Senior Economist / Fikri C Permana
Research Associate / Khairunnisa N. Syahfiraputri
Intern Economist / Wanda M. Ramadhan

Bank Indonesia's Policy Mix and Its Future Implications

BI Reaffirms Its Position as the Monetary and Macroprudential Authority

Bank Indonesia (BI) has once again reaffirmed its position as the key monetary and macroprudential authority in Indonesia. Following the Board of Governors Meeting (RDG) held on 20–21 May 2025, **the central bank announced a 25 bps cut to the BI-Rate, bringing it down to 5.50%.** In line with this decision, the Deposit Facility rate was reduced to 4.75% and the Lending Facility rate to 6.25%. This move reflects BI's continued commitment to maintaining stability while supporting the country's broader economic goals.

The rate cut is supported by a favorable inflation outlook. BI projects that inflation will remain within the target range of 2.5% ± 1% for both 2025 and 2026. This indicates that **price pressures are under control, giving the central bank sufficient room to adopt a more accommodative stance without jeopardizing price stability.**

Another key consideration behind this policy decision is the need to preserve the stability of the Rupiah. BI emphasized that the exchange rate should align with Indonesia's economic fundamentals. In the current global context, where volatility in financial markets remains elevated due to shifting expectations around global interest rates and geopolitical risks, stabilizing the exchange rate is crucial not only to safeguard investor confidence but also to maintain external sector resilience.

In addition to these stability goals, BI's rate cut is aimed at invigorating the domestic economy. By easing the benchmark interest rate alongside continued accommodative macroprudential measures, **BI is actively encouraging credit growth and stimulating domestic demand.** This is crucial for supporting investment and consumption in a context where external uncertainties persist. Complementing monetary policy efforts are ongoing upgrades to the national payment system infrastructure, designed to enhance financial inclusion, promote digital innovation, and increase transactional efficiency across Indonesia's diverse archipelago. These technological improvements facilitate smoother financial intermediation and underpin the broader objective of inclusive economic development.

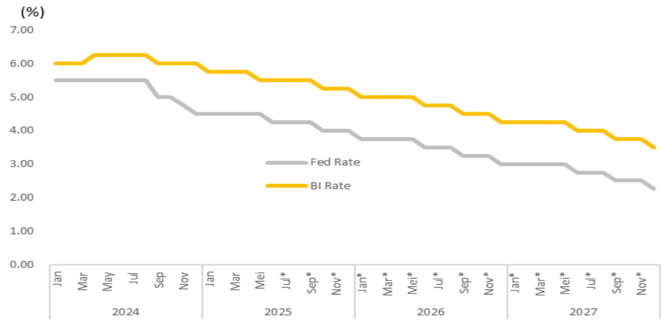
This policy direction is fully aligned with Bank Indonesia's statutory mandate. Article 7 of Law No. 23 of 1999 defines **BI's core objective as achieving and maintaining the stability of the Rupiah. This includes not only price stability but also exchange rate stability**— both of which are pillars of a sound and credible monetary framework. BI's monetary decisions are thus firmly anchored in a long-term vision of economic steadiness and resilience.

Moreover, Bank Indonesia's role as a macroprudential authority has been clearly defined in Law No. 4 of 2023 on the Development and Strengthening of the Financial Sector. Under this legislation, **BI is entrusted with preserving systemic financial stability.** This involves anticipating and mitigating risks that could pose threats to the financial system as a whole, including vulnerabilities arising from the interconnectedness of financial institutions and the procyclicality of credit. The law strengthens BI's responsibility to ensure that the banking sector remains resilient amid macroeconomic fluctuations.

This mandate is consistent with the vision laid out by Governor Perry Warjiyo during his campaigns for both his first term (2018–2023) and second term (2023–2028) as Governor of Bank Indonesia. His leadership emphasized the importance of deepening collaboration with key stakeholders, including the government, the Financial Services Authority (OJK), the House of Representatives (DPR), and other strategic institutions. **Such a cooperative framework is essential for building a more integrated and agile approach to maintaining macroeconomic and financial system stability, particularly during periods of heightened uncertainty.**

BI's decision in May 2025 demonstrates that the central bank is not only reactive to short-term market conditions but also guided by a strategic, long-term policy framework. The balance between inflation targeting, exchange rate stability, financial system health, and support for growth reflects a comprehensive understanding of Indonesia's dynamic economic landscape. As the country continues to navigate global challenges and domestic structural reforms, Bank Indonesia stands as a crucial pillar in maintaining trust, stability, and forward momentum.

Fig 1. KBVS's Outlook on Future BI Rate and Fed Rate Movements



Source: KBVS (2025)

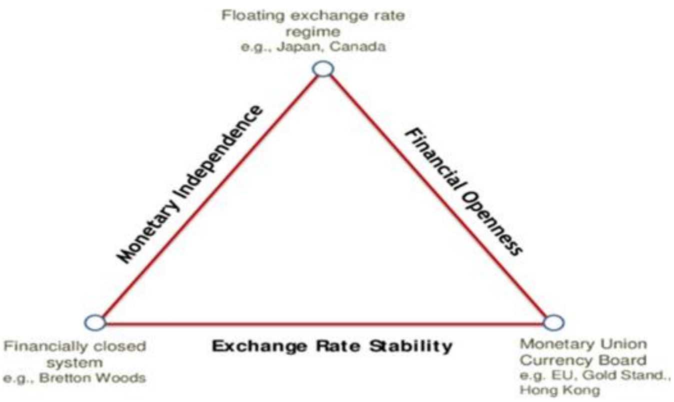
Interestingly, this recent rate cut came sooner than our (KBVS) expectation. At KBVS, the expectation was for the next 25 bps cut to occur in Jun '25, aligning with anticipated Federal Reserve rate easing in the same month. Looking ahead, another 25 bps reduction in the BI-Rate is projected around Sep or Oct '25, coinciding with further anticipated Fed rate cuts in Oct '25. **This sequence underscores BI's responsiveness to both domestic conditions and external monetary policy shifts, reflecting a nuanced approach to maintaining policy alignment with global trends while prioritizing Indonesia's unique economic landscape.**

From "Impossible Trinity" to "Possible Trinity": Bank Indonesia's Evolving Policy Mix in a Complex Economic Era

