IBC
Indonesian Business Council

BUSINESS OUTLOOK 2026

Inflection: Breaking the Growth Plateau

January 2026

Indonesia in 2026

Stable growth,
but **weakening quality**.

Cooling domestic demand: weaker consumption, slower credit, narrow investment spillovers.

External support is fading: narrower trade surpluses, commodity support wanes, rising frictions. than mere macro stabilization.

Policy space is constrained, necessitating productivity-enhancing structural reforms: *rule of law, human capital, and competitive market.*

Outlook in 2026: resilient *but* increasingly constrained; upside depends on reform execution rather than mere macro stabilization.

Indonesia 2026 Outlook:
Macroeconomic Factors and Drivers

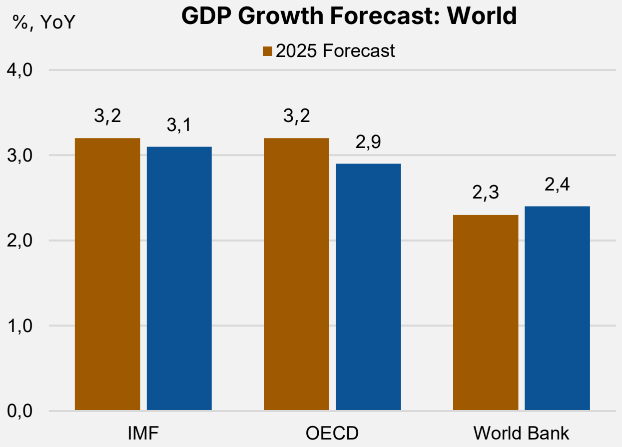
Macro Indicator	Global Factors	Domestic Factors	Indicator Outlook
Economic Growth (GDP)	China slowdown weakens commodity demand; trade fragmentation limits manufacturing exports	Low productivity, declining public capital spending, high ICOR	Growth stagnates (at **4.8–5.0%)**
Productivity	Fragmented supply chains; slower technology diffusion via trade	Declining manufacturing role, high informality	Productivity **stagnant**, ICOR remains high
FDI	China+1, reshoring, and geopolitics reallocate global FDI	Heavy regulations, weak business climate, corruption	Non-commodity FDI remains **(<10%)**, mining dominates
Export	Weaker China demand; stricter green standards (CBAM, EUDR)	High NTMs, inefficient SKA/CoO processes	Commodity exports weaken; manufacturing **does not rise significantly**
Import	Trade diversion from China raises inflow of manufactures & intermediates	Import dependence; domestic NTMs on inputs	Imports move both ways, depending on diversion vs substitution
Trade Balance	Lower commodity prices; higher imports from China/ASEAN	High import dependence; down streaming not yet diversified	Surplus persists but **narrows**
Exchange Rate & Portfolio Flows	Strong USD; volatile capital flows amid fragmentation	Shallow domestic financial markets	Rupiah stable but **prone to volatility**

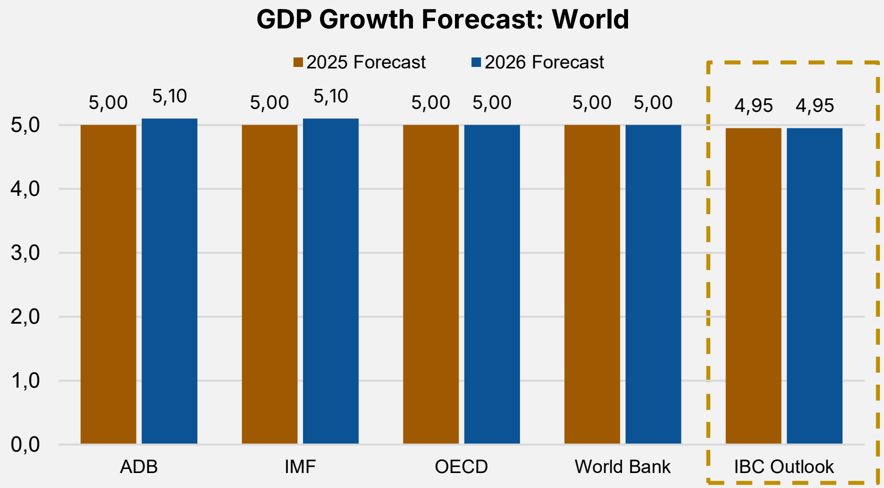
Indonesia 2026 Outlook:

Macroeconomic Factors and Drivers

Macro Indicator	Global Factors	Domestic Factors	Indicator Outlook
Inflation	Food & energy volatility from geopolitics and trade disruptions	Weak domestic distribution, MBG increases food demand	Inflation remains contained but **vulnerable to food shocks**
Credit & Consumption	Global rates ease slowly; external uncertainty	Tight fiscal space, stagnant household income	Consumption grows moderately (at **4.5–4.7%)**
Labour Market Performance	Intense competition in labor-intensive trade sectors	Unemployment, high informality, minimum wage	Limited good jobs creation
Fiscal (Deficit & Tax Ratio)	Global slowdown weighs on trade-related revenues	Stagnant tax ratio, pressured capital spending	Tax ratio **(<10%)**, tight fiscal space
Climate Risks	Global climate rules affect market access and trade costs	Heavy reliance on polluting industries	Hamper growth, increased fiscal burden, reduce welfare and increase inequality

Economic Growth Outlook for 2026





Source: IMF World Economic Outlook, World Bank Global Economic Prospect, ADB Asian Development Outlook, OECD Economic Outlook
Note: All growth forecasts were estimated prior to the Sumatran floods and the US attack on Venezuela.

- Global forecasts from the World Bank, ADB, IMF, and OECD point to a world economy that continues to expand moderately.
- For Indonesia, international institutions **project GDP growth at around 5.0 to 5.1 percent**, slightly above the pre-pandemic average at around 5 percent. **IBC's** forecast of **4.9 – 5.0% in 2026** is aligned with the international projections, placing Indonesia on a path of steady but slightly lower trajectory, supported by private consumption, gradual recovery in investment, and contained inflation, alongside resilient financial sectors.

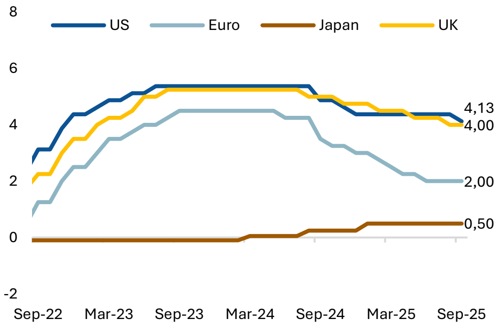
Global Outlook*

The analysis does not include the impact of US-Venezuela conflict.

Global economy conditions

Moderating Global Growth

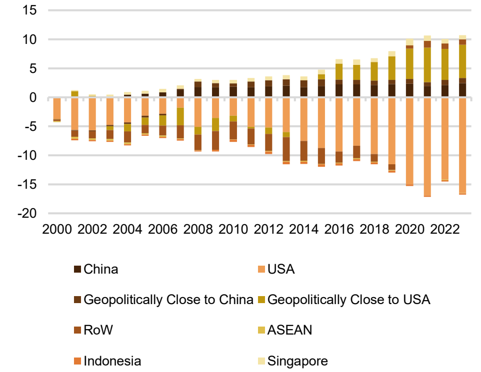
Policy Rates in Some Advanced Economies (%)



- Slower global growth and uneven regional growth
- Declining policy rates while inflation risk at bay
- Growing geopolitical tensions and protectionism
- Heightened regulatory uncertainty

Fragmenting Global Order & Flows

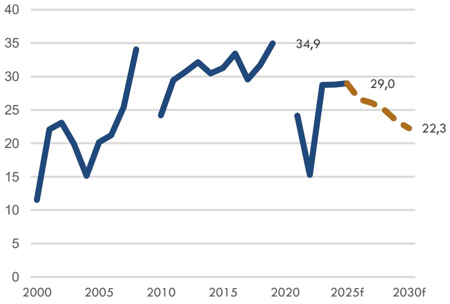
Geopolitical Fragmentation on NIIP (% GDP)



- Trade and capital flows increasingly align with political partners
- US-China decoupling in trade, investment, and research
- EU-Russia rupture and BRICS expansion reshaping blocs

China's Slowdown & Global Spillover

China's Contribution to Global Growth, 2000–2030 (%)



- China's shift to a lower growth-regime
- Softer Chinese demand hitting commodity and goods exporters
- Industrial overcapacity in China pressuring global markets

Implication of the Global Trends to Indonesian Economy

Geopolitical rivalry, sanctions, and increasing global fragmentation

1. Weaken external demand and heighten uncertainty. This puts downward pressure on Indonesia’s GDP through slower export growth and relatively stagnant commodity prices.
2. Exports face additional pressure from China’s structural slowdown and tighter market-access requirements, including sanctions, CBAM, and EUDR.
3. Fragmented supply chains and export controls on strategic inputs limit technology diffusion and increase production inefficiencies.

