

The cost of stability

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Summary

- The faster-than-usual government spending in Q1 2026 may further constrain fiscal space, which has already been pressured by the ongoing Middle East conflict.
- Government has responded to reduced fiscal space through efficiency measures and possible increase in royalty for mineral commodities.
- Yield stabilization efforts by the government may help overall interest expense but is currently constrained by low bid-to-cover ratio due to increased auction issuance.

- The Middle East conflict continued to dominate headlines, with Trump recently calling Iran's ceasefire terms "unacceptable" while Israel and Hezbollah resume their clashes, making a possible resolution to the conflict even more elusive.
- At the same time, the US's tariff story continued its twists and turns. The US Trade court has declared Trump's 10% global tariffs under Section 122 (a replacement for reciprocal tariffs under IEEPA) illegal, injecting further trade uncertainty to a global energy crisis. Unfortunately, the ruling may be of little consequence, since the tariffs are still in-effect while the Administration is appealing to a higher Court, whose decision would likely come after Section 122's expiration on 24th July.
- Despite the Court's attempts to rein him in, Trump have continued to use tariffs in an attempt to gain leverage against (former?) allies. The continued US spat with the EU over the Iran war has escalated further, with the President now threatening 25% tariffs on automobiles, calling into question the state of the earlier trade deal.
- However, not all US relationships are in turmoil. Trump and Xi are scheduled to talk this Wednesday, even amidst the ongoing US war with Iran. While most analysts aren't expecting landmark breakthroughs in the relationship, the bilateral meeting could help cool down the ongoing tension between the Superpowers, which has heightened considerably due to the Iran war and China's refusal to enforce US sanctions against its oil refiners, most notably those from Hengli Group.
- Fortunately, the turbulent flurry of global developments hasn't scratched the paint from Indonesia's growth engine, considering the robust GDP growth experienced in Q1-26 (5.61% YoY), a level rarely seen outside of commodity price booms.

Public driven growth

- However, this robust growth number was mainly supported by state spending, which unfortunately has not been matched by a commensurate growth in state revenue (*see Chart 1*). This could mean that the accelerated spending in Q1 could lead to **lower spending down the road**, creating a sub-optimal growth environment at the end of the year.
- However, it's important to mention a few caveats to these numbers. Some of the increased spending disbursements are attributed to the revised framework for compensation payments. In prior years, compensation is done after the auditing period, giving the central government more leeway in managing the state's cash reserves but also creates an acute need for liquidity in SOE enterprises. However, starting late last year, 70% of compensations are paid one month after, with the remaining 30% paid after auditing. **This 'frontloaded' compensation scheme, then, should help equalize spending throughout the year**, which in the past are quite concentrated in Q4.
- Unfortunately, this accelerated fiscal spending could face some headwinds due to the war in Iran. Historically, **energy compensation tends to**

“Accelerated fiscal spending in Q1 alongside higher ‘mandatory’ spending due to energy price spike could further reduce fiscal space for the rest of the year”

be quite sensitive to crude prices (see Chart 2), with the low oil price during 2025 being quite helpful to keep fiscal deficit under its 3% limit.

- Alas, the opposite scenario seems to be in place for 2026. Even in a scenario of rapid de-escalation (which seems increasingly unlikely considering the still-hard rhetoric from both sides), **crude price seems unlikely to return to pre-war levels this year**, considering the existing damage to oil production facilities around the Hormuz Strait, and the likely increase in demand to restock crude inventories, which has declined considerably during the war.
- Faced with this conundrum, the government has taken further steps to balance the budget. We have seen a **slew of efficiency measures** announced in lockstep with the promise to not increase subsidized fuel prices, such as the reduction in Free Nutritious Meals Program frequency to 4 days / week (expected to save around IDR 50 Tn), and the efficiency measures for ministries and institutions (expected to save around IDR 130 Tn). On the revenue side, there are plans to increase royalty tax for certain mineral commodities.
- Moreover, the government have also enacted **long term supply-side policies** to reduce dependence on fossil fuels. We have seen a faster regulatory deadline to mandate B50 in July 2026, alongside incentives for 100k EV units starting in June 2026.

