

Designing Financial Resilience : Geopolitical Risk, Central Banking and Institutional Innovation in Emerging Economies

Renie Oelviani

Badan Riset Inovasi Nasional (BRIN), Indonesia

Royyan Muhammad Hazballah

Islamic University of Madinah, Saudi Arabia

Abstract

Purpose - This study examines how geopolitical risks affect financial stability in emerging economies, with a particular focus on Indonesia, and explores how central banks can strengthen financial resilience through institutional innovation.

Design/methodology/approach - This conceptual study integrates perspectives from economics, geopolitics and institutional theory. It draws on Geopolitical Risk Theory, Institutional Resilience Theory, Macroprudential Policy Theory, Strategic Foresight Theory and Complex Interdependence Theory to develop a framework for central bank responses to geopolitical disruptions.

Findings - The analysis shows that geopolitical risks can affect Indonesia's financial system through exchange rate volatility, capital flow reversals, inflationary pressures and supply chain disruptions. These challenges also expose the limitations of conventional monetary policy in responding to complex external shocks. In response, the study proposes a four-pillar resilience framework : Anticipate, Absorb, Adapt and Align.

Practical implications - The framework provides guidance for central banks and policymakers to strengthen geopolitical risk monitoring, develop more adaptive macroprudential policies, improve cross-sector coordination and strengthen regional and global financial cooperation.

Originality/value - This study contributes to the literature by linking geopolitical risk with central bank governance and institutional resilience. The Anticipate–Absorb–Adapt–Align (4A) framework provides a structured approach for strengthening financial preparedness and resilience in emerging economies facing increasing geopolitical uncertainty.

Keywords: Geopolitical risk; central banking; financial resilience; emerging economies; Indonesia; macroprudential policy; strategic foresight; institutional resilience



INTRODUCTION

The global financial environment is currently characterized by heightened uncertainty which is driven by a series of interlinked geopolitical conflicts and strategic realignments that have disrupted international trade, capital flows and economic stability (Nemat et al., 2025). Israel–Iran conflict has intensified instability in the Middle East and contributed to energy price fluctuations and investor anxiety in global markets (Patil et al., 2024). At the same time, the ongoing Russia–Ukraine war has severely disrupted global energy and agricultural supply chains which lead to inflationary pressures and widespread volatility in commodity markets (Gopal et al., 2025). These disruptions have triggered financial contagion effects particularly in equity markets where risk spillovers have been transmitted across regions and sectors and impacted emerging economies disproportionately (Li et al., 2024). The Russia–Ukraine war has also intensified uncertainty in the global investment climate as rising geopolitical risk undermines investor confidence and limits access to international financing for developing countries (Nemat et al., 2025). The escalation of trade tensions between the United States and China has also altered global trade patterns and introduced systemic risk into financial markets (Eichengreen, 2024). The conflict has disrupted critical industries including those dependent on rare earth minerals while raising questions about the long-term sustainability of dollar dominance and fueling interest in multipolar currency regimes involving the renminbi and other alternatives (Calefariu Giol et al., 2025)

Geopolitical realignments such as the expansion of BRICS and intensified cooperation within ASEAN are reshaping the institutional foundations of global finance and prompting shifts in investment flows and regional trade architecture (Gopal et al., 2025). These alliance-based shifts have produced varied financial outcomes while Brazil and China have faced increased market volatility, India has deepened its financial ties with Russia, benefiting from realignment opportunities (Gopal et al., 2025). In contrast, countries like Armenia have demonstrated institutional resilience by adjusting their banking systems to adapt to external disruptions (Hakobyan & Margaryan, 2025). Volatility in energy markets amplified by geopolitical shocks has further destabilized global economic systems and prompted corporate strategies that emphasize green transition, decentralized governance and productivity enhancement to ensure operational resilience (Gao et al., 2025). Policymakers in energy-dependent economies have been urged to adopt early warning systems and targeted subsidies to cushion against geopolitical energy risks, underscoring the need for adaptive macroeconomic frameworks capable of managing cross-sector vulnerabilities triggered by external shocks (Gao et al., 2025)

For emerging markets such as Indonesia, these global dynamics present acute challenges due to structural vulnerabilities and high exposure to global trade and capital flows (Nemat et al., 2025). Indonesia's open financial system which is combined with its reliance on foreign capital makes it highly sensitive to shifts in investor sentiment and global liquidity conditions (Akyüz, 2010). The country's economic



fragility is amplified by the volatility of foreign portfolio investment which frequently destabilizes stock markets during global crises (Derbali & Lamouchi, 2020). Moreover, Indonesia's dependence on commodity exports, particularly oil and palm products exposes it to price volatility that affects macroeconomic stability and fiscal planning (Papadavid, 2023).

Indonesia's exposure to the global financial cycle is evident in the strong co-movement between domestic financial indicators and global benchmarks like the VIX. This indicates high vulnerability to external financial shocks (Andaiyani & Falianty, 2017). Currency mismatches and high levels of unhedged external debt further compound these vulnerabilities which increase susceptibility to exchange rate fluctuations and interest rate shocks (Nasution, 2003). The risks are also transmitted through the presence of foreign banks in the domestic financial system where shocks from parent institutions in advanced economies can reduce credit availability and impair financial stability (Masujima, 2020). In Addition, the spillover effects of monetary policy shifts in advanced economies—particularly the United States—pose additional risks to Indonesia's financial sovereignty (Banerjee et al., 2016). When the U.S. Federal Reserve raises interest rates, emerging markets like Indonesia often experience capital outflows and currency depreciation and limit the effectiveness of domestic monetary policies (Han & Wei, 2018). Trade and commodity shocks further constrain policy autonomy as fluctuations in global prices for oil and raw materials directly affect inflation, output and the balance of payments (Kandil, 2016).