The global economic landscape has shifted significantly over the past two decades, prompting central banks—particularly those in emerging markets—to rethink conventional policy frameworks. A growing body of literature points to a gradual departure from the rigid constraints of the "impossible trinity," a concept that posits the incompatibility of simultaneously maintaining an open capital account, a fixed exchange rate, and an independent monetary policy. Instead, scholars such as Palley (2009), Patnaik and Shah (2010), Escudé (2014), and Juhro and Goeltom (2015) have observed a movement toward what is now being referred to as the **"possible trinity"—a more flexible and dynamic approach that allows countries to adopt coordinated and adaptive policy mixes in response to evolving macro-financial challenges.**

In Indonesia, this conceptual shift has materialized through Bank Indonesia's strategic adoption of a policy mix framework since 2010, as elaborated by Juhro et al. (2021). This approach enables the central bank to address increasingly complex monetary dynamics and risk transmissions through a combination of monetary, macroprudential, and exchange rate policies. **One of the most tangible manifestations of this policy mix is the close collaboration—or burden-sharing—between Bank Indonesia and the Ministry of Finance, particularly in managing fiscal-monetary synergies during times of economic stress.**

Fig 2. Trilemma Monetary Policy



Source: Aizenman, Joshua & Chinn, Menzie & Ito, Hiro. (2022).

Bank Indonesia's Triple Intervention strategy stands as a hallmark of this integrated approach. **Through coordinated operations in the spot foreign exchange market, the Domestic Non-Deliverable Forward (DNDF) market, and the government bond (SBN) market, BI actively works to mitigate excessive rupiah volatility, anchor market expectations, and safeguard investor confidence.** The spot market intervention allows BI to address sharp fluctuations in the currency directly. Meanwhile, the DNDF market provides a forward-looking mechanism to influence exchange rate expectations and offers hedging instruments without depleting foreign exchange reserves. Since April 7, 2025, this strategy has also been extended to include interventions in the offshore NDF market, reinforcing the central bank's commitment to FX stability. Additionally, secondary market operations in the SBN market help to smooth bond yield movements, thus supporting broader financial market stability.

These intervention tools are further supported by the introduction of short-term monetary instruments such as SRBI (Sekuritas Rupiah Bank Indonesia), SVBI (Sekuritas Valas Bank Indonesia), and SukBI (Sukuk Bank Indonesia). Designed to enhance the effectiveness of monetary transmission, these instruments play a vital role in liquidity management, foreign exchange stabilization, and deepening money markets. Notably, these tools are increasingly linked to export proceeds from natural resource sectors (DHE SDA), allowing Bank Indonesia to better manage external balance dynamics while supporting rupiah resilience.

The strategic coherence of this policy mix aligns with insights from Montes and Dantas (2024), who emphasize that the credibility of a country's monetary authority hinges on its ability to implement a well-balanced and responsive policy framework. When such a framework is built on internal consistency and is responsive to the full spectrum of the trilemma—monetary independence, exchange rate stability, and capital mobility—it strengthens investor trust and reinforces macroeconomic stability.

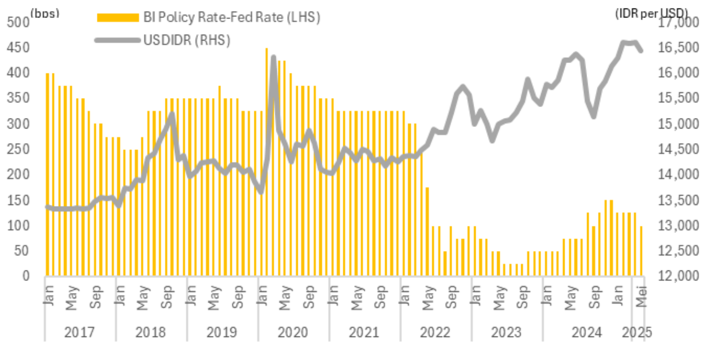
Looking ahead, the current set of policy tools is expected to remain in place at least through 2026. This continuity is necessary given the broader economic adjustments currently underway. The Indonesian government is actively deploying fiscal stimuli through the second half of 2025, including the establishment of strategic institutions such as Danantara and the cooperative initiative "Koperasi Merah Putih." These reforms aim to accelerate structural transformation, enhance productivity, and build inclusive financial ecosystems. **However, the full economic impact of these structural changes is projected to unfold gradually—beginning to take root in early 2026 and expected to reach full effect by the end of 2027.**

Bank Indonesia's approach illustrates how an evolving policy mix can serve as a critical buffer against external shocks while enabling long-term growth. By moving beyond the constraints of traditional policy orthodoxy and embracing a flexible, data-driven framework, BI continues to position itself as a proactive and credible institution in navigating Indonesia through global uncertainties and domestic transitions alike.

Rupiah Stability in Focus Amid Trade War Risks and Narrowing Rate Differentials

Bank Indonesia's latest policy mix signals a carefully calculated effort to sustain domestic economic momentum. **However, it also brings renewed concerns over potential volatility in the Rupiah exchange rate—particularly in the face of lingering global trade tensions and evolving interest rate dynamics.**

Fig 3. BI Rate-Fed Rate VS USDIDR



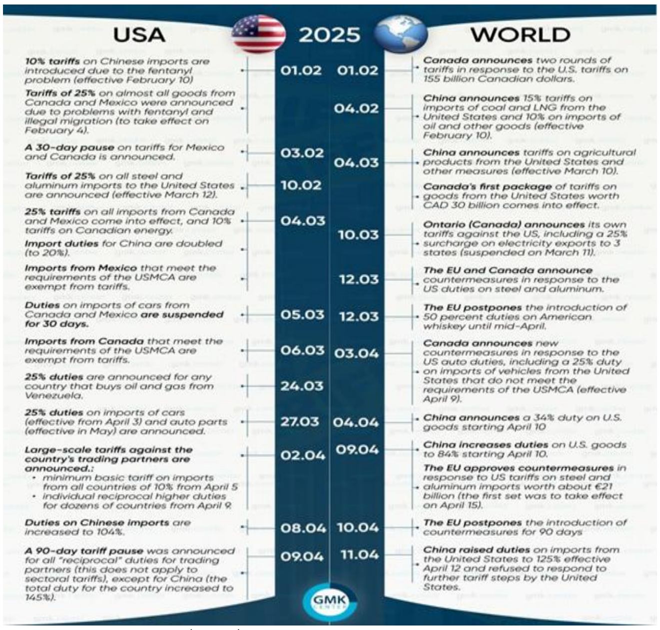
Source: Bank Indonesia, The Fed, and KBVS-treated (2025)

One of the key factors contributing to these concerns is the narrowing interest rate differential between Bank Indonesia's policy rate and that of the U.S. Federal Reserve. As BI eases its benchmark rate to support economic growth, while the Fed maintains a relatively tighter stance, the resulting decline in yield attractiveness for Indonesian assets could trigger capital outflows. These shifts in portfolio flows tend to exert downward pressure on the Rupiah, amplifying currency market fluctuations and increasing the central bank's burden to maintain exchange rate stability.

