Poking the Pandora's box

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Summary

- The government reportedly outlined scenarios for shifting the deficit cap amid the global energy shock, leading to sharp selling pressure in domestic financial markets.
- Indonesia's thin fiscal buffer highlights investors' concerns, although the problem is not unique to Indonesia, while a stable CA outlook should provide a buffer for the economy.
- Rather than improving investors' confidence, declining SBN-UST spreads may reflect reduced foreign investor activity as BI steps up its bond-buying operations.

- The Iran war is entering its third week, yet the outcome remains unclear. Despite signalling last week that the US was close to achieving its military objectives, President Trump executed another pivot in policy direction, with the US president pressuring NATO members to join the US war effort in Iran. At the same time, the Iranian government remains unmoved in its maximalist demands, keeping the Strait of Hormuz closed, which sent benchmark oil prices surging back to USD 104.2/bl as the futures market opened today.
- Massive Gulf oil production shut-ins amidst the Hormuz crisis, such as the recently announced 20% cut in Saudi Arabia's oil production, may help to restore some balance to the global oil market, which in the pre-war period was perceived as oversupplied due to the expected weakness in the Chinese economy.
- It will be interesting to observe how the expected prolonged upward pressure on global oil prices will translate into central banks' policy signals, especially as the Fed is scheduled to update its Summary of Economic Projections during this week's FOMC meeting (other G4 central banks will also hold policy meetings this week). As things stand, most major central banks are widely expected to hold their policy rates at the upcoming meetings, with some analysts already arguing for rate hikes later in the year if the current oil price outlook holds.
- Given the current global macroeconomic backdrop, Bank Indonesia is widely expected to keep its policy rate at 4.75% in the upcoming meeting, as rising oil prices highlight the urgency for the central bank to defend the exchange rate and help stabilise the fiscal posture. However, efforts to keep the Rupiah stable and avoid further increases in sovereign bond yields may require the central bank to double down on SRBI issuance and other market operations, especially as risk-off sentiment and scepticism over the fiscal outlook continue to drive foreign investors out of the Indonesian market.

Driving closer to the 3% cliff

- The fiscal posture narrative continues to dictate foreign investors' lower appetite in entering the Indonesian financial market, especially amidst the backdrop of global energy shocks. As we know, the fiscal balance is reported at an IDR 135.7 Tn deficit by the end of February 2026 (0.53% of GDP), with attention seemingly focused on the IDR 104.6 Tn increase in the budget deficit over the year.
- **While the fiscal deficit has duly widened relative to its position last year, we should note some improvement in the government's fiscal performance**. One promising sign, of course, is the noticeable improvement in tax revenue ***(see Chart 1)***, a trend which may continue for some time as the ongoing festive period supercharges the recovery in household consumption. The uptrend in Indonesia's mainstay commodity ex-ports (such as CPO and coal) due to the Iran war may also translate into higher non-tax revenue, albeit spiking oil prices may add more to the fiscal burden in net terms.
- Indeed, **the cloudy outlook on Indonesia's fiscal posture largely stems from concerns over the risk of runaway spending in the short term**, notably now that analysts have started pricing in higher oil prices in their scenarios. As illustrated in Chart 1, fiscal spending (41.86% YoY) has outgrown revenue (12.97% YoY) in 2M2026, which explains the widening fiscal deficit despite the improving tax revenue. The government is well-aware of this problem, as indicated by the widely reported budget reallocation push in the past two years.
- However, the spike in benchmark government yields throughout the past week shows that investors remain sceptical of the public sector's ability to rein in its spending ***(see Chart 2)***. First, the government appears stoic in facing the call to scale back the budget allotted to its flagship programmes, continuing to argue for said programmes' strategic importance in boosting Indonesia's long-term growth potential. At the same time, it is only natural to anticipate that rising oil prices will eventually punch a hole in the fuel subsidy and compensation budget, highlighting the clash between short-term urgency and the long-term growth agenda for a space in the state budget.

