Fiscal-fed liquidity windfall

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Summary

- Shocks in both revenue and spending parts of the government's budget explain the overshot fiscal deficit in 2025.
- Anaemic private demand, along with disaster relief and reconstruction efforts, highlights the difficulty for the government to trim its spending commitment despite the revenue shortfall.
- Higher net fiscal spending leads to the overflow of liquidity into the domestic banking sector, creating an industry-wide imbalance as the demand for loans remains subdued.

- Geopolitical uncertainties spiked earlier this year, yet global financial markets do not appear to be placing much weight on them. Inflation and interest rate expectations in the US are firmly pointing southward, as de facto US control over Venezuela's heavy sour crude oil is expected to weaken OPEC+'s influence over global oil prices, while tariff-driven rise in core goods inflation is projected to peak in Q1-2026, according to the Fed's own estimates. The market is now pricing another 50 bps in FFR cut this year, with continued weakness in the private non-farm payroll data (37k in Dec-2025, below the 64k forecast) may open the room for an extra 25 bps of FFR cut.
- Despite a possible delay until the change in Fed chairmanship in May 2026, the widely expected continuation of the FFR cutting campaign may continue to fuel the ongoing rally in emerging market assets, including Rupiah-denominated assets.
- Indeed, the Indonesian financial market recorded foreign inflows totalling USD 237.4 Mn last week, with most of it flowing into the domestic stock market and helping propel the benchmark index surge past the 8,900 level for the first time since its inception. Foreign net buys were also recorded in the sovereign bond (SBN) market, although the USD 116.1 Mn in foreign inflows does not seem to produce much result when it comes to keeping the longer end of the SBN yield curve stable ***(see Chart 1)***.

Forced to spend

- The disconnect between short- and long-term yields has previously been noticeable in other, often more developed bond markets, as looming debt concerns in these economies have led investors to demand higher term premia or reduce their exposure to duration altogether. The fact that this trend has begun to emerge in Indonesia may point to a similar conclusion. Last week's announcement revealed that Indonesia's fiscal balance deteriorated to -2.92% of GDP in 2025, making it uncharacteristically close to the -3% of GDP deficit cap ***(see Chart 2)***.

- **Shocks to both revenue and spending explain the deepest fiscal deficit outside of the crisis-impacted years**. The first blow to the government's efforts to meet its revenue target came from the postponed VAT tariff hike, while a sharp drop in commodity prices throughout H1-2025 further steepened the curve for the government to hit its target.
- **Changes in GDP growth drivers may also have detrimentally affected Indonesia's tax revenue realisation**. As we know, the robust GDP growth recorded in 2025 was largely attributed to stronger investment (particularly in Q2-2025) and net exports (in Q3-2025), while the contribution of private spending to headline GDP growth has been declining throughout the past year. Private consumption, of course, feeds directly into government revenues via VAT, excise taxes, and export duties. In contrast, investment is relatively tax-light, as some investing companies may do so to qualify for government tax incentives, while others may still be in the pre-revenue stage.

"The shift towards a more investment-driven growth may negatively affect the short-term outlook on tax revenue"

- **There is some hope for the government to turn the corner on revenue in 2026**. First, consumer spending has shown some encouraging trends since Q4 2025, as indicated by the 9.8% increase in BCA's consumer spending index by the end of December 2025. Second, the prospect of global monetary easing may reverberate positively through commodity demand, with industrial metals (such as copper and nickel) showing a strong uptrend early in the year.
- Previous episodes of fiscal revenue shortfalls, such as during the commodity busts of 2009 and 2014, saw the government sizably trim its spending to meet revenue constraints. Various efforts, ranging from the budget review process conducted earlier last year to the burden-sharing agreement with Bank Indonesia to lower the interest bill, show that the sitting administration has also aspired to do so.
- However, **prevailing circumstances may have rendered the government unable to take more drastic expense-cutting action**, as anaemic private demand has placed a greater burden on the public sector to stabilise domestic aggregate demand, as indicated by realised social assistance spending being 20.9% higher than projected.
- It was not until the recent disaster in Sumatra that the government seemingly lost its last option to close the year with a more balanced fiscal posture ***(see Chart 3)***. Previously, the government has been trying to identify and reallocate unrealised funds from some institutions and ministries, which should speed up spending realisation while keeping the fiscal balance closer to the -2.78% outlook. Alas, **the much-needed disaster relief may have forced the government to break out of its fiscal straitjacket**, leading to the central government overshooting its capital spending by 24.2% and material & services spending by 17.9% (relative to the budget outlook).

