

Indonesia: Investment Grade!

Fitch Upgrades Indonesia to 'BBB-'; Outlook Stable

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Fitch Ratings-Hong Kong/Singapore-15 December 2011: Fitch Ratings has upgraded Indonesia's Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) to 'BBB-' from 'BB+'. The Outlook on both ratings is Stable. The Country Ceiling has been raised to 'BBB', and the Short-Term Foreign-Currency IDR upgraded to 'F3'.

"The upgrades reflect the country's strong and resilient economic growth, low and declining public debt ratios, strengthened external liquidity and a prudent overall macro policy framework," said Philip McNicholas, Director in Fitch's Asia-Pacific Sovereign Ratings group.

Fitch projects GDP growth to average more than 6.0% per annum over the forecast period (to 2013), despite a less conducive global economic backdrop. Indonesia's domestically-oriented economy and success in delivering relatively strong economic growth without the creation of external imbalances, or a reliance on short-term external financing suggests economic growth prospects should prove resilient to external shocks, as was the case in 2008. Low public debt and positive real interest rates give the authorities policy flexibility to respond to any slowdown.

The strengthening of external finances through substantial reserve accumulation (official reserves excluding gold reached USD111.3bn at end-Nov 2011 from USD69.6bn in Jan 2010) has insulated domestic economic and financial stability during recent periods of intensified portfolio capital flow volatility. Importantly, although Indonesia's liquidity ratio of 119% remains below the 'BBB' median of 140%, its basic balance (CAB plus net FDI) is projected to remain in surplus. This mitigates vulnerability to potential short-term capital flow volatility.

Greater comfort with the overall macro policy framework is a key underpinning for the upgrade. Tolerance of nominal currency strength within the monetary policy framework, an observed willingness to tighten policy should inflation reach high single-digit rates, and a prudent fiscal policy bolster the case for an upgrade. Fitch believes the credit profile has tolerance at the new rating level for a modest widening in fiscal deficits if a mooted Land Acquisition Act leads to higher public infrastructure spending. Indonesia's gross government debt to GDP ratio is expected to fall from 26% at end-2010 to 25% by end-2011, well below the 'BBB' median of 36%. Additionally, the debt/revenue ratio is projected to drop from 168% at end-2010 to near the projected 'BBB' median of 126% by 2012, despite Indonesia's structural fiscal weakness of a low revenue take - just 17% of GDP in 2011 against the 'BBB' median of 33%.

Long-standing structural weaknesses, such as low average income (USD3600 versus 'BBB' median of USD9800 in 2011) and problems affecting the business climate, including poor physical infrastructure and corruption, remain to be resolved. However, Indonesia's structural

fundamentals are not the weakest in most of these categories, and these issues do not constrain the rating from the upgrade to 'BBB-'.

Progress in tackling structural weaknesses combined with sustained economic growth, without a build-up of external imbalances or a severe inflation shock, would enhance Indonesia's economic and sovereign credit fundamentals and exert upward pressure on the rating over the medium-term. However, Fitch believes the political environment is becoming less conducive to reform, suggesting Indonesia's sovereign credit profile is likely to remain at the weaker end of the 'BBB' range for some time, warranting Stable Outlooks on the ratings.

Severe capital flow volatility that affect domestic economic and financial stability and substantially erode external buffers would be negative for the ratings. Also, a deterioration in the quality of fiscal or monetary policy management, leading to external imbalances and/or instability in the banking system, would adversely affect the ratings.

Contacts:

Primary Analyst
Philip McNicholas
Director
+852 2263 9891
Fitch (Hong Kong) Ltd
28th Floor, Tower Two, Lippo Centre
89 Queensway, Hong Kong

Secondary Analyst
Andrew Colquhoun
Senior Director
+852 2263 9938

Committee Chairperson
Ed Parker
Managing Director
+44 20 3530 1176

Media Relations: Shivani Sundralingam, Singapore, Tel: + 65 6796 7215, Email: shivani.sundralingam@fitchratings.com.

Additional information is available at www.fitchratings.com. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, "Sovereign Rating Methodology", dated 15 August 2011, is available on www.fitchratings.com.

Applicable Criteria and Related Research:
[Sovereign Rating Methodology](#)

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