> ***"The government remains committed to fiscal agenda, while the costs of maintaining domestic price stability have soared with rising oil prices."***

- Adding to investors' concerns is the lack of clarity regarding how the government will proceed with its spending posture. After some speculations, news finally emerged late last week that **the government is open to the option of breaching the 3% fiscal deficit cap if the spending budget is proven to have become indefensible**, signalling its readiness to do "whatever it takes" to maintain the momentum in domestic aggregate demand growth.
- The government's openness to such an option may stem from its confidence in the SBN market's investability. Indeed, government officials recently pointed to the downward trend in the SBN-UST spread as confirmation of foreign investors' confidence in the Indonesian economy, although **the decline in the SBN-UST spread mostly overlaps with BI's bond-buying operations *(see Chart 3)***. Allowing some sense of complacency when evaluating the supply-demand balance in the SBN market may lead to a sizable increase in the government's lending

rate should the government duly resort to debt-financed spending, although the government may continue to rely on BI to stessssp up its bond-buying operations to ward off extreme volatilities.

- With that being said, shifting the fiscal deficit cap seems to be the most straightforward solution to the government's current predicament, especially considering that the government appears to prioritise short-term GDP growth over long-term fiscal sustainability. After all**, given the widespread uncertainty, fiscal expansion is often inevitable not only for Indonesia but also globally *(see Figure 1)***, meaning that some investors may relegate long-term fiscal sustainability issues in favour of the short-term current account outlook when gauging their investment strategy.
- Moreover, **Indonesia's status as a net energy exporter may provide some cushion against a higher-for-longer oil price scenario**, as prolonged higher oil prices may reduce the opportunity cost of energy substitution (such as the electrification of transportation modes and household fuels). The government, then, may explore and combine several policy options to balance its fiscal burden while avoiding a significant hit to its growth potential, meaning that while the current situation is not great, the Indonesian economy is still far from terrible.

Figure 1

Short-term shock meets long-term concern

The global energy shock due to the Iran war highlights the short-term CA deficit concerns for Indonesia and many economies, while long-term fiscal concerns are still looming large.

	CA (% GDP)	FX cover (months of imports)	Interest burden (% of revenue)	Tax ratio	Debt-to-GDP ratio	Fiscal vulnerability score
Time series	FY2025	Feb-26	FY2025	FY2025	FY2025	
Indonesia	-0.10%	6.1	18.7%	9.3%	40.2%	47
Philippines	-2.57%	10.1	13.9%	15.4%	57.1%	45
Thailand	2.95%	8.4	6.1%	18.5%	57.2%	36
Vietnam	4.05%	2.3	4.5%	19.3%	32.9%	24
Malaysia	1.57%	4.7	14.9%	12.5%	70.4%	63
India	-0.40%	10.2	23.9%	4.2%	81.3%	68
China	3.77%	15.9	4.7%	12.6%	88.3%	47
Mexico	-0.52%	4.7	14.0%	15.2%	51.6%	51
Peru	3.19%	18.6	5.2%	5.3%	23.9%	22
Italy	1.21%	9.3	8.0%	7.7%	136.8%	65
Greece	-5.70%	3.6	6.6%	17.1%	366.3%	73
Romania	-7.96%	6.2	8.1%	40.8%	61.2%	52
Hungary	1.34%	5.2	9.3%	23.1%	60.0%	46

Source: Bloomberg, BCA Economic Research

Chart 2

Higher growth on the spending side

The fastest spending acceleration in more than a decade explains Indonesia's widening fiscal deficit in February 2026, despite some noticeable improvement in revenue performance.

