FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Indonesia at 'BBB'; Outlook Stable

Wed 14 Dec, 2022 - 5:21 AM ET

Fitch Ratings - Hong Kong - 14 Dec 2022: Fitch Ratings has affirmed Indonesia's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'BBB' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS

Low Public Debt; Weak Revenue: Indonesia's rating balances a favourable medium-term growth outlook and low government debt/GDP ratio against weak government revenue and lagging structural features, such as governance indicators, compared with 'BBB' category peers.

Growth Slowing in 2023: Like other sovereigns, Indonesia faces increased yields and a strong US dollar, but as a commodity exporter it is better positioned than many peers to weather the adverse conditions. Strong export performance and a recent domestic recovery from the pandemic support our GDP growth forecast of 5.2% for 2022.

Domestic and external demand are weakening going into 2023, as the domestic rebound should start to fade, higher interest rates will bite, and prices of many commodities wane. We forecast growth to slow to 4.8% in 2023, but there is some upside from the tourism rebound and spending on presidential elections scheduled for February 2024.

Strong Medium-Term Outlook: Fitch forecasts growth to accelerate again to 5.6% in 2024, well above the 'BBB' category median of 3.5%. Investment should receive a boost over the medium term from the implementation of structural reforms over the past two years, including the Omnibus Law on Job Creation. In the near term, investment may, nonetheless, be affected by some policy uncertainty from the elections. The impact on investment and tourism of a controversial amendment of the criminal code in December is still uncertain.

Focus on Infrastructure Development: Infrastructure spending is likely to continue under the next administration, including on the construction of the new capital in East Kalimantan, although the next president may have different priorities. The Indonesia Investment Authority, set up in February 2021, is intended to finance infrastructure development over the next few years from a combination of public and foreign official and private funds, including through disinvestment of government assets, such as toll roads. This may help finance more infrastructure over time, as it is gradually starting its activities.

Fiscal Consolidation to Continue: We expect the fiscal deficit to narrow to 3.4% of GDP in 2022, from 4.6% in 2021, following a strong revenue performance, partly from high commodity-related proceeds. We expect a further narrowing of the deficit to 2.9% of GDP in 2023, as the government is likely to follow through on its statements throughout the pandemic that it will reinstate its budget deficit ceiling of below 3% of GDP. This is below the 3.6% 'BBB' category median and would make Indonesia one of the first governments in Asia-Pacific to return to pre-pandemic fiscal deficit levels.

The government also plans to discontinue monetary debt financing in 2023, although parliament is in the process of discussing a draft law that may formalise the central bank's bond-buying role in times of crisis.

Gradual Decline in Public Debt: In our baseline scenario, government debt will gradually fall from 41.1% of GDP in 2023, which compares well with the 'BBB' category median of 55.6%. However, interest payments are high at 15.0% of our estimated government revenues in 2023 as Indonesia's revenue/GDP ratio, forecast at 14.4%, is the lowest among 'BBB' category sovereigns. The government took steps to enhance revenue, including raising the VAT rate. A hike in administered fuel prices of around 30% in September should in 2023 help reduce the subsidy bill, estimated by the government at 1.6% of GDP.

Strengthened Balance of Payments: We expect the current account to turn into a deficit of 0.8% of GDP in 2023, after two years of small surpluses from pandemic-related import contraction and high commodity prices. A widening of the current account deficit to pre-pandemic levels and a return of the strong dependence on portfolio flows to finance the deficit is less likely to occur in the next few years.

Down-Streaming Gathers Pace: We expect FDI to gradually pick up, including in the electric vehicle sector, which will likely imply increased manufacturing exports and a further increase in down-streaming activities, adding more value to Indonesia's commodity exports. Balance of payments vulnerabilities could be reduced over the medium term, if these developments lead structurally to higher manufacturing exports and FDI inflows, and lower current account deficits.

Shrinking Foreign Reserve Buffers: A strong US dollar and Bank Indonesia's (BI) foreign-exchange interventions caused its reserves to fall by USD10.9 billion since the end of 2021 to USD134.0 billion in November 2022, which equals 5.0 months of current account payments ('BBB' median: 5.5 months). Indonesia's external liquidity, measured by the ratio of the country's liquid external assets to its liquid external liabilities, is weaker than peer medians, according to Fitch's calculations, while it exhibits a higher sovereign external debt ratio.

