KB Valbury Sekuritas
Fikri C Permana
email; fikri.permana@kbvalbury.com
Research Department - email : valburyriset@bloomberg.net

The Sentiment From The US Sovereign Rating Downgrade Is Temporary; Fundamentals Have a More Significant Influence

Fitch Downgrades United States' Long-Term Ratings to 'AA+' from 'AAA' on 1 Aug '23, with a Stable Outlook, while removing the Negative Rating Watch. Fitch notes a sustained deterioration in governance standards over the past two decades, encompassing fiscal and debt-related matters, despite the bipartisan agreement in Jun '23 to suspend the debt limit until Jan '25. However, this reflects concerns about the fiscal trajectory given the country's political system.

The fiscal concerns are evident as Fitch expects the general government deficit to increase to 6.3% of GDP in 2023 (prev: 3.7%), 6.6% of GDP in 2024, and further widen to 6.9% of GDP in 2025. Consequently, the US debt-to-GDP ratio is projected to reach 112.9% by the end of the fiscal year 2023 and rise to 118.4% by the end of fiscal year 2025. This is compounded by apprehensions that higher interest rates and the growing debt balance will elevate the burden of interest servicing. Additionally, an aging population and escalating healthcare costs are expected to elevate expenditures on the elderly unless accompanied by fiscal policy reforms.

The market perceives that while debt is not an immediate concern, it poses a significant long-term challenge. This sentiment has triggered a sell-off in medium- to long-term UST. Over the period between 1 to 4 Aug '23, yields on 10Y and 30Y UST increased by 22.44bps and 28.20bps, respectively. Conversely, 1Y and 2Y yields decreased by 0.45bps and 11.70bps during the same period, despite Fitch's anticipation of a recession between the 4Q23 and the 1Q24. Simultaneously, there has been a shift in asset allocation towards shorter tenors, evident in the 0.95% rise of the USD Index within three days of the Fitch downgrade.

In contrast, countries with a comparable 'AA+' rating, namely Austria, Finland, and New Zealand, have experienced relatively stagnant yields. Even though these countries held the same rating well before the United States, yields on their 10Y bonds are lower than those of the US. Austria's 10Y yield fluctuated between 3.03% and 3.26% since early Aug'23 to 10 Aug '23, while Finland's ranged between 3.00% and 3.10%. Meanwhile, New Zealand's 10Y yield remained stable between 4.65% and 4.91% during the same period.

Although the rise in UST yields initially prompted a risk-on sentiment in the market, this condition appears to be temporary. This is evident from the increase in the global high-yield index (*see Figure 5*). However, a week later, Moody's downgraded credit ratings for 10 small- to mid-sized banks and shifted the outlook to negative for 11 banks, citing growing financial risks and strains that could undermine their profitability.

Consequently, we are of the view that the developments in the US rating will have temporary implications for the overall global market. Our focus remains on how the issuer (in this case, the US) manages its fundamental fiscal aspects. Thus, the Treasury's announcement on 4 Aug '23, to enhance the issuance of long-term debt during this quarter to address the widening gap between tax revenue and government spending, has further propelled the increase in yields on 10Y and 30Y UST.

<u>Impact on Indonesia?</u>

Meanwhile, Indonesia's fiscal condition is still robust, where the performance of the State Budget until the end of the first semester of 2023 remains solid. Furthermore, this is evident from the realization of +5.4% (YoY) State revenues and +0.9% (YoY) State expenditures, resulting in a surplus of 0.71% of GDP in the State Budget. This is also supported by the ongoing current account surplus since 3Q21, reaching even 0.89% of GDP in 1Q23.

These conditions are also bolstered by Indonesia's Trade Balance, which has maintained a surplus for the 38th consecutive month (as of June '23). Similarly, the inflow into the SBN market has reached IDR91.19 tn (ytd, as of 9 Aug'23), even with an IDR0.61 tn inflow amid the US sovereign rating downgrade sentiment (or between 1 and 4 Aug '23). Likewise, the inflow into the stock market has reached IDR20.28 tn (ytd, as of 9 Aug '23), including IDR4.44 tn during 1-4 Aug '23.