While Indonesia has adopted inflation targeting and flexible exchange rates, these tools alone are insufficient when financial frictions limit policy transmission and amplify the effects of global shocks (Banerjee et al., 2016). Despite these efforts, emerging markets like Indonesia remain constrained by limited fiscal and institutional capacity which restricts their ability to implement large-scale counter-cyclical interventions during crises (Papadavid, 2023). As a result, central banks in these economies are increasingly expected to play expanded roles as strategic crisis managers, coordinating macroeconomic policy, financial regulation and international cooperation (Quaglia & Verdun, 2025). In recent years, central banks have become essential actors in managing not only inflation and interest rates, but also systemic financial risk, geopolitical exposure and development financing (Orphanides, 2017).

During past crises—such as the 2008 global financial collapse and the COVID-19 pandemic—central banks adopted unconventional tools including quantitative easing, asset purchases and liquidity support mechanisms, blurring the boundaries between fiscal and monetary policy (Belke & Verheyen, 2014; Hofmann, 2021). Most existing studies focus on technical aspects of monetary policy without exploring how central banks function as active agents of national economic resilience during periods of global disruption (Quaglia & Verdun, 2025). This study explores how geopolitical disruptions translate into systemic financial risks for Indonesia by examining the mechanisms through which global conflicts, trade tensions and alliance realignments affect capital flows, exchange rates and macroeconomic stability. It further investigates



the strategic and institutional responses that Bank Indonesia can employ to manage these risks, including the deployment of monetary policy tools, macroprudential regulations, international cooperation, and crisis management strategies. Ultimately, the study aims to conceptualize the evolving role of central banks in emerging markets, emphasizing how institutions like Bank Indonesia can navigate the dual challenge of maintaining domestic economic resilience while responding to increasing global financial volatility.

THEORETICAL PERSPECTIVES ON CENTRAL BANK RESILIENCE

Geopolitical Risk Theory

Geopolitical Risk Theory (GPR) examines how political disruptions such as wars, terrorism and diplomatic tensions destabilize financial markets and economic systems (Aiswarya & Muthumeenakshi, 2024; Xiong et al., 2020). The theory emphasizes that geopolitical instability affects investor confidence, increases market volatility and disrupts global supply chains (Simonian, 2021). Quantitative methods such as game-theoretic models and machine learning algorithms are increasingly used to evaluate geopolitical risk, complementing qualitative frameworks rooted in international relations theory (Karagozoglu et al., 2022; Simonian, 2021). Empirical evidence shows that geopolitical tensions reduce stock investment and amplify financial uncertainty particularly in emerging markets like Indonesia (Smales, 2021). Research also indicates that oil markets are more sensitive to geopolitical shocks than equity markets due to direct disruptions in energy production (Flouros et al., 2022; Q. Wang et al., 2024). Furthermore, elevated geopolitical risk undermines renewable energy transitions by increasing price volatility and limiting long-term investment certainty (Nguyen et al., 2023; Su et al., 2021). From a macroeconomic standpoint, major powers such as the United States influence global GPR trajectories which affects countries with open capital accounts like Indonesia (Sweidan, 2023; Zhang & Shi, 2023). In response, policy frameworks increasingly emphasize energy diversification, fiscal prudence and green transition strategies to reduce exposure to external shocks (Ali et al., 2025; Zhu et al., 2025). Thus, GPR theory provides essential insights into how central banks must calibrate monetary and financial policies to account for the ripple effects of geopolitical disruption (Ji, 2025; Kaya et al., 2025).

Institutional Resilience Theory

Institutional Resilience Theory (IRT) conceptualizes resilience as a process of adaptive transformation in response to environmental, economic or political shocks (Garschagen, 2013; Mahé & Martel, 2023). The theory underscores that institutions including central banks must continuously evolve through learning, flexibility and strategic realignment (Doerfel et al., 2020; Mohr & White, 2008). IRT posits that resilience is not simply resistance to disruption but an institutional narrative that integrates crisis into a platform for reform and innovation (Mahé & Martel, 2023; Profiroiu, 2021). It further highlights the importance of internal coordination



mechanisms and external stakeholder linkages for effective crisis navigation (Doerfel et al., 2020; Farahmand et al., 2020). Empirical studies show that institutional congruence which is defined as alignment between formal structures and functional demands enhances resilience in interconnected systems such as finance and infrastructure (Farahmand et al., 2020; Mohr & White, 2008). IRT also identifies that cross-level linkages among micro, meso and macro governance levels improve institutional responsiveness during crises (Garschagen, 2013; Mahé & Martel, 2023). In Southeast Asia, examples such as ASEAN's multilateral cooperation and local government adaptation in the Philippines show how strategic institutional design supports resilience under climate and financial stress (Grefalda et al., 2020; Mahé & Martel, 2023). For Bank Indonesia, resilience manifests through coordinated macroeconomic policy, transparency and financial system oversight, aligning with IRT's emphasis on structural learning and context-specific adaptation (Doerfel et al., 2020; Profiroiu, 2021)

