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Executive Summary

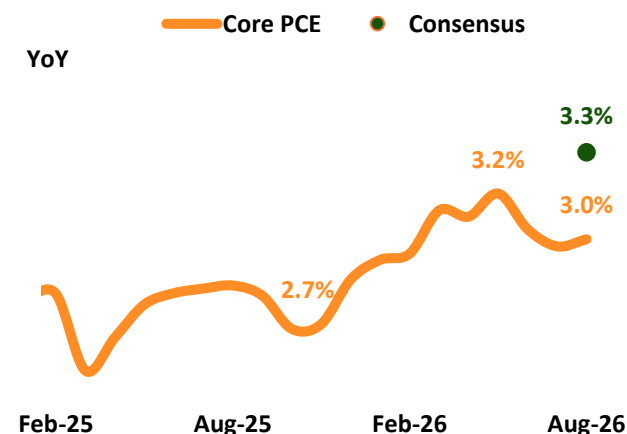
- **Resilient U.S. demand and renewed energy pressures prompted tighter policy, lifting U.S. yields and the dollar.** Softer hiring and core inflation reduced the October Fed hike expectations, but rising production costs kept the broader inflation challenge intact and financing conditions restrictive.
- **Indonesia's manufacturing recovered, the trade surplus rebounded, and fiscal spending supported activity, although household demand remained uneven and investment-loan growth plateaued.** We expect investment and fiscal support to sustain growth, while import needs and external pressures narrow policy flexibility. BI's FX measures should manage volatility, but intensifying pressure could require further rate increases.
- **Stronger car sales contrasted with modest motorcycle growth in August, while September registrations suggested a shift in momentum.** We expect motorcycles to gain ground as car demand normalizes, with selective support for commercial vehicles from investment projects. Higher diesel costs and the ethanol transition add operating and distribution pressures, making affordability, fuel compatibility, and supply readiness increasingly important.

Global Economy

Higher Yields, Softer Hiring, and Renewed Cost Pressures

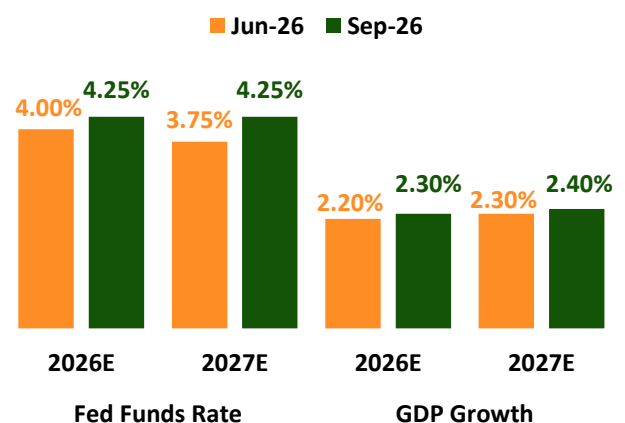
The Fed's September hike and higher dot plot drove a repricing of the U.S. policy path. On September 16, the Fed raised its policy rate by 25bps to 3.75%–4.00%. The median dot implied another 25bps hike by year-end and no easing in 2027, lifting the projected end-2027 rate to 4.1% from 3.6% in June. Policymakers also raised their 2026 growth projection to 2.3%, lowered unemployment to 4.1%, and increased core PCE inflation to 3.4%. The revisions reflected stronger confidence in economic resilience alongside persistent inflation, strengthening the case for prioritizing price stability.

Chart 1. U.S. Core PCE was Softer than Expected



Source: CEIC, Bloomberg

Chart 2. Fed Dots Signal One More Hike



Source: The Federal Reserve System

U.S. consumption remained resilient, but September employment data revealed softer hiring momentum. August real consumption increased 0.6% MoM, while real disposable income was unchanged, leaving the saving rate at 4.1%. However, September payrolls, released on October 2, increased by just 29,000, following a revised 133,000 gain in August. July and August employment was revised down by a combined 60,000. Unemployment edged up to 4.2% from 4.1%, alongside an increase in labor-force participation to 61.8% from 61.6%. Average hourly earnings rose only 0.1% MoM and 3.0% YoY.