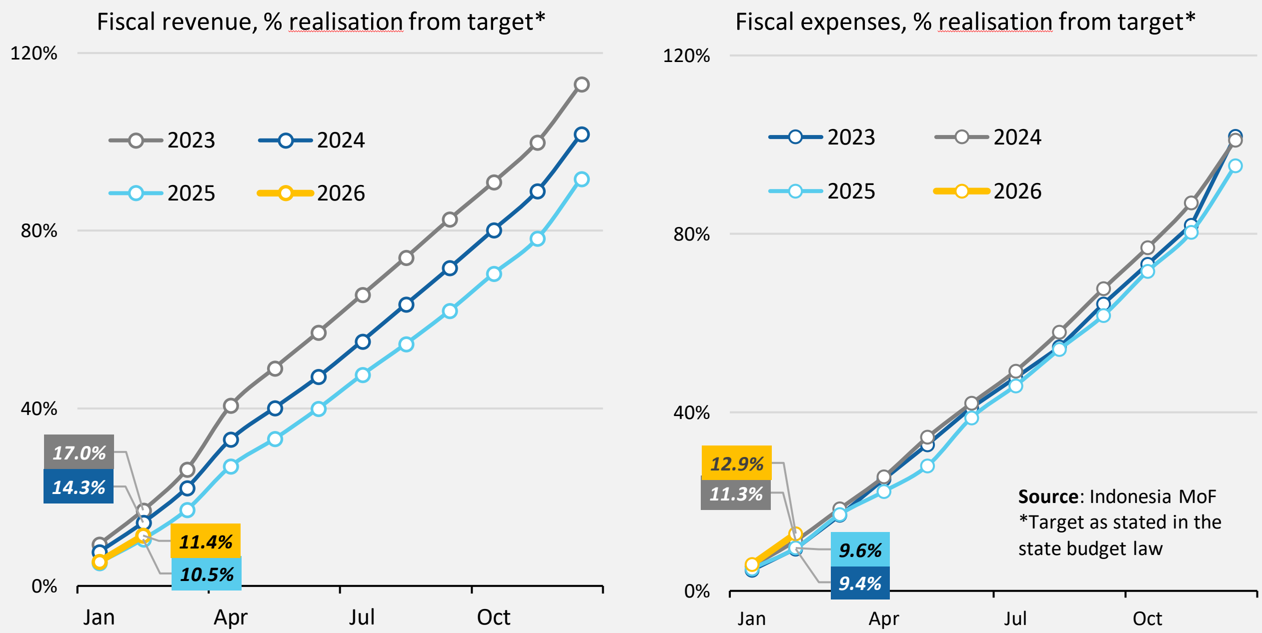


Chart 3

Throwing money at problems

Further rollout of flagship programmes explains the sharp increase in material spending, while the ongoing shock may necessitate higher spending on subsidies and social assistance.

