PEREIRA INTERNATIONAL

INDONESIA : BUSINESS SECTOR UNDER STRESS

Summary

- Businesses operating in Indonesia are feeling the heat from the government. They have been shaken by unfair taxes and fines, confiscation of assets and ill-conceived policy measures.

- The implications are very serious, given the larger context in Indonesia, where political, economic and regulatory shifts have already made the country highly vulnerable to a shock. These domestic developments amplify the stress induced by the Iran war and the ensuing energy shock.

- Initially, Indonesian businesses were inclined to accept these developments as part and parcel of the costs of doing business in the country. However, as the challenges have grown, they are becoming more and more concerned. The risk of a downward spiral that could lead to a full-blown crisis is increasing.

- The end game could therefore be messy. At the minimum, Indonesia is likely to enter a period of political and economic turbulence, with a small but rising chance of a severe political crisis.

Why are Indonesian businesses concerned?

Companies operating in Indonesia, both domestic as well as foreign, have faced a tumultuous time since President Prabowo took office.

First, chaotic economic management has made for a troubled economic environment:

- **The fiscal deficit looks dangerous as a result of ill-thought out**

spending programmes such as the free school lunches scheme and the plan to establish 80,000 cooperatives across the nation are expensive and have caused the fiscal deficit to swell. The administration has also allowed the fuel subsidy bill to expand massively. At the same time, the government has backed off from revenue-raising measures as seen, for example, in the President's decision to cancel the increase in the VAT rate last year. As a result, rating agencies are considering downgrading Indonesia's sovereign rating – which would increase Indonesia's borrowing costs while reinforcing concerns of investors.

- **The result: capital outflows have grown and the Rupiah has sharply weakened:** Bloomberg estimates that global investors have withdrawn around USD2 billion from Indonesian equities alone so far in 2026, for example. The Rupiah has weakened by 5% since the beginning of the year and now trades at an historic low, that is even worse than at the worst moments of the 1997-98 financial crisis. A falling Rupiah creates uncertainty and raises the costs of critical imported items that firms need. Because Indonesians remember all too well how quickly a weakening Rupiah can trigger high inflation, further Rupiah weakness and problems for the banking sector, there is always the risk that Indonesians themselves will pull money out of the country, and thus amplifying the problems.

Second, the firms have to deal with arbitrary fines and confiscations as well:

- **Confiscation of property is now a risk that businesses did not have to deal with before.** Between March 2025 and January 2026, the central government has seized more than 4 million hectares of land from plantations, mine concessions and processing facilities. These assets are now under the control of a new state-owned firm that is run by retired military officers. Prabowo has warned that "This is just the beginning", complaining that the assets were taken from companies that had committed illegal acts such as deforestation. In related cases, a large number of oil palm plantation companies were fined around USD560 million, with 22 mining companies charged USD1.7 billion as compensation for the losses they were accused of causing to the state by their illegal activities – amounts which the firms believe were arbitrarily calculated on offences which were also poorly substantiated.

- **Companies have been forced to lend money to state agencies at below-market interest rates:** Prabowo has established a sovereign wealth fund called Danantara to manage state assets. Indonesia's top business families were pressed to subscribe to Danantara bonds at yield of 2%, far below prevailing lending rates in Indonesia. There are now reports of a second cash call of a similar nature being made to these families.

- **Centralised control of commodity export revenues has been a further shock:** Prabowo announced last week that his government will centralise export sales of key commodities in order to prevent abuses such as under-invoicing of exports by companies. His finance minister has now accused prominent plantation companies such as Wilmar International and Musim Mas of such offences. While some of the abuses may be real, the measures taken seem ill-suited to solving the problem and many observers feel could also lead to corruption.

- **Foreign investors have also been rattled.** The Chinese Chamber of Commerce recently issued a letter complaining bitterly of sharp tax and levy increases, mandatory foreign exchange retention requirements, reduced nickel ore quotas, excessive forestry law enforcement, suspension of major projects and increased scrutiny of work visas. They also reported that fines of USD180 million were imposed on Chinese enterprises who were unfairly accused of not having valid permits to use forested areas. It is not only Chinese investors who are rattled. Hong Kong's Jardine Matheson has seen its Martabe gold mine seized as well, although the government now says the decision is being reviewed.

What are the implications?

A confluence of dangerous factors is in place, threatening to unleash a crisis.

