Economics

Indonesia's 2Q26 Growth Stays Resilient, But Headwinds Mount In 2H26

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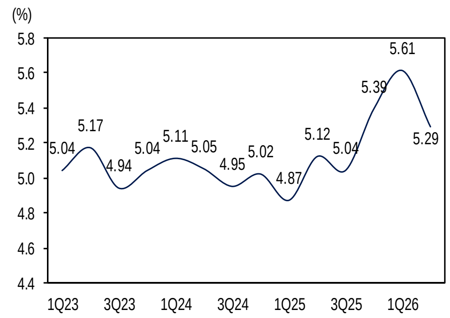
Highlights

- **Resilient but diverging growth profile.** Indonesia's 2Q26 GDP eased to 5.29% yoy (above consensus), underpinned by robust investment in national projects and still-strong government spending, though household consumption moderated under pressure from inflation and higher rates. A notable divergence persists between the resilient headline GDP and weak retail sales – attributed to statistical coverage gaps, seasonal base effects (Eid timing), and unmeasured spending through e-commerce and informal channels. However, the print was broad enough to reassure markets, triggering a positive "Goldilocks" response across equities, the rupiah, and bond yields.
- **2H26 outlook: A tug-of-war between headwinds and selective tailwinds.** Full-year GDP is forecast at 5.3%, with growth in 3Q26 projected at 5.1% and 4Q26 at 5.0% as opposing forces play out. On the downside, a front-loaded state budget leaves scant fiscal room, volatile oil prices threaten higher subsidy costs, and tight credit conditions curb bank lending. Counterbalancing these are selective corporate expansions - chiefly in extractive sectors (driven by high commodity prices) and state-linked infrastructure projects - which, together with a favourable trade balance, are expected to support exports, investment, and a gradual (though not yet assured) spillover into broader consumer activity, provided business sentiment and policy certainty improve.
- **Elevated inflation and a conditional monetary path.** Inflation is projected at 3.4%, at the upper boundary of Bank Indonesia's (BI) target, driven by El Niño-induced food volatility and imported cost pressures (as evidenced by a WPI of 5.6% in July). While the soft 2Q26 GDP and modest July CPI (2.88% yoy) allow BI to hold rates in the near term, the central bank stands ready to deliver two rounds of 25bp hikes (to 6.25%) by year-end if the Federal Reserve resumes tightening, prioritising rupiah stability over domestic credit growth; this is a move that would intensify the ongoing credit slowdown and test the resilience of the 2H26 growth forecast.

Analysis

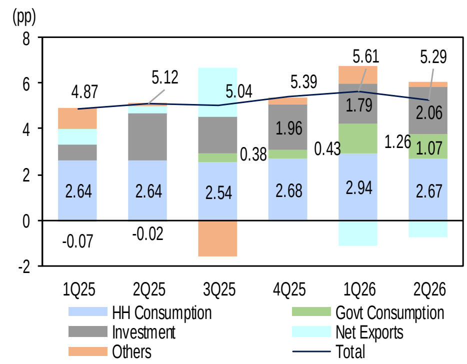
- Indonesia's GDP growth eased to 5.29% yoy in 2Q26, down from 5.61% in the previous quarter, though the print came in above both the market consensus of 5.14% and our own forecast of 5.21%, indicating that underlying economic resilience remains intact despite a modest deceleration. On the demand side, the slowdown was driven by several factors - household consumption grew by 5.06%, decelerating amid subdued labour market conditions, significantly higher inflation and higher interest rates, though this was partly cushioned by increased social assistance and larger government staff expenditure.
- Government consumption expanded by 15.97% - still historically robust - but moderated from 1Q26's exceptionally high growth, reflecting normalisation from a low base and reduced budget disbursements for goods, capital spending, subsidies, and regional transfers. Net exports weighed on growth as imports surged rapidly amid high global oil prices while exports remained relatively soft, worsening the trade balance. In contrast, investment accelerated to 6.87%, supported by the ongoing realisation of national priority projects, while private sector activity showed nascent signs of improvement, as evidenced by rising credit disbursement and a reacceleration of working

Growth Of Indonesia's GDP



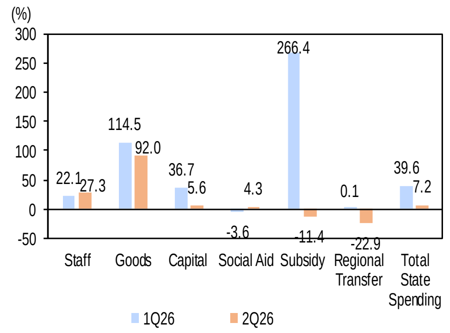
Source: BPS

Components Of Indonesia's GDP



Source: BPS

Growth Of State Spending (APBN)



Source: MoF

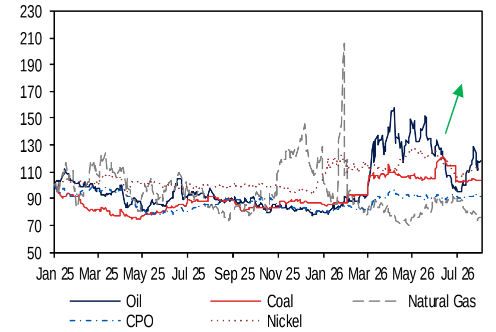
capital credit following an earlier corporate-led investment credit boom. However, this slight uptick in corporate activity has yet to spill over into consumer and retail spending, which remain relatively weak.

