Fitch Ratings

15 MAR 2024

Fitch Affirms Indonesia at 'BBB'; Outlook Stable

Fitch Ratings - Hong Kong - 15 Mar 2024: 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

Credit Fundamentals: 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. Several external finance metrics, such as its current account, are stronger than pre-Covid-19 pandemic levels, but should normalise to some extent in the next few years, on the assumption that commodity prices will fall further.

Growth to Remain Solid: Our forecast for GDP growth in 2024 is broadly stable at 4.9%, slightly down from 5.05% in 2023. We expect slower export momentum in the first of half of this year, given weakening global demand, but strong domestic investment and consumption will most likely support growth, also due in part to spending related to local elections to be held country-wide in November. We forecast GDP growth to accelerate to 5.3% in 2025, as investment should strengthen following reduced near-term policy uncertainty after a new government takes office in October this year.

Inflation Within Target Range: Consumer price inflation is under control, at 2.8% in February with core inflation even lower at 1.7%. We expect inflation to remain within Indonesia's inflation target band, that was lowered for this year to 2.5% +/- 1pp, with an end-2024 forecast of 2.7% and a slight increase to 3.0% by end-2025 in line with strengthening economic growth. We believe that Bank Indonesia will cut its policy rates by 75bp to 5.25% later this year, when interest rates start falling in the US, and by another 75bp to 4.5% in 2025.

Broad Policy Continuity Likely: We assume broad economic policy continuity in the next government following the recent first round of presidential elections, in which Defence Minister Prabowo Subianto claimed victory. We expect it will maintain a focus on infrastructure development, including in the new capital city Nusantara being built in East Kalimantan, and sustain efforts to support commodity downstreaming and expand battery and electric-vehicle (EV) manufacturing. Monetary and fiscal policy settings are also likely to remain supportive of macro stability, at least during the remainder of this year.

Medium-Term Fiscal Uncertainty: We believe medium-term fiscal risks have risen, however, as the next government's fiscal plans remain uncertain and some campaign pledges seem costly. Minister Prabowo's campaign, for instance, advocated a free school lunch and milk programme that could cost around 2% of GDP annually, according to his team. He also stated that Indonesia could sustain a significantly higher government debt/GDP ratio and would aim for 8% GDP growth.

However, presidential candidates, including Prabowo, also advocated a significant rise in the level of government revenue/GDP, which may take time to realise, but would strengthen Indonesia's fiscal structure.

Falling Debt Remains Baseline: We still assume Indonesia's government debt to continue on a gradually declining path, from 39.1% in 2024 to 37.2% in 2027. The next president will have to depend on a coalition in parliament and Indonesia's fiscal record would suggest continued broad support across the political spectrum for prudent fiscal policies and deficits within the 3% of GDP budget ceiling. The fiscal deficit was quickly reduced after the pandemic shock to 1.7% of GDP in 2023.

Constraints to finance significantly larger deficits may be illustrated by Bank Indonesia's financing of half the 6.1% deficit at the height of the pandemic shock in 2020. We expect the deficit to rise to 2.5% of GDP in 2024, when the current government is mostly still in power, but more uncertainty surrounds our forecast of 2.9% for 2025.

Revenue Intake to Weaken: We expect the general government revenue/GDP ratio to fall to 14.6% in 2024 from 15.0% in 2023, the lowest in the 'BBB' category and well below the median of 21.3%. The government has enhanced revenue in recent years, such as raising the VAT rate by 1pp in 2022, which should generate additional revenue of 0.3% to 0.4% of GDP a year. Another increase of 1pp has been agreed for 2025, but we expect falling commodity prices to have a larger impact. The interest/revenue ratio, which we project at 14.8% in 2024, is significantly higher than the 'BBB' category median of 8.7%.

