

INDONESIA: Policy mix aligns

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- *Indonesia's macro narrative has turned more constructive in 2H26.*
- *Key domestic policy concerns have eased.*
- *Policy alignment has improved.*
- *Greater fiscal discipline should allow BI to remain focused on price stability.*
- *The current account is likely to widen as the trade surplus narrows.*
- *Portfolio and FDI inflows should, however, narrow the BOP shortfall.*
- *Few monitorables remain, including factors in the 2027 fiscal math.*
- *IDR performance will remain heavily influenced by global conditions.*

SHIFT IN NARRATIVE

After a rough first half of the year, the narrative around Indonesia's economy has turned relatively constructive. The macro outlook is on the mend, and policy coherence has strengthened. Recent budget developments have reduced the likelihood of an outright fiscal slippage. A more disciplined fiscal trajectory should also provide room for monetary policy to stay focused on its price stability mandate rather than on addressing financial stability risks due to fiscal concerns.

On the markets front, even as external triggers impacted the rupiah, the one-sided sharp depreciation run in the currency in the first half of the year has stalled. Debt markets have attracted offshore interest, alongside strong demand for shorter-tenor SRBI securities, all of which have contributed to the overall capital flows picture.

Ahead of MSCI's final take on the domestic equity market's classification in November, however, equity markets find little favour. Nonetheless, material improvements in the stock listings and regulatory requirements undertaken by the stock market and financial regulators are expected to contribute to the medium-term stability of the capital markets.

Key domestic risks that plagued the economy in the first half of the year have been alleviated to some extent, while a few other monitorables remain.

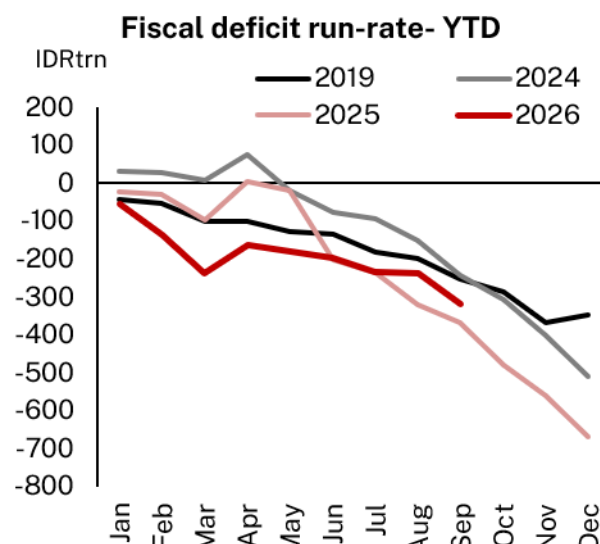
NEAR-TERM FISCAL WORRIES RECEDE

Fiscal fears have moderated in the near term. New Finance Minister Suhasil Nazara reaffirmed the government's commitment to maintain the annual deficit below -3% of GDP threshold. The 2026 run-rate suggests that the deficit is likely to close within the budgeted target.

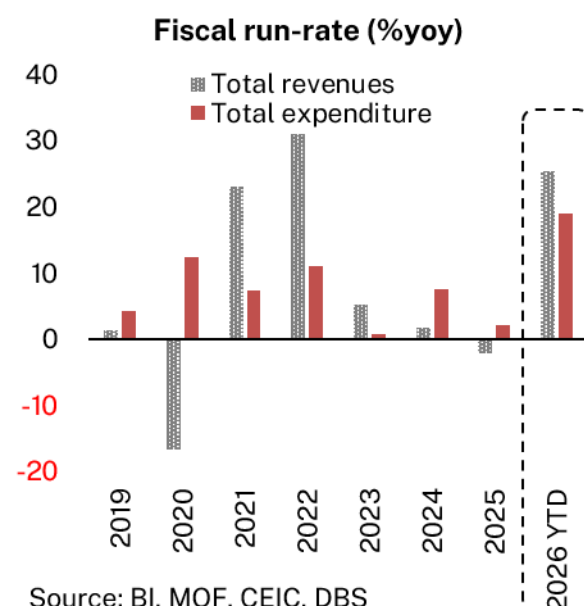
By September 2026, the fiscal deficit stood at 1.2% of GDP, reflecting a normalisation in spending and firm revenue growth. Total spending rose by a still-strong 19% yoy, even though the pace moderated from 1H, backed by disbursements towards the flagship free food program, subsidy and compensation outlays, as well as personnel expenditure. Realised expenditure stood at 69% of the full-year budget by 9M26.

