Indonesia Market Color

Stability Through Transition

4 August 2026

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Executive Summary

- **Global financial conditions remained restrictive despite modest improvements in risk sentiment following the July FOMC meeting and easing geopolitical tensions.** The Federal Reserve's higher-for-longer stance continued to support elevated U.S. Treasury yields and a resilient U.S. dollar, limiting capital flows into emerging markets and keeping pressure on regional currencies.
- **Against this backdrop, Indonesia's policy challenge has increasingly shifted toward preserving external stability.** Although headline inflation moderated in July, the improvement was largely driven by temporary food-related factors, while a second consecutive monthly trade deficit highlighted weakening structural FX inflows amid rising energy and investment-related capital goods imports.
- **We believe July marks the beginning of a gradual transition in Bank Indonesia's policy framework.** As weakening external buffers coincide with tighter domestic liquidity and a leadership transition, BI is increasingly relying on calibrated liquidity management, active FX intervention, and market-deepening measures alongside the policy rate to preserve rupiah stability.
- **Greater policy flexibility should not be mistaken for policy easing.** We expect Bank Indonesia to maintain a stability-oriented stance, with further policy tightening remaining a realistic option should external pressures or policy credibility risks intensify. We therefore maintain our terminal BI Rate forecast of 6.25%, while expecting the timing of any additional tightening to depend primarily on external conditions and investor confidence rather than domestic inflation.

Global Markets

Higher-for-Longer Remains the Dominant Market Theme

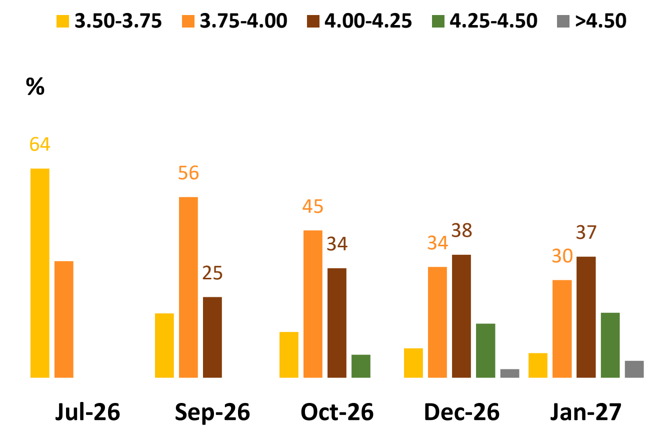
Global financial conditions remained restrictive despite a modest improvement in risk sentiment following the July FOMC meeting and easing geopolitical tensions in the Middle East. The Federal Reserve kept the federal funds rate unchanged at 3.50–3.75%, while three FOMC members dissented in favor of an immediate 25bp rate hike, the strongest hawkish dissent in decades. The outcome reinforced that inflation remains the Fed's primary concern and that further policy tightening remains a realistic possibility.

Although headline inflation moderated from its June peak, underlying price pressures remained persistent. Sticky core inflation, resilient household spending, and a still-tight labor market continued to support domestic demand despite restrictive financial conditions. Meanwhile, the inflationary impact of tariff measures, elevated input costs, and sustained AI-related investment has complicated the disinflation process, limiting the Fed's confidence that inflation will return sustainably to its 2% target.

Reflecting these dynamics, the 10-year U.S. Treasury yield has risen further to around 4.69% as of early August, while Fed funds futures continue to price a meaningful-

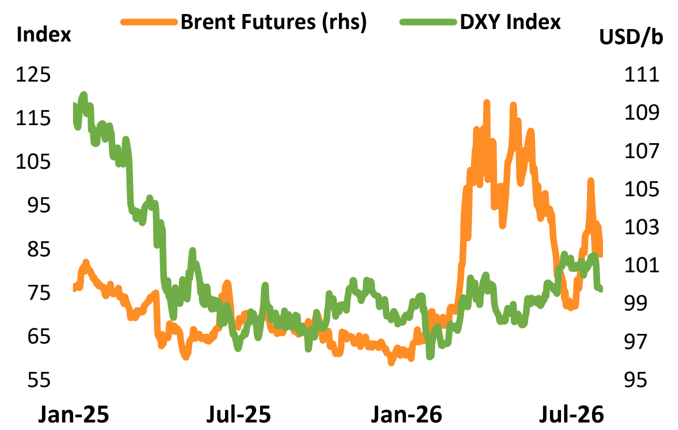
probability of another rate hike later this year. Although oil prices moderated as geopolitical tensions eased, the U.S. dollar remained resilient, suggesting that global financial conditions are likely to stay restrictive. For emerging markets, this environment continues to constrain capital inflows and reinforces the need for policymakers to maintain attractive domestic yields and preserve policy credibility.

