

Policy Noise and Time Inconsistency: Shifting Expectations in Indonesia's Financial Markets

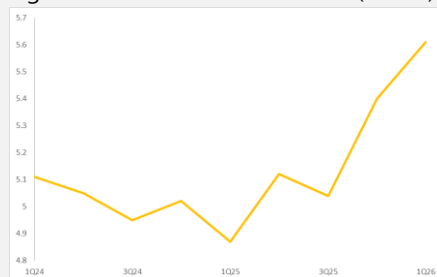
Executive Summary

Despite resilient macroeconomic fundamentals, Indonesia's financial markets are experiencing a broad-based confidence shock rooted in policy noise and time inconsistency. This tension reflected in the depreciation of the Rupiah to an all-time low of IDR17,705/USD, a sharp -32.5% decline in the JCI from its peak, rising government bond yields across the curve, and a surge in 5-year CDS premiums. Negative market sentiment was further exacerbated by the revision of the sovereign debt outlook to "Negative" by Moody's and Fitch Ratings, and the risk of a downgrade by S&P Global Ratings. The negative outlook revision highlighted weak institutional coordination, fiscal policy uncertainty, and the lack of transparency in Danantara's governance. From a fiscal perspective, aggressive spending on priority programs such as the Free Nutritious Meals Program (MBG) and the Merah Putih Village Cooperatives (KDMP) drove government expenditure growth to 34.3% YoY, resulting in a fiscal deficit of IDR164.4 tn (-0.64% of GDP) as of Apr '26. The imbalance was further exacerbated by Indonesia's tax-to-GDP ratio, which remains among the lowest in ASEAN, alongside technical constraints related to the Coretax system migration. Amid government communication that has appeared increasingly defensive and dismissive of market concerns, authorities are now being urgently challenged to align political ambitions with fiscal realities through stronger inter-agency communication coordination and improved governance transparency, to prevent the ongoing confidence shock from escalating into a deeper macroeconomic crisis.

I. Macroeconomic Resilience Amid Financial Market Stress

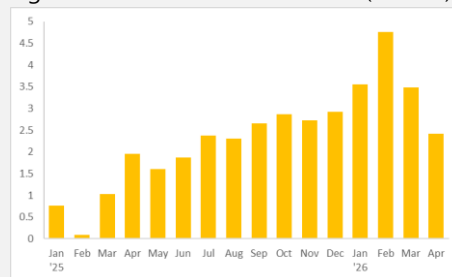
At first glance, Indonesia's economic fundamentals during the early part of 2026 continued to demonstrate resilience amid global volatility, supported by improving growth momentum, easing inflation, and sustained foreign capital inflows. Economic growth accelerated to 5.61% YoY in 1Q26 from 5.39% YoY in the previous quarter, indicating that the domestic economy continues to expand at a stable pace above its long-term historical average. Meanwhile, inflation moderated to 2.42% YoY in Apr '26 from 3.48% YoY previously, suggesting that post-Ramadan price pressures were successfully brought back within Bank Indonesia's target range. In addition, Indonesia's FDI realization remained relatively solid at IDR250.0 tn in 1Q26 despite a slight quarterly decline, reflecting continued foreign investor confidence in the country's long-term economic prospects.

Fig1. Indonesia Economic Growth (% YoY)



Source: BPS (2026)

Fig 2. Indonesia Inflation Rate (% YoY)



Source: BPS (2026)

Fig 3. Indonesia FDI (IDR tn)



Source: Trading Economics (2026)

Nevertheless, despite resilient macroeconomic fundamentals, recent developments in Indonesia's financial markets suggest a broad-based tightening in domestic financial conditions. The Rupiah briefly depreciated to IDR17,654/USD on 22 May '26, significantly exceeding the 2026 APBN macroeconomic assumption. Although Bank Indonesia (BI) responded through aggressive interventions in both the spot and forward markets to stabilize the exchange rate, these measures have come at the expense of external liquidity. BI reported that Indonesia's foreign exchange reserves declined to USD146.2 bn as of end-Apr '26, down from USD148.2 bn at end-Mar '26, highlighting the substantial costs incurred by monetary authorities in containing currency depreciation.