Softer PCE inflation reduced expectations for an immediate follow-up hike, although September surveys showed renewed upstream pressure. August headline PCE inflation registered 0.3% MoM and 3.4% YoY, while core inflation rose 0.2% MoM and 3.0% YoY. The September 30 release reinforced the repricing already triggered by New York Fed President John Williams's comments that further tightening was not urgent. October hike probabilities fell to roughly one-third from around 70% a week earlier. The subsequent September manufacturing and payroll releases presented a mixed picture with weaker hiring and modest wage growth alongside stronger factory cost pressures. This divergence distinguished easing labor-related pressure from continuing supply and input-cost strains.

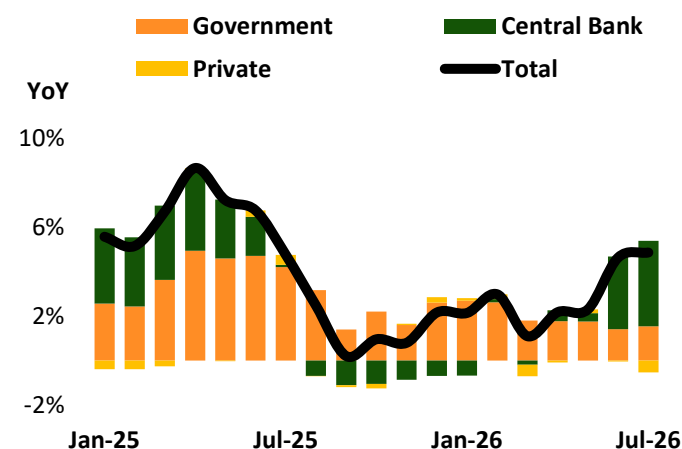
The late-month inflation relief failed to reverse September's Treasury selloff and dollar recovery. Treasury yields initially declined following the PCE release, but the long end reversed the move. The UST 10Y yield rose approximately 53bps over September, its largest monthly increase since September 2022. DXY traded near 101.5 at month-end, recording a monthly gain after two consecutive declines. Energy reinforced the inflation pressure with Brent rose around 14% during September, while WTI gained approximately 5%. Higher U.S. yields and a firmer dollar consequently raised the hurdle for emerging-market assets, despite reduced expectations for consecutive Fed hikes.

Domestic Economy

Trade Relief Meets a Tougher External Financing Backdrop

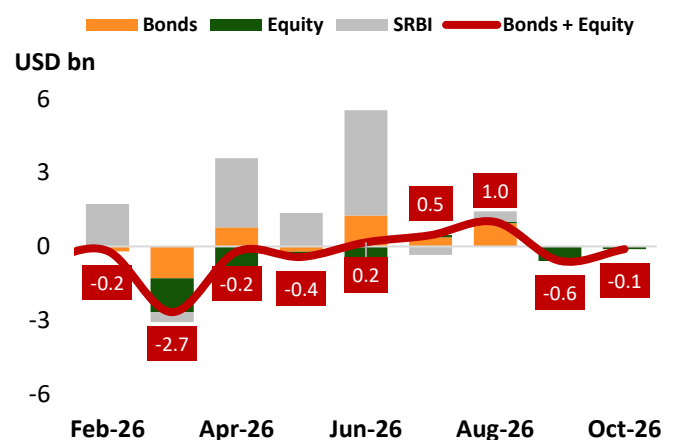
The trade surplus rebounded but import demand continued to constrain the external buffer. August trade data showed a USD3.6bn surplus, up from USD0.1bn in July. Exports reached USD26.6bn, growing 6.7% YoY, while imports stood at USD23.1bn, up 19.1%. Over January–August, import growth of 19.8% substantially exceeded export growth of 4.7%, leaving a cumulative surplus of USD7.3bn. The monthly recovery provided relief, while elevated production and investment-related imports continued to absorb export receipts.

Chart 3. Public Sector Leads External Financing



Source: Bank Indonesia, Bank Danamon Indonesia Calculation

Chart 4. Capital Flows Remain on the Sideline



Source: Bloomberg as of Oct-02

Public borrowing supported external financing as private offshore debt contracted. July external debt, published in September, stood at USD455bn, broadly unchanged from June but up 4.9% YoY. Government external debt increased 3.2% to USD218bn, supported by international SBN inflows, while private external debt declined 1.2% to USD195bn. The divergence highlighted the public sector's greater contribution to external financing amid subdued private offshore borrowing.