Adding to the complexity is the broader backdrop of ongoing global uncertainty, which remains highly sensitive to developments in international trade policy. The legacy of Trump-era tariffs and retaliatory actions by key trading partners continues to loom large, with many investors wary of the potential for renewed escalation. Although the Trump administration has refrained from announcing new tariff measures over the past two months, the geopolitical tone remains fragile. Markets remain on edge, pricing in a spectrum of scenarios that range from incremental easing to sudden re-escalation of trade hostilities.

Nevertheless, the central bank's accommodative stance may also reflect a degree of optimism that trade tensions will gradually ease. The current pause in tariff escalation could suggest a tactical shift or recalibration in U.S. trade policy strategy. Bank Indonesia may be interpreting this lull as a window of opportunity to rebalance domestic growth and price stability, while maintaining sufficient buffers to respond should external shocks resurface.

Fig 4. Tariff War: Trump VS The World



Source: GMK Centre (2025)

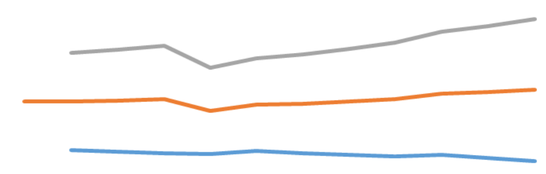
To better understand the potential outcomes, we have constructed several scenarios that reflect a range of macroeconomic assumptions. In the base case, the Rupiah is expected to move in line with current market conditions, assuming no significant deterioration or improvement in global trade dynamics. This scenario reflects the status quo, with trade flows and investor sentiment remaining largely unchanged in the near term.

In a more optimistic scenario, referred to as Risk (-), the outlook improves markedly. This assumes that trade disruptions begin to ease, global macroeconomic conditions recover, and external demand for Indonesian goods strengthens. Under such circumstances, the Rupiah would likely benefit from renewed capital inflows and export-driven growth, leading to a period of relative exchange rate stability or even appreciation.

Conversely, the Risk (+) scenario envisions a deterioration in global conditions. This could be triggered by renewed trade conflicts, escalating geopolitical tensions, or unexpected policy shocks that disrupt financial markets. Should such risks materialize, the Rupiah may face significant volatility, driven by capital outflows and a more risk-averse global investor climate.

Taken together, **these scenarios underscore the importance of continued vigilance in monitoring global developments, particularly those tied to trade policy and central bank actions in advanced economies.** Bank Indonesia must navigate a complex landscape, balancing the need for domestic economic support with the imperative of maintaining external stability. The evolving nature of global risks makes it essential for policymakers to remain flexible, data-driven, and forward-looking in their response.

Fig 5. Rupiah Outlook Scenario by KBVS



	Q1	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*
	2025*				2026*				2027*			
Base	16,456	16,472	16,484	16,537	16,133	16,351	16,388	16,457	16,536	16,750	16,790	16,867
Risk (-)		14,797	14,718	14,667	14,642	14,747	14,679	14,628	14,576	14,629	14,514	14,417
Risk (+)		18,147	18,250	18,407	17,624	17,955	18,097	18,285	18,496	18,872	19,065	19,317

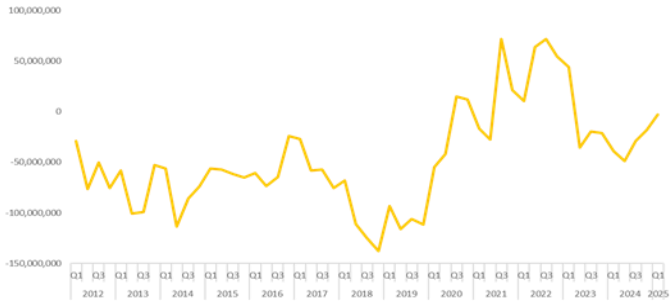
Source: KBVS (2025)

Ultimately, the trajectory of the Rupiah will depend on how global trade relations, geopolitical risk, monetary policy stances, and another global risk evolve in the coming months, and whether geopolitical tensions subside or re-emerge. For now, market participants and policymakers alike must prepare for a range of outcomes, while working to build resilience against potential external shocks.

The Risk of Rupiah Volatility Amid a Persistent Current Account Deficit

Concerns over the stability of the rupiah have escalated in recent months, driven primarily by Indonesia's ongoing struggle with a persistent current account deficit (CAD). For eight consecutive quarters, the country has recorded a deficit in its current account—a trend that continues to signal underlying structural imbalances in the external sector. While temporary factors may have played a role, the sustained nature of the CAD is now a central risk consideration for both policymakers and market participants. In our own assessments, we have flagged this as a key risk factor under the Risk (+) scenario. On the flip side, a reversal in global economic conditions leading to a current account surplus is already considered in our Risk (-) projections.

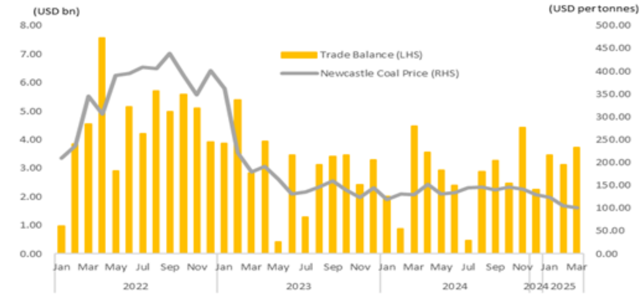
Fig 6. Indonesia's Current Account



Sources: Bank Indonesia, BPS (2025)

The prolonged CAD underscores the rupiah's heightened vulnerability to external shocks. In an open economy like Indonesia's, where capital mobility and trade dynamics are deeply intertwined with global conditions, the currency becomes highly sensitive to changes beyond its borders. **One of the most significant exposures lies in Indonesia's export composition. Heavily reliant on commodities** such as coal, palm oil, and minerals, Indonesia's trade performance—and by extension, the rupiah-is inherently tied to the boom-and-bust cycles of global commodity prices. Any sudden correction in these markets could swiftly undermine export earnings and worsen the trade balance, further pressuring the currency.