Chart 1. FOMC Rate Probabilities



Source: CME Fed Watch

Chart 2. Oil Price & DXY Index



Source: CEIC

Indonesia's External Balance

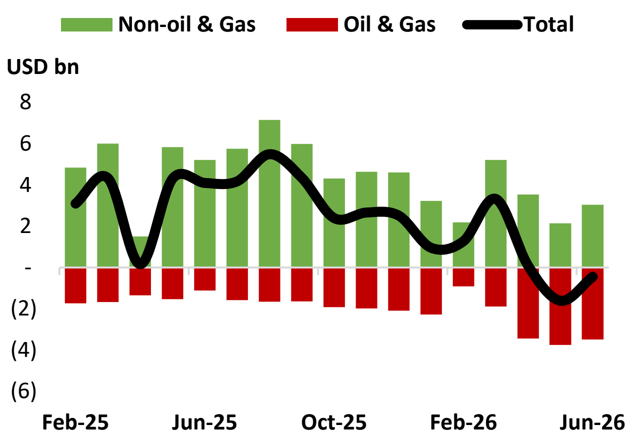
External Buffers Are Becoming Less Supportive

Indonesia recorded a second consecutive monthly trade deficit in June, posting a deficit of USD0.5bn after May's USD1.6bn deficit. Although the deficit narrowed more than expected on stronger exports, the outcome confirms that the structural support previously provided by persistent trade surpluses has become less reliable. Rather than signalling weakening external demand, the latest data point to a gradual erosion of Indonesia's traditional external buffer.

Importantly, the deterioration was driven by imports rather than exports. Exports remained resilient, growing 8.8% YoY in June, supported by nickel products, palm oil, and other resource-based commodities. Meanwhile, imports surged 34.3% YoY, led by a 105.2% YoY increase in oil and gas imports amid elevated energy prices and stronger domestic fuel demand. Imports of capital goods and intermediate inputs also remained robust, reflecting continued investment in downstream industries, manufacturing, infrastructure, and digital projects.

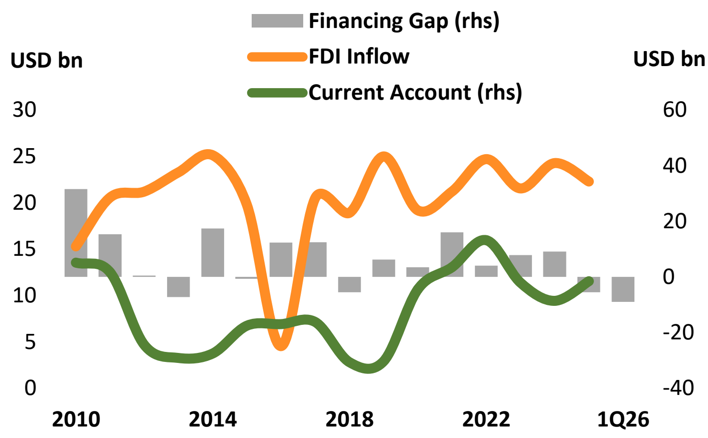
This shift presents an increasingly important macroeconomic trade-off. While investment-related imports support Indonesia's medium-term productive capacity, they also increase near-term demand for foreign currency and reduce structural FX inflows generated by the trade balance. As a result, Indonesia is becoming increasingly dependent on financial-account inflows to finance its external position. Since 4Q25, the financing gap has turned negative, indicating that current account deficits increasingly require external capital to maintain balance-of-payments stability. In this environment, preserving investor confidence and maintaining attractive returns on rupiah assets become increasingly important, reinforcing Bank Indonesia's focus on external stability.

Chart 3. Trade Balance



Source: Statistics Indonesia

Chart 4. Balance of Payment



Source: Bank Indonesia, Bank Danamon Indonesia Calculation

Domestic Economy

Temporary Inflation Relief as Food Prices Ease

Headline inflation eased to 2.88% YoY (-0.14% MoM) in July from 3.34% YoY in June, largely reflecting seasonal declines in volatile food prices, including shallots, chilies, eggs, and tomatoes. Lower non-subsidized fuel prices also helped moderate administered-price inflation on a monthly basis, although the component remained relatively elevated in year-on-year terms due to base effects. Overall, the latest CPI release suggests that the recent moderation in inflation was driven primarily by improving supply conditions rather than weakening domestic demand.

