

## **Economic Bulletin – Issue 68**

### **Narrowing Indonesia–United States 30-year Sovereign Yields Spread: Structural Analysis and Outlook**

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- Indonesia's 30-year sovereign bond yield spread has narrowed significantly in recent years, declining from a historical average of 5–6% above US Treasury yields to around 3%, a level near two standard deviations below its long-run mean. This convergence raises important questions about whether the compression reflects structural improvements in macroeconomic credibility or is a temporary response to global conditions.
- This paper addresses this gap by analyzing global and domestic policies as well as employing a VAR model to forecast Indonesia's 30-year yield spread under baseline, upper, and lower-bound scenarios through 2026, contributing to the study on the persistence and drivers of sovereign risk pricing in emerging markets.
- Historical data suggest that several favorable macroeconomic and market factors have contributed to the narrowing of Indonesia's yield spread. Stable economic growth, a benign inflation environment, and prudent fiscal management have strengthened investor confidence and limited bond supply growth.
- Structurally, several factors have contributed to the narrowing yield spread, including Indonesia's strong macroeconomic fundamentals characterized by stable economic growth, low inflation, prudent fiscal management, and reduced external vulnerability which have collectively enhanced investor confidence and supported long-term debt sustainability.
- Risk profile also contributed as increase country's upgrade to investment-grade credit ratings (BBB-/Baa2) and falling 10-year CDS spreads signal reduced default risk. These developments reflect improved macro and fiscal Indonesia credibility, contributing to lower sovereign risk premiums.
- We also find that supportive market dynamics have contributed to the narrowing yield spread. Increased domestic bond ownership driven by Bank Indonesia's burden-sharing arrangement and declining foreign holdings have enhanced market stability. Together with ample liquidity and Indonesia's inclusion in major global bond indices, these factors have maintained strong investor demand and helped compress long-term yields, even amid global monetary tightening.
- This study finds that the narrowing of Indonesia's 30-year sovereign yield spread is likely to persist through late 2026, indicating a shift toward lower perceived sovereign risk, underpinned by stronger structural fundamentals in both macroeconomic and credit dimensions of Indonesia.
- This study highlights that this compression is not guaranteed to be permanent, as it remains susceptible to global financial shocks. The upper- and lower-bound scenarios presented illustrate the extent of potential deviation. While a return to historical spread levels appears unlikely, maintaining this "new normal" will depend on Indonesia's continued fiscal prudence and resilience to external volatility.

**Ibrahim Kholilul Rohman**

[Ibrahim.kholilul@ifg.id](mailto:Ibrahim.kholilul@ifg.id)

Senior Research  
Associate / Universitas  
Indonesia

**Mohammad Alvin Prabowosunu**

[Alvin.prabowosunu@ifg.id](mailto:Alvin.prabowosunu@ifg.id)

Junior Lead Research  
Associate

**Erin Glory Pavayosa Ginting**

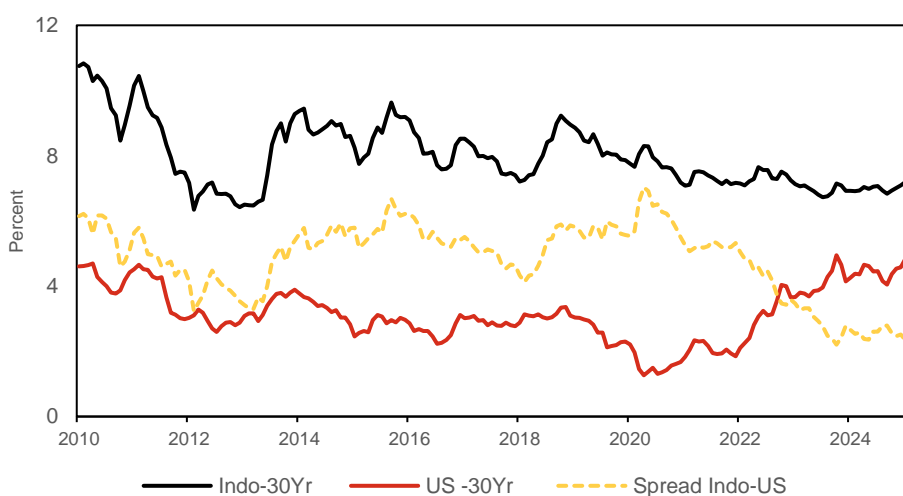
[Erin.glory@ifg.id](mailto:Erin.glory@ifg.id)

Junior Research  
Associate

## Introduction

Over the past decade, Indonesia's 30-year sovereign bond yield spread versus developed markets has narrowed dramatically (Exhibit 1). Historically, Indonesian long-term yields carried a spread of roughly 5–6% above US and G7 yields, but recently this gap has shrunk to around 3% (around two standard deviations below the long-run average). In other words, Indonesia's 30-year yield (currently near ~7%) now stands only ~3% above U.S. 30-year Treasury yields, a striking convergence from earlier years. This phenomenon raises important questions, particularly regarding whether the observed spread compression reflects a structural shift in Indonesia's risk profile or a cyclical response to global financial conditions. If the yield spread narrowing is structurally driven by improved fiscal management, macroeconomic stability, and institutional credibility it may signal a long-term decline in risk premia and borrowing costs, encouraging further development of the domestic debt market. On the other hand, if the convergence is cyclical driven by temporary global liquidity, search-for-yield behavior, or transitory capital flows, it could expose Indonesia to sudden reversals as global conditions tighten, thereby amplifying refinancing and rollover risks.

