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Research Update:

Ratings On Indonesia Affirmed At 'BB+/B'; Outlook Remains Positive

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Overview

- In our view, Indonesia's fiscal framework has improved, which should improve the quality of public expenditure and lead to more predictable fiscal outcomes.
- However, fiscal performance has not improved in tandem for cyclical and structural reasons.
- We are therefore affirming our 'BB+' long-term and 'B' short-term sovereign credit ratings on Indonesia. We are also affirming our 'axBBB+/axA-2' ASEAN regional scale ratings on Indonesia.
- The positive outlook reflects the possibility that we may raise the ratings if the improved fiscal framework indeed delivers better fiscal performance, such that deficits decline and borrowings remain low.

Rating Action

On June 1, 2016, S&P Global Ratings affirmed its 'BB+' long-term and 'B' short-term sovereign credit ratings on the Republic of Indonesia. We also affirmed our 'axBBB+/axA-2' ASEAN regional scale ratings on Indonesia. The outlook on the long-term rating is positive.

Rationale

The ratings on Indonesia balance the country's low per capita income plus middling fiscal and external indicators, against improved policy and institutional settings, credible monetary policy, and buoyant economic growth.

After free and fair parliamentary and local assembly elections in July 2014, the Indonesian Democratic Party of Struggle (PDI-P) administration has improved fiscal flexibility by reducing energy subsidies (principally on gasoline, diesel, and electricity) and by tightening revenue administration. The government has spent the resultant savings from these initiatives on energy and transport infrastructure and targeted social programs. The government is also taking steps to improve Indonesia's business climate by streamlining regulations and business licensing, cutting red tape, reforming tax incentives for foreigners, upgrading infrastructure, and promoting labor market flexibility. In addition, the government strengthened rules for procurement and licensing, expanded financial interest disclosure for members of parliament, and appointed ministers based on merit in order to improve public administration.

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We believe these reforms will promote greater policy flexibility and responsiveness. Over time, these measures should raise public sector savings, which in turn should help to contain current account deficits and a slow erosion of external liquidity metrics. Thus, we do not expect a reoccurrence of the delays seen last year in the execution of the spending program on public infrastructure. Similarly, we expect the government to overcome its apparent hesitancy to allow domestic gasoline prices to fully track international prices. Over the rest of this government's term, we expect the administration to further improve critical infrastructure, address legal and regulatory uncertainties, and tackle bureaucratic obstacles and entrenched patronage in order to lift Indonesia's growth potential and its creditworthiness. Hence, we maintain our positive outlook on the rating.

Indonesia's low GDP per capita, which we estimate at US$3,600 in 2016, is a rating constraint, suggesting past policies have not delivered prosperity for this resource-rich country. Indonesia is a major commodity exporter of natural gas, coal, palm oil, and petroleum. Its growth slowed to an estimated 4.8% in 2015, from 5% in 2014, because of weaker export prices, lower demand from China, and bans on exports of partially processed minerals (including copper, nickel, zinc, and bauxite ore). We expect GDP to expand by about 5% (3.7% in GDP per capita terms) in 2016, supported by public sector investment, which we estimate to rise by about 6%. Our projection is for Indonesia's GDP annual growth to average 5.5% over 2016-2019 (4.2% in GDP per capita terms).

Bank Indonesia (the central bank) modestly loosened monetary policy by 75 basis points over January to May to 6.75%. Consumer price inflation is low at 3.6% for the 12 months to April 2016--within the target range of 4% plus or minus 1 percentage point. These data points suggest high real rates, which will make achieving this year's growth difficult while ensuring a more sustainable economic performance and keeping the current account in check.

We base our expectation of Indonesia's budgetary performance on the government's target of keeping general government fiscal deficits below 3% of GDP and borrowings below 60% of GDP. The fuel subsidy reforms, if carried through, should create additional room for the government to raise social and capital spending, although we note that lower oil revenue has substantially offset gains from the subsidy reforms to date. Better revenue performance should also come from improving tax compliance and higher non-oil revenues (mainly through higher excise taxes on tobacco and luxury goods). We estimate the fiscal deficit at 2.7% of GDP in 2016, compared with 2.5% in 2015, and to average about 3% of GDP over 2016-2019. We expect heavy infrastructure spending of a quasi-fiscal nature by government-owned enterprises (such as PT Perusahaan Listrik Negara, Perusahaan Daerah Air Minum, and PN Hutama Karya) to amount to another 2% of GDP on average annually over 2016-2019.