Wider Current Account Deficit: We expect the current account deficit to widen gradually to 1.0% in 2024 and 1.8% in 2025, from 0.1% in 2023, given weaker global demand and further declining commodity prices. However, we do not expect the current account deficit to return to pre-pandemic levels over the next few years and expect lower dependence on portfolio flows to finance the current account deficit than pre-pandemic, provided that the fiscal deficit remains within the ceiling.

FX Exposure Declines: The government's exposure to foreign-exchange fluctuation has fallen, as 28% of government debt is denominated in foreign currency, down from 44% a decade ago, in part because local-currency government debt jumped due to the pandemic. The share of non-resident holdings of local-currency government debt has fallen to 15% of total outstanding tradeable government securities, from 39% in 2019.

FX Reserve Buffers: Official reserves of USD144 billion as of February are equivalent to around 5.5 months of current-account payments, above the 4.6-month 'BBB' median. Bank Indonesia's reserves fell by USD2.4 billion since last December, in part due to interventions to smooth market volatility. Indonesia's gross and net external debt/GDP ratios are improving, but external liquidity - measured by the ratio of liquid external assets to liquid external liabilities - is weaker than many peers and the country also remains more dependent on commodity exports.

Potentially Stronger External Finances: We expect FDI to pick up gradually, including in the EV sector, as downstreaming activities gather pace, increasing manufacturing exports and adding more value to commodity exports. This could reduce balance-of-payment vulnerabilities over the medium term if these developments structurally lead to higher manufacturing exports and FDI inflows, and lower current account deficits. FDI inflows fell, however, as a percentage of GDP in 2023 to 1.6% and 1.1% on a gross and net basis, respectively, which may partly reflect temporary uncertainty due to the elections.

ESG - Governance: Indonesia has an ESG Relevance Score (RS) of '5' and 5[+] respectively for both 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 the 48.4th percentile, reflecting a recent 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

- Public Finances: A material increase in the overall public debt burden closer to the level of 'BBB' category peers, resulting, for example, from a substantial rise in fiscal deficits.

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

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

- Public Finances: A marked improvement in the government revenue ratio 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 or lower exposure to commodity price volatility.

- Structural: Significant improvement in 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 did not adjust the output from the SRM score to arrive at the final LT FC IDR.

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.

Country Ceiling

The Country Ceiling for Indonesia is 'BBB', in line with the LT FC IDR. This reflects no material constraints and incentives, relative to the IDR, against capital or exchange controls being imposed that would prevent or significantly impede the private sector from converting local currency into foreign currency and transferring the proceeds to non-resident creditors to service debt payments.

Fitch's Country Ceiling Model produced a starting point uplift of 0 notch above the IDR. Fitch's rating committee did not apply a qualitative adjustment to the model result.

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 WBGIs 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 and Regulatory Quality and Control of Corruption as WBGIs 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 WBGIs 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.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/topics/esg/products#esg-relevance-scores.

Fitch Ratings Analysts

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

George Xu
Director
Secondary Rating Analyst
+852 2263 9629

Toby Iles
Senior Director
Committee Chairperson
+852 2263 9832

Media Contacts

Peter Hoflich
Singapore
+65 6796 7229
peter.hoflich@thefitchgroup.com

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

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Indonesia	LT IDR	BBB	Affirmed		BBB
	ST IDR	F2	Affirmed		F2
	LC LT IDR	BBB	Affirmed		BBB
	LC ST IDR	F2	Affirmed		F2

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	Country Ceiling	BBB	Affirmed		BBB
• senior unsecured	LT	BBB	Affirmed		BBB
Perusahaan Penerbit SBSN Indonesia III					
• senior unsecured	LT	BBB	Affirmed		BBB

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Country Ceiling Criteria (pub.24 Jul 2023)

Sovereign Rating Criteria (pub.06 Apr 2023) (including rating assumption sensitivity)

Sukuk Rating Criteria (pub.13 Jun 2022)

Applicable Models

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

Country Ceiling Model, v2.0.1 (1)

Debt Dynamics Model, v1.3.2 (1)

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

Sovereign Rating Model, v3.14.1 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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

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