On the other hand, revenues rose sharply by 25.5% yoy (partly benefiting from base effects as readings were negative at the same time last year), helped by higher tax collections, export duties, and non-tax receipts. Revenues have already accounted for 74% of the budgeted scale by 9M26, suggesting full-year target is likely to be met.

Global crude prices are a key risk for the fiscal outlook, as prevailing Brent prices are above \$100/b at the time of writing (vs budgeted ICP at \$70/b), which will feed through higher subsidy and compensation outgoes, as authorities remain hesitant to raise fuel pump prices.



Source: BI, Bloomberg, CEIC, DBS



Source: BI, MOF, CEIC, DBS

Significant efficiency measures have, however, been put in place to contain spending, including reductions in outlays towards flagship schemes, which will help contain the extent of deterioration in the fiscal math. For instance, the flagship MBG program, which started with an allocation of IDR 35trn, was moderated to IDR 268trn (realised spending by Sep26 was IDR 153trn). Successive stimulus packages

have been announced but the scale has been contained.

2027 math signals fiscal prudence, soft spots warrant attention

The official goalposts for 2027 point to a continued preference for fiscal prudence rather than fiscal activism.

Spending is on course to surpass the symbolic IDR 4000tn level, rising nearly 4% yoy, with outlays divided between the centre and regional governments. The mix points to steady allocations towards subsidies, social transfers, and capital expenditure, with ministry-level spending (K/L) set to contract, while non-K/L spending is budgeted to increase. More notably, spending is expected to rise on key flagship programs – for instance, social protection (up 10%), the largest component education (up 14%), which includes the free meals program at IDR 240trn.

APBN 2026: Budgeted & Official 2026 Outlook			
IDR tn	APBN 2026	2026 - Revised	APBN 2027
Revenue	3,153.60	3,208.10	3,435.0
Expenditure	3,842.70	3,942.40	4,106.0
Deficit	689.1	734.3	671.2
Deficit (% GDP)	2.68%	2.85%	2.40%

Source: MOF, press, DBS

Key economic assumptions		
	2026	2027
	State Budget	State Budget
Growth, % yoy	5.4	6.0
Inflation, % yoy	2.5	2.5
10Y SBN	6.9	6.9
USDIDR	16,500	17,500
ICP (\$bl)	70	75
Crude Oil Lifting – 1k bl/ day	610	612.5
Natural Gas Lifting – 1,000 barrels of oil/day	984	954

Source: MOF, press, DBS

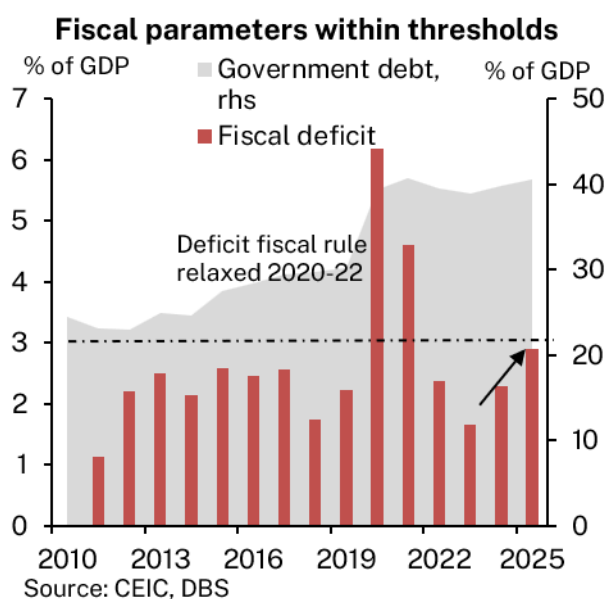
On the revenue end, state revenues are expected to rise by 9% yoy compared to the budgeted 2026 APBN/ 7% vs the revised 2026 outlook. Compared to baseline 2026, tax revenues are expected to rise 10.5%, besides higher non-tax collections. **This math lands the 2027 budgeted deficit at -2.4% of GDP vs revised 2026 at -2.85% of GDP.**

Few uncertainties that loom. Firstly, next year's math rests on an upbeat growth projection of 6.0% (DBSf 5.2%), besides modest depreciation in the rupiah and about a 7% increase in the Indonesia crude price assumption (see table). Some of these expectations might be challenged as the year unfolds. **Next**, state revenues are expected to rise to an upbeat 12.5% of GDP, likely riding on a strong growth forecast, better tax due diligence, and improved administration via the Coretax mechanism.

