2026 State budget:

Consolidation and centralization

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Samuel Theophilus Artha
samuel_artha@bca.co.id

Lazuardin Thariq Hamzah
lazuardin_hamzah@bca.co.id

Victor George Petrus Matindas
victor_matindas@bca.co.id

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Summary

- The government's high tax growth target hinges upon tax base expansion and potential tax code adjustment combined, along with higher NGDP growth.
- The government allocates more funds for its eight key priority programs. However, the spending budget remains conservative due to lower regional transfers and village funds.
- The deficit-to-GDP ratio remains prudent at 2.48%, but higher expected SBN net issuance may constrain deposit growth.

- President Prabowo Subianto unveiled the 2026 draft of the state budget last Friday, which will be the first among his tenure. In his speech, President Prabowo outlined the need and aspirations of his administration around his Eight key programs (*Asta Cita*); many of which requires sizable funding.
- While the speech may paint the picture of an ambitious fiscal program, the actual spending budget is quite subdued, with 2026 deficit-to-GDP reaching 2.48% (IDR 638.8 Tn), still well below the 3% red line. Moreover, despite its lofty target, the government's macroeconomic assumptions are largely quite conservative, possibly allowing for additional fiscal space if best case scenarios were to happen while simultaneously guarding against potential downturns.
- This controlled, careful approach to government spending paints a stark contrast to more fiscal exuberance abroad among developed markets. **As a result, 10Y SBN yield barely budged since the speech and is still among its historical lows, a sign of the market appreciating the government's prudent fiscal management**.

Revenue: Rooted on a higher domestic growth

- Headline revenue is projected to rise by 9.8% this year, consisting of a 12.8% rise in taxes and customs, while non-tax revenue falls by 4.7% ***(see Chart 1)***, a product of the transfer of SOEs' dividend earnings to Danantara, among other factors.
- While the 12.8% targeted increase in taxes seems daunting at first, it is important to note that **the government's targeted Nominal GDP growth of 8.2% would have covered around two-thirds of the increase**, especially as VAT tends to correspond strongest with NGDP growth. **The low base**

effect due to the weaker revenue performance in 2025 should also be considered, especially as the tax revenue shortfall is also influenced by a one-off event, creating an opportune moment for the government to 'catch up'.

- However, there are some hurdles that the government may first need to jump over in meeting its revenue target. **Global conditions resemble such a challenge**, as the ongoing slump in global manufacturing activity continues to drag commodity prices lower, which may also explain the projected 4.7% YoY decline in non-tax revenue.
- It is fair to say, then, that **the government will look to raise revenue domestically, further highlighting the crucial role the higher nominal GDP growth assumption plays in the 2026 state budget.** However, even assuming nominal GDP growth of 8.2% YoY in 2026, the revenue target is the 2026 state budget is still positioned above the historical trend ***(see Chart 2)***, implying an extraordinary effort that is necessary in meeting the target.
- There are two main ways for the government to meet its fiscal revenue target. First, **the government have signalled its intention to widen the tax base,** spearheaded by the recent data synchronisation push among different public institutions to identify new tax subjects. This policy objective is evident in the target to increase the tax ratio from 10.0% in 2025 to 10.5% in 2026, which is also crucial to strengthening Indonesia's revenue potential in the long term.
- Another strategy the government may consider is executing the planned adjustments to its tax code. Indeed, several initiatives aimed at boosting the fiscal revenue have been delayed, such as the excise on sugary beverages and the 1% VAT rate increase originally scheduled for 2025. Alas, taking the planned tax increases out of the fridge and back to the table may not be as simple as it seems, as **putting a higher tax on consumption runs contrast to the government's effort to use its fiscal lever to energize household spending.**

"Slump in global conditions resulted in the state budget's high reliance upon higher NGDP growth"

Spending: Taking from one hand and giving it to another

- As noted earlier, the government has proposed a conservative budget for 2026, targeting total public spending growth of 7.3% YoY (compared with the NGDP growth target of 8.2%), thereby keeping the deficit at a prudent 2.48% of GDP. This less-expansive spending stance may come as a surprise, particularly when set against the government's relatively stagnant global growth outlook (as reflected in its assumption of lower oil prices, among other factors).
- Whether the budget is viewed as expansive or contractionary is ultimately a matter of perspective. **From the central government's**

standpoint, the budget appears sufficiently expansive, with a 17.8% increase in central government spending. In contrast, regional governments may identify a potential squeeze to their budget, given the 24.8% drop in regional transfers ***(see Chart 3)***. Admittedly, large-scale programmes require more robust and effective oversight, which makes a degree of centralisation necessary.

