Indonesia

16 July 2025

Cutting a deal and rates

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- Indonesian authorities cut to the chase today. The government cut a deal with the US authorities on tariffs reducing the rate to 19% from 32%.
- Separately, BI cut its policy rate by 25bs, in line with our expectations but against consensus expectations of no change, taking the policy rate to 5.25%.
- We are now adding a cumulative 50bps in rate cuts for the remainder of 2025. With this, we expect the policy rate to be 4.75% by end-2025.

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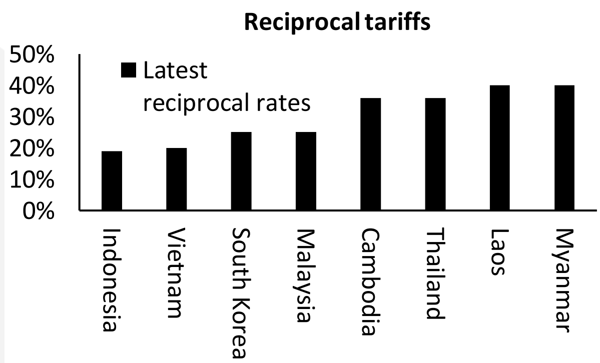
Cutting a deal with the US

The Indonesian government struck a deal with the US administration in lowering the tariff rate to 19% from 32% that was stated in the 7 July letter and 2 April announcement. US President Trump revealed that Indonesia has agreed to purchase 50 Boeing jets, USD15bn worth of US energy products, and USD4.5bn worth of US agricultural products. This will essentially reduce Indonesia's trade imbalance with the US. Indonesia's trade surplus with the US was USD17bn in 2024 and USD7.2bn for the first five months of 2025. Mr Susiwijono Moegiarso, a senior official with Indonesia's Coordinating Ministry for Economic Affairs, said that a US-Indonesia joint statement is being prepared, with more details to be provided.

Source: CEIC; OCBC.



Source: Bloomberg; White House; OCBC.

As always, the devil is in the details. There will be some perceptible headline relief from the lower tariff rate of 19% compared to 32% as well as Indonesia retaining some degree of competitiveness compared to regional peers. The tariff rate for Vietnam is 20%, with the risk of doubling for exports deemed transshipments. In addition, President Trump when he spoke to media personnel stated that Indonesia had provided full access of the domestic market to the US. It remains to be seen what sort of access this refers to, and the details of the deal could shed some light of these aspects.

Prior to this deal, we noted that most of Indonesia's exports to the US were subject to a baseline tariff of 10%. This will now rise to 19%. Our calculations suggest that Indonesia received the lowest export exemptions, both in dollar terms and as a share of total exports to the US, since 2 April. This means that most exporters are already bearing the brunt of tariffs. While the extent of the tariff impact will deepen given the increase in the tariff rate from 10%, our estimates still suggest a relatively modest impact on GDP growth (*ASEAN-4: Trial by tariffs*, 8 July 2025). As such, we maintain our 2025 GDP growth forecast of 4.7%.

In the context of what Indonesia's deal means for other Asian economies, we believe there cannot be a clear extrapolation because the discussions could be quite different. The outcomes with Indonesia do show that the US is willing to negotiate on the tariff rate but for economies like Malaysia, the tariff on specific products such as semiconductors will also matter. Right now, there is a large proportion of Malaysia's exports to US are exempt from tariffs.

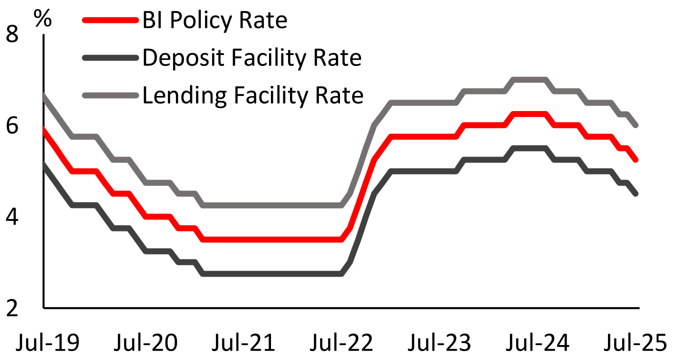
With tariff negotiations largely ticked off the Indonesian government's to-do list — implementation notwithstanding, the focus will likely shift back to domestic matters.

BI cuts by 25bps and leaves the door open for more

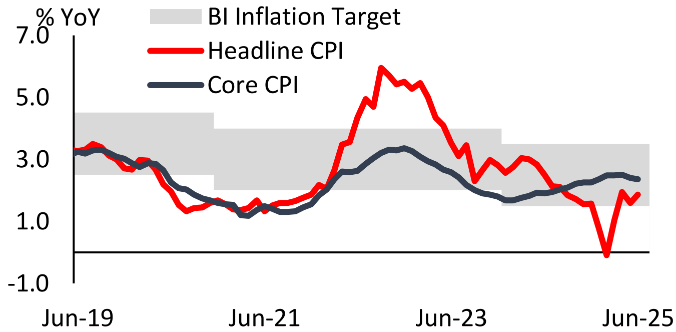
Bank Indonesia duly picked up the government's serve in nudging growth prospects along. It cut its policy rate by 25bps in line with our expectations but against consensus of no change, taking the policy rate to 5.25%. BI left the door open for further rate cuts as it buttresses economic and credit growth prospects.

During the press conference in conjunction with BI's decision, Governor Perry Warijyo stated that global economic uncertainty had risen on account of US tariff policies and that domestic growth needed to be supported. He noted that global growth could slow to 2.9% (versus the previous estimate of 3%) while the domestic growth forecast range of 4.6%-5.4% was left unchanged.

Governor Perry noted that the currency (IDR) had remained stable despite volatile market conditions. Indeed, IDR gains versus USD were relatively muted since BI's last meeting on 18 May. Following BI's rate decision, the spot USD/IDR traded around 16290 levels, the equity index closed 0.7% higher while the ten-year government bond yield was last seen at 6.55% levels.



Source: Bank Indonesia, CEIC, OCBC



Source: Statistics Indonesia (BPS), Bloomberg, OCBC.

Interestingly, the Governor's change in assessment was for core inflation. He noted that core inflation could be lower than expected. Core inflation was stable at 2.4% YoY in May and June 2025, compared to 2.3% in end-2024. Our baseline forecast is for headline inflation to remain well contained, averaging 2.0% YoY in 2025 from 2.3% in 2024. This implies higher inflation in the coming months, but still within BI's target range of 1.5-3.5%.

Finally, Governor Perry focused on the need to improve credit growth to within its 8-11% target range for 2025. Loan growth slowed further to 7.8% YoY in June from 8.4% in May. The Governor noted that banks are cautious to lend amidst slowing third party fund growth. Indeed, deposit growth has slowed in recent months, with the loan to deposit ratio hovering around 88%.

Looking ahead, we add another 50bps in rate cut expectations for the remainder of the year. Governor Perry sounded dovish and left the door open for further rate cuts. He noted that BI will make an 'all out' effort in encouraging growth and lending while continuing to take 'calculated risk' decisions. The timing of these forthcoming rate cuts will be done keeping in mind IDR stability, in our view. As such, our revised forecast is for the BI policy to be 4.75% by end-2025.

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