Stabilizing the cashflow

- This increased fiscal pressure, combined with the risk-off sentiment prevalent during the Middle East war, have resulted in considerable net outflow from both stocks and bonds, prompting sluggish performance on the JCI and an upward creep in bond yields. In response to the latter, the MoF has indicated a **desire to stabilize bond yields**, initially under a ‘Bond Stabilization Fund’ scheme before signalling a pivot to use existing excess state funds (SAL) and its own cash reserves.
 - In our view however, it’s unlikely for the government to use its intervention on benchmark bond series. Benchmark series are often reissued during auctions, resulting in a considerable outstanding amount. This property can help secondary trading activity, increase liquidity and thus drive down yields. However, this same property makes **any potential bond buybacks quite unpalatable**, since the government would then be disincentivized to reissue debt through this popular series to prevent neutralizing their buybacks.
 - An alternative approach is for the government to try buying relatively cheaper (higher yield) series while increasing issuance of more expensive (lower yield) ones, **arbitraging away the difference in yields**. Indeed, there has been a notable yield divergence within different gov bond series even with similar maturity profiles (*see Chart 3*).
- “The government may try to buy higher yield series while increasing issuance of lower yield ones, arbitraging away the difference”*
- The chart highlights 2 interesting patterns: first, yields on **low outstanding amount bonds tend to be higher** compared to their more popular counterparts. This could be caused by the illiquidity premium, where thinly traded bonds would be hard to transact in and thus commands a discount.
 - Second, **sharia bonds tend to have considerably lower yields** compared to conventional bonds. This divergence could stem from narrower investment choices for sharia-compliant financial institutions, who are often restricted from buying conventional bonds and thus represents a captive buyer.
 - Therefore, there may be room for the government to issue additional sharia bonds while retiring the thinly traded bonds to bridge the yield gap between the two series. Unfortunately, **this approach has its own share of drawbacks**. The government has issued relatively high bond amounts throughout 2026 so far (*see Chart 4*), resulting in a lower bid-to-cover ratio.
 - This lower ratio might induce **greater elasticity of bond yields to issuance**, resulting in a significant increase in yields if the government opt to further boost bond issuance through auctions. With this risk in mind, then, the government may opt to wait in the sidelines until leading indicators point to an opportune time, such as a potential moderation in global inflation expectations.

Glossary

- Bid-to-Cover ratio: the ratio between incoming bids at bond auctions compared to accepted bids. Higher Bid-to-Cover implies higher interest for the bonds, allowing them to be sold at a premium and vice versa.

Chart 1

From one pocket onto another

Accelerated fiscal spending in Q1-26 helped drive robust growth, but risks slowing down in the future if revenue remains near its long run average