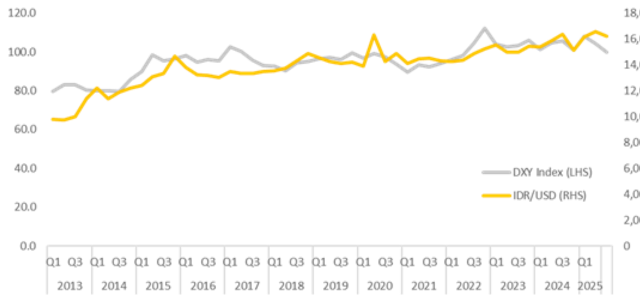
Fig 7. Indonesia's Trade Balance VS Coal Price



Sources: BPS, Bloomberg, and KBVS-treated (2025)

At a deeper level, Rupiah volatility does not operate in isolation—it reverberates throughout the broader economy. Its impact extends to the trade balance, the current account, capital flows, and ultimately back to the currency itself in a feedback loop that can either reinforce stability or amplify disruption. One notable area of concern is government revenue, particularly from non-tax income such as royalties and fees linked to commodity exports. A weaker Rupiah can suppress these revenue streams, especially if it coincides with falling global commodity prices.

Fig 8. DXY VS USDIDR



Source: Bloomberg (2025)

Implications for Economic Growth

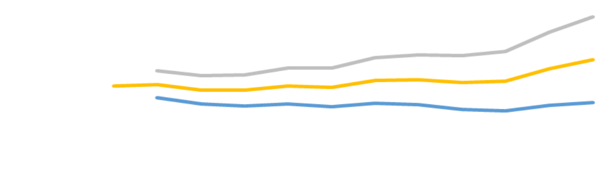
The recent cut in Bank Indonesia's benchmark interest rate sets off a ripple effect that extends well beyond monetary transmission channels. One of the more immediate impacts emerges through exchange rate dynamics—specifically, the heightened volatility of the Rupiah. Such fluctuations can directly influence domestic purchasing power, particularly through the cost of imported goods. As these prices rise, household budgets feel the strain, which in turn may dampen consumer confidence and curtail spending in key sectors. Household consumption, a critical pillar of Indonesia's GDP, becomes vulnerable, as does private investment—especially when businesses perceive the currency environment as uncertain or unstable.

Export-oriented industries stand at a complex crossroads. On one hand, a weaker Rupiah can make Indonesian products more attractive on the global market, potentially boosting export revenues. On the other hand, many of these same industries are dependent on imported capital goods or intermediate inputs, and a depreciating currency drives up those costs. As a result, competitiveness gains can be partially offset by rising production expenses. For sectors reliant on advanced foreign technology or equipment, the uncertainty surrounding exchange rates can delay or deter long-term investment decisions.

Beyond the private sector, prolonged exchange rate instability can challenge the government's fiscal strategy. Planning and allocating subsidies becomes more difficult when foreign-denominated obligations or global price benchmarks shift unpredictably. The cost of public projects—especially those involving imported materials—can escalate, putting strain on the state budget. At the macro level, this constellation of effects begins to shape Indonesia's broader economic growth trajectory. Sustained Rupiah volatility, particularly in the context of a persistent current account deficit, acts not merely as a short-term market concern, but as a signal of deeper structural imbalances.

In such a context, the role of policy—both monetary and fiscal—gains heightened importance. **Bank Indonesia's policy decisions can provide essential buffers, but they cannot work in isolation.** Structural reforms are equally critical, especially those aimed at broadening Indonesia's export base and enhancing the depth and resilience of domestic financial markets. By doing so, the country can reduce its reliance on volatile capital flows and imported goods, thereby mitigating its exposure to external shocks. A more diversified economy not only insulates the Rupiah from sudden global shifts but also builds a stronger foundation for inclusive and sustainable growth.

Fig 9. Domestic Ecpnomic Growth Outlook Scenario by KBVS



	Q1	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*
	2025*				2026*				2027*			
Base	4.87	4.95	4.70	4.68	4.88	4.83	5.12	5.13	5.03	5.08	5.63	6.03
Risk (-)		5.55	5.33	5.36	5.66	5.68	6.11	6.23	6.22	6.40	7.24	7.93
Risk (+)		4.35	4.08	3.99	4.09	3.97	4.12	4.03	3.84	3.77	4.03	4.14

Source: KBVS (2025)

Measured quantitatively, our estimates suggest that the direct impact of a 25-basis-point cut in the BI Rate could lift economic growth by approximately 0.03% to 0.17% from the baseline over the next one to two quarters. Secondary effects, including multiplier impacts on consumption and investment, could add another 0.06% to 0.30% over the same period. **These figures, while modest on the surface, are significant when viewed in the context of today's global economic uncertainty and the delicate balance Indonesia must maintain between supporting growth and preserving macroeconomic stability.**

Ultimately, navigating this landscape calls for a balanced and strategic approach—one that addresses immediate vulnerabilities without losing sight of long-term transformation goals. A credible monetary policy framework, underpinned by prudent fiscal management and a clear commitment to reform, is essential. Transparent market communication, targeted fiscal support, and investment in domestic productivity will all be key to restoring investor confidence. The road ahead is not without its challenges, but with the right policy mix and sustained reform momentum, Indonesia is well-positioned not only to weather the current storms but to emerge more resilient, more competitive, and more inclusive in the years to come.

Indonesia's Enduring Appeal Amid Global Market Volatility

Despite prevailing global uncertainties, Indonesia continues to stand out as a promising destination for capital inflows, particularly when viewed through the lens of asset class competitiveness. We share Bank Indonesia's optimism, which is underpinned by several structural advantages that set the country apart from its peers.

Among the most compelling is Indonesia's government bond market, where yields remain notably higher than those offered by countries with comparable — or even superior — credit ratings. This yield premium provides a cushion for investors seeking stable returns in an increasingly yield-starved global environment, enhancing the attractiveness of Indonesia's sovereign debt.