Pressure in the foreign exchange market subsequently spilled over into the domestic equity market. The JCI experienced a sharp correction after briefly reaching an all-time high of 9,134.7 in Jan '26. Selling pressure intensified further amid escalating US-Iran geopolitical tensions, MSCI index rebalancing flows, the recent BI Rate hike, and negative sentiment stemming from Rupiah depreciation, dragging the index down to 6,162.05 as of 22 May '26. This represents a decline of -32.54% from its Jan '26 peak, equivalent to a year-to-date correction of -28.74%. Reflecting deteriorating investor risk appetite, foreign investors recorded net outflows of IDR41.28 tn from the domestic equity market during the period from Jan–May '26.

Risk aversion was also evident in the government bond market, where benchmark SBN yields shifted higher across the curve. As of 22 May '26, the 1Y yield rose to 6.59% (+4.50 bps), followed by the 2Y at 6.57% (+3.10 bps), 3Y at 6.57% (+0.80 bps) and 5Y at 6.67% (+1.20 bps). This broad-based increase in yields reflects mounting pressure on sovereign borrowing costs. The steepening yield curve, particularly at the longer end, further signals worsening term premium and growing concerns over sovereign risk exposure.

The increase in market risk perception was further confirmed by the surge in Indonesia's 5-year Credit Default Swap (CDS) premium. Indonesia's CDS briefly climbed to 101.27 bps in Mar '26 before moderating to 92.53 bps as of 22 May '26. YtD, the 5-year CDS average stands at 85.01 bps, significantly higher than the 2025 average of 69.5 bps, and far exceeds regional peers such as Singapore (23.25 bps) and Malaysia (38.04 bps). This CDS increase reflects the increasingly expensive "insurance" against default risk in the eyes of global investors, particularly as the market begins to systematically reprice risk against government debt approaching IDR10,000 tn amid historically high upcoming maturities of IDR833.96 tn.

Fig 4. USD/IDR (as of 22 May '26)



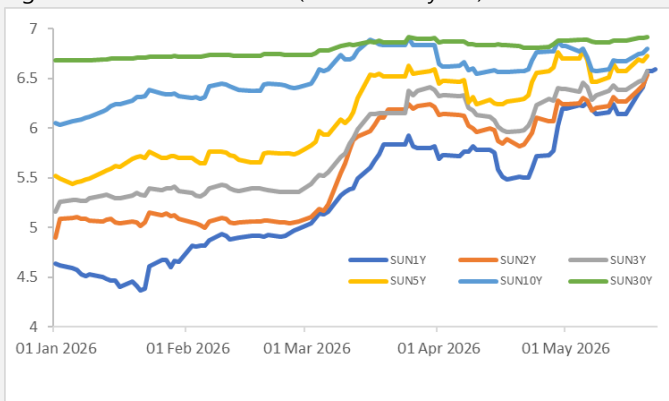
Source: Bloomberg (2026)

Fig 5. Jakarta Composite Index (JCI/IHSG) (as of 22 May '26)



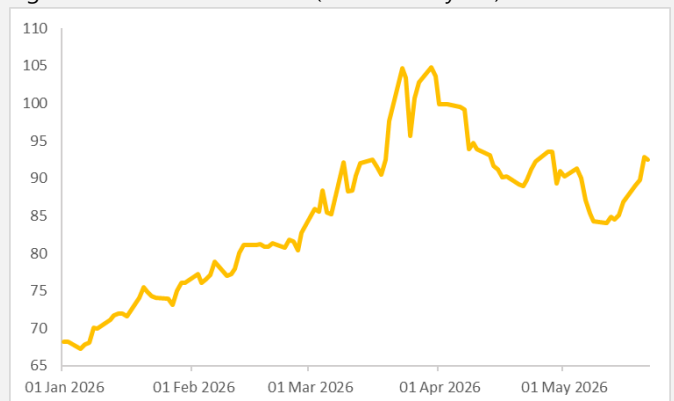
Source: Bloomberg (2026)

