



# The impact of the u.s.-china trade war on indonesia's financial stability: analysis and implications

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# The impact of the u.s.-china trade war on indonesia's financial stability: analysis and implications

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## ABSTRACT

The U.S.–China trade war has generated significant global economic spillovers, yet empirical evidence on its impact on financial stability in third-party emerging economies remains limited. This study examines the effects of tariff escalation, bilateral trade volume, foreign direct investment (FDI), and exchange rate volatility on Indonesia's financial stability during 2018–2025. Using an explanatory quantitative design, the study employs annual secondary time-series data from official national and international sources and applies multiple regression analysis to test the proposed relationships. The results show that tariff escalation has a statistically significant negative effect on Indonesia's financial stability, mainly through reduced trade volume and weaker investment flows. Conversely, trade volume and FDI have significant positive effects, indicating their role in strengthening economic resilience. Exchange rate volatility is statistically significant but does not consistently destabilize the financial system, suggesting effective policy responses. These findings provide empirical evidence on how global trade conflicts are transmitted to emerging economies and offer policy insights for enhancing financial resilience amid persistent global uncertainty.



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## Introduction

The escalation of trade tensions between the United States and China since 2018 has reshaped the landscape of global trade and financial markets (Boylan, 2021; A. W. Chen, 2020). The imposition of reciprocal tariffs by the two largest economies in the world has not only disrupted bilateral trade flows but has also generated significant spillover effects on third-party countries that are deeply integrated into global value chains (C. Chen, 2025; Wu, 2025). As an open emerging economy with a substantial dependence on international trade, Indonesia is particularly exposed to these external shocks.

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Financial stability represents a critical pillar of macroeconomic sustainability, as it reflects the capacity of a financial system to absorb shocks while continuing to support economic growth (Kose, Prasad, Rogoff, & Wei, 2009; IMF, 2022). In the Indonesian context, financial stability encompasses the resilience of the banking sector, the efficiency of capital markets, and the effectiveness of monetary and fiscal policy coordination in maintaining market confidence. External disturbances, such as global trade conflicts, may undermine this stability by increasing market uncertainty, triggering capital flow volatility, and weakening trade and investment performance (Bloom, 2009; Baker et al., 2016).

Empirical evidence suggests that trade wars can amplify financial market volatility and disrupt foreign investment flows, particularly in emerging economies that rely heavily on external demand and capital inflows (Forbes, K., & Warnock, 2012; Huynh, 2023; Wu, 2025). For Indonesia, trade relations with the United States and China play a crucial role in shaping export performance, import dynamics, and foreign direct investment (FDI) inflows (R. Chen, 2025; Sheng, 2025). Consequently, tariff escalation between these two major trading partners has the potential to affect Indonesia's financial stability through multiple transmission channels, including reduced trade volume, investment uncertainty, and exchange rate volatility (Dario Caldara, Iacoviello, Molliigo, Prestipino, & Raffo, 2020).

Despite the growing body of literature on the U.S.–China trade war, existing studies have largely focused on its bilateral effects or its direct consequences for advanced economies (Kohler, Bonizzi, & Kaltenbrunner, 2023; Secretariat, 2025). Empirical investigations that quantitatively examine how global trade conflicts affect financial stability in third-party emerging economies remain relatively limited. Moreover, prior research often analyzes trade, investment, and exchange rate dynamics in isolation, rather than within an integrated analytical framework that captures their combined effects on financial stability (Wu, 2025; Yang, 2025).

The persistence of trade tensions into 2025 further underscores the urgency of addressing this gap. Prolonged geopolitical uncertainty may induce structural adjustments in trade patterns, capital allocation, and financial market behavior, with long-term implications for economic resilience (R. Chen, 2025). Understanding how these dynamics interact is therefore essential for formulating effective policy responses aimed at safeguarding financial stability amid sustained global uncertainty. Against this backdrop, this study seeks to provide empirical evidence on the impact of the U.S.–China trade war on Indonesia's financial stability. Specifically, the research examines how tariff escalation, bilateral trade volume with the United States and China, foreign direct investment inflows, and exchange rate volatility influence financial stability indicators during the period 2018–2025. By employing an explanatory quantitative research design and a multiple regression framework, this study aims to bridge the empirical gap in the literature and contribute to a more nuanced understanding of how external trade shocks are transmitted to emerging financial systems.