Slowdown ofx China’s economy

1. China’s economic slowdown weakens demand for Indonesian exports and suppresses global commodity prices, particularly for coal and CPO.
2. Escalating trade tensions may redirect Chinese exports from the US toward ASEAN markets, including Indonesia. A surge in imports, especially manufactured and intermediate goods, could reduce domestic industrial utilization and narrow Indonesia’s trade surplus.
3. Trade diversion may intensify import competition in labor-intensive industries.

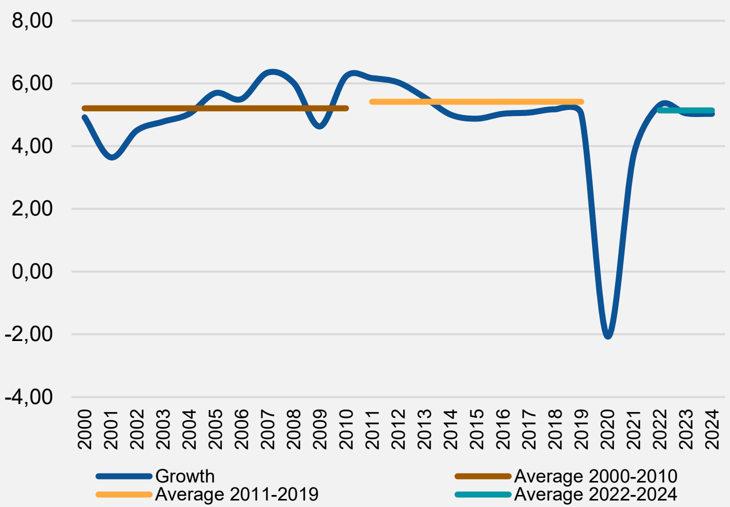
Global Uncertainty, Financial Channels, and Macroeconomic Spillovers

1. Heightened global uncertainty and subdued commodity prices weaken income prospects, leading firms and households to adopt precautionary behavior. This dampens credit growth and household consumption, while FDI becomes more selective and risk premiums for long-term investment rise.
2. External shocks pass through to inflation mainly via energy, food, fertilizer, and imported input prices, while safe-haven dynamics affect domestic asset prices.
3. The global trend of easing policy rates may allow Indonesia to maintain an accommodative monetary stance, providing some expansionary support. However, higher global risk aversion and interest rate differentials heighten exchange rate and portfolio flow volatility, complicating macroeconomic stabilization and constraining fiscal space through weaker revenues, higher subsidy needs, and rising debt-servicing pressures.

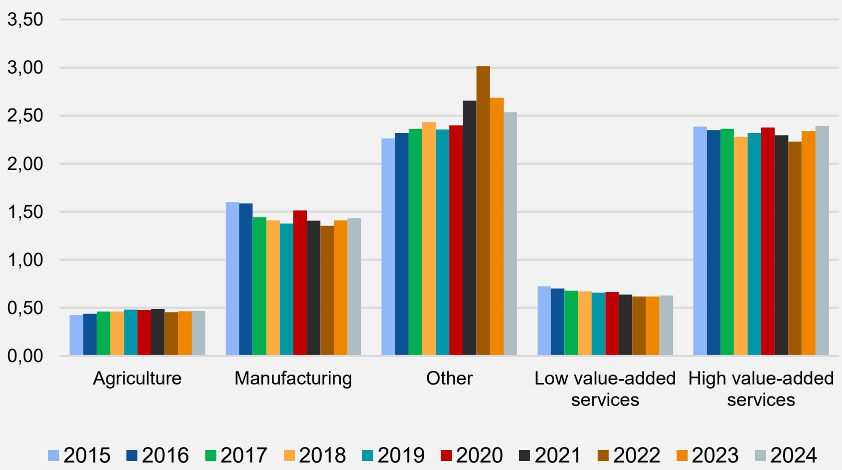
Domestic Outlook**

***The analysis does not include the impact of natural disaster in Sumatra, Kalimantan, and Bali, and the US-Venezuela conflict.*

Indonesia sustains 5% growth, but productivity shifts away from manufacturing



Source: Statistics Indonesia, LPEM FEB UI calculations

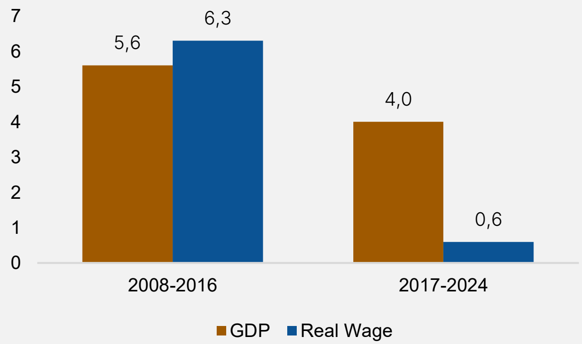


Source: Statistics Indonesia, LPEM FEB UI calculations

- Indonesia's GDP growth **has remained relatively stable at around 5%** over the past two decades.
- However, **contribution of manufacturing to overall growth is steadily decreasing**.

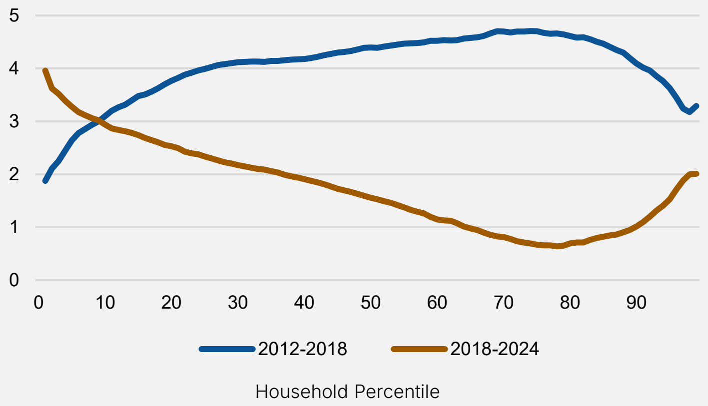
Indonesia has maintained its 5% growth for the past decades. However, the economic growth has been getting less inclusive

Real Wage and GDP Growth (%)