Core inflation remained broadly stable at 2.76% YoY, with continued price increases across transportation, restaurants, education, and personal care. This suggests that underlying demand conditions remain resilient, while the easing in headline inflation reflects temporary food-related factors rather than a broad-based disinflation trend.

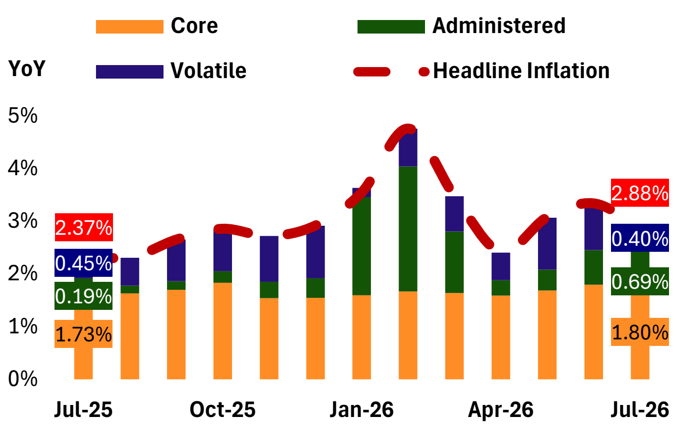
Manufacturing Recovery Signals Stable Inflation Ahead

Forward-looking indicators also point to a gradual improvement in domestic activity. Indonesia's S&P Global Manufacturing PMI rebounded to 50.2 in July from 46.9 in June, returning to expansion territory for the first time since February. The recovery was supported by higher production, stabilizing new orders, and the first increase in manufacturing employment in five months, although export orders continued to contract, indicating that the recovery remains primarily domestically driven.

Importantly, the PMI survey does not point to building inflationary pressure. While manufacturers continued to face elevated raw material costs, input cost inflation eased to a four-month low, and competitive conditions continued to constrain firms' pricing power. Together with contained core inflation, the survey suggests that domestic demand is recovering at a pace consistent with stable inflation rather than an overheating economy.

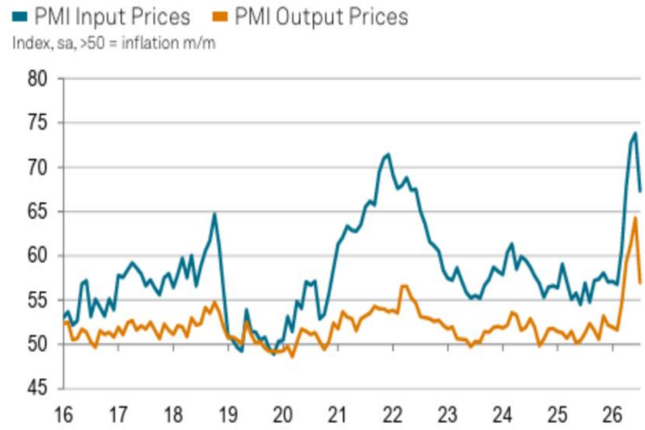
Looking ahead, inflation risks remain increasingly concentrated on the supply side. Food inflation remains vulnerable to adverse weather conditions, including the potential emergence of El Niño, which could disrupt agricultural production and push up prices of key staples. At the same time, administered-price inflation remains sensitive to developments in global energy markets. Although government policies have so far limited the domestic pass-through of higher oil prices, renewed geopolitical tensions or another spike in crude oil prices could place upward pressure on fuel prices, transportation costs, and broader administered-price inflation.