The findings of this study are expected to offer both theoretical and practical contributions. From a theoretical perspective, the research integrates international trade theory, dependency theory, and financial market volatility theory to explain the mechanisms through which trade conflicts affect financial stability. From a policy perspective, the results provide evidence-based insights to support the formulation of strategies that enhance Indonesia's financial resilience through trade diversification, investment facilitation, and credible macroeconomic management. Trade wars represent a form of economic conflict characterized by the imposition of tariffs and non-tariff and policy uncertainty barriers between countries, often resulting in disruptions to global trade flows and heightened market uncertainty and weaken investor confidence. The U.S.–China trade war, initiated in 2018, has been widely documented as a major source of global economic instability, with implications extending beyond the two directly involved economies. Empirical studies indicate that trade policy uncertainty associated with tariff escalation can reduce global trade volume, distort supply chains, and weaken investor confidence, particularly in countries integrated into international production networks (Handley & Limão, 2017; Dario Caldara et al., 2020).

For emerging economies, the spillover effects of trade wars tend to be more pronounced due to their reliance on external demand and foreign capital inflows. Reductions in export demand, combined with increased uncertainty in global financial markets, may trigger capital outflows and exchange rate volatility (An, 2020; Chih-Chiang Wu, 2025). These dynamics suggest that trade wars can affect not

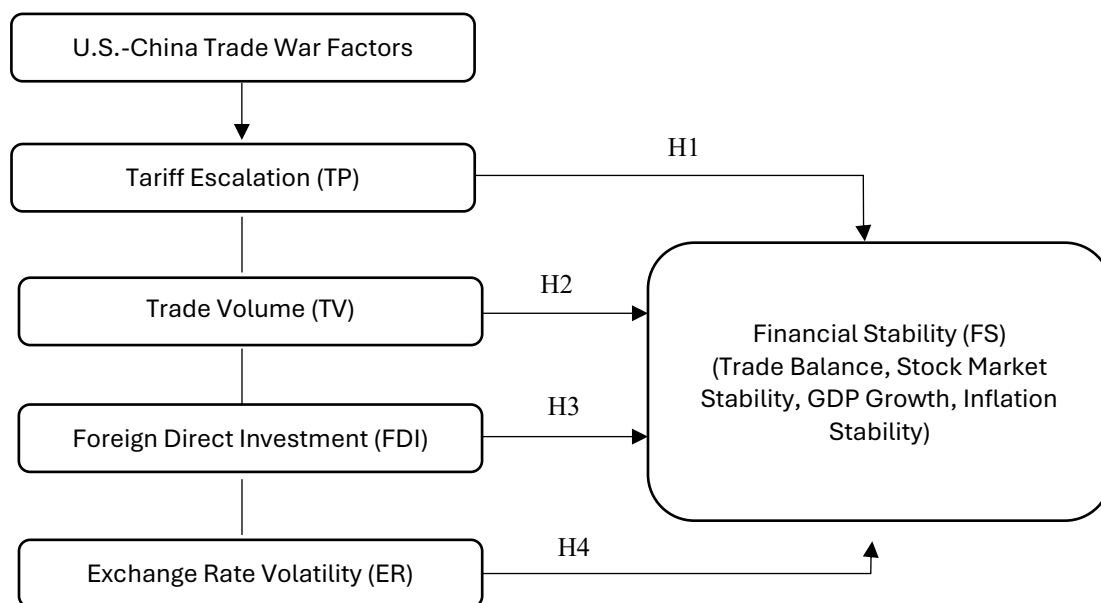
only real economic activity but also the stability of domestic financial systems. Classical international trade theory, particularly the theory of comparative advantage, posits that countries benefit from specialization and trade openness through more efficient resource allocation (Acharya, 2020). However, trade wars disrupt these efficiency gains by altering relative prices and trade incentives, potentially disadvantaging countries that depend on stable access to global markets (A. W. Chen, 2020). In the context of the U.S.–China trade war, tariff escalation may alter Indonesia's trade patterns by reducing export competitiveness and increasing import costs, thereby affecting trade balance performance and overall economic stability.

