

## Bond Stabilisation Fund (BSF) in Indonesia: Lessons Learned and Its Precautionary Measures

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**ABSTRACT:** We conduct a qualitative literature review on Indonesia's proposed Bond Stabilisation Fund (BSF), synthesising international evidence to assess its viability and risks. The BSF is intended as a liquidity backstop to protect government bond markets from volatility. Our review draws on academic studies and policy reports (2020–2026) to identify theoretical rationales, practical design issues, and historical precedents. We find that while BSFs can reduce short-term yield spikes, they carry significant risks of market distortion and moral hazard. For example, interventions may undercut price signals and encourage excessive borrowing. Crucially, the effectiveness of a BSF depends on precautionary design: activation triggers tied to acute crises, punitive pricing to discourage casual use, strict eligibility (e.g. viability tests, no payouts) and clear exit strategies. Case studies (Thailand's unused BSF, Korea's reactivated fund) illustrate that overly restrictive conditions can render a BSF ineffective, whereas too lax policies invite abuse. Our key recommendation is that Indonesia should treat the BSF as a true *last-resort* tool: it should be well-capitalised but only deployed under severe market stress, with legislative guardrails to limit size and duration. Under these guidelines, a BSF can enhance debt-market stability without creating permanent fiscal risks or encouraging irresponsibility.

**KEYWORDS:** Bond Stabilisation Fund; Market Intervention; Moral Hazard; Indonesia; Financial Stability; Liquidity Support; Central Bank; Emerging Markets; Fiscal Policy; Crisis Management.

**JEL Classification:** E58; G01; G28; H63; D78.

### INTRODUCTION

Indonesia's sovereign bond market has come under strain from recent global and domestic shocks. Rising U.S. yields and tight monetary policy led to capital outflows from emerging markets, and Indonesia saw its 10-year bond yield approach multi-year highs by mid-2026 (Trading Economics, 2026). The rupiah's weakness and inflation concerns exacerbated this stress. In response, the government proposed a **Bond Stabilisation Fund (BSF)** to buy government bonds and shore up prices. The BSF, financed via Indonesia's excess budget reserves (SAL) and special-purpose vehicles, is designed as an emergency liquidity backstop for the domestic bond market (Estherina, 2026; Rahman, 2026).

However, such interventions are controversial. Central banks and researchers warn that frequent bond-buying can "underprice risk" and foster **moral hazard**, inviting investors and issuers to take on excessive debt (Aldridge et al., 2025; BIS, 2022a). For instance, a Bank of Canada review finds that large-scale crisis interventions often "negatively impact market liquidity, distort asset prices", and encourage rent-seeking (Aldridge et al., 2025). In short, an intervention like a BSF can stabilise prices in the short

run but potentially sow the seeds of future crises by dulling market discipline.

This paper examines the **controversies and precautionary considerations** of a BSF in Indonesia, with emphasis on lessons from global experiences. The central research questions are: How can Indonesia deploy a BSF effectively as a backstop without triggering significant market distortions or moral hazard? What design features and safeguards are necessary? We address these by reviewing theoretical arguments and empirical cases, synthesising themes from the literature. The methodology is a narrative qualitative review, as detailed below, drawing heavily on recent sources (post-2020 academic articles and official reports).

In the next section, we outline the conceptual foundations of BSFs and their risks. We then review precautionary design principles and international case studies (Thailand, Korea, etc.). Section 3 describes our qualitative review methodology. Section 4 presents thematic results on BSF effectiveness factors, risks, and safeguards. Section 5 discusses these findings relative to Indonesia's needs. The final section offers substantive policy recommendations:

how to operationalise the BSF so that it achieves its market-stabilisation goals while minimising adverse side-effects.