- Theoretically, the government's fiscal strategy to concentrate spending on the central government is not without its merit. The central government's priority programmes are more directly targeted at lower- and middle-income households, which – if backed by sufficient funding – could generate significant multiplier effects.

"The government's priority programmes may generate substantial growth multiplier effects, depending on their realisation and oversight"

- However, there are at least two things to consider from the government's fiscal concentration strategy. **First, the effectiveness of translating the sizable spending target into realised expenditure will be critical**, as shown by the drag on GDP growth in Q1-2025 when slower fiscal disbursement amidst the budget efficiency process dampened the growth momentum.

- Unfortunately, early developments point to a potential drag on spending realisation. The government has announced guidelines for another round of budget efficiency in 2026, covering 15 items that may affect multiple sectors. Such an early announcement risks creating a self-fulfilling prophecy, as businesses (including banks) may pre-emptively limit their exposure to sectors likely to be affected.

- **Second, the significant reallocation of funds from regional transfers to central government spending warrants careful monitoring to ensure the multiplier effect on domestic demand is not undermined (see Chart 4).** Statistically, there is a 61% correlation between an increasing ratio of regional transfers and the domestic demand multiplier of total government spending, highlighting the need to empower regional government to fulfil its fiscal agenda.

- It is also important to consider that the reduction in regional funding may somewhat temper the increased consumption effect, as most regional governments remain reliant on transfers from the central government. This potential funding shortfall may even incentivise local officials to either raise taxes (with estate taxes being one notable example), and/or replicate the central government's 'efficiency drive' earlier this year.

- Another noteworthy change is the 12.1% reduction in the budget earmarked for the village funds programme. It is perhaps for this reason that the rollout of the Red-White Cooperatives Programme (KMP) has become necessary, as cooperatives born out of the programme have been billed to be capable of generating stronger local economic activity than the village funds alone. Indeed, the government have set aside around IDR 57.8 Tn in its investment financing budget to support the programme, bringing its total investment financing to the record-high IDR 203.1 Tn.

Financing: As prudent as it could be

- The overall theme of prudentialism in the proposed 2026 state budget may seem inconsistent with the 6.9% benchmark yield target next year, considering the record-low 6.39% 10Y SBN yield at the present. **The expectedly higher SBN supply seems to explain this number**, as the government is looking to flood the SBN market with another IDR 749.2 Tn in net issuance ***(see Chart 5)***, an IDR 164.1 Tn increase (+28.0%) compared to the outlook for 2025.
- **The higher SBN issuance may reflect the narrowing financing options available for the government in 2026**. The government managed to keep SBN issuance stable (relative to the total financing needs) in the past couple of years by relying more on external creditors, which explains the upward trend in Indonesia's external debt position since Q2-2024.
- Along with the already-utilised bilateral and multilateral credit facilities, **the fiscal shift towards more discretionary spending may also help explain the lower target for external loan withdrawals in 2026**, as reflected in the IDR 44.3 Tn drop in project-based loan withdrawals (out of the overall IDR 160.1 Tn decline) earmarked for next year.

"Higher net SBN issuance and faster nominal GDP growth may explain the expectation of higher SBN yield in 2026"

- The higher net SBN issuance poses a challenge for the domestic banking sector. On one hand, banks are expected to support private sector investment financing, which is crucial to sustaining growth momentum in the gross fixed capital formation part of the GDP (which played a large part in the 5.12% YoY GDP growth in Q2-2025). On the other hand, **higher SBN issuance may continue to constrain deposit growth *(see Chart 6)***, unless the 2026 nominal GDP growth manage to recover to its potential.
- With that being said, the SBN market may remain relatively stable in 2026. Like what happened this year, **the government may continue to benefit from the sizable excess budget balance (SAL) in 2026, reducing the risk of net SBN issuance beyond the IDR 749.2 Tn target if the deficit widens**. The parliament, currently operating under a confidence-and-supply agreement, should smooth the way for the government to tap further into its SAL balance beyond the IDR 60 Tn target if needed, enabling more liquidity to flow from the public sector and support the private sector's liquidity conditions.

Chart 1

Using the ol' reliable

The bulk of government's projected revenue increase for 2026 came from strong VAT growth from NGDP along with several measures to improve income tax compliance.

