

INDONESIA: PANIC OR PARADIGM SHIFT?

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The Jakarta Composite Index (JCI) plunged as much as 5.7% intraday to 5,842, marking a fresh low for 2026 and bringing the market back to levels last seen during the selloff of 2025. At the same time, the Indonesian Rupiah weakened to Rp17,953 per US Dollar, making it one of the worst-performing currencies in Asia year-to-date. Foreign investors have continued to exit Indonesian assets aggressively, with cumulative net equity outflows reaching IDR66.2 trillion year-to-date.

What makes the current episode particularly striking is the growing divergence between Indonesia and the rest of the world. While major global equity markets continue to trade near record highs, Indonesian assets have moved in the opposite direction. This is no longer a story about a broad-based Emerging Market selloff. Increasingly, it is becoming a story about Indonesia-specific risk.

For many investors, the discussion has already moved beyond the question of why markets are falling. The drivers are well understood. ***The more important question now is whether Indonesia is experiencing a temporary confidence shock or entering a more prolonged period of structural de-rating.***

WHAT IS THE MARKET ACTUALLY PRICING?

Under normal circumstances, market corrections are driven by slower economic growth, weaker corporate earnings, or adverse external developments. The current environment appears different.

What investors are selling today is not merely Indonesian equities. They are selling confidence in the broader Indonesia investment narrative.

The scale of underperformance has become increasingly difficult to ignore. Indonesia-focused ETF EIDO has delivered a total return of -28.6% in US Dollar terms since the beginning of 2025, making it one of the weakest-performing major equity markets globally. This compares with gains of +64.6% for Emerging Markets, +63.2% for Vietnam, +107.2% for Taiwan, and +30.9% for US equities over the same period.

In other words, global investors are not abandoning Emerging Markets. They are specifically reducing exposure to Indonesia.

THE BEAR CASE: WHY INVESTORS ARE CONCERNED

In our view, five key concerns are currently driving investor sentiment.

First, concerns surrounding governance and policy credibility have intensified. Both Moody's and Fitch have revised Indonesia's outlook to Negative, while investors increasingly speculate whether S&P Global Ratings could eventually follow a similar path. Importantly, the issue is not economic growth itself, but rather growing concerns regarding institutional quality, policy predictability, and decision-making consistency.

Second, currency pressures continue to build. A Rupiah approaching 18,000 per US Dollar raises concerns about imported inflation, household purchasing power, and the attractiveness of Indonesian financial assets for foreign investors. Indonesia's trade surplus narrowed sharply to just USD90 million in April 2026, the smallest surplus since April 2020, as an 85% surge in oil and gas imports offset otherwise healthy double-digit export growth.

Third, investors are increasingly questioning the strength of domestic consumption. For years, Indonesia's investment case rested heavily on the narrative of a rapidly expanding middle class. Recent data, however, suggest the middle-class population has declined from approximately 61.5 million in 2018 to around 46.6 million in 2026, raising questions about the long-term strength of Indonesia's most important growth engine.

Fourth, persistent foreign capital outflows continue to weigh on market sentiment. Despite the JCI currently trading at roughly 9-11x earnings—compared to around 11-12x during the depths of the Covid-19 crisis—foreign investors remain net sellers, suggesting that valuation alone has not yet been sufficient to attract meaningful inflows.

Fifth, leadership risk and policy communication risk have become increasingly important considerations. Investor concerns are no longer limited to fiscal policy, the Rupiah, or the equity market itself. Instead, attention has shifted toward how policymakers respond to market stress and communicate economic priorities. Growing uncertainty regarding policy direction and government messaging risks prolonging the current confidence crisis, even though underlying macroeconomic conditions remain far from a full-blown financial crisis.

Should these concerns persist simultaneously, Indonesia could face a period of structural de-rating similar to what has been observed in markets such as Brazil, Turkey, and South Africa during certain periods—economies that continued to grow, yet traded at persistently lower valuations due to elevated risk premiums.