**Exhibit 1. Historical 30-Year Yield Spread (Indonesia minus US)**



Source : PT Penilai Harga Efek Indonesia (PHEI), Federal Reserve Board, CEIC (2025)

Empirical literature provides mixed insights. Uribe and Yue (2006) highlight that global factors such as US interest rates and global risk sentiment (e.g., the VIX) play a dominant role in driving emerging market yield spreads. Baldacci et al. (2008) further emphasize the role of domestic fiscal performance, external vulnerabilities, and inflation credibility. However, Indonesia remains underexplored in this literature, despite its deepening local currency bond market and high share of nonresident holdings. Recent Indonesia-focused analyses (e.g., IMF, 2023; Chandra et al., 2023) point to strong interactions between sovereign yields and exchange rate expectations, fiscal credibility, and foreign ownership structure, yet offer limited predictive insight into future yield dynamics.

To address this gap, IFG Progress Economics Bulletin 68 examines the structural reasons behind the long-term decline in this yield spread, focusing on why Indonesia's 30-year yields have trended downward even as developed-market yields (notably US Treasuries) have risen in recent years. We analyze the key macroeconomic drivers (inflation, growth, policies) and technical/market factors (risk perceptions, liquidity, investor base) that have contributed to the narrowing spread. We then present three possible scenarios for the next three years, baseline, widening, and further narrowing, with the assumptions underpinning each. By producing baseline, upper, and lower-bound scenario forecasts, this analysis aims to contribute not only to empirical modeling of yield spreads, but also to the broader debate on whether Indonesia's sovereign risk pricing is entering a more stable structural regime or remains vulnerable to cyclical swings.

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## *Macroeconomics Factors*

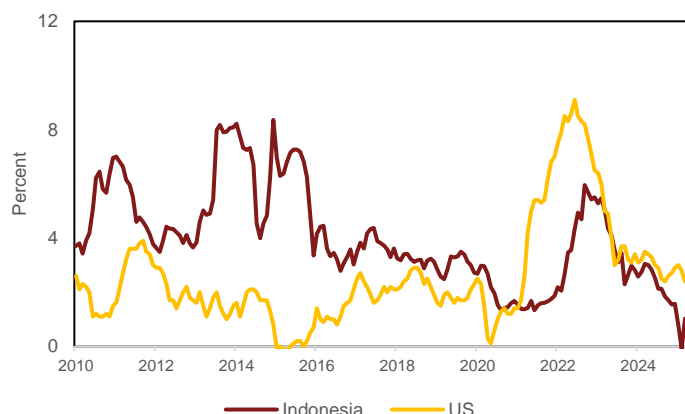
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### **Lower Inflation and Anchored Expectations**

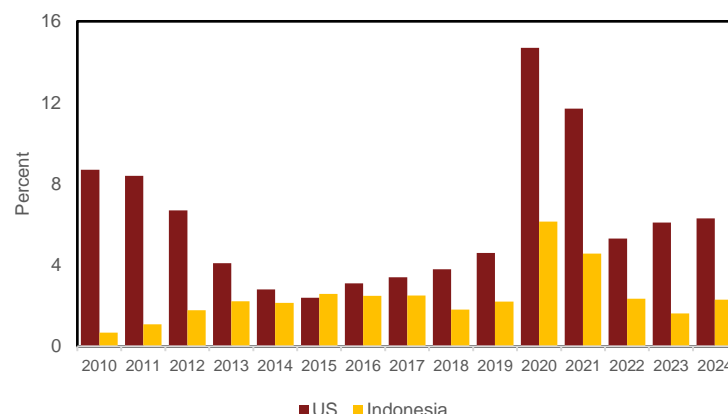
Indonesia has maintained moderate inflation over the past decade, averaging around 3–4% annually (a notable improvement from double-digit rates in the early 2000s). Bank Indonesia's inflation targeting and prudent monetary policy have kept price growth in check, which in turn lowered nominal bond yields. For example, inflation was 2.4% YoY in 2024 and is projected near 2% YoY in 2025, firmly within BI's target range, whereas US inflation spiked to multi-decade highs in 2021–2022 (peaking around ~8% YoY) before easing (Exhibit 2). This divergence meant the US Federal Reserve (The Fed) had to hike interest rates aggressively, lifting 30-year Treasury yields from ~2% to ~4–5%, while Indonesia's rate hikes were more measured. Indonesia's inflation environment became relatively benign, reducing its required yield premium, even as developed markets faced renewed inflation and rising yields (IMF, 2023). The result is a narrower inflation-adjusted yield gap.