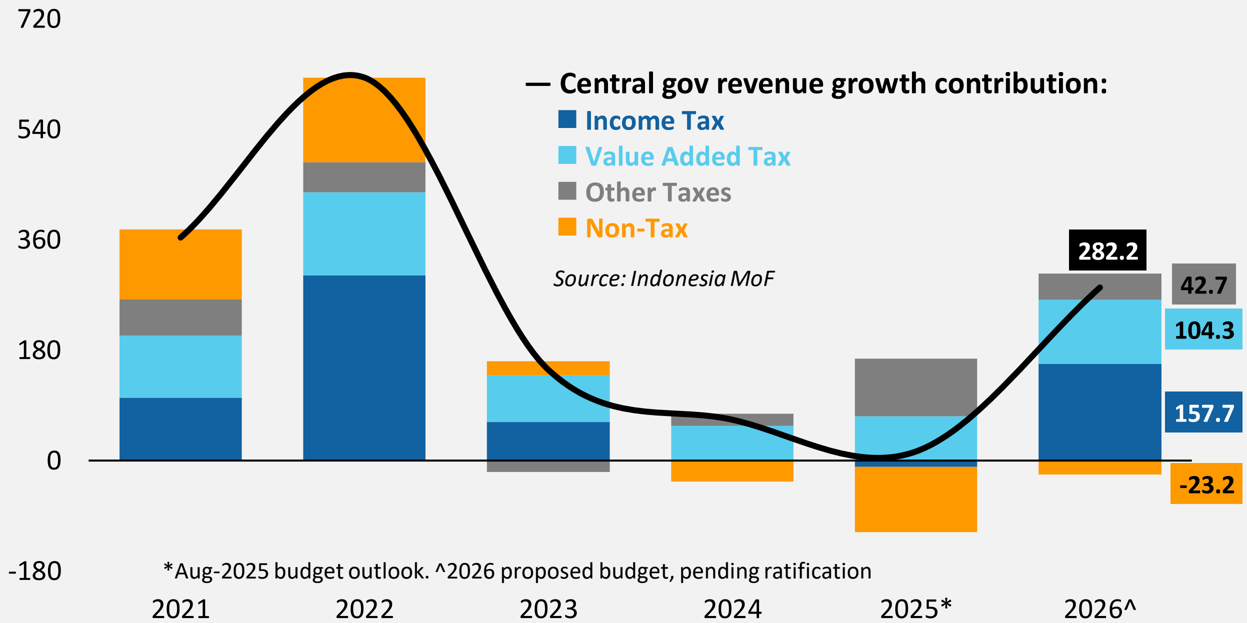
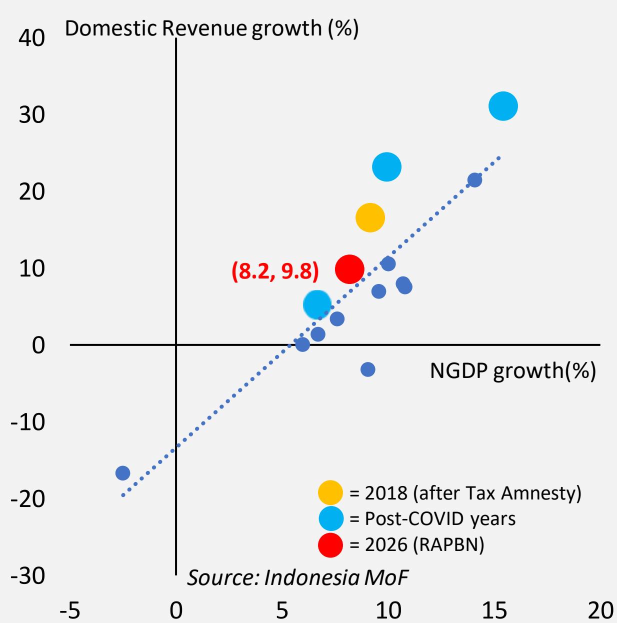


Chart 2

Finding the missing coins

Assuming NGDP growth of 8.2%, revenue target in 2026 is positioned above the historical average. This implies significant effort ahead, such as new reforms or policies to broaden the tax base.