## LITERATURE REVIEW

### Conceptual Framework: Market Interventions and Stabilisation Funds

A Bond Stabilisation Fund functions essentially as a **market support mechanism**. In practical terms, a government (often via state agencies) commits to purchasing sovereign debt when markets freeze up, akin to an extended central-bank liquidity facility (Wessel, 2025). The goal is to prevent disorderly price collapses and maintain confidence. Central banks have long used asset purchases to address crises, and a BSF is a way to formalise this role for government bonds. For example, a BIS market committee notes that emergency liquidity facilities “can prevent extreme price fluctuations” and bolster investor confidence during stress (AMRO, 2023).

Economically, such interventions are often justified by models of self-fulfilling crises. If bond investors fear default, they may flee, driving yields to unsustainable levels and forcing default – a classic coordination failure. A BSF can break this cycle: by credibly committing to buy, it reassures investors, lowering yields and potentially restoring normal issuance. Fontanier (2024) models how known central-bank support can “stabilise rollover expectations,” preventing sharp liquidity shortfalls. In short, a BSF serves as a **lender-of-last-resort for bond markets** (AMRO, 2023).

However, central-bank and fiscal interventions are not neutral. Chang et al. (2025) analyse the European Central Bank’s bond-buying, finding that policymakers increasingly view purchases as *not inherently causing moral hazard*, reframing them as legitimate policy tools (Chang et al., 2025). In other words, the perception of bond purchases has shifted: while once seen as extraordinary, major central banks now accept them as part of the “conventional” toolkit. This legitimisation suggests that with careful framing and safeguards, market interventions can be integrated into normal policy regimes without automatically becoming open-ended bailouts (Chang et al., 2025).

### Risks and Precautionary Principles

Despite possible benefits, the literature stresses several risks from BSFs. First, **moral hazard**: If firms and investors expect government support, they may take on extra risk. The BIS warns that heavy interventions “may underprice risk-taking” and encourage excessive leverage (BIS, 2022a). Second, **market distortion**: Large-scale bond purchases can reduce price informativeness. Fontanier (2024) shows that central-bank demand “swamps” private signals, leading to mispricing (e.g. undervaluing default risk) (Bousselmi et al., 2026). Third, **fiscal dominance**: Frequent debt purchases blur lines between monetary and fiscal policy. A BIS report cautions that perceived linkages between central bank

purchases and government financing can threaten central-bank independence (BIS, 2022a).

To address these, analysts emphasise **precautionary design**. Key principles include: (1) **Backstop usage** – deploy the BSF only when markets are in acute distress (so it remains an emergency instrument) (BIS, 2022a). The BIS explicitly states that interventions should be a last resort to preserve price discovery. (2) **Pricing deterrents** – e.g. penalty interest rates on BSF funding, which was implemented in Thailand’s BSF (2020) (Runkel, 2022). By making BSF funds more expensive than market rates, only truly insolvent borrowers would access it. (3) **Conditionality and restrictions** – strict eligibility criteria, such as requiring pre-funding from private sources and forbidding dividends or share buybacks by assisted firms (Runkel, 2022). (4) **Temporary nature** – clear sunset or review provisions so the BSF doesn’t become permanent. Thailand’s experience showed that without a clear end date, programs can linger indefinitely if not used correctly. (5) **Transparency and oversight** – full public reporting and perhaps legislative approval to ensure political accountability. These safeguards mirror recommendations from academic and BIS analyses, which stress maintaining market discipline (Aldridge et al., 2025; BIS, 2022a).

### Global Experiences (Successes and Failures)

Examining real-world cases highlights what design features matter. Thailand’s **Corporate Bond Stabilisation Fund (2020)** was announced to support corporate debt, but ended up **unused**. Its architects built in stringent conditions: companies had to show alternative financing and commit to no dividends, and the interest rate on BSF loans was high (Runkel, 2022). These rules ensured caution, but in practice, firms found them too onerous and did not apply. The BSF was quietly wound down by late 2022 (Runkel, 2022). This case shows that overly harsh terms can render a BSF ineffective – the potential negative side (moral hazard) was averted, but also the intended liquidity support never materialised.