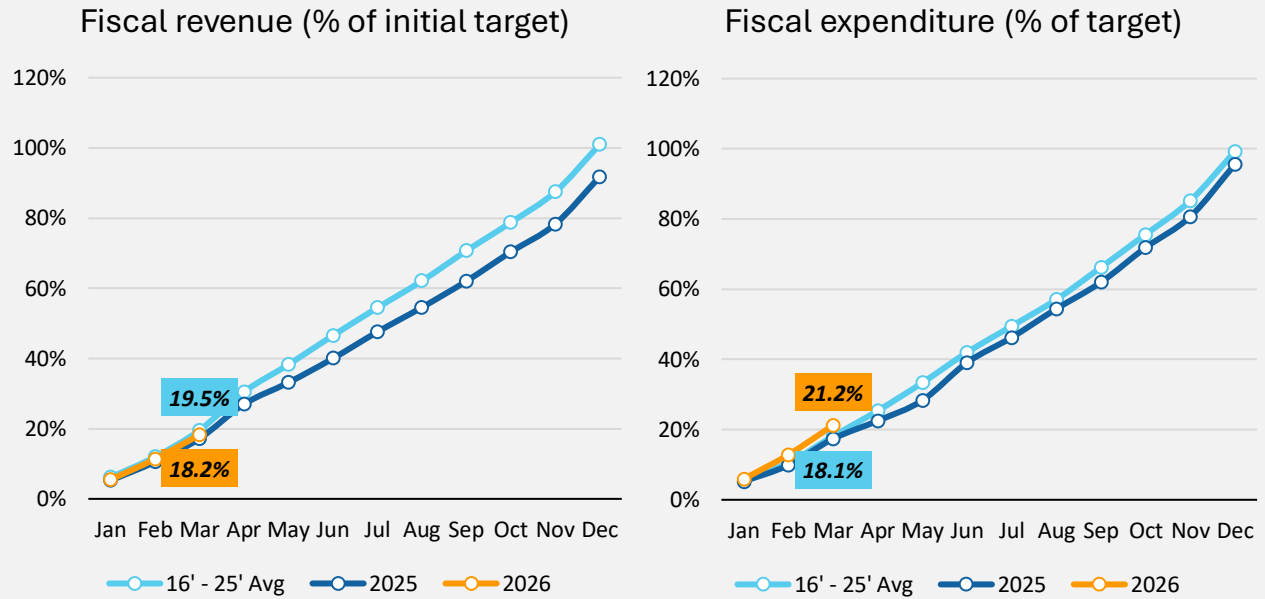


Chart 2

Pricier than expected

Compensation spending could rise considerably if ICP price averages US\$100/bbl this year, significantly reducing fiscal space if subsidized fuel prices are kept stable

