

**Rating Action: Moody's upgrades Indonesia's sovereign rating to Baa3; outlook stable**

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Global Credit Research - 18 Jan 2012

Singapore, January 18, 2012 -- Moody's Investors Service has today upgraded the Government of Indonesia's foreign and local currency bond ratings to Baa3 from Ba1.

The ratings outlook is stable.

The key drivers of this decision are:

1. Moody's anticipation that government financial metrics will remain in line with Baa peers.
2. The demonstrated resilience of Indonesia's economic growth to large external shocks.
3. The presence of policy buffers and tools that address financial vulnerabilities.
4. A healthier banking system capable of withstanding stress.

**RATIONALE FOR THE UPGRADE TO Baa3**

Indonesia's cyclical resilience to large external shocks points to sustainably high trend growth over the medium term. A more favorable assessment of Indonesia's economic strength is underpinned by gains in investment spending, improved prospects for infrastructure development following key policy reforms, and a well-managed financial system.

In addition, robust growth has been accompanied by the continued health of its external payments position, supported by increasingly large flows of foreign direct investment, while inflationary expectations are becoming better anchored at a more stable and historically lower level.

Prudent fiscal management has contained budget deficits at very low levels and has reduced the government's debt burden as a share of GDP.

As a result, Indonesia's fiscal ratios now surpass many of its higher-rated peers, providing more fiscal headroom to respond to economic shocks. It has also reduced risk perceptions, enabling the government to access international funding markets even during periods of heightened risk aversion.

Policy buffers, including the central bank's large stock of foreign exchange reserves and the government's bond stabilization framework, have been recently deployed and remain ample as significant lines of defense against destabilizing capital outflows. In addition, the banking sector does not pose immediate or significant contingent risks to the government's balance sheet, thereby raising fiscal headroom and added scope to policy responsiveness to future shocks.

Issues related to governance and a fundamental assessment of institutional strength remain a concern in regard to a further improvement in Indonesia's credit fundamentals. In addition, continued progress on targeted subsidy reform would be credit positive.

The stable outlook also reflects the expectation of continued policy flexibility and the adept management of risks stemming from global financial market volatility, based in turn on the tepid recovery in the US and the ongoing sovereign debt stress apparent in the euro zone.

Indonesia's long-term foreign currency (FC) bond ceiling was also raised to Baa2 from Baa3, while the long-term FC deposit ceiling was aligned with the government bond rating at Baa3. In addition, the short-term FC bond and deposit ceilings were upgraded to P-3. The outlook for these ceilings is stable. These ceilings act as a cap on ratings that can be assigned to the FC obligations of other entities domiciled in the country.

The local currency bond and deposit ceilings were also upgraded to A3 from Baa1.

#### WHAT COULD CHANGE THE RATING--UP

The following factors could lead to an upgrade: Increased fiscal space resulting from improved revenue mobilization; continued health of the country's balance of payments and the financial system, coupled with a longer track record of monetary and price stability; sustained progress in addressing infrastructure bottlenecks that contribute to an increase in potential growth; or a gradual deepening of local capital and credit markets to support the onshore finance-ability of the government's borrowing requirements.

#### WHAT COULD CHANGE THE RATING--DOWN

The following factors could lead to a downgrade: Sustained loss of inflation control and monetary stability; or a large shock to the country's fiscal, debt and foreign currency reserve position, derived, for instance, from policy mismanagement, or some other domestic political shock, which results in a deep deterioration of resident and investor confidence.

#### METHODOLOGY

The principal methodology used in this rating was Sovereign Bond Ratings published in September 2008. Please see the Credit Policy page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

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