By contrast, **South Korea** has actively used a BSF-like tool. In 2008, the government created a **Bond Market Stabilisation Fund** (focused on corporate bonds), which was later reactivated in 2022 during a market crunch (AMRO, 2023). The Korean program allowed the central bank and government entities to buy corporate bonds and CP, broadly supporting liquidity. Crucially, Korea implemented oversight and was prepared to absorb losses if necessary, avoiding the political fallout. The Korean and Thai examples suggest that a successful BSF must calibrate participation incentives: too strict, and it never helps; too loose, and it encourages moral hazard.

Other countries provide stark lessons of failure. For example, Argentina’s long-term experiment with keeping yields low via central bank support led eventually to high inflation and default – the short-term stability was bought at

a high cost (Wessel, 2025). Similarly, Turkey’s attempts to cap yields before elections undermined confidence and forced a painful policy reversal. Lebanon and Zimbabwe’s experiences were even more dire: massive domestic debt support without productivity growth precipitated complete economic collapse. While detailed case studies of those crises are beyond our scope, they underscore a common pattern: **stabilisation measures without structural reforms merely delay a worse crisis** (AMRO, 2023). These cases warn that Indonesia’s BSF cannot substitute for sound fiscal policy or economic reform; it can only provide temporary relief.

## METHODOLOGY

This study is a **qualitative literature review** (non-systematic) aiming to synthesise recent insights on BSFs. We conducted structured searches for peer-reviewed journal articles (2020 onward) and reputable policy reports addressing bond market interventions, central bank crisis tools, and moral hazard. Key sources include academic journals (e.g. *Journal of Common Market Studies*, *Journal of Financial Crises*), as well as official analyses from the BIS, IMF, ADB, AMRO, and national central banks. We

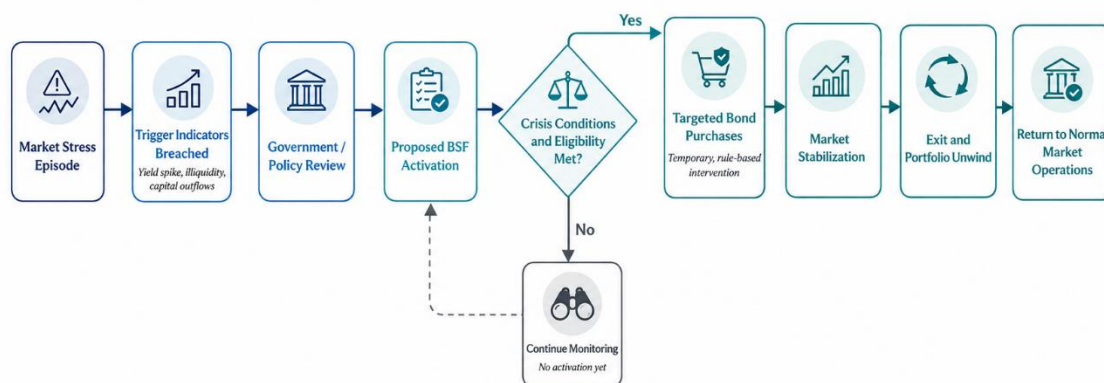
prioritised materials that explicitly discuss government/central-bank bond purchase programs and extract thematic findings.

The review process involved: (1) identifying core concepts (“stabilization funds,” “market intervention,” “moral hazard”) and their synonyms; (2) searching databases like EconLit, Google Scholar, and organizations’ repositories for relevant work from 2020–2025; (3) screening for relevance (e.g. whether a source empirically assesses bond-buying schemes); and (4) coding the literature by theme (e.g. “risks,” “design features,” “case outcomes”). We also used references from key papers to find further studies. Inclusion was limited to sources with rigorous analysis (peer-reviewed or official) and published since 2020 to ensure up-to-date perspectives. Limitations include the non-systematic nature (so not all studies are captured) and reliance on English-language publications.

As an illustrative guide to the analysis process, we depict a simplified workflow of BSF activation below. This flowchart (Figure 1) outlines how a BSF might be triggered by a market crisis, undergo a decision process with conditions, and then be unwound when normalcy returns.