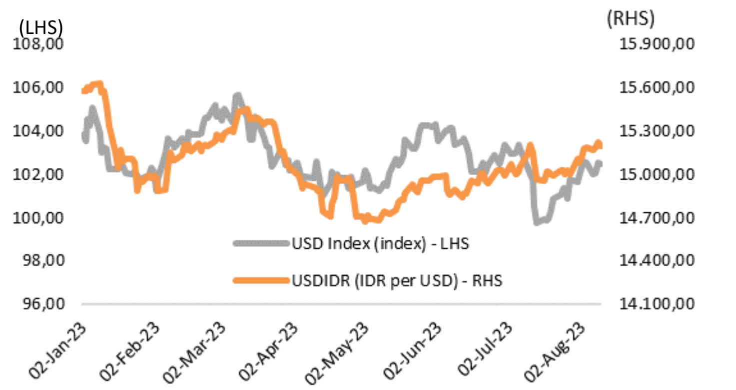
On the other hand, the development of the SBN issuance realization has only reached 45.17% of the APBN target as of 28 Jul '23, equivalent to IDR529.66 tn. It's worth noting that the issuance target for SBN in 2023 is also expected to reach IDR150 tn, with a significant portion coming from retail bonds, representing a 40% increase from the issuance in 2022. We observe that in addition to being supported by domestic liquidity, this is also driven by improving financial literacy, leading to increased individual ownership of Tradable SBN, which has reached IDR37.38 tn (ytd, as of 9 Aug '23), alongside a rise in ownership of

KB Valbury Sekuritas
Fikri C Permana
email; fikri.permana@kbvalbury.com
Research Department - email : valburyriset@bloomberg.net

tradable government bonds by Insurance & Pension funds, amounting to IDR101.28 tn (see *Figure 7*).

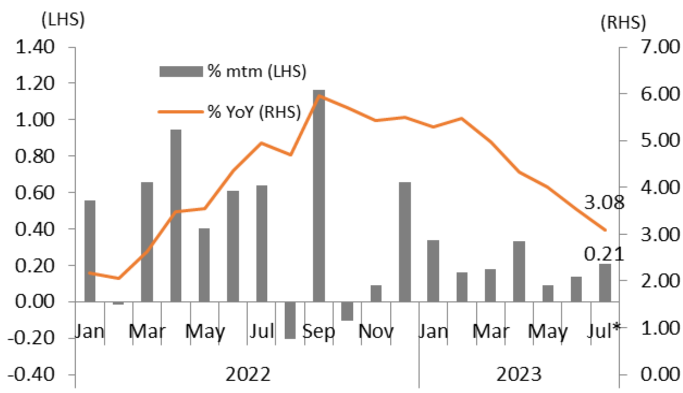
Therefore, we hold the view that the downgrade of the US sovereign rating might actually have a positive impact on Indonesia. This is due to the narrowing gap in ratings, especially considering R&I's upgrade of Indonesia's sovereign rating outlook on 25 Jul '23, in line with the medium-term economic prospects, policy discipline, and strong synergy among domestic economic authorities. As a result, given the ongoing developments in the real sector, particularly in APBN's revenue side and the current account, supported by liquidity, we maintain our anticipation for the possibility of a decline in government bond yields until the end of 2023, with the estimated 10Y SUN yield at around 6.06%. This scenario is particularly plausible if it is coupled with the likelihood of a reduction in the BI7DRRR, aligned with controlled inflation and a stable Rupiah exchange rate. Furthermore, the expected progress in DHE (foreign exchange export receipt) is anticipated to have a favorable impact on advancing domestic liquidity, maintaining Rupiah stability, and fostering overall economic growth.

Fig 1. USD Index and USDIDR



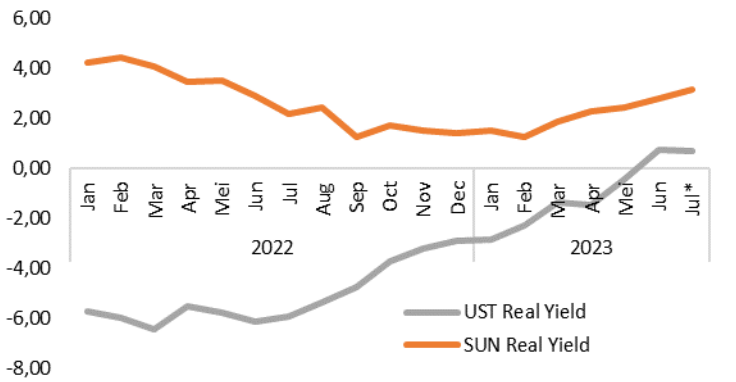
Sources: Bloomberg, KBVS Research – treated (2023)