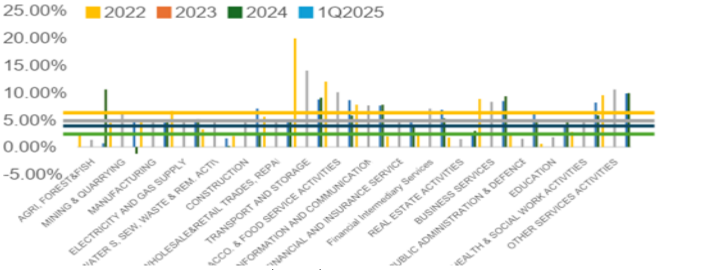
Equally important is the valuation of Indonesia's equity market. **When measured by the forward price-to-earnings (P/E) ratio, Indonesian stocks continue to offer more compelling entry points compared to regional and global peers**, including those with less robust economic growth trajectories. This relative undervaluation not only reflects room for upside but also suggests a degree of resilience in the face of external shocks.

Inflation, a critical determinant of real investment returns, further strengthens Indonesia's case. **The country has managed to maintain a relatively lower inflation rate compared to many of its peers, preserving the real value of returns across both bond and equity markets.** This macroeconomic stability lends confidence to foreign investors navigating the complexities of emerging markets.

Together, these factors — competitive bond yields, appealing equity valuations, and controlled inflation — reinforce the narrative that Indonesia remains a structurally attractive investment destination. In an environment where investors are increasingly discerning, such fundamentals offer a solid foundation for sustained capital inflows.

the persistent mismatch between sectoral economic growth and the capacity to absorb labor. This structural imbalance is vividly reflected in the rising share of informal employment, which reached 59.40% in the first quarter of 2025, up from 57.9% previously.

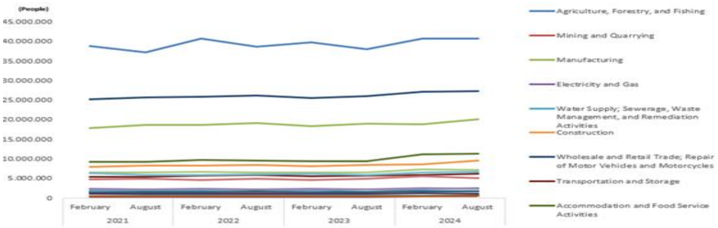
Fig 10. Economic Growth By Sector



Sources: BPS, KBVS-treated (2025)

At the same time, Indonesia's economy appears to be gradually finding a new equilibrium, influenced by a fiscal realignment that aligns with the priorities set forth during the recent election cycle. Within this evolving landscape, Bank Indonesia's pro-growth stance underscores a growing concern over weak labor market absorption and the underlying vulnerabilities within the real sector.

Fig 11. Economic Growth By Sector



Sources: BPS, KBVS-treated (2025)

Table 1. indonesia's Heatmap VS Peers

Country	S&P Rating	Yield Gov't Bond 10Y* (%)	Stocks Index Forward PE (2025E)	GDP Growth (% YoY)	Policy Rate (%)	Inflation Rate (%, YoY)	Debt/GDP (%)	Current Account (% to GDP)
China	A+	1.69	12.94	5.4	3.00	-0.1	88.3	2.2
India	BBB-	6.25	23.73	6.2	6.00	3.2	81.6	-0.7
Indonesia	BBB	6.81	11.88	4.87	5.50	2.0	38.8	-0.6
Malaysia	A-	3.56	13.86	4.4	3.00	1.4	69.8	1.7
Philippines	BBB+	6.26	13.15	5.4	5.50	1.4	60.7	-3.8
South Korea	AA	2.76	8.52	-0.1	2.75	2.1	46.8	5.3
Thailand	BBB+	1.89	12.66	3.1	1.75	-0.2	63.7	-0.2
Vietnam	BB+	3.20	10.95	6.93	4.50	3.1	32.9	6.1

Sources: Trading Economics, SPGR, Bloomberg, and KBVS-treated (2025)

The Risk of Limited Job Absorption

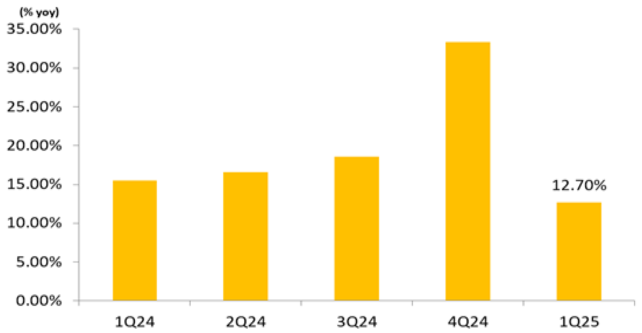
Drawing from Perry Warjiyo's insights on the transmission mechanism of monetary policy, it becomes clear that the effectiveness of such policy hinges significantly on the development of the real sector—particularly through boosting productivity and fostering robust job creation. However, a pressing challenge lies in

Given this reality, it is imperative that attention be directed beyond monetary policy alone. A comprehensive approach is needed—one that involves fiscal measures, regulatory reforms, improved ease of doing business, and stronger legal certainty. Equally important is the encouragement of entrepreneurial activity to drive employment opportunities, particularly as formal sector growth remains sluggish. By fostering a dynamic entrepreneurial ecosystem, Indonesia can create new avenues for job creation even as the formal sector faces slower momentum, thereby mitigating the risk of limited job absorption and supporting more inclusive economic development.

Investment Trends and Intermediaries Sector

The latest data on Indonesia's investment landscape reveals a notable shift in investor sentiment that carries important implications for investment trends and intermediaries alike. Foreign Direct Investment (FDI) growth experienced a marked slowdown in the first quarter of 2025, contracting to 12.70% YoY from a robust peak of 33.60% in the final quarter of 2024. This moderation likely reflects a combination of heightened global uncertainties and a cautious, wait-and-see stance among foreign investors, especially in light of the ongoing monetary easing through rate cuts in early 2025. Such signals urge Bank Indonesia to exercise prudence when calibrating policies that influence foreign capital flows, as abrupt shifts could further deter foreign participation amid global volatility.