**Figure 1. Conceptual Workflow of BSF Activation and Exit**

*Illustrative decision pathway for using a Bond Stabilization Fund during market stress*



*Source: Author's conceptual synthesis based on the qualitative literature review.*

Figure 1 illustrates the proposed decision sequence through which a Bond Stabilisation Fund should operate if it is to function as a disciplined crisis-management instrument rather than a routine market-support facility (Wessel, 2025). The workflow begins with a market stress episode, such as a sharp rise in sovereign bond yields, declining market liquidity, foreign investor outflows, or disorderly selling pressure in the secondary market. These symptoms do not automatically justify BSF intervention. Instead, they should first be translated into measurable trigger indicators. This distinction is important because temporary volatility is a

normal feature of bond markets, whereas a BSF should only respond to conditions that threaten broader financial stability, fiscal refinancing capacity, or the orderly functioning of the sovereign debt market.

The second stage in the figure emphasises policy review before activation. This step reflects the need for institutional discipline. A BSF should not be activated merely because yields are rising or bond prices are falling. Rising yields may reflect legitimate changes in inflation expectations, fiscal risk, exchange-rate pressure, or global interest-rate conditions. If the government intervenes too early or too

aggressively, it may suppress useful market signals and weaken price discovery. Therefore, the policy review stage should assess whether market movements are excessive relative to fundamentals, whether liquidity conditions have become dysfunctional, and whether the sell-off is creating a self-reinforcing spiral that could impair government financing or financial-sector stability.

The decision diamond—“Crisis Conditions and Eligibility Met?”—is the most important part of the workflow. It represents the institutional checkpoint that prevents the BSF from becoming an unconditional buyer of bonds. A “Yes” decision should only be made when predefined crisis criteria are met, such as abnormal yield spikes, unusually wide bid-ask spreads, failed auctions, sharp foreign outflows, or evidence of panic selling. At this stage, eligibility rules should also be assessed. For Indonesia, this may include determining which bonds are eligible, whether purchases are limited to government securities, how much can be bought, which institutions may execute the transactions, and how the intervention will be reported. This checkpoint is essential to avoid moral hazard because it ensures that support is conditional, rule-based, and temporary rather than discretionary and politically motivated.

The “No” branch in the figure is equally important. If crisis conditions are not met, the appropriate response is continued monitoring rather than premature intervention. This reinforces the principle that the BSF should be a last-resort stabilisation device, not a tool for keeping yields permanently low. In practical policy terms, this means that the authorities may intensify surveillance, communicate with market participants, review auction strategy, or adjust cash management, but they should avoid bond purchases unless market dysfunction is evident. This branch preserves market discipline by allowing investors to continue pricing risk while giving policymakers time to prepare if conditions worsen.

Once the BSF is activated, the figure shows that purchases should be targeted, temporary, and rule-based. This means the fund should not indiscriminately buy all bonds or support all market participants. Instead, it should concentrate on restoring liquidity in specific segments of the market where dysfunction is most severe. The intervention should aim to break panic dynamics, not to eliminate risk premia. After market stabilisation is achieved, the BSF should move into an exit and portfolio-unwind phase. This is crucial because a stabilisation fund that does not exist becomes a permanent market maker. The final stage—return to normal market operations—therefore represents the restoration of private price discovery, normal auction functioning, and market-based allocation of capital.

## RESULTS

### Thematic Findings on BSF Effectiveness

From the literature, we identify several key themes. **Market Function vs. Fiscal Cost:** Many sources note that BSFs can quickly restore liquidity. For example, AMRO (2023) reports that in the COVID crisis, coordinated bond-buying in ASEAN reduced panic selling (AMRO, 2023). However, this comes at potential fiscal costs. Studies caution that large purchases must eventually be financed, possibly generating future inflation if done without sterilisation (BIS, 2022a). Thus, the benefit of stabilising yields must be weighed against longer-term fiscal impacts (Rosariastoko, 2026).