Fig 2. Indonesia CPI Inflation



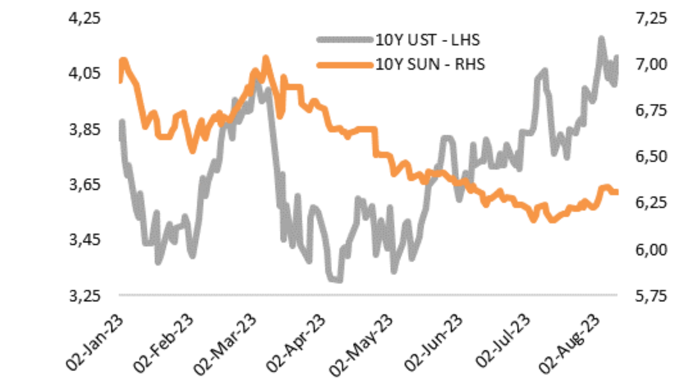
Sources: Bloomberg, KBVS Research – treated (2023)

Fig 3. Real Yield UST vs SUN (in bps)



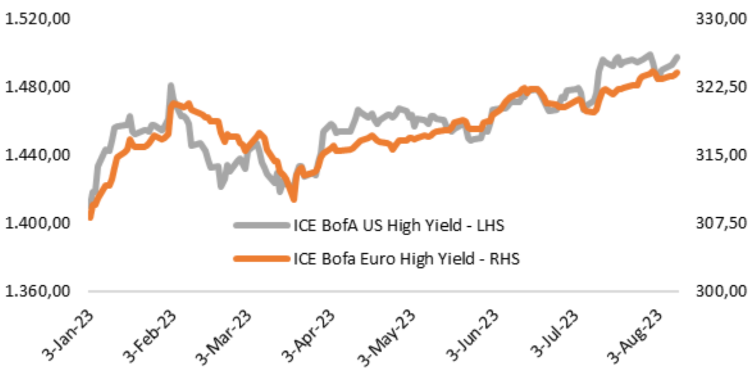
Sources: Bloomberg, KBVS Research – treated (2023)

Fig 4. Yield of 10Yr UST and SUN (in %)



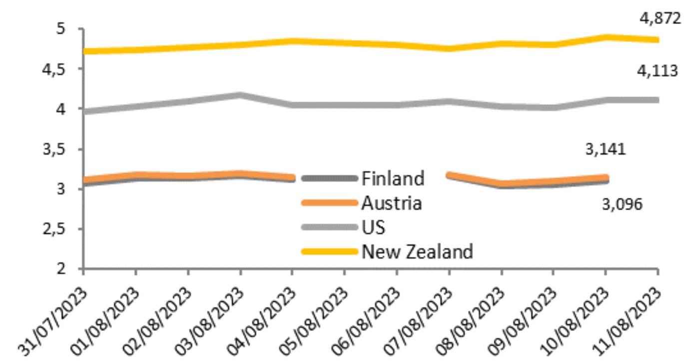
Sources: Bloomberg, KBVS Research – treated (2023)

Fig 5. Global High Yield Index



Sources: Bloomberg, KBVS Research – treated (2023)

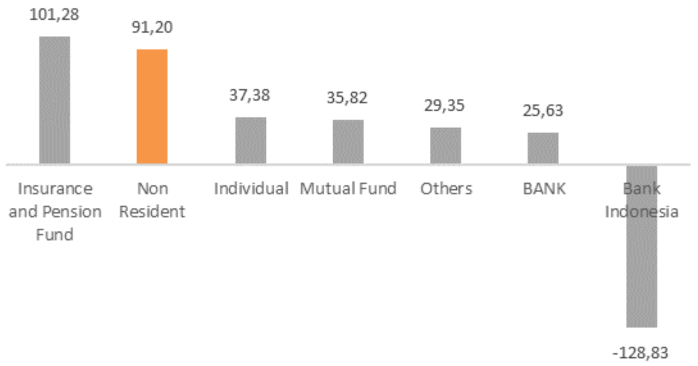
Fig 6. US&Peers 10Y Government Bond Yield 31 Jul- 11 Ags '23



