

Table 1

Indonesia--Selected Indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Usable reserves/CAPs (months)	5.6	5.4	7.5	6.2	5.4	4.9	4.8	4.6	4.4	4.3
Usable reserves (mil. $)	113,544	124,782	134,133	144,625	129,638	132,369	141,919	147,115	153,727	160,851
Fiscal indicators (general government; %)										
Balance/GDP	(1.7)	(2.1)	(6.1)	(4.4)	(2.2)	(1.6)	(2.5)	(2.9)	(2.9)	(2.9)
Change in net debt/GDP	3.2	2.2	7.4	5.1	3.7	1.7	2.5	2.9	2.9	2.9
Primary balance/GDP	0.0	(0.4)	(4.0)	(2.4)	(0.2)	0.5	(0.4)	(0.8)	(0.8)	(0.8)
Revenue/GDP	14.9	14.3	12.4	13.7	15.2	15.0	14.8	14.8	14.8	14.8
Expenditures/GDP	16.6	16.4	18.4	18.1	17.4	16.6	17.3	17.7	17.7	17.7
Interest/revenues	11.7	12.2	16.5	14.7	13.0	14.3	14.4	14.0	14.0	14.0
Debt/GDP	30.1	30.6	39.7	41.1	40.1	39.6	39.3	39.2	39.3	39.3
Debt/revenues	201.9	214.2	321.8	299.9	264.6	263.9	265.7	265.2	265.5	265.6
Net debt/GDP	27.2	27.6	35.7	37.6	36.2	35.7	35.7	35.8	36.1	36.3
Liquid assets/GDP	3.0	2.9	4.0	3.6	3.9	3.8	3.6	3.4	3.2	3.0
Monetary indicators (%)										
CPI growth	3.1	2.8	2.0	1.6	4.2	3.7	2.8	3.0	3.1	3.0
GDP deflator growth	3.8	1.6	(0.4)	6.0	9.6	1.5	2.5	3.2	3.0	3.0
Exchange rate, year-end (LC/$)	14481.00	13901.01	14105.01	14269.01	15731.00	15416.00	16000.00	15900.00	15950.00	16000.00
Banks' claims on resident non-gov't sector growth	12.4	5.8	(1.2)	4.6	10.1	8.3	10.0	10.0	10.0	10.0
Banks' claims on resident non-gov't sector/GDP	36.0	35.7	36.2	34.4	32.8	33.3	34.1	34.6	35.2	35.8
Foreign currency share of claims by banks on residents	13.6	12.3	11.8	11.8	12.4	12.2	12.0	12.0	12.0	12.0
Foreign currency share of residents' bank deposits	15.0	14.5	13.9	14.0	15.6	16.1	15.0	15.0	15.0	15.0

Table 1

Indonesia--Selected Indicators (cont.)

	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Real effective exchange rate growth	(6.3)	4.5	(1.8)	(1.5)	2.9	2.9	2.9	2.9	2.9	2.9

Sources: Bank Sentral Republik Indonesia (Economic/External Indicators), International Monetary Fund and Bank Sentral Republik Indonesia (Monetary Indicators), Directorate General of Budget Financing and Risk Management, Ministry of Finance and Bank Sentral Republik Indonesia (Fiscal/Debt Indicators).
Adjustments: None
Definitions: 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 claims on nonresidents minus financial-sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. N/A--Not applicable. 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

Indonesia--Ratings Score Snapshot

Key rating factors	Score	Explanation
Institutional assessment	3	Generally effective policymaking promoting balanced economic growth and sustainable public finances. Moderate policy predictability, with possible policy shifts with changes in administration. Generally cohesive civil society.
Economic assessment	4	Based on GDP per capita (US$) and growth trends as per Selected Indicators in table 1. Weighted average real GDP per capita trend growth over a 10-year period is well above that of sovereigns in the same GDP category.
External assessment	3	Based on narrow net external debt (% of current account receipts) and gross external financing needs (% of current account receipts and usable reserves) as per the Selected Indicators in table 1.
Fiscal assessment: flexibility and performance	3	Based on the change in net general government debt (% of GDP) as per Selected Indicators in table 1.
Fiscal assessment: debt burden	4	Based on net general government debt (% of GDP) and general government interest expenditure (% of general government revenue) as per Selected Indicators in table 1.
Monetary assessment	3	The rupiah is a free-floating currency. However, the central bank intervenes intermittently in foreign exchange markets. The central bank has operational independence and uses market-based monetary instruments such as seven-day repo rate. However, there is some reliance on reserve requirements. CPI as per Selected Indicators in table 1. The central bank has the ability to act as lender of last resort for the financial system.
Indicative rating	bbb	As per table 1 of "Sovereign Rating Methodology."
Notches of supplemental adjustments and flexibility	0	
Final rating		
Foreign currency	BBB	
Notches of uplift	0	Default risks do not apply differently to foreign- and local-currency debt.

Table 2

Indonesia--Ratings Score Snapshot (cont.)

Key rating factors	Score	Explanation
Local currency	BBB	

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). S&P Global Ratings' "Sovereign Rating Methodology," published on Dec. 18, 2017, details how we derive and combine the scores and then derive the sovereign foreign currency rating. In accordance with S&P Global Ratings' sovereign ratings methodology, a change in score 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 scores. In determining the final rating the committee can make use of the flexibility afforded by §15 and §§126-128 of the rating methodology.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | Sovereigns: Sovereign Rating Methodology, Dec. 18, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Methodology For Rating Sukuk, Jan. 19, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Criteria For Determining Transfer And Convertibility Assessments, May 18, 2009

Related Research

- Global Sovereign Rating Trends Midyear 2024: Outlook Balance Improves, July 25, 2024
- Asia-Pacific Sovereign Rating Trends Midyear 2024: Fiscal Strains Rise, July 25, 2024
- Sovereign Ratings History, July 17, 2024
- Sovereign Ratings List, July 17, 2024
- Sovereign Risk Indicators, July 8, 2024
- Sovereign Ratings Score Snapshot, July 2, 2024
- Banking Industry Country Risk Assessment Update: June 2024, June 29, 2024
- 2023 Annual Global Sovereign Default And Rating Transition Study, March 28, 2024
- Sovereign Debt 2024: Asia-Pacific Central Government Borrowing Stabilizes At Close To US$4 Trillion, Feb. 27, 2024
- 2024 Asian Elections: The Sovereign Credit Issues, Feb. 5, 2024

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's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

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

Ratings Affirmed	
Indonesia	
Sovereign Credit Rating	BBB/Stable/A-2
Transfer & Convertibility Assessment	BBB+
Indonesia	
Senior Unsecured	BBB
Perusahaan Penerbit SBSN Indonesia III	
Senior Unsecured	BBB