Further Monetary Policy Tightening: Inflation appears to have peaked at 6.0% in September after the administered fuel price increase, but we expect BI to retain a tightening bias, given our assumption of continued US dollar strength with further Fed policy rate hikes in the pipeline. We forecast BI will raise its policy rate by a further 50bp to a terminal rate of 5.75% in early 2023, after hiking by a cumulative 175bp in 2H22. This should help bringing inflation towards the inflation target range of 3% +/- 1% by end-2023.

ESG - Governance: Indonesia has an ESG Relevance Score (RS) of '5' and '5[+]' for Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. Theses scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model.

Indonesia has a medium WBGI ranking at 49th reflecting a recent track record of peaceful political transitions, a moderate level of rights for participation in the political process, moderate institutional capacity, established rule of law and a high level of corruption.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- External Finances: A sustained decline in foreign-exchange reserve buffers, resulting, for example, from outflows stemming from a deterioration in investor confidence or large foreign-exchange interventions.

- Macroeconomic: A weakening of the policy framework that could undermine macroeconomic stability, for instance, resulting from continued monetary financing of the deficit in the next few years.

- Public Finances: A material increase in the overall public debt burden closer to the level of 'BBB' category peers, for example, resulting from failure to reduce the fiscal deficit to pre-crisis levels or accumulation of debt by publicly owned entities.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Public Finances: A marked improvement in the government revenue ratio in the next few years closer to the level of 'BBB' category peers, including from better tax compliance or a broader tax base, which would strengthen public finance flexibility.

- External Finances: A material reduction in external vulnerabilities, for instance, through a sustained increase in foreign-exchange reserves, a further decline in the dependence on portfolio flows or lower exposure to commodity price volatility.

- Structural: Significant improvement of structural indicators, such as governance standards, closer to those of 'BBB' category peers.

SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)

Fitch's proprietary SRM assigns Indonesia a score equivalent to a rating of 'BBB-' on the Long-Term Foreign-Currency (LT FC) IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LT FC IDR by applying its QO, relative to SRM data and output, as follows:

- Macro: +1 notch adjustment to offset the deterioration in the SRM output driven by the pandemic shock, in particular from the growth volatility variable. Fitch believes that Indonesia has absorbed the shock without lasting effects on medium-term macroeconomic stability

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

Indonesia has an ESG Relevance Score of '5' for Political Stability and Rights as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight. As Indonesia has a percentile rank below 50 for the respective Governance Indicator, this has a negative impact on the credit profile.

Indonesia has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as World Bank Governance Indicators have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight. As Indonesia has a percentile rank above 50 for the respective Governance Indicators, this has a positive impact on the credit profile.

Indonesia has an ESG Relevance Score of '4[+]'for Human Rights and Political Freedoms as the Voice and Accountability pillar of the World Bank Governance Indicators is relevant to the rating and a rating driver. As Indonesia has a percentile rank above 50 for the respective Governance Indicator, this has a positive impact on the credit profile.

Indonesia has an ESG Relevance Score of '4' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Indonesia, as for all sovereigns. As Indonesia has a fairly recent restructuring of public debt in 2005, this has a negative impact on the credit profile.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Indonesia	LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
	LC LT IDR	BBB Rating Outlook Stable	Affirmed	BBB Rating Outlook Stable
	LC ST IDR	F2	Affirmed	F2
	Country Ceiling	BBB	Affirmed	BBB

senior unsecured	LT	BBB	Affirmed	BBB
Perusahaan Penerbit SBSN Indonesia III				
senior unsecured	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Thomas Rookmaaker
Senior Director
Primary Rating Analyst
+852 2263 9891
thomas.rookmaaker@fitchratings.com
Fitch (Hong Kong) Limited
19/F Man Yee Building 60-68 Des Voeux Road Central Hong Kong

Andrew Fennell
Senior Director
Secondary Rating Analyst
+852 2263 9925
andrew.fennell@fitchratings.com

Toby Iles
Senior Director
Committee Chairperson
+852 2263 9832
toby.iles@fitchratings.com

MEDIA CONTACTS

Wai Lun Wan
Hong Kong
+852 2263 9935
wailun.wan@thefitchgroup.com

Leslie Tan
Singapore
+65 6796 7234
leslie.tan@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Country Ceilings Criteria (pub. 01 Jul 2020)

Sukuk Rating Criteria (pub. 13 Jun 2022)

Sovereign Rating Criteria (pub. 12 Jul 2022) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v1.7.2 (1)

Debt Dynamics Model, v1.3.1 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.13.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Indonesia	EU Endorsed, UK Endorsed
Perusahaan Penerbit SBSN Indonesia III	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Sovereigns Islamic Finance Asia-Pacific Indonesia