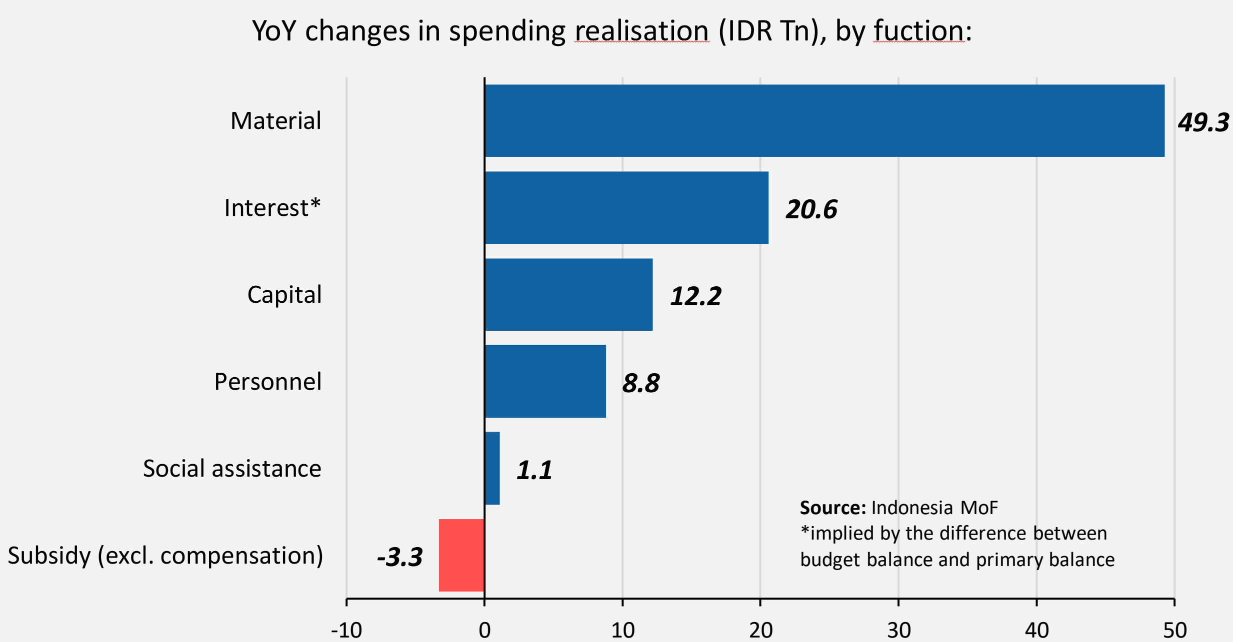
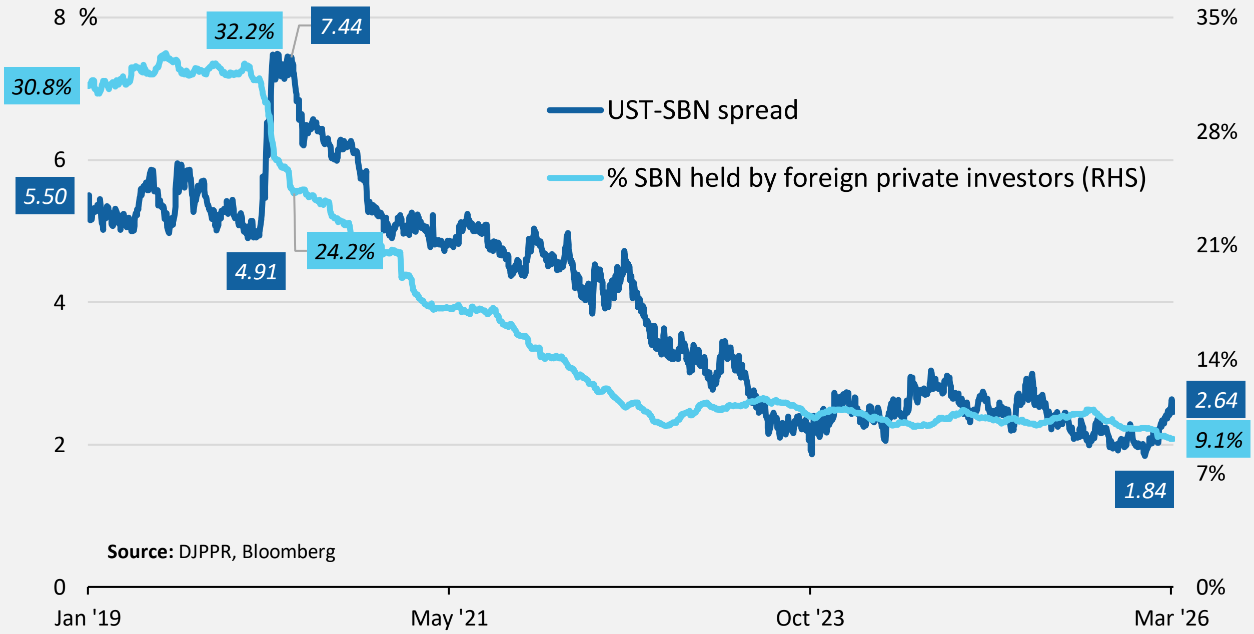


Chart 4

Spreading out

The spread between UST and SBN widen as the ongoing war put global volatility in an overdrive, a trend that may encourage BI to increase their activity in the SBN market.



Source: DJPPR, Bloomberg

Economic Calendar

		Actual	Previous	Forecast*
02 March 2026				
ID	S&P Global Manufacturing PMI	53.8	52.6	52
ID	**Trade balance (Jan-25), USD Bn**	**0.95**	**2.52**	**2.7**
ID	**Inflation Rate YoY, %**	**4.76**	**3.55**	**4.0**
US	S&P Global Manufacturing PMI	51.6	52.4	51.2
05 March 2026				
EA	Retail Sales YoY, %	2	1.8	1.7
06 March 2026				
ID	**Foreign Exchange Reserves, USD Bn**	**151.9**	**154.6**	**-**
US	Non Farm Payrolls, th	-92	126	70.0
US	Retail Sales YoY (Jan-26), %	3.2	2.4	2.0
09 March 2026				
CN	Inflation Rate YoY, %	1.3	0.2	0.7
ID	Motorbike Sales YoY, %	1.0	3.1	-
ID	Consumer Confidence	125.2	127.0	128
10 March 2026				
CN	Trade balance, (Jan-Feb) USD Bn	213.62	114.11	165.0
ID	Retail Sales YoY, %	5.7	3.5	4.0
11 March 2026				
US	Inflation Rate YoY, %	2.4	2.4	2.4
12 March 2026				
US	Trade balance (Jan-26), USD Bn	-54.5	-72.9	-65.0
13 March 2026				
US	PCE Price Index YoY, %	2.8	2.9	2.8
ID	Car Sales YoY, %	12.2	7	-
16 March 2026				
CN	Retail Sales YoY, (Jan-Feb) %	2.8	0.9	1.1
17 March 2026				
ID	**BI-Rate Decision, %**		**4.75**	4.75
ID	Loan Growth YoY, %		9.96	-
19 March 2026				
US	**Fed Interest Rate Decision, %**		**3.75**	**3.75**
27 March 2026				
ID	M2 Money Supply YoY, %		10.0	-

