Tighten the belt, loosen the shirt

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Samuel Theophilus Artha
samuel_artha@bca.co.id

Victor George Petrus Matindas
victor_matindas@bca.co.id

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Summary

- The assumption within the government budget would likely require a more accommodative global environment as well as robust investments from the private sector.
- Other spending category continued to grow even with the assumption of lower oil prices, possibly pointing to increased 'anticipatory' spending.
- Significant increase in investment financing has resulted in still-high net debt issuance even with a smaller deficit.
- Recent increases in government FX debt issuance would likely lower borrowing costs but can heighten exposure to FX volatility risks.

- The US remained the dominant source of financial news this past week, with Treasury Secretary Scott Bessent's announcement to double the planned buyback of longer-dated bonds to USD 4 Bn per operation serving as a clear signal that his Treasury is adopting a more activist and interventionist stance.
- However, the Treasury's latest approach seems to find scarce praise in the markets. The 30-year yield quickly rebounded past the buyback announcement while the finance commentariat class provided warnings against the Treasury's attempt to enact its quasi-monetary policy, largely favouring a 'market-based' approach to controlling the yield curve, such as lowering the US's 6% deficit-to-GDP ratio.
- However, the buyback announcement seemed to be only the tip of the iceberg. Some Treasury officials have reportedly floated the idea of a more expansive intervention using the TGA (Treasury General Account), whose outstanding balance has ballooned (nearing US$ 1 Trillion) since the 2008 financial crisis.
- Unfortunately, the setbacks of the Trump Administration have spread further than the financial markets. The trade deal between the US and Canada has blown up, leading the US to implement a 50% tariff rate on Canada while the latter promised retaliation. Even though the longevity of this latest kerfuffle is still uncertain, the reduced reliability of America has incentivized Canada to further diversify its trading partners, with Carney touting a comprehensive discussion with the EU as a potential fallback.
- The self-inflicted regulatory uncertainty of the US economy has broadly weakened the DXY (which fell by 0.7% after the buyback announcement), as investors reassess the attractiveness of US bonds. This relative weakness in the greenback has helped lift EM currencies, with the Rupiah strengthening to the 17,700–17,800 range.

Presuming the best conditions

- The government currently assumes 6% real GDP growth (and 8.5% implicit nominal growth) with 3.9% nominal expenditure growth for FY 2027 ***(see Chart 1)***. The lower expenditure growth (compared to NGDP) implies that the private sector is expected to be the main growth driver moving forward, as opposed to the high government spending seen so far throughout H1-26.

- However, while the NGDP growth assumption is quite achievable (especially if Indonesia's terms of trade are improved), Indonesia's 6% real growth rate is quite rare. Achieving this growth figure would require a substantial increase in Direct Investment, implicitly putting high expectations on the government's latest initiatives (International Financial Centre, greater exports invoice monitoring, and Danantara's Development Management Fund).

"BI surplus has become a significant contributor of non-tax revenue, providing an upside potential to government fiscal space"

- Another crucial factor is the development of global conditions during 2027. Indonesia has scarcely seen a 6% real GDP growth rate outside of commodity boom periods in the 21st century, through which elevated oil prices have often been an accompanying factor. The government currently assumes US$ 75/bbl oil, implying a cessation of conflict between the US and Iran.

- Another source of uncertainty would be the strength of the Rupiah. Recently, Indonesia's CA deficit has reached 3.3% of GDP in Q2-26, prompting the Central Bank to induce inflows through discounts on FX hedges as well as greater SRBI issuance. However, this pro-stability measure mainly consists of portfolio inflows so far, which may lead to outflows in the short term if the heightened interest rates are not maintained (possibly at the cost of real sector headwinds).

- To be clear, **we don't view these assumptions as signs of budget imprudence.** The government has pegged the deficit at 2.4% of GDP, leaving out a considerable buffer zone even if the deficit were to rise unexpectedly and/or GDP growth were to fall below expectation.

- Moreover, there may be upside potential to government revenue to further close the gap, such as the surplus transfer from the Central Bank. So far, the surplus amount has been assumed at 0 for 2027, despite the high surplus BI is expected to give out in 2026 (est. IDR 55 Tn).