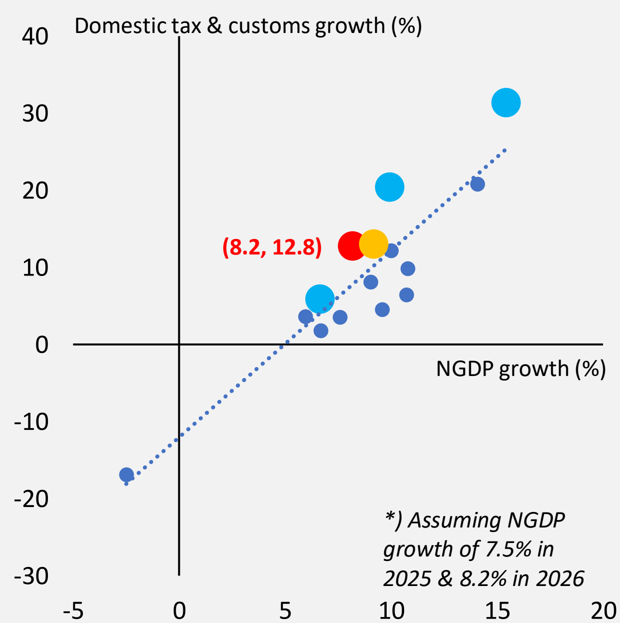
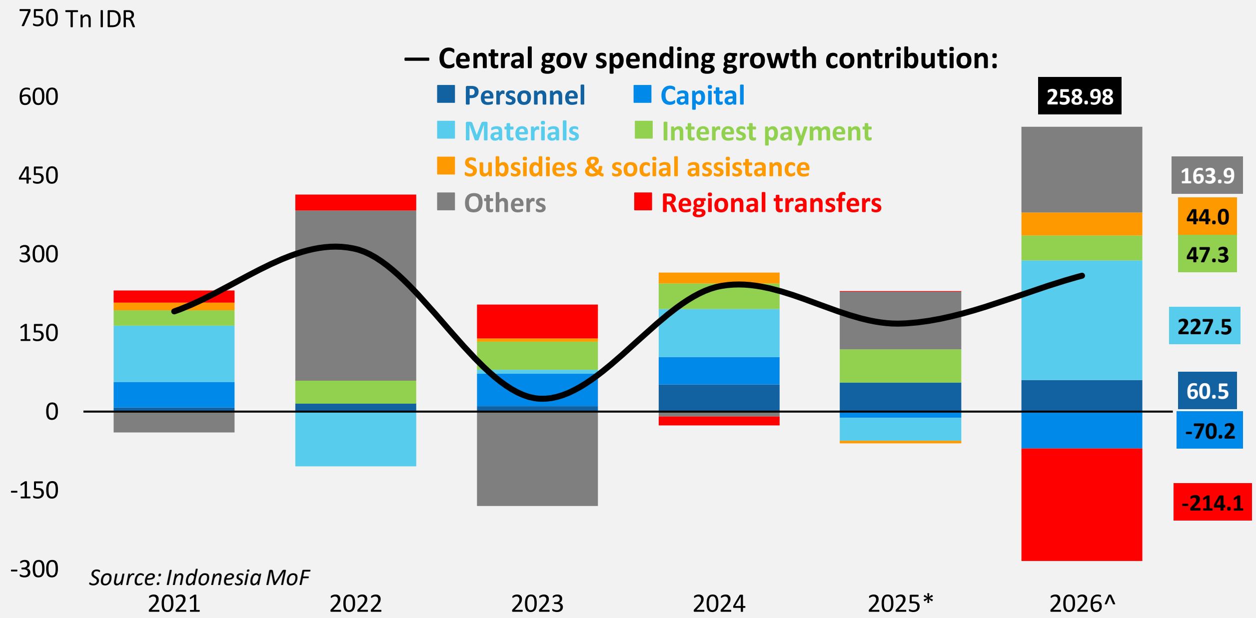


Chart 3

Centralization to distribution

The government chose to fund its slew of new programs largely by reducing regional transfers.