Source: Statistics; LPEM FEB UI calculation

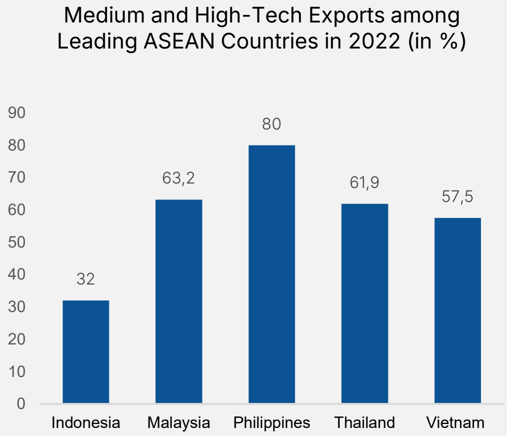
Growth Incidence Curve



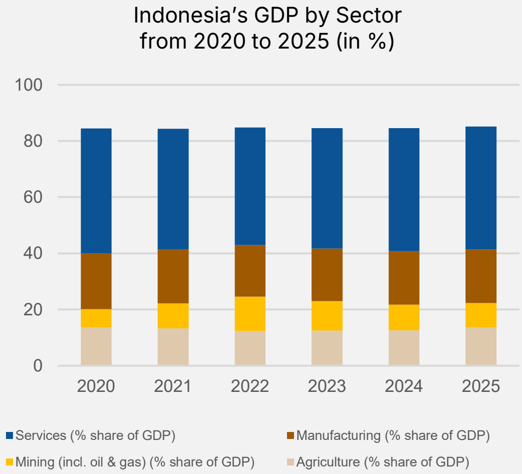
Source: Statistics, LPEM FEB UI calculation

- During 2017-2024, real wage only grew by 0.6% on average while GDP growth reached 4.0% on average during the same period.
- Unequal distribution of economic growth has been impacting the middle class. Since 2018, middle-class experienced lower expenditure growth compared to low-income and high-income population.

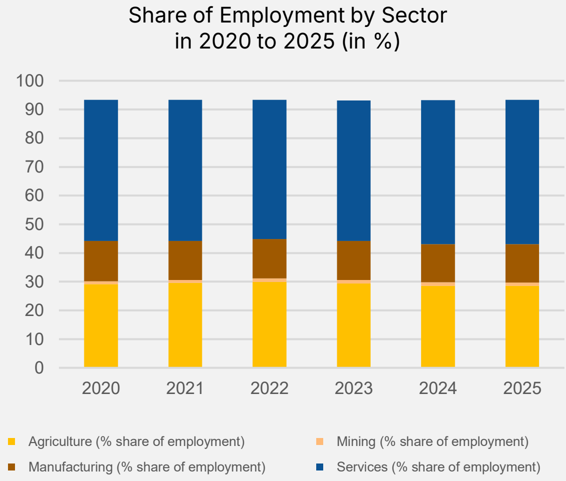
Indonesia's losing opportunity due to low productivity and weakening manufacturing sector



Source: APO & Ministry of National Planning (2025).



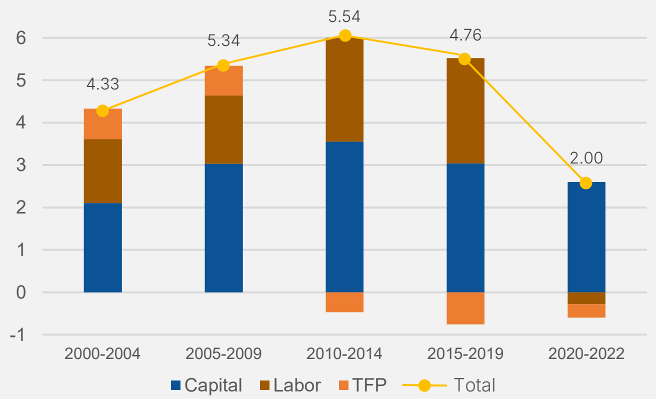
Source: BPS (2025)



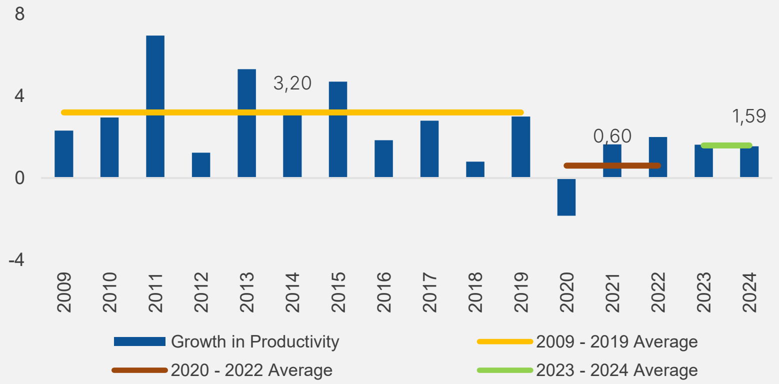
Source: Labour Force Survey, Statistics Indonesia

- In 2018, the share of manufacturing reallocation from China to Indonesia is really low compared to Thailand and Vietnam. Moreover, Indonesia has the lowest share of Medium and High-Tech exports compared to leading ASEAN countries in 2022. It signals the urgency for Indonesia to accelerate technological advancement in order to catch-up with peer ASEAN countries.
- There's been a persistent declining trend of manufacturing sector contribution to Indonesia's GDP from 19.87% in 2020 to 19.02% in 2025. It is also seen on the decreasing share of employment from the manufacturing sector, from 14.01% in 2020 to 13.45% in 2025.

Indonesia is at a critical point in shifting from input-driven development to TFP-led growth economy.



Source: APO Data (2023)



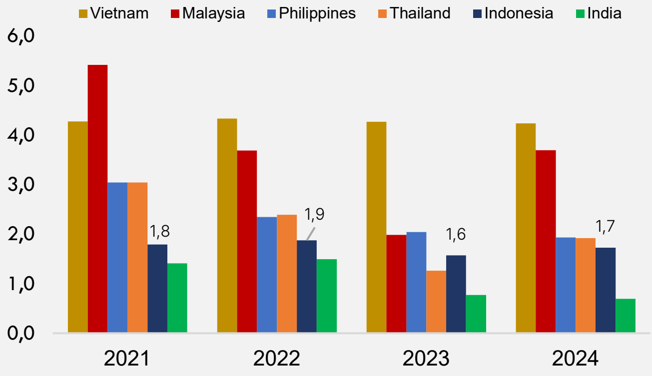
Source: Labour Force Survey, Statistics Indonesia

- Capital accumulation performs as the primary source of growth consistently with a steady increasing contribution. However, contribution from the TFP and labor has been fluctuating and roughly decreasing over two last decades.
- A worsening condition of productivity is also seen on decreasing labour productivity growth over the past three years. Productivity growth reached 2% in 2022, but it reduced to 1.63% in 2023, and further to 1.55% in 2024
- The correlation between TFP and output is estimated at 0.89, highlighting the growing crucial role of TFP in sustaining economic growth for Indonesia.

With FDI stalling and momentum weakening in 2025, 2026 should focus on quick wins that reduce policy uncertainty and improve execution to bring investors back

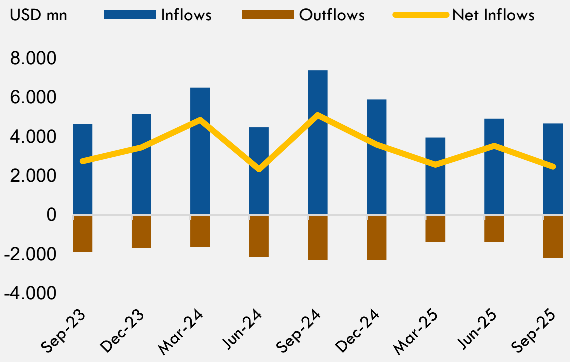
IBC
Indonesian Business Council

Net Inflows of FDI, % of GDP



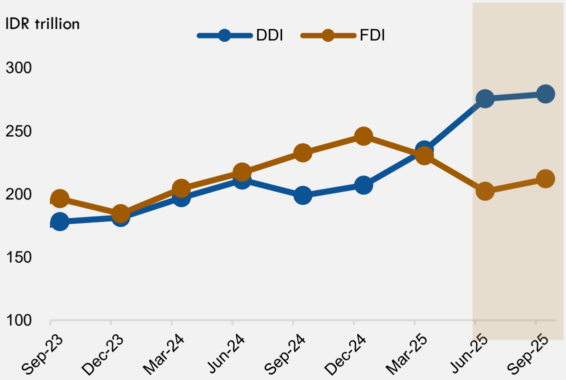
Source: BoP (BPM6); LPEM FEB UI calculation