BI strengthened its FX defences while maintaining the policy rate at 5.75%. Following the Fed's September hike, BI increased swap premium discounts to 15%/20%/25% for 3M/6M/12M tenors and DNDF discounts to 25%/30% for 6M/12M tenors. Eligible transactions covered portfolio inflows, banks' foreign borrowing, and FDI. Larger incentives at longer maturities reflected an effort to attract more durable funding and reduce hedging costs. The decision preserved BI's policy mix: FX stabilization and monetary discipline alongside accommodative macroprudential measures supporting domestic intermediation.

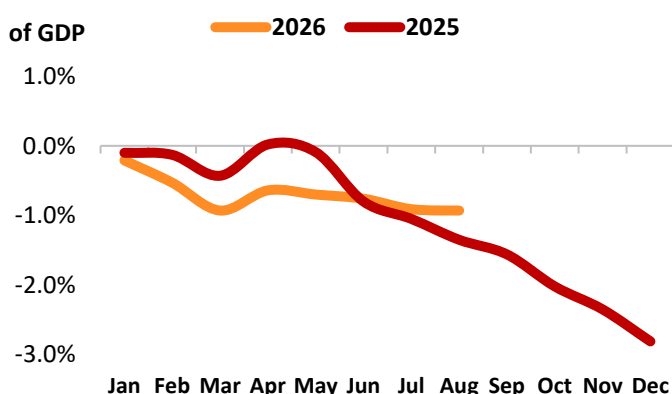
Higher diesel prices create a second channel of vulnerability through both external balances and inflation. Refinery disruptions have tightened diesel supply and lifted product prices, broadening the energy shock beyond crude oil alone. For Indonesia, higher diesel prices increase the energy import bill and FX demand while simultaneously raising transportation and logistics costs. The combination comes as inflation has already accelerated to 3.28% YoY in Sep-26, suggesting that energy-related pass-through risks are gradually becoming more relevant for the inflation outlook.

Manufacturing Regain Momentum as Fiscal Spending Gains Pace

Manufacturing regained momentum, while underlying inflation remained contained. September PMI rose to 52.4 from 49.8 in August, supported by stronger orders, production, and employment. New orders expanded at their fastest pace since February, while input and selling-price inflation eased to six-month lows. At the same time, Core inflation declined to 2.84% YoY from 2.92%, indicating that the headline acceleration was concentrated outside core rather than reflecting a broad strengthening of demand-driven prices.

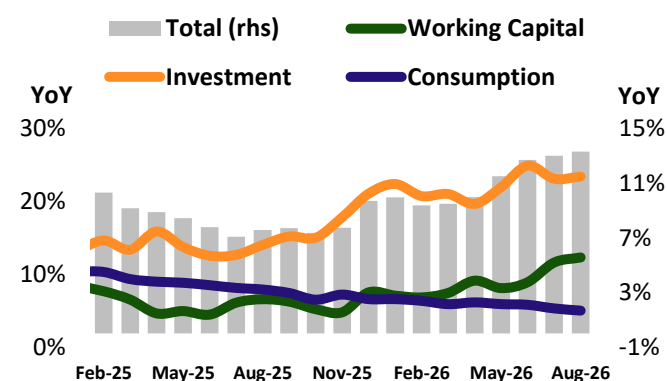
Food prices drove September's inflation increase, while underlying pressure remained subdued. Volatile food prices rose 1.5% MoM, contributing 0.24ppt of the 0.3% monthly CPI increase, with pressure concentrated in chicken meat, bird's eye chili, rice, and beef. Headline inflation consequently edged up to 3.28% YoY from 3.19% in August. Administered prices were broadly unchanged on the month, while core inflation rose just 0.1% MoM and eased to 2.84% YoY.

Chart 5. Fiscal Deficit Contained as Revenue Improved



Source: CEIC, Bank Danamon Indonesia Calculation

Chart 6. Investment Loan Growth Shows Signs of Peaking



Source: Bank Indonesia

Investment-loan growth plateaued as lending outpaced funding growth. August credit expanded 13.3% YoY, led by investment loans at 23.4%, broadly unchanged from July. Working-capital and consumption loans grew 12.3% and 5.0%, respectively. Deposits increased 10.9%, while liquid assets stood at 23.0% of deposits. The levelling off in investment-loan growth was consistent with tighter funding constraints on further balance-sheet expansion, despite adequate aggregate liquidity.