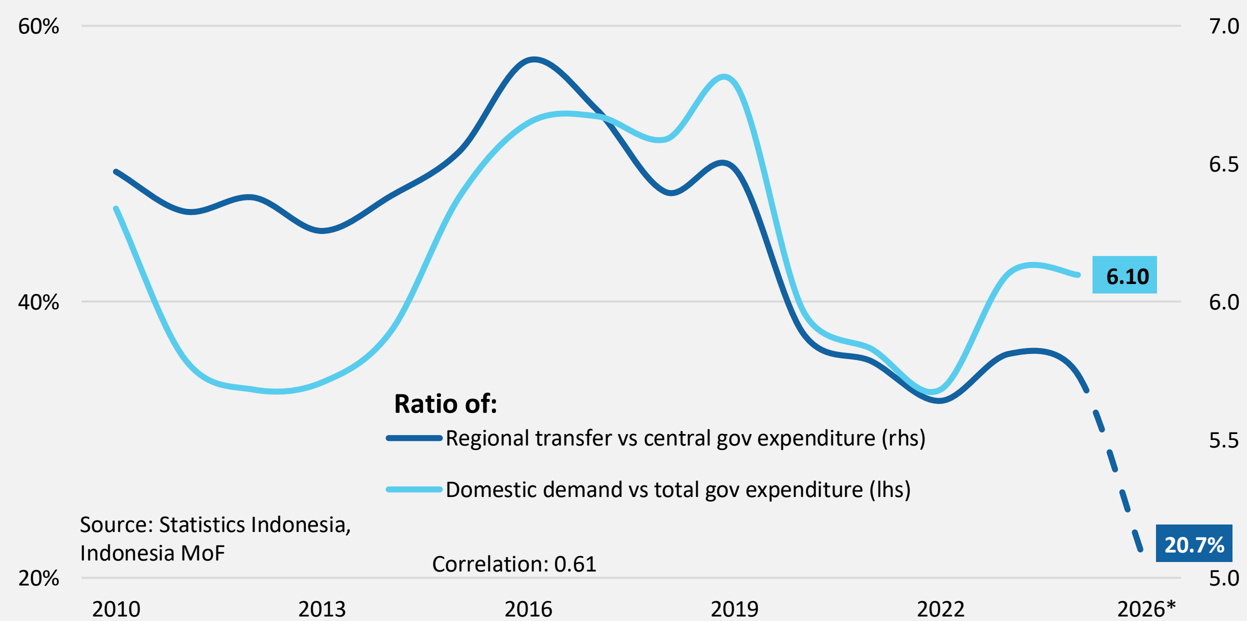


*Aug-2025 budget outlook. ^2026 proposed budget, pending ratification

Chart 4

Be wary to not kill the goose

Lower funds allocation towards regional governments have historically resulted in a steeper slump in domestic demand.