- While next year's surplus may have declined due to BI's ongoing FX hedge discount and large SRBI balance (many issued when Indonesia's yield curve is 'inverted'), the Central Bank tends to be profitable year-to-year when not burdened with extraordinary obligations (such as the Burden Sharing agreement enacted during COVID).

Spending: Pocket reallocation

- In 2026's budget outlook we can see an uptick in other spending ***(see Chart 2)***, mainly due to the increased energy compensation to maintain Pertalite prices. While regular subsidy spending is categorized under the subsidy budget, significant fluctuations in input prices (such as crude oil) often require an increase in compensation by the government, which is classified under 'other spending'.
- **However, the 2027 budget still expects further growth in this spending category, in spite of the significantly lower oil price assumption.** Part of this increase could be attributed to compensation obligations in 2026 being paid in 2027 (as historically compensation payments often lag the fiscal year), as well as an increase in 'anticipatory' spending which cannot be categorized yet.
- This increase in 'anticipatory' spending could be caused by the multitudes of uncertainties stalking over 2027. The 'Godzilla' El Nino is currently forecast to persist until early next year, potentially complicating Indonesia's food production and putting upward pressure on prices. Moreover, the US-IR peace progress continued to show conflicting signs, making pre-emptive budgetary allocations quite prudent.
- On the other hand, we see some contraction in other forms of spending to make up for it, mainly in materials and capital, likely reflecting the decline in the Free Lunch Program's budget as well as continuing the departure away from public infrastructure projects as an engine of growth. However, we have seen a significant increase in investment credit growth this year, signifying a possible 'transfer' of investment build-out from the State to Danantara and its subsidiaries.
- Furthermore, while regional transfer does increase marginally in 2027, it's important to mention the greater operational needs that Red & White Cooperatives will have next year (since this year is somewhat focused on unit build-out). While the financing so far has been funded through Agrinas loans from SOE banks, the State will cover the payment of these loans through Village Funds (which are projected to increase 39.3% in 2027). Regional transfer has also undergone one of the most significant cuts in 2026, meaning a partial resurgence in 2027 may not be enough to fully alleviate regional budget concerns.

> ***"The government has increased its investment financing, resulting in net debt issuance barely declining even with a smaller deficit"***

- 2027 also oversees a continuation of the government's newfound reliance on investment financing ***(see Chart 3)***, resulting in still-high net debt issuance despite the reduction in headline deficit. The key to this assumption is the trajectory of interest rates. In a scenario where interest rates remain higher for longer next year, there are consequences in which these investments yield lower returns compared to the financing costs borne by the state. Thus, while this increase in investment financing would likely boost growth, it would come at the expense of higher interest payments, whose cost cannot be fully countervailed by the financial return of those investments alone.
- Fortunately, in the face of rising debt issuance (and interest payments), the government

seems to have diversified its debt issuance recently with the inaugural issuance of dim sum & panda bonds this year, possibly due to the lower cost of funding in China. We can see the high issuance of FX debt spilling over into the government's FX interest payments ***(see Chart 4)***, which are expected to grow faster than their Rupiah counterpart. While the issuance of FX bonds does give the opportunity of lower yields (especially given the assumption of a stable Rupiah), they may increase the government's budget sensitivity to future FX fluctuations and could worsen Indonesia's Current Account Deficit in the long term, which is already under pressure amidst elevated energy prices.

Chart 1

Private-led growth once more?

The government plans for 2027 expenditure to grow slower than its NGDP growth, implicitly aiming for more private-led growth next year.