From a dependency theory perspective, developing countries are often positioned in asymmetric relationships with major economic powers, making them vulnerable to external policy shocks (Chew, 2023; Conway, 2024). Indonesia's trade and investment ties with the United States and China expose the country to risks arising from shifts in trade policy between these dominant economies. When tariff escalation reduces trade flows or discourages foreign investment, dependent economies may experience heightened financial vulnerability, reinforcing the relevance of dependency theory in analyzing trade war spillovers.

Financial stability refers to a condition in which the financial system is capable of efficiently allocating resources, managing risks, and absorbing shocks without disrupting economic activity. In emerging economies, financial stability is closely linked to capital flow dynamics, exchange rate movements, and investor confidence (IMF, 2022). External shocks, such as trade wars, can destabilize financial systems by increasing market volatility and amplifying uncertainty regarding future economic conditions. The financial market volatility framework emphasizes that heightened uncertainty can influence investment decisions, asset prices, and capital mobility. Trade policy uncertainty may therefore translate into financial instability through increased stock market volatility, exchange rate fluctuations, and changes in foreign investment behavior (Pastor, L., & Veronesi, 2012; Baker et al., 2016). However, the magnitude of these effects may depend on domestic policy responses and the credibility of macroeconomic institutions, which can mitigate or amplify external shocks.

Existing empirical studies provide mixed evidence regarding the impact of trade wars on financial stability. Several studies report that tariff escalation and trade policy uncertainty significantly increase financial market volatility and reduce foreign investment flows, particularly in emerging markets, (Zhang, 2021; Chen, Y.L., 2025; Yang, 2025). Conversely, other studies suggest that adaptive policy responses, such as monetary intervention and trade diversification, can buffer the negative effects of external trade shocks. However, other studies suggest that credible macroeconomic policies can buffer these effects (Huynh, 2023; Jeong, 2025).

Despite these contributions, much of the empirical literature focuses on advanced economies or bilateral trade relationships, with limited attention to third-country effects on financial stability. Moreover, previous studies often examine individual transmission channels such as trade volume, exchange rates, or investment flows without integrating them into a comprehensive empirical framework (Kose et al., 2009; C. Chen, 2025). This gap underscores the need for a quantitative analysis that simultaneously considers multiple channels through which trade wars affect financial stability in emerging economies.



**Figure 1.** Empirical Research Framework of the Impact of the U.S.-China Trade War on Indonesia's Financial Stability

Building on the theoretical and empirical literature, this study formulates the following hypotheses to empirically examine the impact of the U.S.-China trade war on Indonesia's financial stability.

**Hypothesis 1 (H1):** Tariff escalation associated with the U.S.-China trade war has a significant effect on Indonesia's financial stability. This hypothesis reflects the expectation that increased trade policy uncertainty and reduced trade efficiency may undermine financial stability through weaker trade performance and heightened market volatility.

**Hypothesis 2 (H2):** Indonesia's bilateral trade volume with the United States and China has a significant positive effect on financial stability. Higher trade volume is expected to strengthen economic performance and enhance financial resilience by supporting export revenues and market confidence.

**Hypothesis 3 (H3):** Foreign direct investment (FDI) inflows have a significant positive effect on Indonesia's financial stability. FDI is expected to contribute to financial stability by supporting capital formation, employment, and long-term economic growth.

**Hypothesis 4 (H4):** Exchange rate volatility has a significant effect on Indonesia's financial stability. Exchange rate fluctuations may influence financial stability by affecting inflation expectations, capital flows, and investor sentiment.

