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Bank Indonesia Maintains a Stability-First Policy Stance

Bank Indonesia (BI) once again demonstrated a stability-over-growth policy orientation at its latest Board of Governors' Meeting by keeping the BI Rate unchanged at 4.75%. The central bank also maintained the Deposit Facility rate at 3.75% and the Lending Facility rate at 5.50%. As a result, the interest rate differential between the Federal Funds Rate and the BI Rate remains preserved at around 100 basis points (bps). This spread is expected to help sustain the attractiveness of Indonesian portfolio assets, particularly domestic fixed-income instruments.

We view this cautious stance as primarily driven by persistent depreciation pressures on the rupiah. In December, the rupiah weakened by 0.21% month-to-date (as of 16 December 2025). Notably, even after the Federal Reserve cut its policy rate by 25 bps on 10 December—an action that pushed the DXY down by 1.08%—the rupiah still depreciated by approximately 0.1% against the US dollar. This divergence highlights the ongoing vulnerability of domestic fundamentals and investor confidence.

Supporting this view, foreign inflows into government bonds (SBN) remained limited, with net foreign purchases totaling only IDR1.23 trillion over the same period. Meanwhile, the equity market recorded a net foreign sell of IDR-0.02 trillion over the past week. These developments occurred despite Indonesia's trade surplus, which narrowed to USD2.39 billion in October 2025, the lowest level since April 2025. Although Indonesia posted a USD 4 billion financial account surplus in 3Q25, inflows were largely short-term and portfolio-driven, leaving the economy exposed to shifts in global risk sentiment.

Fiscal considerations also play a critical role in BI's policy calculus. The fiscal deficit had reached -2.02% of GDP by the end of October 2025, raising concerns that it could exceed 2.7% by year-end. Against this backdrop, BI has been compelled to keep bond yields competitive while actively supporting the government bond market. Year-to-date (as of 16 December 2025), BI has purchased IDR 327.45 trillion of SBN, including secondary market purchases and debt-switching operations with the government amounting to IDR 241.99 trillion. This underscores the need for monetary policy to remain aligned with fiscal stability in safeguarding overall macroeconomic resilience.

Inflation Risks Limit Policy Flexibility

Inflation dynamics remain another key constraint on BI's monetary flexibility. Headline inflation stood at 2.72% year-on-year in November 2025, comfortably within BI's target range of 2.5% ±1%. However, rupiah depreciation continues to pose upside risks to core inflation through exchange rate pass-through effects.

Additionally, rising supply-side pressures are becoming increasingly visible. Floods and crop failures across several regions have heightened concerns over supply shock inflation, particularly as inflation in the food, beverages, and tobacco category reached 4.25% YoY in November 2025. With the rainy season intensifying and Tropical Cyclone Senyar expected by BMKG to persist through February 2026, risks related to harvest disruptions, flooding, and logistical bottlenecks remain elevated. These factors could further complicate BI's efforts to contain inflationary pressures.

Weak Transmission of Past Rate Cuts

A third consideration is the still-muted transmission of previous monetary easing to the banking sector. Despite cumulative policy rate cuts of 125 bps year-to-date (as of December 2025), the one-month deposit rate has declined by only around 67 bps, while lending rates have adjusted by a mere 24 bps. This suggests that monetary easing has yet to fully translate into more accommodative financial conditions for the real economy.

To address this, BI continues to deploy targeted incentives under the Macroprudential Liquidity Incentive (KLM) framework. The interest rate channel incentive has been increased from 0.5% to 1.0% of third-party funds (DPK), while the lending channel incentive has been set at 4.5% of DPK, aimed at encouraging banks to accelerate credit distribution.

Outlook: Policy Space Remains, but Risks Are Rising

Nevertheless, BI continues to signal that there remains room for a potential policy rate cut going forward, supported by anchored inflation expectations for 2026 within the 2.5% ±1% target range and the need to sustain economic growth momentum.

That said, we anticipate potential anomalies in global capital flows in the near term. In particular, the expected Bank of Japan rate hike on 19 December has already pushed Japan's 10-year government bond yield to its highest level in 16 years. This development could divert global capital flows away from emerging markets, limiting the positive spillover from the Fed's rate cuts to Indonesia and keeping the rupiah under pressure.