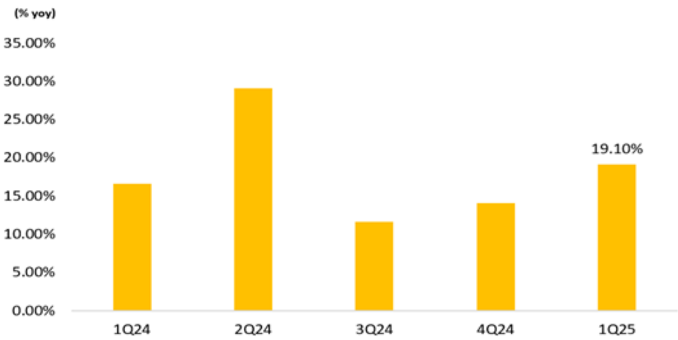
Fig 12. Development of Foreign Direct Investment (FDI) in Indonesia



Source: BKPM (2025)

In contrast, Domestic Direct Investment (DDI) painted a more optimistic picture, rebounding strongly to 19.10% growth in 1Q25 from 13.90% in the previous quarter. This uptick indicates renewed confidence among local investors, arguably bolstered by the easing of funding costs from financial institutions. Lower interest rates tend to stimulate borrowing and investment domestically, creating a more conducive environment for business expansion and capital expenditure. However, the impact of rate cuts is expected to unfold gradually, as the transmission mechanism from benchmark rate reductions to lower lending rates is often slower than the adjustment in deposit rates. This delayed transmission means that while investment activity benefits from policy easing, the full effects may take time to materialize across the broader economy.

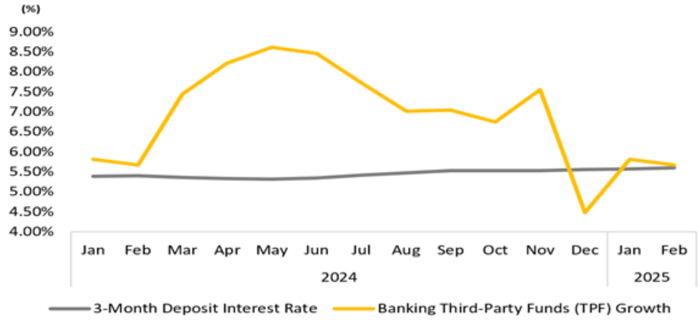
Fig 13. Development of Domestic Direct Investment (DDI) in Indonesia



Source: BKPM (2025)

At the same time, emerging concerns about the weakening labor market threaten to constrain household disposable income, which could dampen consumption and overall economic momentum. The limited growth in third-party funds (TPF) reflects a cautious public attitude toward saving, which has pushed the banking sector's loan-to-deposit ratio (LDR) higher, signaling tighter liquidity conditions. The recent BI Rate cuts may inadvertently discourage further deposit accumulation, as reduced interest rates diminish the appeal of bank savings, potentially exacerbating the slowdown in deposit growth.

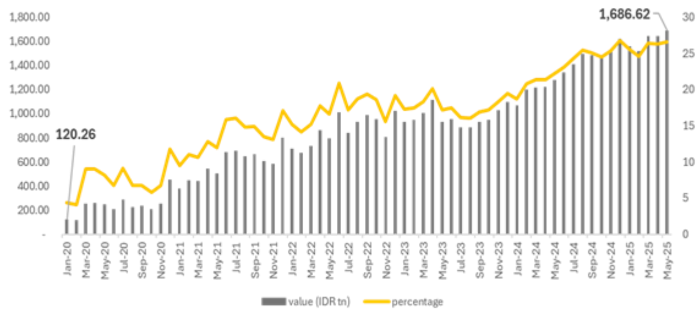
Fig 14. Three-Month Deposit Interest Rate and Banking Third-Party Funds (TPF) Growth



Source: OJK (2025)

Meanwhile, Bank Indonesia's burden-sharing policy has seen its holdings of tradable government securities (SBN) surge dramatically—from IDR120.26 trillion in 2020 to an impressive IDR1,686.62 trillion by May '25. This expansion has simultaneously enhanced liquidity in the secondary SBN market and led to the creation of new monetary instruments designed to absorb excess liquidity, balancing low risk with attractive returns.

Fig 15. BI's Ownership of Tradable SBN



Sources: DJPPR, KBVS-treated (2025)

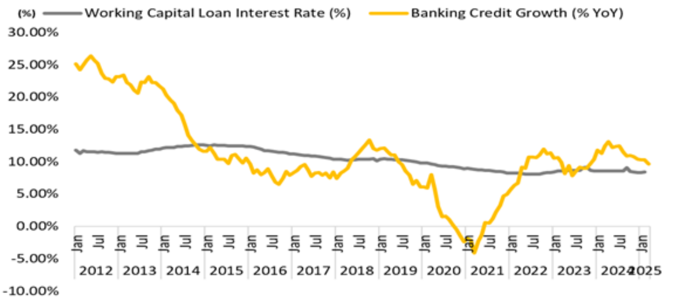
Amid evolving consumer lifestyles, a gradually recovering real sector, and a cautious, risk-averse banking behavior, the effects of the BI Rate cuts are likely to manifest first in the consumption sector—particularly in mortgage financing—and among productive sectors that are existing bank clients. Given the current relatively high LDR, which stems from limited growth in deposits compared to rising credit demand, banks are treading carefully in extending new loans. This delicate balance underscores the nuanced and gradual nature of the monetary transmission process, where stimulative policies meet structural and behavioral constraints within the financial system.

In sum, the interplay between slowing foreign investment, recovering domestic investment, cautious banking practices, and evolving economic conditions frames a complex environment. Investment trends and intermediaries must navigate this landscape with awareness of the gradual effects of monetary policy, shifting investor confidence, and the broader macroeconomic backdrop that shapes Indonesia's financial ecosystem in 2025 and beyond.

Concerns Over Rising Inflation Amid BI Rate Cut

The recent cut in the BI Rate is widely anticipated to stimulate domestic investment and boost credit demand. Yet, this effect generally unfolds with a lag of one to four quarters, especially as Indonesia continues its complex economic transformation.