Thirdly, crude prices are a key risk to the fiscal math. Given the economy's position as a net oil importer, various official commentaries put the sensitivity at every \$1pb oil worsening the fiscal balance by IDR 6trn, after accounting for oil-related revenues. This implies that for every \$10pb increase, the deficit could be impacted by ~IDR 60trn, not far from MOF's sensitivity of IDR 68trn (~0.25-0.30% of GDP) due to higher subsidy and compensation costs (ICT assumed at \$75bl vs prevailing Brent at \$100bl). Spending will need to reprioritised to accommodate additional allocation towards subsidies and compensation.

Next, the direction of travel on the contribution of SOE dividends from the investment agency to the state coffers for 2027 remains unclear, after being accounted for this year. **Lastly**, successive stimulus measures in-kind and wage subsidies were announced this year and could marginally add to the strain in 2027 (0.1-0.2% of GDP).

Discussions around the State Finance Law also warrant a watch. We maintain our deficit forecast at a wider -2.8% to -2.9% range to account for any revenue shortfall or a gradual pace of growth. Nonetheless, deficits/debt are likely to stay below key thresholds and not emerge as a flashpoint for the markets.



MONETARY POLICY ON AN EVEN KEEL

Bank Indonesia has left the benchmark rate unchanged since July 2026, after 100bp hikes in 1H26. While tighter global financial conditions and geopolitical

risks were key risks on the horizon, the BI held the domestic GDP forecast at 4.9-5.7% (DBSf: 5.3%) alongside manageable inflation, notwithstanding El Nino-related risks. Inflation rose to 3.3% yoy in Sep26, towards the high end of the target range. Authorities have, however, assured that the impact of higher food prices due to poor weather will be addressed through administrative measures by regional bodies.

Contained inflation expectations have reduced the urgency for BI to tighten policy further, allowing policymakers to prioritise growth and financial stability considerations. The emphasis on strengthening the balance of payments position reflects continued caution over external financing conditions and capital flows. However, with the rupiah expected to remain stable on the back of policy measures and fundamentals, the BI did not view current external pressures as severe enough to warrant additional tightening.

BI introduced a host of measures at the June to September policy meetings, including FX monetary hedging instruments and a mechanism to provide foreign investors with greater flexibility in managing IDR-denominated investments in Indonesia.

These included –

- a) swap hedging per tenor bucket was increased to 3M - 15%; 6M - 20%; 12M - 25%, from 12.5% earlier.
- b) DNDF incentive was increased to 6M - 25% and 12M - 30%. An increase in FX/NDF swap premium incentives for longer tenors will lower hedging costs and

encourage longer tenor positions, in turn increasing longevity of these flows;

c) Launch of the VASTRA scheme (FX Market Transactions for Hedging through Partner Banks) got underway, with the naming of 14 domestic partner banks. This facility is designed to help investors transact with lower underlying documentation requirements, tap into longer banking hours, and access onshore hedging facilities.

d) deepen FX and money markets by expanding Local Currency Transactions (LCT) between IDR and CNY, besides a few other currencies.

Indonesia-US 10Y spread narrows



Source: CEIC, DBS

Policymakers are likely to tap a combination of administrative and macroprudential measures rather than solely interest rates to defend the currency as well as keep inflationary expectations in check.

We expect the pause on rates to extend into 4Q26. This call might be at risk if depreciation pressures on the rupiah mount again on unfavourable global

developments and if the US Fed undertakes a more aggressive hiking cycle than our baseline (of 75bp hikes).