Chart 5. Indonesia's Inflation Contribution



Source: National Bureau of Statistics

Chart 6. S&P PMI Manufacturing



Source: S&P Global PMI

Monetary Policy

Liquidity and Credibility Take Center Stage

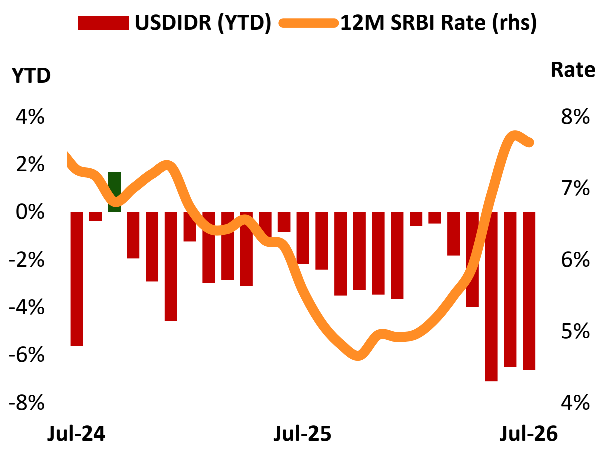
Bank Indonesia kept the BI Rate unchanged at 5.75% in July after delivering 100bp of cumulative tightening since May, while maintaining the Deposit Facility and Lending Facility rates at 4.75% and 6.50%, respectively. We view the decision as reflecting not a reduced commitment to rupiah stability, but a shift toward a more measured policy calibration as liquidity conditions become increasingly important. Although system liquidity remains broadly adequate, tighter liquidity distribution is becoming more evident. The liquid-assets-to-deposit ratio declined to 23.1% in June from 24.7% in May, while credit growth of 12.7% YoY continued to raise funding needs. Against this backdrop, liquidity management is likely to become as important as the policy rate in shaping BI's policy stance during the second half of the year.

Within this framework, SRBI remains both a liquidity-management instrument and a key channel for attracting foreign capital. Non-resident holdings increased from IDR238tn in mid-June to IDR289tn by 20 July, equivalent to 27.1% of total outstanding, supported by higher SRBI yields. However, we believe the next phase of policy will involve a gradual normalization of SRBI outstanding rather than continued aggressive liquidity absorption. This should be viewed as a recalibration rather than monetary easing, aimed at easing funding pressures and reducing liquidity segmentation while preserving the attractiveness of rupiah assets. BI's broader policy toolkit, including active intervention in the spot, DNDF and offshore NDF markets, higher swap-hedging incentives, and refinements to KLM, further reinforces this more flexible, multi-instrument approach.

The unexpected resignation of Governor Perry Warjiyo on July 27 adds another layer to this policy calibration. The appointment of Senior Deputy Governor Destry Damayanti as interim governor provides near-term continuity, particularly given her commitment to maintain BI's focus on rupiah and financial-system stability. The initial market reaction was contained but cautious, with the rupiah weakening 0.36% to IDR18,000/USD on the day of the announcement. Going forward, however, the definitive appointment will become increasingly important for market pricing, as investors assess whether BI's established reaction function (prioritizing currency stability, maintaining attractive rupiah returns, and tightening when necessary) will remain intact.

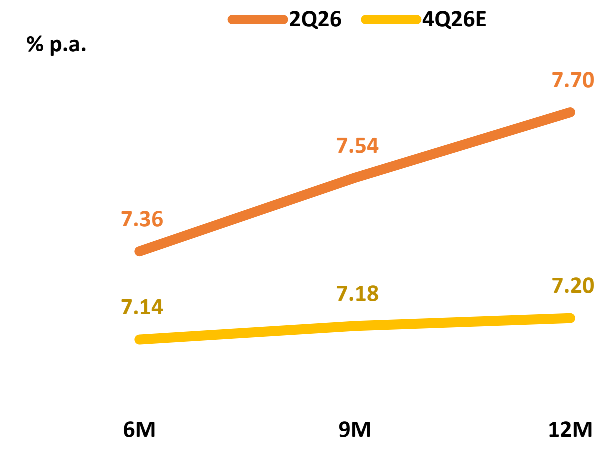
Our base case is that Bank Indonesia will continue to sequence its policy response carefully, allowing gradual SRBI normalization to ease liquidity pressures while relying on FX intervention and other non-rate measures. However, this flexibility should not be interpreted as policy easing. Should U.S. yields rise further, the U.S. dollar strengthen, commodity prices rebound, or policy credibility weaken during the leadership transition, the policy rate would return to the forefront. We therefore maintain our terminal BI Rate forecast of 6.25%, with any additional tightening viewed primarily as an insurance response to external and credibility risks rather than domestic inflation.