**Investor Behaviour and Confidence:** A BSF signal by itself can calm markets if credible. Country experiences (e.g. Korea 2022) show that the mere announcement of a solid backstop can halt outflows. Yet confidence effects are fragile. The BIS warns that if market participants perceive the BSF as unlimited, they may become complacent, reducing market discipline (BIS, 2022a). Our review indicates that building confidence requires that the BSF be seen as *conditional* support, not a free guarantee (Laxton & Rhee, 2022).

### Objective Factors for Effectiveness

Certain objective factors must be addressed to make a BSF work:

- **Adequate Funding:** The BSF needs deep financial resources. The Indonesian proposal leverages the SAL and state vehicles to meet this need. Comparable programs (e.g. Korea’s) had substantial capital. Without enough firepower, a BSF risks being overwhelmed by demand. The IMF notes that BI’s holdings of rupiah debt jumped ~10 percentage points during COVID, implying that central support became a material share of the market (IMF, 2023). A BSF must anticipate such a scale if foreign investors flee.
- **Debt Structure and Liquidity:** Highly liquid markets allow easier exit from BSF positions. Indonesia’s bond market is moderately liquid, but a large BSF would still occupy a large share. The ADB (2023) shows Indonesian bond turnover is lower than in some peers. Thus, liquidity constraints argue for careful calibration of BSF size and targeted use of instruments (e.g. short-term vs. long-term bonds).
- **Institutional Coordination:** The literature stresses coordination between the fiscal authority and the central bank. In Indonesia’s case, the government funds the BSF, but Bank Indonesia (BI) holds much of the debt. Clear governance is needed to ensure BI’s monetary policy remains focused. Several authors note that overlapping roles can impair credibility (BIS, 2022a). A designated

management committee could help delineate responsibilities.

### Precautionary Measures and Safeguards

Key precautionary design principles emerged consistently:

- **Activation Criteria:** A well-defined trigger (e.g. rapid yield spike or credit spread surge) can prevent arbitrary use. Some IMF and BIS analyses suggest using objective thresholds tied to economic stress indicators (BIS, 2022a).
- **Pricing Mechanisms:** Setting BSF funding rates above market rates is critical. Thailand’s BSF charged incrementally higher rates that made the fund unattractive unless yields were very high (Runkel, 2022). This approach preserves discipline by ensuring that borrowers only tap the fund when necessary.
- **Eligibility Conditions:** Implementing strict conditions prevents misuse. For instance, forbidding corporate buybacks or dividends during support, as Thailand did (Runkel, 2022) ensures companies focus on stabilising liabilities. Limiting BSF eligibility to solvent, critically ill institutions (with collateral or recovery plans) is advisable. These methods align with the BIS’s guidance that interventions should not distort “ordinary price discovery” (BIS, 2022a).
- **Duration Limits and Transparency:** The literature stresses that a BSF must have a clear sunset or review. Transparency in timing and extent of interventions helps prevent unintended market cues. Regular reporting to parliament or the public can maintain trust. Without these constraints, a BSF might morph into permanent balance-sheet support (as happened in some crises) (Runkel, 2022).

### Safeguards Against Moral Hazard

Several sources emphasise safeguards specifically to counter moral hazard. These include: (a) **Co-financing requirements:** for example, requiring firms to raise, say, 30% of funding privately before BSF aid; (b) **Equity kicker or fees:** charging an extra fee on BSF loans helps offset risk and deter frivolous borrowing; (c) **Limiting asset scope:** maybe allow the BSF to buy only government bonds (not corporate debt), thus focusing on sovereign yields. (d) **Independent oversight:** an independent fiscal council or central bank committee could vet BSF operations to ensure rules are followed. The idea is to make the BSF unattractive for normal financing needs so that it is reserved only for genuine emergencies. These prescriptions echo those found in Runkel (2022), where Thailand’s strict BSF rules exemplified moral-hazard prevention (Runkel, 2022).

The review finds that moral hazard is the most persistent risk in BSF design. Moral hazard arises when investors,

issuers, or policymakers change their behaviour because they expect the state to absorb losses. In the context of a BSF, this may occur if investors buy more government bonds at high yields because they believe the government will later support prices, or if policymakers delay fiscal consolidation. After all, bond-market pressure has been temporarily suppressed (Kandrac & Schlusche, 2025; Mohd et al., 2024).

