Economics

DBS Flash

Indonesia: Spillover risks from the Middle East crisis

Economics/Indonesia

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- *The Middle East conflict poses dual risks: higher costs and supply delays.*
- *We see two channels of impact, via financial markets and spillover on the economic variables.*
- *Adjustments to administered prices will prove to be inflationary.*
- *The energy crisis comes as strong early fiscal spending had already raised full-year concerns.*
- *Options will be explored to manage fiscal pressures from the current energy crisis.*
- ***Implications for markets:** We have dropped our earlier call for cuts and expect the BI to stay on hold in 2026.*
- *Rate hikes would require either sharp currency depreciation or a fuel price increase.*

Tough geopolitical terrain

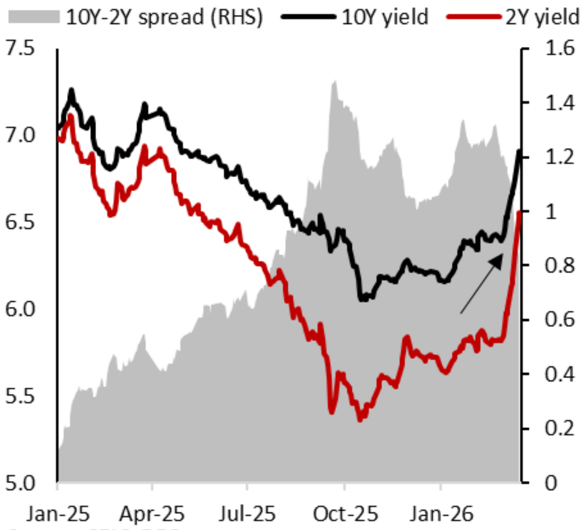
Heightened instability in key energy-producing countries in the Middle East and disruptions to critical maritime routes, particularly Strait of Hormuz, have generated significant economic spillovers across Asia, primarily through higher energy prices, financial market volatility, rising trade costs, and disrupted supply chains. **Unlike previous oil and energy shocks that mainly affected prices, this time the issue involves both rising costs and reduced supply, which together intensify the overall impact.**

Channels of impact

There are two channels of impact for Indonesia – risk sentiments and economic spillover, with the intensity of fallout to be guided by the duration of the conflict and extent of resultant supply shocks.

Onshore financial markets faced considerable volatility in March 2026, with a sharp rise in bond yields (flattening impact on the curve – see chart), rupiah briefly at a new low and equity markets staying under pressure. Geopolitical uncertainties have compounded domestic headwinds– cautious review by the index provider MSCI on the equity markets and outlook downgrades by two global rating agencies earlier in the year. Investors were also concerned over the fiscal outlook, as external uncertainties add to existing spending commitments.

IDR bond yields price action



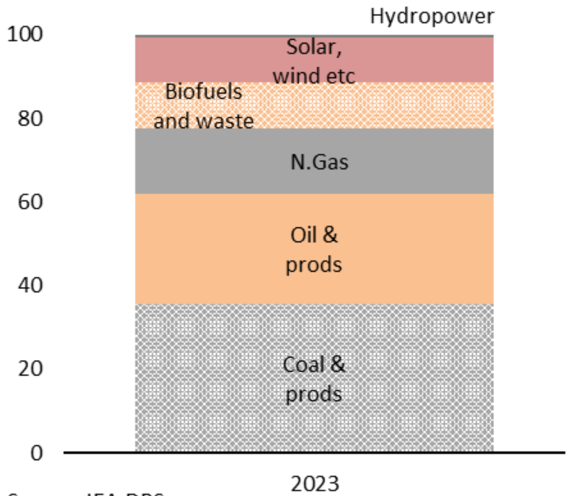
Source: CEIC, DBS

On the economic end, we explore Indonesia's exposure to trade and spillover risk from higher energy prices.

-Energy mix

From the domestic point of view, coal & products (36% share) dominate the sources of energy, followed by oil (26%) and natural gas (at 15.6%).

