

Indonesia's Mounting Risks

In a Nutshell: The abrupt **removal of Finance Minister Sri Mulyani Indrawati** risks dangerously eroding **fiscal-monetary policy credibility**. Especially given the *optics of political expedience* to side-step binding fiscal constraints. And **Bank Indonesia's "burden sharing" amplifies risks** as the *threat of monetary policy subordination to fiscal dominance* further compromise macro-stability. **Wider credit spreads** exacerbated by rising *global term premium* suggest **higher cost of capital**. **Rupiah debasement risks** also mount as investor assess debt monetization. And in any case, *Bank Indonesia's easing may impose sharper IDR stability trade-offs*.

- **Risks to Indonesian assets are mounting as fiscal and monetary policy threats conspire to undermine credibility.** The *latest assault on confidence* stems from abrupt **removal of internationally respected Finance Minister (FinMin) Sri Mulyani Indrawati**.
- To be sure, her replacement **Purbaya Yudhi Sadewa is accomplished** in both finance and public service.
- So, this is not about suitability or qualifications. He is amply qualified and **would ordinarily feature very favourably as a successor. But these are not ordinary times.** In fact, the **timing and abruptness** of the move is **extraordinary** and **very inconvenient**.
- An abrupt and presumably unplanned removal **creates optics of political expedience at the expense of fiscal/macro stability.** Especially given FinMin Indrawati's pushback to overly-aggressive/unrealistic fiscal plans/projections put forward by the President.
- Upshot being, given *President Prabowo's aggressive populist policies that sometimes bend fiscal feasibility it is critical to project fiscal credibility* to temper risks and assure investors.
- And (ex-)FinMin Indrawati **did precisely that.** As an independent figure with **a track record of objectivity, and when required, objections.** Whereas the onus may be on in-coming FinMin Prubaya to reassure investors that fiscal integrity will not be compromised.
- *Making matters worse*, that this **follows hot on the heels of Bank Indonesia's "burden sharing" arrangement**, which we warned* was problematic of policy/macro stability even with FinMin Indrawati's backing. Specifically, "burden sharing" **undermines monetary policy** by *potentially subordinating it to fiscal objectives*.
- Consequently, the worse-case iterations **threaten to subject rupiah to debasement** from *debt monetization risks* (perceived or real).
- This **feeds off, and into, mounting risks of wider credit spreads** *exacerbated by rising global term premium* to **drive up Indonesia's yields** (pressuring bond prices).
- That will inevitably present itself as a **higher effective cost of capital** burdening growth. And more so as "crowding out" pressures also rise. For now, Bank Indonesia will have to watch macro/FX-stability closely and lean against capital outflows risks. As a corollary, this might **compromise scope to ease** as the *trade-off with rupiah stability sharpens*.

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