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Barbell Positioning: Balancing Resilience and Growth

Executive Summary

The signing of the US-Iran Memorandum of Understanding (MoU) on 17 Jun '26 marked an important turning point in the global macroeconomic environment, as it is expected to reduce geopolitical risk premiums and accelerate the normalization of global energy markets. Following the reopening of the Strait of Hormuz, Brent crude oil prices declined to around USD71/bbl, easing concerns over energy supply disruptions and imported inflation. The correction in energy prices has reinforced the global disinflation narrative, fostering a more supportive backdrop for financial markets even as major central banks maintain a cautious and data-dependent policy stance.

For Indonesia, improving external conditions have reduced imported inflation risks, eased pressure on the Rupiah, and increased Bank Indonesia's (BI) policy flexibility following an extended tightening cycle. These developments have supported the stabilization of government bond yields and the normalization of sovereign risk premiums, creating a more constructive environment for domestic financial assets. However, while the geopolitical shock has largely been priced out, the recovery in Indonesian equities is expected to remain gradual, as stronger foreign portfolio inflows will increasingly depend on domestic policy credibility alongside continued improvements in global macroeconomic conditions.

Against this backdrop, **we maintain a cautiously constructive outlook for Jul–Aug 2026 and continue to recommend a barbell positioning that balances resilience and growth**. In fixed income, we favor short-duration government bonds (1–3Y) for defensive carry and liquidity while selectively accumulating long-duration government bonds (15Y+) to capture attractive yields and potential capital gains as rates gradually normalize. Within corporate bonds, we prefer high-quality longer-tenor credits alongside selectively chosen medium-rated short-tenor issuances to optimize risk-adjusted returns. In equities, we maintain an overweight stance on defensive sectors—including banking, telecommunications, towers, poultry, and retail—while selectively adding exposure to structural growth beneficiaries such as metal mining and plantation companies, positioning portfolios to navigate near-term uncertainty while participating in the next phase of economic recovery.

1. Global Macro Landscape

1.1 Geopolitical De-escalation

The signing of the Islamabad Memorandum of Understanding (MoU) on 17 Jun '26 marked a significant de-escalation in the US-Israel-Iran conflict, reducing geopolitical risks that had disrupted global energy markets and heightened financial market volatility throughout 2Q26. Although the agreement does not represent a permanent peace settlement, it establishes a 60-day negotiation framework aimed at preventing further military escalation while restoring regional stability. The conflict, which escalated in Mar '26, had temporarily disrupted global energy markets following the closure of the Strait of Hormuz, a key shipping route that carries around one-fifth of global seaborne crude oil trade.

The MoU introduced several measures aimed at reducing geopolitical risks and restoring confidence in regional energy logistics. Among its provisions, the reopening of the Strait of Hormuz represents the most economically significant outcome, as it restores the primary corridor for crude oil exports from the Middle East and substantially lowers the probability of further supply

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disruptions during the negotiation period. The agreement also includes the cessation of military operations, the gradual easing of selected sanctions on Iran's energy sector, and the restoration of commercial access to Iranian ports, supporting a gradual normalization of regional trade.

Financial markets responded favorably as commercial shipping gradually resumed through the Strait of Hormuz. **With anxieties over disruptions to global crude oil and liquefied natural gas (LNG) supplies significantly eased, investors rapidly unwound the geopolitical risk premiums that had accumulated during the conflict.** The improvement in energy supply expectations also encouraged investors to rotate back into risk assets while reducing demand for traditional safe-haven instruments such as US Treasuries and gold. Although negotiations remain ongoing and geopolitical risks have not disappeared entirely, markets increasingly view the probability of a renewed large-scale supply disruption as materially lower than during the peak of the conflict.

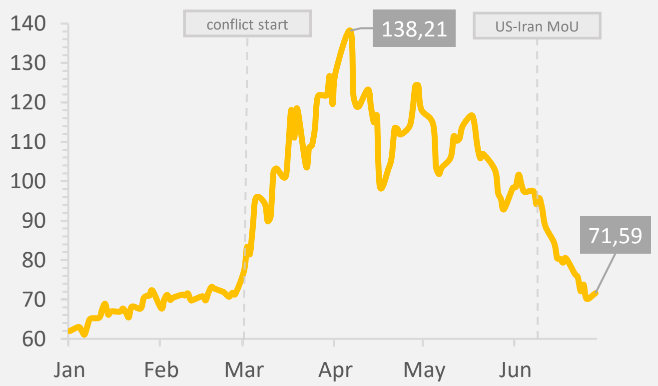
Hence, **the reopening of the Strait of Hormuz is more important than the ceasefire itself from a market perspective,** as energy logistics represent the primary transmission channel through which geopolitical events affect global financial markets. The gradual normalization of regional energy transportation has therefore accelerated the unwinding of geopolitical risk premiums across commodity markets, with energy prices becoming the first transmission channel through which improving geopolitical conditions affect the broader macroeconomic environment.

1.2 Energy Market Outlook

Global crude oil prices corrected sharply following the reopening of the Strait of Hormuz, as improving supply expectations prompted a broad repricing across global energy markets. Unlike the sharp price increase observed during the conflict, which was largely driven by fears of supply disruptions, the subsequent correction primarily reflects in improving market confidence that regional energy transportation and export activities will gradually normalize over the coming months.

Brent crude oil prices, which surged from around USD60/bbl in early '26 to a peak of approximately USD138/bbl in Apr '26, **declined around USD71/bbl by end-Jun '26**. Similarly, WTI crude oil prices retraced from its peak of around USD114/bbl in Apr '26 to around USD71/bbl over the same period. The sharp correction reflects market reassessment of supply risks following the implementation of the MoU and gradual recovery in tanker traffic through the Strait of Hormuz. As a result, a significant portion of the geopolitical risk premium accumulated during the conflict has been priced out of global energy markets.

