Mizuho Flash: Indonesia

Economics & Strategy | Asia ex-Japan

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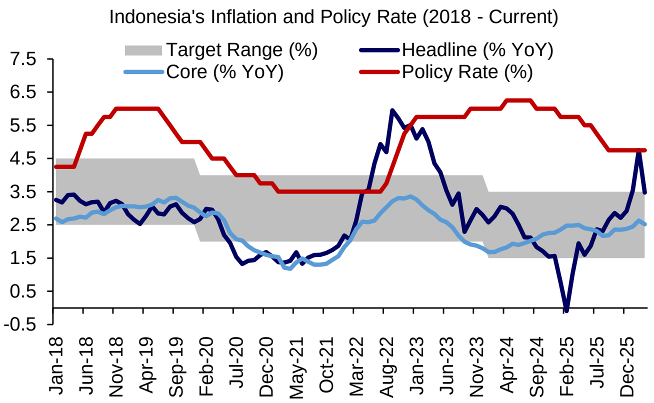
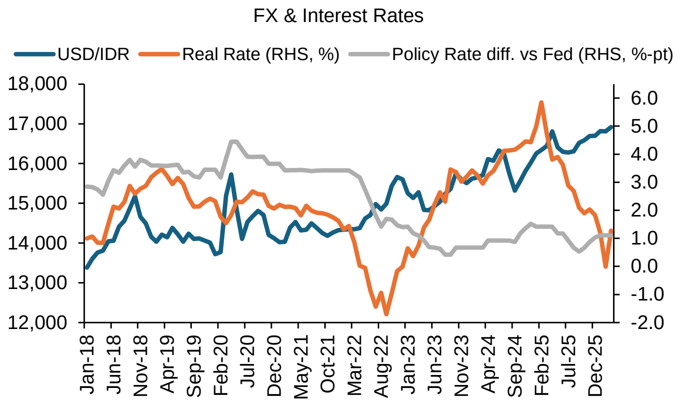
Indonesia's March CPI: Start of Higher for Longer?

In a Nutshell: March's headline inflation print has remained elevated at 3.5%, staying near Bank Indonesia's target range of 1.5%-3.5% for the third consecutive month, largely due to base effects and festive demand. This could mark the beginning of higher-for-longer inflation for Indonesia, with global oil prices likely to remain elevated. Even as fuel prices remain largely capped domestically due to the government's subsidised fuel regime, food inflation is likely to stay elevated on supply chain disruptions such as fertiliser costs. As real rates become compressed, IDR weakness is likely to emerge. However, headline CPI pressures alone are unlikely to prompt Bank Indonesia to hike rates, particularly in the absence of Fed rate hikes seen in 2022. Accordingly, BI is likely to keep rates on hold.
That said, a prolonged period of elevated global oil prices represents material upside tail risk to inflation. Should fiscal pressures necessitate a lift in the subsidised fuel price ceiling and exacerbate IDR weakness, the resulting shock to inflation could prompt BI to deliver additional rate hikes.

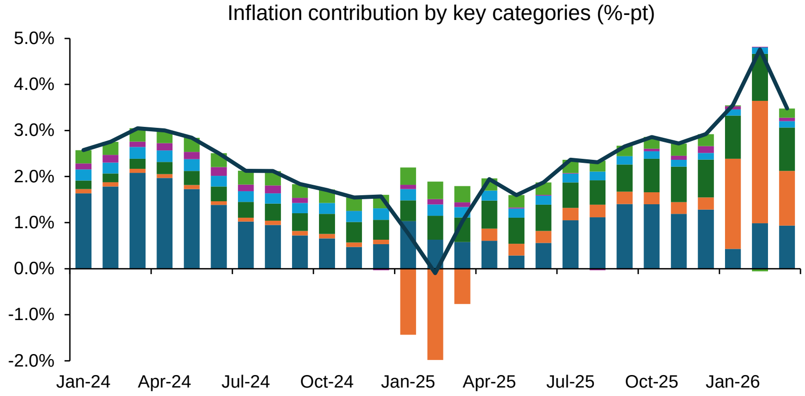


Sources: CEIC, Mizuho



Sources: CEIC, Bloomberg, Mizuho

- Recap: March's 3.5% YoY print was mainly driven by low base effect from electricity tariff (+1.0%-pt) and higher prices of gold jewelry (+1.0%-pt). The low base effect was due to electricity tariff rebates provided from January-February 2025, with billing lags for post-paid households where February's discount was settled in March last year.
- Food, Beverage and Tobacco contributed 0.9%-pt, reflecting a seasonal peak in demand due to Ramadan and Hari Raya Idul Fitri holidays, with significant price increases in food items such as chicken, fresh fish and rice.
- Transportation inflation contributed 0.07%-pt, with the increase in prices likely due to 'mudik' where workers return to their hometowns during the holidays. Elevated global oil prices only had a limited impact on transport inflation as the government has committed to maintaining subsidised fuel price ceilings for most fuel types (Pertalite, Solar (Diesel) and Kerosene), absorbing the higher prices through higher fiscal expenditure. As a result, price pass-through was only confined to non-subsidised fuel (14% of gasoline consumption) such as Pertamax which rose around 5% MoM in March.



