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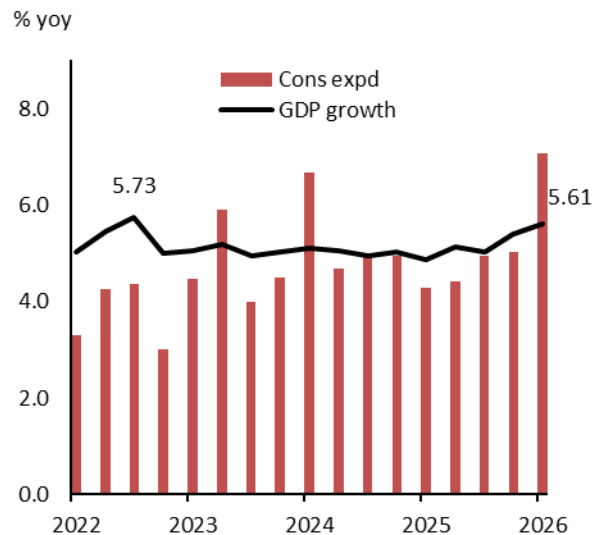
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- *Indonesia's economy expanded 5.6% yoy in 1Q26, matching our above-consensus forecast.*
- *Government spending emerged as a key support, while net exports weakened.*
- *1Q26 likely marked the peak*
- *Speed bumps lie ahead by way of high energy prices and pressure to consolidate public finances.*
- *Authorities are likely to delay increases to the fuel pump prices.*
- *This will necessitate adroit fiscal management to keep within the -3% of GDP.*
- *Implications for markets: Rupiah might surface as a bigger bother than inflation for the BI.*
- *Jump in SRBI returns has resulted in stealth policy tightening.*

**Strong start to the year**

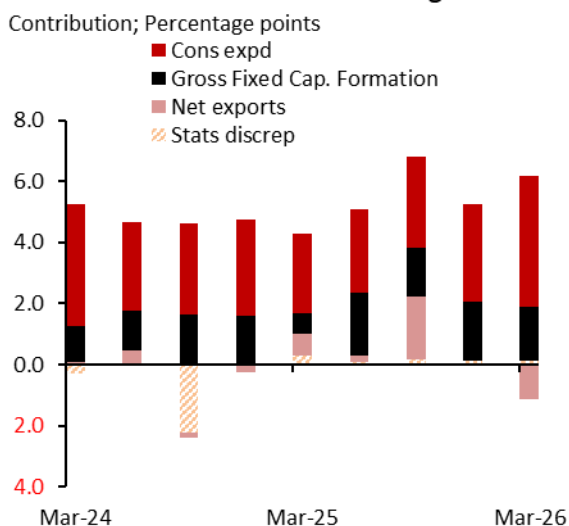
**Indonesia's economy expanded by a firm 5.6% yoy in 1Q26**, in line with our forecast. This marks the fastest quarterly growth since 3Q22. Economic momentum was relatively resilient at the start of the year, supported by higher consumption due to religious festivities, fiscal stimulus measures including the traditional holiday allowance, low base effects, strong government spending and firmer sentiments. Activity, however, softened at the tail end of the quarter around March, due to volatility in the equity markets, and firms facing supply distortions as well as high costs due to the onset of the US-Iran tensions.

**Domestic activity props headline growth**

Source: CEIC, DBS

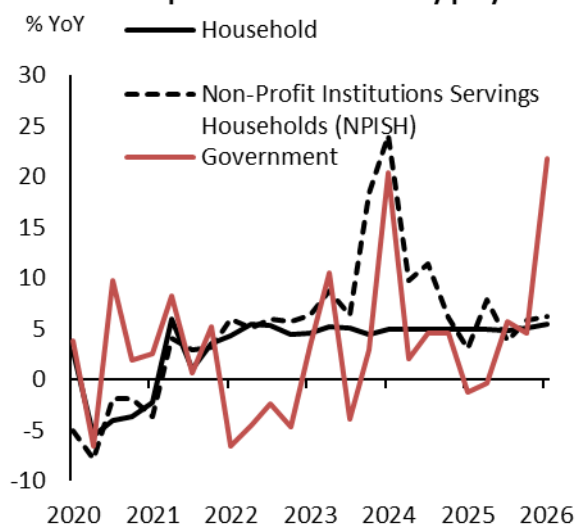
Consumption rose by 7% yoy, helped by higher household and government spending. Investment growth also maintained a strong beat at around 6% yoy in the quarter. Net exports surfaced as a key drag in the period, subtracting 1.2ppt off the headline.