Bank liquidity: From shortfall to windfall in a year

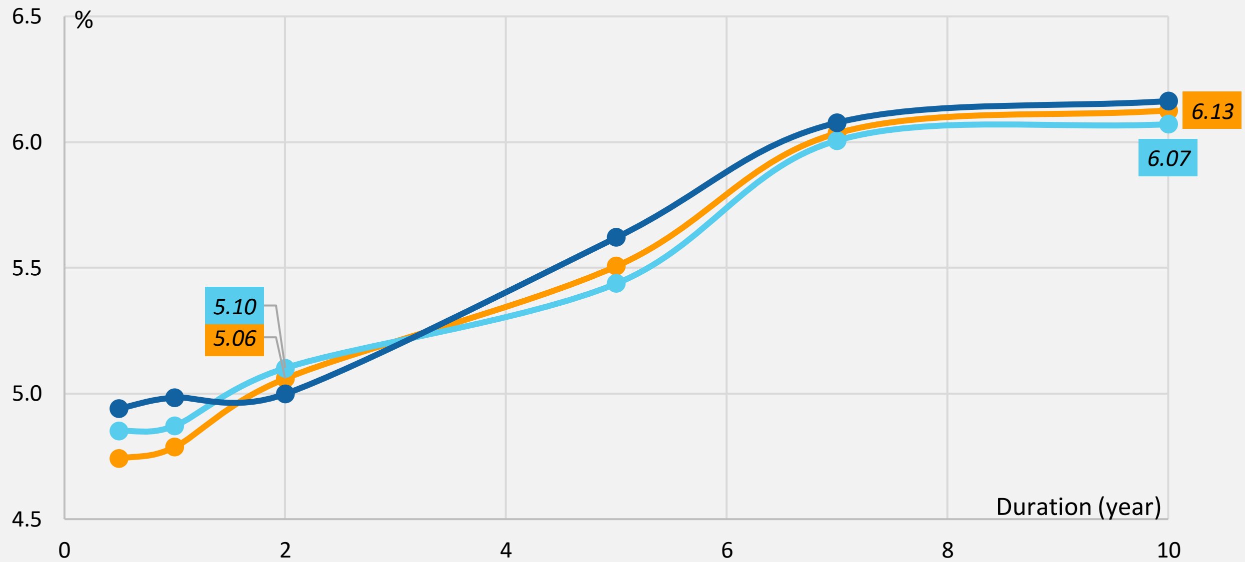
- The unplanned and emergency nature of the government's spending in December 2025 is further indicated by the decision to withdraw some of the cash it had previously stashed within the banking system. Interestingly, while we previously cautioned that a sudden withdrawal of public liquidity might lead to a spike in interbank rates, **the accelerated spending that followed may have turned the cash withdrawal into a liquidity-positive event *(see Chart 4)***, as some of the liquidity withdrawn from SOE banks' term deposits may have flowed more broadly into banks' CASA as the government spent the funds.
- The government have expressed their intention to maintain the pace of spending realisation (partly due to the still-going disaster relief and reconstruction operations), which will spread out fiscal expenditures and, thus, provide a more stable buffer for the domestic aggregate demand condition. **However, the government's strategy to start spending early in the year may have contributed in turning the liquidity condition within the domestic banking sector into a surplus**, as indicated by the sharp drop in the benchmark interbank rate ***(see Chart 5)***.
- As such, **the challenge facing the domestic banking sector now comes in the form of excess liquidity**, in contrast to the conditions banks experienced for much of H1 2025. Coupled with subdued and concentrated loan demand, the overflow of public spending-driven liquidity portends weakening pricing power for some banks. This dynamic could unleash unhealthy competition among banks; however, a preferable scenario (especially for the government) would be for banks to increase their risk appetite and begin venturing into currently underserved segments of the lending market, such as MSME loans. Alas, given the growing credit risk, it is uncertain whether banks could afford to absorb more risks into their lending portfolio, despite the ample liquidity condition.
- Ergo, the SBN market may continue to be the preferred option for banks to park their excess liquidity ***(see Chart 6)***, which could help to keep the SBN yield relatively stable despite the expected higher supply. Herein lies the government's dilemma: strong demand from banks may help stabilise SBN yields, but at the cost of banks shying away from the lending activity needed to enable more businesses to participate in the government's growth strategy.