Fig 6. Indonesia SUN Yields (as of 22 May '26)



Source: Bloomberg (2026)

Fig 7. Indonesia CDS 5 Years (as of 22 May '26)



Source: Investing (2026)

II. Sovereign Rating Pressure from International Credit Rating Agencies

Although this adjustment is broadly consistent with global developments, including elevated UST yields and shifting expectations surrounding the Fed's policy path, the increasing co-movement between domestic asset volatility and periods of policy uncertainty has become more apparent. These concerns were further reflected in the decision by Moody's Ratings to revise Indonesia's sovereign credit outlook to Negative while affirming its 'Baa2' rating. Moody's identified four systemic vulnerabilities driving this outlook downward: a pronounced reduction in policymaking predictability, weakened institutional coordination and communication that dilute policy effectiveness, rising fiscal pressures from aggressive spending expansion without matching revenue mobilization, and mounting contingent liability and governance risks associated with the newly established Danantara Indonesia. While the rating affirmation at Baa2 acknowledges Indonesia's robust domestic economic resilience and favorable demographic-resource structural advantages, the Negative Outlook revision serves as an institutional warning shot regarding the sustainability and credibility of the current policy framework. Historically, outlook revisions by major rating agencies often influence global portfolio allocation decisions and may increase scrutiny from other rating institutions, thereby elevating the risk of broader reassessments toward Indonesia's sovereign credit profile.

Furthermore, Fitch Ratings followed by revising Indonesia's outlook to Negative while affirming the sovereign rating at 'BBB'. The outlook revision reflects rising policy uncertainty and the weakening consistency and credibility of the policy framework amid increasing centralization in policymaking authority that threatens to derail the medium-term fiscal outlook. From a fiscal perspective, the divergence between relatively weak revenue collection and rising expenditure commitments, including the MBG program, has gradually narrowed Indonesia's fiscal space. Although government debt remains moderate at around 41% of GDP, Fitch highlighted the deterioration in debt servicing capacity, with interest payments accounting for 17% of government revenue, among the highest levels within Indonesia's rating category. Fitch also warned that any material relaxation of the long-standing 3% fiscal deficit ceiling could weaken policy credibility and place further pressure on Indonesia's sovereign rating.

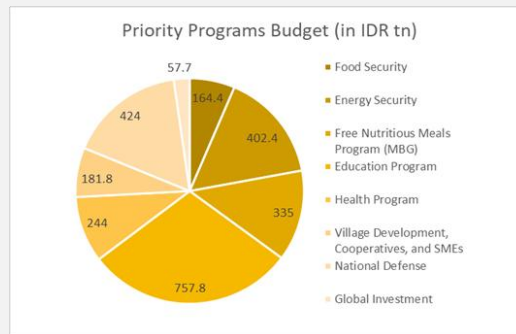
Moreover, S&P Global Ratings is likely soon to downgrade Indonesia's sovereign debt rating for the first time since the Asian Financial Crisis. Although Indonesia's debt-to-GDP ratio remains relatively stable at around 40%, interest payments consuming approximately 16% of government revenue indicate rising pressure on fiscal sustainability. S&P previously stated that a sustained increase in the interest payment ratio above 15% could become a negative rating consideration. Taken together, the assessments from the three major rating agencies suggest growing concerns over Indonesia's fiscal trajectory and policy credibility, particularly if the government fails to present a credible medium-term fiscal consolidation strategy.