Fig 1. Brent Spot Crude Oil Price (USD/bbl)



Source: Investing, KBVS Research (2026)

Fig 2. WTI Spot Crude Oil Price (USD/bbl)

Source: Investing, KBVS Research (2026)

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The improving supply outlook is also reflected in the latest projections from major international institutions. Morgan Stanley recently revised its Brent crude oil forecast to USD75/bbl for both 3Q26 and 4Q26, while Goldman Sachs expects Brent prices to moderate to around USD80/bbl by end-'26 and USD75/bbl in '27. Similarly, the US Energy Information Administration (EIA) projects global liquid fuel supply to outpace demand over the medium term.

Crucially, the recent correction in crude oil prices appears to reflect the unwinding of geopolitical risk premiums rather than weakening global demand, making the current adjustment fundamentally different from previous oil price declines associated with economic slowdowns. Consequently, **lower oil prices should be interpreted as a normalization of supply conditions rather than a deterioration in global economic activity**. This distinction is particularly important, as it implies a more constructive macroeconomic environment in which moderating energy costs can coexist with relatively resilient global growth.

For the broader global economy, **lower energy prices provide an important source of disinflation by reducing production, transportation, and logistics costs across a broad range of industries.** Net energy-importing economies are expected to benefit from lower import bills and improving purchasing power, while energy-exporting countries may experience some moderation in export revenues. For Indonesia, the decline in crude oil prices is broadly supportive given its status as a net oil importer. In our view, lower international oil prices should help reduce imported inflation risks, ease fiscal pressure associated with energy subsidies, and improve the outlook for domestic monetary policy, thereby creating a more favorable environment for government bonds and other Rupiah-denominated financial assets. Beyond its direct impact on energy markets, the correction in crude oil prices also reinforces the global disinflation narrative, setting the stage for changes in inflation and monetary policy expectations over the coming quarters.

1.3 Global Inflation & Monetary Policy

The normalization of global energy prices has strengthened the global disinflation narrative, mitigating the severe supply-side headwinds that constrained monetary policy throughout 1H26. **As oil and LNG prices retreated from their conflict-driven peaks, transportation, manufacturing, and logistics costs also moderated, easing cost-push pressures across both advanced and emerging economies.** While the pace of disinflation remains uneven across countries, improving energy market conditions have provided a more supportive backdrop for inflation over the coming quarters.

Recent inflation data suggest that **the disinflation process remains uneven across major economies**. Inflation has moderated more noticeably in the Eurozone and China, where softer domestic demand and lower energy costs have helped contain price pressures. By contrast, inflation in the United States, India, and Indonesia remains relatively elevated due to the lagged pass-through of higher energy costs earlier this year. Nevertheless, the recent decline in oil prices is expected to gradually reduce imported inflation across these economies over the coming quarters.

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Table 1. Recent Inflation Trends Across Major Economies

Economy	Headline CPI (YoY)	Previous (YoY)	Trend
United States	4.20%	3.30%	↑ Accelerating
European Union	2.80%	3.00%	↓ Easing
United Kingdom	2.80%	2.80%	Stable
Japan	1.50%	1.50%	Stable
China	1.20%	1.30%	↓ Easing
India	3.93%	3.40%	↑ Accelerating
Indonesia	3.34%	3.08%	↑ Accelerating

Source: KBVS Research (2026)

The improving inflation outlook is broadly consistent with recent assessments from major international institutions. In its Apr '26 World Economic Outlook, the IMF projected global headline inflation at 4.4% YoY, a baseline built on the assumption of persistently elevated energy costs. However, the subsequent decline in crude oil prices following the US-Iran MoU suggests that inflation risks have shifted modestly to the downside relative to the IMF's baseline assumptions, provided geopolitical stability is maintained. Similarly, the OECD expects easing energy market conditions to support further global disinflation, estimating that an additional -10% decline in oil, natural gas, and fertilizer prices during 2H26 could lower global inflation by around 0.3 percentage points in 2027.

While lower energy prices have improved the medium-term inflation outlook, financial markets remain cautious regarding the pace of monetary policy normalization, particularly in the US where inflation remains above target. Consequently, major central banks are expected to remain data dependent, balancing improving inflation dynamics against the risk that underlying price pressures could prove more persistent than anticipated.

Table 2. Fed Probabilities (as of 8 Jul '26)

MEETING DATE	325-350	350-375	375-400	400-425	425-450	450-475	475-500
29-Jul-26	0,0%	70,6%	29,4%	0,0%	0,0%	0,0%	0,0%
16-Sep-26	0,0%	37,0%	49,0%	14,0%	0,0%	0,0%	0,0%
28-Oct-26	0,0%	28,0%	46,1%	22,5%	3,4%	0,0%	0,0%
09-Dec-26	0,0%	17,9%	39,6%	31,0%	10,3%	1,2%	0,0%
27-Jan-27	0,0%	15,0%	36,1%	32,4%	13,6%	2,7%	0,2%
17-Mar-27	0,0%	12,4%	32,4%	33,0%	16,9%	4,6%	0,6%
28-Apr-27	0,0%	11,8%	31,5%	33,0%	17,6%	5,1%	0,8%
09-Jun-27	0,8%	13,2%	31,6%	31,9%	16,8%	4,8%	0,8%

Source: CME Group, KBVS Research (2026)

As of 8 Jul '26, CME FedWatch indicates that markets continue to expect the Federal Reserve to maintain the federal funds target range at 350-375bps at the Jul FOMC meeting, with a 74.9% probability. Beyond Jul '26, however, market pricing skews relatively hawkish. By the Sep '26 meeting, futures imply a 49.0% probability of at least one 25bps rate hike, with the aggregate probability of one or more interest rate increases scaling upward toward year-end. Although lower energy prices have reduced inflation

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risks, markets continue to expect the Federal Reserve to prioritize price stability until inflation shows more convincing signs of returning toward its target.