The first safeguard against moral hazard is **loss-sharing**. The BSF should not fully protect investors from market losses. Instead, intervention should aim to restore orderly market functioning while allowing risk premia to continue reflecting fiscal, inflation, and exchange-rate fundamentals. If the BSF eliminates risk premia completely, it will weaken the disciplinary role of the bond market (Gonzalez & Nunez, 2021; RBA, 2026).

The second safeguard is **co-financing**. Where the BSF supports corporate or quasi-sovereign bonds, beneficiaries should be required to obtain a meaningful share of funding from private markets. Thailand’s requirement that borrowers secure at least half of their funding needs from other sources provides a useful precedent because it preserved private-market discipline and reduced reliance on public support (Runkel, 2022). For Indonesia, a comparable principle could be applied by limiting intervention to specific government securities and ensuring that the primary market continues to test investor appetite through auctions.

The third safeguard is **separation between stabilisation and fiscal financing**. A BSF should not be used to finance budget deficits indirectly. If markets interpret BSF purchases as a method of absorbing government debt issuance, the fund may increase fears of fiscal dominance. The BIS warns that perceived links between central-bank operations and government financing needs can threaten central-bank independence, especially in emerging-market economies (BIS, 2022a).

The fourth safeguard is **portfolio transparency**. The public should be able to distinguish between temporary purchases made to restore liquidity and structural purchases that permanently transfer sovereign risk to the public balance sheet. This distinction is important because a temporary liquidity backstop can support market confidence, whereas permanent absorption of debt may weaken confidence in fiscal sustainability (Dewi et al., 2021; Siwi, 2026).

The fifth safeguard is **credible exit**. The BSF should publish criteria for ending purchases and reducing holdings. Exit should be linked to market-functioning indicators such as normalised bid-ask spreads, stable auction coverage, reduced volatility, and restored secondary-market liquidity. The absence of an exit strategy would increase the probability that the BSF becomes a permanent subsidy to bondholders (BIS, 2022b; Kawai et al., 2012; Rahmad & Olavia, 2026).