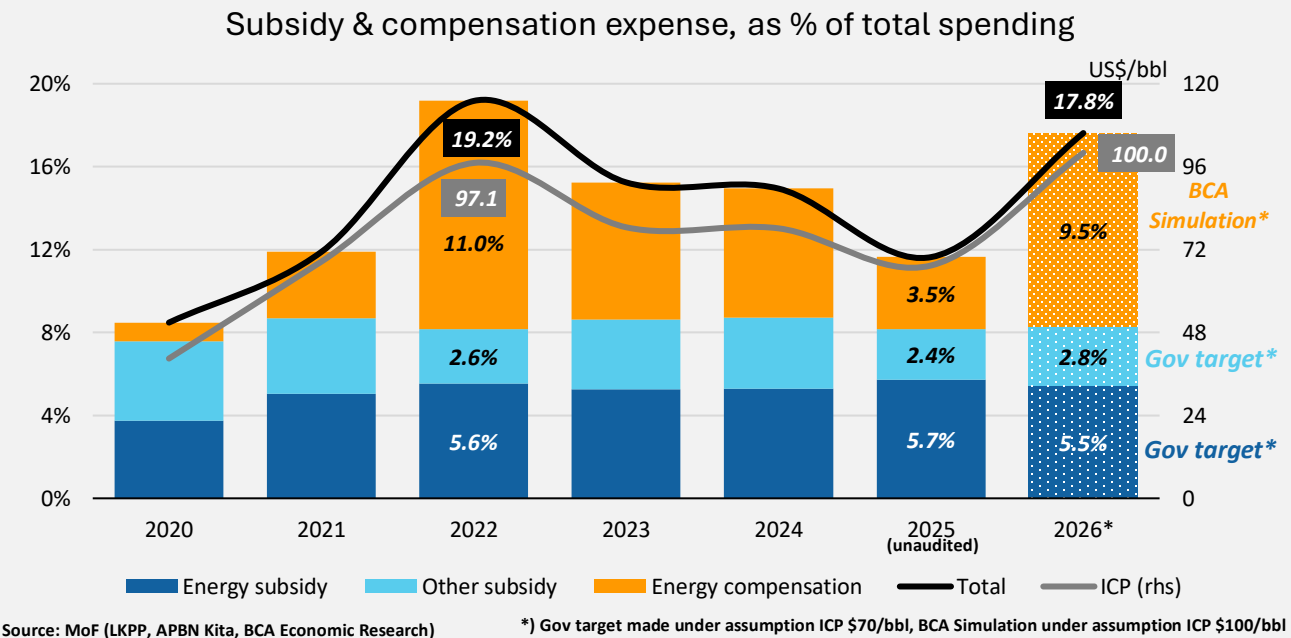


Chart 3

Premium in the leftovers

Bond series with low outstanding amount tend to have higher yields to maturity (lower prices), allowing MoF to buy discounted series while increasing liquidity in the secondary market

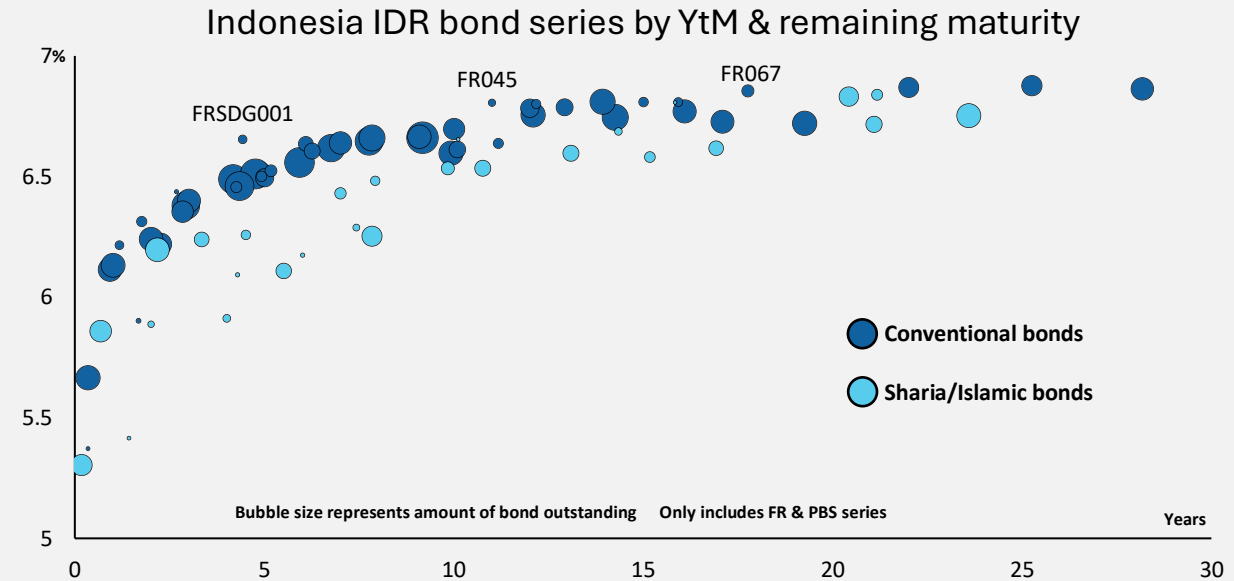
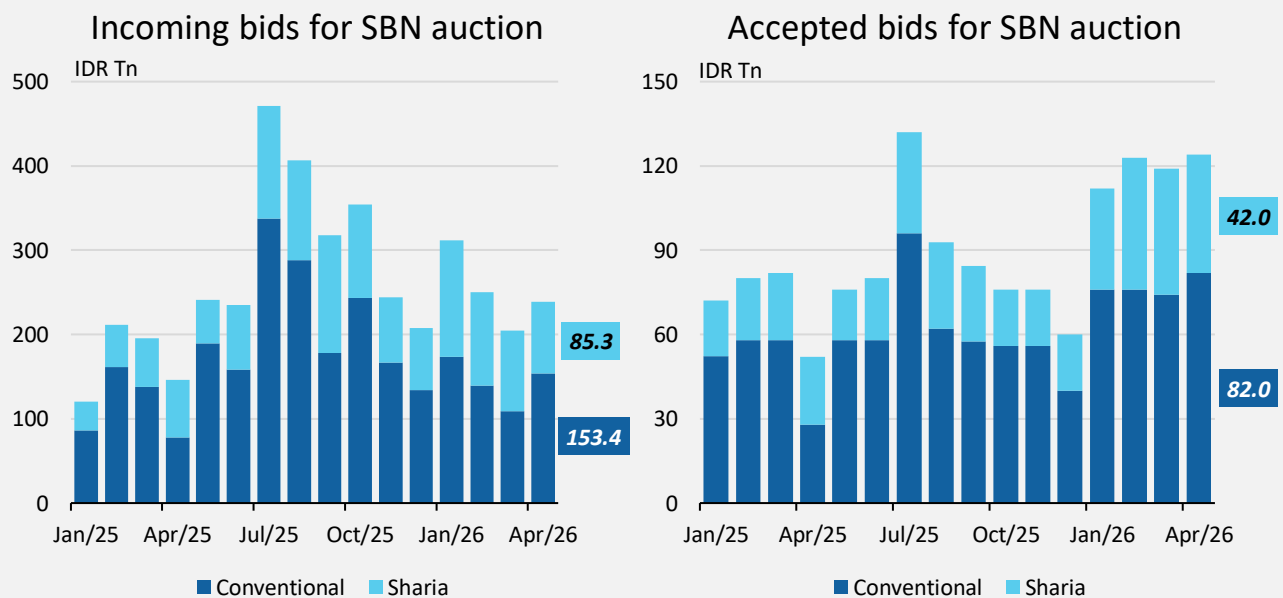