Table 3. Global Policy Interest Rate

Policy Rate (%)	Jun '26		Monthly Changes (in bps)	Ytd Changes (in bps)
	Latest	M-1		
United States	3.75	3.75	0.0	0.0
European Union	2.40	2.15	25.0	25.0
United Kingdom	3.75	3.75	0.0	0.0
Japan	1.00	0.75	25.0	25.0
China	3.00	3.00	0.0	0.0
India	5.25	5.25	0.0	0.0
Thailand	1.00	1.00	0.0	(25.0)
Philippines	4.75	4.50	25.0	25.0
Indonesia	5.75	5.50	25.0	100.0

Source:KBVS Research (2026)

Policy responses across major economies remain differentiated, reflecting distinct domestic inflation dynamics and underlying economic conditions. The European Central Bank and the Bank of Japan continued policy normalization through 25bps rate hikes in Jun '26, while the Bank of England and the People's Bank of China left their policy rates unchanged amid stable inflation and softer domestic demand. Across Asia, Indonesia and the Philippines also maintained relatively restrictive monetary conditions to preserve inflation expectations and exchange rate stability, whereas Thailand adopted a more accommodative stance following signs of moderating inflation.

Monetary policy expectations have also shaped movements across global sovereign bond markets. Although moderating inflation expectations have supported bond prices, sovereign yields remain relatively elevated as investors continue to price a higher-for-longer policy environment, particularly in the United States.

The UST10Y yield declined from a peak of 4.55% on 8 Jun '26 to 4.37% on 26 Jun '26 following the easing of geopolitical tensions. However, the yield **subsequently rebounded to 4.49% by 3 Jul '26**, reflecting persistent expectations that the Federal Reserve will maintain a restrictive policy stance until inflation shows more convincing signs of returning toward target.

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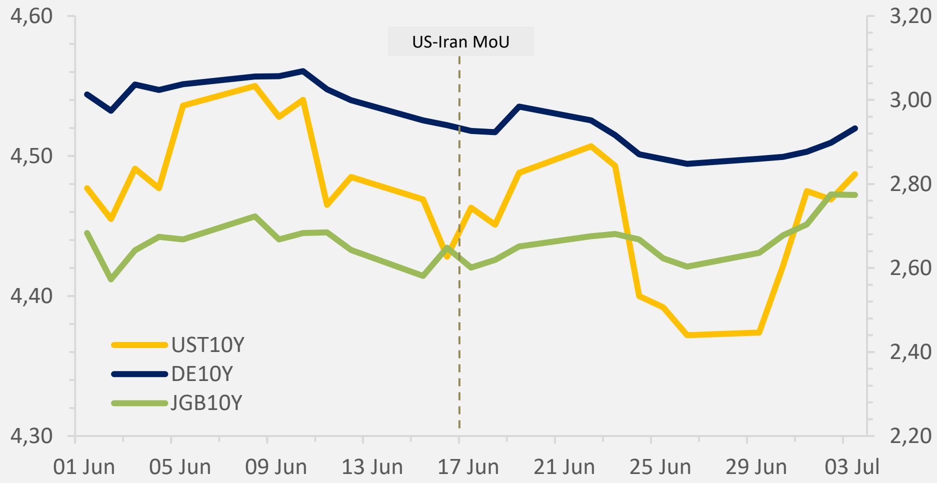
Fig 3. 10Y Global Government Bond Yield (%)



Source: Investing, KBVS Research (2026)

A similar, albeit more moderate, adjustment was observed across other major developed bond markets. The German 10Y Bund yield (DE10) declined from 3.01% in early Jun '26 to 2.93% by 3 Jul '26 after reaching a monthly low of 2.85% in late Jun. The retraction reflected improving inflation expectations following the normalization of energy prices. However, yields remained relatively elevated after the European Central Bank raised its policy rate by 25bps in Jun '26, reinforcing expectations that monetary policy would remain restrictive despite easing price pressures.

In contrast, the Japanese Government Bond (JGB) 10Y yield rose from 2.68% on 1 Jun '26 to 2.77% on 3 Jul '26, briefly touching 2.78% on 2 Jul '26. Unlike Germany, where lower inflation expectations supported bond prices, movements in Japanese government bonds were primarily driven by domestic policy normalization following the Bank of Japan's 25bps rate hike to 1.00%. Consequently, the impact of improving global energy conditions was largely outweighed by expectations of further monetary policy normalization.

Overall, improving inflation dynamics have strengthened the global macroeconomic backdrop by reducing geopolitical risk premiums and supporting a more stable environment for financial markets. Nevertheless, the persistence of relatively restrictive monetary policy, particularly in the United States, suggests that the transmission of improving external conditions into emerging markets is likely to remain gradual rather than immediate. Against this backdrop, the following chapter examines how these evolving global conditions are influencing Bank Indonesia's monetary policy stance and Indonesia's fixed income market.

2. Indonesia Fixed Income Market

2.1 Domestic Monetary Policy

While improving energy prices have strengthened the global macroeconomic backdrop, the Federal Reserve's higher-for-longer policy stance suggests that external conditions remain relatively restrictive. Against this backdrop, **Bank Indonesia has entered a more balanced phase of monetary policy following three consecutive rate hikes that brought the BI Rate to 5.75%.** Throughout 1H26, the central bank focused to maintain Rupiah stability and contain imported inflation arising from elevated global energy prices, persistent

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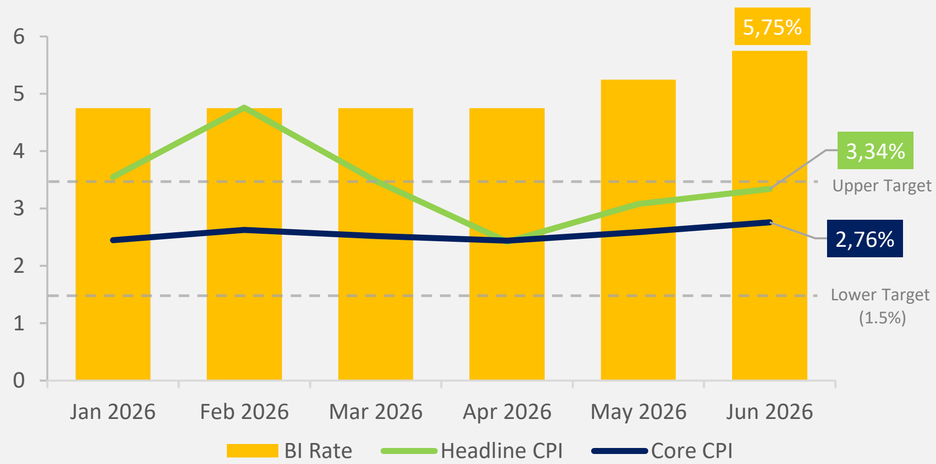
USD strength, and heightened geopolitical uncertainty. These headwinds forced BI to adopt a proactive tightening stance despite relatively moderate domestic demand.