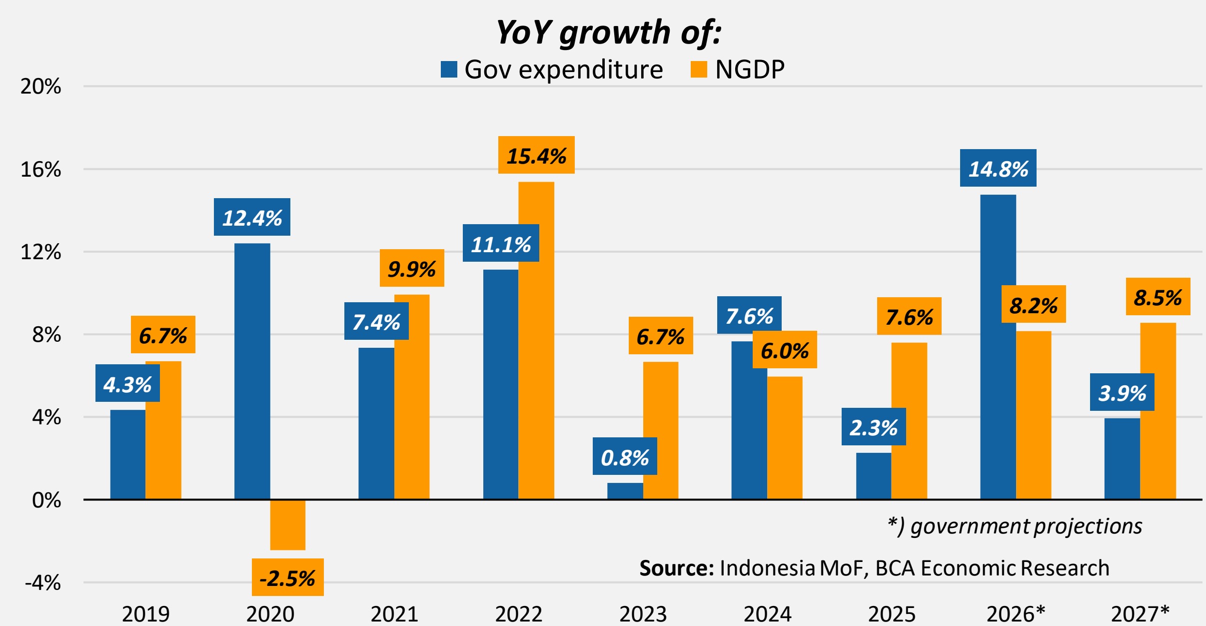
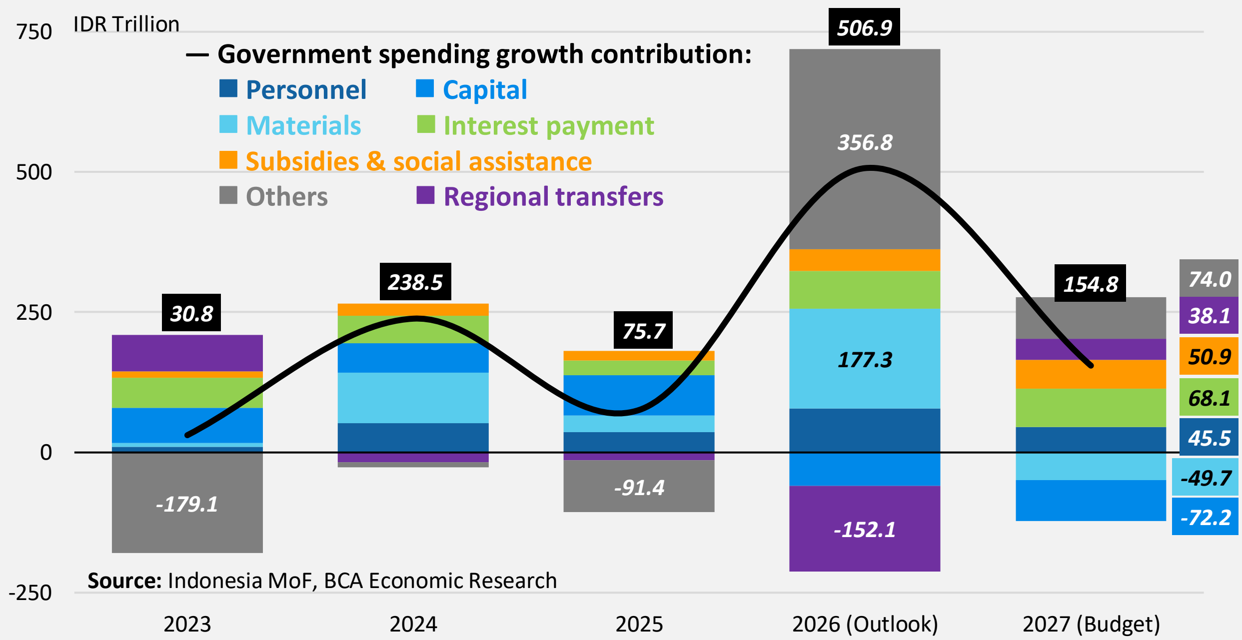


