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Economics | Indonesia

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Economics

3Q26 GDP: Headline Beat Masks Weaker Domestic Demand

Highlights

- **Headline GDP beat is a statistical anomaly, not a sign of stronger growth.** Indonesia's 3Q26 GDP grew 5.47% yoy, above consensus and our forecast, but the upside was driven mainly by a narrower net-export contraction, high inventory growth, and a significant rise in statistical discrepancy, not by broad-based domestic demand.
- **Domestic demand continues to weaken.** Household consumption, government spending, and investment all remain on a slowing trend. Household consumption grew 5.04%, supported largely by subsidies and social aid, while labour market conditions worsened. Informal sector employment rose to 57.93% of the workforce and average wages grew only 2.52% yoy, below inflation.
- **Outlook remains steady but risks are building.** We forecast GDP growth of 5.3% in 4Q26 and 5.3%-5.6% in 2027, supported by expansive fiscal policy and commodity-related investment. However, weakening domestic demand, rising external-balance risks, potential MSCI/credit-rating downgrades, and higher inflation are likely to keep pressure on Bank Indonesia to raise rates. We expect at least one 25bp hike to 6.00% by end-26 and another in 1Q27.

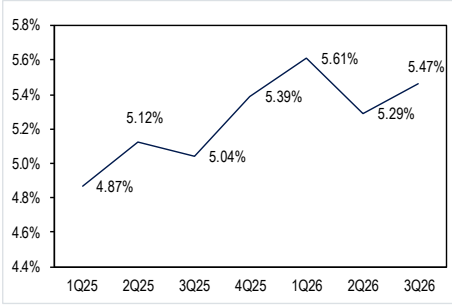
Analysis

- Indonesia's GDP grew 5.47% yoy in 3Q26, slightly accelerating from 5.29% in 2Q26 and coming in well above both market consensus (5.20%) and our forecast (5.18%). Despite the stronger headline print, we view the result as a statistical anomaly rather than evidence of robust economic growth. The upside surprise was driven mainly by: a) a narrower contraction in net exports due to slower import growth; b) high inventory growth amid weaker domestic purchasing power; and c) a consistent rise in statistical discrepancy.
- By contrast, all major domestic demand components – household consumption, investment, and government spending – remain on a slowing trend.
- **Household consumption grew 5.04%,** slower than in the previous quarter, and was supported largely by state subsidies, which rose 28.0% yoy, and social assistance, which grew 8.1% yoy. Labour market indicators also point to further deterioration. The share of workers in the informal sector continued to rise, reaching 57.93% of the total workforce, or approximately 85.73m people. Meanwhile, average wages grew only 2.52% yoy in Aug 26 to Rp3.415mn, below national inflation of 3.19% yoy.
- **Government consumption grew 8.95% yoy,** down from 15.97% in the previous quarter, reflecting slower staff and goods spending amid increasingly limited fiscal space. Investment growth also slowed to 6.06%, weighed down by higher interest rates and weaker private sector confidence, despite government capital-goods spending rising 20.1% yoy.
- On the production side, the stronger GDP print was supported by acceleration in several major sectors. Manufacturing grew 5.87% yoy, helped by higher CPO and nickel prices. Mining recorded a slight acceleration to 0.91% yoy, supported by higher mineral prices.
- Several sectors also benefitted from government-related activity. Accommodation and food and beverage growth improved, partly due to the Free Nutritious Meals (MBG) programme. Wholesale and retail trade grew 7.14% yoy, driven by government procurement of goods for priority programmes. However, agriculture – a significant contributor to GDP – slowed to 0.46% yoy due to forest fires in Sumatra and Kalimantan.

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Growth Of Indonesia's GDP



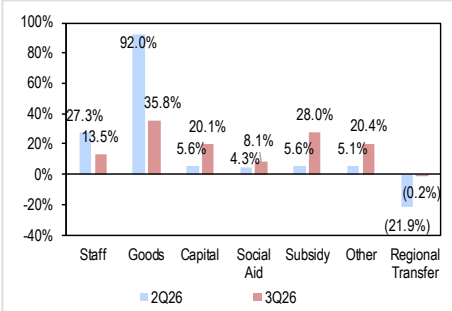
Source: BPS

Growth Of GDP Components

% yoy	3Q25	2Q26	3Q26
GDP	5.04	5.29	5.47
Household Consumption	4.89	5.06	5.04
Investment	5.04	6.87	6.06
Government Consumption	5.66	15.97	8.95
Export	9.14	4.07	4.59
Import	0.86	9.34	7.31
Net Export	53.76	-23.10	-5.04
Inventory	-53.62	0.33	32.63
Statistical Discrepency	314.85	9.50	4.85

Source: BPS

Growth Of State Spending (APBN)