Indonesia's Direct Investment Flows



Source: BoP (BPM6); LPEM FEB UI calculation

FDI and DDI (IDR trillion)

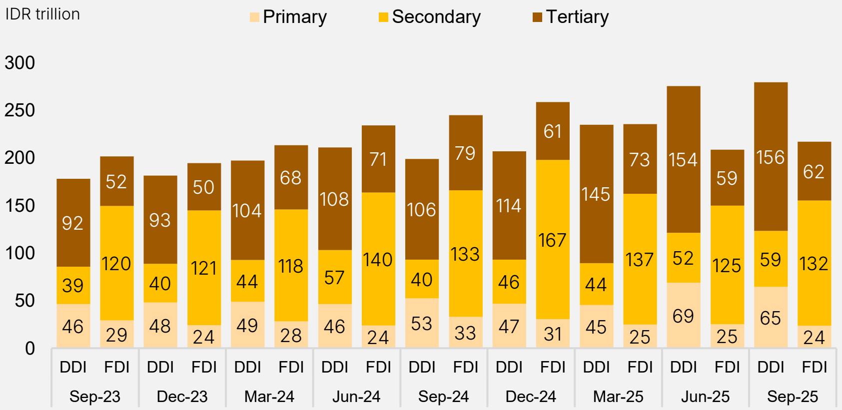


Source: BKPM, LPEM FEB UI calculation

- Indonesia's **FDI is stable in aggregate but not accelerating.** Net inflows in 2024 were around 1.7% of GDP, still far below peers such as Vietnam and Malaysia.
- 2025 shows a **clear loss of momentum with Q3 net inflows fell to about USD 2.46 billion** and cumulative Q1–Q3 dropped to USD 8.55 billion, consistent with an 8.9% YoY decline in BKPM realized FDI, while Vietnam still recorded growth, suggesting reallocation within the region rather than a uniform regional pullback.

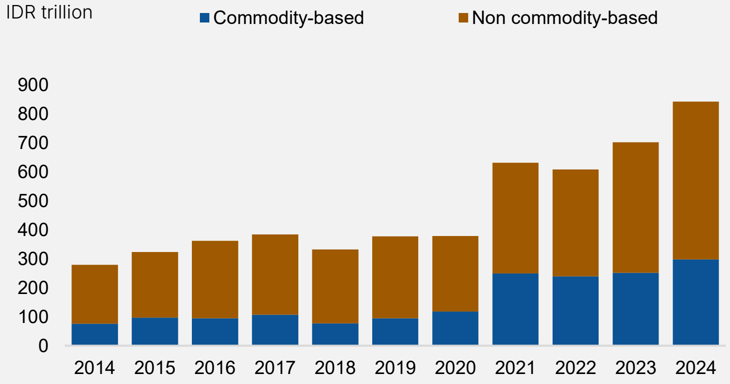
Without structural reforms, Indonesia will struggle to attract diversified FDI beyond commodities and mineral resources

DDI and FDI by Sectors (IDR trillion)



Source: BKPM, LPEM FEB UI calculation

Indonesia's FDI Inflows: Commodity vs Non Commodity-based (IDR trillion)



Source: BKPM, LPEM FEB UI calculation

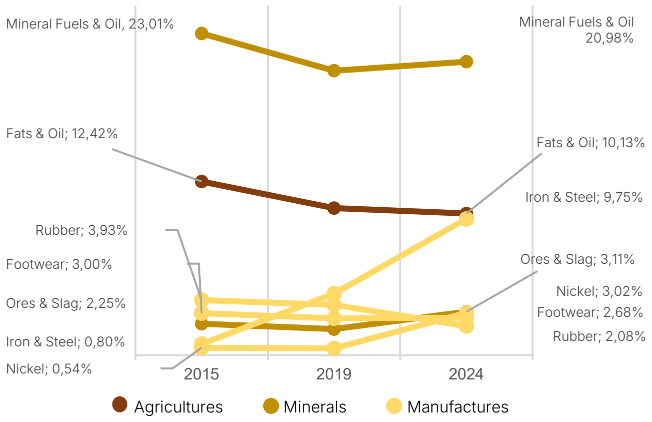
- Indonesia's FDI is still heavily skewed toward commodity and natural resource linked activities. Mining and metal processing take about 25.6% of inflows in Jan to Sep 2025, while non resource manufacturing is only about 1.54% and modern services about 8.4%, which leaves **Indonesia more exposed to commodity price swings and limits foreign capital for export manufacturing and higher value services.**
- In Q1 to Q3 2025, the sharpest FDI easing was in primary and tertiary sectors, while the secondary still grew but much of it remains tied to commodity downstreaming including China's nickel and mining projects.

Persistent trade surplus in the last five years is expected to narrow in 2026 due to slowing global demand and fluctuating commodity prices

Indonesia's export expanded at an average pace of 4.2% annually, overperforming several mature economies but trailing the more rapid growth recorded in China, India, and Viet Nam.

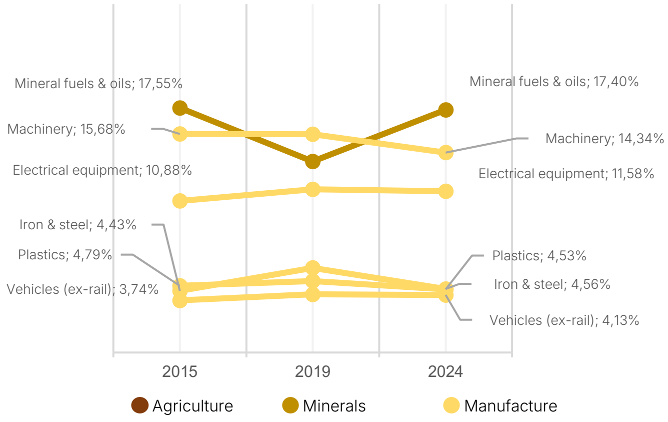
Indonesia remains **positioned in lower-value added segments of global value chains**, often focused on assembly and processing rather than higher-value activities.

Indonesia's Export Dynamics, 2015-2024 (% of Total Exports)



Source: International Trade Center, 2024

Indonesia's Import Dynamics, 2015-2024 (% of Total Imports)



Source: International Trade Center, 2024

Indonesia's export structure remains concentrated in resource-based commodities, with gradual diversification into higher-value products, while trade shifts towards emerging Asia and reliance on China grows, reducing its presence in high-income markets.

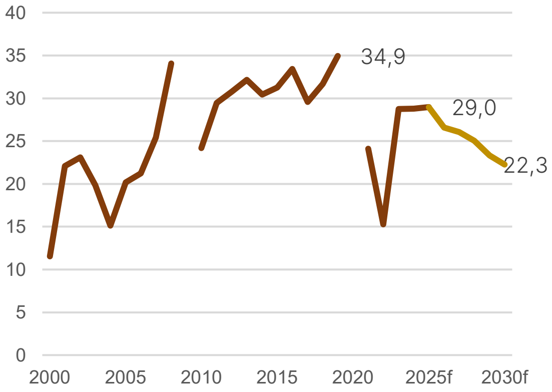
Increasing Indonesia's dependence on Chinese production inputs

Indonesia's import structure is dominated by capital and intermediate goods, with rising concentration and China becoming a key supplier, particularly in machinery, electrical equipment, plastics, and vehicles

External demand, commodities, and regulatory frictions will narrow the surplus

Indonesia's 2026 trade outlook will hinge on shifts in external demand and domestic regulatory and institutional constraints.