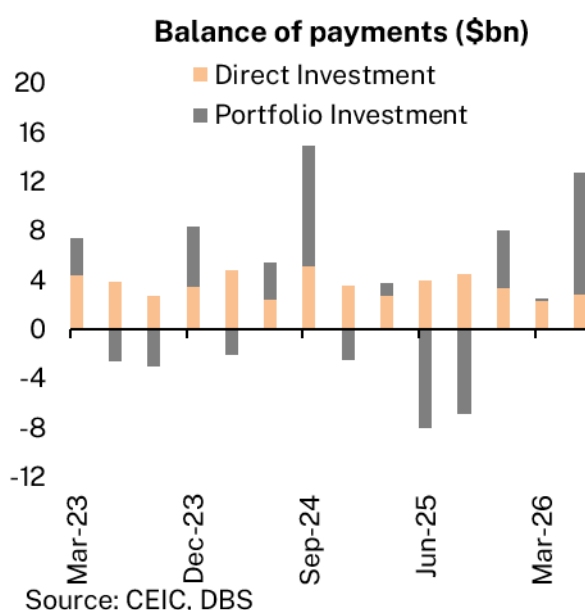
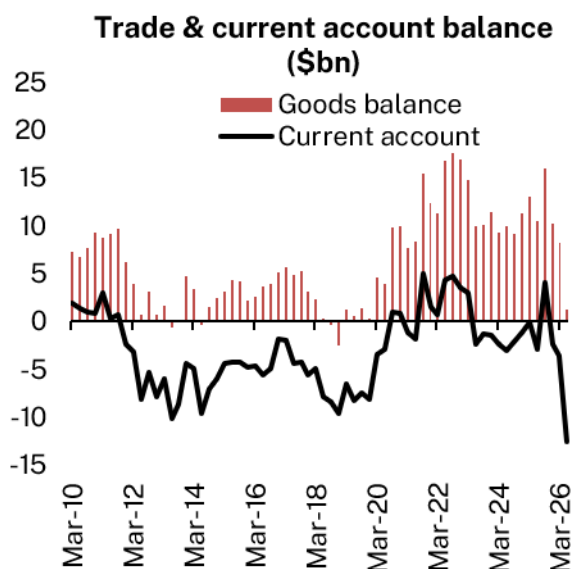
WIDER CAD WILL BE PARTLY OFFSET BY POSITIVE FLOWS

Indonesia's 1H26 current account deficit (CAD) widened significantly to - \$16bn vs -\$3bn in the comparable period a year ago. Much of this deterioration was led by a narrower goods trade balance, while the services deficit widened on the seasonal travel account due to the Hajj period. Higher coupon payments weighed on the primary account. This pressure is likely to persist in 2H as the oil & gas trade deficit remains wide and export performance has been firm but tracking lower than regional peers, likely also impacted by the El Nino phenomenon in key agri commodities. We expect full year CAD to be closer to 1.8-2% of GDP from -0.1% in 2025.

Much rests on the capital flows account.

While 1H balance of payments (BOP) also widened, there was palpable improvement in 2Q26 vs 1Q. 2Q BOP narrowed significantly to \$0.9bn from a wide \$9.1bn in 1Q, helped by positive capital account flows – primarily stronger portfolio investment on SRBI and debt inflows, and net FDI position. This dependency is likely to extend to 2H, with capital flows till Sep26 holding up on account of hedging discounts and moves to improve inflows. Global conditions, including the narrow ID-US yields, however, warrant attention. Nonetheless, full-year BOP could remain

wide, on a scale comparable to the 2025 gap.



18000, while 10Y yield hovered around 7.15-7.25%. A jump in the Aug goods trade surplus aided this respite, alongside foreign purchases of domestic debt, which have remained positive this month and on a YTD basis. Insurers, the central bank, and retail investors have remained key anchors for the bond market. SRBI rates are off highs to sub-7% levels but are attracting steady demand, likely encouraged by hedging discounts. An improved outlook for flows has helped contain spillovers from a wider current account deficit. This does not take away from the fact that the rupiah is amongst the worst performers on a year-to-date basis.

Separately, markets will also monitor developments in the political economy, institutional architecture, and formation, as well as the role of state-led agencies (e.g., DSI) and progress on the centralisation of decision-making. We expect the BI to keep on hold, however, pressure to tighten policy might return if the US Fed hikes rates well into 2027 and the US dollar benefits from a risk-off environment, weighing on the currency.

IN SUMMARY

IDR markets have been relatively steady in October despite higher oil prices and a bid dollar, though sentiment remains sensitive to external developments and swings in global risk appetite. USDIDR traded within 17600-

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