> ***"The government's effort to stabilise yield conditions may depend on whether banks are able to accelerate their lending growth"***

Chart 1

Troubles on the horizon

Indonesia's short-term yield decline on the back of BI's accommodative stance, while fiscal concerns push long-term yields higher

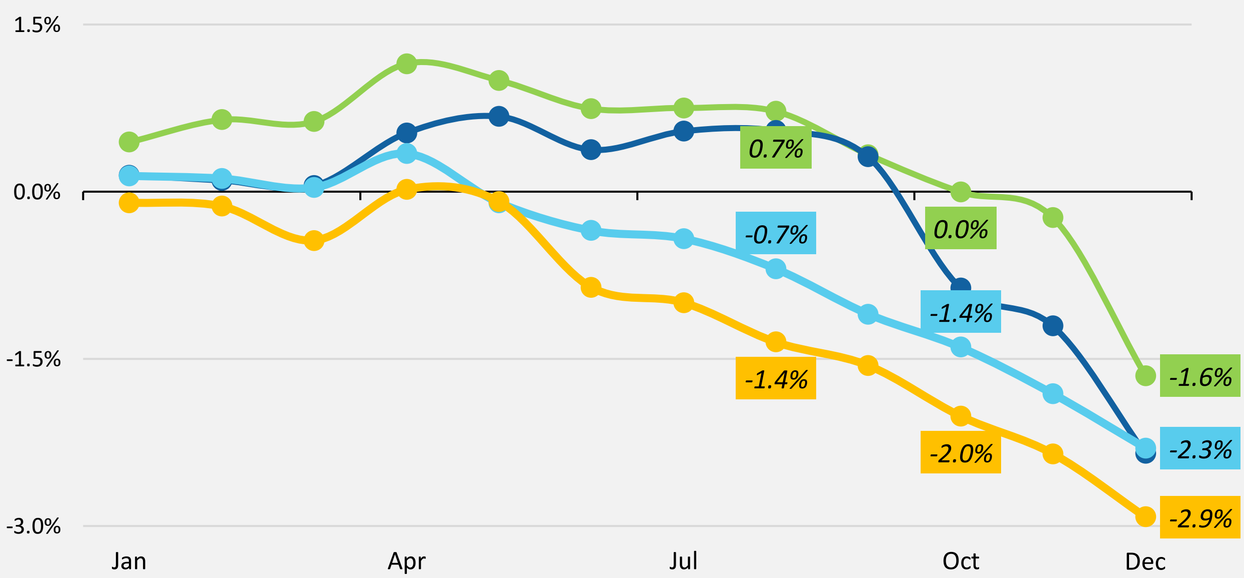


SBN yield curve: (Yellow) Recent | (Sky blue) 1-week ago | (Dark Blue) 1-month ago. **Source:** Bloomberg

Chart 2

Stopping right at the edge

Indonesia recorded the deepest fiscal deficit outside of the pandemic in 2025 as spending accelerates in Q4-2025 while revenue remains constrained.

