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Media Release

RAM Ratings upgrades Indonesia's ASEAN-scale rating

RAM Ratings has upgraded Indonesia's ASEAN-scale rating to $_{sea}AA_2$(pi)/Stable, from $_{sea}AA_2$(pi)/Positive. "The upgrade reflects the granular improvements in Indonesia's growth, monetary and fiscal performance through the years, underscored by administrative and business-friendly reforms as well as better inter-governmental coordination," explains Esther Lai, RAM's head of Sovereign Ratings. Meanwhile, Indonesia's global-scale $_{g}BBB_2$(pi)/Stable sovereign rating has been reaffirmed, premised on the country's resilient economic fundamentals and low debt level, which balance its sensitivity to external shocks.

Various reforms implemented since 2015 have improved the country's economic and business environment. "President Joko Widodo's second-term victory by a wider margin also engenders optimism on policy continuity and renewed efforts in ongoing reforms," adds Lai. Better alignment and coordination with regional governments to enhance policy effectiveness and hasten programme implementation could bolster market confidence. Besides building public infrastructure, the focus on Indonesia's human capital development via the upcoming labour law reforms, streamlining regulatory procedures and simplifying bureaucratic processes also bode well for the country.

Relative to the twin-deficit countries in the region, Indonesia enjoys greater stability. A good case in point is its steady economic growth – averaging 5.0% per annum in the last five years – and track record of low and stable inflation. Despite volatile commodity prices and external shocks, efforts to improve logistics performance, better coordination and monitoring of food supply at regional level in recent years have led to a respectable track record of containing price pressures. Headline inflation clocked in at an average of 3.1% in 9M 2019, compared to 5.5% between 2010 and 2014.

Given the elevated foreign ownership of government securities in Indonesia (end-December 2018: 40.6%), significant capital flight was observed last year. Over the medium term, stronger import demand from the country's ongoing infrastructure activities will exacerbate the stress on its external position and may increase the need for short-term financing from foreign sources. While fiscal incentives attempt to entice FDI, the cooperativeness of government bodies in managing the effects of capital outflows and measures to contain imports help keep the country's balance of payment in check.

Notably, Indonesia's weak fiscal earnings is an inherent weakness. Government revenue, which had risen to 13.1% of GDP as at end-2018 (end-2017: 12.3%), is still below ASEAN's median of 16.4% and is a constraint against public spending as the country's fiscal deficit is capped at 3.0% of GDP by law. Contrary to its earlier trend of underperformance, fiscal revenue jumped an extraordinary 16.6% (past five-year average: 4.6%), attributable to the rise in non-tax revenue from natural resources. Amid ongoing efforts to improve tax capacity, the current focus on automatic exchange of information, IT enhancement and digitalisation of the nation's tax database is aimed at increasing compliance rates and, ultimately, boosting fiscal revenue.

Indonesia's global-scale rating may be upgraded if there is a sustained increase in the momentum of FDI and fiscal revenue from the non-resource sector. An upward rating revision would also consider multiplier effects from a longer track record of infrastructure rollout and continuous progress in implementing reforms that translate into productivity gain and above-average GDP growth. On the other hand, the ratings may be revised downwards if policy reversals and a persistent as well as severe deterioration in its external position materially affect the country's growth performance and/or fiscal position.

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Date of release: 31 October 2019

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Published by RAM Rating Services Berhad