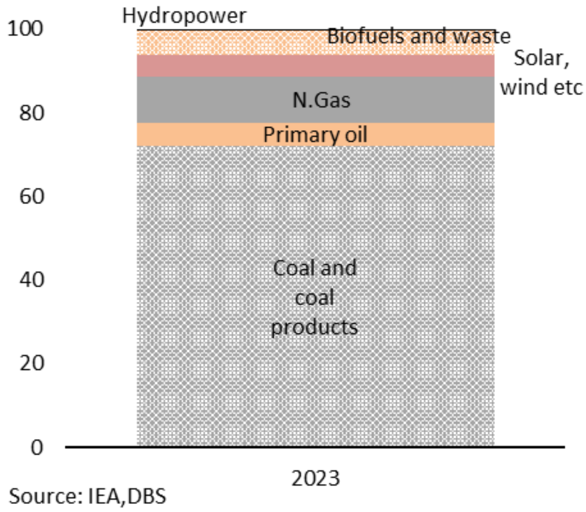
Indonesia: Largest sources of energy, % share



Source: IEA,DBS

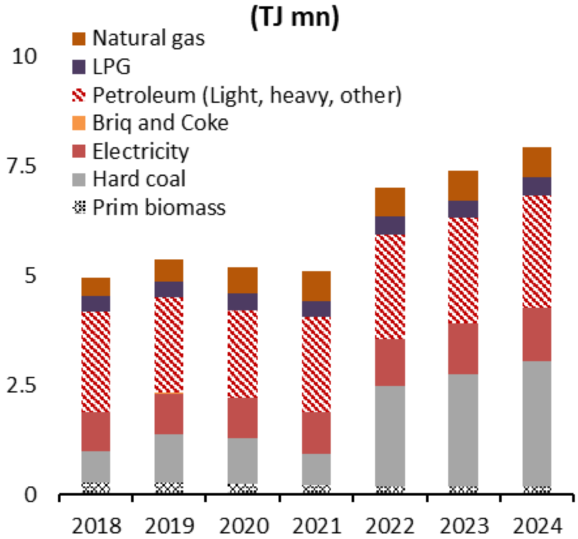
By contrast, the domestic energy production mix is led by coal at a significant 72%, underscoring the ability of the country to not only meet local coal needs but also turn into a net exporter. The next two charts highlight the domestic energy production-consumption composition. **Primary oil and natural gas production while significant falls short of the energy needs, necessitating imports (oil importer, gas exporter)**.

Indonesia: domestic energy production, % share



Source: IEA,DBS

Indonesia: Total energy consumption (TJ mn)



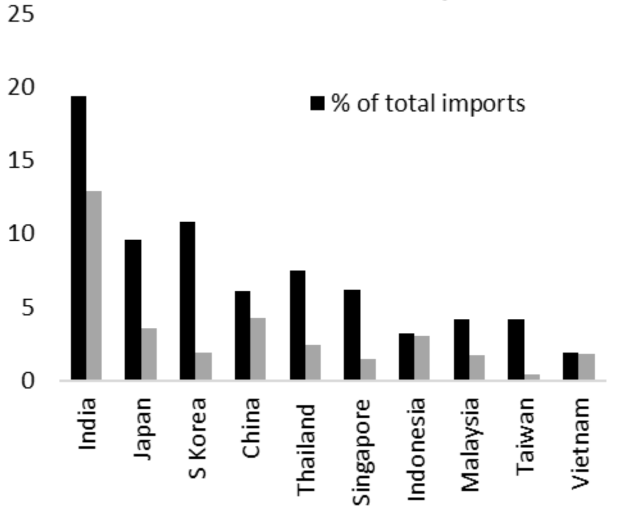
Source: CEIC, DBS

-Economic impact

Indonesia is a net energy exporter, with the energy balance led by coal and gas, insulating the economy to some extent from the current turmoil, compared to regional peers. Nonetheless, dependency on supplies from the Middle East is non-trivial.