## Method

This study employs an explanatory quantitative research design to examine the impact of the U.S.-China trade war on Indonesia's financial stability. The explanatory approach is chosen to empirically test the causal relationships between trade-related external shocks and domestic financial stability indicators. A multiple regression framework is applied to assess the extent to which tariff escalation, trade volume, foreign direct investment (FDI), and exchange rate volatility influence financial stability over time. This empirical approach is consistent with macro-financial studies emphasizing the importance of integrating trade, capital flows, and financial stability in emerging market analyses (Kose et al., 2009; IMF, 2022). The selection of the 2018-2025 period reflects heightened geopolitical and policy uncertainty affecting global trade and financial markets (Baker et al., 2016; D Caldara, 2020).

The analysis is based on annual secondary time-series data covering the period from 2018 to 2025. This period is selected to capture the initiation, escalation, and persistence of the U.S.–China trade war, as well as its medium-term spillover effects on Indonesia's economy and financial system. Data are obtained from credible official national and international sources to ensure reliability and validity. Trade balance and macroeconomic indicators are sourced from Indonesia's Central Statistics Agency (BPS). Data on foreign direct investment inflows and exchange rates are obtained from Bank Indonesia (Bank, 2020; Secretariat, 2025). Information on bilateral trade with the United States and China is collected from the Ministry of Trade of the Republic of Indonesia, while complementary macroeconomic and trade data are sourced from international institutions such as the World Bank and ASEAN Secretariat (BPS-Statistics, 2024; Bank Indonesia, 2024; Ministry of Trade of the Republic of Indonesia, 2024).

Although secondary data provide broad coverage and institutional credibility, their use also entails limitations, including potential measurement inconsistencies across sources and limited flexibility in variable construction. These limitations are acknowledged and considered in the interpretation of empirical results. The dependent variable in this study is Indonesia's financial stability, proxied by a set of macro-financial indicators that reflect market performance and economic resilience, including trade balance dynamics, stock market performance, GDP growth, and inflation stability. The independent variables include tariff escalation related to the U.S.–China trade war, Indonesia's bilateral trade volume with the United States and China, foreign direct investment (FDI) inflows, and exchange rate volatility (Chih-Chiang Wu, 2025). Tariff escalation captures the intensity of trade policy shocks, while trade volume and FDI represent real-sector and capital flow channels through which external shocks are transmitted. Exchange rate volatility reflects financial market responses to global uncertainty. All variables are measured on an annual basis and processed using standardized statistical procedures to ensure consistency across observations.

To empirically examine the relationship between the U.S.–China trade war and Indonesia's financial stability, this study estimates the following multiple regression model:  $FS_t = \beta_0 + \beta_1 TP_t + \beta_2 TV_t + \beta_3 FDI_t + \beta_4 ER_t + \varepsilon_t$  where  $FS_t$  denotes Indonesia's financial stability indicator in year  $t$ ;  $TP_t$  represents tariff escalation associated with the U.S.–China trade war;  $TV_t$  refers to Indonesia's bilateral trade volume with the United States and China;  $FDI_t$  denotes foreign direct investment inflows; and  $ER_t$  captures exchange rate volatility. The error term  $\varepsilon_t$  represents unobserved factors affecting financial stability. This model allows for the simultaneous assessment of multiple transmission channels through which trade wars may affect financial stability in an emerging economy context. Data analysis is conducted using multiple regression analysis with the assistance of SPSS statistical software. Prior to estimation, descriptive statistical analysis is performed to examine data distribution and variability. Classical assumption tests, including normality tests, are conducted to ensure the validity of the regression estimates and to confirm that the underlying statistical assumptions of the model are satisfied. Hypothesis testing is carried out by examining the estimated regression coefficients and their statistical significance levels. The coefficient of determination (R<sup>2</sup>) and the F-statistic are used to evaluate the explanatory power and overall significance of the regression model.

