Indonesian Banks Could Withstand Strain From Rising Rates

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HONG KONG (Standard & Poor's) Sept. 1, 2014--Indonesian banks are in a position of relative strength to withstand the strain from rising interest rates, said Standard & Poor's Ratings Services in a report published today titled, "Why Indonesian Banks Won't Likely Crumble Under The Weight Of Rising Domestic Interest Rates."

The banks weathered capital outflows in 2013 with commendable resilience, and we believe they are well placed to handle further rate hikes into 2015-2016. With their solid fundamentals, we believe the banks can deal with the potential impact of rising interest rates with their credit ratings intact.

"Indonesian banks have the highest pre-provision operating profits in the Asia-Pacific region, and we believe they can absorb a potential increase in credit costs as long as the central bank takes a cautious approach to raising interest rates, as we expect it will," said Standard & Poor's credit analyst Cheul Soo Cho.

The Indonesian rupiah has been pushed down over the past one year, when the U.S. started to reverse its loose monetary policy. The sliding rupiah left Bank Indonesia (BI), the central bank, with little choice but to raise its policy rate to defend the currency.

"Indonesian banks have continued to perform well despite these operating

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conditions because they largely match their foreign currency assets with foreign currency liabilities," Mr. Cho said. Indonesian interest rate levels, despite climbing sharply in a short period, are still historically low.

We believe the structural weaknesses in the Indonesian economy (being a net external borrower with current account deficits expected for at least the next few years) forced BI to increase interest rates since May 2013 despite its forecasts of an economic slowdown.

"Rather than cut rates to stimulate growth, the central bank instead chose to tighten its monetary policy to defend the rupiah, attract foreign capital, and lower the current account deficit," Mr. Cho said.

Rising rates put pressure on the solvency of borrowers, which could eventually hurt Indonesian banks' asset quality. Nevertheless, the country's banks so far have weathered higher interest rates reasonably well.

"Our ratings on Indonesian banks are all in the 'BB' category as we already factored in the risks associated with the country's structural weakness," Mr. Cho added.

RELATED CRITERIA AND RESEARCH

Related Criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

Related Research

- Banking Industry Country Risk Assessment: Indonesia, Sept. 19, 2013
- Rising Credit Risks Could Reveal Vulnerabilities In Indonesian Banks, June 30, 2013

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@standardandpoors.com. Ratings information can also be found on Standard & Poor's public Web site by using the Ratings search box located in the left column at www.standardandpoors.com. Members of the media may request a copy of this report by contacting the media representative provided.