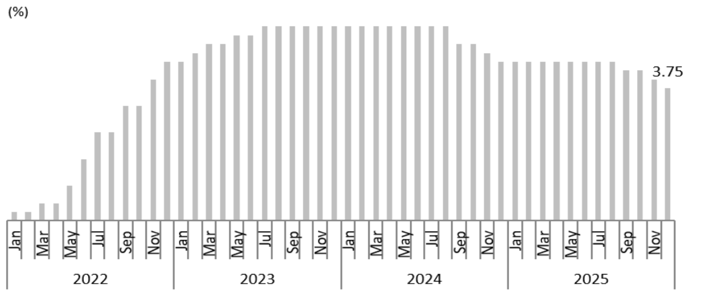
Combined with rising inflation risks, heightened short-term banking sector vulnerabilities, and a potentially prolonged domestic economic recovery due to natural disasters and precautionary fiscal behavior, **these factors reinforce BI's preference for a cautious and stability-oriented policy approach in the near term**.

Table 1. Interest Rate Data

Indicators	17-Dec-25 Latest	17-Dec-25 M-1	Monthly Changes (in bps)	Ytd Changes (in bps)
Policy Rate (in %)				
United States	3.75	4.00	(25.0)	(175.0)
European Union	2.15	2.15	0.0	(235.0)
United Kingdom	4.00	4.00	0.0	(125.0)
Japan	0.50	0.50	0.0	60.0
China	3.00	3.00	0.0	(45.0)
India	5.25	5.50	(25.0)	(125.0)
Thailand	1.50	1.50	0.0	(100.0)
Philippines	4.50	4.75	(25.0)	(200.0)
Indonesia	4.75	4.75	0.0	(125.0)
Global Monetary Policy Change (in number of countries)				
Easing	0	6		
Unchanged	20	18		
Tightening	20	0		
Average International Interest Rate (in %)				
USD LIBOR -1 Month	4.21	4.00	21.0	(12.0)
USD LIBOR -3 Months	4.49	3.86	63.0	19.0
USD LIBOR -6 Months	4.74	3.69	105.0	50.0
Domestic Interbank Money Market (in %)				
INDONIA	4.03	4.01	2.3	(199.7)
JIBOR - 1 Month	5.05	5.14	(8.2)	(156.6)
JIBOR - 3 Months	5.47	5.53	(6.1)	(145.0)
JIBOR - 6 Months	5.60	5.66	(6.2)	(146.1)
JIBOR - 12 Months	5.72	5.78	(6.1)	(150.2)

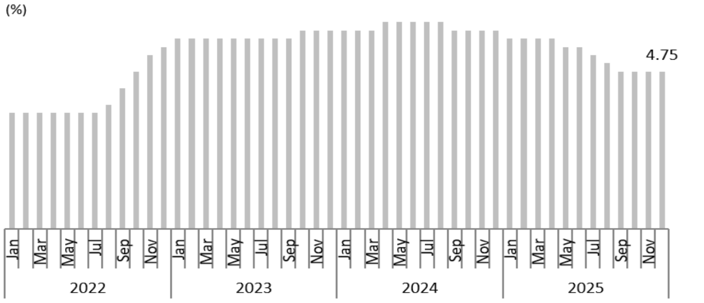
Sources: Each Central Bank and GlobalRates – treated (2025)

Fig 1. Fed Rate



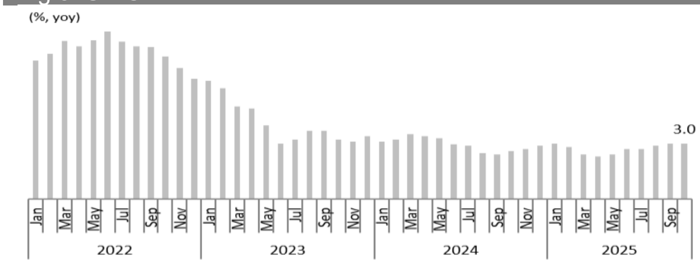
Source: The Fed – treated (2025)

Fig 2. BI Rate



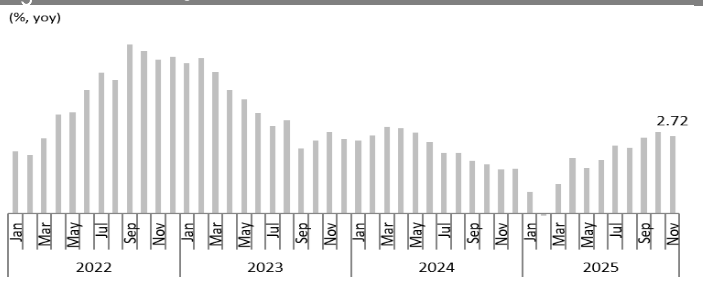
Source: Bank Indonesia – treated (2025)