Macroprudential Policy Theory

Macroprudential Policy Theory explains how systemic financial risks are managed through institutionally embedded policy instruments that promote financial stability and mitigate contagion effects (van Hengel & Hilbers, 2020; Vučinić, 2016). The theory evolved in the aftermath of the 2008 global financial crisis and emphasized the limitations of microprudential regulation and the need for systemic risk oversight (Buch et al., 2016; Seryakova, 2024). Macroprudential policies are designed to prevent excessive credit expansion, asset bubbles and the mispricing of risk which threaten systemic integrity (Fernandez-Gallardo, 2023; Vučinić, 2016). Dynamic provisioning, countercyclical capital buffers and sectoral exposure limits are key tools for containing macro-financial imbalances (Amorello, 2025; Hui & Zhang, 2020). Stress testing plays a central role by simulating the impacts of adverse scenarios on financial institutions and guiding risk mitigation efforts (Fernandez-Gallardo, 2023; Pacicco et al., 2021). The IMF's Global Macroprudential Policy Instruments (GMPI) database facilitates cross-country learning and comparative analysis of policy effectiveness (Apergis et al., 2022; Narayan & Kumar, 2024). Despite its growing application, macroprudential theory highlights implementation challenges related to institutional design, political economy constraints and empirical uncertainty (Kranke & Yarrow, 2019; Pacelli & Povia, 2025). Bank Indonesia's macroprudential strategy aligns with this framework by incorporating reserve requirements, capital flow management tools and coordinated monetary-fiscal operations to counter external shocks (Amorello, 2025; Fernandez-Gallardo, 2023). Thus, macroprudential policy theory provides central banks with a comprehensive toolkit for stabilizing financial systems in an interconnected and risk-prone global environment (van Hengel & Hilbers, 2020; Vučinić, 2016)



Strategic Foresight Theory

Strategic Foresight Theory emphasizes the capacity of institutions to anticipate emerging risks and prepare for uncertain futures through long-term as adaptive planning (Esposito & Park, 2025; Poli, 2012). This theory frames foresight as an essential governance capability that promotes resilience by integrating scenario analysis, horizon scanning and participatory visioning into policy cycles (Heo & Seo, 2021; Kuosa, 2016). Anticipatory governance, a core concept of the theory, links foresight processes with decision-making structures, feedback loops and governance networks to manage complexity and ambiguity (Poli, 2012; Stephens et al., 2025). Studies demonstrate that strategic foresight enhances institutional adaptability by allowing for the exploration of multiple future trajectories which improve both responsiveness and agility (Coelho et al., 2012; Ehls et al., 2022). In public agencies, foresight initiatives have supported innovation and risk preparedness in sectors such as science, energy, and finance (Coelho et al., 2012; Esposito & Park, 2025). Central banks benefit from foresight by modeling disruptions in areas such as climate risk, digital currency and geopolitical conflict, all of which affect long-term financial stability (Kuosu, 2016; Stephens et al., 2025). Future receptivity as the capacity of institutions and stakeholders to value foresight is essential for embedding this practice into policy design (Heo & Seo, 2021; Poli, 2012). For Bank Indonesia, integrating foresight into macroprudential planning enhances anticipatory resilience and complements operational risk management frameworks (Esposito & Park, 2025; Stephens et al., 2025). Thus, Strategic Foresight Theory contributes a critical perspective on how central banks can proactively shape adaptive strategies rather than simply reacting to shocks (Ehls et al., 2022; Poli, 2012).

Complex Interdependence Theory

Complex Interdependence Theory contends that states and institutions are embedded in dense networks of economic, political and institutional linkages that create both cooperation opportunities and mutual vulnerabilities (Walker, 2013). The theory contrasts with realist paradigms by emphasizing non-military domains of influence and the rising role of international institutions in managing global interdependence (Milner & Moravcsik, 2009; Newman & Zaring, 2010). Empirical studies show that in areas such as antitrust law, financial regulation and aviation safety, cross-border regulatory cooperation reflects the growing importance of transgovernmental networks (Newman & Zaring, 2010; Pardo, 2017). Moreover, complex interdependence creates cascading risks across critical infrastructures where disturbances in one sector (e.g., energy or finance) can rapidly affect others (Rachunok & Nateghi, 2019; Y. Wang et al., 2020a). Arctic regional governance after 2014 exemplifies how cooperation can persist in certain domains even amid geopolitical conflict, reinforcing the theory's core proposition (Byers, 2017; Snyder, 2016). However, asymmetric interdependence can also exacerbate strategic vulnerabilities, particularly for developing economies exposed to external debt, commodity dependence and



volatile capital flows (Niknami, 2022; Y. Wang et al., 2020b). For Bank Indonesia, this theory clarifies how domestic financial policy must be situated within global institutions and regional alliances to reduce exposure to exogenous shocks (Milner & Moravcsik, 2009). Thus, Complex Interdependence Theory provides a systemic perspective on how central banks can balance sovereignty with interdependence in the governance of financial resilience (Pardo, 2017; Walker, 2013)

Mapping Geopolitical Risks to Financial Vulnerabilities

Geopolitical shocks such as war, conflict, trade sanctions, economic decoupling and strategic realignments are no longer isolated political events; they are increasingly recognized as multidimensional stressors that directly transmit into financial vulnerabilities (Aiswarya & Muthumeenakshi, 2024; Xiong et al., 2020). These shocks disrupt macroeconomic fundamentals, distort financial markets and impair institutional resilience especially in open and developing economies like Indonesia (Zhang & Shi, 2023). In an era defined by complex interdependence, such disruptions are global in scale yet asymmetrical in impact, triggering cascading risks through exchange rates, capital flows, trade networks, inflation and investor behavior (Snyder, 2016; Q. Wang et al., 2024).

