CSIS COMMENTARIES

CSIS Commentaries CSISCOM01125
July 22nd, 2025

Indonesia's Macroeconomic Paradox: Stable, but Stuck

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Keywords: *macroeconomic, monetary policy, central bank independence*

For years, Indonesia has found itself caught in a puzzling macroeconomic paradox. Despite the government's expansive fiscal posture and Bank Indonesia (BI) exceptional accumulation of government bonds (SBN), economic growth remains stubbornly flat at around 5 percent. Moreover, inflation is subdued, the rupiah faces persistent depreciation pressures, and employment creation remains sluggish.

On the surface, this appears contradictory: if both fiscal and monetary tools are engaged, shouldn't growth accelerate? Yet in Indonesia's case, the very architecture of macroeconomic policy coordination reveals tension beneath the surface.

Fiscal Acceleration, Monetary Braking

Since the COVID-19 crisis, Indonesia's fiscal stance has remained decisively expansionary. Following emergency measures in 2020-2022, the government maintained high public spending aimed at sustaining the recovery and financing populist programs, including infrastructure development and politically popular initiatives such as energy subsidies and free school meals. This condition has kept the budget deficit hovering around 2.5-3 percent of GDP, primarily financed by the issuance of government bonds (SBN).

At the same time, BI has stepped in as a buyer of the last resort to support market stability and help absorb this issuance. As of March 2025, BI holds over Rp 1,600 trillion in SBN, equivalent to roughly 26 percent of tradable SBN and 8 percent of GDP. While this was justified during the pandemic under the burden-sharing framework, BI's continued SBN purchases during normal times raise critical policy concerns.

Paradoxically, BI has maintained a tight stance, holding the policy rate relatively high at around 6 percent and sterilizing liquidity through instruments such as SRBI and reverse repos, effectively offsetting the impact of its bond purchases. Rather than expansionary, these measures are defensive, aimed at containing inflation, stabilizing the rupiah, and preserving credibility.

Thus, the net effect of Indonesia's macroeconomic framework is a policy contradiction: pushing the gas and the brake at the same time. Fiscal arm steps on the gas, but monetary arm steps on the brake.

Unsurprisingly, this push-pull dynamic has produced lacklustre results. The economy continues to grow, albeit at a slower pace. Household consumption, the main driver of Indonesia's GDP, remains restrained by high borrowing costs and stagnant real wages.

Private investment is similarly subdued as many businesses remain hesitant to expand capacity or hire aggressively due to high interest rates, uncertain demand, and risk aversion among lenders. Although public investment continues, it has failed to generate significant multiplier effects in the meantime.

Fiscal expansion, in short, has not translated into robust demand. Despite ample fiscal injection, the overall demand impulse remains weak, partly due to crowding-out effects and low absorptive capacity.

External Constraints, Internal Dilemmas

Compounding the challenge is Indonesia's deteriorating external position. Following a brief surplus during the 2021–2022 commodity boom, declining coal and palm oil prices, combined with strong import demand, led to the current account returning to deficit by 2023.

Capital outflows, driven by U.S. rate gaps and geopolitical tensions, have pressured the rupiah, which at times breached Rp16,850 per dollar. In this context, BI has understandably prioritized exchange rate stability, limiting room for rate cuts or liquidity easing.

This condition put monetary policy in a bind. Easing risks of capital flight, currency depreciation, and imported inflation, while keeping high interest rates, dampens domestic demand and blunts the impact of fiscal stimulus. The country's external vulnerabilities, in short, are constraining BI's ability to support growth through liquidity or rate cuts.

Although BI's bond purchases inject liquidity, sterilization quickly neutralizes it. Aside from that, Banks remain risk-averse, credit demand is weak, and businesses prefer parking funds in BI's instruments over investing in the real economy.

With high borrowing costs and uncertainty, money is abundant but circulates slowly, creating a liquidity trap. Despite healthy balance sheets, transmission to the real economy is weak. Indonesia risks settling into a low-growth, low-inflation equilibrium: stable, but stagnant.

Guarding Central Bank Independence

Amid this complex macroeconomic balancing act, preserving Bank Indonesia's independence is more important than ever. BI's credibility as an independent central bank, focused on maintaining price stability and managing the exchange rate, has helped anchor expectations and reassured market confidence.

BI's reluctance to excessively monetize fiscal deficits, combined with its commitment to sterilize liquidity from SBN purchases, reflects its continued independence, prioritizing macroeconomic stability over short-term political convenience. These safeguards have shielded the economy from overheating and excessive currency volatility.

However, sustained reliance on BI to absorb government bonds, directly or indirectly via the secondary market, poses long-term risks, gradually eroding its independence. It blurs the line between fiscal and monetary boundaries, raising fears of fiscal dominance. If markets perceive BI as an arm of government financing, inflation expectations may rise along with investor risk premiums on Indonesian assets. BI's independence, in this case, is not just a legal concept; it is a foundation of macroeconomic credibility.

Currently, however, Indonesia's macroeconomic management faces not a crisis of capacity, but a crisis of coordination. Fiscal and monetary authorities pursue separate mandates, with growth on one side and stability on the other, resulting in little alignment. Without a shared strategy, their efforts risk working at cross purposes. What is needed is not just coordination, but strategic coherence: clear roles, agreed-upon objectives, and defined boundaries.

From Stability to Progress

Looking ahead, several course corrections are needed. First, fiscal and monetary coordination must be aligned with medium-term goals, not just crisis response. If BI continues to support SBN financing, a credible exit strategy and quantitative limits must be in place to avoid the perception of fiscal dominance.

Second, fiscal policy must shift from consumption-heavy populism toward productivity-enhancing investment, focusing on public goods that enable private sector dynamism, such as legal certainty, logistics infrastructure, and digital transformation. Crowding in private investment, not crowding out, must be the priority.

Third, if inflation remains subdued and external conditions allow, BI could consider gradual and cautious easing to support demand, without compromising currency stability and market trust.

Finally, deeper structural reforms, especially in tax administration, labour flexibility, and manufacturing competitiveness, must be revived to improve Indonesia competitiveness and resilience, lifting the country out of its middle-income inertia.

In summary, Indonesia is not in crisis, but in a trap: a middle-income, mid-growth, and macro-managed trap. Stability is preserved, but underused. This reflects not a lack of policy tools, but rather a lack of coordination and strategic direction.

To move forward, Indonesia must align fiscal ambition with monetary discipline. Without such coherence, Indonesia risks remaining stable but stuck.

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