Chart 4

Not decreased demand, but increased supply

Low bid-to-cover ratio throughout 2026 mainly stems from higher bonds issuance due to faster expenditure alongside refinancing of maturing bonds



Economic Calendar				
		Actual	Previous	Forecast*
04 May 2026				
ID	S&P Global Manufacturing PMI	49.1	50.1	50.5
ID	Trade balance (Mar-26), USD Bn	3.32	1.28	4.2
ID	Inflation Rate YoY, %	2.42	3.48	3.0
05 May 2026				
ID	GDP Growth Rate YoY, %	5.61	5.39	5.6
US	Trade balance (Mar-26), USD Bn	-60.3	-57.8	-61.4
07 May 2026				
EA	Retail Sales YoY, %	1.2	1.3	1.1
08 May 2026				
ID	Foreign Exchange Reserves, USD Bn	146.2	148.2	-
ID	Property Price Indeks YoY, %	0.62	0.83	0.5
US	Non Farm Payrolls, th	115	185	95.0
09 May 2026				
CN	Trade balance, USD Bn	84.82	51.13	79.1
10 May 2026				
ID	Car Sales YoY, %	55.0	-13.8	-7.0
11 May 2026				
CN	Inflation Rate YoY, %	1.2	1	0.9
ID	Consumer Confidence	123.0	122.9	122
ID	Motorbike Sales YoY, %	28.1	-17.1	-
12 May 2026				
ID	Retail Sales YoY, %	3.4	6.5	6.8
US	Inflation Rate YoY, %		3.3	-
14 May 2026				
US	Retail Sales YoY, %		4.0	-
18 May 2026				
CN	Retail Sales YoY, %		1.7	-
20 May 2026				
ID	BI-Rate Decision, %		4.75	-
ID	Loan Growth YoY, %		9.49	-
22 May 2026				
ID	Current Account, (USD Bn)		-2.5	2.1
ID	M2 Money Supply YoY, %		9.7	-
28 May 2026				
US	PCE Price Index YoY, %		3.5	-