The external environment has since turned more favorable following the de-escalation of the US-Iran conflict. The normalization of global oil prices has reduced imported inflation risks, while improving global risk sentiment and expectations that the Federal Reserve is unlikely to tighten policy significantly beyond current market pricing have eased pressure on emerging market currencies. Together, these developments provide Bank Indonesia with greater policy flexibility than during the peak of the geopolitical crisis.

Fig 4. BI Rate and Inflation (%)



Source: Bank Indonesia, KBVS Research (2026)

Domestically, inflation remains elevated but is increasingly viewed as transitory. Headline CPI accelerated to 3.34% YoY in Jun '26, approaching the upper bound of Bank Indonesia's 1.5%–3.5% target range, primarily reflecting adjustments in non-subsidized fuel prices and temporary food supply disruptions during the dry season. However, these pressures remain largely supply-driven rather than demand-driven. As lower global energy prices gradually feed into domestic transportation and production costs over the coming months, inflationary pressures are expected to moderate, allowing headline inflation to move closer toward the midpoint of BI's target range.

Expectations that the BI Rate is approaching its cyclical peak have gradually begun to influence Indonesia's short-term money market instruments, particularly Sekuritas Rupiah Bank Indonesia (SRBI). Although SRBI yields briefly increased after Bank Indonesia raised the BI Rate to 5.75% on 18 Jun '26, the adjustment proved temporary. The 6-month SRBI yield rose to 7.42% on 19 Jun '26 before gradually easing to 7.26% by 3 Jul '26. A similar pattern was observed across the 9-month and 12-month tenors, which declined from 7.55% to 7.45% and from 7.74% to 7.67%, respectively.

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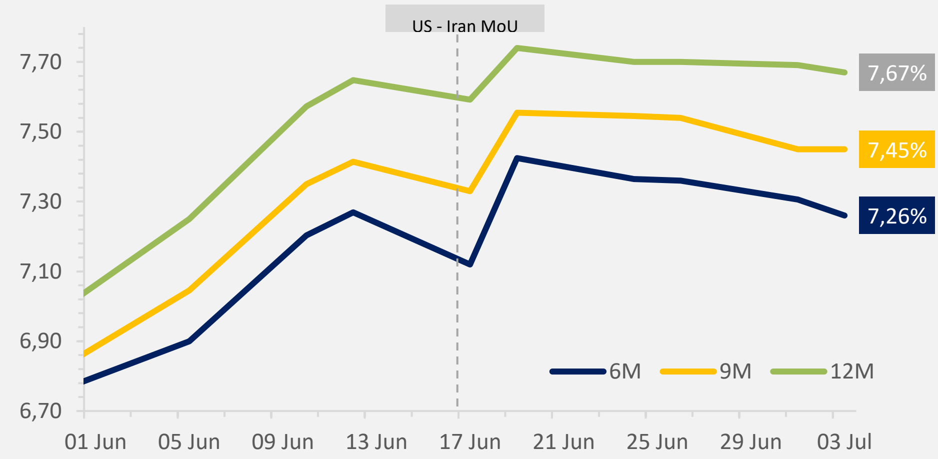
Fig 5. Daily SRBI Yield (%)



Source: Bank Indonesia, KBVS Research (2026)

The subsequent stabilization in SRBI yields reflects improving market confidence following the normalization of global energy prices and easing geopolitical uncertainty. As expectations of further domestic monetary tightening gradually diminished, investors increasingly viewed the current BI Rate as approaching its cyclical peak, reducing upward pressure on short-term money market yields while keeping them at highly attractive levels. Although Bank Indonesia is expected to maintain a prudent policy stance in the near term, improving external conditions have reinforced market expectations that the current tightening cycle is approaching its peak. This should help contain volatility across Indonesia's money market and provide a more stable foundation for the domestic fixed income market.

2.2 Fiscal Outlook

The improvement in global macroeconomic conditions has also strengthened Indonesia's fiscal outlook. Although the official RAPBN 2027 will not be formally submitted to Parliament until Aug '26, the preliminary macroeconomic assumptions agreed under the Macroeconomic Framework and Fiscal Policy Principles (KEM-PPKF) provide an early indication of the government's baseline expectations for 2027. More importantly, these assumptions offer valuable guidance on how policymakers assess the evolving domestic and external macroeconomic environment.

Table 4. Preliminary Macroeconomic Assumptions for RAPBN 2027

Indicator	Assumption
Real GDP Growth	5.8 - 6.5%
Inflation	1.5 – 3.5%
Exchange Rate	IDR16,800 – 17,500/USD
10Y Government Bond Yield	6.5 – 7.3%
Indonesian Crude Price (ICP)	USD70-95/bbl
Oil Lifting	605-620 kb/d
Gas Lifting	951-990 kb/d

Source: Ministry of Finance, DPR RI (2026)

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The agreed macroeconomic assumptions broadly reflect the government's expectation that improving global conditions will translate into a more stable domestic macroeconomic environment in 2027. The inflation assumption of 1.5%-3.5%, together with the Indonesian Crude Price (ICP) assumption of USD70-95/bbl, suggests that policymakers expect imported inflation pressures to ease as global energy markets continue to normalize following the de-escalation in the Middle East. Meanwhile, the exchange rate assumption of IDR16,800-17,500/USD and the 10-year government bond yield assumption of 6.5%-7.3% indicate that the government continues to anticipate relatively tight global financial conditions despite improving domestic fundamentals. Overall, these assumptions point toward a balanced policy framework that incorporates improving external conditions while remaining prudent against renewed global volatility.

