

ABSTRACT

This study aims to analyze the relationship between government external debt and inflation in Indonesia, while examining the application of the Impossible Trinity (trilemma) framework within the country's macroeconomic policy context from 2007Q1 to 2023Q4. The research focuses on how the trade-offs between exchange rate stability, monetary policy independence, and capital mobility shape Indonesia's macroeconomic dynamics amid external pressures and global uncertainty.

The study employs a modified Mundell–Fleming framework using Ordinary Least Squares (OLS) estimation to capture the interactions across key macroeconomic variables such as government external debt, domestic interest rates, exchange rates, inflation, and foreign exchange reserves. This approach allows the analysis to trace the transmission mechanisms linking fiscal conditions, monetary responses, and external sector developments, and to evaluate the extent to which the trilemma constraints manifest in Indonesia's policy choices.

The findings indicate that Indonesia has tended to sacrifice part of its monetary policy independence in favor of maintaining exchange rate stability and supporting capital mobility. This is evidenced by the significant negative relationship between rupiah depreciation and the stock of government external debt, as well as the critical role of foreign exchange reserves in stabilizing the currency. Moreover, domestic interest rates appear reactive to inflationary pressures and external shocks. Overall, the results underscore the substantial influence of global conditions on Indonesia's macroeconomic policymaking and highlight trade-offs that align with the trilemma framework.

Keywords: external debt, monetary policy, credibility, independence, impossible trinity, trilemma

