

INDONESIA

14

PRESSURE ON PUBLIC FINANCES AND EXTERNAL ACCOUNTS

Indonesia is less exposed to the consequences of the US tariff increases than other ASEAN countries, but risks are tilted to the downside. Companies have begun to suspend their investments. Against this backdrop, the authorities have stepped up measures to support the economy. The central bank has cut its key interest rates more than in other Asian countries, and the new Finance Minister has announced an increase in social spending. Public debt remains under control, but it is financed mainly on bond markets, particularly by foreign investors who are concerned about fiscal slippage under the Prabowo administration. However, although this government is less conservative than the previous one and the situation calls for greater vigilance, the risks to debt sustainability are contained.

STRONG GROWTH SO FAR, BUT A SLOWDOWN AHEAD

In the first three quarters of 2025, real GDP growth reached 5% y/y. Domestic demand remained strong, underpinned by robust household consumption and a sharp rise in investment in machinery and equipment. Net exports made a positive contribution to growth. Like in other ASEAN countries, Indonesia's exports accelerated significantly in Q2 2025 (compared with the same period in 2024) due to the anticipated increase in US tariffs. Growth rebounded significantly in agriculture and manufacturing (excluding machinery and transport equipment), while slowing in services.

Growth is expected to slow in Q4, and downside risks are high. Labour-intensive industries are threatened by rising US tariffs and increased imports of low-cost Chinese goods. Household consumption is expected to remain robust, supported by government social spending and an unemployment rate that has remained stable at 4.8% for the past year. On the other hand, companies might suspend some of their investments (as illustrated by the sharp slowdown in imports of capital goods in August) due to uncertainty in the international environment.

Although still higher than in Thailand and Malaysia (but lower than in Vietnam), real GDP growth is expected to reach 5% in 2025 and 2026, a rate of growth far from sufficient to meet the significant need for job creation, particularly among young people.

MONETARY EASING

The Indonesian central bank cut its key rates by 125bp between January and October 2025, bringing them down to 4.75%. Although its stance remains accommodative, it might keep rates at this level until the end of the year due to downward pressure on the Indonesian rupiah and a slight rebound in inflation (+2.9% y/y in October, compared with an average of 1.6% since the start of the year, see Chart 1). However, inflation remains within the central bank's target range of 2.5% (± 1 pp).

Monetary easing has had only a very limited impact on lending rates. Between January and September, they fell by just 56bp on average for investment loans and remained virtually unchanged for consumer credit. Growth in bank lending continued to slow.

EXTERNAL ACCOUNTS UNDER PRESSURE

Among ASEAN countries, Indonesia, along with Malaysia, is one of the most vulnerable to the international financial environment.

Although the country's foreign exchange reserves cover 1.5 times its short-term external financing needs, they are still too modest to help contain the structurally high volatility of the rupiah. To strengthen the country's external liquidity position, since March 2025 the authorities have required commodity-exporting companies to keep all their foreign currency earnings in the country.

FORECASTS

	2022	2023	2024	2025e	2026e
Real GDP growth (%)	5.3	5.0	5.0	5.0	5.0
Inflation (CPI, year average, %)	4.2	3.7	2.3	1.9	2.5
Gen. Gov. balance / GDP (%)	-2.4	-1.7	-2.3	-2.9	-2.9
Gen. Gov. debt / GDP (%)	39.7	39.2	39.4	40.0	40.3
Current account balance / GDP (%)	1.1	-0.2	-0.6	-0.9	-1.2
External debt / GDP (%)	30.1	29.8	29.6	30.1	30.3
Forex reserves (USD bn)	124	133	140	132	134
Forex reserves, in months of imports	5.5	6.0	6.1	5.5	5.6

TABLE 1

e: ESTIMATES & FORECASTS
SOURCE: BNP PARIBAS ECONOMIC RESEARCH

INDONESIA: MODERATE INFLATIONARY PRESSURES

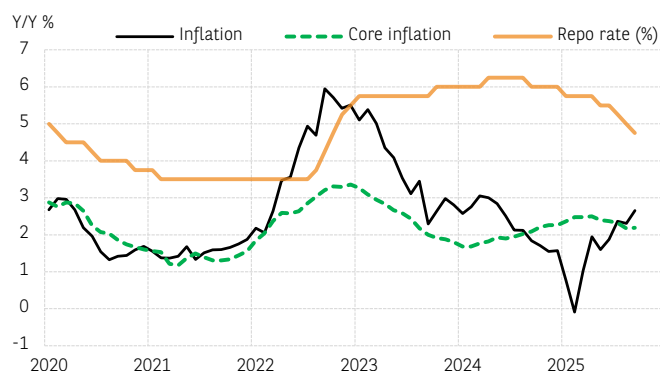


CHART 1

SOURCE: CEIC, BI, BNP PARIBAS

In H1 2025, external accounts deteriorated, mainly due to a decline in net capital inflows. While the current account deficit narrowed by 0.3 points of GDP to just -0.6% of GDP, the financial account deteriorated and recorded a deficit of -0.8% of GDP (vs. a balance of 0% in H1 2024).

In Q2 2025, net foreign direct investment (FDI) inflows reached one of their lowest levels ever (0.7% of GDP vs. 1.3% of GDP on average over the last five years, see Chart 2). In comparison, FDI inflows amounted to 1.6% of GDP in Malaysia and 3.7% of GDP in Vietnam.