### **Economic Growth and Stability**

Indonesia's economy has sustained solid growth of ~5% per year with improving macro stability, which bolsters investor confidence. Steady growth with low volatility reduces the risk premium on long-term Indonesian debt. Over the last decade, Indonesia has also improved its external accounts, benefiting from high commodity prices in recent years which turned the current account closer to balance. In contrast, many advanced economies saw slower trend growth and required extraordinary stimulus after the Global Financial Crisis and the pandemic. Indonesia's resilient growth amid global headwinds has made its bonds relatively more attractive, allowing yields to decline structurally (BCA, 2023). Robust growth also helps keep Indonesia's debt-to-GDP low, reinforcing creditworthiness. Meanwhile, developed markets (especially the US) dramatically expanded fiscal and monetary stimulus in the 2010s and 2020s, which, as those economies recovered and inflation rose, put upward pressure on their yields. Thus, strong Indonesian fundamentals versus more strained developed-market dynamics narrowed the yield spread.

**Exhibit 2. Inflation Rate Comparison of Indonesia & US**

Source : Bank Indonesia, Bloomberg (2025)

**Exhibit 3. Percentage Fiscal Deficit to GDP**

Source: Ministry of Finance Republic Indonesia, Bloomberg (2025)

### Fiscal Discipline and Debt Levels

A critical structural factor is Indonesia's relatively prudent fiscal management. Indonesia entered the 2020s with low public debt (around 30% of GDP pre-COVID) and a statutory budget deficit ceiling of 3% of GDP. Even after pandemic spending, debt is moderate (~40% of GDP in 2023) and the deficit was brought back under 3% in 2023 (Exhibit 3). This fiscal prudence limits bond supply growth and reassures investors about long-term debt sustainability. Indeed, high commodity revenues and a tax rebound in 2022–2023 bolstered government coffers, allowing Indonesia to issue fewer bonds than initially feared (BCA, 2023). The relatively conservative budget outlook for 2025 (with spending growth kept in check) has made the domestic bond market a *seller's market* the government can afford to be tactical about issuance, which supports higher bond prices and lower yields (BCA, 2023). In contrast, the US and other G7 economies have seen rising debt ratios and large fiscal deficits, especially post-2020. The heavy issuance of US Treasuries to fund deficits has started to push up long-term yields via a rising term premium (BIS, 2023). In other words, Indonesia's supply-demand balance for bonds improved, while the US faced supply pressure, which is a recipe for a shrinking yield differential.

### Credible Monetary Policy and FX Stability

Bank Indonesia (BI) has built credibility over the years, enhancing investor trust that inflation and the currency will be well-managed. Apart from controlling inflation, BI has been proactive in stabilizing the rupiah (e.g. using its policy mix of rate hikes and intervention when needed). A more stable currency reduces exchange-rate risk for foreign bondholders, which lowers the extra yield they demand. Since the taper tantrum of 2013 (when Indonesia was labeled one of the "fragile five" emerging markets), the country has strengthened its FX reserve buffer and reduced reliance on short-term hot money. By the late 2010s, Indonesia's external vulnerabilities had lessened, contributing to a lower country risk premium. In the last couple of years, despite global turbulence, the rupiah held relatively well until very recently. All of these

macro factors (low inflation, solid growth, fiscal health, and stability) have structurally moved Indonesia's 30-year yield *lower* relative to where it used to be, compressing the spread versus developed-market yields

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## *Technical and Market Structure Factors*

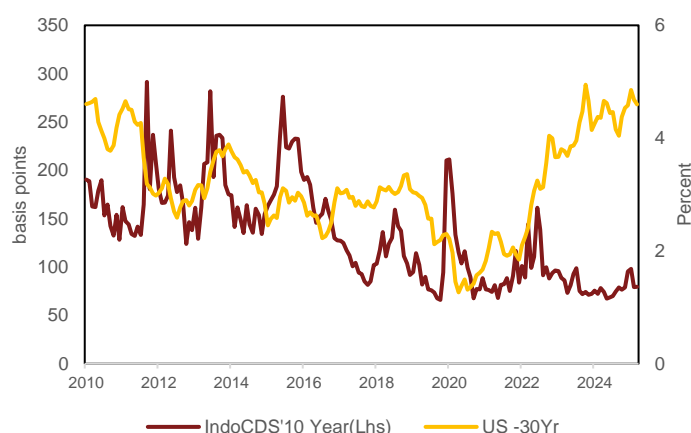
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### **Improved Credit Rating and Risk Perception**

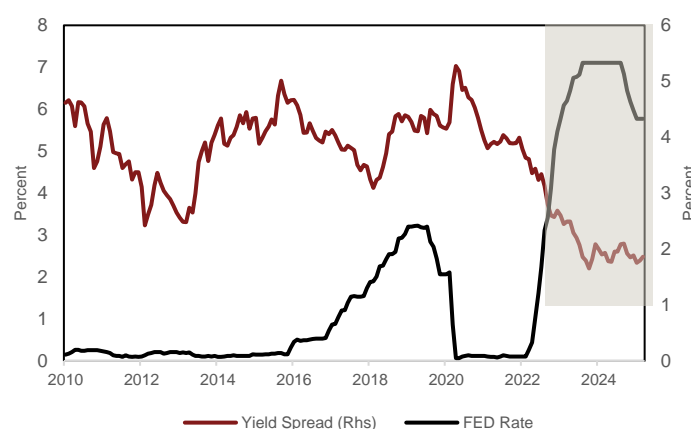
Indonesia's sovereign credit ratings climbed into investment grade territory (BBB-/Baa2) by the late 2010s, reflecting reduced default risk. Alongside this, credit spreads on Indonesian debt have narrowed significantly. For instance, Indonesia's 10-year USD credit default swap (CDS) premium is around 98–80 basis points as per first quarter of 2025, down from well over 200 bps a decade ago during more turbulent times (CEIC, 2025). A lower CDS spread indicates investors see Indonesia as much less risky, so they require less of a yield cushion. This trend is supported by Indonesia's relative strength among peer emerging markets, unlike some of its "fragile" peers (Brazil, South Africa, Turkey), Indonesia's risk metrics *improved* in the 2020s (BCA, 2023). The cumulative effect of rating upgrades and better risk sentiment is a narrowing of Indonesia's credit spread over safe-haven yields, compressing the 30-year yield differential (Exhibit 4).

