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Indonesia

Perception pains

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- Ahead of Bank Indonesia's (BI) 21 January meeting, investor sentiment has been impacted by the recent news flow on fiscal slippage risks, personnel changes and domestic policy direction.
- While real GDP likely stabilised around 5% YoY in 2025 and expenditures on flagship schemes has improved, fiscal risks have returned to the fore exacerbated by personnel changes.
- BI has been clear in its stance to defend IDR against undue depreciation pressures, but its meeting on 21 January will be watched closely. While our baseline is for BI to remain on hold, there is a rising risk of a 25bp policy rate cut.

Ahead of BI's 21 January meeting, investor sentiment has been impacted by the recent news flow on fiscal slippage risks, personnel changes and domestic policy direction. The reaction in asset markets has been mixed with the exchange rate largely acting as a shock absorber, with IDR underperforming regional peers in the last five trading days similar to INR. The JCI has ticked higher this week alongside 10-year IndoGB yields. This déjà vu from early 2025 places focus on policy perception risks above inherent macroeconomic stability.

BI has been clear in its stance to defend IDR against undue depreciation pressures but its meeting on 21 January will be watched closely. Thomas Djiwandono was nominated Deputy Governor of BI on 19 January, replacing Juda Agung. The latter's term was meant to end in 2027. Thomas Djiwandono is also a Deputy Finance Minister, a position he has held since July 2024. It is fairly standard practice across Asian EMs for government appointees to sit in central bank rate setting committees - Reserve Bank of India and Bank of Thailand have this representation. However, the unexpected nature of the move has exacerbated market perception about policy independence.

While our baseline is for BI to remain on hold, there is a rising risk of a 25bp policy rate cut. We see the outcome of tomorrow's meeting as a close call, and we assign a probability of 55-45% to BI remaining on hold versus reducing its policy rate by 25bp. BI could also continue to ease macroprudential policies. Easier monetary policy is still broadly consistent with our forecast for BI to deliver cumulative 50bp of rate cuts in 2026. BI adopted an 'all out pro growth' stance in September 2025. The timing of our forecasted rate cuts will depend largely on the wiggle room provided by IDR moves. However, should BI reprioritise growth at its 21 January meeting, it could signal a higher threshold of tolerance towards IDR depreciation in the near term, allowing for BI to deliver on further policy easing. More fundamentally, BI's gross FX reserves at USD156.5bn at end-2025, and net FX reserves at USD141.7bn (by our estimates) suggest there still remains room to buffer against sharp volatility in IDR.

Meanwhile, fiscal policies are likely to remain supportive of growth albeit to a limited degree, assuming that the 3% of GDP legal fiscal deficit limit is adhered to. Notwithstanding, better execution of expenditures on the free meal scheme can see the fiscal deficit test the 3% of GDP legal limit, similar to 2.9% of GDP in 2025. The recent rally in commodity prices of nickel, copper and aluminium could provide some tailwinds for revenue collections. The upshot is that we see fiscal slippage for this year, with the deficit at 2.8% of GDP versus a targeted 2.68% of GDP (see *Indonesia: Mind the fiscal gap, 9 January 2026*).

We see the GDP growth outlook as slowing modestly to 4.8% in 2026 versus 5% in 2025. Our baseline remains for fiscal and monetary policies to remain geared towards supporting economic growth momentum.