Indonesia's direct exposure to the Middle east region is more contained (at 3% of total trade) that the regional peers, as the chart below shows. Exports primarily comprise palm oil, seafood, selected manufactured and consumer goods etc. while imports are dominated by oil & gas, petrochemical and industrial inputs etc.

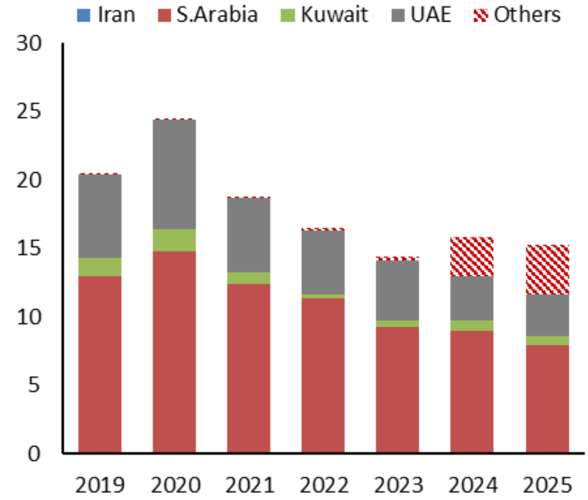
Asia's Middle East trade exposure



Source: CEIC, DBS. Middle-East: Iran, Iraq, Kuwait, Qatar, Saudi Arabia, UAE

Digging deeper, Indonesia's oil & gas exports made up 5% of total trade in 2025, while imports make a larger 14% of total purchases. Of these O&G imports, purchases of petroleum, crude and products from the Middle East account for ~15% of the share (2% of overall imports) – see chart.

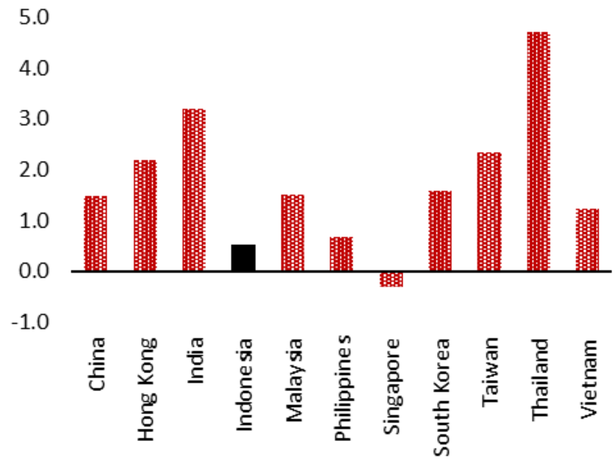
Oil & Gas imports from West Asia (% share of total O&G)



Source: CEIC, DBS

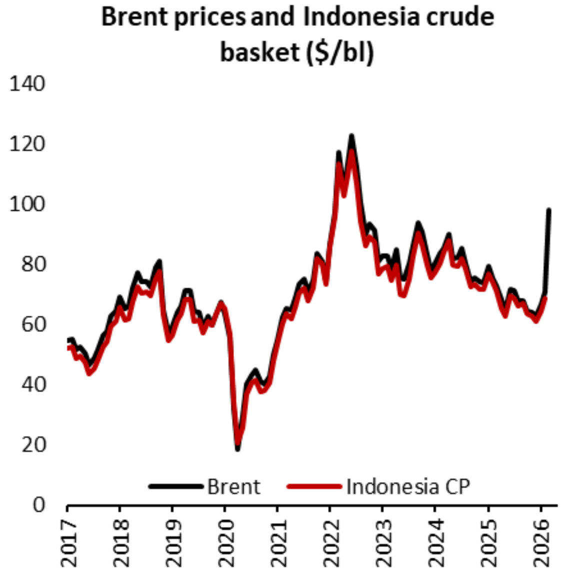
Indonesia's net oil position (see chart) in the past five years has been measured at ~0.6% of GDP. Nonetheless, it imports around 40% of the oil needs, with a quarter of that passing through the Middle East, primarily Strait of Hormuz. About ~30% of LPG supplies are sourced from the Middle East, primarily from state owned names in Saudi Arabia, besides about a third forming gas imports. Strategic reserves are low at ~20-25 days.