### **Global Liquidity and Yield Hunt**

The 2010s decade featured extraordinarily loose monetary policy in advanced economies (near-zero policy rates and large-scale QE) which drove developed-market yields to historic lows. This pushed global investors to hunt for yield in emerging markets. Indonesia, offering high yields and a now-stable outlook, attracted substantial foreign inflows, which bid up Indonesian bond prices and drove yields down. The yield spread compressed as a result of this global search for yield. Even as the cycle turned (Fed tightening from 2022 onward), emerging-market spreads initially widened but then tightened again on renewed investor optimism. By late 2024, yield premiums on Asian investment-grade bonds hit record lows around 75 bps on average, reflecting how strong the chase for yield remained (Reuters, 2024). In Indonesia's case, periods of abundant global liquidity (e.g. 2010–2019, and post-COVID stimulus) led to record-tight spreads as investors were willing to accept lower EM yields. While US yields have recently risen with Fed tightening, the broader trend of ample liquidity and inclusion of Indonesia in major bond indices has kept international demand high, preventing Indonesian yields from rising in step with US yields which shown by Exhibit 5 where the spread is maintained to decrease in the middle of these condition.

**Exhibit 4. Indonesia's Credit Risk Spread vs. U.S. Yield**

Source: Bloomberg, CEIC (2025)

**Exhibit 5. Yield Spread and FED Rate**

Source: PT Penilai Harga Efek Indonesia (PHEI), CEIC (2025)

### Changing Investor Base and Market Depth

A notable technical shift is the composition of Indonesia's government bond holders. Prior to 2020, foreign investors held a very large share of Indonesian rupiah government bonds (around 39% of outstanding bonds at end-2019, one of the highest foreign ownership levels among emerging markets) (IMF, 2023). This high foreign share had historically required a premium yield to compensate for potential capital-flow volatility. However, during the pandemic, Indonesia's financing mix changed: the government's burden-sharing agreement with Bank Indonesia and increased purchases by domestic banks meant foreigners' share fell to only ~14% by the end of 2022 (IMF, 2023). Essentially, domestic institutions stepped in to buy government bonds, decoupling Indonesian yields from global outflow pressures. BI itself bought large quantities of bonds in 2020–2021 as part of emergency measures, directly suppressing yields on the long end (IMF, 2023). A deeper local investor base, including banks, insurers, and pension funds, now provides more stable demand for bonds, which reduces the liquidity-risk premium. With less "free float" in foreign hands, Indonesian yields became less sensitive to global shocks and remained lower than they would have in earlier crises. This structural deepening of the market (along with reforms to market infrastructure and inclusion in global bond indexes) improved liquidity and transparency, which lowered the liquidity premium that investors demand (IMF, 2023). All these market factors helped bring Indonesia's long-term yields down closer to developed-market levels over time.

### Lower Term Premium and Curve Dynamics

Another technical aspect is the behavior of the yield curve. In the mid-2010s, Indonesia's yield curve was quite steep, partly reflecting high term premia (investors demanding extra yield for longer maturities due to uncertainty). As the country's financial stability improved, the term

premium in Indonesian bonds fell, flattening the long end of the curve relative to short-term rates. At the same time, US and G7 yield curves went through unusual flattening/inversion episodes, short rates at zero dragged long yields down in the 2010s, but more recently long-term rates have been climbing on term premia increases (e.g. due to concerns about high debt and persistent inflation) (BIS, 2023). This opposite movement in term premia, falling in Indonesia, rising in the US, has narrowed the long-term spread. Additionally, Indonesia's inclusion in global indices (such as JPMorgan's GBI-EM for local bonds) brought in structural foreign demand and arbitrage that keep its yields more aligned with global benchmarks than before, further compressing the spread.

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## *Divergent Yield Trends: Indonesia vs. the United States*

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A core focus is understanding why Indonesia's 30-year bond yields have shown a downward or flat trend in recent years, whereas US (and other G7) yields have trended upward. Several contrasting factors explain this divergence

### **Pandemic Aftermath and Policy Response**

In the initial pandemic shock of 2020, both Indonesian and US long-term yields fell sharply as central banks slashed rates and investors sought safe assets. Indonesia's 30-year yield, which had been around 8% in 2018–19, dropped into the 6–7% range by 2020–21. US 30-year yields fell below 2% at one point. However, the recovery phase saw a reversal: The US enacted massive fiscal stimulus and the Fed signaled tighter policy to combat surging inflation, causing US yields to climb. By contrast, Indonesia's fiscal and monetary response, while robust, was more contained and inflation remained comparatively modest. The result was that US yields rebounded off record lows much faster and higher than Indonesia's did. According to the IMF, the decline in the Indonesia–US yield gap since 2020 was “driven fully by higher US bond yields, while yields on Indonesia's local-currency debt declined” in that period (IMF, 2023). Indeed, most of the spread compression occurred in 2022 when the Fed's rapid rate hikes lifted U.S. long yields significantly, even as Indonesia's yields stayed stable or fell (IMF, 2023).