Wars and territorial conflicts, particularly those involving major powers or energy producers, destabilize financial markets through abrupt commodity price swings and strategic uncertainty (Ali et al., 2025; Zhu et al., 2025). For instance, the Russia–Ukraine conflict has disrupted global grain and energy markets, increasing inflationary pressure and reducing investor confidence in vulnerable economies (Sivaprasad et al., 2025). Similarly, trade sanctions and economic decoupling between geopolitical rivals like the U.S. and China have introduced structural shocks to the global technology and capital markets, affecting supply chains, export orientation, and capital allocation (Byers, 2017; Milner & Moravcsik, 2009). These shocks also strain multilateral institutions and reduce regulatory predictability, heightening risk premiums in emerging economies (Newman & Zaring, 2010).

The first major transmission channel through which geopolitical shocks evolve into financial vulnerabilities is exchange rate volatility. In emerging markets, geopolitical uncertainty typically triggers capital flight to safer assets, causing sharp currency depreciation (Smales, 2021). For Indonesia, whose currency and capital markets are heavily influenced by global risk sentiment, such depreciation increases import costs and amplifies the burden of foreign-denominated debt (Ji, 2025; Kaya et al., 2025). A weakened rupiah exacerbates inflation, widens the current account deficit and forces Bank Indonesia to intervene via foreign reserves or monetary tightening, thereby constraining its policy flexibility (Fernandez-Gallardo, 2023; Guizani et al., 2023).

Capital outflows represent a second key channel. During geopolitical turmoil, foreign institutional investors tend to reallocate assets away from emerging markets due to heightened uncertainty and perceived liquidity risk (Kranke & Yarrow, 2019;



Pacelli & Povia, 2025). In Indonesia, capital outflows have historically correlated with regional or global geopolitical crises, compelling central bank interventions that create fiscal-monetary tensions (van Hengel & Hilbers, 2020; Vučinić, 2016). The dual challenge of stabilizing capital markets while supporting domestic recovery poses a policy trade-off that can weaken financial sector resilience (Buch et al., 2016; Hui & Zhang, 2020).

A third major pathway is trade disruption. Sanctions, export controls and logistical chokepoints reduce the availability of critical inputs, stall production and raise costs across sectors (Foglia et al., 2023). Indonesia as an export-oriented economy integrated into global supply chains is particularly susceptible to trade reconfigurations and shipping risks in geopolitically tense zones like the South China Sea (Khan et al., 2023). Geopolitical shocks can undermine industrial output, reduce foreign earnings and trigger employment volatility, contributing to structural financial stress (Rachunok & Nateghi, 2019; Y. Wang et al., 2020a).

Inflationary pressures are an immediate consequence of war-related commodity shocks and trade constraints. Price spikes in energy, food and raw materials are frequently linked to geopolitical flashpoints in energy-producing regions or agricultural exporters (Ali et al., 2025; Flouros et al., 2022). Indonesia's reliance on imported fuel and food renders its inflation profile highly sensitive to such disruptions even as domestic subsidies provide only temporary relief (Su et al., 2021; Zhu et al., 2025). Inflation not only erodes purchasing power but also pressures the central bank to tighten monetary policy which can stifle investment and exacerbate financial fragility (Amorello, 2025; Fernandez-Gallardo, 2023).

Supply chain fragmentation is another structural consequence of sustained geopolitical risk. Strategic decoupling and nearshoring reduce supply chain efficiency and alter the geography of trade and investment flows (Coelho et al., 2012; Stephens et al., 2025). For Indonesia, shifts in regional production networks especially in semiconductors, electric vehicles and critical minerals can affect export potential and FDI inflows (Ehls et al., 2022; Esposito & Park, 2025). Such reconfigurations pose long-term vulnerabilities to employment, revenue and tax systems that support financial stability.

Investor panic represents a behavioral transmission channel where perceptions of risk escalate market instability. In financial systems with high foreign investor participation such as Indonesia shocks to investor sentiment quickly translate into market sell-offs, liquidity shortages and increased bond yields (Ji, 2025; Smales, 2021). These conditions challenge central banks' dual mandate of maintaining stability and supporting growth particularly when reserves are limited or credibility is in question (Doerfel et al., 2020; Profiroi, 2021).

All of these transmission channels converge to destabilize macroeconomic fundamentals particularly in economies with open capital accounts, import dependence and external debt burdens. Indonesia exemplifies such vulnerabilities: its current account is persistently in deficit, foreign portfolio holdings constitute a



significant share of its bond market, and fuel imports represent a major component of national expenditure (Aiswarya & Muthumeenakshi, 2024). Exchange rate movements thus feed directly into inflation while capital flight strains financial intermediation and liquidity provision (Buch et al., 2016; Fernandez-Gallardo, 2023).