Net oil importers, 2025 (as % of GDP)



Source: CEIC, DBS. Net oil import is excess of imports over exports of oil. Positive values are net importer while negative ones are net exporter of oil. EU 27 exc. UK data is for 2024.

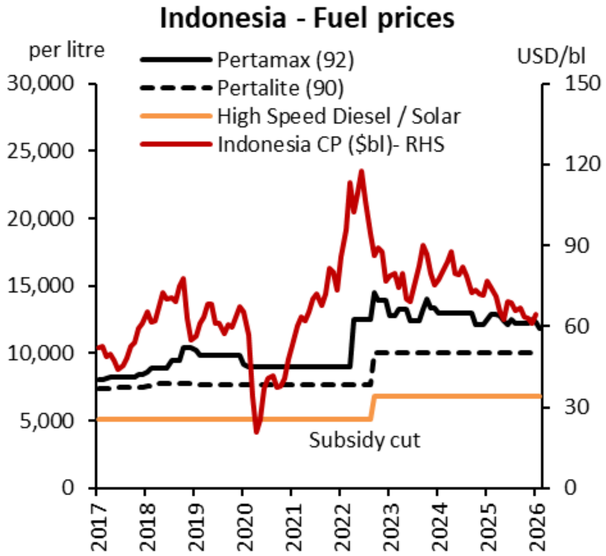
Global crude benchmark prices have jumped sharply in Mar26, averaging $98/bl vs Jan-Feb26 average at $68.70/bl. The Indonesia crude basket is also expected to catch-up when more recent numbers are made available, taking it back to 2022 levels.



Source: CEIC, DBS

Rising energy prices raise pressure to adjust administered fuel prices and electricity tariffs, with the final decision resting with the authorities' willingness to pass on the increase in costs to limit losses of the state-owned energy company as well as ease pressure on the fiscal math (subsidies). The most used fuel variants, including Pertalite, were last increased in Sep22 and have remained unchanged for more than three years. Non-subsidised Pertadex as well as LPG prices (12kg) have been adjusted to keep up with the domestic benchmark prices.

As a baseline assumption, price adjustments in the subsidized retail pump prices are unlikely, unless fiscal pressures build up significantly on prolonged conflict and supply disruptions.



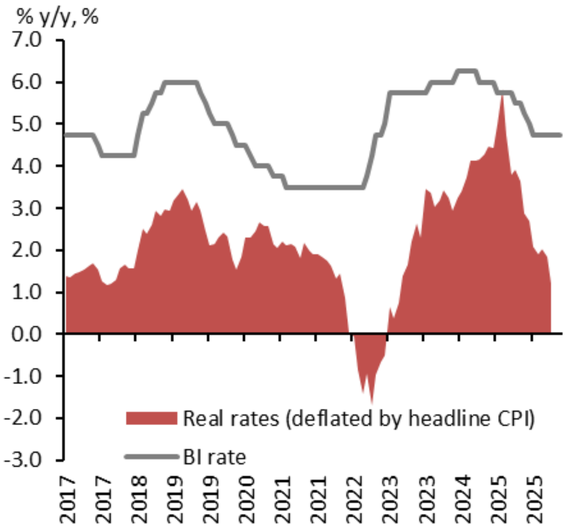
Source: CEIC, DBS

Beyond fuel, price risks to the food segment are also likely. Indonesia is a net importer of fertiliser (China, Russia, and Canada are key sources), despite being a significant producer and exporter of urea. While the country has a strong domestic industry for nitrogen-based fertilisers (using natural gas), it imports phosphate and potash-based variants. The risk is also that higher fertiliser costs might strain farm margins further and influence planting decisions in the coming season, affecting the final crop mix.