III. Fiscal Pressures: Spending Rigidity and Revenue Vulnerability

A. Priority Spending Programs

The Free Nutritious Meals Program (MBG) has emerged as the market's most significant fiscal concern, driven by the disproportionate scale of its budget expansion relative to revenue capacity and governance transparency. MBG's allocation surged from IDR51.5 tn realized in 2025 to a ceiling of IDR335.0 tn in the 2026 APBN, a 550.5% increase, competing directly for resources against Education (IDR757.8 tn), Defense (IDR424.0 tn), and Energy Security (IDR402.4 tn). Realization through Apr '26 reached IDR75.0 tn (22.4% of the original ceiling), supported by 27,952 SPPG units now operational. The ceiling was subsequently revised down by IDR67.0 tn to IDR268.0 tn via presidential instruction, bringing the absorption ratio to 28.0% of the adjusted ceiling. While the revision signals some fiscal responsiveness, it raises questions about the robustness of the program's initial budget planning. More broadly, MBG creates significant "spending rigidity" risk: expenditure commitments of this scale are politically difficult to unwind, an estimated 34.2% inclusion error undermines targeting efficiency, and the program's rapid expansion poses disruption risks to millions of local food sector businesses. For markets, the combination of fiscal inflexibility and limited data transparency is viewed as a systemic risk that could force the government to crowd out productive capital expenditure in favor of politically entrenched spending priorities.

Fig 8. Budget Allocation for Priority Programs in the 2026 APBN (IDR tn)



Source: Ministry of Finance (2026)

In a broader context, state expenditure is now concentrated across eight priority agendas for 2026, absorbing IDR2,567.9 tn (around 66.8% of FY26). Beyond MBG, the market is closely monitoring pressures from allocations toward Energy Security (IDR402.4 tn), Defense (IDR424.0 tn), and the ambitious establishment of 81,000 Merah Putih Village Cooperatives (KDMP), estimated to require approximately IDR250.0 tn. Market concerns have deepened over the KDMP financing mechanism, which is seen as sacrificing regional fiscal autonomy, evidenced by the mandate to channel 58.03% of Village Funds through PMK No. 7/2026 and a reduction in Transfers to Regions (TKD) from IDR919.0 tn to IDR692.0 tn. While President Prabowo Subianto has affirmed that this funding represents a reallocation from savings generated by plugging budget leakages and corruption to stimulate grassroots economic activity, the market continues to react negatively to the lack of governance transparency and the risk of inclusion errors haunting these large-scale programs. The dominance of central government spending that erodes regional fiscal capacity is ultimately perceived as a systemic risk that could trigger a crowding-out effect and undermine the foundations of medium-term national economic growth.

Looking at the 4M26 fiscal posture, investor concerns have increasingly centered on sustainability and the credibility of Indonesia's statutory 3.0% of GDP deficit ceiling for the remainder of the year. Total expenditure through Apr '26 reached IDR1,082.8 tn (+34.3% YoY) driven by the front-loaded disbursement of three major priority programs running concurrently in early 2026. The MBG program alone absorbed IDR75.0 tn as of Apr '26, even as its full-year budget was subsequently revised down from IDR335.0 tn to IDR268.0 tn by Presidential instruction in a bid to improve efficiency. Alongside MBG, subsidy and compensation expenditure amidst the volatility of rising energy prices reached IDR153.1 tn (34.4% of APBN). In addition, food security expenditure also contributed to IDR61.3 tn, with fertilizer subsidies as the single largest component at IDR28.8 tn. The aggregate result is a spending trajectory that, if left unmoderated, implies a full-year deficit materially wider than the IDR689.1 tn APBN target. The deficit as of Apr '26 stood at IDR164.4 tn (-0.64% of GDP) due to primary balance returning to a surplus of IDR28 tn, offering some near-term reassurance. Nonetheless, with government spending, especially K/L spending, growing at 57.9% YoY and revenue largely concentrated in the second half of the year, market scrutiny of Indonesia's fiscal trajectory is unlikely to ease anytime soon.

Table 1. APBN Posture Comparison for 4M26 (IDR tn)

Indicator	4M25	4M26	FY26	Growth (% YoY)	% of GDP
Government Revenue	810.5	918.4	3,153.6	13.3%	29.12%
Government Spending	806.2	1,082.8	3,842.7	34.3%	28.18%
Primary Balance	173.9	28.0	-89.7	-83.9%	-31.22
Surplus/Deficit	4.3	-164.4	-689.1	3,888.9%	23.86%
% of GDP	0.02%	-0.64%	-2.68%	-	-
Budget Financing	281.2	298.5	689.1	6.2%	43.32%

Source: Ministry of Finance (2026)