Alongside these macroeconomic assumptions, **the government continues to emphasize prudent fiscal management while preserving sufficient room to support economic growth.** The preliminary fiscal framework targets a fiscal deficit of 1.8–2.4% of GDP, with the government debt-to-GDP ratio projected to remain broadly stable at around 40%. Revenue mobilization is expected to improve through a higher tax ratio and stronger non-tax revenues, while expenditure priorities remain focused on strengthening human capital, accelerating downstream industrialization, maintaining household purchasing power, and supporting long-term economic transformation.

Table 5. Preliminary Fiscal Framework for RAPBN 2027

Indicator	Assumption (% of GDP)
Revenue	12.01 – 12.40
Tax Revenue	10.16 – 10.50
Expenditure	13.81 – 14.80
Fiscal Deficit	1.8 – 2.4
Primary Balance	+0.45 to -0.1
Government Debt	40.31 – 40.64

Source: Ministry of Finance, DPR RI (2026)

From a fixed income perspective, the preliminary fiscal framework reinforces confidence that fiscal policy will remain supportive of macroeconomic stability. The government's commitment to maintaining a contained fiscal deficit and stable debt ratio should help preserve investor confidence, limit sovereign borrowing costs, and complement Bank Indonesia's efforts to maintain financial market stability.

2.3 Government Bond Market

The improvement in Indonesia's macroeconomic outlook, together with the government's preliminary RAPBN 2027 assumptions, provides a more constructive backdrop for the domestic government bond market. Expectations of moderating inflation, lower energy prices, and continued fiscal discipline have strengthened investor confidence by reducing pressure on both monetary policy and sovereign financing costs.

The Indonesian government bond market stabilized significantly following the US–Iran ceasefire and the subsequent easing of geopolitical tensions. During the early Jun '26, escalating conflict in the Middle East pushed yields sharply higher across the curve as investors demanded a larger risk premium amid rising oil prices, elevated inflation expectations, and persistent uncertainty

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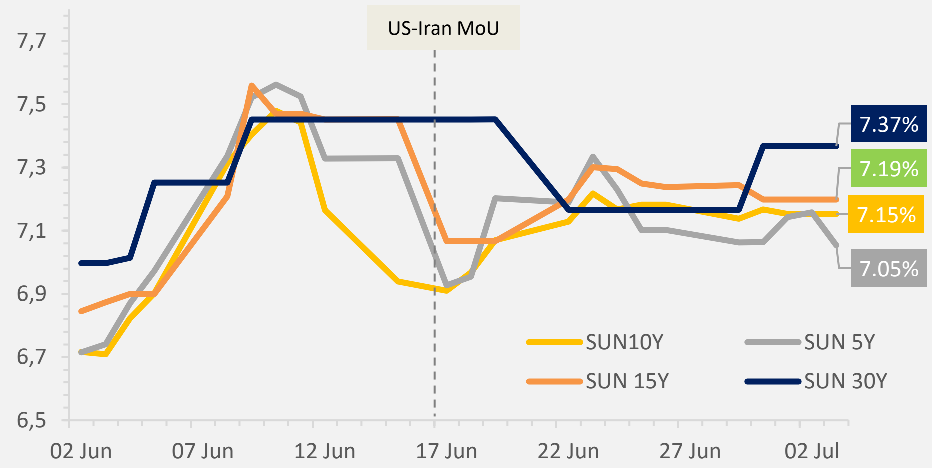
surrounding the global interest-rate outlook. The benchmark SUN10Y yield climbed from 6.72% in early Jun '26 to a monthly peak of 7.48% on 10 Jun '26, reflecting broad-based selling pressure in the domestic bond market.

Following the announcement of the peace agreement, market sentiment gradually improved as lower energy prices reduced concerns over imported inflation and eased pressure on Bank Indonesia to maintain an aggressive tightening bias. The SUN10Y yield subsequently declined to around 6.91% by mid-Jun '26 before stabilizing within a relatively narrow range of 7.13–7.18% through the remainder of the month. The limited volatility suggests that investors have largely repriced the geopolitical risk premium, while awaiting clearer signals from both Bank Indonesia and the Federal Reserve regarding the timing of future policy easing.

Fig 6. Indonesia Government Bond Yield (%)



Source: Investing, KBVS Research (2026)

The shape of the government bond yield curve also became more orderly following the de-escalation. Unlike the early phase of the conflict, when yields across almost all maturities moved higher simultaneously, the post-ceasefire period was characterized by a relatively stable medium- and long-end curve. Meanwhile, short-term yields remained elevated as markets continued to price in a prolonged period of restrictive monetary policy by Bank Indonesia. As a result, the yield curve has shifted from a period of heightened volatility toward a more normalized configuration, with the inversion at the front end primarily reflecting expectations that policy rates will remain elevated in the near term before gradually easing as inflation continues to moderate.

The normalization of the yield curve indicates that market pricing has become increasingly driven by domestic macroeconomic expectations rather than geopolitical uncertainty. This marks an important shift from the 1H26, when movements in government bond yields were largely dominated by external risk sentiment.

Yield curve spreads also point to a more normalized market structure. The 10Y-5Y spread, which briefly turned negative during the conflict, recovered into positive territory and stabilized at around 10bps by early July, suggesting that the inversion observed earlier had largely disappeared. Meanwhile, spreads between the 15Y and 10Y, as well as the 30Y and 10Y maturities, narrowed compared with the peak of the conflict, indicating lower long-term inflation and risk premiums. This suggests that investors have largely repriced the geopolitical shock and are increasingly refocusing on domestic macroeconomic fundamentals.