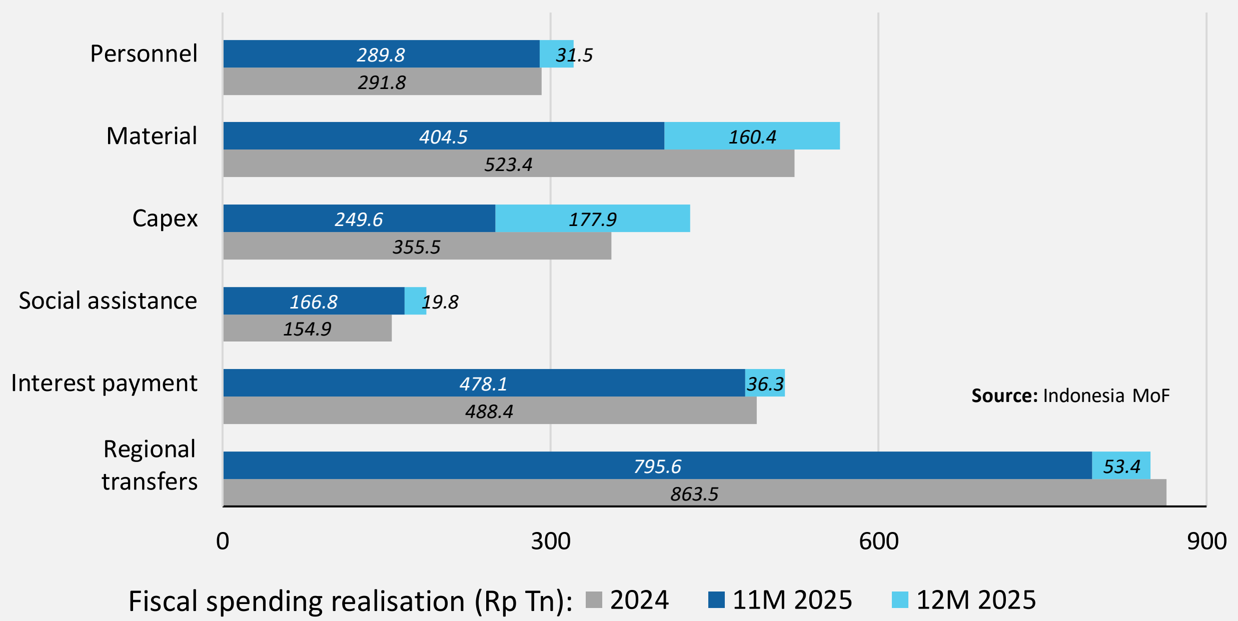


Budget balance, % of GDP: (Dark blue) 2022 | (Sky blue) 2024 | (Green) 2023 | (Yellow) 2025 . **Source:** Bloomberg

Chart 3

Struck by disaster

The government was on-track to hit its spending target in 2025. Alas, emergency-related spending may have force them to loosen the fiscal straitjacket.