Sources: CEIC, Mizuho

- Outlook: Beyond this March print, a sustained period of elevated oil prices would pose more meaningful upside risks to inflation. A key channel is food inflation, as higher energy prices tend to feed through to food prices via elevated fertiliser and transportation costs. This was observed in 2022 during the Russia-Ukraine conflict, where food prices remained elevated beyond the festive period. Unlike the 2022 shock which hit food supply directly, the current disruption is more likely to compound over time as increased fertiliser costs weigh on agriculture. We expect elevated food prices to lift 2026 headline inflation by an average of up to 0.9%-pt.
- This will likely push **headline inflation prints to range between 3.5-4.0%,** above BI's target range. We expect these inflation prints to be insufficient to prompt rate hikes by BI, given the absence of concurrent Fed rate hikes and the consequent growth trade-offs.
- However, the compression of real rates, coupled with fiscal pressures from a higher energy subsidies bill will likely put pressure on the IDR.
- We expect BI to continue **prioritising currency stability and keep the policy rate on a precarious hold amid IDR depreciation pressures.** BI has already demonstrated this, by its policy rate hold at its earlier March meeting, and the dropping of prior language around considering further rate cuts in the policy statement.

Base Case Forecasts

	Q4 2025	Q1 2026	Q2 2026	Q3 2026	Q4 2026	Q1 2027
Policy Rate (%)	4.75%	4.50%	4.50%	4.50%	4.50%	4.50%
USD/IDR	16500-16800	16700-16995	16800-17500	16900-17600	17000-17450	16900-17250
	16690	16995	17250	17200	17200	17150
GDP (% YoY)	5.4	5.0	5.1	4.9	5.1	5.0
CPI (% YoY)	2.8	3.9	3.3	3.7	3.8	3.7

Note: Values in black are historical whereas those in blue represent forecasts.
* Point forecast is for end-period. Ranges are only indicative.

A Non-Trivial Tail Risk – Lifting the Ceiling

- A compounding upside risk to the base case inflation outlook is a tail risk of a potential lifting of the subsidised fuel price ceiling.
- Currently, the cost of subsidising the fuel price ceiling is being borne by their fiscal balance sheet. Admittedly, its fiscal buffers are more constrained now than in 2022. To comply with the statutory fiscal deficit ceiling of 3%, the government has announced up to IDR$280 trillion (1.2% of GDP) in budget cuts[1]. Should the full extent of budget cuts be realised, the deficit ceiling could be sustained for the rest of 2026.
- That said, the potential growth trade-off and social implications from efficiency related measures may restrain the ability to capture the entirety of these savings, cutting short the runway for maintaining the fuel price ceiling.
- Even as there are uncertainties around budget cuts, the government retains off-balance sheet levers that could delay or reduce the urgency of increasing the price ceiling of subsidised fuel.
- The most significant is directing Pertamina to absorb the compensation shortfall through additional debt rather than receiving timely budget transfers. This arrangement is not without precedent. Between 2017 – 2019, the government deferred compensation payments to Pertamina and PLN to maintain fiscal stability and purchasing power of households that resulted in a deterioration of their balance sheets.
- If Pertamina's debt headroom narrows sufficiently and the savings in government spending fails to materialise amid a prolonged period of elevated oil prices, the government **may be compelled to raise subsidised fuel prices in Q3, to remain within the deficit ceiling should oil prices remain elevated above US$100/barrel**.
- Such a move would potentially push headline inflation significantly above BI's target range through end-2026, with transportation adding to inflation by an average of up to 0.5%-pt.
- Crucially, the **fiscal backdrop necessitating a lifting** of the price ceiling would **trigger sharp IDR weakness** tilting the policy calculus towards ensuring broader FX and macroeconomic stability. Under this scenario**, we see scope for BI to deliver 2 additional rate hikes to support the IDR and restrain inflationary pressures**.

Alternate Tail Risk Forecasts

	Q4 2025	Q1 2026	Q2 2026	Q3 2026	Q4 2026	Q1 2027
Policy Rate (%)	4.75%	4.50%	4.50%	4.75%	5.00%	5.00%
USD/IDR	16500-16800	16700-16995	16800-17500	17100-18000	17200-17900	17000-17700
	16690	16995	17250	17500	17450	17350
GDP (% YoY)	5.4	5.0	5.1	4.9	5.1	5.0
CPI (% YoY)	2.8	3.9	3.3	4.1	5.0	4.8

Note: Values in black are historical whereas those in blue represent forecasts.
* Point forecast is for end-period. Ranges are only indicative.

[1] Breakdown as follows: IDR$40 trillion from scaling back of the President's flagship free meals programme (from 6 days to 5 days a week for primary and secondary schools); IDR$130.2 trillion from efficiency measures such as cutting spending on official travel and ceremonial activities; IDR$48 trillion from rollout of 50% biodiesel blend for subsidised diesel; IDR$6.2 trillion from potential fuel savings from government employees working from home and IDR$59 trillion from reduced fuel consumption with the government encouraging private sector employees to adopt similar work-from-home policies and for public to use public transportation.