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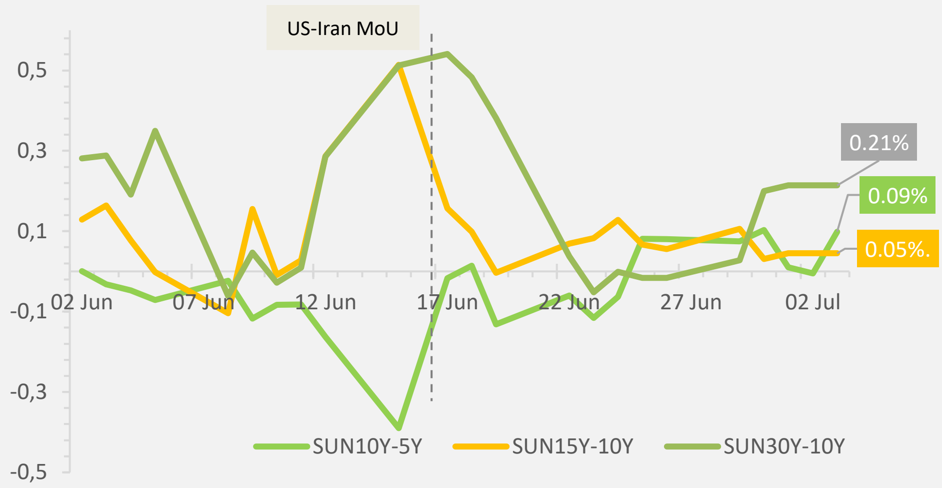
Fig 7. Yield Spread SUN10Y-5Y, SUN15Y-10Y, SUN30Y-10Y



Source: KBVS Research (2026)

Overall, the stabilization in Indonesia's government bond market suggests that the sharp repricing observed during the peak of the geopolitical crisis has largely run its course. Moving forward, further movements in government bond yields will likely depend less on external geopolitical developments and increasingly on Bank Indonesia's policy trajectory, domestic inflation dynamics, and the pace of foreign portfolio inflows. Collectively, improving external conditions, prudent fiscal management, and expectations that the BI Rate is approaching its cyclical peak support a constructive medium-term outlook for Indonesia's government bond market.

3. Indonesia Equity Market

3.1 Sovereign Risk Premium

The de-escalation of the US-Iran conflict significantly improved Indonesia's sovereign risk perception, as reflected in the gradual normalization of Credit Default Swap (CDS) spreads. During the peak of the conflict in early Jun '26, CDS spreads widened across all maturities as investors priced in higher geopolitical uncertainty, elevated oil prices, and potential spillovers to Indonesia's external sector. The widening was most pronounced in the medium- and long-term tenors, indicating that investors demanded a higher premium to compensate for rising macroeconomic, fiscal, and external risks associated with the prolonged conflict.

Following the signing of MoU, CDS spreads retraced a significant portion of their earlier gains. Indonesia's 10Y CDS declined from a peak of around 155bps in early Jun '26 to approximately 139 bps immediately after the agreement before stabilizing around 143bps in early Jul '26. Similar declines were observed across the 5Y and 7Y, suggesting that investors gradually removed part of the geopolitical risk premium accumulated during the conflict. Although CDS spreads remained slightly above their pre-conflict levels, the stabilization indicates that markets viewed the probability of a broader regional escalation as materially lower following the reopening of the Strait of Hormuz and the continuation of ceasefire negotiations.

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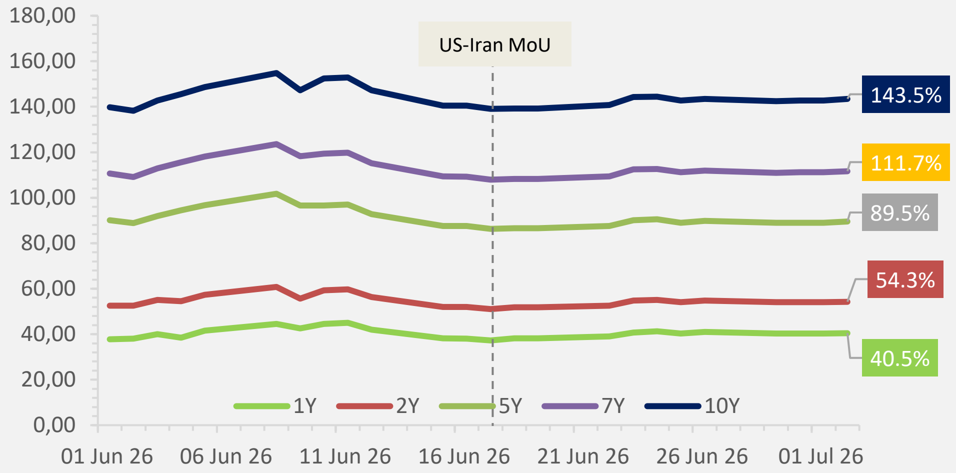
Fig 8. Indonesia' Credit Default Swap/CDS (USD)



Source: Investing, KBVS Research (2026)

Lower CDS spreads improve the attractiveness of Indonesian government bonds and other Rupiah-denominated assets. Together with easing inflationary pressures and improving global risk sentiment, the normalization in sovereign risk perception provides a more supportive backdrop for capital inflows and contributes to greater stability in domestic financial markets.

Nevertheless, CDS spreads have yet to fully return to their pre-conflict levels, suggesting that investors continue to price residual geopolitical uncertainty while monitoring the implementation of the MoU and broader regional negotiations. Accordingly, the sustainability of further CDS compression will increasingly depend on the return of foreign portfolio inflows and improvements in domestic policy credibility, discussed in the following sections.

3.2 Foreign Capital Flow

The improvement in Indonesia's sovereign risk perception provided a more supportive backdrop for foreign portfolio flows following the US-Iran MoU. Nevertheless, **the recovery in foreign investor participation remained highly sensitive to both global macroeconomic crosscurrents and domestic policy developments.**

As illustrated in Fig. 9, foreign investors recorded a net buy of approximately IDR2.51 tn on 17 Jun '26, coinciding with the signing of the MoU. The sharp reversal into net buying reflected investors' reassessment of geopolitical risks and a reduction in defensive positioning toward Indonesian equities.