DANANTARA: SAVIOR OR ANOTHER REFLECTION OF SOVEREIGN RISK?

One of the most overlooked developments amid the recent market turmoil is Moody's decision to assign a first-time Baa2 issuer rating to Danantara Investment Management (DIM) while simultaneously attaching a Negative Outlook. At first glance, the rating itself remains investment grade and appears supportive. However, the more important message lies beneath the headline. Moody's explicitly stated that Danantara's Negative Outlook is aligned with Indonesia's sovereign outlook, reflecting the strong credit linkage between DIM and the Government of Indonesia.

This distinction is important because the market is not questioning Danantara's standalone creditworthiness. The market is questioning what Moody's is indirectly saying about Indonesia. Danantara was originally envisioned as one of the government's flagship investment vehicles, expected to attract global capital, support strategic industries, and strengthen investor confidence in Indonesia's long-term growth story. Yet Moody's latest assessment suggests that sovereign concerns may now be spilling over into institutions that were intended to become part of the solution.

For international investors, the issue is no longer whether Danantara can execute its mandate. The bigger question is whether sovereign-linked institutions can continue to serve as confidence anchors when sovereign risk itself is becoming the primary source of concern. Put differently, if Indonesia's sovereign outlook deteriorates and Danantara's outlook deteriorates alongside it, investors inevitably begin asking a far more uncomfortable question: ***if sovereign risk itself is becoming the source of concern, can sovereign-linked institutions still serve as the solution?***

STRUCTURAL DE-RATING: FROM GROWTH STORY TO RISK STORY?

This, in our view, is the single most important risk currently facing Indonesian assets.

Structural de-rating does not imply an economic collapse, a banking crisis, or a recession. In fact, the more challenging scenario is one where the economy continues to grow, companies continue to generate earnings, and GDP remains relatively resilient—yet investors become unwilling to pay the same valuation multiples because perceived risks have permanently increased.

For much of the past two decades, Indonesia enjoyed one of the most compelling investment narratives in Emerging Markets. Investors were willing to assign premium valuations based on a combination of favorable demographics, an expanding middle class, robust domestic consumption, political stability, and an improving institutional framework.

In such an environment, corporate earnings can continue growing, GDP can remain near 5%, and businesses can continue operating normally, yet equity markets may still underperform because investors demand a higher risk premium. The consequence is lower valuation multiples, weaker capital inflows, higher funding costs, and structurally lower market returns.

This phenomenon has been observed repeatedly across Emerging Markets. Brazil, Turkey, and South Africa all experienced periods where economic activity continued, yet financial assets traded at discounted valuations for years due to persistent concerns surrounding policy credibility, governance, institutional strength, and investor confidence.

This is why the debate today is no longer whether Indonesia can continue growing. ***The more important question is whether Indonesia still deserves a premium valuation as one of Asia's growth stories, or whether it is gradually transitioning into a market that requires a permanent risk discount.***

THE NEXT 14 DAYS: INDONESIA'S STRESS TEST

While investors have spent the last several months focusing on what has already gone wrong, attention is now shifting toward what could happen next.

The next two weeks may prove to be among the most important periods for Indonesian assets this year.

Key upcoming events include:

- 19 June: MSCI Global Market Accessibility Review
- 22 June: FTSE Russell Rebalancing Effective Date
- 24 June: MSCI Annual Market Classification Review 2026

These reviews carry significance well beyond index inclusion or exclusion decisions. They represent independent assessments of the factors global investors care most about: ***market accessibility, governance standards, free float availability, transparency, liquidity, and investability.***

In many respects, these reviews have become a referendum on Indonesia's standing within the global investment community. If MSCI and FTSE maintain Indonesia's current status without material changes, markets may conclude that recent fears have become excessive and that much of the bad news has already been reflected in prices.

However, if either institution signals a deterioration in market accessibility or investability, investors could interpret this as confirmation of the broader de-rating narrative currently developing around Indonesia. For this reason, we view the June MSCI and FTSE reviews as potentially more important than any individual economic data release over the coming weeks.