Chart 7. SRBI Yields & IDR Depreciation



Source: Bloomberg, Bank Indonesia

Chart 8. SRBI Yield Curve



Source: Bank Indonesia, Bank Danamon Indonesia Calculation

Automotive Industry

Higher Fuel Prices Accelerate Indonesia's Shift Toward Electrification

Vehicle Registrations Point to Softer Demand. Indonesian National Police vehicle registration data suggest that automotive demand moderated in Jul-26 across both four-wheelers (4W) and two-wheelers (2W). New 4W registrations rose to 76,412 units (+9.8% YoY), while 2W registrations reached 571,544 units (+5.1% YoY). Although both segments continued to grow, the slower pace suggests that mobility demand is coming under pressure as higher fuel prices raise transportation costs while seasonal education spending temporarily absorbs household disposable income. Taken together, the Jul-26 data indicate that the automotive recovery is becoming less broad-based, particularly in the mass-market segment.

The Jul-26 launching spree may offset demand softness by refreshing consumer interest. Indonesia recorded 26 new 4W model launches in Jul-26, lifting YTD launches to 50 models, with more than half of new releases concentrated in a single month. BEVs accounted for 52% of Jul-26 launches, largely dominated by IDR300-500mn crossover models, which directly target the urban middle-class segment. PHEV launches also increased, with five models introduced in the same price range, while three REEV models made their debut in Indonesia after being largely absent in previous years. This product mix is consistent with our view that consumers are increasingly looking for electrified vehicles with better range security, rather than purely adopting EVs for technology appeal.

Higher fuel prices are accelerating the shift toward New Energy Vehicles. NEVs accounted for 78% of total Jul-26 launches, showing that manufacturers are increasingly positioning electrified models as the center of their 2026 product strategy. This shift is being reinforced by fuel price developments, as the government eventually raised RON 92 and RON 95 prices after nearly three months of delay, bringing cumulative price increases to 37.5%. Higher non-subsidized fuel prices raise the running cost of conventional vehicles, making NEVs more attractive for urban households with high daily mobility needs. As a result, NEV adoption is increasingly being driven not only by policy incentives and model availability, but also by household cost-saving considerations. Lower fuel bills and negligible tax liability, at least in the near-term, are pushing the average urban private commuter to switch.

Higher NEV penetration is helping contain the usual fuel-switching response. Historically, increases in non-subsidized fuel prices have pushed consumers toward subsidized fuels, causing Pertalite RON 90 and Bio Solar CN 48 consumption to overshoot quota allocations. This pattern has not fully materialized in 2026. Based on Pertamina's preliminary data, we estimate 7M26 RON 90 consumption at 16.8 mn kiloliters, equivalent to 58% of quota (+3.2% YoY), while CN 48 consumption reached 11.2 mn kiloliters, equivalent to 60% of quota (+4.7% YoY). Both remain below the 7M22 fuel-shock episode, when RON 90 and CN 48 consumption had already reached 73% and 66% of quota, respectively. The more muted switching effect suggests that higher NEV adoption is beginning to reduce household dependence on conventional fuels, limiting the spill over into subsidized fuel demand.

Fiscal incentives were effective in accelerating NEV adoption, but their impact remains less than proportional. According to the 2025 Audited Central Government Financial Report (LKPP), the government provided IDR4.2tn in NEV-related tax incentives, of which IDR3.9tn was allocated to BEVs. The incentives applied to both locally assembled CKD and imported CBU BEVs until December 31, 2025, lowering acquisition costs and widening consumer access to electrified models. Together with Greater Jakarta's odd-even exemption, the policy helped trigger a Jun-25 price war and a year-end spike in BEV wholesales. As model availability improved and price competition intensified, NEV wholesale market share rose from 12.1% in 2024 to 21.9% in 2025. However, the policy multiplier appears inelastic, as our estimate suggests that every 1% increase in tax incentives only raised NEV market share by 0.29%, implying that incentives work best when accompanied by broader affordability, infrastructure, and product-range improvements. All three are concurrently happening in the Indonesian market, benefiting consumers along the way.