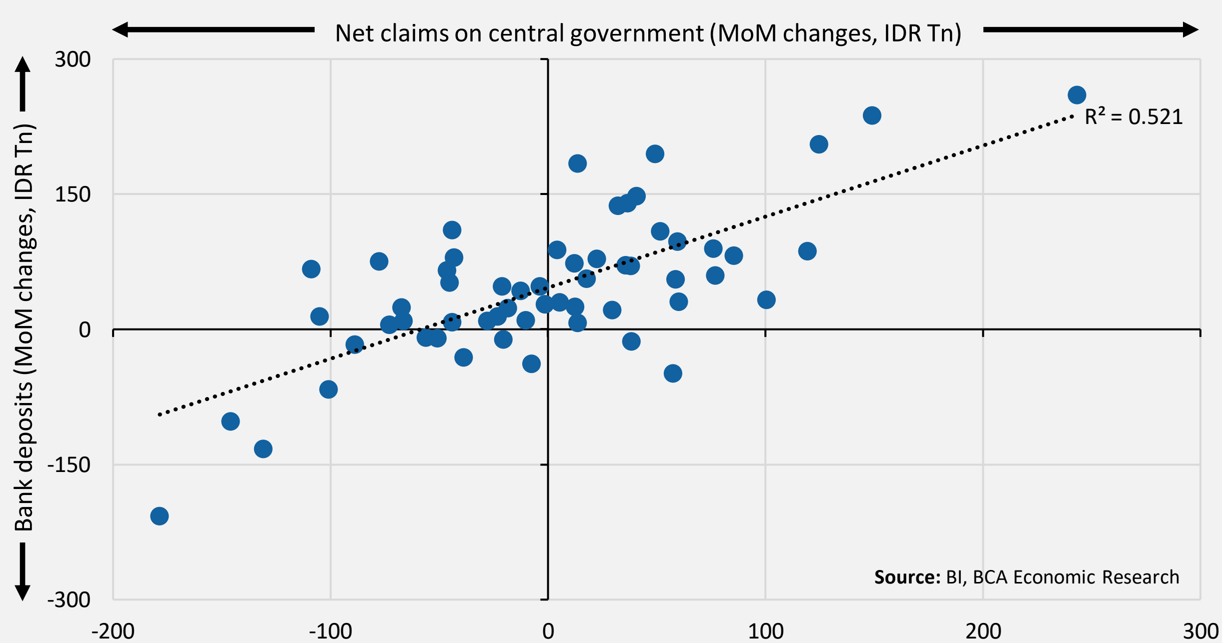


Source: Indonesia MoF

Chart 4

One man's spending is another man's saving

The government's decision to withdraw its cash from banks turn out to be a liquidity-positive event as higher net fiscal spending positively affect banks' liquidity.

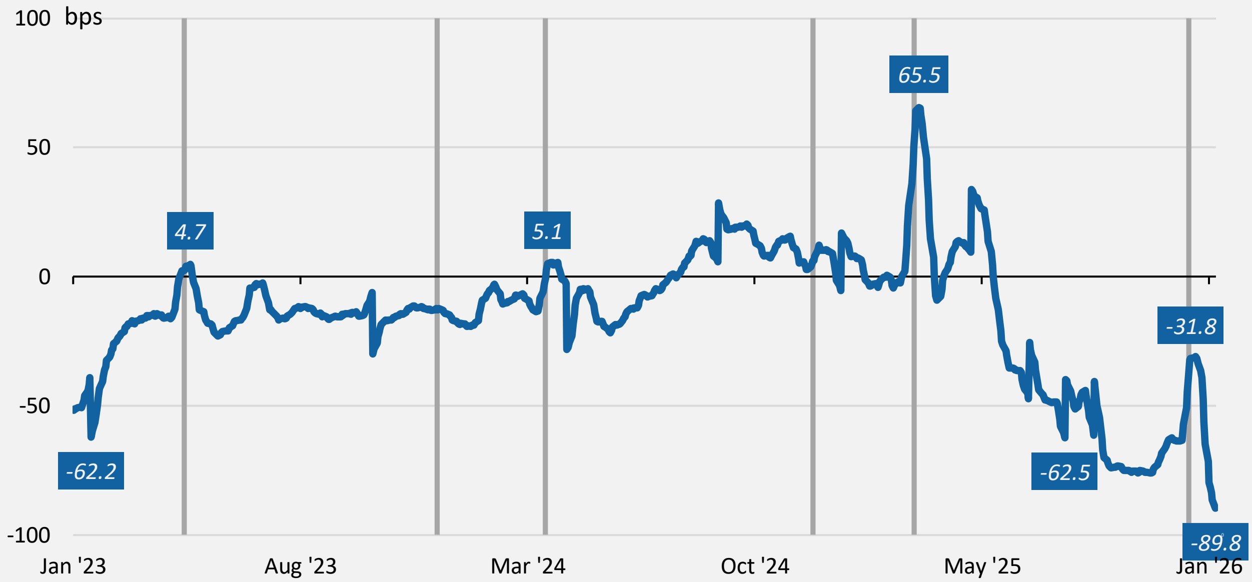


Source: BI, BCA Economic Research

Chart 5

Liquidity on the cheap

The recent sharp drop in the interbank rate may signal the government's strategy to maintain its spending realisation pace, given public spending's increasing influence on banks' liquidity.



(Line) IndONIA – BI Rate spread, bps | **(Shaded area)** Eid and Year-end festivities. **Source:** Bloomberg