B. Tax Policy Pipeline

Market concerns are further compounded by a series of new tax policies and proposed measures, which are seen as increasing compliance burdens and reducing business predictability. Table 1 distinguishes between policies already in effect and those still under discussion or public consultation. The government is now seriously advancing proposals for windfall taxes on the nickel, coal, and petroleum sectors, with proposed corporate income tax rates of 25.0%–30.0%, to offset ballooning energy subsidies driven by rising global oil prices. Investor uncertainty peaked with plans for mineral and coal royalty revisions targeted for effectiveness in Jun '26, including a significant proposed increase in gold royalties to 14.0%–20.0% and tin royalties to 5.0%–20.0%. Additionally, the Global Minimum Tax (GMT) of 15.0% effective Jan '26 and the planned sugar-sweetened beverage exercise (MBDK) in Jul '26 add to a growing list of new fiscal burdens for businesses. For market participants, the emergence of various "windfall" and reactionary sectoral levies creates significant predictability risks in long-term business calculations, particularly for the mining, energy, and digital economy sectors. The dominance of central government spending relying on aggressive fiscal instruments risks undermining the competitiveness of Indonesia's strategic industries amid heightened global market volatility.

Table 2. Summary of 2026 Tax Policies & Proposed Measures

Tax/Levy Type	Rate	Target/Allocation	Status
Income Tax & Corporate Tax			
Global Minimum Tax (GMT)	Min. 15% (top up via UTPR)	Multinational Enterprises (MNEs) with group revenue ≥ EUR750 mn	Jan '26 (Pillar 2/UTPR)
PPh No. 22 Final - Crypto	- Via domestic PPMSE/PAKD: 0.21% of transaction value - Via non-PAKD PPMSE: 1.0% of transaction value	Individual investors/traders with crypto transactions >USD50,000	Jan '26 (PMK 50/2025)
General PPh - Crypto Miners	Progressive rate (PPh no. 17)	Crypto asset miners	Jan '26 (PMK 50/2025)
Final PPh - MSMEs	0.5% of gross revenue	MSMEs with revenue of IDR500 mn - IDR4.8 bn	Extended '26 (UU HPP No. 7/2021 & PP 55/2022)
PPh No. 22 - Online/E-commerce Sellers	0.5% of gross revenue	Online sellers with revenue >IDR500 mn per year	Pending (until GDP reaches ≥ 6%) - PMK 37/2025
Windfall Tax - Coal, CPO, Copper	Proposed: Corporate tax 25.0%-30.0%	Commodity exporters/producers earning above-normal profits.	Target 2027
Windfall Tax - Nickel	Proposed: Corporate tax 25.0%-30.0%	Nickel mining companies are earning excess profits from price surges	To be confirmed
Consumption & Transaction Tax			
Excise - Sugar-Sweetened Beverages (MBDK)	IDR1,771-IDR2,500/litre	Producers (manufacturers) or importers of sweetened beverages	Target Jul '26
VAT - Toll Road Services	11.0%	Toll road users (general public/logistic companies)	Target 2028
Royalties & Natural Resources Levies			
Gold Royalty	14.0%-20.0%	Companies holding gold mining IUP/IUK licenses	Public consultation (Target Jun '26)
Nickel Royalty	14.0-19.0%	Companies holding nickel mining IUP/IUK licenses	Public consultation (Target Jun '26)
Copper Royalty	Concentrate: 9.0%-13.0%; Cathode: 7.0%-10.0%	Copper mining & processing (smelter) companies	Public consultation (Target Jun '26)
Tin Royalty	5.0%-20.0%	Tin mining companies	Public consultation (Target Jun '26)
Export Levy - Nickel & Coal	To be determined	Exporters of raw/semi-processed materials	Under MoF-ESDM discussion
Environmental & Sector-Specific Tax			
Carbon Tax - Coal- Fired Power Plants (PLTU)	Min. IDR30/kg CO2e	Coal-fired power plant (PLTU) operators	In regulation
Electric Vehicle Tax (PKB EV)	To be determined	Private and commercial electric vehicle owners	To be confirmed

Source: Ministry of Finance & Ortax (2026)