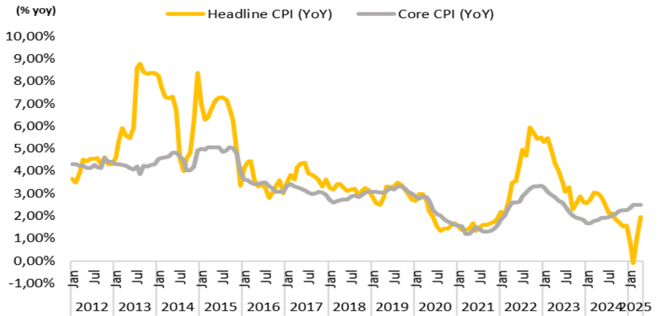
Fig 16. Domestic Working Capital Loan Interest Rate and Banking Credit Growth



Source: OJK (2025)

At the same time, persistent current account deficits pose a significant challenge, potentially limiting the inflow of foreign capital—both direct investment and portfolio flows. This constraint, coupled with a relatively shallow pool of domestic liquidity, particularly in terms of third-party funds (TPF), raises concerns for the monetary sector. There is a tangible risk that the rate cut may inadvertently fuel consumption-driven demand rather than productive investment, thereby exacerbating inflationary pressures that have already been noticeable over the past two months.

Fig 17. Core and Headline Inflation



Source: OJK (2025)

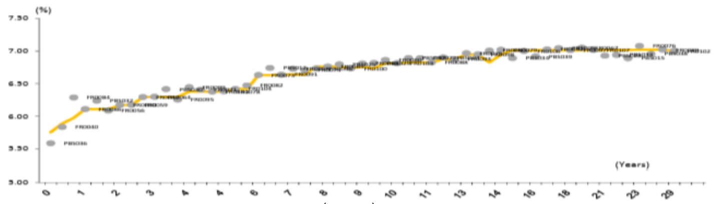
To navigate these challenges effectively, Bank Indonesia's steadfast commitment to its inflation target must remain the cornerstone of policy, supported by a coordinated effort among various authorities. In particular, the National and Regional Inflation Control Teams play a crucial role in maintaining a balanced approach to ensuring steady supply and price stability across essential goods. Complementing these efforts, there is hope for additional subsidies targeted at lower-income groups, or alternative measures such as electricity tariff discounts, similar to those implemented earlier this year in January and February. Such interventions are critical to mitigating inflation within administered price categories, ultimately helping to ease the burden on vulnerable households and stabilize the broader economy.

Financial Market Implications

The evolving macroeconomic landscape—shaped by growing expectations of further Bank Indonesia (BI) rate cuts—has begun to ripple across various sectors, with the financial markets showing early signs of reaction. These expectations have sparked several nuanced shifts in investor behavior and asset performance, particularly visible in both the bond and equity markets.

One of the most immediate consequences of a declining interest rate environment is the potential increase in prices of government bonds (SBN), particularly those offering higher coupons and shorter maturities. These instruments quickly gain appeal among investors seeking to secure attractive yields before further monetary easing takes place. In such a scenario, it is not surprising to see yields on SBNs begin to decline, with short-term bonds likely experiencing a more pronounced adjustment. This dynamic stems from a well-documented market pattern in which lower benchmark rates compress yields more aggressively on the short end of the curve than on the longer end.

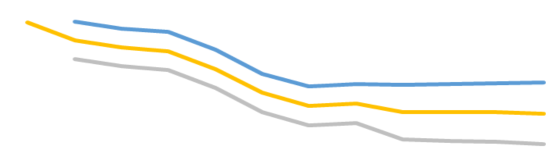
Fig 18. Yield Curve SUN, as of 27 May '25



Sources: Bloomberg, KBVS-treated (2025)

As investors reposition their portfolios, the yield curve may start to steepen at the short end, reflecting sharper declines in yields for shorter tenors. This steeper curve suggests heightened investor appetite for locking in returns early, anticipating further cuts. Simultaneously, this environment may also support a gradual normalization at the longer end of the curve, as confidence in long-term macroeconomic stability returns. A healthier long-term yield curve, supported by improved sentiment and reduced volatility, could reinforce the structural appeal of longer-dated government securities in the months ahead.

Fig 9. Yield SUN's 10-Year Tenor Outlook Scenario by KBVS



	Q1	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*	Q1*	Q2*	Q3*	Q4*
	2025*				2026*				2027*			
Base	6.98	6.71	6.61	6.55	6.28	5.91	5.71	5.75	5.62	5.62	5.61	5.60
Risk (-)		6.42	6.32	6.26	5.98	5.62	5.42	5.45	5.20	5.18	5.16	5.13
Risk (+)		7.00	6.89	6.84	6.57	6.20	6.01	6.04	6.04	6.05	6.06	6.06

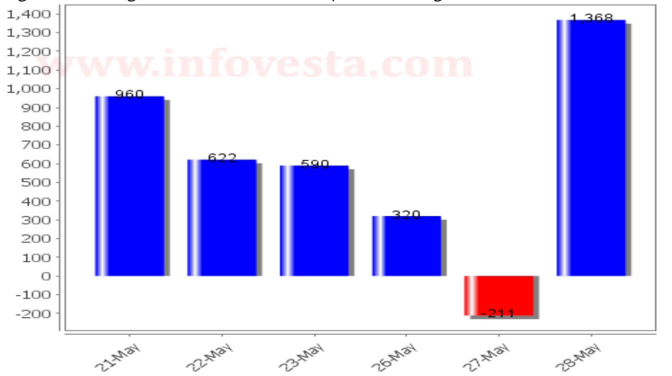
Source: KBVS (2025)

At the same time, the equity market is witnessing a noticeable shift in sentiment, with a rising inclination toward risk-taking behavior. This change is not occurring in isolation but is largely fueled by the broader macroeconomic backdrop, particularly the trend of lower interest rates. As yields on safer instruments like money market funds become less attractive, investors are naturally drawn toward higher-yielding alternatives. This rotation of capital often finds its way into equities and other assets more directly tied to the real economy.

In this landscape, certain sectors are emerging as prime beneficiaries—most notably, the consumer sector. The rationale is intuitive: with lower borrowing costs, disposable incomes are expected to rise, and this fuels optimism surrounding consumer spending. As confidence improves, so too does the outlook for companies that rely on domestic demand, reinforcing the sector's appeal.

The banking sector, too, stands to gain, albeit through a different mechanism. Historically, a rate cut often leads to a widening of net interest margins within a lag period of one to three months. This dynamic occurs as banks gradually adjust their lending and deposit rates, enhancing profitability. For equity investors—both domestic and foreign. This represents a strategic opportunity to capitalize on the early stages of monetary easing, particularly as banking stocks begin to reprice in anticipation of improved earnings. The convergence of these factors is shaping a more favorable environment for equities, reinforcing the case for a proactive portfolio realignment in the current cycle.