Stronger revenue contained the deficit despite substantially higher expenditure. Through August, revenue reached IDR2,055.6tn, up 25.4% YoY, while spending rose 17.1% to IDR2,295.7tn. The deficit stood at IDR240.1tn, or 0.93% of GDP, with a primary surplus of IDR154tn. Tax revenue increased 24.1%, while non-tax revenue grew 41.7%. The revenue improvement absorbed much of the additional expenditure, keeping the cumulative fiscal balance contained as spending expanded.

Fiscal support was increasingly concentrated at the central-government level. Expenditure reached 59.7% of the annual budget. Central-government spending grew 29.0% YoY, including ministry and agency expenditure of 33.0% and non-ministry expenditure of 25.1%. Transfers to regions, however, declined 11.8%. The composition showed an uneven distribution of fiscal support, with central programs driving spending growth while regional transfers contracted. Subsidies, compensation, and social protection remained important channels for cushioning household costs.

Automotive Industry

Auto Demand Diverges as the Diesel Squeeze Intensifies

August vehicle sales highlighted uneven demand across segments. Four-wheel (4W) wholesales reached 81,756 units (+32.4% YoY), while two-wheel (2W) sales increased a modest 3.2% to 596,461 units. Stronger car sales were consistent with post-GIIAS deliveries and demand for new models, including electrified vehicles. The divergence suggested greater resilience in discretionary spending than in the mass market, although wholesales also reflect dealer inventory movements.

September registrations pointed to stronger motorcycle momentum as car growth flattened. Vehicle-population additions reached 588,607 units for 2W (+8.4% YoY), compared with 82,334 units for 4W (-0.1%). The contrast indicated a shift in segment momentum, potentially consistent with commodity-linked income support for motorcycles and normalization of the earlier car-sales boost. However, registration and wholesale data capture different stages of the sales cycle and should be assessed separately.

Refining constraints broadened the energy shock beyond crude oil. Supply disruptions and limited refining capacity increased pressure on diesel and other refined products. For Indonesia, the shock created exposure through fuel-import costs and the operating expenses of transport and distribution businesses. Its domestic impact depended on fuel-price adjustments, subsidy coverage, and the fuel specifications required by individual vehicles.

The government reiterated its ethanol ambitions as fuel-security concerns intensified. September statements outlined E10 ambitions for 2027 and E20 around 2028, alongside a target of 20 new ethanol plants by 2027. These announcements expanded the policy focus from biodiesel to gasoline substitution, linking energy security with agricultural supply and investment in fuel-grade ethanol capacity.

Outlook

Macroeconomy: Resilient Growth Despite Tightening Constraints

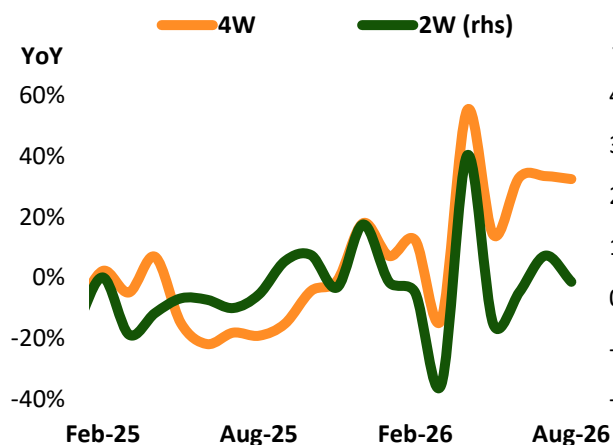
Indonesia enters the final quarter with growth increasingly supported by investment and fiscal spending, while the household recovery remains uneven. Priority projects, data centers, and downstream industries should sustain activity, underpinning our 2026 GDP forecast of 5.2%. Yet translating these growth pockets into broader gains in employment and purchasing power remains the key challenge. Plateauing investment-loan growth and tighter bank funding reflect private-sector expansion constrain, leaving fiscal execution increasingly important. Household assistance and energy compensation should cushion spending, but add to budget demands, taking our projected fiscal deficit to 2.89% of GDP.

The central policy tension is that supporting domestic demand also sustains imports at a time when global financing remains expensive. The trade rebound offers relief but does not remove the external pressure from investment-related imports, energy costs, and a firmer dollar. BI's hedging incentives and intervention should help manage volatility, but their effectiveness could diminish if higher U.S. yields, a stronger dollar, and elevated energy import costs intensify external pressure. We therefore retain an end-2026 BI Rate forecast of 6.25% and USD/IDR at 17,963.