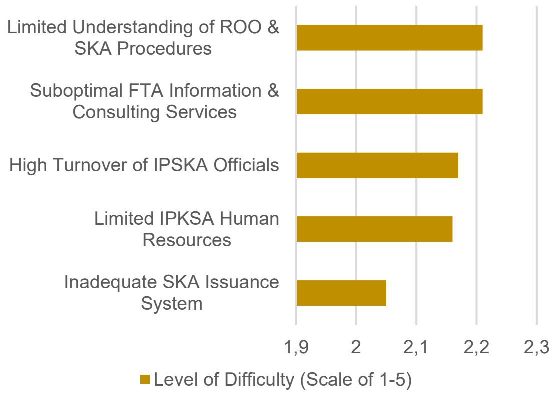
China's Contribution to Global Growth, 2000–2030 (%)*



Source: IMF World Economic Outlook, LPEM FEB UI calculation
*excluding 2009 and 2020

China's slowdown is expected to **weaken demand** for Indonesia's commodity exports.

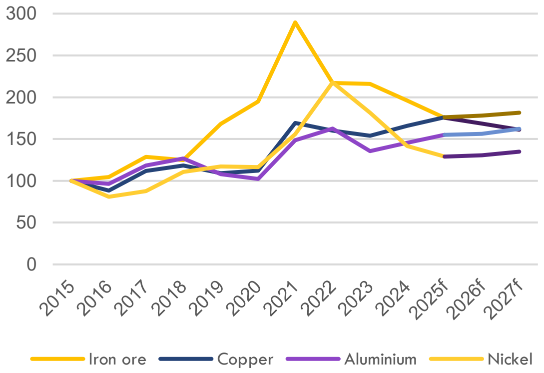
Level of Difficulty of COO/SKA



Source: LPEM and Directorate General of Customs and Excise Studies (2024)

Market access is **becoming more conditional** due to stricter environmental & sustainability standards, as well as risk of US-Indonesia trade talks breakdown.

Commodity Price for China's major imports (2015 = 100)

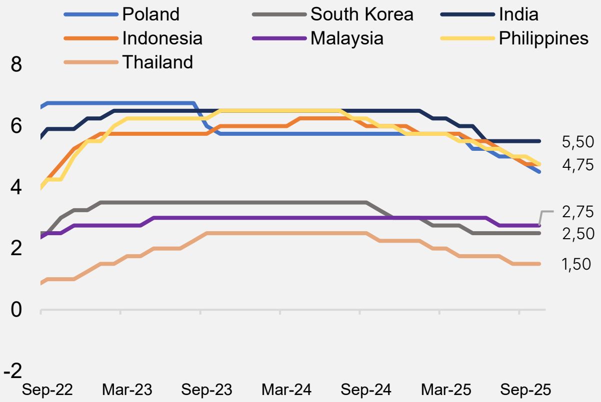


Source : World Bank Commodity Markets

China's excess capacity is **likely to spill into ASEAN markets**. Several factors will moderate nominal import growth: lower oil prices, cautious private investment, subdued domestic consumption.

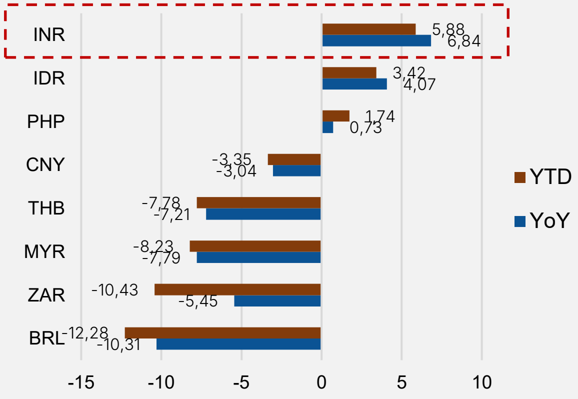
2026 will still be shaped by dollar cycle driven volatility, even with more supportive global policy rates

Policy Rates in Some Emerging Economies (Percent)



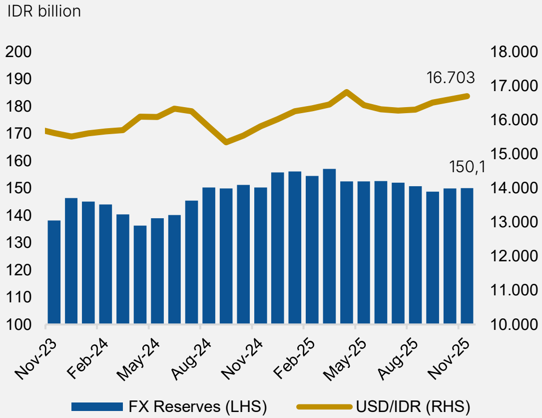
Source: Bank Indonesia and other selected central banks; LPEM FEB UI calculations

Depreciation Rate of Emerging Economy Currencies against the USD as of December'25 (Percent)



Source: investing.com; LPEM FEB UI calculations

Indonesia's Foreign Exchange Reserves and USD/IDR



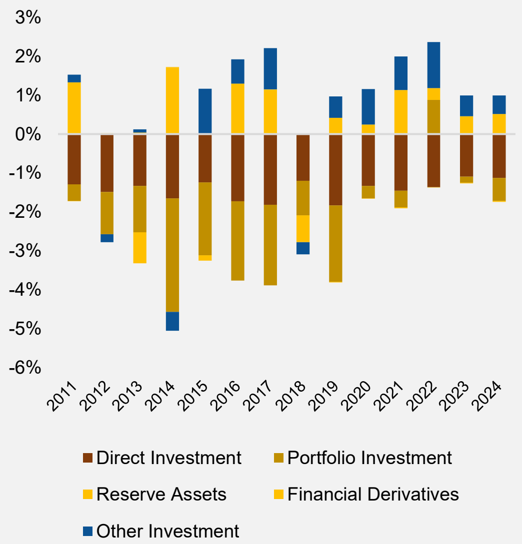
Source: Bank Indonesia; LPEM FEB UI calculations

- As inflation risk is still at bay due to geopolitical and security risk, central banks have been able to lowered interest rates, including BI's 100 bps cut in 2025. However, **Rupiah remained highly sensitive to the dollar cycle and portfolio shifts**, with deeper depreciation compared with peers and more episodes of market stress that required active market intervention.
- Indonesia's **FX reserves** provide a strong buffer, **but it has no power to eliminate volatility**, so 2026 should be treated as a risk management period where stability depends on policy credibility, market depth, and readiness to respond to sudden flow reversals.

Strong buffers from reserves help, but thin domestic financial market exacerbate volatility

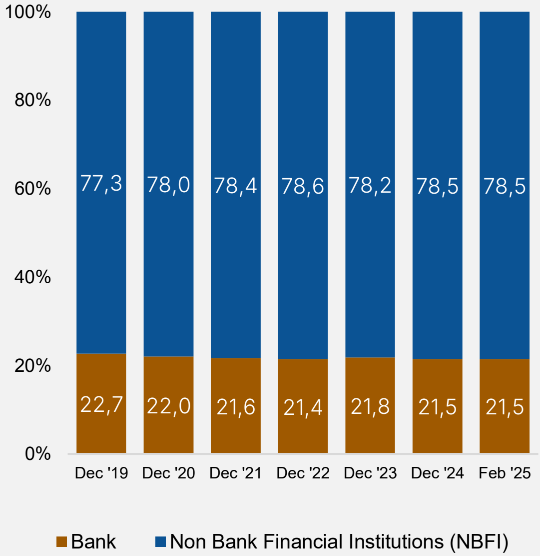
- Global financial integration has expanded sharply, but **cross border finance is still dominated by advanced economies and USD markets**, so shifts in the dollar cycle can trigger fast portfolio reallocations that spill into EMDEs exchange rates and yields.
- Indonesia's external position is safer than a decade ago, with a smaller NIIP deficit and stronger reserves, but it remains a **net debtor with buffers tied to commodity earnings.**
- In 2026, thin domestic financial markets mean **these external shocks can pass through more sharply into USD/IDR and** domestic yields, since liquidity and investable instruments are limited.