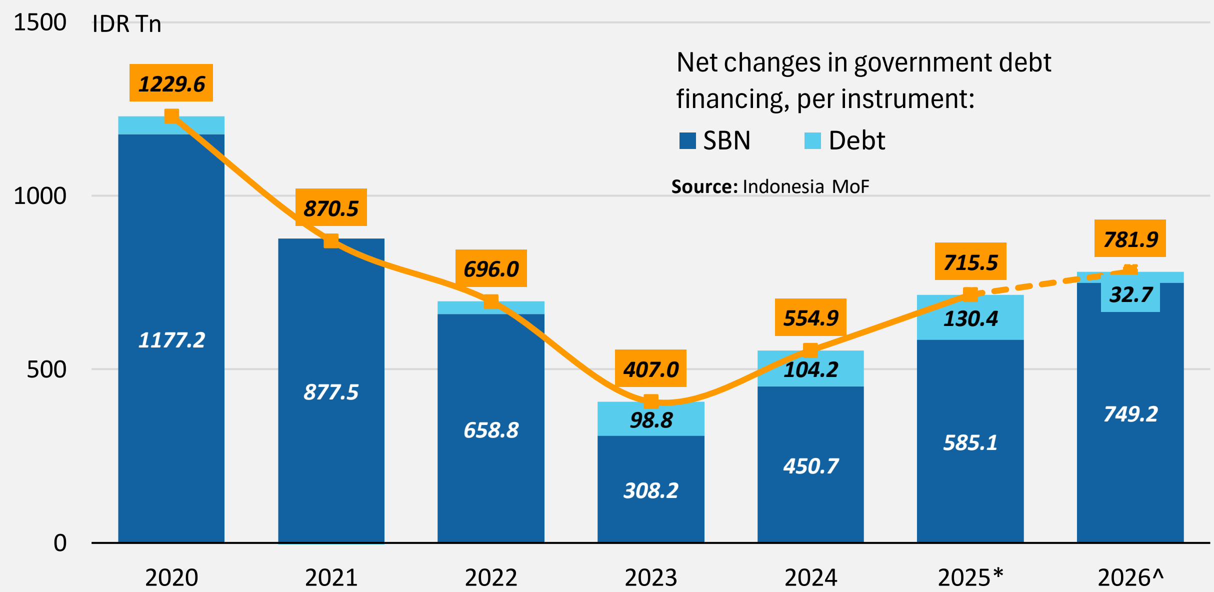


*2026 proposed budget, pending ratification

Chart 5

Over the (credit) line and back to the market

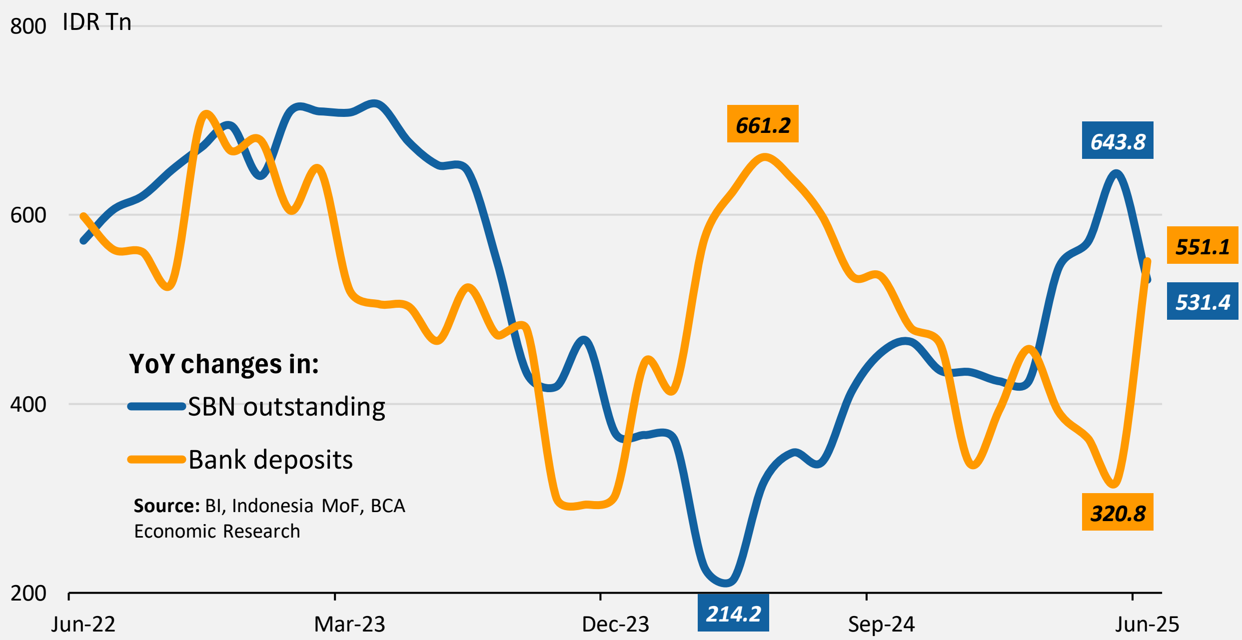
The government looks to lower its debt withdrawals in 2026, resulting in a higher net SBN issuance in 2026 despite the lower deficit target.



*Aug-2025 budget outlook. ^2026 proposed budget, pending ratification

No need to compete if the pot grows larger

Low NGDP growth in 2024 broke down the relationship between SBN and deposits, meaning that a higher SBN issuance may continue to suppress deposit growth unless NGDP growth recovers.



Macroeconomic assumptions

Budget Assumptions	2023		2024		2025	2026
	Budget	Realisation	Budget	Realisation	Outlook	Proposed
Growth (%, YoY)	5.1	5.1	5.1	5.0	5.0	5.4
Inflation (%, YoY)	3.1	2.6	2.7	1.6	2.6	2.5
Exchange Rate (IDR/USD)	15,100	15,255	16,000	15,847	16,800	16,500
10Y SBN Yield (%)	6.8	6.6	6.9	6.8	7.3	6.9
Indonesian Crude Price (USD/bl)	78	78	82	78	82	70
Crude oil lifting (Th bl/day)	614	606	592	580	597	610
Natural gas lifting (Th BoE/day)	985	1,006	990	1,017	980	984

State budget summary

Category (IDR Tn)	2023		2024		2025	2026
	Budget	Realisation	Budget	Realisation	Outlook	Proposed
Total Revenue	2,637.3	2,783.9	2,802.3	2,850.6	2,865.5	3,147.7
Tax revenue	2,118.4	2,154.2	2,309.9	2,231.8	2,387.3	2,692.0
Non-tax revenue	515.8	612.5	492.0	584.4	477.2	455.0
Total spending	3,117.2	3,121.2	3,325.1	3,359.8	3,527.5	3,786.5
Budget deficit (% GDP)	-2.27	-1.61	-2.29	-2,30	-2.78	-2.48