Sources: Bloomberg, KBVS Research – treated (2023)

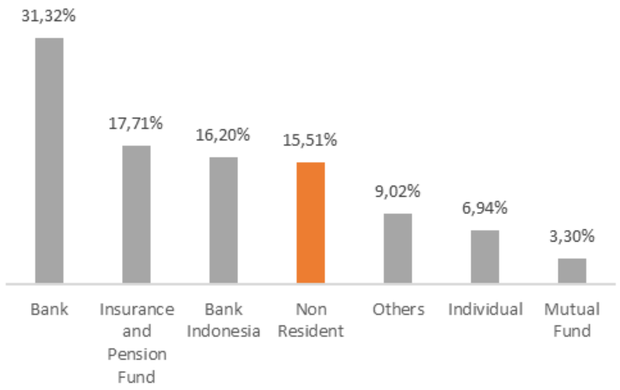
Fikri C Permana
email; fikri.permana@kbvalbury.com
Research Department - email : valburyriset@bloomberg.net

Fig 7. Change of Tradable SBN Ownership ytd as of 9 Ags '23 (IDR Tn)



Sources: DJPPR, KBVS Research – treated (2023)

Fig 8. Share of Tradable SBN Ownership (as of, 9 Aug 23)



Sources: DJPPR, KBVS Research – treated (2023)

Table 1. G20 Latest Economic Fundamental Development

Country	GDP	GDP YoY	GDP QoQ	Interest Rate	Inflation Rate	Jobless Rate	Gov. Budget	Debt/GDP	Current Account	Population
United States	25,463	2.60	2.40	5.50	3.20	3.50	(5.80)	129.00	(3.70)	334.23
China	17,963	6.30	0.80	3.55	(0.30)	5.20	(7.40)	76.90	2.20	1,411.75
Euro Area	14,041	0.60	0.30	4.25	5.30	6.40	(3.60)	91.50	(1.00)	342.89
Japan	4,231	1.30	0.70	(0.10)	3.30	2.50	(6.40)	263.90	1.90	124.95
Germany	4,072	(0.20)	0.00	4.25	6.20	5.60	(2.60)	66.30	4.20	84.40
India	3,385	6.10	1.90	6.50	4.81	8.00	(6.44)	88.26	(2.60)	1,373.76
United Kingdom	3,071	0.20	0.10	5.25	7.90	4.00	(5.50)	100.60	(5.60)	67.53
France	2,738	0.90	0.50	4.25	4.30	7.10	(4.70)	111.60	(2.10)	67.84
Russia	2,240	(1.80)	(0.80)	8.50	4.30	3.10	(2.30)	17.20	10.30	145.60
Canada	2,140	2.21	0.80	5.00	2.80	5.50	(3.60)	112.80	(0.40)	39.29
Italy	2,010	0.55	(0.34)	4.25	5.90	7.40	(8.00)	114.70	(1.30)	58.98
Brazil	1,920	4.00	1.90	13.25	3.16	8.00	(4.60)	72.87	(2.92)	214.83
Australia	1,675	2.30	0.20	4.10	6.00	3.50	(1.40)	22.30	1.90	26.27
South Korea	1,665	0.90	0.60	3.50	2.30	2.80	(7.00)	49.60	3.20	51.69
Mexico	1,414	3.70	0.90	11.25	4.79	2.70	(3.40)	49.60	(0.90)	129.00
Indonesia	1,319	5.17	3.86	5.75	3.08	5.45	(2.38)	40.90	1.00	275.80
Saudi Arabia	1,108	1.10	(0.10)	6.00	2.70	5.10	2.50	30.00	13.80	32.18
Turkey	906	4.00	0.30	17.50	47.83	9.60	(0.90)	31.70	(5.40)	85.28
Argentina	663	1.30	0.68	97.00	115.60	6.90	(2.40)	85.00	(0.70)	46.24
South Africa	406	0.20	0.40	8.25	5.40	32.90	(4.20)	67.40	(0.50)	59.89

Sources: Trading economics, KBVS Research – treated (2023)

Disclaimer

KB Valbury Sekuritas

Headquarters
Sahid Sudirman Center Lantai 41 Unit AC
Jl. Jenderal Sudirman No. 86
Kelurahan Karet Tengsin, Kecamatan Tanah Abang
Jakarta Pusat 10220, Indonesia
T +62 21 250 98 300
F +62 21 255 33 778