- On the production side, the slowdown was most pronounced in the largest contributing sectors - manufacturing and agriculture decelerated due to limited demand, while mining continued to contract, weighed by coal production restrictions. Consumption-sensitive services, particularly transportation and restaurants, also slowed in line with weaker household consumption, whereas government-related sectors such as construction, real estate, and wholesale trade continued to accelerate, buoyed by the realisation of the Village Cooperative Programme.
- Regionally, the slowdown was widespread, with growth moderating in Java, Sumatera, and Sulawesi largely owing to a decline in regional transfers, which constitute a significant share of regional economic activity; the most pronounced decelerations were recorded in Bali & Nusra and Maluku, driven by a slowdown in nickel production and a pullback in investment in nickel smelters, while Kalimantan was the exception, posting a slight acceleration underpinned by stronger manufacturing and trading activities.
- In our view, the relatively steady GDP figure is not perfectly aligned with other official and private indicators, most notably the contraction in retail sales, which would typically suggest a much weaker household consumption outcome. We attribute this divergence primarily to statistical and compositional differences: BI's retail sales data narrowly track goods sold through formal modern retail channels, whereas BPS household consumption in the GDP accounts captures a far broader basket that includes services, informal market transactions, utilities, and housing - all of which have remained resilient but are either excluded or undercounted in retail surveys.
- Seasonal base effects further amplify the gap, as Eid al-Fitr fell on 30–31 March in 2025, pushing post-holiday spending into 2Q25 and creating a high base for 2Q26, whereas Eid 2026 occurred in mid-March, concentrating festive consumption within 1Q26. Moreover, government programmes such as the free nutritious meal programme and the rapid expansion of e-commerce boost household purchasing power, but much of this spending flows through non-retail or poorly captured digital channels. Nevertheless, the GDP numbers remain broadly consistent with other macro indicators, including real broad money supply, the Manufacturing PMI, investment data, trade balance figures, and APBN realisation.
- Financial markets responded positively to the print, reducing market concerns of a significant decline in economic growth. The Jakarta Composite Index rallied, the rupiah strengthened, and the 10-year government bond yield declined, but these were partly offset by falling global oil prices amid hopes of a de-escalation in the Middle East conflict. Markets interpreted the steady GDP figure as a "Goldilocks" outcome, robust enough to sustain growth but unlikely to stoke inflationary pressures that would force BI to raise rates imminently.

Outlook

- After a slight slowdown in 2Q26, we project steady growth of 5.1% in 3Q26 and 5.0% in 4Q26, though this momentum will be shaped by opposing forces. The growth outlook for 2H26 faces formidable challenges - the state budget (APBN) has been heavily front-loaded, leaving limited fiscal space, while volatile global oil prices (driven by escalating Middle Eastern tensions) threaten to increase fuel subsidy costs and further strain public finances. Simultaneously, higher interest rates are likely to take their toll, with banks expected to reduce credit growth.

Indonesia Commodity Price Index (1 Jan 25=100)



Source: MoF

- Offsetting these headwinds, we note nascent signs of improving corporate activity; in the best-case scenario, this activity spills over into consumer spending and broader economic participation. However, this outcome hinges on improved business sentiment, underpinned by greater policy certainty and rising consumer confidence. Our baseline case therefore assumes selective corporate expansion, primarily driven by hiring in extractive sectors - buoyed by sustained high global commodity prices - and state-linked investment projects. Together with an improving trade balance from elevated commodity prices, these factors are expected to support household consumption, investment, and exports, leading us to forecast full-year GDP growth of 5.3% in 2026.
- On inflation, we project a print of 3.4%, sitting at the upper bound of BI's 1.5-3.5% target range. This elevated forecast is driven by the emerging El Niño weather pattern, which could exacerbate volatile food inflation, alongside imported inflation, which is evident in the wholesale price index (WPI) inflation, which reached 5.66% yoy in Jul 26.
- Given the relatively soft 2Q26 GDP reading and modest Jul 26 inflation of 2.88%, we expect the central bank to maintain the BI Rate in the near term amid slowing domestic momentum. However, should the Federal Reserve raise its funds rate, we anticipate BI will respond with two rounds of 25bp hikes, bringing the BI Rate to 6.25% by year-end in a defensive move to stabilise the rupiah.