Moreover, external debt poses an additional layer of vulnerability. Much of Indonesia's public and private external debt is denominated in foreign currencies, rendering debt-servicing costs highly sensitive to exchange rate movements (Ji, 2025; Zhang & Shi, 2023). During periods of heightened geopolitical risk, sovereign credit default swaps widen, raising borrowing costs and increasing rollover risk (Guizani et al., 2023; Kaya et al., 2025). Central banks must then decide whether to defend the currency using reserves, raise interest rates, or allow depreciation—each with substantial trade-offs (Amorello, 2025; Hui & Zhang, 2020)

In this context, Bank Indonesia's response capacity is both operational and strategic. From an institutional resilience perspective, it must enhance adaptive capacity through dynamic macroprudential policies, improved scenario planning, and stronger cross-border policy coordination (Garschagen, 2013; Mahé & Martel, 2023). Strategic foresight methodologies—including stress testing under geopolitical scenarios and early-warning indicators—are increasingly essential to anticipate cascading risks (Poli, 2012; Stephens et al., 2025). The growing use of TVP-VAR models and big data analytics in geopolitical-financial risk mapping supports this institutional transition (Aiswarya & Muthumeenakshi, 2024; Xiong et al., 2020).

In addition, complex interdependence theory helps explain Indonesia's structural exposure to global risks. As economic and regulatory systems become globally integrated, shocks in one jurisdiction can rapidly affect others through cross-border trade, capital and governance channels (Newman & Zaring, 2010). Indonesia's financial vulnerabilities cannot be disentangled from its role in global value chains, regional geopolitical alignments and the international financial architecture (Pardo, 2017; Walker, 2013).

Table 1 : Mapping Geopolitical Risks to Financial Vulnerabilities

Geopolitical Risk	Transmission Channel	Impact on Indonesia	Key References
War & Armed Conflict	Commodity price volatility, investor uncertainty	Inflation from energy/food prices; reduced investor confidence; macro instability	Zhu et al., 2025; Ali et al., 2025; Sivaprasad et al., 2025



Trade Sanctions & Economic Decoupling	Trade disruption, supply chain fragmentation	Reduced exports and inputs; loss of export markets; pressure on industrial output and employment	Byers, 2017; Milner & Moravcsik, 2009; Foglia et al., 2023
Strategic Rivalries (e.g., US–China)	Regulatory unpredictability, capital reallocation	Investor exit; FDI shifts away from Indonesia; higher risk premiums	Newman & Zaring, 2010; Esposito & Park, 2025
Currency & Capital Market Sensitivity	Exchange rate volatility	Rupiah depreciation; increased cost of debt servicing; inflation; tighter monetary policy	Ji, 2025; Kaya et al., 2025; Fernandez- Gallardo, 2023
Capital Flight from EMEs	Sudden capital outflows	Liquidity shortages; bond yield spikes; central bank intervention; constrained fiscal- monetary policy	Pacelli & Povia, 2025;
Trade Disruption (e.g., SCS chokepoints)	Logistics bottlenecks	Disrupted production/export earnings; reduced revenue; employment volatility	Khan et al., 2023;
Commodity Shocks (Energy, Food)	Imported inflation	Domestic price spikes; pressure on subsidies; monetary tightening	Flouros et al., 2022; Su et al., 2021; Zhu et al., 2025
Supply Chain Reconfiguration (Decoupling)	FDI relocation, trade flow shift	Loss of competitiveness in key sectors (EVs, semiconductors); long-term structural unemployment and fiscal strain	Stephens et al., 2025; Ehls et al., 2022



Investor Sentiment Collapse	Market panic, asset revaluation	Capital sell-off; market volatility; higher sovereign bond yields; challenge to credibility	Smales, 2021; Ji, 2025; Doerfel et al., 2020
External Debt Exposure	FX mismatch, rollover risk	Rising debt service burden; risk of default; credit downgrade	Zhang & Shi, 2023; Guizani et al., 2023
Institutional Gaps & Policy Trade-offs	Weak adaptive capacity	Policy constraints; slow response; erosion of public trust in monetary authority	Mahé & Martel, 2023;
Global Interdependence	Cross-border spillovers	Systemic vulnerability through trade, capital, and institutional channels	Pardo, 2017

Source : Author's Work

Indonesia's Strategic Position in a Shifting Global Order

Indonesia's geopolitical significance stems from its strategic maritime location and status as ASEAN's largest economy, placing it at the nexus of Indo-Pacific power rivalries (Al Banna Choiruzzad, 2024; Anwar, 2020). Through ASEAN centrality, Indonesia promotes a peaceful and inclusive Indo-Pacific vision to balance between the US and China (Anwar, 2023; Mubah, 2019). Its hedging strategy includes economic engagement with China via the Belt and Road Initiative (BRI) and security alignment with the US (Mubah, 2019; Yoshimatsu, 2022). This dual approach enables Indonesia to navigate competing influences while preserving diplomatic autonomy (Anwar, 2023; Hadi, 2012).

Economically, Indonesia's growth has been underpinned by strong domestic consumption and sound financial governance (Santoso, 2019). However, external shocks and geopolitical tensions increasingly influence macro-financial stability (Yap, 2011). Bank Indonesia plays a stabilizing role through inflation targeting, exchange rate flexibility and capital flow measures (McLeod, 2009; Tabakis, 2009). Yet, tensions in the South China Sea and US-China decoupling continue to disrupt investor sentiment and currency stability (Fitriani, 2021).