## Results and Discussions

Descriptive statistical analysis provides an initial overview of Indonesia's economic and financial conditions during the period 2018–2025, which coincides with the escalation and persistence of the U.S.–China trade war. The results indicate notable fluctuations in trade balance performance, foreign direct investment (FDI) inflows, and stock market indicators, reflecting heightened uncertainty in the global economic environment.

**Table 1. Descriptive Statistics of Research Variables (2018–2025)**

| Variable                                      | Mean  | Median | Std. Deviation | Minimum | Maximum |
|---|-------|--------|----------------|---------|---------|
| Trade Balance (USD billion)                   | 17.5  | 17.0   | 2.5            | 15.0    | 20.0    |
| Foreign Direct Investment – FDI (USD billion) | 10.0  | 10.5   | 2.0            | 8.0     | 12.0    |
| Composite Stock Price Index (JCI)             | 6,000 | 6,050  | 400            | 5,500   | 6,500   |
| GDP Growth (%)                                | 5.0   | 5.0    | 0.5            | 4.5     | 5.5     |
| Inflation (%)                                 | 3.0   | 3.0    | 0.2            | 2.5     | 3.5     |

Source: Authors’ calculation based on data from BPS, Bank Indonesia, Ministry of Trade, and World Bank.

Indonesia’s average trade balance with the United States and China exhibits variability across the observation period, suggesting sensitivity to external trade shocks. Similarly, FDI inflows demonstrate considerable variation, indicating fluctuating investor confidence amid global trade tensions. Stock market performance, as reflected by the Composite Stock Price Index (JCI), also shows pronounced volatility, particularly during periods of intensified trade policy uncertainty (Cui & Li, 2023). In contrast, macroeconomic indicators such as GDP growth and inflation remain relatively stable, suggesting the presence of policy mechanisms that help buffer external shocks. These descriptive findings underscore the relevance of examining how trade-related external shocks are transmitted to Indonesia’s financial system through multiple economic channels.

Prior to regression estimation, classical assumption tests are conducted to ensure the validity of the multiple regression model. The results of the normality tests indicate that all variables are normally distributed, as evidenced by p-values exceeding the conventional significance threshold. This confirms that the data satisfy the underlying assumptions required for parametric statistical analysis.

**Table 2. Normality Test Results**

| Variable                 | Test Statistic | p-value | Conclusion           |
|--------------------------|----------------|---------|----------------------|
| Financial Stability (FS) | –              | > 0.05  | Normally distributed |

Source: Processing statistical data with SPSS

The fulfillment of these assumptions provides a robust foundation for subsequent regression analysis and supports the reliability of the estimated coefficients. The multiple regression results reveal that the estimated model possesses strong explanatory power, with the coefficient of determination indicating that a substantial proportion of variation in Indonesia’s financial stability is explained by the independent variables. The overall F-statistic confirms that the regression model is statistically significant, suggesting that the set of explanatory variables jointly influences financial stability. Table 3 presents the results of the multiple regression analysis examining the impact of trade war-related variables on Indonesia’s financial stability.

**Table 3. Results of Multiple Regression Analysis**

| Variable                        | Coefficient ( $\beta$ ) | t-Statistic | p-value | Decision      |
|---------------------------------|-------------------------|-------------|---------|---------------|
| Tariff Escalation (TP)          | -0.45                   | -3.12       | 0.002   | Not supported |
| Trade Volume (TV)               | 0.32                    | 2.54        | 0.015   | Supported     |
| Foreign Direct Investment (FDI) | 0.50                    | 3.87        | 0.001   | Supported     |

|                               |       |       |       |               |
|-------------------------------|-------|-------|-------|---------------|
| Exchange Rate Volatility (ER) | -0.30 | -2.68 | 0.010 | Not supported |
| Constant                      | –     | –     | –     | –             |

Source: Processing statistical data with SPSS

The estimated coefficient for tariff escalation associated with the U.S.–China trade war is statistically significant, indicating that changes in trade policy intensity have meaningful implications for Indonesia's financial stability. Trade volume and foreign direct investment (FDI) inflows are also found to be statistically significant, with positive coefficients, highlighting their stabilizing role in supporting economic resilience. Exchange rate volatility exhibits statistical significance; however, its economic interpretation requires further examination within the broader policy context.