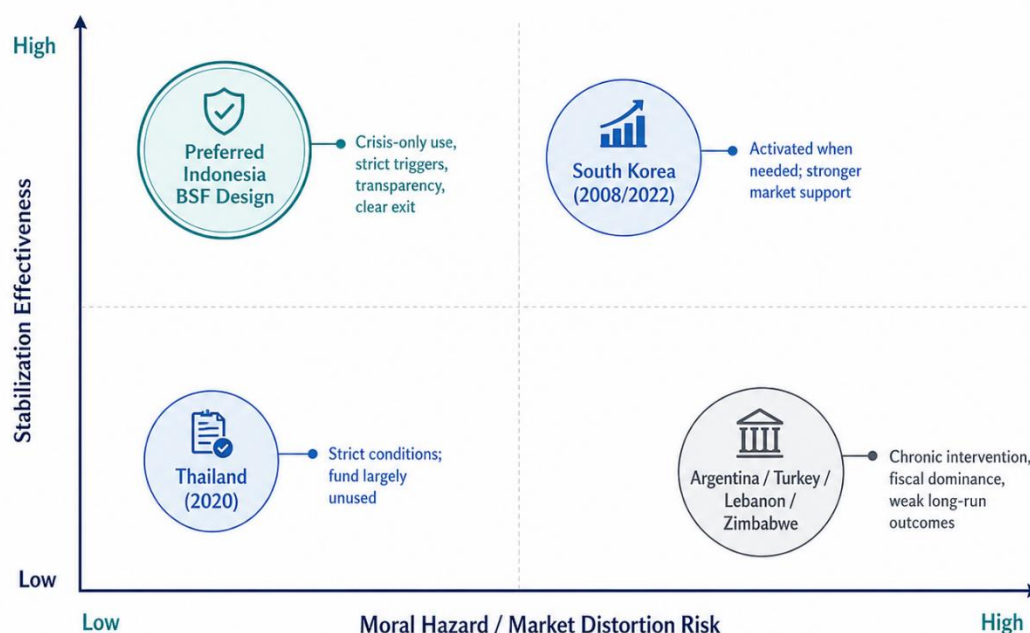
## DISCUSSION AND ANALYSIS

Our thematic findings converge on a clear message: **Balance is essential.** The benefits of a BSF—stabilising yields and preventing crisis spirals—must be weighed against the costs of reduced discipline. The BIS (2022) aptly summarises this tension: interventions should remain a

*backstop* only, not a tool of normal policy, to avoid “underpricing risk” (BIS, 2022a). In Indonesia’s case, the analysis suggests that the country’s macro fundamentals (low debt-to-GDP, fairly high reserves) make it *feasible* to stand up a BSF, but only under strict conditions.

**Figure 2. Comparative Lessons from BSF Experiences**

*Qualitative positioning of selected country experiences by stabilization effectiveness and moral-hazard risk*



*Source: Author's synthesis of the qualitative literature review.*

Figure 2 provides a qualitative comparative map of international experiences with BSF-like interventions. The horizontal axis captures the degree of moral hazard and market-distortion risk, while the vertical axis captures stabilisation effectiveness. The purpose of this figure is not to provide a statistical ranking of countries, but to synthesise the literature’s core lesson: bond-market intervention can be useful, but its policy value depends heavily on design, credibility, timing, and exit discipline. In this sense, the figure helps readers understand why the same broad instrument may produce very different outcomes across countries.

Thailand’s experience is placed in the lower-left quadrant because its Corporate Bond Stabilisation Fund was designed with strong safeguards but was ultimately underused. The Thai case demonstrates the advantages and limitations of a highly restrictive design. On the positive side, strict eligibility requirements, penalty pricing, and restrictions on corporate payouts helped minimise moral hazard. These features made it difficult for firms to treat the fund as cheap public support. However, the same restrictions also reduced participation, meaning the fund had a limited direct

stabilising impact. The Thai case, therefore, offers Indonesia an important warning: safeguards are necessary, but if they are too restrictive, the BSF may fail to operate effectively during genuine stress.

South Korea is positioned in the upper-middle area because its bond-market stabilisation mechanism has been more operationally active and has demonstrated stronger crisis-response capacity. Korea’s experience suggests that a BSF can be effective when the authorities are prepared to intervene decisively, communicate clearly, and provide sufficient funding capacity. However, because a more active fund implies a stronger state presence in the bond market, the moral-hazard risk is higher than in the Thai case. The Korean lesson for Indonesia is therefore one of calibration. A BSF must be credible enough to convince markets that panic selling will be contained, but not so generous that investors assume the government will always absorb losses. The lower-right quadrant groups cases such as Argentina, Turkey, Lebanon, and Zimbabwe as cautionary examples of chronic intervention, fiscal dominance, and weak long-run outcomes. These cases differ institutionally and historically, but they share a common pattern: market stabilisation

became entangled with fiscal financing, monetary expansion, weak credibility, or delayed structural adjustment. In such cases, intervention may temporarily suppress yields or postpone market pressure, but it does not restore confidence because the underlying fiscal and macroeconomic problems remain unresolved. For Indonesia, this quadrant highlights the danger of treating BSF purchases as a substitute for fiscal reform, debt-management discipline, or credible monetary policy.

The highlighted “Preferred Indonesia BSF Design” bubble is deliberately placed in the upper-left area of the figure. This represents the desired policy position: high stabilisation effectiveness with relatively low moral-hazard risk. Achieving this position requires a combination of crisis-only activation, strict triggers, transparent governance, credible funding, and clear exit rules. Indonesia should not simply imitate Thailand’s restrictive model or Korea’s active model. Instead, it should adapt lessons from both. The ideal Indonesian BSF should be strong enough to stop disorderly market dynamics, but constrained enough to prevent dependency, speculation, or hidden fiscal dominance.

