Manulife Asset Management

Investment Note

22 May 2017

The wait is over. Indonesia finally wins full investment grade status from S&P.

Indonesia's long wait to achieve full investment grade rank is finally over. As of 19 May 2017, Standard & Poor's Global Ratings (S&P) has raised the long-term sovereign credit rating of Indonesia to "BBB-" (investment grade) from "BB+".

In anticipation of this, we've been overweighting Indonesia in our strategies for a while now. Endre Pedersen, Manulife Asset Management's Chief Investment Officer for Fixed Income (Asia ex-Japan) summarises what this upgrade means for Indonesia, and what opportunities it could present going forward.

What's new?

On 19 May 2017, S&P announced raising Indonesia's long-term sovereign credit rating to "BBB-", from "BB+". It also raises Indonesia's short-term sovereign credit rating to 'A-3' from 'B'.

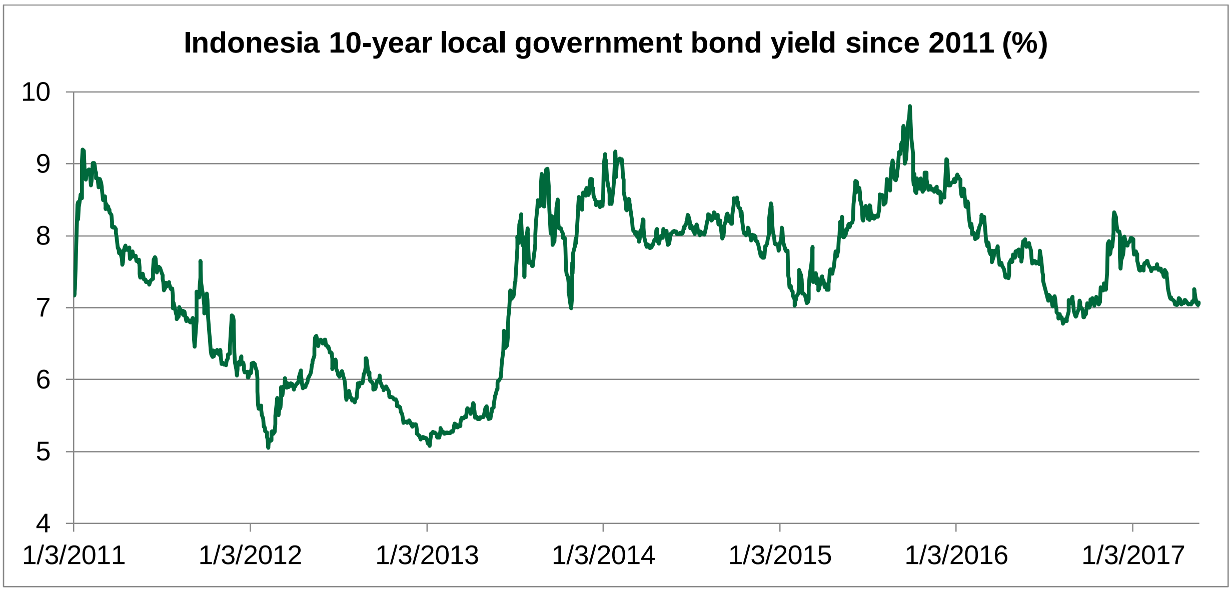
According to S&P, the Indonesian authorities have taken effective expenditure and revenue measures to stabilise the country's public finances despite the terms of trade shock. As a result, the rating agency expects net general government debt to stabilise near its current low levels as the budget deficit gradually declines.

What's the implication?

Endre Pedersen, Chief Investment Officer, Fixed Income (Asia ex-Japan), Manulife Asset Management commented, "We have been strategically overweighting Indonesia for several months across our Asian bond portfolios in anticipation of the upgrade by Standard & Poor's. We have leveraged notable insights from our well-established local fixed income team in Jakarta. Indonesian bonds have been a major contributor to the positive returns of our strategies, including in our Asia Total Return Bond and Asian Bond Absolute Return strategies over the past year."

According to Pedersen, all stars are aligned for Indonesia with a compelling real GDP growth of 5% year-on-year[1], moderate inflation, a more stable rupiah, an improving current account, and a reformist government. The upgrade to full investment grade status means Indonesia would likely see inflows from clients who observe stricter credit requirements, such as Japanese investors. Indonesia's ten-year local bonds are currently yielding 7%[2] which is, in our view, compelling relative to other investment grade government bonds around the world.

[1] Bloomberg: 5.01% real GDP growth (year-on-year) as of Q1 2017.
[2] Bloomberg, as of 19 May 2017.



Source: Bloomberg, as of 19 May 2017.

Fitch Ratings and Moody's Investors Service awarded Indonesia investment grade status more than five years ago. S&P gave Indonesia a positive outlook in May 2015 for President Joko Widodo's move to remove gasoline subsidies. In June 2016, it denied Indonesia its investment grade, citing weak government revenue collection and worsening corporate credit quality.

S&P's latest move is the first time since the Asian financial crisis that Indonesia's sovereign bonds are rated investment grade by all three major rating agencies.

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