BNP PARIBAS

The bank
for a changing
world

At the same time, net portfolio investment outflows reached 2.2% of GDP (the highest level since the pandemic in 2020). Downward pressure on the rupiah (-2.4% against the dollar between July and October) suggests that capital outflows intensified in Q3. Divestments, which mainly involved sovereign bonds (54.3% of sales), were the result of narrowing yield spreads between Indonesian and US bonds (with sharp cuts in key interest rates since the start of the year), the risk of fiscal slippage and fears about the independence of the central bank (with the reactivation of burden sharing).

RISK OF SLIPPAGE IN PUBLIC FINANCES

Despite low fiscal revenues, Indonesia has managed to keep its public debt at modest levels for two decades by capping the fiscal deficit at 3% of GDP (excluding the pandemic period). However, since coming to power in October 2024, the Prabowo government has made a number of fiscal adjustments that are not in line with the Widodo government's conservative strategy and have raised concerns about the risk of slippage in public finances, already weakened by the pandemic crisis.

In particular, Prabowo reversed the previous government's decision to raise the VAT rate on all consumer goods from 11% to 12%. In January 2025, only luxury goods saw their rate increase. The loss of revenue is estimated at 0.3% of GDP. At the same time, the creation of the Danantara sovereign wealth fund, financed by dividends from public companies, deprives the government of revenue estimated at 0.4% of GDP over a full year. Contrary to the Widodo government's goals, fiscal revenues are likely to remain among the lowest in Asia (along with those of India), severely limiting the government's fiscal room for manoeuvre to support its economic growth.

In the first eight months of 2025, revenue fell by 7.8% y/y and is expected to reach just 12.0% of GDP this year, well below the level recorded over the last three years (13.2% of GDP) and below that of Malaysia (16.8% of GDP) and Thailand (21% of GDP). Although this contraction is partly due to lower commodity prices and payment delays linked to the adoption of the new digital system, the fact remains that fiscal revenues are likely to remain low in the long term, while expenditure continues to rise.

In line with its campaign pledge, the Prabowo government has increased social spending to support the most disadvantaged households (notably through the distribution of free food hampers). Social spending is expected to double by 2026.

As a result, between January and August 2025, the fiscal deficit more than doubled compared with the same period last year. For the full year, it has been revised upwards by the Ministry of Finance to 2.8% of GDP (compared with 2.3% of GDP in 2024). For 2026, the risks of the deficit slipping beyond the 3% of GDP threshold are increasing.

A new finance minister, Purbaya Yudhi Sadewa, has been appointed to replace the former minister, who was known for her fiscal orthodoxy. Although he has announced that he will keep the deficit at 2.7% of GDP (compared with the 2.5% initially announced), this forecast seems optimistic as it is based on a high growth assumption (5.4%). Furthermore, although the 2026 budget forecasts a modest increase in total expenditure, its structure has changed. Non-productive expenditure (such as food) has increased at the expense of capital expenditure, which will weigh on growth in the medium term.

INDONESIA: SHARP FALL IN NET CAPITAL INFLOWS

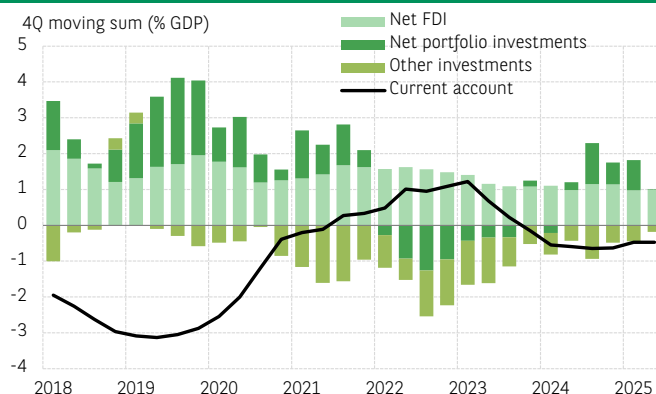


CHART 2

SOURCE: CEIC, BI, BNP PARIBAS

In the first eight months of 2025, as in previous years, the fiscal deficit was almost exclusively financed with debt securities. In Q2 2025, government debt reached 39.7% of GDP, slightly up on Q2 2024 and 10.5 points of GDP above the level reached at the end of 2019. The debt is not only exposed to currency risk but also to foreign investors' confidence shocks. In Q2, 28.3% of total government debt was denominated in foreign currency and nearly 37% was held by foreign investors (vs. 21.3% of government debt in Malaysia, 8.3% in Thailand and 1.4% in India). Debt securities accounted for 86.6% of the debt (of which 34.2% was in foreign currency and 42.7% was held by foreign investors). The country's dependence on external financing is weighing on its fiscal and monetary room for manoeuvre.

Interest payments on debt increased by 0.5 points of GDP between 2019 and 2024, and this trend is set to continue in the short term. Interest payments are expected to reach 2.3% of GDP this year and absorb 18.4% of government revenues (well above the levels in Thailand and Malaysia). Nevertheless, the reactivation (in an adjusted form) of the burden sharing process between the government and the central bank, initially put in place during COVID, could give the government greater latitude to finance its priority programmes. However, the reactivation of this mechanism raises even more concerns about the government's willingness to consolidate its public finances, and foreign investors may demand higher returns.

However, although the situation warrants greater vigilance than under Widodo's presidency, the risks to debt sustainability remain contained.

Completed on 3 November 2025

Johanna Melka

johanna.melka@bnpparibas.com



BNP PARIBAS

The bank
for a changing
world