Economic Calendar

		Actual	Previous	Forecast*
01 August 2025				
ID	S&P Global Manufacturing PMI	49.2	46.9	48.5
ID	**Trade balance (Jun-25), USD Bn**	**4.11**	**4.3**	**4.0**
ID	**Inflation Rate YoY, %**	**2.37**	**1.87**	**2.1**
US	S&P Global Manufacturing PMI	49.8	52.9	49.5
US	Non Farm Payrolls, th	73	14	110
05 August 2025				
ID	**GDP Growth Rate YoY, %**	**5.12**	**4.87**	**5**
US	Trade balance, USD Bn	-60.2	-71.7	-61.4
06 August 2025				
EA	Retail Sales YoY, %	3.1	1.9	2.5
ID	Property Price Index YoY, %	0.90	1.07	-
07 August 2025				
CN	Trade balance, USD Bn	98.24	114.77	117.3
ID	**Foreign Exchange Reserves, USD Bn**	**152**	**152.6**	**-**
08 August 2025				
ID	Consumer Confidence	118.1	117.8	118.4
ID	Motorbike Sales YoY, %	-2.0	-0.3	-
09 August 2025				
CN	Inflation Rate YoY, %	0.0	0.1	-0.1
11 August 2025				
ID	Retail Sales YoY, %	1.3	1.9	1.7
ID	Car Sales YoY, %	-18.4	-22.6	-
12 August 2025				
US	Inflation Rate YoY, %	2.7	2.7	2.7
15 August 2025				
CN	Retail Sales YoY, %	3.7	4.8	5.0
US	Retail Sales YoY, %	3.9	4.4	3.5
20 August 2025				
ID	**BI-Rate Decision, %**		**5.25**	**-**
21 August 2025				
ID	Loan Growth YoY, %		7.77	-
22 August 2025				
ID	Current Account, (USD Bn)		-0.2	0.5
ID	M2 Money Supply YoY, %		6.5	-
29 August 2025				
US	PCE Price Index YoY, %		2.6	2.6

*Forecasts of some indicators are simply based on market consensus
Bold indicates indicators covered by the BCA Monthly Economic Briefing report

Selected Macroeconomic Indicator

Key Policy Rates	Rate (%)	Last Change	Real Rate (%)
US	4.50	Dec-24	1.80
UK	4.00	Aug-25	0.40
EU	2.15	Jun-25	0.15
Japan	0.50	Jan-25	-2.80
China (lending)	2.00	Sep-24	4.35
Korea	2.50	May-25	0.40
India	5.50	Jun-25	3.95
Indonesia	5.25	Jul-25	2.88

Money Mkt Rates	15-Aug	-1 mth	Chg (bps)
SPN (1Y)	5.16	5.57	-40.3
SUN (10Y)	6.38	6.56	-18.4
INDONIA (O/N, Rp)	4.77	5.14	-36.9
JIBOR 1M (Rp)	5.86	6.13	-27.1

Bank Rates (Rp)	May	Apr	Chg (bps)
Lending (WC)	8.64	8.66	-1.72
Deposit 1M	4.86	5.02	-15.57
Savings	0.70	0.69	1.18

Currency/USD	15-Aug	-1 mth	Chg (%)
UK Pound	0.738	0.747	1.27
Euro	0.854	0.862	0.88
Japanese Yen	147.2	148.9	1.15
Chinese RMB	7.185	7.183	-0.03
Indonesia Rupiah	16,160	16,260	0.62

Capital Mkt	15-Aug	-1 mth	Chg (%)
JCI	7,898.4	7,140.5	10.61
DJIA	44,946.1	44,023.3	2.10
FTSE	9,138.9	8,938.3	2.24
Nikkei 225	43,378.3	39,678.0	9.33
Hang Seng	25,270.1	24,590.1	2.77

Foreign portfolio ownership (Rp Tn)	Jul	Jun	Chg (Rp Tn)
Stock	3,539.4	3,336.8	202.60
Govt. Bond	935.7	995.6	-59.93
Corp. Bond	4.7	4.3	0.39