**Indonesia: breakdown of GDP growth**



Source: CEIC, DBS

**Consumption breakdown - key players**



Source: CEIC, DBS

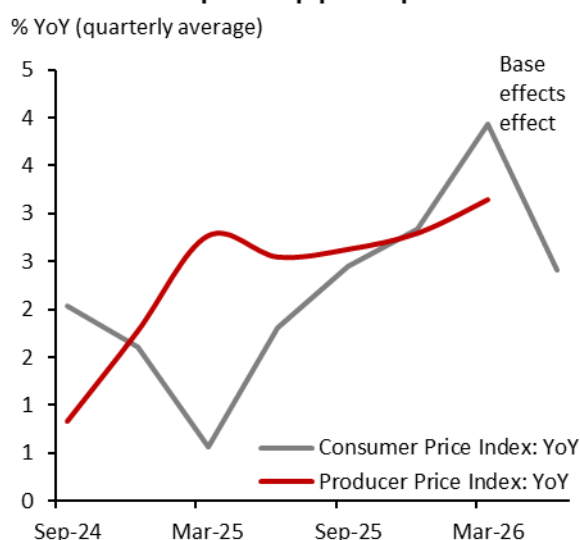
**Outlook: The first quarter likely marked the growth peak**, with the momentum set to moderate as real activity could be dampened by high energy prices and pressure to consolidate public finances. Factoring in these risks, we moderate our growth forecast slightly to 5.1% vs 5.3% currently for 2026.

**Bank Indonesia – hawkish pivot**

1Q26 CPI inflation averaged a strong 3.9% yoy vs 2.1% average in 2025. An assessment based on these numbers should be viewed with

caution due to a low base, with headline CPI inflation expected to normalise 2Q onwards. True to the word, April 2026 inflation eased to 2.4% yoy driven by fading power subsidy-related base effects and demand moderated post-Lebaran. Nonetheless, a gradual but steady pick up in the PPI measure warrants attention as firms face higher upstream input costs and are yet to fully pass these to the final output prices.

**Wholesale prices - pipeline pressures**



Source: CEIC, DBS

**We see two channels of price impact. Firstly**, a decision of changes in the retail pump prices and associated second derivative impact will be crucial. Our full year CPI inflation forecast at 3.2% assumes no change in the administered fuel prices this year, which is also affirmed by our onshore channel checks as the government appears to treat any subsidy cut as a move of last resort. Nonetheless, with the Strait of Hormuz closure, the passthrough from higher oil, natural gas and fertilisers warrant attention, which could translate into ~0.05-0.1% impact, assuming static retail prices. Notably, the share of energy consumption is higher amongst the middle-class vs other household categories. This deals additional strain on purchasing power, magnified by the absence of social

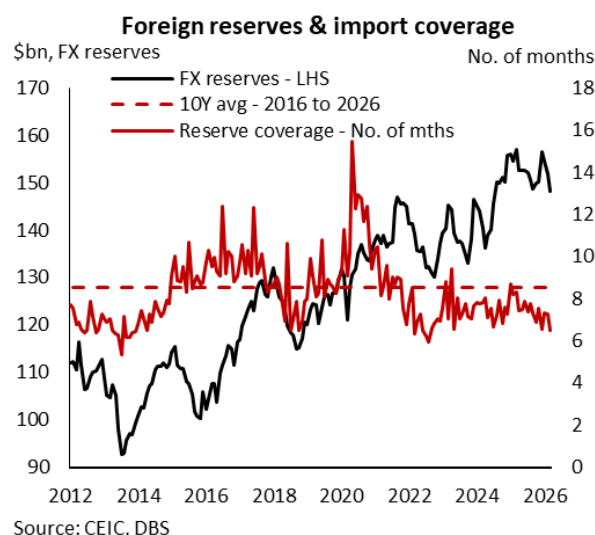
assistance or welfare measures for this stratum of the populace. Aggregate minimum wage has also risen by a more modest pace than in the past few years. **Secondly**, other factors like rupiah depreciation and El Nino-related disruptions in this quarter and next.

Energy consumption - share (% of total expenditure - by class



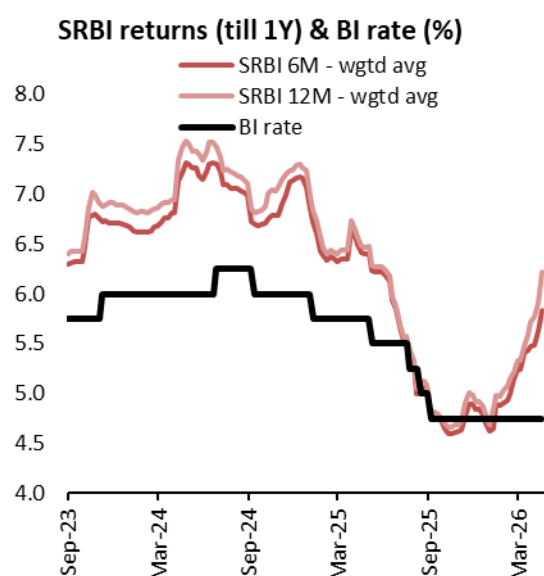
Source: LPEM FEB UI, BPS

**Bank Indonesia** held rates unchanged in April but guidance carried hawkish undercurrents. We see two pre-conditions for the BI to shift to a tightening bias: firstly, sharp depreciation pressures on the currency, and secondly, an increase in the domestic administered subsidised fuel prices, which could generate both direct and second-round price pressures, taking inflation beyond the official target range. While we see a lower probability of an increase in the pump prices, rupiah depreciation will be a concern for the central bank, with the FX reserve buffer also moderating in recent months – see chart.