### **Inflation and Monetary Tightening Cycle**

US inflation jumped to ~7–9% in 2021–2022, prompting an aggressive Fed tightening (raising policy rates from 0% to over 5% in little over a year). This pushed 10-year and 30-year Treasury yields up dramatically (the 30-year rose from ~1.5% in mid-2020 to around 4.5–5% by mid-2023). Meanwhile, Indonesia's inflation peaked around 4–5% in 2022 – above target, but far lower than the US spike. Bank Indonesia did raise its policy rate (from 3.5% to 5.75% in 2022–2023), but it was largely preemptive and succeeded in re-anchoring inflation expectations quickly. Consequently, Indonesia's 30-year yield did not rise in tandem with US yields. In fact, Indonesian yields in late 2022 were slightly lower than a year earlier (~7% in 2022Q4 vs ~7.5% in 2021), even as US yields were substantially higher, thus compressing the spread. The divergent inflation dynamics (benign in Indonesia, extreme in the US) meant Indonesian bonds



didn't need to price in as much inflation premium. Additionally, US yields faced an upward push from expectations that rates would stay “higher for longer,” whereas investors anticipated that Indonesia's rate hikes, having contained inflation, might not need to go much higher. This policy divergence kept Indonesia's yields on a downward trajectory relative to U.S. yields (BIS, 2023).

### **Safe-Haven Flows vs. Domestic Support**

Typically, in times of global stress, US Treasuries rally (yields fall) as a safe haven, and EM bonds sell off (yields rise). In the recent cycle, however, this pattern was muddled. During 2022's volatility, US Treasuries sold off (because the stress came from inflation and Fed tightening, not a financial crisis), so their yields rose. Emerging-market bonds like Indonesia's did face capital outflows at times (risk-off sentiment), but Indonesia had an unusual backstop, its own central bank and banks were buying bonds, preventing yields from spiking (IMF, 2023). So instead of the spread widening in a risk-off environment, it narrowed. To illustrate: in 2022, global investors pulled money from many EM bond markets due to high US yields, but Indonesia's yield only inched up briefly and then fell back as BI's bond purchases and a stable domestic investor base absorbed the selling. At the same time, the US Treasury market lacked a price-insensitive buyer once the Fed stepped back, and heavy Treasury supply caused yields to climb (BIS, 2023). Thus, Indonesia's yields were cushioned while US yields were exposed, an inversion of the usual relationship, leading to a tighter spread.

### **Structural Trend vs. Cyclical Shift**

It's important to note that Indonesia's long-term yields have been on a structural downtrend since the early 2010s, reflecting the country's improving fundamentals as discussed. In contrast, developed-market yields were structurally low for a decade (due to secular stagnation forces and QE policies), but have undergone a cyclical upward shift recently (as those forces abate and inflation returns). We are essentially seeing a convergence: one side (Indonesia) coming down from previously high yields, and the other side (US/G7) normalizing up from ultra-low yields. This convergence is partly structural (narrower risk and inflation differentials than in the past) and partly a result of the asynchronous cycles. Going forward, a key question is whether the spread will revert toward its historical mean or if this new, narrower spread is the “new normal” given Indonesia's improved standing.



## *VAR Model Result of Indonesia and US 30-year Sovereign Bond Yields Forecast*

### **Two-Year Yield Spread Outlook: Baseline, Downside, and Upside Scenarios**

Looking ahead, the Indonesia–developed market yield spread could follow different paths. We present three scenarios through the end of 2026, outlining baseline expectations and two alternatives (wider and narrower spreads). Each scenario is accompanied by key assumptions:

- Baseline Scenario – Gradual Mean Reversion:** Under the baseline, we assume no drastic shocks. Global growth continues at a moderate pace, and inflation in both Indonesia and advanced economies gradually eases toward targets. The US Fed is expected to stop tightening and possibly start mild rate cuts by second half of 2025, while Bank Indonesia similarly might further trim rates if inflation stays low. The new Indonesian government under President Prabowo maintains fiscal discipline, adhering to the 3% deficit cap (as promised), and refrains from populist policies that spook markets. In this scenario, Indonesia's 30-year yield may dip slightly from current levels into the mid-6% range, as global risk-free rates settle at a higher plateau than the 2010s and as BI unwinds its pandemic-era support. Meanwhile, US 30-year yields could ease slightly from ~5% to around 4–4.5% as inflation comes down and Fed cuts begin. The net effect would be the spread slightly narrowing in the 2–3% range. This modest spread narrowing reflects a partial reversion toward the historical average, driven by Indonesia's risk premium normalizing downward. Structural improvements prevent a return to the old 5%+ spreads. In the baseline, Indonesia retains its BBB ratings and stable outlook and no crisis unfolds. Essentially, the spread stabilizes near current levels, with a gentle bias downward as both countries' yields gradually decline in tandem (keeping the difference relatively steady).
- Downside Scenario – Widening Spread (Higher Indonesia Yields):** In a bearish scenario, the spread could widen significantly back toward historical norms (e.g., 3-4%). This could occur if Indonesia-specific risks materialize or global conditions turn sharply risk-off. One trigger could be a loss of investor confidence in Indonesia's policy direction, for instance if President Prabowo pursues expansive populist programs without credible financing, leading to larger deficits and debt. Early signals such as a proposed \$30 billion school lunch program and hints at weakening the central bank's independence have alarmed markets (Al Jazeera, 2025). In this scenario, investors demand a higher premium: Indonesia's 30-year yield could climb into the high single digits (7–8% or more). A related assumption is higher domestic inflation or currency pressure, perhaps commodity prices slump, or the rupiah continues sliding to record lows, forcing BI to hike rates dramatically. At the same time, advanced-economy yields might fall if this scenario is driven by global recession or risk aversion (flight-to-quality into US Treasuries). For example, a US recession in 2025 could push the 30-year Treasury yield up to ~5%, while