Indonesia's trade structure—dominated by China, the US, Japan, and the Middle East—supports GDP growth but exposes the economy to external risks (Ing & Vadila, 2019). The US–China trade war led to commodity price declines and rupiah depreciation, revealing Indonesia's trade dependence (Akdag et al., 2023; Iqbal et al., 2022). While FTAs such as the EU–Indonesia agreement promise FDI and competitiveness gains (Hennessy & Winanti, 2022), proximity to contested waters raises exposure to supply chain and security disruptions (Masroor, 2018; S. Pramono & Novita, 2020). The China's Belt and Road (BRI) enhances infrastructure, but also raises concerns over foreign debt dependence (Dewi, 2024; Sintusingha et al., 2021)

Indonesia's reliance on commodity exports like palm oil, coal and nickel makes it vulnerable to global price shocks (Ekananda, 2022; Yunani, 2022). Exchange rate volatility, linked to commodity cycles, undermines fiscal stability and export competitiveness (Handoyo et al., 2022; Sugiharti et al., 2020). The 2012 commodity bust revealed weaknesses such as premature deindustrialization and fiscal rigidity (Wihardja, 2016). During recent global shocks—including the US–China trade war and COVID-19—export concentration intensified macroeconomic pressures (Iqbal et al., 2022). Diversification remains essential to reduce volatility and promote structural resilience (Basri & Rahardja, 2010; Burke & Resosudarmo, 2012).

Foreign direct investment from China, Singapore, and Japan supports Indonesia's infrastructure and industrial base but increases strategic exposure (Fazaalloh, 2024; A. H. Pramono et al., 2021). Chinese-led BRI projects often raise governance, transparency and debt concerns (Dewi, 2024; Wei et al., 2022). Open capital markets expose Indonesia to speculative flows, complicating monetary policy and financial sovereignty (Al-Fadhat & Nadhir, 2019; Guild, 2023). In response, Indonesia has strengthened domestic capital mobilization and directed FDI via state-linked entities to enhance control (Coxhead & Li, 2008; Widyasanti, 2017).

Multilaterally, Indonesia engages through ASEAN, RCEP and the BRI to deepen economic and diplomatic ties (Mubah, 2019; Sangwan, 2022). While ASEAN promotes regional cohesion, new minilateral groupings like AUKUS and the Quad challenge Indonesia's balancing strategy and ASEAN's relevance (Ha, 2022; Shekhar, 2022). Indonesia's "double hedging" reflects a strategy of extracting benefits from all sides while maintaining non-alignment (Wicaksana & Yakti, 2025). This pragmatic autonomy is essential in a world of fluid alliances and strategic competition (Al Banna Choiruzzad, 2024; Mubah, 2019).

Indonesia's geopolitical and economic profile reflects both embedded vulnerabilities and strategic agility (Anwar, 2023). Bank Indonesia must manage exposure to commodity shocks, trade disruptions, and capital volatility through resilient monetary frameworks and anticipatory governance (McLeod, 2009; Tabakis, 2009). Strategic diversification, institutional robustness and multilateral engagement will be vital to sustaining Indonesia's stability amid a shifting global order (Basri & Rahardja, 2010).

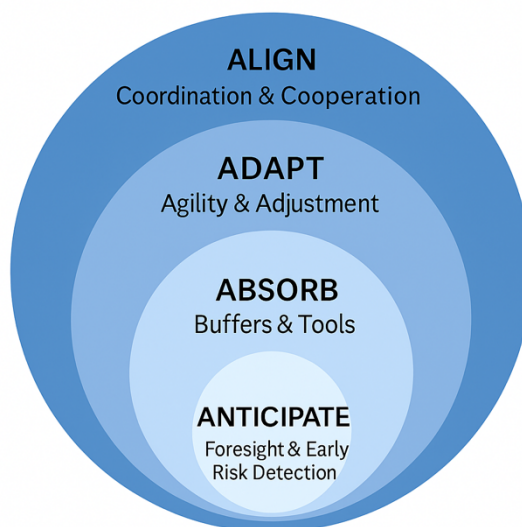


Strategic Navigation of Geopolitical Risks by Central Banks: A Four-Pillar Framework

As geopolitical risks intensify—ranging from great-power rivalries and sanctions to trade fragmentation and energy insecurity—central banks, particularly in emerging markets, must evolve from being reactive monetary authorities to becoming proactive, strategic institutions. In the Indonesian context, where economic vulnerabilities are amplified by global volatility, Bank Indonesia must adopt a holistic approach to managing financial risks rooted in geopolitical disruptions. This paper proposes a four-pillar conceptual framework—Anticipate, Absorb, Adapt, and Align—that synthesizes contemporary insights from geopolitical risk literature to guide central banks in navigating systemic uncertainties.

The first pillar, Anticipate, focuses on forecasting and preparing for potential geopolitical disruptions before they materialize into systemic financial risks. This forward-looking capacity is grounded in the deployment of advanced analytic tools, including game-theoretic modeling, artificial intelligence, and algorithmic forecasting systems that can identify early warning signals of geopolitical instability (Simonian, 2021). These tools facilitate dynamic scenario planning that considers the potential economic consequences of events such as supply chain disruptions, regional conflicts, or trade realignments. In addition, anticipation requires the establishment of robust geopolitical monitoring dashboards that track real-time indicators—such as diplomatic tensions, military activity, and shifts in global alliances—to assess their likely spillover into financial markets (Kumar & Rao, 2024). For central banks like Bank Indonesia, institutionalizing these anticipatory mechanisms can significantly enhance strategic foresight and reduce reaction time in the face of fast-moving geopolitical shocks.