Composition of Indonesia's Net International Investment Position (% GDP)



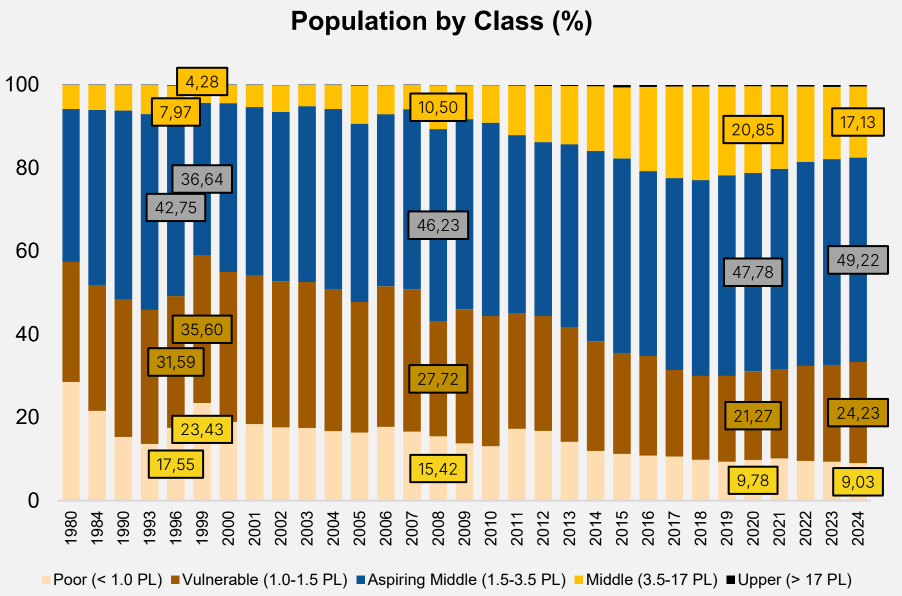
Source : IMF International Financial Statistics (IFS), LPEM FEB UI calculations

Bank vs Non-Bank Financial Assets to Total Financial Assets (%)



Source : Bank Indonesia

Economic growth has not fully translated into household purchasing power

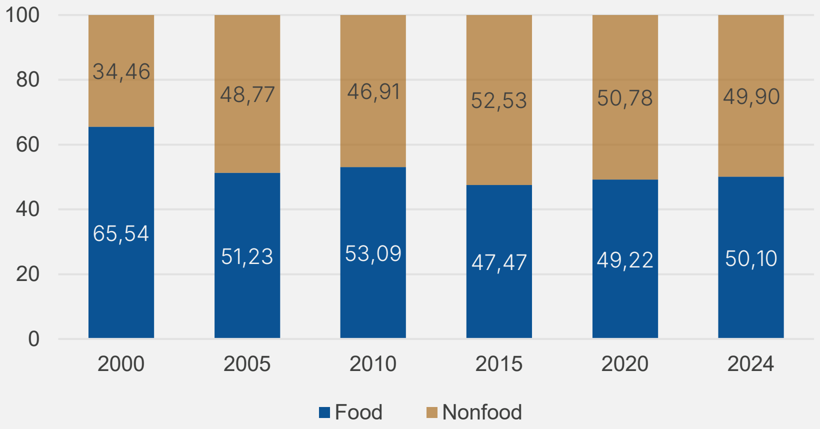


Source: Statistics Indonesia; LPEM FEB UI calculations

- As of 2024, 9.03% of Indonesia's population remains below the national poverty line.
- The population profile is heavily skewed toward lower income groups, with around 9% classified as poor, 24% as vulnerable, and 49% in the aspiring middle class.
- The aspiring middle class has emerged as the largest single group, representing approximately 49% of the population in 2024. Although they have moved beyond vulnerability, their economic position remains fragile.

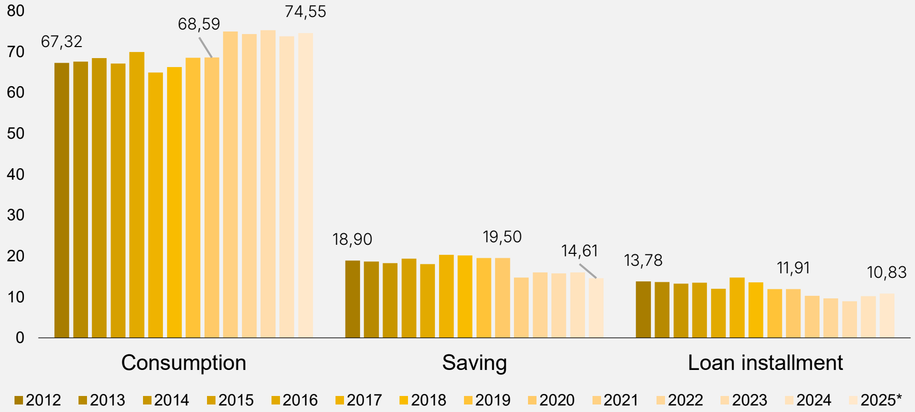
Household spending sustained by essentials and reduced savings

Food and Nonfood Expenditure (%)



Source: Statistics Indonesia; LPEM FEB UI calculations

Household Income Use (%)



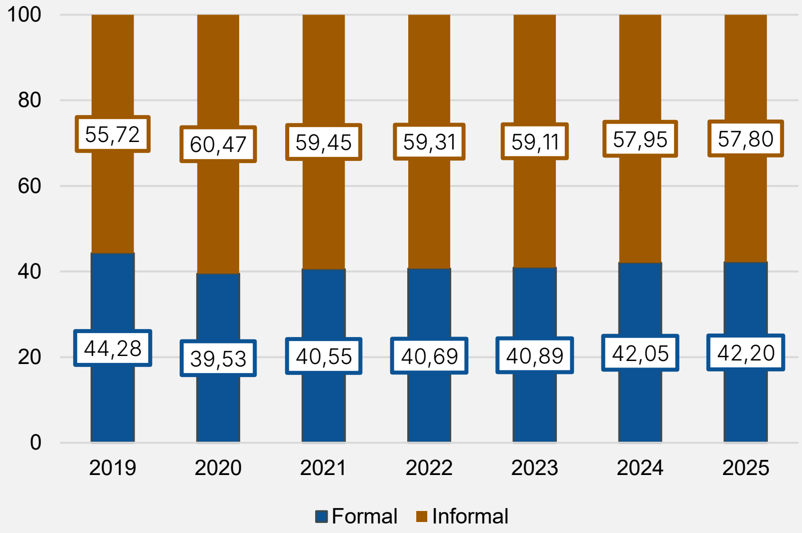
Source: Bank Indonesia; LPEM FEB UI calculations
* 2025 figure is average from January - May

- The share of food in household spending has risen again, from 47.5% in 2015 to 50.1% in 2024. This reversal across income groups signals renewed pressure on purchasing power, as households reallocate budgets away from nonessential consumption to cover basic needs.
- The share of household income spent on consumption has climbed steadily, reaching 74.6% in early 2025, while savings and loan repayments have been squeezed.

High global competition in labor-intensive sectors, combined with domestic constraints, is increasingly limiting Indonesia's capacity to create quality job

- **Global uncertainty, trade fragmentation, and supply-chain relocation have intensified competition**, including a surge of Chinese exports into ASEAN.
- Despite these shifts, Indonesia lags behind Vietnam in capturing reallocated export markets due to higher labor costs, technological lag, and the absence of a strong industrial policy.
- **China's industrial overcapacity has flooded domestic markets with cheap imports**, severely hitting labor-intensive industries such as textiles and garments.
- **Indonesia's investment has shifted toward capital-intensive extractive sectors,** weakening employment absorption despite rising investment values.
- **Employment growth is concentrated in informal and low-value-added services,** with only modest gains in formal jobs alongside rising underemployment and declining full-time work.