In 2022, crude prices averaged $100/bl on the after the Russian invasion of Ukraine. Consequently, headline inflation rose from 1.6% in 2022 to 4.2% in 2022 (compared to earlier forecast of 3%) on the back of a fuel subsidy cut, factoring in direct and subdued indirect impact. Spectre of higher energy prices and food pushing up inflation is a risk this year, with the scale of rise to be determined by decisions on administered prices.

We revise our 2026 inflation forecast to 3.2% yoy due to base effects and likely changes in unadministered fuel variants. Further upside of 50-70bp is likely to subsidized prices are increased. **We have dropped our earlier expectation of two rate cuts in 2H26 and now anticipate that Bank Indonesia will remain on an extended pause**. Any move toward rate hikes would likely require either sharp currency depreciation or fuel price increases, like 2022. We will reassess our growth forecast at 5.3% if the supply shortages spill over to 2Q-3Q.

BI benchmark rate vs real rate buffer



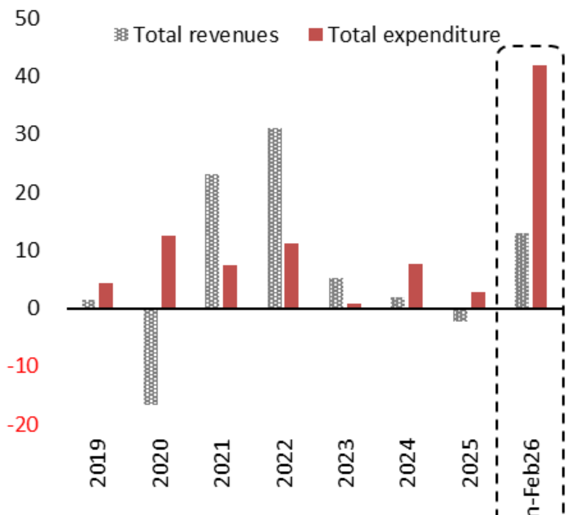
Source: CEIC, Bloomberg, DBS

On external trade, the negative balance on the oil & gas front will be offset by strong gains in the non-oil & gas sectors, particularly coal, palm oil, metals etc., via positive terms of trade gains. Export gains will nonetheless be punctuated by domestic policy changes, for instance, export tax levy or temporary steps to ensure adequate domestic stocks of key commodities. Impact on the current account math might be measured. We raise our current account deficit forecast to -0.8% of GDP, with further pressure to build if the reopening of the Strait of Hormuz is delayed (-0.1% to -0.4% of GDP additional strain).

External risks return focus to fiscal math

The Middle East energy crisis compounds existing concerns over the fiscal outlook. The January-February budget recorded a modest deficit at the start of the year marking a departure from the customary surplus typically seen during the same period. Government spending jumped 41% yoy in Jan-Feb26, on higher revenue, capital and social assistance disbursements. Revenue growth also rose by double-digits, with part of the scale of lift driven by base effects. We had noted earlier that the government has been keen to fast-track expenditure to boost growth, amid expectations that this would draw in the private sector and improve livelihood of low-income households via to the free meal, village cooperatives and other programs.

Fiscal run-rate (%yoy)

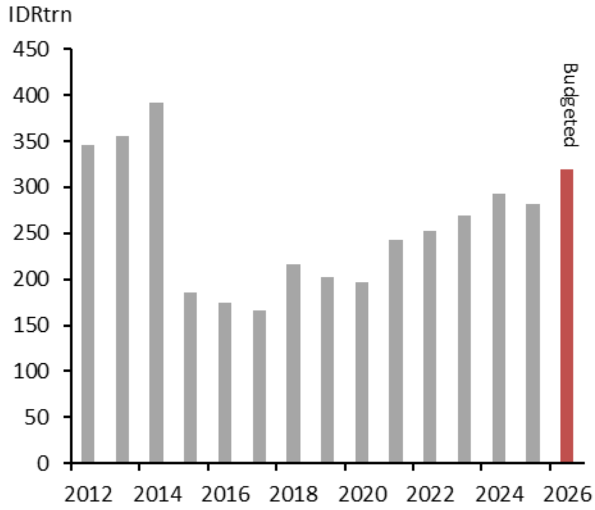


Source: BI, MOF, CEIC, DBS

Key 2026 Budget economic assumptions - Indonesia crude basket at $70/bl and rupiah at IDR16500/USD - have been tested. This compares with Mar26 average of Brent at $98/bl (+40% increase), while the IDR is closer to 17000/USD (3% weaker than budgeted).