Indonesia's 30-year jumps to 8.5%, reopening a 3.5% gap. Even if US yields don't fall that far, Indonesia's yield could rise enough (e.g., due to capital outflows) to widen the spread. In essence, this scenario envisages a return of the "fragile EM" risk premium: concerns about fiscal loosening or institutional erosion (such as undermining BI's autonomy) lead to an exodus of foreign investors and a spike in yields. Other factors could amplify it, such as higher-for-longer US rates or another financial shock), Indonesia's relatively lower foreign reserve buffers could prompt a sell-off. The widened spread would reflect both Indonesia's yields rising and possibly developed economies yields falling, a *double-whammy* in spread terms. This downside case, while not our base expectation, is plausible if policy missteps or external shocks occur. It would mark a partial reversal of the past decade's convergence.

- Upside Scenario – Further Narrowing (Convergence to Developed Yields):** In a more optimistic scenario, the spread could narrow even further, potentially falling to sub-2%, levels that would have seemed incredible a decade ago. This would require favorable conditions on multiple fronts. One assumption is that Indonesia's macro performance exceeds expectations: inflation remains consistently low (perhaps Indonesia enters a period of sub-3% inflation as structural reforms boost productivity), and growth stays robust around 5% without overheating. Such goldilocks scenario could lead to credit rating upgrades for Indonesia (e.g., to BBB+ or A-), instantly reducing required yields. If Indonesia manages to, say, achieve an upgrade by demonstrating sustained fiscal prudence and governance reform, investors might accept much lower yields for its bonds. We also assume global conditions are benign, for example, major central banks successfully tame inflation and start easing policy without igniting volatility. US long-term yields might drift slightly lower or remain around 4%. Meanwhile, Indonesia's yields, under pressure from strong demand, could fall into the 5.5–6% range. For instance, renewed foreign inflows might occur if global investors view Indonesian bonds as a prime yield pick with improving safety. Another driver could be excess global liquidity, pushing investors to reignite the search for yield. This "convergence" scenario might also involve Indonesia leveraging its strengths: a commodities windfall or new structural reforms (such as in infrastructure or tax base improvements) that further reduce risk perceptions. It's worth noting that a spread below 2% would be unprecedented for Indonesia's 30-year. While not impossible (some emerging markets like Poland or Malaysia at times have spreads that low when rated in the A-category), it represents a bull case where Indonesia firmly sheds its former risk profile. Investors would effectively view Indonesia as a stable, quasi-developed market in this scenario.

In a way, need to be noted that these scenarios hinge on the linkages of domestic and external macroeconomic factors (inflation paths, growth, fiscal policy) and market sentiment. They are illustrative, as the actual outcome may lie between these cases. Importantly, the baseline expects some persistence of the recent structural narrowing, whereas the widening scenario reintroduces a higher risk premium, and the narrowing

scenario implies an almost full convergence to developed-market yield levels. Market participants should monitor indicators like Indonesia's inflation trend, policy signals (e.g., adherence to the fiscal rule, central bank independence), global interest rate trajectories, and risk appetite measures (EM bond spreads, capital flows) to gauge which scenario the world is gravitating toward.

### Vector Autoregression (VAR) Model Result of Indonesia and US 30-year Sovereign Bond Yields Forecast

This study employs a fairly simple Vector Autoregression (VAR) framework to model and forecast the **30-Year** Government Bond Yield using a set of macro-financial variables. The VAR model is particularly suitable for this analysis due to its ability to capture the dynamic interrelationships among multiple time series variables, allowing each variable in the system to be influenced by its own past values and the past values of all other variables. The data covers the period from late 2016 to March 2025 on a monthly basis, providing a sufficient time span and frequency to capture short-run and medium-term dynamics relevant to bond markets.

$$\begin{aligned}
 30YrGovtBondt_{x_t} = & \alpha + \sum_{j=1}^2 \beta_j Diff - Inflation_{t-i} + \sum_{j=1}^2 \gamma_{t-i} Diff - \%ForeignHolder_{t-i} \\
 & + \sum_{j=1}^2 \partial_{t-i} Diff - 10YrCDS_{t-i} + \sum_{j=1}^2 \varphi_{t-i} \%DeficitAPBN \\
 & + \sum_{j=1}^2 \rho_{t-i} ExchangeRate + \sum_{j=1}^2 \omega_{t-i} VIX + \varepsilon_t
 \end{aligned}$$