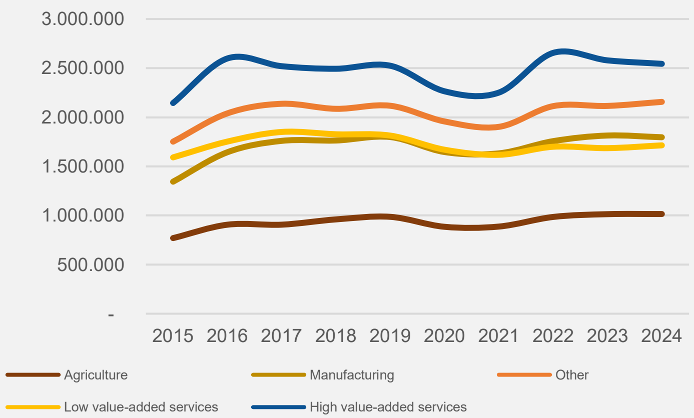
Proportion of Formal and Informal Workers (%), 2019-2025



Source : Statistics Indonesia, LPEM FEB UI calculation

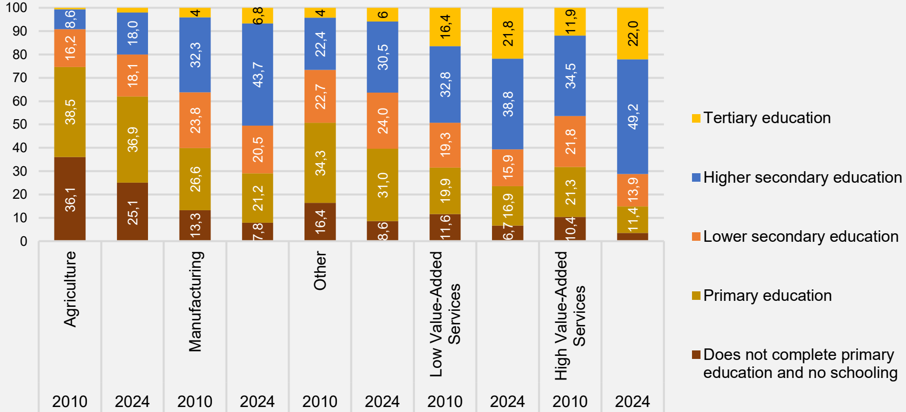
Labor market conditions remain broadly stable, while productivity, wages, and skills gaps persist

Real Wage by Sector (IDR), **2015-2024**



Source : Statistics Indonesia, LPEM FEB UI calculation

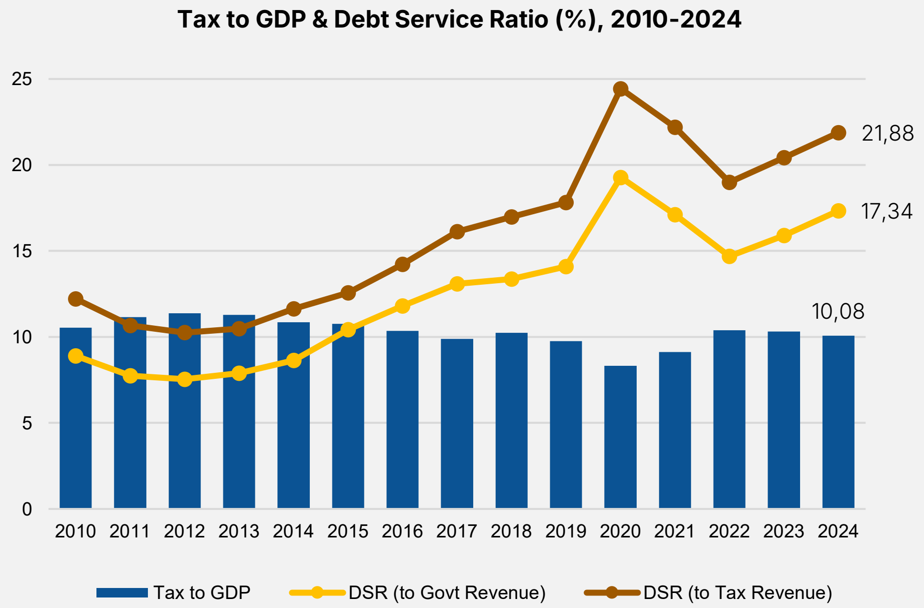
Worker's Educational Attainment by Sector (%), 2010 & 2024



Source : Statistics Indonesia, LPEM FEB UI calculation

- **Unemployment declined to 4.85% in 2025, but the number of unemployed remained at 7.46 million**, with rising layoffs, youth unemployment above 16%, and new jobs concentrated in low-wage sectors.
- **Real wages increased across sectors but gaps persist**: high-value services pay the most, agriculture pay the least despite employing many workers.
- **Education levels improved, yet disparities remain:** workers with higher education concentrated in high-value services (71% in 2024).

Fiscal space is increasingly constrained by weak revenues and rising debt service



Source: CEIC & Bank of Indonesia, LPEM FEB UI calculation
Note: Excise duties & Duties on Land and Building are excluded from tax income

- Indonesia's tax-to-GDP ratio has remained stuck at around 10% for more than a decade.
- By 2024, debt service absorbed over 17% of government revenue and nearly 22% of tax revenue, significantly higher than pre-pandemic norms, compressing fiscal space for capital expenditure and growth-enhancing investments.
- Large budget reallocations in 2025 and 2026 have shifted spending toward programs with delayed or uncertain growth payoffs, while cutting capital expenditure and regional transfers. This has tightened budgets at both the central and subnational levels, raising risks to public service delivery, infrastructure investment, and regional growth, particularly in transfer-dependent regions.
- Danantara introduces near-term fiscal and investment risks, as foregone SOE dividends, uncertain governance and project selection, and potential crowding out of private investment may weaken short-run growth before any long-term efficiency gains materialize.

Despite progress on the climate mitigation part, Indonesia is still lacking on the adaptation aspect

In terms of achieving the climate agenda, such as Net Zero Emission (NZE) by 2060, Indonesia focuses more on the mitigation effort, and several investments have been made in various sectors to reduce carbon emission. In the energy sector, investment in solar panel, geothermal, wind, and hydropower made its progress.

However, pushing for more development of renewable energy in Indonesia faces its own challenges as Indonesia is currently having oversupply in electricity. In 2024, Indonesia has 36.7 thousand GWh of electricity oversupply (PLN, 2025).

Indonesia's mitigation strategy continues to rely heavily on the land sector, particularly through the Forestry and Other Land Use (FOLU) Net Sink 2030 target, which pledges net negative emissions of 140 $MtCO_2e$ by the end of the decade. However, the credibility of this target has been called into question due to conflicting development priorities, such as food estate expansion and large-scale bioenergy projects (Climate Action Tracker, 2025).

Despite being the second most disaster-prone country in the world (World Disaster Risk Report, 2025), Indonesia is still facing a big gap between disaster risk and implemented mitigation efforts.

Currently, only 15.1% of all regions (provinces) have such mitigation systems in place (Statistics, 2024). This means that there are still many areas in Indonesia that are not prepared and are at high risk of experiencing significant impacts during disasters.