Figure 1 : A Four-Pillar Framework



Source : Author's Work



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Building on this predictive capacity, the second pillar, Absorb, emphasizes the importance of shock resilience through sound risk mitigation strategies. This entails strengthening monetary and fiscal buffers that can absorb the immediate financial effects of external disruptions. In particular, foreign exchange reserves, inflation-targeting frameworks, and capital flow management tools serve as essential instruments for maintaining macro-financial stability during episodes of heightened global uncertainty (Kumar & Rao, 2024). Additionally, the use of real options valuation—especially under fuzzy modeling techniques—provides flexibility in decision-making under ambiguous geopolitical scenarios, offering central banks a method to hedge against volatile outcomes without prematurely locking into fixed policy paths (Kinnunen et al., 2024). These absorptive tools are particularly crucial in contexts where geopolitical shocks can rapidly destabilize capital markets and investor confidence, underscoring the need for preemptive liquidity mechanisms and countercyclical policy space.

The third pillar, Adapt, highlights institutional agility in adjusting policy instruments and operational strategies in response to evolving geopolitical landscapes. Unlike short-term shock absorption, adaptation requires continuous reassessment of central bank strategies and the ability to pivot in real time as conditions change. Dynamic asset allocation serves as a central mechanism in this process, enabling central banks and sovereign wealth managers to shift their exposure across asset classes, currencies, and jurisdictions in line with fluctuating geopolitical risks and market correlations (Hill, 2022). Moreover, adaptation involves promoting an internal culture of innovation, where institutions are encouraged to experiment with new regulatory technologies, digital infrastructures, and cross-sectoral coordination models. This trial-and-error approach—anchored in experiential learning—builds institutional memory and improves resilience over time (Snitker et al., 2024). In Indonesia's case, integrating such adaptive capacities into the governance structure of Bank Indonesia would enhance its responsiveness to global disruptions, from conflict-induced inflation shocks to trade route blockades.

The final pillar, Align, underscores the need for coherence and coordination across national and international actors to manage geopolitical risk effectively. At the policy level, alignment involves embedding geopolitical risk assessments into the broader framework of financial governance, ensuring that monetary and macroprudential tools are designed with geopolitical contingencies in mind (Chenet et al., 2021; Simonian, 2021). On an operational level, alignment entails strengthening inter-agency collaboration between Bank Indonesia, the Ministry of Finance, the Financial Services Authority (OJK), and external affairs departments to ensure policy coherence during crises. Furthermore, alignment extends beyond national borders. Regional integration mechanisms such as the Chiang Mai Initiative Multilateralisation (CMIM) and ASEAN+3 financial surveillance networks provide collective risk-sharing mechanisms that reduce individual exposure to external shocks. Effective alignment also requires inclusive stakeholder engagement—connecting public institutions, civil



society, and private actors to ensure a unified, society-wide response to geopolitical risks (Wróblewski et al., 2025). For Indonesia, aligning national policy with regional and global financial safety nets will be critical in enhancing systemic resilience amid multipolar disorder.

These four strategic pillars are not isolated domains but function as interdependent components of a cohesive risk management architecture. Conceptually, they can be visualized as concentric layers: Anticipate forms the core, enabling early recognition of risks; Absorb builds the immediate protective shell; Adapt provides strategic flexibility under dynamic conditions; and Align ensures external coherence and multilateral coordination. Depending on the nature of the geopolitical shock, different layers are activated. For instance, a trade embargo may first necessitate anticipatory scenario modeling, followed by monetary buffer deployment and cross-agency coordination. Conversely, a prolonged global decoupling might emphasize long-term adaptation and strategic alignment with new economic blocs. This dynamic interplay ensures that central banks are not only insulated from geopolitical fallout but are also empowered to act as forward-looking agents of macro-financial stability.

This four-pillar framework offers a comprehensive and pragmatic approach for central banks—especially those in emerging markets—to manage complex geopolitical risks. It integrates foresight, resilience, agility, and institutional coherence into a unified strategy that can be tailored to national contexts while aligned with global financial governance principles. For Bank Indonesia, adopting this framework could enhance its ability to anticipate and respond to external shocks, maintain investor confidence, and contribute to broader economic resilience. As the global financial architecture becomes increasingly shaped by non-economic forces, central banks must equip themselves with strategic frameworks that transcend conventional macroeconomic models. By internalizing the Anticipate–Absorb–Adapt–Align logic, central banks can transform geopolitical volatility from a source of systemic fragility into an opportunity for institutional learning and strategic capacity building.

Implications and Policy Recommendations

The findings of this study underscore the profound and multifaceted impact of geopolitical shocks on Indonesia’s financial system, illustrating the urgent need for a resilient, anticipatory, and adaptive central banking strategy. As geopolitical volatility intensifies through conflicts, trade decoupling, and strategic realignments, the implications for Indonesia span across exchange rate stability, capital flow dynamics, inflationary pressures, and macroeconomic governance. These vulnerabilities are not merely cyclical or external—they are structurally embedded in Indonesia’s financial architecture, which is characterized by high openness, commodity dependence, and foreign capital reliance :

1. Reconceptualizing Central Bank Roles Beyond Monetary Orthodoxy



Emerging market central banks like Bank Indonesia must reconceptualize their roles beyond traditional monetary stability to include strategic crisis management and resilience-building. The rising systemic exposure to geopolitical shocks calls for an expanded institutional mandate that integrates macroprudential surveillance, fiscal coordination, and international engagement. Central banks can no longer operate in isolation but must act as strategic nodes in a broader network of crisis governance (Orphanides, 2017; Quaglia & Verdun, 2025). This evolution aligns with the concept of institutional resilience, where central banks must learn, adapt, and strategically realign in response to evolving threats (Mahé & Martel, 2023).