**Our base case is for the BI to stay on hold this quarter but see an increasing likelihood of a measured hike to defend the currency in 2Q.** USDIDR rose past a new high at 17400 in May, due to a bid dollar, higher oil and seasonal flows (repatriation), notwithstanding persistent intervention efforts.

Returns on the SRBI instruments continues to climb to draw in more offshore interests, building a yawning gap with the benchmark rate as well as short end yields. **We see this increase as a stealth move to increase rates to draw rate sensitive flows.** When the spread between the BI rate vs SRBIs/ SBN yields was similarly wide back in 2024, a few spillover developments were; a) some extent of cannibalisation of (ex-retail) inflows into the short-term bonds; b) lent an upside bias to the 1Y-2Y yield movements, effectively flattening the curve as official bond purchases helped to contain the long end yield; c) draw in flows from banks especially if global or domestic environment is not conducive; d) absorb banking system liquidity away from productive purposes like boosting credit growth. **Investors are likely to be mindful of these developments this year as well.**



Source: BI, CEIC, DBS

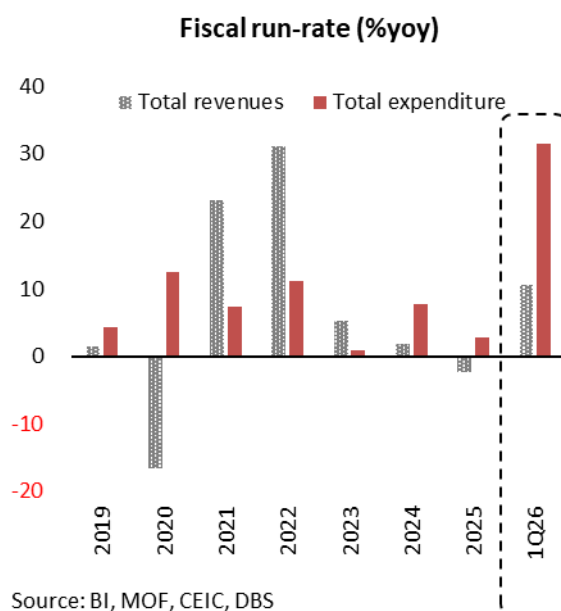
Separately, to help better align offshore NDF with onshore pricing, BI had intended to relax its restriction on domestic banks' participation in the NDF market. Selected primary dealers, particularly those that play a key role in the money markets and foreign exchange, will be allowed to sell in offshore NDFs.

### Fiscal deficit to stay anchored

We are mindful of the sensitives of the fiscal math to changes in crude prices (Indonesia Crude ICP) and rupiah movements. For instance, market estimates are that every USD 10bl increase in ICP compared to baseline (\$70bl) will increase net fiscal spending by IDR 103trn (0.3% of GDP). Meanwhile, assumption on the exchange rate is that every IDR100/ USD depreciation will raise net fiscal spending by IDR 800bn. **For instance**, a scenario under which ICP averages \$92.5bl for the year with an exchange rate at USDIDR 17000, could see the deficit edge above the 3.0% of GDP deficit threshold by 20bp.

**Despite elevated pressure on the fiscal math due to high energy costs and consequent need for budgetary support, we expect the -3% of GDP annual deficit threshold to be maintained.**

For a start, 1Q26 run rate saw expenditure being frontloaded, rising 30% yoy accompanied by 10% increase in revenues – see chart. This led the 1Q fiscal deficit to jump to -0.93% of GDP vs customary- flat-to-small surplus in most years. Given this weak start to the year, we expect the pace of spending to moderate in the next three quarters, while also carving out savings from existing schemes and flagship programs (including the nutritious food program). The pace of disbursements for the MBG program decelerated into 2Q, which along with broader pronouncements of plans to lower allocation to the program might result in 0.2-0.4ppt of GDP worth room.



Source: BI, MOF, CEIC, DBS

Growth in revenues was strong in 1Q26, partly driven by a low base. While the quarterly pace will slow over the next three quarters, overall revenues are expected to receive a hand from: a) export duties on select commodities; b) better tax administration measures; c) natural resource-based revenues due to higher energy

and base metal prices. **The underlying fiscal math will also be subject to other considerations** for instance , a) if there is any formal roadmap that is tabled to seek a temporary wider deficit akin to the pandemic and then being brought back below -3% of GDP; b) spending in deferred or treated as below the line; c) sharp untenable rally in global crude prices, necessitating a passthrough to subsidised and non-subsidised prices, which will help better balance the fiscal books.

### Financial markets

Rupiah has persistently been one of the underperformers this year, aggravated by the outbreak of the US-Iran tensions since March. April-May are seasonally weak periods for the currency on USD repatriation demand. While the macro data is still proving to be relatively resilient, investors have adopted a cautious stance ahead of the MSCI review, rating agencies outlook downgrade and governance issues. **With these in view, we would be cautious on the IDR asset performance this quarter, expecting fiscal rationalisation efforts to be supportive in 2H.**

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