*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 (%)	Trade & Commodities	11-May	-1 mth	Chg (%)
US	3.75	Dec-25	0.45	Baltic Dry Index	3,001.0	2,201.0	36.3
UK	3.75	Dec-25	0.45	S&P GSCI Index	744.5	704.7	5.7
EU	2.15	Jun-25	-0.85	Oil (Brent, \$/brl)	104.2	95.2	9.5
Japan	0.75	Dec-25	-0.75	Coal (\$/MT)	136.4	130.5	4.5
China (lending)	2.00	Sep-24	3.15	Gas (\$/MMBtu)	2.82	2.64	6.8
Korea	2.50	May-25	-0.10	Gold (\$/oz.)	4,736.2	4,749.8	-0.3
India	5.25	Dec-25	1.85	Copper (\$/MT)	13,893.1	12,819.4	8.4
Indonesia	4.75	Sep-25	2.33	Nickel (\$/MT)	19,049.0	17,040.5	11.8
				CPO (\$/MT)	1,152.8	1,152.6	0.0
				Rubber (\$/kg)	2.25	2.08	8.2
Money Mkt Rates	11-May	-1 mth	Chg (bps)	External Sector	Mar	Feb	Chg (%)
SPN (1Y)	5.81	5.21	59.9	Export (\$ bn)	22.53	22.17	1.62
SUN (10Y)	6.59	6.55	4.0	Import (\$ bn)	19.21	20.89	-8.08
INDONIA (O/N, Rp)	4.23	4.12	11.0	Trade bal. (\$ bn)	3.32	1.27	160.82
JIBOR 1M (Rp)	5.03	5.03	0.0	Central bank reserves (\$ bn)*	148.2	151.9	-2.47
Bank Rates (Rp)	Feb	Jan	Chg (bps)	Prompt Indicators	Apr	Mar	Feb
Lending (WC)	8.05	8.06	-1.00	Consumer confidence index (CCI)	123.0	122.9	125.2
Deposit 1M	4.47	4.46	1.00	Car sales (%YoY)	55.0	-13.8	12.3
Savings	0.68	0.69	-1.00	Motorcycle sales (%YoY)	28.1	-17.1	1.0
Currency/USD	11-May	-1 mth	Chg (%)	Manufacturing PMI	Apr	Mar	Chg (bps)
UK Pound	0.735	0.743	1.10	USA	54.5	52.3	220
Euro	0.849	0.853	0.51	Eurozone	52.2	51.6	60
Japanese Yen	157.2	159.3	1.32	Japan	55.1	51.6	350
Chinese RMB	6.796	6.829	0.50	China	52.2	50.8	140
Indonesia Rupiah	17,412	17,098	-1.80	Korea	53.6	52.6	100
				Indonesia	49.1	50.1	-100
Capital Mkt	11-May	-1 mth	Chg (%)				
JCI	6,905.6	7,458.5	-7.41				
DJIA	49,704.5	47,916.6	3.73				
FTSE	10,269.4	10,600.5	-3.12				
Nikkei 225	62,417.9	56,924.1	9.65				
Hang Seng	26,406.8	25,893.5	1.98				
Foreign portfolio ownership (Rp Tn)	Apr	Mar	Chg (Rp Tn)				
Stock	3,158.9	3,208.6	-49.72				
Govt. Bond	862.4	853.6	8.80				
Corp. Bond	5.8	6.2	-0.41				

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	8.0
GDP per capita (USD)	3912	4350	4784	4920	4960	5083	5457
CPI inflation (% YoY)	1.7	1.9	5.5	2.6	1.6	2.9	3.3
BI Rate (%)	3.75	3.50	5.50	6.00	6.00	4.75	4.75
SBN 10Y yield (%)	5.86	6.36	6.92	6.45	6.97	6.05	6.76
USD/IDR exchange rate (average)	14,529	14,297	14,874	15,248	15,841	16,468	17,216
USD/IDR exchange rate (end of year)	14,050	14,262	15,568	15,397	16,102	16,690	17,430
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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