Automotive Industry: Motorcycles Gain Ground as Car Demand Normalizes

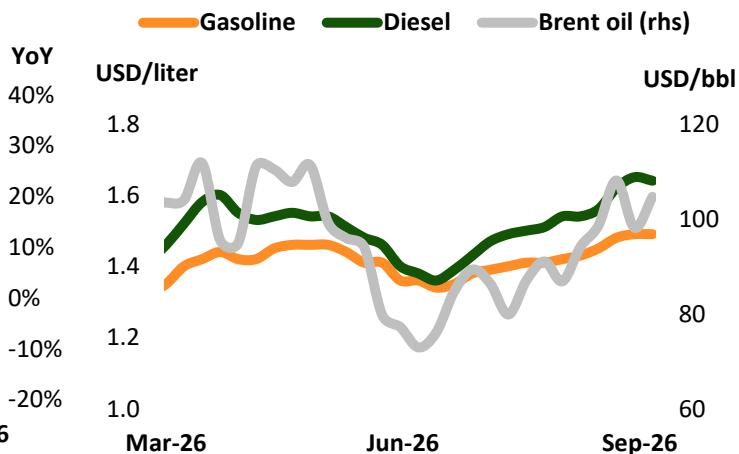
We expect demand to shift toward motorcycles in 4Q26, with 4W wholesales at 191,000 units (-21.2% YoY) and 2W sales at 1.7mn units (+9.7% YoY). Commodity-linked income gains should support motorcycles in producing regions, although food inflation and constrained household budgets could limit the recovery's breadth. Car sales should normalize after the earlier surge, while construction, data centers, and downstream investment support selected commercial-vehicle segments. Higher diesel costs could weigh on purchase decisions and used-vehicle valuations, while rising freight expenses pressure dealer margins and pricing. Ethanol expansion offers longer-term import savings but mandates that outpace domestic feedstock and processing capacity could require imports, reducing the initial FX benefit. Vehicle compatibility, fuel economy, and distribution readiness will also shape transition costs, making a phased rollout with clear specifications important as domestic supply expands.

Chart 7. Domestic Wholesales Plateaued for 4W



Source: CEIC, Bank Danamon Indonesia Calculation

Chart 8. Global Diesel Prices Climb



Source: Compiled

Indonesia's Selected Economic Indicators

	2023	2024	2025	2026E
National Accounts				
Real GDP (% y-o-y)	5.0	5.03	5.11	5.15
Domestic demand ex. inventory (% y-o-y)	4.6	4.94	4.99	5.08
Real Consumption: Private (% y-o-y)	4.9	4.9	4.98	5.13
Real Gross Fixed Capital Formation (% y-o-y)	4.4	4.61	5.09	5.18
GDP (USD bn) — nominal	1,371	1,440	1,445	1,681
GDP per capita (USD) — nominal	4,920	4,960	5,083	5,398
Open Unemployment Rate (%)	5.3	4.9	4.7	4.5
External Sector				
Exports (% y-o-y, BoP Basis)	-11.3	6.51	6.15	4.56
Imports (% y-o-y, BoP Basis)	-7.3	7.95	2.83	16.29
Trade balance (USD bn, BoP Basis)	46.4	31.04	41.05	9.75
Current account (% of GDP)	-0.1	-0.3	-0.1	-1.5
Central government debt (% of GDP)	38.9	39.13	40.50	41.54
International Reserves –IRFCL (USD bn)	146.4	155.7	156.5	147.5
Reserve Cover (Months of imports & ext. debt)	6.5	6.5	6.3	5.6
Currency/USD (Year-end)	15,399	16,235	16,703	17,963
Currency/USD (Average)	15,244	15,920	16,482	17,635
USD/CNH (Year-end)	7.13	7.34	6.98	6.65
USD/CNH (Average)	7.09	7.21	7.19	6.70
Currency/CNH (Year-end)	2,161	2,199	2,391	2,701
Currency/CNH (Average)	2,150	2,199	2,292	2,632
Other				
BI Rate (% year end)	6.0	6.0	4.75	6.25
Consumer prices (% year end)	2.61	1.57	2.92	3.29
Fiscal balance (% of GDP; FY)	-1.65	-2.3	-2.92	-2.89
S&P's Rating – FCY	BBB	BBB	BBB	BBB

Source: CEIC, E= Danamon Estimates

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