Fig 19. Foreign Transaction Recap Following the BI Rate Cut in JCI



Source: infovesta (2025)

However, not all implications are straightforwardly positive. The increased optimism is also giving rise to herding behavior, with fear-of-missing-out (FOMO) sentiment gradually taking hold. While this can fuel short-term rallies, it may also inflate asset prices beyond fundamentals, raising concerns about market sustainability. At the same time, despite the positive outlook, capital inflows may not materialize as robustly as expected. Global uncertainties and the perception of Indonesia's monetary policy stance could hold foreign investors back, particularly if BI's policy direction appears inconsistent or overly reactive—potentially undermining its credibility.

Another consequence of the anticipated rate cuts is the declining attractiveness of money market instruments. With BI's monetary tools expected to offer lower returns going forward, investors are likely to divert funds elsewhere in search of more rewarding opportunities. This shift may coincide with rising public demand for instruments that promise higher yields, further draining liquidity from the short end of the market.

Ultimately, the impact of BI's evolving policy stance on financial markets is multifaceted. It offers both opportunities and challenges—rewarding those who adapt strategically, but potentially penalizing those who move without caution. As expectations of lower interest rates continue to shape investment decisions, market participants must remain vigilant, navigating not only the favorable winds of lower yields but also the undercurrents of volatility and credibility risks.

Disclaimer

The research presented in this report is based on the information obtained by KBVS from sources believed to be reliable, however KBVS do not make representations as to their accuracy, completeness or correctness. KBVS accepts no liability for any direct, indirect and/or consequential loss (including any claims for loss of profit) arising from the use of the material presented in this report and further communication given or relied in relation to this document. The material in this report is not to be construed as an offer or a solicitation of an offer to buy or sell any securities or financial products. This report is not to be relied upon in substitution for the exercise of independent judgement. Past performance and no representation or warranty, express or implied, is made regarding future performance. Information, valuations, opinions, forecasts and estimates contained in this report reflects a judgement at its original date of publication by KBVS and are subject to change without notice, its accuracy is not guaranteed or it may be incomplete.

The Research Analyst(s) primarily responsible for the content of this research report, in part or as a whole, certifies that the views about the companies and their securities expressed in this report accurately reflect his/her personal views. The Analyst also certifies that no part of his/her compensation was, is or will related to specific recommendation views expressed in this report. It also certifies that the views and recommendations expressed in this report do not and will not take into account client circumstances, objectives, needs and no intentions involved as a use for recommendations for sale or buy any securities or financial instruments.

KB Valbury Sekuritas
Head Office

Sahid Sudirman Center 41st Floor Unit A-C
Jalan Jenderal Sudirman No. 86 Kelurahan Karet Tengsin,
Kecamatan Tanah Abang, Jakarta Pusat 10220, Indonesia
T. (021) 25098300
F. (021) 25098400

Branch Office

Jakarta – Sudirman
Sahid Sudirman Center 41st Floor Unit A-C
Jalan Jenderal Sudirman No. 86 Karet Tengsin,
Tanah Abang, Jakarta Pusat 10220
T. (021) 25098300/301

Jakarta – Kelapa Gading
Rukan Plaza Pasifik
Jl. Boulevard Barat Raya Blok A1 No. 10
Jakarta Utara 14240
T. (021) 29451577

Jakarta – Puri Indah
Rukan Grand Aries Niaga Blok E1 No. IV
Jl. Taman Aries, Kembangan
Jakarta Barat 11620
T. (021) 22542390

Jakarta – Pluit
Jl. Pluit Putra Raya No. 2
Jakarta Utara 14450
T. (021) 6692119

Bandung
Jl. Abdul Rivai No. 1A, Kel. Pasirkaliki,
Kec. Cicendo Bandung 40171
T. (022) 3003133

Malang
Jl. Pahlawan Trip No. 7
Malang 65112
T. (0341) 585888

Banjarmasin
Jl. Gatot Subroto No. 33
Banjarmasin 70235
T. (0511) 3265918

Pekanbaru
Jl. Tuanku Tambusai, Komplek CNN
Blok A No. 3 Pekanbaru 28291
T. (0761) 839393

Palembang
Komplek PTC Mall Blok I No. 7
Jl. R. Sukamto
Palembang 30114
T. (0711) 2005050

Surabaya
Pakuwon Center Lt 21
Jl. Embong Malang No.1
Surabaya 60261
T. (031) 21008080

Padang
Jl. Proklamasi No. 60A
Padang Timur 25121
T. (0751) 8688080

Yogyakarta
Jl. Magelang KM 5,5 No. 75
Yogyakarta 55000
T. (0274) 8099090

Semarang
Jl. Gajahmada 23A,
Kecamatan Semarang Tengah,
Kelurahan Kembang Sari 50241
T. (024) 40098080

Makassar
Komplek Ruko Citraland City Losari
Business Park, Blok B2 No. 09
Jl. Citraland Boulevard Makassar 90111
T. (0411) 6000818

Medan
Komplek Golden Trade Center
Jl. Jenderal Gatot Subroto No. 18-19
Medan 20112
T. (061) 50339090

Denpasar
Jl. Teuku Umar No. 177
Komplek Ibis Styles Hotel
Denpasar Bali 80114
T. (0361) 225229

Pontianak
Jl. Prof. M Yamin No. 14
Kotabaru, Pontianak Selatan
Kalimantan Barat 78116
T. (0561) 8069000

Investment Gallery

Jakarta
Citra Garden 6 Ruko Sixth Avenue
Blok J.1 A/18, Cengkareng
Jakarta Barat 11820
T. (021) 52392181

Tangerang
Ruko Aniva Junction Blok D No. 32
Gading Serpong, Tangerang,
Banten 15334
T. (021) 35293147

Semarang
Jl. Jati Raya No. D6,
Srondol Wetan, Banyumanik,
Semarang 50263
T. (024) 8415195

Salatiga
Jl. Diponegoro No. 68
Salatiga 50711
T. (0298) 313007

Solo
Jl. Ronggowarsito No. 34
Surakarta 57118
T. (0271) 3199090

Jambi
Jl. Orang Kayo Hitam No. 48 B
Jambi Timur 36123
T. (0741) 3068533

KB Valbury Sekuritas