Trade & Commodities	15-Aug	-1 mth	Chg (%)
Baltic Dry Index	2,044.0	1,866.0	9.5
S&P GSCI Index	534.2	544.7	-1.9
Oil (Brent, $/brl)	65.9	68.7	-4.2
Coal ($/MT)	110.6	113.7	-2.7
Gas ($/MMBtu)	2.97	3.32	-10.5
Gold ($/oz.)	3,336.2	3,324.6	0.4
Copper ($/MT)	9,679.8	9,597.2	0.9
Nickel ($/MT)	14,953.1	14,935.2	0.1
CPO ($/MT)	1,039.5	972.7	6.9
Rubber ($/kg)	1.75	1.69	3.6

External Sector	Jun	May	Chg (%)
Export ($ bn)	23.44	24.61	-4.78
Import ($ bn)	19.33	20.31	-4.82
Trade bal. ($ bn)	4.10	4.30	-4.60
Central bank reserves ($ bn)*	152.6	152.5	0.05

Prompt Indicators	Jul	Jun	May
Consumer confidence index (CCI)	118.1	117.8	117.5
Car sales (%YoY)	-18.4	-22.5	-15.1
Motorcycle sales (%YoY)	-0.5	-0.3	-0.1

Manufacturing PMI	Jul	Jun	Chg (bps)
USA	49.8	52.9	-310
Eurozone	49.8	49.5	30
Japan	48.9	50.1	-120
China	49.5	50.4	-90
Korea	48.0	48.7	-70
Indonesia	49.2	46.9	230

Source: Bloomberg, BI, BPS

Notes:

*Data from an earlier period

For changes in currency: **Black indicates appreciation against USD, **Red** otherwise

***For PMI, **>50** indicates economic expansion, **<50** otherwise

Indonesia – Economic Indicators Projection

	2019	2020	2021	2022	2023	2024	2025E
Real GDP growth (% YoY)	5.0	-2.1	3.7	5.3	5.0	5.0	5.0
Nominal GDP growth (% YoY)	6.7	-2.5	9.9	15.4	6.7	6.0	7.2
GDP per capita (USD)	4175	3912	4350	4784	4920	4960	5100
CPI inflation (% YoY)	2.7	1.7	1.9	5.5	2.6	1.6	2.2
BI Rate (%)	5.00	3.75	3.50	5.50	6.00	6.00	4.75
SBN 10Y yield (%)	7.04	5.86	6.36	6.92	6.45	6.97	6.57
USD/IDR exchange rate (average)	14,141	14,529	14,297	14,874	15,248	15,841	16,350
USD/IDR exchange rate (end of year)	13,866	14,050	14,262	15,568	15,397	16,102	16,625
Trade balance (USD Bn)	-3.2	21.7	35.3	54.5	37.0	31.0	26.0
Current account balance (% of GDP)	-2.7	-0.4	0.3	1.0	-0.1	-0.6	-1.0

Notes:

- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*

Economic, Banking & Industry Research Team

David E.Sumual
Chief Economist
david_sumual@bca.co.id
+6221 2358 8000 Ext:1051352

Agus Salim Hardjodinoto
Head of Industry and Regional Research
agus_lim@bca.co.id
+6221 2358 8000 Ext: 1005314

Victor George Petrus Matindas
Head of Banking Research and Analytics
victor_matindas@bca.co.id
+6221 2358 8000 Ext: 1058408

Gabriella Yolivia
Industry Analyst
gabriella_yolivia@bca.co.id
+6221 2358 8000 Ext: 1063933

Lazuardin Thariq Hamzah
Economist / Analyst
lazuardin_hamzah@bca.co.id
+6221 2358 8000 Ext: 1071724

Elbert Timothy Lasiman
Economist / Analyst
Elbert_lasiman@bca.co.id
+6221 2358 8000 Ext: 1007431

Thierris Nora Kusuma
Economist / Analyst
thierris_kusuma@bca.co.id
+6221 2358 8000 Ext: 1071930

Nicholas Husni
Economist / Analyst
nicholas_husni@bca.co.id
+6221 2358 8000 Ext: 1079839

Samuel Theophilus Artha
Economist / Analyst
samuel_artha@bca.co.id
+6221 2358 8000 Ext: 1080373

Jennifer Calysta Farrell
Economist / Analyst
jennifer_farrell@bca.co.id
+6221 2358 8000 Ext: 1082423

PT Bank Central Asia Tbk

Economic, Banking & Industry Research of BCA Group
20th Grand Indonesia, Menara BCA
Jl. M.H Thamrin No. 1, Jakarta 10310, Indonesia
Ph : (62-21) 2358-8000   Fax : (62-21) 2358-8343