Chart 2

Reallocating capital

Other spending category continued rising despite the lower oil price assumption, while regional transfers and capital spending continued to decline compared to several previous years.

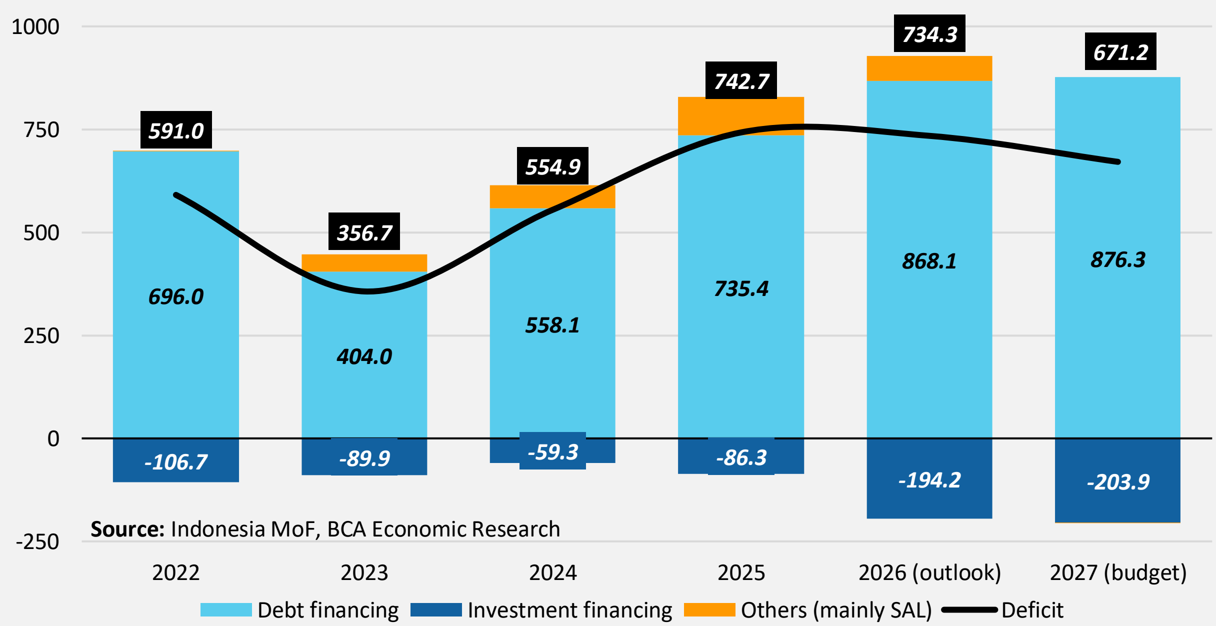


Source: Indonesia MoF, BCA Economic Research

Chart 3

Loosening the shirt

While headline deficit is projected to decline next year, debt financing still remains high due to increased investment financing and no existing plans to use the government's SAL.