2. Embedding Strategic Foresight into Policy Cycles

Anticipatory governance is critical in the current geopolitical climate. Bank Indonesia should institutionalize foresight practices—such as scenario analysis, geopolitical stress-testing, and early-warning dashboards—into its macroprudential and monetary policy frameworks (Poli, 2012; Stephens et al., 2025). Foresight capacity would allow the central bank to assess future disruptions in commodity supply, capital market sentiment, or trade flows, improving pre-emptive decision-making and policy agility. These practices must be embedded not as auxiliary tools but as central elements of policy planning.

3. Enhancing Shock Absorption Through Financial Buffers and Liquidity Mechanisms

The findings reaffirm the importance of adequate foreign exchange reserves, dynamic capital flow measures, and flexible inflation-targeting regimes in absorbing the immediate impact of external shocks. In this context, Bank Indonesia should strengthen its buffer capacity not only through reserve accumulation but also via bilateral and multilateral liquidity lines, including swaps and regional safety nets such as the Chiang Mai Initiative Multilateralisation (CMIM) (Fernandez-Gallardo, 2023; van Hengel & Hilbers, 2020). Strengthening the toolkit for countercyclical response during financial stress is vital to maintaining investor confidence and exchange rate stability amid capital outflows.

4. Institutionalizing Adaptive Governance and Policy Flexibility

Given the unpredictable and evolving nature of geopolitical disruptions, central banks must design adaptive institutional structures that allow policy experimentation and iterative learning. This requires building a policy culture open to innovation, the use of regulatory sandboxes for macroprudential tools, and flexible asset management strategies responsive to geopolitical triggers (Hill, 2022; Snitker et al., 2024). For Indonesia, adaptation must also involve cross-sectoral coordination—



linking monetary operations to energy risk, industrial planning, and supply chain resilience.

5. Coordinating Policy Across Domestic Institutions

The alignment of central bank actions with fiscal authorities, regulatory bodies, and trade and foreign affairs agencies is crucial for managing systemic risks. Institutional coordination during crises enhances consistency, improves communication with markets, and reduces fragmented responses (Doerfel et al., 2020; Profiroiu, 2021). Bank Indonesia should formalize strategic coordination platforms—such as inter-agency task forces and crisis response frameworks—with the Ministry of Finance, OJK, and Bappenas to synchronize economic policies during external shocks.

6. Diversifying Economic Structure and External Linkages

The overreliance on commodity exports, imported energy, and external debt leaves Indonesia structurally vulnerable to global price and interest rate volatility. Long-term resilience requires economic diversification, including strengthening domestic manufacturing, enhancing green energy investments, and building domestic capital markets to reduce dependence on volatile portfolio flows (Basri & Rahardja, 2010; Ekananda, 2022). Bank Indonesia, in coordination with the government, should support initiatives for financial deepening—such as local currency bond markets and fintech integration—that enhance domestic funding resilience.

7. Strengthening Multilateral and Regional Engagement

Indonesia's embeddedness in complex interdependence systems implies that financial resilience cannot be pursued solely through national instruments. Multilateralism and regional cooperation are essential for risk-sharing and policy coherence (Pardo, 2017). Bank Indonesia should intensify its participation in ASEAN+3 financial forums, IMF consultations, and regional economic surveillance to gain access to real-time intelligence, support networks, and collective stabilization tools. Engagement with emerging frameworks such as BRICS banking arrangements or digital currency coordination can further expand Indonesia's strategic options.

8. Developing a National Geopolitical Risk Framework

The central bank should advocate for the establishment of a national geopolitical risk management framework that integrates economic, diplomatic, and security insights. A national geopolitical risk dashboard—developed in coordination with defense, foreign affairs, and intelligence agencies—could inform both central bank policy and broader economic strategy. This would ensure that macroeconomic governance in Indonesia is not blindsided by global developments but remains proactively engaged in shaping its responses.



CONCLUSION

The evolving landscape of global geopolitics—marked by intensifying conflict, economic decoupling, and shifting alliances—has redefined the nature of financial risk for emerging economies like Indonesia. These risks are transmitted through multiple interconnected channels, including exchange rate volatility, capital outflows, trade disruption, inflationary pressures, and structural dependence on global commodity and financial cycles. In this context, Indonesia's financial stability is no longer solely a function of domestic macroeconomic management, but increasingly a product of its resilience to external geopolitical shocks. This study highlights that Bank Indonesia must transition from a conventional monetary authority into a strategically adaptive institution equipped to manage complex, multidimensional risks. The proposed four-pillar framework—Anticipate, Absorb, Adapt, and Align—offers a comprehensive model for central banks to operate as foresight-driven, resilient, and agile policy actors in an increasingly unstable global environment. These pillars are not static; they must operate in synergy to support institutional coherence, policy innovation, and cross-sectoral coordination. Ultimately, Indonesia's financial sovereignty and macroeconomic stability will depend on its ability to diversify its economic structure, enhance institutional flexibility, and deepen multilateral cooperation. Central banks are now on the frontlines of geopolitical disruption and must be empowered with both the tools and the mandate to respond proactively. For Bank Indonesia, adopting a strategic posture rooted in foresight and resilience will not only safeguard against future crises but will also reinforce its role as a pillar of national economic security in a rapidly transforming world order.

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