S&P Global Ratings estimates the fiscal deficit to result in net general government debt of 25% of GDP in 2016, rising modestly to about 27% in 2019. We project the ratio of general government interest expense to revenue to remain above 10% for the forecast horizon.

Broader credit conditions, however, cast a shadow on the sovereign's credit profile. The credit quality of the corporate sector has been declining since the end of 2014 with balance sheets deteriorating across sectors. That trend accelerated since 2015 because sustained capital investment coincided with a softer consumer sentiment and commodity price falls. As a result, revenue growth slowed and operating cash flows declined while debt servicing requirements remained high. We currently have a negative rating outlook on just under a third of corporate credit ratings in Indonesia--a universe that spans private and government-owned companies of different sizes across sectors, and we have taken over a dozen negative rating actions on the rated corporate sector since 2014 (see "Related Research" below for a sample). At the same time, the banking system's nonperforming loans (NPLs) rose to 2.8% as of March 2016, from an historical low of 1.8% in 2013. Special mention loans, an indicator of potential credit stress in the banking system, stood at about 5.8%. We believe the special mention loans are a potential source of additional NPLs. The government relaxed its guidance on classifying restructured loans in August 2015.

A growing number of rated Indonesian companies are also starting to face liquidity or refinancing-related risks from a rapid rise in foreign borrowing between 2011 and the first half of 2014. Their ability to refinance at manageable costs will remain exposed to investor sentiment. The credit quality of state-owned companies continued to deteriorate in 2015 following large debt-funded infrastructure investment. We estimate that the aggregated net debt of listed Indonesian public enterprises nearly doubled between 2010 and 2015. That said, the government will make cash injections in some public enterprises and we expect the cash flow and capitalization of those public enterprises to be sufficient to carry the burden of weaker profitability stemming from this infrastructure expenditure.

Accordingly, we have not worsened our assessment of public finances for these contingent fiscal risks, given the size of the financial and public enterprise sectors, and the government's room to maneuver within the boundaries set out in our criteria.

Regarding the country's external accounts, we expect Indonesia's liquidity to weaken, reflecting the corporate sector's dependence on foreign funding, combined with limited hedging of foreign currency debt, rising refinancing risks, and persistent U.S. dollar nominal strength (although in real effective terms the rupiah is about 8% higher than in September 2015). Notwithstanding the government's goal of keeping the current account deficit low, we expect the deficit to average just under 3% of GDP over 2016-2019 due to a recovery in domestic demand.

Bank Indonesia's foreign reserves exceed US$100 billion or over six months of current account payments as of April 2016. The authorities have undrawn contingent financing facilities of US$77 billion through the Chiang Mai Initiative Multilateralization and through bilateral swap arrangements with the People's Bank of China, among others.

Outlook

The positive outlook signals that upward pressure on the ratings still persists over the next 12 months. We could raise our ratings on the government this year or next if the improvement in institutional settings, particularly its fiscal framework, delivers better quality spending, deficits on a declining trend, moderate government debt, and limited contingent fiscal liabilities. Full and timely execution of the government's fuel subsidy reform would be one step in this direction.

On the other hand, we may revise the outlook to stable if problems in the banking or public enterprise sectors fester, reform momentum slows or stalls, fiscal metrics do not improve, or the trend in weakening external liquidity does not abate.