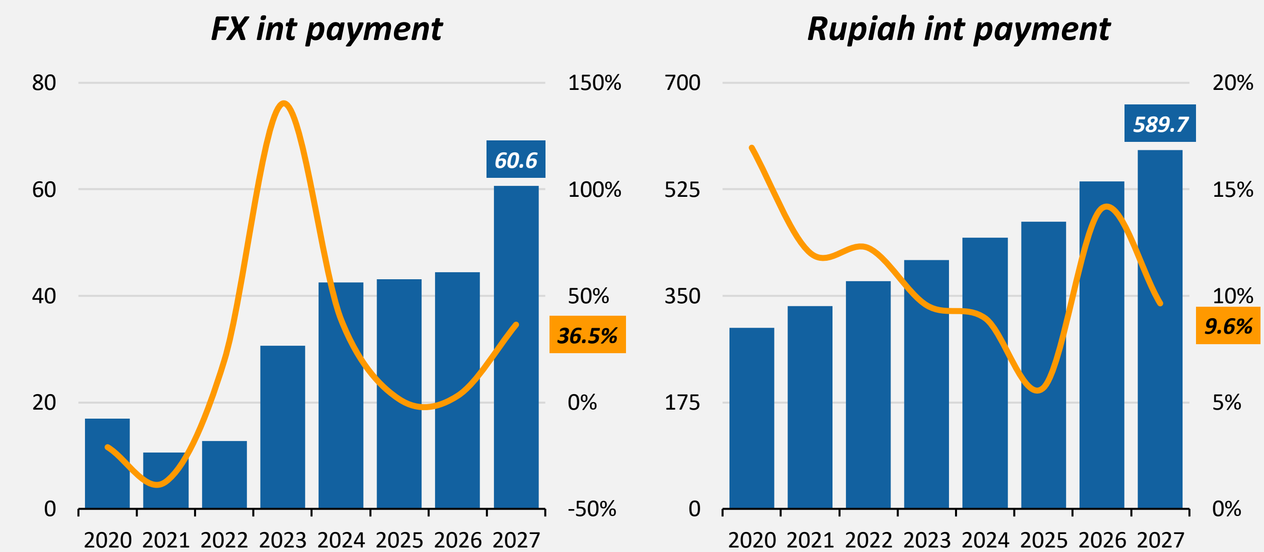


Source: Indonesia MoF, BCA Economic Research

Chart 4

Switching on the outside faucet

The government has significantly increased amount of FX debt it issued for lower yields and currency stabilization. However, it comes with a trade-off of increased FX volatility.



Source: Indonesia MoF, BCA Economic Research **) 2026 & 2027 are government projections*

■ Nominal amount (IDR Tn, lhs) — YoY growth (rhs)

Economic Calendar

		Actual	Previous	Forecast*
04 August 2026				
US	Trade balance (Jun-26), USD Bn	-73.3	-77.6	-73.0
05 August 2026				
ID	**GDP Growth Rate YoY, %**	**5.29**	**5.61**	**5.3**
06 August 2026				
EA	Retail Sales YoY, %	0.7	1.9	0.9
07 August 2026				
CN	Trade balance, USD Bn	112.5	125.62	105.0
ID	**Foreign Exchange Reserves, USD Bn**	**145.3**	**145.6**	**-**
ID	Property Price Indeks YoY, %	0.69	0.62	0.8
US	Non Farm Payrolls, th	-23	20	79.0
09 August 2026				
CN	Inflation Rate YoY, %	0.5	1	0.9
10 August 2026				
ID	Consumer Confidence	116.8	117.8	116
ID	Motorbike Sales YoY, %	8.3	1.1	-
11 August 2026				
ID	Retail Sales YoY, %	-3	-3.9	1.8
ID	Car Sales YoY, %	33.3	32.9	-
12 August 2026				
US	Inflation Rate YoY, %	3.4	3.5	3.4
14 August 2026				
US	Retail Sales YoY, %	**5**	6.8	6.0
17 August 2026				
CN	Retail Sales YoY, %	0.6	1	1.5
19 August 2026				
ID	**BI-Rate Decision, %**	**5.75**	**5.75**	**5.75**
ID	Loan Growth YoY, %	13.58	12.67	13.0
21 August 2026				
ID	Current Account, (USD Bn)	-12.5	-3.6	-1.8
24 August 2026				
ID	M2 Money Supply YoY, %	8.3	8.7	-