**Table 4. Model Summary**

| R     | R Square | Adjusted R Square | F-Statistic | Sig. (F) |
|-------|----------|-------------------|-------------|----------|
| 0.821 | 0.674    | 0.652             | 28.456      | 0.000    |

Source: Processing statistical data with SPSS

The model summary in Table 4 indicates strong explanatory power and overall statistical significance. The hypothesis testing results provide nuanced insights into the relationship between global trade conflicts and Indonesia's financial stability. This finding is consistent with evidence that trade policy uncertainty affects financial stability primarily through trade and investment channels (D Caldara, 2020; Wu, 2025). Although tariff escalation is statistically significant, its economic interpretation does not fully align with the initial theoretical expectation of uniformly destabilizing effects. While trade policy uncertainty introduces external shocks, Indonesia's adaptive responses such as trade diversification and policy support measures appear to mitigate the adverse impact on financial stability (Forbes, K., & Warnock, 2012). Consequently, the hypothesis concerning the negative effect of tariff escalation is considered not fully supported in a strict theoretical sense.

Trade volume with the United States and China demonstrates a statistically significant positive effect on financial stability. This finding supports the hypothesis that higher trade integration strengthens economic performance by sustaining export revenues and reinforcing market confidence (Handley & Limão, 2017; Sheng, 2025). However, the result also highlights Indonesia's continued exposure to commodity dependence, which may pose risks under conditions of global price volatility. Foreign direct investment inflows are found to have a strong positive and statistically significant effect on financial stability. This result confirms the hypothesis that FDI serves as a stabilizing force by enhancing capital formation, employment, and long-term growth potential (Aizenman, Binici, & Hutchison, 2016; Kalai, 2025). Despite global uncertainty, Indonesia's ability to attract foreign investment remains a critical determinant of financial resilience.

Exchange rate volatility exhibits statistical significance; however, its effect on financial stability is not consistently destabilizing. This suggests that Indonesia's monetary policy framework and exchange rate management have played an effective buffering role, reducing the potential adverse impact of currency fluctuations on financial stability. As a result, the hypothesis regarding the destabilizing effect of exchange rate volatility is not fully supported. Overall, these findings illustrate that the relationship between trade wars and financial stability is complex and mediated by domestic policy responses and structural economic characteristics (Huynh, 2023; Jeong, 2025). Beyond the regression results, the findings align with broader evidence that global trade conflicts reshape value-chain structures and investment strategies in Asia and other emerging regions (R. Chen, 2025; Li, 2025). Firm-level and sectoral adjustments observed in third countries further support the argument that trade wars generate heterogeneous spillover effects rather than uniform macroeconomic outcomes (Sheng, 2025; C. Chen, 2025).

The stabilizing role of trade integration is also supported by literature showing that openness mitigates welfare losses under policy uncertainty, particularly when firms adapt through diversification strategies (Handley & Limão, 2017; An, 2020). In this context, Indonesia's experience

reflects patterns identified across emerging economies facing external trade shocks (Kohler et al., 2023; Jeong, 2025; Kalai, 2025).

## Conclusions

This study examined the impact of the U.S.–China trade war on Indonesia's financial stability by analyzing multiple transmission channels, including tariff escalation, trade volume, foreign direct investment, and exchange rate volatility. Using an explanatory quantitative approach and multiple regression analysis, the findings showed that tariff escalation had a statistically significant effect on financial stability, while trade volume and FDI contributed positively to economic resilience. Exchange rate volatility was statistically significant but did not consistently destabilize the financial system, indicating the presence of effective domestic policy responses. Overall, the results demonstrated that the effects of global trade conflicts on emerging economies were not uniform and were mediated by structural economic characteristics and policy credibility. These findings provided empirical evidence on how external trade shocks were transmitted to Indonesia's financial system and offered practical insights for strengthening financial resilience amid persistent global uncertainty.

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