Indonesia's tax revenue mobilization continues to face structural challenges, reflecting persistent gaps in taxpayer compliance, tax base expansion, and administrative capacity. As of Apr '26, tax revenue realization reached IDR646.3 tn (+13.7% YoY), equivalent to 27.7% of the APBN target. This achievement marks a significant recovery after two consecutive years of revenue performance below expectations. In terms of compliance, the number of Income Tax Returns (SPT PPh) filed for the 2025 tax year as of Apr '26 was recorded at only 13.1 mn, below the target of 15.3 mn, reflecting a compliance ratio of 85.5%. This reality highlights the wide gap between registered and active taxpayers, which continues to limit the capacity for national revenue mobilization.

Table 3. Indonesia Tax Revenue (IDR tn)

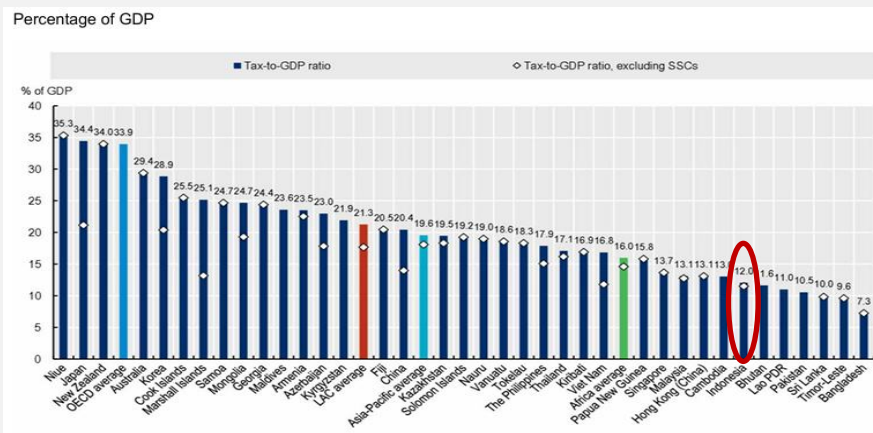
Period	APBN Target	Realization	% Realization	Growth (% YoY)
2020	1,198.8	1,072.1	89.4%	-19.7%
2021	1,229.6	1,277.5	103.9%	19.2%
2022	1,485.0	1,716.8	115.6%	34.3%
2023	1,718.0	1,869.2	108.8%	8.8%
2024	1,988.9	1,932.4	97.2%	3.5%
2025	2,189.3	1,917.6	87.6%	-0.7%
2026 (Jan – Apr)	2,357.7	646.3	27.4%	16.1%

Source: Ministry of Finance (2026)

Historically, Indonesia's tax revenue trajectory has shown a high dependence on the commodity windfall, rather than relying on structural improvements to the tax base. In 2020, revenue contracted sharply by -19.7% YoY, with realization reaching only 89.4% of the target. This condition reflects the twin shocks of the paralysis of economic activity due to COVID-19 and the collapse of global commodity prices. In 2021–2022, realization reached 103.9% and 115.6% of the target, respectively. This performance was supported by a surge in Corporate Income Tax (PPh) and royalties from the coal, CPO, and mineral sectors due to the escalation of the Russia-Ukraine conflict. As commodity prices eased, revenue growth slowed sharply in 2023 and 2024, to +8.8% YoY and +3.5% YoY respectively, with the 2024 fiscal year realization slightly missing the target at 97.2%. Structural vulnerabilities were fully apparent in the 2025 fiscal year. Indonesia recorded a revenue deficit of IDR271.7 tn, with realization reaching only IDR1,917.6 tn, or 87.6% of the target. This figure marked a -0.7% YoY contraction, the first negative growth since the 2020 pandemic. This decline was triggered, in part, by technical constraints on Coretax and fiscal policies deliberately designed to protect household purchasing power

From a tax-to-GDP perspective, Indonesia recorded 12.0% on a full-year basis, the lowest among major ASEAN economies, trailing Singapore (13.7%), the Philippines (17.9%), Thailand (17.1%), Vietnam (16.8%), Malaysia (13.1%), Cambodia (13.0%), and significantly below the OECD average of 33.9%. This revenue deficit reflects structural factors, including a large informal economy, a narrow formal taxpayer base, and relatively limited enforcement reach, challenges that the government's ongoing tax administration reform agenda, including Coretax, aims to address over the medium term.