There were initial indications that that the deficit target might be temporarily breached on emergency grounds to accommodate higher-than-budgeted oil prices and resultant increase in subsidies. Officials had reportedly discussed a few revised assumptions to incorporate the impact of the Middle East war. The fiscal deficit was already at risk of widening prior to the escalation of tensions in the Middle East (outlook revision by Fitch), given a strong jump in spending in Jan-Feb26 and pre-commitments to large social sector programs this year. Markets remain unconvinced that the first official response should be to test the mandated threshold instead of spending rationalisation.

Government expenditure - total subsidies



Source: BI, MOF, CEIC, DBS

Fiscal math faces a two-way tug from higher commodity prices – higher revenues from natural resources but offset by need for price support and energy subsidies. About 1% oil price increase to the baseline adds IDR10.3trn (0.04% of GDP) to expenditure (subsidies and compensation to state companies) according to industry analysis.

Official simulations reportedly showed that oil at $92/bl could push the deficit well past 3% of GDP mandated threshold. Add to this, is additional pressure from a weaker currency.

Subsidy allocation for 2026 stands at IDR 381trn, which includes direct price support and compensation for SOEs, with about 13-14% already disbursed by Jan-Feb26. Notably, the flagship free meal nutrition program was the largest recipient in the state budget at IDR335trn.

The authorities are likely to explore one of the three alternatives:

-Raise fuel prices to pass on additional costs (positive for economy but negative for sentiments and purchasing power)

-Seek savings to absorb additional subsidy outlay, with indications that this is already underway. Local authorities are reportedly mulling over risk mitigation steps in the face of an increase in energy costs and supply shortages, including work-from-home work policy, seeking to curb non-essential use of vehicles/ transport and hybrid school sessions to conserve fuel usage, according to the local press reports. **Budgetary savings** of up to IDR120trn are likely to be carved out for contingency purposes, including part of it from the flagship free meal program (reduce allocation by at least ~IDR40trn) and savings from past budgets. Our baseline deficit forecast stands at -2.9% of GDP with upside risks.

-Maintain subsidies and push up expenditure to absorb the additional outlay. This will increase the scope of a breach of the mandated fiscal deficit target this year, weighing on markets and inviting scrutiny by the rating agencies.

We expect authorities to proceed with the second alternative to maintain a balance between fiscal pressures and need to preserve consumption in the near-term. The Finance Ministry recently reiterated their intention to stay within the deficit threshold, amidst concerns over an absence of fresh revenue generation to finance the welfare programs, high debt servicing ratios (rising interest payment burden) and financing concerns (portfolio flows, SRBI linked flows etc.)

A breach of -3% of GDP cap is only likely if there is an official move to seek a temporary relaxation of these limits, like the arrangement during the pandemic. This would preferably be accompanied by a roadmap to return the deficit math towards consolidation as and when the situation stabilizes. Beyond this crisis, fiscal policy will be required to direct resources towards developmental areas to boost multiplier impact on growth, chart out fresh revenue measures to improve related ratios and privatise/ monetize state assets, presumably under the new investment agency.

Market implications

In all, bond markets are looking at an environment of higher risk premium as rate cuts are removed from the curve and the likelihood of additional bond issuance increase in the face of fiscal risks. The view of rating agencies after the outlook downgrade is also in view. BI is likely to provide stiff resistance to rupiah depreciation, with a stagflationary shock expected to keep them from raising rates in a hurry.

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