Key Statistics

Table 1

Republic of Indonesia - Selected Indicators										
ECONOMIC INDICATORS (%)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Nominal GDP (bil. LC)	6,864,133	7,831,726	8,615,705	9,546,134	10,565,817	11,540,790	12,575,220	13,809,166	15,119,366	16,584,953
Nominal GDP (bil. $)	755	893	918	913	890	862	927	991	1,085	1,190
GDP per capita (000s $)	3.1	3.7	3.7	3.7	3.5	3.4	3.6	3.8	4.1	4.4
Real GDP growth	6.2	6.2	6.0	5.6	5.0	4.8	5.0	5.2	5.5	5.8
Real GDP per capita growth	4.8	4.8	4.7	4.3	3.8	3.5	3.7	3.9	4.1	4.4
Real investment growth	8.5	8.9	9.1	5.0	4.6	5.1	5.7	7.5	7.9	7.9
Investment/GDP	32.9	33.0	34.8	34.4	34.2	32.9	34.8	36.0	37.0	37.0
Savings/GDP	33.6	33.2	32.1	31.3	31.1	30.9	32.2	33.2	34.0	34.0
Exports/GDP	24.3	26.3	24.6	21.4	21.0	18.5	16.5	15.8	15.5	15.4
Real exports growth	15.3	14.8	1.6	(6)	0.8	(2.3)	(1.9)	3.2	3.6	4.6
Unemployment rate	7.1	6.6	6.1	6.3	5.9	6.2	6.0	5.9	5.5	5.5
EXTERNAL INDICATORS (%)										
Current account balance/GDP	0.7	0.2	(2.7)	(3.2)	(3.1)	(2.1)	(2.6)	(2.9)	(3.0)	(3.0)
Current account balance/CARs	2.9	0.8	(11)	(13.5)	(13.1)	(9.7)	(13.4)	(15.7)	(16.9)	(17.0)
Trade balance/GDP	4.1	3.8	0.9	0.6	0.8	1.5	0.7	0.4	0.3	0.3
Net FDI/GDP	1.5	1.3	1.5	1.3	1.7	1.9	1.3	1.2	1.2	1.2

Table 1

Republic of Indonesia - Selected Indicators (cont.)

ECONOMIC INDICATORS (%)	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Net portfolio equity inflow/GDP	1.7	0.4	1.0	1.2	2.9	1.9	1.0	1.0	1.0	1.0
Gross external financing needs/CARs plus usable reserves	85.3	82.8	88.5	91.9	95.5	89.3	92.7	98.4	100.0	100.7
Narrow net external debt/CARs	37.3	32.9	42.8	55.3	60.9	81.2	88.4	89.4	86.4	82.9
Net external liabilities/CARs	165.2	142.5	162.9	171.8	187.6	207.3	226.4	234.1	231.5	227.5
Short-term external debt by remaining maturity/CARs	20.2	19.3	21.5	26.4	27.5	34.1	34.9	40.9	38.8	36.1
Reserves/CAPs (months)	4.6	5.2	5.4	5.5	5.0	6.7	6.4	6.1	5.7	5.3
FISCAL INDICATORS (%, General government)										
Balance/GDP	(0.7)	(1.1)	(1.8)	(2.2)	(2.1)	(2.5)	(2.7)	(2.8)	(2.8)	(2.8)
Change in debt/GDP	1.3	1.6	2.0	4.2	2.2	4.3	2.7	2.8	2.8	2.8
Primary balance/GDP	0.6	0.1	(0.6)	(1)	(0.9)	(1.2)	(1.2)	(1.2)	(1.1)	(1.1)
Revenue/GDP	14.5	15.5	15.5	15.1	16.5	14.8	14.0	14.3	14.6	14.9
Expenditures/GDP	15.2	16.5	17.3	17.3	18.6	17.4	16.7	17.1	17.4	17.7
Interest /revenues	8.9	7.7	7.5	7.8	7.7	9.1	11.0	11.2	11.5	11.4
Debt/GDP	24.5	23.1	23.0	24.9	24.8	27.0	27.4	27.8	28.2	28.5
Debt/Revenue	169.2	149.6	148.2	165.4	150.4	181.8	196.5	193.8	192.8	191.2
Net debt/GDP	22.4	21.0	21.3	23.1	22.8	24.6	25.3	25.8	26.4	26.8
Liquid assets/GDP	2.2	2.2	1.7	1.9	2.0	2.4	2.2	2.0	1.8	1.6
MONETARY INDICATORS (%)										
CPI growth	5.1	5.4	4.3	6.4	6.4	6.4	4.4	5.0	4.4	4.3
GDP deflator growth	8.3	7.5	3.8	5.0	5.4	4.2	3.7	4.3	3.8	3.7
Exchange rate, year-end (LC/$)	8,991.0	9,068.0	9,670.0	12,189.0	12,440.0	13,795.0	13,588.7	14,045.6	13,824.8	14,045.6
Banks' claims on resident non-gov't sector growth	24.0	25.0	22.8	20.8	12.3	9.0	10.0	12.0	15.5	16.0
Banks' claims on resident non-gov't sector/GDP	27.6	30.2	33.8	36.8	37.4	37.3	37.6	38.4	40.5	42.8
Foreign currency share of claims by banks on residents	9.4	10.1	10.2	11.9	11.1	10.3	10.0	12.0	14.5	14.5
Foreign currency share of residents' bank deposits	15.2	14.6	15.5	18.4	17.1	17.3	16.4	16.4	16.4	16.4