Branch Office

Jakarta - Kelapa Gading
Rukan Plaza Pasifik
Jl. Raya Boulevard Barat Blok A1 No. 10
Jakarta 11620
T +62 21 - 29451577

Jakarta - Puri Indah
Rukan Grand Aries Niaga
Blok E.1 No. 1 V Jl. Taman Aries, Kembangan,
Jakarta 14450
T +62 21 - 22542390
F +62 21 - 29264310

Jakarta - Pluit
Jl. Pluit Putra Raya No. 2
Jakarta 14240
T +62 21 - 29264300
F +62 21 - 22542391

Bandung
Jl. HOS Cokroaminoto No. 82
Bandung 40171
T +62 22 - 87255888
T +62 22 - 87255800
F +62 22 - 87255811

Semarang
Candi Plaza Building Lt. Dasar
Jl. Sultan Agung No. 90-90A
Semarang 50252
T +62 24 - 3521888
T +62 24 - 8501122
F +62 24 - 8507450

Yogyakarta
Jl. Magelang KM 5.5 no. 75
Yogyakarta 55284
T +62 274 - 4469500
T +62 274 - 623111
F +62 274 - 623222

Surabaya
Pakuwon Center Tunjungan Plaza Lantai 21
Jl. Embong Malang No.1
Surabaya 60261
T +62 31 - 2955777
T +62 31 - 2955788
F +62 31 - 2955716

Solo
Jl. Ronggo Warsito no. 34
Solo 57118
T +62 271 632888
F +62 271 656988

Malang
Jl. Pahlawan Trip no. 7
Malang 65112
T +62 341 - 585888
F +62 341 - 560056

Denpasar
Komplek Ibis Styles Hotel
Jl. Teuku Umar No. 177
Denpasar Bali 80114
T +62 361 - 255888
T +62 361 - 225229
F +62 361 - 225339

Banjarmasin
Jl.Gatot Subroto No.33 Kel. Kebun Bunga
Kec. Banjarmasin Timur
Kalimantan Selatan 70235
T +62 511 - 3265918
F +62 511 - 3253432

Manado
Kawasan Megamas, Ruko Megaprofit
Blok IF2 No. 38 Manado. 95254
T +62 431 7917 836
F +62 431 880 2129

Medan
Komplek Jati Junction No. P5-5A
Jl. Perintis Kemerdekaan
Medan 20218
T +62 61 - 88816222
F 62 61 - 88816333

Pekanbaru
Komplek CNN Blok A no. 3
Pekanbaru 28291
T +62 761 - 839393
F +62 761 - 839313

Padang
Jl. Kampung Nias II no. 10,
Kel. Belakang Pondok,
Kec. Padang Selatan
T +62 751 8955747

Palembang
Komp. PTC Mall Blok I No. 7 Jl. R. Sukamto
Kel. 8 Ilir Kec. Ilir Timur II
Palembang 30114
T 07115700281

Makasar
Kompleks RUKO Citraland City Losari Makassar,
Business Park, Blok B2 No. 09
Jl. Citraland Boulevard
Kel. Maccini Sombala, Kec. Tamalate
Makassar, Sulawesi Selatan 90111
T +62 411 6000818

Galeri Investasi

Jakarta
Citra Garden 6 Ruko Sixth Avenue
Blok J.1 A/18 Cengkareng,
Jakarta Barat 11820
T +62 21 52392181

Semarang
Jl. MT Haryono 637 Semarang
T +62 24 8415195

Solo
Jl. Ronggowarsito No. 34
Surakarta 57118

Padang
Jl. Kampung Nias II no. 10,
Kel. Belakang Pondok,
Kec. Padang Selatan
T +62 751 8955747

Salatiga
Jl. Diponegoro No. 68, Rt. 007 Rw. 011,
Kel. Salatiga, Kec. Sidorejo 50711
T +62 298 313007

Galeri Investasi BEI - KBVS

Yogyakarta
Universitas Kristen Duta Wacana
T +62 274 - 544032

Manado
Universitas Prisma Manado
T 0431 8800850

Jakarta
Universitas Gunadarma
T +62 21 - 8727541