Chart 6

Liquidity on the cheap

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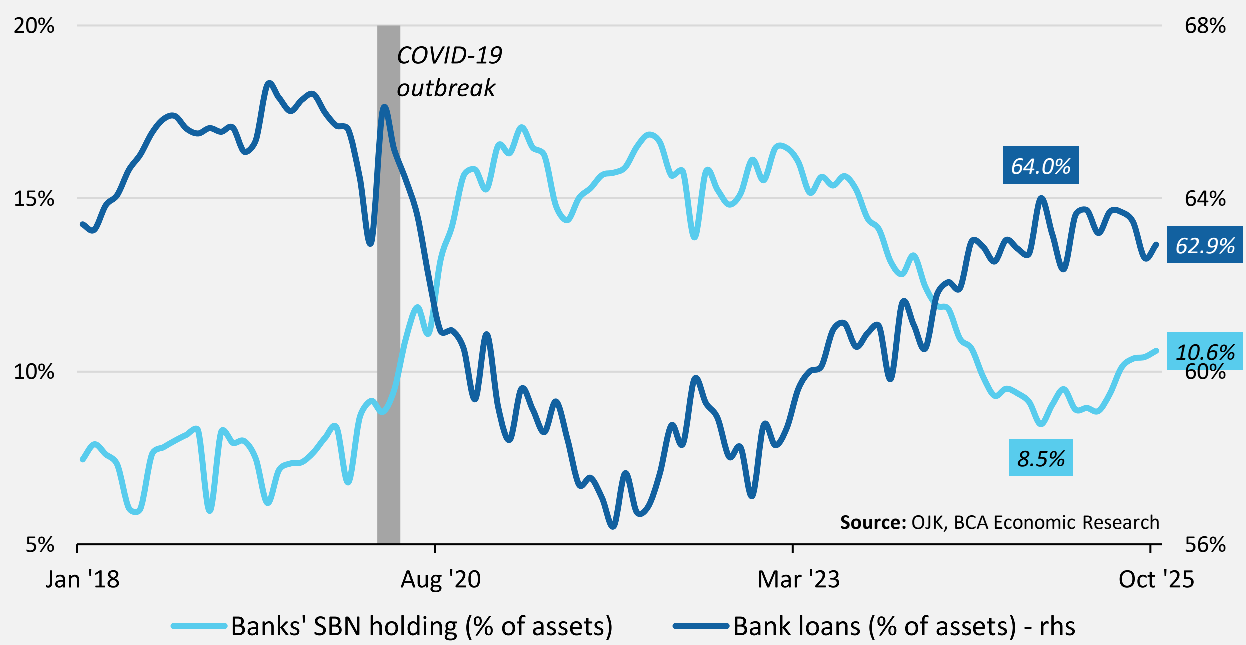

Source: OJK, BCA Economic Research

Economic Calendar

		Actual	Previous	Forecast*
05 January 2026				
ID	**Trade balance (Oct-25), USD Bn**	**2.66**	**2.4**	**2.7**
ID	**Inflation Rate YoY, %**	**2.92**	**2.72**	**2.5**
08 January 2026				
US	Trade balance (Oct-25), USD Bn	-29.4	-52.8	-54.0
ID	**Foreign Exchange Reserves, USD Bn**	**156.5**	**150.1**	**-**
09 January 2026				
CN	Inflation Rate YoY, %	0.8	0.7	0.7
ID	Consumer Confidence	123.5	124.0	125
EA	Retail Sales YoY, %	2.3	1.9	1.9
ID	Motorbike Sales YoY, %	14.5	2.1	3.6
ID	Car Sales YoY, %	25.7	-0.8	1.9
US	Non Farm Payrolls, th	50	56	45.0
12 January 2026				
ID	Retail Sales YoY, %	6.3	4.3	4.0
13 January 2026				
US	Inflation Rate YoY, %		2.7	-
14 January 2026				
CN	Trade balance, USD Bn		111.68	105
US	Retail Sales YoY (Nov-25), %		3.5	3.0
15 January 2026				
ID	Loan Growth YoY, %		7.74	-
ID	**BI-Rate Decision, %**		**4.75**	**4.75**
US	Retail Sales YoY (Dec-25), %		-	-
16 January 2026				
CN	Retail Sales YoY, %		1.3	-
23 January 2026				
ID	M2 Money Supply YoY, %		8.3	-
29 January 2026				
US	**Fed Interest Rate Decision, %**		**3.75**	**3.75**
US	Trade balance (Nov-25), USD Bn		-	-53.0
US	PCE Price Index YoY (Oct), %		2.8	2.8
30 January 2026				
ID	**Foreign Direct Investment YoY, %**		-	**-**

*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	3.75	Dec-25	1.05
UK	3.75	Aug-25	0.55
EU	2.15	Jun-25	0.15
Japan	0.75	Jan-25	-2.15
China (lending)	2.00	Sep-24	3.55
Korea	2.50	May-25	0.20
India	5.25	Jun-25	3.92
Indonesia	4.75	Sep-25	1.83