That inflow, however, proved short-lived. On 18 Jun '26, net foreign flows reversed sharply into net selling, driven by a confluence of hawkish policy signals on both the global and domestic front rather than a renewed escalation in the Middle East. Globally, the Federal Reserve kept the federal funds target range unchanged at 350-375bps during its 17 Jun '26 FOMC meeting but raised its median 2026 PCE inflation projection to 3.6% and signaled a less dovish policy stance. Domestically, BI raised the BI-Rate by a further 25bps to 5.75%, its second consecutive weekly hike as it continued to front-load policy tightening against imported inflation risk. The combination

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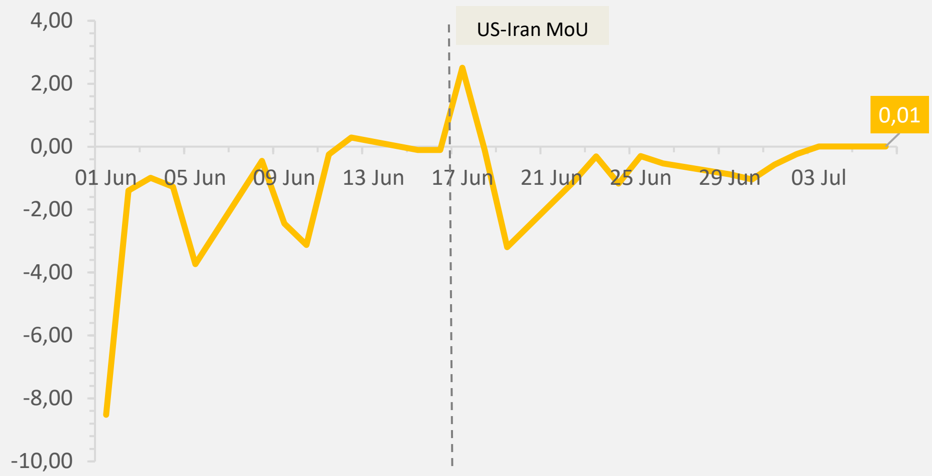
of a more hawkish Fed and a higher domestic cost of capital was sufficient to outweigh the improving geopolitical backdrop, prompting a wave of profit-taking by foreign investors just a day after the MoU-driven inflow.

Fig 9. Indonesia Daily Net Foreign Buy/Sell



Source: Bloomberg, KBVS Research (2026)

Foreign investor positioning had already become volatile before the signing of the MoU, indicating that geopolitical developments were not the only driver of capital flows. Several trading sessions in early-to-mid Jun '26 recorded sizeable net foreign selling ahead of the MSCI May '26 SAIR implementation and Bank Indonesia's successive policy rate hikes. Toward end-Jun '26, foreign trading activity was also impacted by MSCI and FTSE index rebalancing, which triggered one-off passive fund adjustments despite improving macroeconomic conditions. Therefore, not all foreign selling observed during this period should be attributed solely to geopolitical risk aversion, as technical and policy-driven factors also influenced market flows. As these temporary technical factors fade, **foreign portfolio flows are expected to increasingly reflect Indonesia's underlying macroeconomic fundamentals and domestic policy credibility.**

3.3 Domestic Policy Governance

The Indonesian government introduced a 2H26 economic stimulus package worth IDR26.34 tn to support domestic demand following the easing of geopolitical tensions and the normalization of energy prices. The package specifically prioritizes household consumption, employment support, and targeted food assistance, reflecting a strategic effort by policymakers to sustain economic momentum without compromising fiscal discipline.

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Table 6. Fiscal Stimulus Package

Pillar	Policy Focus	Budget Allocation
Stimulus & Incentives	Author tax incentive, holiday-season transport discounts, 0% import duty on LPG & plastic feedstock	±IDR2.04 tn
Internship & Vocational Training	Phase-II National Internship Program (150,000 participants) and vocational training	IDR6.26 tn
Food Assistance	10kg rice assistance for 33.24 mn beneficiary families (Jul-Sep) & soybean price stabilization	IDR18.04 tn
Total	8 policies	IDR26.34 tn

Source: KBVS Research (2026)

The stimulus package is expected to provide modest support to domestic demand during 2H26 by cushioning the impact of higher energy prices on household purchasing power. Combined with easing imported inflation, these measures should reduce downside risks to near-term growth. However, fiscal support alone is unlikely to meaningfully revive investor sentiment without stronger confidence in underlying policy execution.

Financial markets are increasingly placing greater emphasis on policy credibility rather than policy direction alone. Beyond the announcement of new policy measures, investors are focusing on the transparency, consistency, and predictability of policy implementation, which continue to influence Indonesia's sovereign risk premium and foreign portfolio flows.

A prime example of this execution risk is the repeated downsizing of the Free Nutritious Meals (MBG) program, one of the government's flagship spending initiatives. The program's initial budget allocation for 2026 of approximately IDR335 tn has been revised downward to IDR268 tn, and clawed back yet again to IDR228 tn, with authorities indicating that the final allocation could be even lower following further evaluations. These successive downward revisions stem from governance concerns surrounding the newly established National Nutrition Agency (BGN), including operational challenges, infrastructure bottlenecks, and structural reviews. While tightening the purse strings expands near-term fiscal flexibility by lowering immediate expenditure commitments, the erratic budgeting process highlights deep-seated uncertainty surrounding policy execution and medium-term fiscal planning.

More broadly, concerns regarding policy credibility extend beyond the MBG initiative. International rating agencies have increasingly tied governance quality, policy predictability, and institutional transparency directly to Indonesia's sovereign risk profile. Previous assessments by major rating agencies have consistently flagged vulnerabilities in policy communication, governance arrangements surrounding state investment vehicles, and the long-term consistency of fiscal policy implementation. These lingering issues have contributed to a persistent 'confidence discount' in Indonesian financial assets, limiting the extent to which improving global conditions translate into stronger capital inflows.