On this forecast model, **30-Year Government Bond Yield**, the model doesn't treat it as strictly dependent, rather, it interacts dynamically with macro-financial variables like inflation, exchange rates, foreign investor behavior, and market risk. Moreover, the core dependent variable is the 30-Year Government Bond Yield, estimated separately for each country in the sample to account for country-specific structural factors. The explanatory variables include: (i) inflation rate (CPI), (ii) percentage of government bonds held by foreign investors (%ForeignHolder), (iii) 10-Year Credit Default Swap spread (10YrCDS) as a proxy for sovereign risk perception, (iv) fiscal deficit-to-GDP ratio (%DeficitAPBN) as a measure of fiscal sustainability, (v) exchange rate (Rupiah to USD), and (vi) VIX index, a global measure of financial market volatility. To ensure the statistical properties of the time series are properly addressed, unit root tests are conducted. Variables that exhibit non-stationarity at level are transformed into first differences, while those that are stationary are kept in levels. A lag order of one is selected for the VAR system based on the Akaike Information Criterion (AIC) to capture immediate dynamic effects.

This specification treats the bond yield as a function of the lagged values of macro-financial drivers, capturing their delayed effects and also enables forecasting of the 30-year yield, as future values are computed based on the historical interactions and lag structures identified in the estimation period. The forecast of the 30-Year Government

Bond Yield Spread between Indonesia and the United States is conducted under three distinct scenarios which are baseline, upper-bound (adverse), and lower-bound (favorable) and projected from March 2025 to December 2026. The baseline scenario represents the most probable trajectory based on historical data and macro-financial dynamics as captured by the estimated VAR model. The upper and lower-bound scenarios reflect the range of plausible outcomes given model uncertainty and macroeconomic volatility, derived from forecast error variance and confidence intervals.

Exhibit 6. Historical and Forecast 30yr Yield Spread

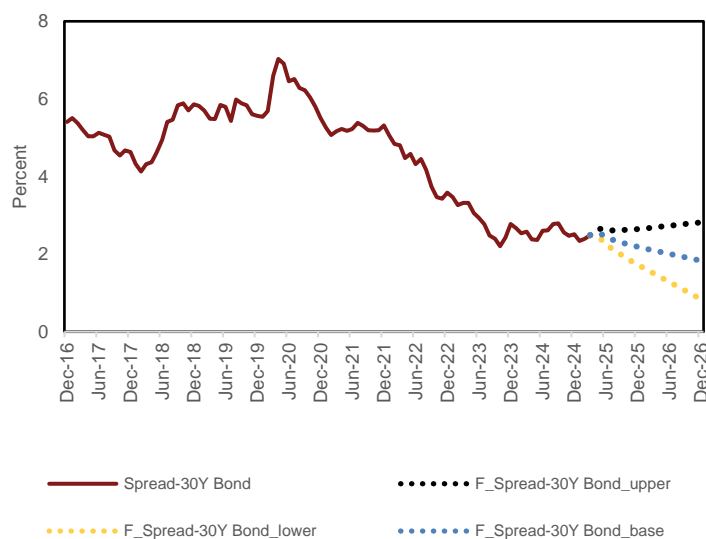
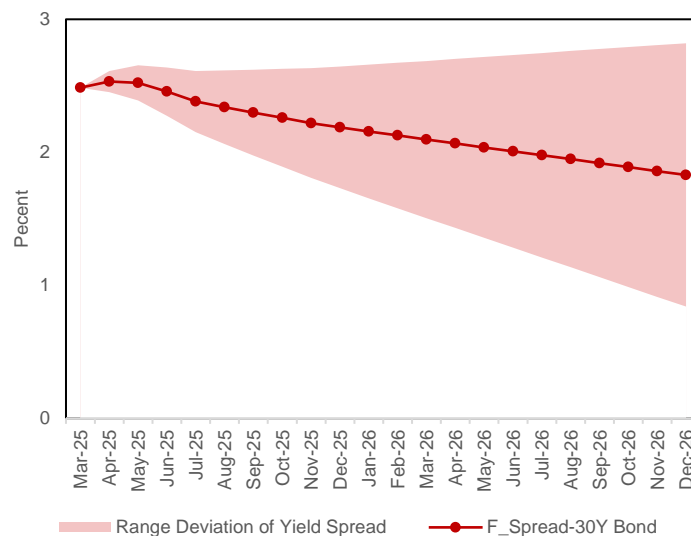


Exhibit 7. Forecast 30yr Yield Spread



Sumber: PT Penilai Harga Efek Indonesia (PHEI), Federal Reserve Board, IFGP Analysis (2025)

The forecast output present in exhibit 6 and more detailed at Exhibit 7, those shown that baseline projection of the spread of the yield indicates a gradual decline over the forecast horizon. Beginning at 2.48% in March 2025, on the baseline scenario, spread is forecasted to fall consistently to 1.83% by December 2026. This gradual decline reflects expectations of relative macroeconomic stability, anchored inflation, and sustained investor confidence features consistent with the emergence of a more stable structural regime. The upper-bound scenario assuming more adverse macro-financial conditions such as exchange rate depreciation or a surge in global risk projects the spread could rise modestly from 2.48% in March 2025 to 2.82% by December 2026. In contrast, the lower-bound scenario incorporating more favorable assumptions such as stronger Indonesia's fiscal metrics or improved external perceptions on Indonesia's condition, showing the spread could compress from 2.48% to as low as 0.84% over the same period.