As we saw in August, the political ground is unhappy to the point that negative events can quickly escalate into violent protests – the middle class has shrunk and median wages have stagnated in real terms. Infighting within the government coalition and even within Prabowo's own faction compound these risks. Now we have a global energy shock which is raising inflation, weakening Indonesia's already precarious fiscal position and weakening its Rupiah.

The last thing Indonesia needs now is for its own domestic firms and the foreign investors whose capital and technology are vital to lose confidence. If they cut back on investment, economic growth could tank. If they pull money out of the country, the weakening of the Rupiah could turn into an outright rout.

The government's responses have amplified the stresses the economy is already under.

When Chinese investors issued their complaint described above, the Finance Minister's initial response was cold and insensitive, dismissing their concerns with this extraordinary statement - "If [investors] want to move, they can look for minerals [elsewhere]. Foreign investors can still invest in other countries if they feel Indonesian policies do not align with their business interests."

It was also quite disturbing that, at a time when the Rupiah is under severe pressure and investors already pulling money out of Indonesia, senior leaders were making decisions and statements that could only aggravate the loss of confidence. For example, Prabowo chose to make his statement about centralising export sales in the middle of this ongoing loss of confidence showing little awareness of the underlying dangers. He went on to announce targets for economic growth and the fiscal deficit this year that were wildly implausible.

The conclusion a lot of local as well as foreign investors will draw is that the policy makers have lost touch with reality.

The end game: prepare for further deterioration

We set out our revised scenarios below:

The critical swing factors are:

- Appointment of credible, strong technocrats who are empowered to bring in reforms such as abolition of fuel subsidies, cutting spending on political projects, and a reversal of the statist interventionist model that Prabowo has been following.

- Governance reforms in Danantara and elsewhere.

- Assurances to the major Indonesian business families against arbitrary policies.

The trouble is that Prabowo is unlikely to enact these. Hence the downbeat scenarios.

Scenario	External conditions	Domestic conditions
Optimistic ~25%	• Hormuz stalemate reaches a sustained pause; shipping resumes, energy prices stabilise • Global risk sentiment improves; capital flows return to emerging markets • Only limited Fed tightening; US bond yields stabilise • USD softens modestly; emerging market (EM) currencies partially recover, taking the pressure off the Rupiah	• Bank Indonesia (BI) delivers further hikes (50bps or more) and is permitted to hold rates "higher for longer" • Meaningful fiscal consolidation, including genuine downsizing of politically salient programmes e.g., MBG • Institutional repair: credible technocratic appointments at the Finance Ministry and central bank restore market confidence • OJK governance reforms satisfy MSCI ahead of June review; Frontier reclassification risk removed

Scenario	External conditions	Domestic conditions
Central "Muddling Through" ~45%	• Hormuz disruption persists but does not escalate; oil stays elevated without spiking further • Global risk-off continues at reduced intensity; EM outflows slow but do not reverse • Fed holds but maintains hawkish rhetoric; UST 10-year stays above 4.5% • USD remains firm; rupiah weakens but does not collapse	• BI delivers a further ~50bps in hikes but faces growing political pressure to pause • Modest fiscal adjustment; MBG and other flagship programmes left broadly intact; cuts concentrated in infrastructure and transfers • No meaningful institutional repair; governance discount on Indonesian assets grows • MSCI maintains freeze; no Frontier reclassification but no restoration of positive changes; further passive outflows • Economic growth weakens sharply, inflation spikes up, there are protests on the street and Prabowo struggles, but ultimately holds his coalition together with military support.

Scenario	External conditions	Domestic conditions
Pessimistic ~30%, with fat tail risk	• Hormuz conflict escalates or spreads; oil spikes materially above current levels • Broad EM capital flight accelerates; global risk-off intensifies • Fed delivers one or more additional hikes; UST 10-year stays elevated at around 5% • Indonesia Rupiah weakens sharply	• BI hikes rates but faces acute political pressure to cut prematurely before rupiah stabilises; a premature pivot triggers a further leg down • Political interference in monetary policy intensifies; BI independence openly questioned by markets • Fiscal position deteriorates toward or past the 3% ceiling; no credible consolidation; rating agencies act • MSCI issues formal Frontier reclassification; mandate-driven outflows continue • Economic growth stagnant, inflation rises. Widespread political turmoil, efforts to impeach Prabowo are mounted. These do not succeed but Prabowo is left a lame duck.

Pereira International Pte Ltd
1 Fullerton Road,
#02-01, One Fullerton,
Singapore 049213
Tel : +65 6248 4790
Cell : +65 9622 3361

www.pereiraintl.com

email :
info@pereiraintl.com
derwin.pereira@pereiraintl.com