Consequently, while the external backdrop has turned decidedly more supportive following the US-Iran peace agreement, any structural re-rating of Indonesian assets will increasingly hinge on domestic policy credibility. **Tangible improvements in policy transparency, execution consistency, and institutional governance remain absolute prerequisites to fortifying investor trust and anchoring sustained foreign portfolio inflows.**

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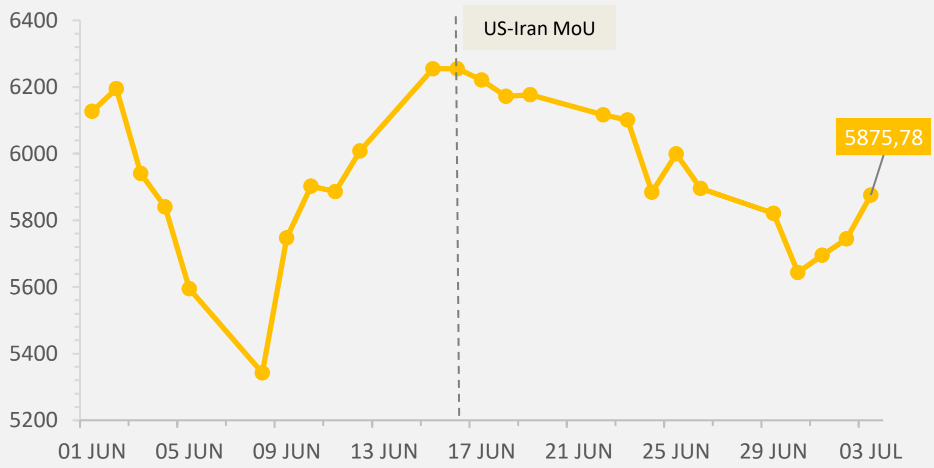
3.4 Equity Market Outlook

Despite the improvement in global macroeconomic conditions following the US-Iran peace agreement, **Indonesia's equity market has only partially recovered from the geopolitical shock, signaling a deep-seated caution among investors toward domestic risk assets.** While external risks have retreated, elevated domestic policy uncertainty and restrictive monetary conditions continue to cap a broader re-rating of Indonesian equities.

The Jakarta Composite Index (JCI) remained highly volatile throughout Jun '26. The index declined sharply from 6,127 on 1 Jun '26 to an intra-month low of 5,342 on 8 Jun '26 as escalating tensions in the Middle East triggered broad-based risk aversion, rising oil prices, and concerns over higher global inflation. The decline was accompanied by sizeable foreign selling and widening sovereign risk premiums as investors shifted toward defensive assets.

Market sentiment improved following the signing of the MoU on 17 Jun '26. The easing of geopolitical tensions and subsequent decline in oil prices reduced concerns over imported inflation, allowing the JCI to rebound to around 6,255 during the month. However, the rally proved temporary, with the index gradually retracing before stabilizing around 5,876 by early Jul '26. This suggests that investors quickly shifted their focus from geopolitical developments to domestic macroeconomic fundamentals and policy expectations.

Fig 10. JCI Performance



Source: Bloomberg, KBVS Research (2026)

Several factors continue to hamper the recovery in Indonesian equities. First, although lower oil prices have improved the external environment, the Federal Reserve's higher-for-longer monetary stance has kept US Treasury yields elevated, thereby restricting capital reallocation toward emerging markets. Second, Bank Indonesia's relatively restrictive monetary policy and still-attractive SRBI yields continue to support fixed income instruments, reducing the relative appeal of equities. Third, domestic policy credibility remains a important overhang; persistent uncertainty surrounding fiscal implementation, policy consistency, and transparency in government regulations continues to weigh on investor sentiment, preventing a full valuation recovery despite the more supportive global backdrop.

Overall, the JCI appears to be transitioning from a geopolitically driven correction toward a fundamentally driven market environment. The sharp geopolitical risk premium embedded during the conflict has largely been priced out. However, a sustained re-

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rating of Indonesian equities will increasingly depend on stronger foreign portfolio inflows, improving domestic policy credibility, and greater confidence in Indonesia's medium-term macroeconomic outlook.

4. Market Outlook and Recommendations

Our base case assumes that the US-Iran negotiation process will advance without a renewed escalation, allowing global energy markets to normalize further through Jul-Aug '26. Under this scenario, lower crude oil prices should continue to ease imported inflation pressures, while improving global risk sentiment provides a more supportive backdrop for Indonesian financial markets. Although the Federal Reserve is expected to maintain a cautious and data-dependent policy stance, the risk of additional aggressive tightening has diminished, allowing Bank Indonesia greater flexibility as domestic inflation gradually moderates.

For Indonesia, we expect government bonds to remain relatively well supported as inflation eases, fiscal policy remains prudent, and the BI Rate approaches its cyclical peak. Meanwhile, the recovery in Indonesian equities is likely to remain more gradual. While the geopolitical risk premium has largely been priced out, stronger foreign portfolio inflows will increasingly depend on improvements in domestic policy credibility and policy implementation rather than external conditions alone.

Table 7. Market Scenarios

Catalyst	Base Case	Bull Case	Bear Case
US-Iran Negotiations	Negotiations continue with no major escalation	Comprehensive agreement reached earlier than expected	Negotiations collapse and tensions re-escalate
Energy Market	Oil prices remain around current levels (USD70-80/bbl)	Faster normalization pushes oil prices lower	Renewed supply disruption lifts oil prices sharply
Federal Reserve	Data-dependent, higher-for-longer	Softer inflation supports a more dovish stance	Persistent inflation leads to further tightening
Indonesia	Inflation moderates, BI maintains policy flexibility	Faster foreign inflows support Rupiah and bonds	Rupiah weakens, imported inflation re-emerges
Market Implication	Bond yields gradually decline; JCI recovers selectively	Stronger bond rally and broader equity re-rating	Higher yields, renewed equity volatility, foreign outflows

Source: KBVS Research (2026)

Overall, we maintain a cautiously constructive outlook for Jul–Aug ‘26. The worst phase of the geopolitical shock appears to have passed, but a sustained improvement in Indonesian asset prices will require both a stable external environment and stronger domestic policy execution. Accordingly, we continue to favor this investment takeaway:

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Table 8. Investment Takeaways

Market	Investment Takeaway
Fixed Income	Barbell strategy: (1) Focus on short-end (1–3Y) government bonds to secure defensive carry, minimize duration risk, and maintain high portfolio liquidity, (2) Selectively accumulate long-end (15Y+) government bond to capture yield pickup and maximize capital gain potential, (3) Complement the sovereign allocation by favoring high-rated, long-tenor (>3Y) and medium-rated, short-tenor (<2Y) corporate issuances to balance yield enhancement with credit risk.
Equity Market	Barbell strategy: (1) Defensive stocks (Banking, Poultry, Telecommunication, Tower and Retail) (2) Growth stocks (Metal mining and Plantation)

Source: KBVS Research (2026)

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