Fig 9. Tax-to-GDP Ratios in Asian and Pacific Economies and OECD Averages



Source: OECD (2025)

IV. Bureaucratic Anomalies and Governance Uncertainty Surrounding Danantara

Market concerns are reinforced by a bureaucratic anomaly: the delayed release of the 1Q26 APBN Report (APBN KiTa) on two separate occasions. Market participants have interpreted these delays as an indication of weak state revenue realization amid a widening deficit. Although the government has sought to boost revenues through various aggressive levy proposals and royalty adjustments, data show that total tax revenues through March reached only 16.7% of the annual target. This shortfall is compounded by technical disruptions during the transition to the new tax administration system (Coretax). If this expansionary expenditure structure continues to be imposed without a meaningful improvement in taxpayer compliance and clear cash-flow visibility, Indonesia's fiscal discipline risks reaching rock bottom, triggering budget liquidity risks that could hamper development in the second half of the year.

Separately, Danantara's role as an off-budget investment super-holding was initially positioned as a mechanism to mobilize investment without adding pressure to the APBN. In practice, however, the structure has increasingly been viewed as less transparent, with limited visibility over the full extent of risk allocation and financial linkages across entities. The Economist highlighted this overlap, noting that the three largest state-owned banks have reportedly extended preferential loans totaling around USD8.0 bn to Agrinas to support KDMP-related projects and affiliated initiatives in the food sector. These arrangements are further complicated by Bank Indonesia's (BI) participation in a renewed burden-sharing framework, including the provision of higher remuneration on government deposits to support Danantara-related financing. In addition, the government's recent plan to centralize strategic commodity exports under PT Danantara Sumber Daya Indonesia and mandate the placement of export proceeds (DHE) within state-owned banks under Danantara's umbrella, drawing warnings from S&P Global Ratings regarding heightened risks to export performance, the balance of payments, and state revenues. From an investor perspective, these developments have contributed to perceptions of reduced transparency and have yet to convincingly translate into a visible acceleration of private investment inflows, while discussions around institutional changes, including potential amendments to the BI Law, have further added to uncertainty around governance and policy separation.

V. Theoretical Review: Time Inconsistency Effects and Policy Communications

The potential disconnects between Indonesia's still-resilient macroeconomic fundamentals and prevailing market sentiment became increasingly evident as policymakers responded to the weakening domestic financial markets. Amid the simultaneous depreciation of the Rupiah and the sharp decline in the JCI, conditions that would normally call for a measured and technically grounded response, Prabowo Subianto appeared to downplay the market turbulence by using a notably dismissive characterization of the stock market, while suggesting that Rupiah depreciation had limited relevance for broader segments of the population. A similar tone was later echoed by Purbaya Yudhi Sadewa, who described both the Rupiah weakness and the equity market correction as largely temporary in nature, while maintaining that underlying economic fundamentals remain solid.

The main issue was not simply the content of these statements, but the way they were communicated. Rather than recognizing investors' concerns regarding fiscal sustainability and institutional credibility, policymakers appeared dismissive of the market reaction itself. This created the impression that market signals were being ignored instead of addressed through credible policy responses. For global investors who depend on official communication as a form of forward guidance, such responses were not seen as reassuring but instead raised further doubts about domestic policy credibility.

This dynamic reflects a perceived lack of time consistency in policy communication. Building on earlier concerns around transparency and the evolving structure of off-budget financing, market participants increasingly assess the degree to which announced fiscal and regulatory intentions remain stable and credible over time. The concept, introduced by Kydland and Prescott (1977), captures how deviations between initial policy guidance and subsequent revisions, clarifications, or implicit contradictions can weaken forward-looking expectations formation. In practice, such episodes tend to elevate uncertainty premia embedded in FX, equity, and fixed income pricing, as investors recalibrate assumptions about policy continuity and execution. In the Indonesian context, where questions around fiscal deficit trajectories, financing composition, and the medium-term policy stance have become more salient, perceived inconsistency may

shorten investor planning horizons and increase sensitivity to headline-driven information flows. As a result, market volatility can be amplified even in the absence of large underlying macroeconomic shocks.