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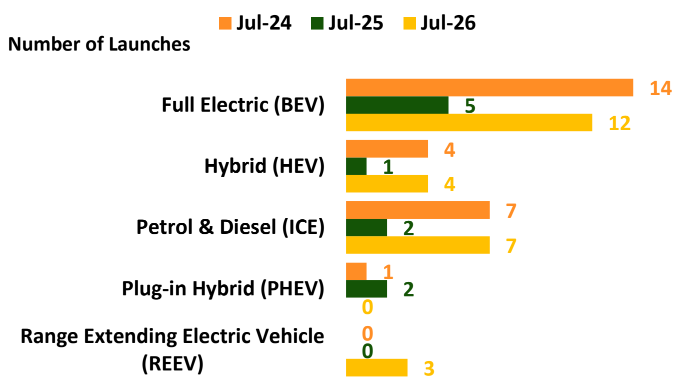
Industry Outlook

NEVs to Lead Automotive Growth in 2H26

NEV adoption is set to become the primary driver of wholesale growth in 2H26. With NEV incentives reintroduced from Aug-26 onwards, we expect electrified vehicle demand to accelerate further as consumers respond to persistently high and uncertain fuel prices. The combination of stronger cost-saving incentives, lower operational expenses, and improving model availability should continue to support the shift away from conventional internal combustion vehicles.

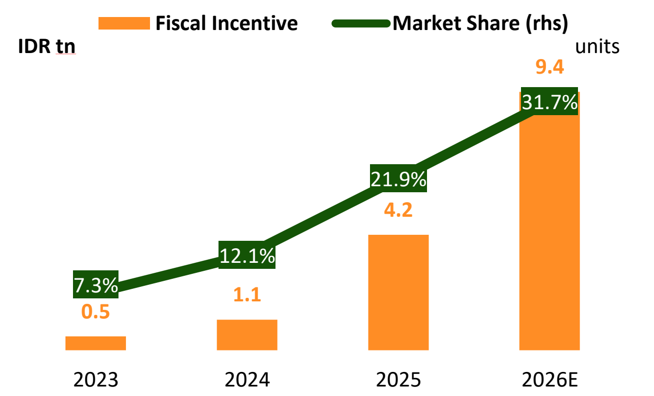
NEV penetration is expected to reach a new high in 2026. We project NEV wholesales of around 261,248 units, equivalent to 31.7% of total wholesales this year. Growth should be led by BEV adoption in Greater Jakarta, where charging infrastructure and policy support remain more developed, while PHEVs and REEVs are likely to gain traction among urban consumers outside Jakarta, where range flexibility remains a more important purchasing consideration for long trips.

Chart 9. 4W Launches by Type



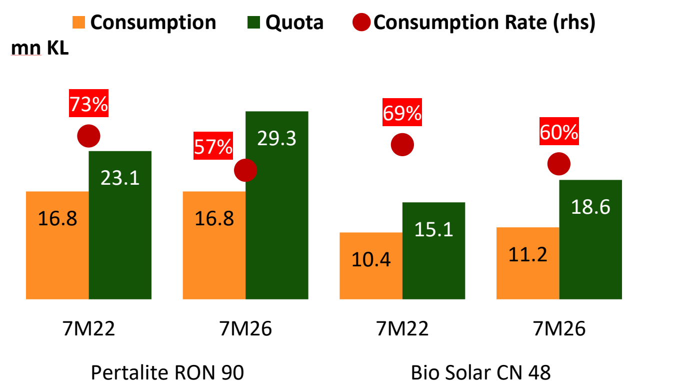
Source: Compiled, Bank Danamon Indonesia Calculation

Chart 10. Fiscal Incentives & NEV Market Share



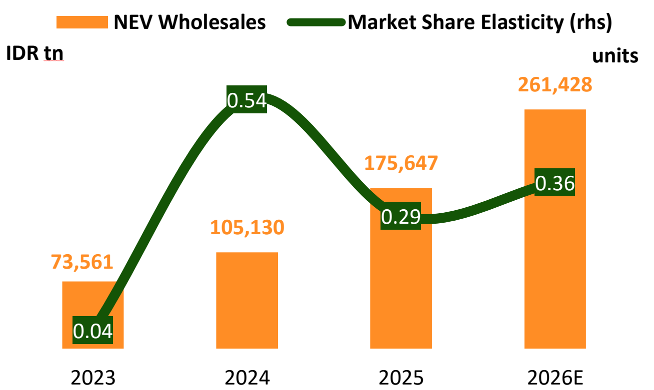
Source: Ministry of Finance, Bank Danamon Indonesia Calculation

Chart 11. Fuel Consumption vs Quota



Source: Pertamina Patra Niaga, Bank Danamon Indonesia Calculation

Chart 12. Fiscal Incentives & Market Share Elasticity



Source: Bank Danamon Indonesia Calculation

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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	-1.1
Central government debt (% of GDP)	38.9	39.13	40.50	40.74
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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