Table 1

Republic of Indonesia - Selected Indicators (cont.)										
ECONOMIC INDICATORS (%)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Real effective exchange rate growth	6.0	(1.2)	(5.4)	(11.6)	10.0	(1.6)	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	Neutral
Monetary assessment	Neutral

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 And Research

Related Criteria

- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Standard & Poor's National And Regional Scale Mapping Tables - January 19, 2016
- General Criteria: Methodology For Linking Short-Term And Long-Term Ratings For Corporate, Insurance, And Sovereign Issuers - May 7, 2013
- Criteria - Governments - Sovereigns: Sovereign Rating Methodology - December 23, 2014
- General Criteria: Methodology: Criteria For Determining Transfer And

Convertibility Assessments - May 18, 2009
- General Criteria: National And Regional Scale Credit Ratings - September 22, 2014

Related Research

- Banking Industry Country Risk Assessment Update: May 2016, 17-May-2016
- Corporate And Government Ratings That Exceed The Sovereign Rating, 12-May-2016
- Sector Review: ASEAN Banks Can Withstand Asset-Quality Pain In 2016, 11-May-2016
- Sovereign Risk In Southeast Asia Pivots On Politics, 09-May-2016
- Sovereign Ratings Score Snapshot, 04-May-2016
- Contingent Liabilities And Sovereign Risk In Emerging Markets: A Mounting Menace?, 04-May-2016
- Sovereign Risk Indicators at http://spratings.com/sri
- PT Multipolar Tbk. And PT Matahari Putra Prima Tbk. Downgraded To 'B'; Outlook Stable, 04-May-2016
- Is The Pain Easing For Indonesian Corporate Issuers?, 21-Mar-2016
- Are Credit Conditions In Indonesia Brightening?, 21-Mar-2016
- Global Aging 2016: 58 Shades Of Gray, 28-Apr-2016
- Economic Research: How China's Rebalancing Shifts The Ground Under All Of Asia-Pacific, 28-Apr-2016
- Emerging Markets Sovereign Debt Report 2016: Borrowing Is Pointing Up This Year, Feb. 29, 2016
- Global Sovereign Debt Report 2016: Borrowing To Drop By 2% To US$6.7 Trillion, Feb. 29, 2016
- Asia-Pacific Sovereign Debt Report 2016: Borrowing Of US$2.5 Trillion Is Likely This Year, Feb. 29, 2016
- For Indonesian Banks, No Respite From Headwinds In 2016, 18-Feb-2016
- Pertamina 'BB+' Rating Affirmed With Positive Outlook; SACP Lowered To 'bb' On Lower Oil Prices, High Capital Spending, 22-Jan-2016
- Lippo Karawaci Outlook Revised To Negative As Delayed Asset Sales Weaken Prospective Cash Flow; 'BB-' Ratings Affirmed, 13-Jan-2016
- Indonesia's U.S. Dollar-Denominated Notes Rated 'BB+', 03-Dec-2015
- Indonesia's Sukuk Issue Assigned 'BB+' Preliminary Rating, 21-May-2015

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 political assessment had improved while Indonesia's fiscal assessments had weakened. All other key rating factors were unchanged.

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 (Republic of)	
Sovereign Credit Rating	BB+/Positive/B
ASEAN Regional Scale	axBBB+/--/axA-2
Indonesia (Republic of)	
Senior Unsecured	BB+
Perusahaan Penerbit SBSN Indonesia II	
Senior Unsecured	BB+
Perusahaan Penerbit SBSN Indonesia III	
Senior Unsecured	BB+

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.