Fig 3. US CPI Inflation



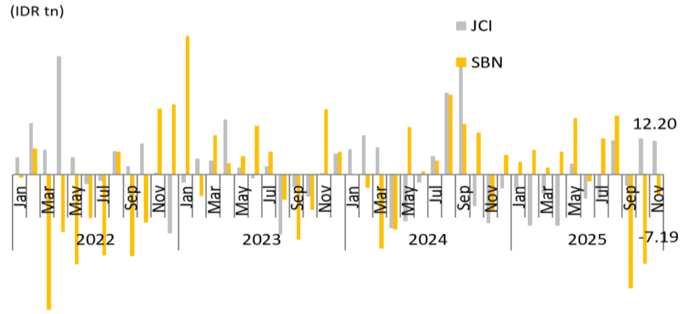
Source: US BLS– treated (2025)

Fig 4. Indonesia CPI Inflation



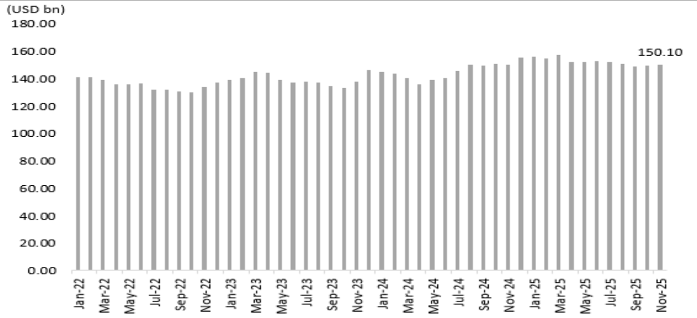
Source: BPS – treated (2025)

Fig 5. Indonesia Portofolio Flow



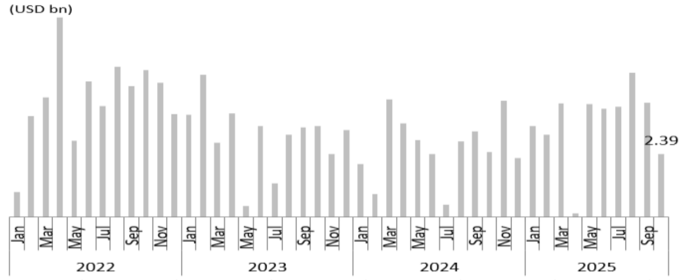
Source: Bloomberg – treated (2025)

Fig 6. Indonesia FX Reserves



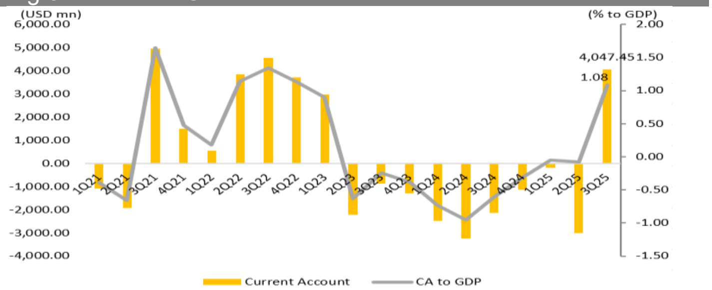
Source: BI – treated (2025)

Fig 7. Indonesia Trade Balance



Source: BI – treated (2025)

Fig 8. Indonesia Current Account



Source: BI – treated (2025)

Table 2. Fed Rate Probabilities, as of 17 Dec '25

MEETING DATE	200-225	200-225	225-250	250-275	275-300	300-325	325-350	350-375
28-Jan-26	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	25.5%	74.5%
18-Mar-26	0.0%	0.0%	0.0%	0.0%	0.0%	9.0%	42.8%	48.3%
29-Apr-26	0.0%	0.0%	0.0%	0.0%	2.0%	16.7%	44.0%	37.3%
17-Jun-26	0.0%	0.0%	0.0%	1.1%	9.7%	30.9%	40.5%	17.9%
29-Jul-26	0.0%	0.0%	0.3%	3.6%	16.0%	33.8%	33.7%	12.5%
16-Sep-26	0.0%	0.1%	1.5%	7.9%	22.1%	33.8%	26.4%	8.2%
28-Oct-26	0.0%	0.3%	2.5%	10.1%	23.9%	32.6%	23.6%	6.9%
9-Dec-26	0.1%	0.7%	3.8%	12.5%	25.4%	31.1%	20.7%	5.7%

Source: CME Group – treated (2025)

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