Following Moody's and Fitch, MSCI and FTSE now represent the next major credibility test for Indonesian financial markets.

THE BULL CASE: WHAT IF THE MARKET IS TOO PESSIMISTIC?

Amid the prevailing pessimism, there is one question that deserves greater attention:

What negative development remains unknown to the market?

Over the past six months, investors have already absorbed an extraordinary amount of adverse news.

- The Rupiah has weakened sharply.
- Foreign capital outflows have accelerated.
- Moody's revised its outlook to Negative.
- Fitch revised its outlook to Negative.
- Concerns regarding a potential S&P action have intensified.
- MSCI and FTSE have launched reviews of Indonesia.
- The JCI has become one of the worst-performing major equity markets in the region.

At some point, the investment debate shifts from identifying risks to evaluating whether those risks have already been priced in.

Today, investor positioning toward Indonesia appears overwhelmingly cautious. Historically, periods of extreme pessimism often create conditions where even modest positive surprises can generate disproportionately large market reactions.

Importantly, several of the market's greatest fears remain hypothetical rather than realized. ***Indonesia continues to retain its investment-grade status.***

- S&P continues to maintain a Stable outlook.
- MSCI has not altered Indonesia's market classification.
- FTSE has not placed Indonesia on a downgrade watch list.

In other words, the market is increasingly pricing outcomes that have not yet occurred. This does not mean the risks are insignificant. It simply means that expectations have become extremely low.

History shows that some of the strongest returns emerge not when conditions improve dramatically, but when reality proves less negative than feared.

WHAT WOULD CHANGE THE NARRATIVE?

At this stage, we do not believe investors should be searching for reasons to become aggressively bullish. Instead, the focus should be on identifying conditions that would signal the confidence crisis is beginning to stabilize.

We would become more constructive if several developments begin to emerge:

- The Rupiah stabilizes and moves decisively away from the 18,000 level.
- Foreign outflows moderate meaningfully.
- S&P maintains its Stable outlook and refrains from following Moody's and Fitch.
- MSCI and FTSE refrain from taking more aggressive actions toward Indonesia.
- Policymakers deliver a clearer, more consistent, and more predictable policy framework.

Until these conditions begin to materialize, a defensive positioning remains appropriate.

KIWOOM RESEARCH OPINION

In our view, the market is no longer questioning Indonesia's growth potential.

The market is questioning Indonesia's credibility.

The distinction is critical.

Economic growth can recover within quarters. Investor confidence often takes years. Indonesia's economy is not currently exhibiting the characteristics of a traditional financial crisis. Banks remain functional, fiscal metrics remain manageable, and economic growth remains positive. Yet markets do not price current conditions they price future confidence.

That is precisely why Indonesian assets continue to struggle despite relatively resilient macroeconomic data. The key issue is not whether Indonesia can grow.

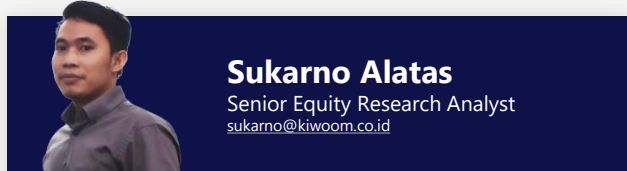
The key issue is whether investors still believe in the policy framework, institutional trajectory, and long-term investment narrative that historically justified premium valuations. For now, most of the reasons behind the selloff are already widely known and increasingly reflected in prices.

The next phase will likely be determined not by additional bad news, but by whether policymakers, regulators, and institutions can provide investors with a reason to believe that the current confidence crisis is temporary rather than structural.

The market is no longer debating whether Indonesia can grow. The market is debating whether Indonesia deserves to be valued like a growth story.

Ultimately, the market is no longer looking for reasons to sell. The market is looking for reasons to stop selling.

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