Blinder et al. (2008) emphasize that public communication itself can function as a credible policy instrument, capable of reducing market volatility even prior to the implementation of actual policy measures. In this sense, consistent and well-coordinated messaging across institutions becomes an important channel for anchoring expectations and stabilizing investor sentiment. Accordingly, restoring confidence would require stronger synchronization in inter-agency communication to more directly address investor concerns regarding forward fiscal risks and policy direction. This issue can be further framed through the credibility and flexibility trade-off described by Barro and Gordon (1983), which highlights the structural tension faced by policymakers between adhering to announced commitments and pursuing short-term economic or political objectives. When such tensions become more visible, rational investors are likely to incorporate a higher probability of policy deviation into their expectations. As a result, rather than fully internalizing official guidance, markets tend to price in this risk through higher required risk premia.

However, Woodford (2003) explains that clear and consistent communication itself can serve as a primary macroeconomic stabilization tool, as it helps guide market expectation and reduce uncertainty. Empirically, Dincer and Eichengreen (2014) found that greater policy transparency is directly associated with lower long-term interest rates and sovereign risk premiums. In the Indonesia's context, Rahmadian & Warjiyo (2013) also highlight that inconsistent government communication will ultimately erode the credibility of the authorities, causing investors to form more pessimistic expectations compared to the government's official targets.

VI. Outlook & Recommendation

Looking ahead, the domestic economic outlook will hinge critically on the government's ability to synchronize political ambitions with fiscal realities. The implications of the current high uncertainty extend beyond asset price volatility, and risk evolving into a structural problem of declining investment competitiveness relative to Indonesia's ASEAN peers.

Three key risks warrant close monitoring. First, if the government's communication strategy remains reactive and defensive rather than proactive and educational, the market will continue to reprice risk, ultimately elevating the long-term cost of funds. This could trigger a cycle of stagnant economic growth in which fiscal space is fully consumed by debt interest payments and subsidies, while productive capital expenditure is marginalized. Second, if post-Coretax tax revenue realization fails to show significant improvement in 2Q26, speculation about budget liquidity pressure in the second half of the year will intensify. Third, the absence of clarity on Danantara's governance will continue to serve as a source of confidence discount, irrespective of the government's positive achievements in bond issuances.

As the remainder of 2Q26 approaches, the domestic economic outlook stands at a crossroads and will depend heavily on the government's ability to synchronize its political ambitions with fiscal reality. The potential for a technical market rebound remains open, provided the government can demonstrate concrete budget efficiency realizations—not merely rhetorical commitments—and successfully maintain the year-end deficit below the 3.0% GDP safety threshold without the use of questionable emergency regulatory mechanisms (Perppu). The foundations for building a positive narrative are in place: 1Q26 economic growth exceeded market expectations, and domestic asset valuations are currently trading at a significant discount (undervalued), making them attractive for long-term investors seeking selective accumulation.

However, to realize the potential for a sentiment reversal, the government must urgently establish a far more coordinated inter-authority communication protocol involving the Ministry of Finance, Bank Indonesia, and Danantara, to send a consistent message on fiscal discipline. In this context, governance transparency in Danantara, including periodic reporting obligations on investment performance and clear contingent risk exposure, becomes a critical prerequisite to unwinding the sovereign-corporate blur that has long concerned investors.

Structural reforms and credible public communication are therefore no longer a strategic choice, but an absolute necessity to prevent this crisis of confidence from evolving into a deeper macroeconomic crisis. For investors, if this policy ambiguity has not substantially

abated, maintaining a defensive positioning focused on fundamentally sound equities, particularly those with low foreign currency debt exposure and high sensitivity to domestic consumption, remains the optimal strategy, while closely monitoring monthly tax revenue realization, Danantara governance developments, and signals from international rating agencies.

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