*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	0.35
UK	3.75	Dec-25	0.85
EU	2.40	Jun-26	-0.50
Japan	1.00	Jun-26	-0.90
China (lending)	2.00	Sep-24	3.85
Korea	3.00	Jul-26	0.20
India	5.25	Dec-25	0.80
Indonesia	5.75	Jun-26	2.87
Money Mkt Rates	**26-Aug**	**-1 mth**	**Chg (bps)**
SPN (1Y)	6.74	7.47	-73.2
SUN (10Y)	7.02	7.33	-31.1
INDONIA (O/N, Rp)	6.12	6.30	-17.6
JIBOR 1M (Rp)	5.03	5.03	0.0
Bank Rates (Rp)	**Jun**	**May**	**Chg (bps)**
Lending (WC)	8.07	7.95	12.00
Deposit 1M	4.96	4.52	44.00
Savings	0.68	0.68	0.00
Currency/USD	**26-Aug**	**-1 mth**	**Chg (%)**
UK Pound	0.736	0.750	2.03
Euro	0.858	0.880	2.47
Japanese Yen	159.3	163.8	2.84
Chinese RMB	6.722	6.771	0.73
Indonesia Rupiah	17,712	17,943	1.30
Capital Mkt	**26-Aug**	**-1 mth**	**Chg (%)**
JCI	6,405.7	6,196.4	3.38
DJIA	53,463.9	51,947.3	2.92
FTSE	10,878.1	10,736.2	1.32
Nikkei 225	66,262.2	64,611.2	2.56
Hang Seng	25,653.0	24,963.2	2.76
Foreign portfolio ownership (Rp Tn)	**Jul**	**Jun**	**Chg (Rp Tn)**
Stock	2,805.0	2,573.5	231.50
Govt. Bond	892.0	885.7	6.39
Corp. Bond	5.6	5.7	-0.08

Trade & Commodities	26-Aug	-1 mth	Chg (%)
Baltic Dry Index	3,056.0	2,743.0	11.4
S&P GSCI Index	698.4	700.9	-0.3
Oil (Brent, $/brl)	87.8	96.8	-9.2
Coal ($/MT)	139.0	139.0	0.0
Gas ($/MMBtu)	2.81	2.86	-1.9
Gold ($/oz.)	4,591.1	4,052.8	13.3
Copper ($/MT)	14,461.6	13,653.8	5.9
Nickel ($/MT)	16,712.8	17,184.4	-2.7
CPO ($/MT)	1,140.6	1,125.3	1.4
Rubber ($/kg)	2.38	2.18	9.2
External Sector	**Jun**	**May**	**Chg (%)**
Export ($ bn)	25.46	23.20	9.72
Import ($ bn)	25.91	24.81	4.41
Trade bal. ($ bn)	-0.45	-1.61	-72.02
Central bank reserves ($ bn)*	145.6	144.9	0.48
Prompt Indicators	**Jul**	**Jun**	**May**
Consumer confidence index (CCI)	116.8	117.8	120.9
Car sales (%YoY)	33.3	33.0	14.0
Motorcycle sales (%YoY)	8.3	1.1	-5.1
Manufacturing PMI	**Jul**	**Jun**	**Chg (bps)**
USA	53.9	53.9	0
Eurozone	51.9	51.4	50
Japan	54.5	54.8	-30
China	50.9	51.7	-80
Korea	53.1	52.1	100
Indonesia	50.2	46.9	330

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	5.3
Nominal GDP growth (% YoY)	-2.5	9.9	15.4	6.7	6.0	7.6	9.1
GDP per capita (USD)	3912	4350	4784	4920	4960	5083	5126
CPI inflation (% YoY)	1.7	1.9	5.5	2.6	1.6	2.9	3.2
BI Rate (%)	3.75	3.50	5.50	6.00	6.00	4.75	6.00
SBN 10Y yield (%)	5.86	6.36	6.92	6.45	6.97	6.05	7.31
USD/IDR exchange rate (average)	14,529	14,297	14,874	15,248	15,841	16,468	17,621
USD/IDR exchange rate (end of year)	14,050	14,262	15,568	15,397	16,102	16,690	18,238
Trade balance (USD Bn)	21.7	35.3	54.5	37.0	31.0	41.1	19.2

Notes:

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

BCA Economic & Industry Research

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

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

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

Arif Agung Wibowo
Economist / Analyst
arif_agung@bca.co.id
+6221 2358 8000 Ext: -

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

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

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