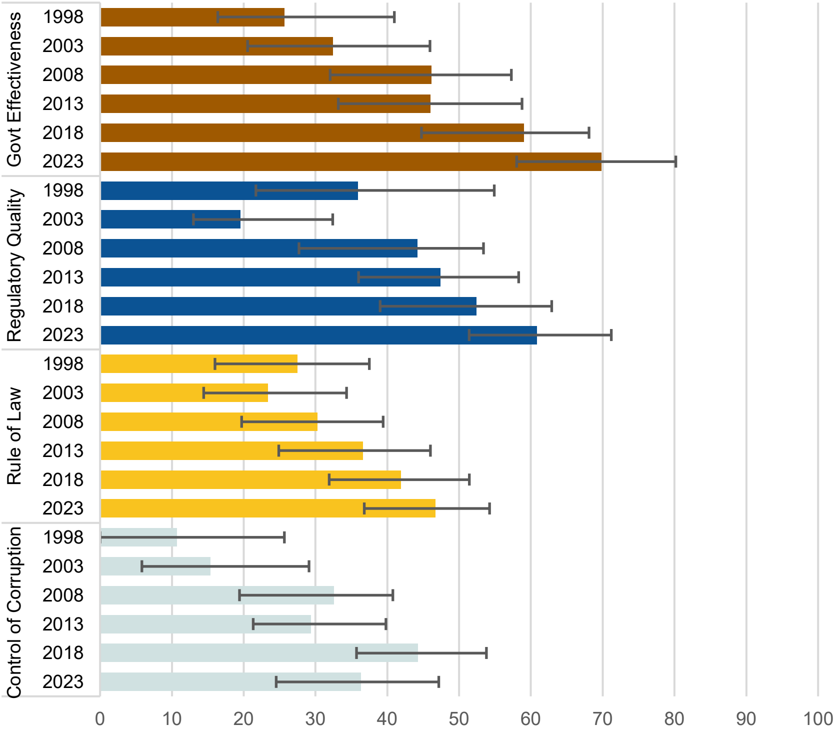
Three Catalysts (3C) for Optimized Growth:

Certainty, Capability, Capital

Certainty: Rule of Law

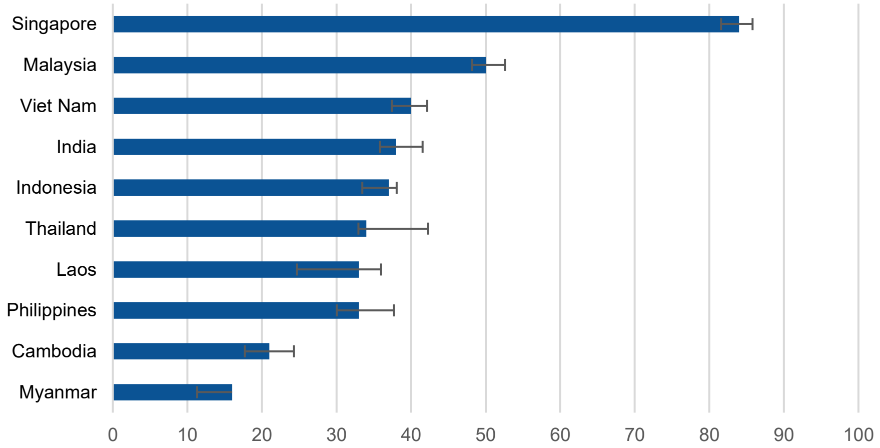
Quality of governance has not made great strides since 2008

Indonesia's Governance Indicator (in n-th percentile)



Source: World Bank Governance Indicators

2024 Corruption Perception Index, Selected Peer Countries



Source: Transparency International

- Significant leap in governance quality compared to 1998, but **progress has stuck since 2008.**
- **Corruption perception-wise**, Indonesia is comparable to its fast-growing peers such as Viet Nam and India. Nonetheless, **we are only clearly ahead of war-ridden Myanmar** and an **authoritarian Cambodia** in ASEAN.

Capability: Investment in Human Capital

Human capital quality, not access, is now the binding constraint on Indonesia's productivity-led growth

Productivity is the binding driver of long-term growth, and depends critically on human capital, health, skills, and learning quality that enable technology adoption, innovation, and movement into higher value-added activities (World Bank, 2018).

Human capital outcomes lag peers. As of 2020, Indonesia's Human Capital Index at 54%, below the East Asia & Pacific average (59%) and upper-middle-income peers (56%), implying substantial foregone future productivity.

The constraint is outcomes, not access, high enrolment and child survival coexist with low learning-adjusted years of schooling and persistent stunting, limiting workforce readiness and lifetime productivity.

i. Shift focus from expanding coverage to improving effectiveness across the life cycle, ensuring health and education spending translates into learning, skills, and sustained work capacity.

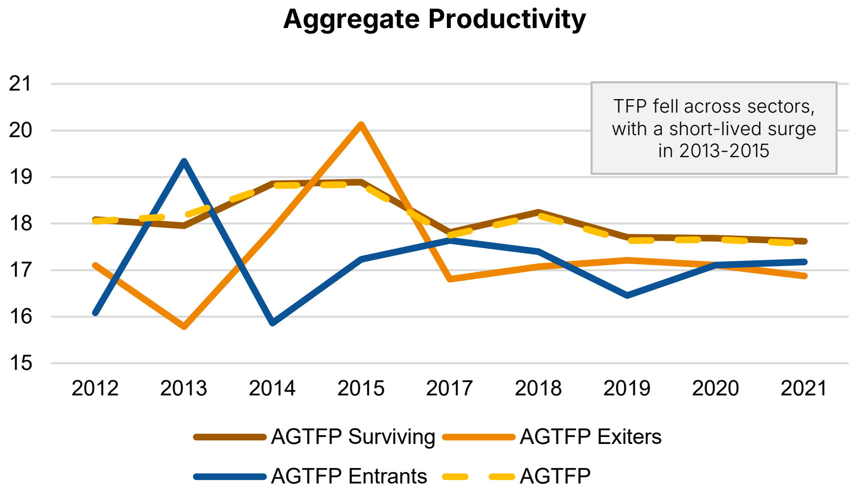
ii. Prioritise high-return early interventions, scaling targeted nutrition, health, and early childhood development programmes to prevent irreversible productivity losses and raise the effectiveness of later education spending.

iii. Reorient basic education toward learning outcomes, strengthening teaching quality, curriculum relevance, and accountability to build foundational literacy and numeracy that support technology adoption and productivity growth.

Beyond basic education, aligning vocational and tertiary skills formation with industry needs, including through SEZ-based university–industry collaboration and targeted skills for global labor markets, is critical to meet labour market demand.

Capital: Competitive Market and Access to Finance

Creating competitive market and promoting access to capital and finance are the primary catalyst to break the current economic growth stagnation



Source: Lufti et al., 2025

Aggregate productivity growth is driven by two components:

- **Within Effect**: firms improving internal efficiency through innovation
- **Between Effect:** market-driven reallocation toward more productive firms

- **Total Factor Productivity (TFP) growth in 2013-2015** was driven by **unhealthy market composition,** as **more productive firms exited while less productive firms entered**, indicating a clear **selection failure.**
- Productivity decomposition shows a shift from **innovation-led growth (2011-2015)** to **growth driven by market reallocation among incumbents (2017-2021)**, alongside declining internal efficiency, raising the risk of **Destructive Creation.**
- Restoring Creative Destruction requires **structural reforms** (lower entry-exit barriers, greater trade openness, redesigned industrial incentives, stronger competition enforcement) and **institutional reforms** (upholding the rule of law, protecting innovation, expanding SME access to finance, investing in skills, and strengthening governance and screening mechanisms).
- **Easing financing constraints, which helps firms become more productive** and contribute more to the economy, is also an important driver of growth in 2026.

Recommendations

Recommendations

For Government

Pushing growth to meet the government’s 5.4% optimistic projection in 2026 require policy shifts:

1. Raise tax buoyancy through base broadening and compliance, then shift spending back toward high multiplier areas like infrastructure, logistics, health, and education while keeping social programs targeted.
2. Maintain a pro growth stance with clear guardrails for fiscal monetary coordination, and improve transmission by deepening money, repo, and bond markets to narrow spreads.
3. Improve credit allocation using stronger credit infrastructure and more cash flow based lending, tighten consumer protection in digital credit, and expand non bank finance for long term funding.
4. Reduce policy uncertainty by strengthening rule of law and regulatory consistency, limit SOE crowding out, and cut rent seeking through simpler risk based regulation and better enforcement.

For Business

1. Diversify customer segments toward more resilient demand pockets
2. Manage input costs through supplier diversification
3. Invest selectively in workforce capabilities
4. Prepare for emerging climate and sustainability requirement

THANK YOU