*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	1.35
UK	3.75	Dec-25	0.75
EU	2.15	Jun-25	0.25
Japan	0.75	Dec-25	-0.75
China (lending)	2.00	Sep-24	3.05
Korea	2.50	May-25	0.50
India	5.25	Dec-25	2.04
Indonesia	4.75	Sep-25	-0.01
Money Mkt Rates	**13-Mar**	**-1 mth**	**Chg (bps)**
SPN (1Y)	4.84	4.68	16.5
SUN (10Y)	6.78	6.44	34.2
INDONIA (O/N, Rp)	4.01	3.86	15.3
JIBOR 1M (Rp)	5.03	5.03	0.0
Bank Rates (Rp)	**Dec**	**Nov**	**Chg (bps)**
Lending (WC)	8.08	8.24	-16.00
Deposit 1M	4.54	4.60	-6.00
Savings	0.70	0.67	3.00
Currency/USD	**13-Mar**	**-1 mth**	**Chg (%)**
UK Pound	0.756	0.733	-3.03
Euro	0.876	0.841	-4.02
Japanese Yen	159.7	154.4	-3.34
Chinese RMB	6.904	6.913	0.13
Indonesia Rupiah	16,944	16,800	-0.85
Capital Mkt	**13-Mar**	**-1 mth**	**Chg (%)**
JCI	7,137.2	8,131.7	-12.23
DJIA	46,558.5	50,188.1	-7.23
FTSE	10,261.2	10,353.8	-0.90
Nikkei 225	53,819.6	57,650.5	-6.65
Hang Seng	25,465.6	27,183.2	-6.32
Foreign portfolio ownership (Rp Tn)	**Feb**	**Jan**	**Chg (Rp Tn)**
Stock	3,864.0	4,021.0	-156.95
Govt. Bond	875.4	1,327.7	-452.36
Corp. Bond	5.1	5.2	-0.13

Trade & Commodities	13-Mar	-1 mth	Chg (%)
Baltic Dry Index	2,028.0	1,882.0	7.8
S&P GSCI Index	722.9	587.9	23.0
Oil (Brent, $/brl)	103.1	68.8	49.9
Coal ($/MT)	137.3	116.2	18.2
Gas ($/MMBtu)	103.14	68.80	49.9
Gold ($/oz.)	103.1	68.8	49.9
Copper ($/MT)	103.1	68.8	49.9
Nickel ($/MT)	103.1	68.8	49.9
CPO ($/MT)	103.1	68.8	49.9
Rubber ($/kg)	103.14	68.80	49.9
External Sector	**Jan**	**Dec**	**Chg (%)**
Export ($ bn)	22.16	26.35	-15.91
Import ($ bn)	21.20	23.83	-11.05
Trade bal. ($ bn)	0.95	2.51	-62.02
Central bank reserves ($ bn)*	154.6	156.5	-1.21
Prompt Indicators	**Feb**	**Jan**	**Dec**
Consumer confidence index (CCI)	125.2	127.0	123.5
Car sales (%YoY)	12.2	7.1	17.9
Motorcycle sales (%YoY)	1.0	3.1	14.5
Manufacturing PMI	**Feb**	**Jan**	**Chg (bps)**
USA	51.6	52.4	-80
Eurozone	50.8	49.5	130
Japan	53.0	51.5	150
China	52.1	50.3	180
Korea	51.1	51.2	-10
Indonesia	53.8	52.6	120

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	2025	2026E
Real GDP growth (% YoY)	-2.1	3.7	5.3	5.0	5.0	5.1	5.1
Nominal GDP growth (% YoY)	-2.5	9.9	15.4	6.7	6.0	7.6	7.9
GDP per capita (USD)	3912	4350	4784	4920	4960	5083	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	4.50
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	41.1	33.8
Current account balance (% of GDP)	-0.4	0.3	1.0	-0.1	-0.6	-0.1	-0.4

Notes:

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

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