Taken together, the scenario-based forecasts suggest that the ongoing compression in Indonesia's long-term sovereign yield spread reflects both structural improvements and lingering cyclical sensitivities. The baseline projection, which anticipates a gradual

decline in the spread from 2.48% to 1.83% by end-2026, points to a potential shift toward a new, structurally lower risk premium supported by improved macroeconomic management, stronger fiscal discipline, and enhanced institutional credibility.

These gains appear to have increased investor confidence and reduced Indonesia's perceived sovereign risk. However, the upper-bound scenario where spreads rise in response to adverse shocks such as exchange rate depreciation or heightened global risk aversion underscores that the compression is conditional rather than permanent. The asymmetric responses across scenarios indicate that Indonesia's sovereign yield spread remains vulnerable to external volatility, especially given its reliance on global capital flows and nonresident investor participation. Thus, while the spread may not fully revert to its historical average of 5–6%, it is unlikely to remain compressed in all states of the world. The evidence supports the view that Indonesia may be entering a new, lower-spread regime, but this “new normal” remains fragile dependent on continued macroeconomic prudence, credible fiscal policy, and global financial stability.

Further, the narrowing spread may reflect improved fundamentals and a repricing of Indonesia's sovereign risk, it should not yet be interpreted as an irreversible “new normal.” Rather, it represents a potentially stable but still vulnerable state, especially considering Indonesia's exposure to global capital flows and shifting investor sentiment. Long-term stability will therefore require continued discipline in fiscal and debt management, along with robust policy frameworks to insulate the economy from global volatility.

#### Exhibit 8. Summary of Scenario Analysis and Result

Scenario	Condition	Implication
Baseline Scenario	No drastic shock, moderate global growth, inflation ease in US and Indonesia, FED Rate cut, Indonesia retains its BBB ratings and stable outlook, no crisis unfolds.	The spread gradually decline to around 1.83% by December 2026. Indonesia's yield continue falling and the US yield increasing around current levels.
Lower Bound (Favorable)	Indonesia inflation remains consistently low, credit rating upgrades for Indonesia, fiscal prudence, and tax base improvements. Globally, US recession can induce excess liquidity so investors will reignite the search for yields.	US long-term yields drift slightly lower, Indonesia's yields has strong demand that lead to decrease in yield, yield spread predicted could compress as low to -0.84% at the end of 2026.
Upper bound (Adverse)	Higher domestic inflation or currency pressure, commodity prices slump, rupiah continues sliding to record lows, forcing BI to hike rates dramatically. Higher-for-longer US rates, global recession triggering flight-to-quality into US Treasuries.	US yields fall, Indonesia's yield could rise enough, yield spread rise modestly around 2.82% at the end of December 2026.

Source : IFGP Analysis, 2025<sup>1</sup>

<sup>1</sup> Scenarios hinge on the linkages of domestic and external macroeconomic factors (inflation paths, growth, fiscal policy) and market sentiment. They are illustrative, as the actual outcome may lie between these cases.

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## Conclusion

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Indonesia's long-term yields have been anchored or pulled down by improved fundamentals and supportive market structures, while developed-market yields (US in particular) have been pushed up from ultra-low levels by inflation and policy normalization. These forces combined to shrink the Indonesia–US yield spread to historically narrow levels. Indonesia's downward yield trend coincided with rising developed-market yields, producing the sharp narrowing of spreads observed in recent years. The current sub-3% Indonesia–US 30Y spread is a product of these unusual dynamics.

Scenario-based forecasts result has shown that narrowing of Indonesia's 30-year sovereign yield spread is likely to persist through late 2026, indicating a shift toward lower perceived sovereign risk, underpinned by stronger structural fundamentals in both macroeconomic and credit dimensions of Indonesia. The baseline projection showing a gradual decline in the spread from 2.48% in March 2025 to an unprecedented level of 1.83% by December 2026 suggests that improvements in macroeconomic stability and fiscal credibility have contributed to a structurally lower risk premium. However, the divergence seen in the upper- and lower-bound scenarios reveals that this trend remains sensitive to global financial conditions and domestic vulnerabilities. Under adverse conditions, the spread could rise to 2.82%, while under favorable assumptions, it may fall to as low as 0.84%. While the country may be moving toward a more stable risk profile, the persistence of cyclical sensitivity highlights the need for managing external exposure and reinforcing investor confidence.

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**Indonesia Financial Group (IFG)**

 Gedung Graha CIMB Niaga, 18<sup>th</sup> Floor  
 Jl. Jendral Sudirman Kav. 58

 RT.5/RW.3, Senayan, Kebayoran Baru  
 Kota Jakarta Selatan, DKI Jakarta 12190

 (+62) 021 2505080

Indonesia Financial Group



PT. Bahana Pembinaan Usaha Indonesia – Persero



@indonesiainancialgroup



@ifg\_id

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