Money Mkt Rates	12-Jan	-1 mth	Chg (bps)
SPN (1Y)	4.39	4.70	-31.6
SUN (10Y)	6.17	6.16	0.2
INDONIA (O/N, Rp)	3.77	4.09	-31.3
JIBOR 1M (Rp)	5.03	5.03	-0.1

Bank Rates (Rp)	Oct	Sep	Chg (bps)
Lending (WC)	8.30	8.46	-16.00
Deposit 1M	4.75	4.96	-21.00
Savings	0.68	0.70	-2.00

Currency/USD	12-Jan	-1 mth	Chg (%)
UK Pound	0.743	0.748	0.70
Euro	0.857	0.852	-0.62
Japanese Yen	158.1	155.8	-1.47
Chinese RMB	6.973	7.055	1.17
Indonesia Rupiah	16,833	16,640	-1.15

Capital Mkt	12-Jan	-1 mth	Chg (%)
JCI	8,884.7	8,660.5	2.59
DJIA	49,590.2	48,458.1	2.34
FTSE	10,140.7	9,649.0	5.10
Nikkei 225	51,939.9	50,836.6	2.17
Hang Seng	26,608.5	25,976.8	2.43

Foreign portfolio ownership (Rp Tn)	Dec	Nov	Chg (Rp Tn)
Stock	4,186.7	4,017.6	169.11
Govt. Bond	878.7	1,343.0	-464.38
Corp. Bond	4.7	4.1	0.64

Trade & Commodities	12-Jan	-1 mth	Chg (%)
Baltic Dry Index	1,659.0	2,205.0	-24.8
S&P GSCI Index	563.7	545.5	3.3
Oil (Brent, $/brl)	63.9	61.1	4.5
Coal ($/MT)	107.4	107.8	-0.3
Gas ($/MMBtu)	2.90	4.06	-28.6
Gold ($/oz.)	4,597.5	4,299.6	6.9
Copper ($/MT)	13,273.8	11,535.7	15.1
Nickel ($/MT)	17,687.5	14,400.6	22.8
CPO ($/MT)	985.5	978.9	0.7
Rubber ($/kg)	1.89	1.77	6.8

External Sector	Nov	Oct	Chg (%)
Export ($ bn)	22.52	24.24	-7.08
Import ($ bn)	19.86	21.84	-9.08
Trade bal. ($ bn)	2.66	2.39	11.23
Central bank reserves ($ bn)*	150.1	149.9	0.09

Prompt Indicators	Oct	Sep	Aug
Consumer confidence index (CCI)	121.2	115.0	117.2
Car sales (%YoY)	-4.4	-15.1	-19.0
Motorcycle sales (%YoY)	8.4	7.3	0.7

Manufacturing PMI	Dec	Nov	Chg (bps)
USA	51.8	52.2	-40
Eurozone	48.8	49.6	-80
Japan	50.0	48.7	130
China	50.1	49.9	20
Korea	50.1	49.4	70
Indonesia	51.2	53.3	-210

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

	2020	2021	2022	2023	2024	2025E	2026E
Real GDP growth (% YoY)	-2.1	3.7	5.3	5.0	5.0	5.0	5.1
Nominal GDP growth (% YoY)	-2.5	9.9	15.4	6.7	6.0	7.2	7.9
GDP per capita (USD)	3912	4350	4784	4920	4960	5014	5362
CPI inflation (% YoY)	1.7	1.9	5.5	2.6	1.6	2.9*	2.5
BI Rate (%)	3.75	3.50	5.50	6.00	6.00	4.75*	4.00
SBN 10Y yield (%)	5.86	6.36	6.92	6.45	6.97	6.05*	6.50
USD/IDR exchange rate (average)	14,529	14,297	14,874	15,248	15,841	16,468*	16,784
USD/IDR exchange rate (end of year)	14,050	14,262	15,568	15,397	16,102	16,690*	16,842
Trade balance (USD Bn)	21.7	35.3	54.5	37.0	31.0	40.0	33.8

Notes:
- *USD/IDR exchange rate projections are for fundamental values; market values may diverge significantly at any moment in time*
- *Numbers marked with (*) for 2025 are final; other numbers for 2025 are our projections*

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