Source: MoF

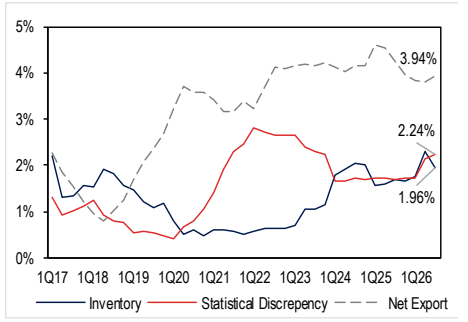
- Regionally, the acceleration was driven largely by manufacturing – heavy regions such as Java, which grew 5.84% and accounts for 56% of the economy, and Sumatra, which grew 4.95% yoy. Higher global commodity prices supported growth in commodity-heavy regions such as Bali & Nusa and Maluku & Papua. In contrast, the rapid spread of forest fires caused growth to taper slightly in Kalimantan, while growth in Sulawesi slowed due to weaker construction activity on government projects.
- In our view, the higher-than-expected GDP figures point to a disturbing trend: The growing role of inventory and statistical discrepancy in Indonesia's GDP data. In 3Q26, these two components accounted for almost 5% of real GDP and have been on an upward trend since the COVID-19 pandemic in 2020.
- We believe the larger role of inventory reflects relatively weak purchasing power and increased competition from cheap imports, which are causing firms to increasingly overproduce goods. On the other side, the growing role of statistical discrepancy may stem from increasing informality in the economy or, more technically, from the gap between GDP calculated using the expenditure approach and GDP calculated using the production approach.
- In addition, the latest GDP figures signal the rising role of external demand, as shown by net exports' increasing contribution to GDP, rising from around 1% in 2018 to 5% in 2026. This is mostly driven by higher exports, especially in extractive sectors such as coal and CPO. Conversely, domestic demand has been weakening, as reflected in the declining shares of household consumption, government consumption, and investment. This is another major warning sign, since Indonesia's economy has mostly been domestically oriented – a feature that has made it relatively resilient amid global shocks.
- Financial-market reaction to the GDP figures has been relatively muted, with much of the focus on concerns about slowing domestic demand. However, relatively stable GDP figures and high volatile inflation have caused markets to increasingly price in another 25bp rate hike in Bank Indonesia's policy rate in Nov 26.

Outlook

- **After the higher GDP print in 3Q26, we project still-steady but slightly lower growth of 5.3% in 4Q26.** The moderation will be driven by several factors. First, state spending is likely to contract by 2.8% yoy due to front-loading in the first half of the year. Second, higher inflation – which has caused the GDP deflator to increase significantly – is likely to weigh on domestic purchasing power and therefore on consumption.
- **Relatively expansive fiscal policy and high global commodity prices should support investment activity, despite higher interest rates.** We expect net exports to remain significant, supported by slightly lower oil prices and still relatively strong export demand from China, the United States, and India.
- **For 2027, we still expect relatively high GDP growth in the range of 5.3%-5.6% yoy,** driven by expansive fiscal policy, state-related activities by state-owned enterprises, and domestic investment in commodity-related sectors. Despite the still-high GDP growth, we expect further deterioration in macro risk, especially from the external balance, such as a worsening current-account balance and increased capital outflows due to a looming MSCI downgrade and possibly a credit-rating downgrade. Geopolitical tension is also expected to keep oil prices high, maintaining pressure on Indonesia's fiscal balance.

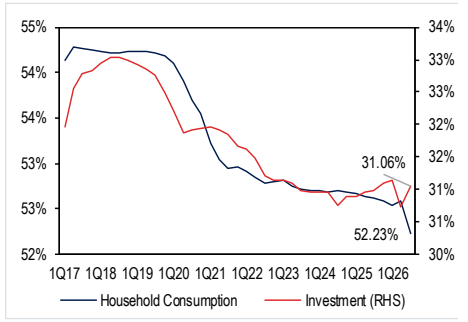
- **Meanwhile, domestic inflation in 2027 is likely to fall back into the 1.5%-3.5% yoy range,** driven by the dissipating El Niño weather phenomenon and

Contribution of Real GDP Components (4Q-MA)



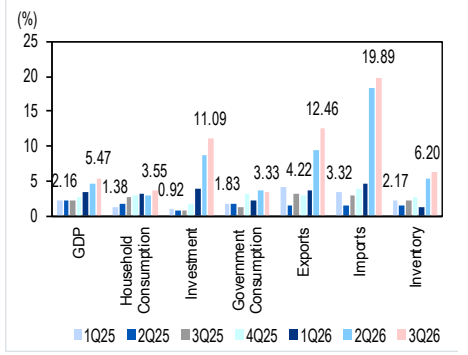
Source: BPS, UOB Kay Hian

Contribution of Real GDP Components (4Q-MA)



Source: BPS, UOB Kay Hian

GDP Deflator Growth



Source: BPS, UOB Kay Hian

lower food inflation. However, still-high oil prices may force the government to increase subsidised fuel prices, driving inflation significantly higher.

- These developments – expansive fiscal policy, an expanding current-account deficit, and rupiah depreciation – will further increase pressure on Bank Indonesia to raise its policy rate, especially with global central banks continuing to increase rates amid higher global inflation. Therefore, we expect at a minimum one 25bp hike to 6.00% by end-26 and another 25bp hike in 1Q27.

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