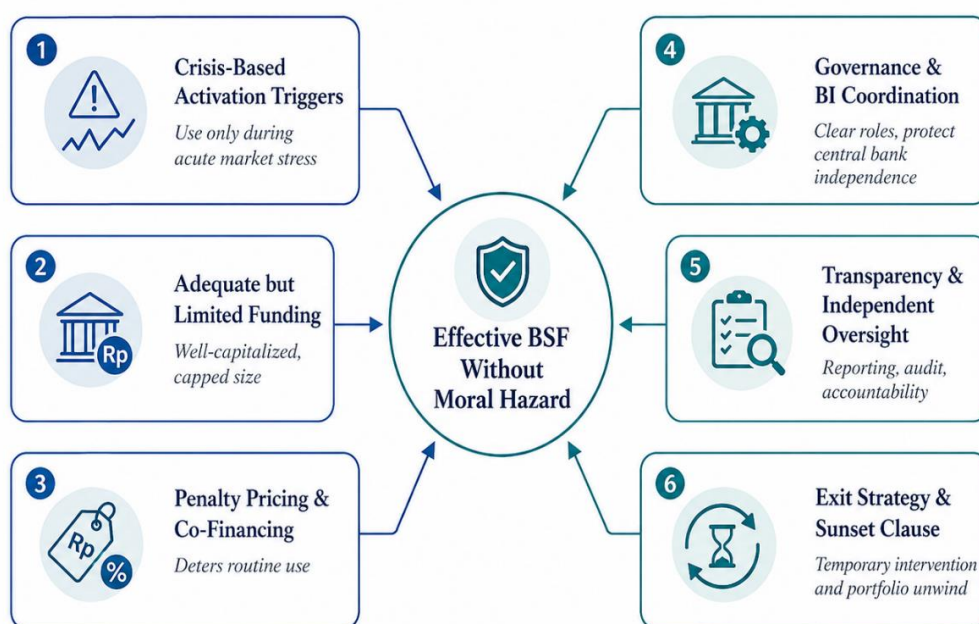
The figure also shows that BSF design involves a trade-off rather than a simple yes-or-no choice. A fund that is too weak may fail to reassure markets, while a fund that is too strong and unconditional may damage market discipline. The optimal design lies between these extremes. For Indonesia, this means the BSF should be embedded in a broader macro-financial framework that includes prudent fiscal management, deepening of domestic institutional

investors, coordination with Bank Indonesia, and transparent reporting to the public and parliament. Without these complementary safeguards, the BSF could shift from a stabilising instrument into a source of future vulnerability.

Comparing cases, Thailand’s experience reinforces that if a BSF’s rules are too harsh, it will be unused (good on moral hazard, but a lost opportunity if needed). Korea’s case shows that governments can successfully employ bond funds when needed by being ready to use them. The Indonesian context is unique: with Bank Indonesia already a major buyer of bonds (IMF, 2023), a formal BSF could simply be an extension of current practice. The key question is governance: will the BSF function with clear separation from monetary operations? If not, interventions could appear as monetary financing, increasing inflation worries. Therefore, design choices such as an independent trusteeship for the BSF and coordination with BI are crucial. The literature also highlights **timing**: interventions should be limited to actual stress periods. Fontanier’s theoretical model implies that if governments act *only during bad times*, market participants learn that policy is “countercyclical,” which is stabilising. But if interventions are frequent or predictable, then borrowing could increase (Bousselmi et al., 2026). Chang et al. (2025) found that European officials framed bond purchases as conditional on avoiding crisis, thereby quelling moral hazard concerns (Chang et al., 2025). Indonesia must similarly communicate that the BSF is a crisis tool, not a routine subsidy.

**Figure 3. Precautionary Architecture for an Effective BSF in Indonesia**

*Key safeguards to stabilize the bond market while limiting moral hazard*



*Source: Author’s conceptual synthesis based on the qualitative literature review.*

Figure 3 summarises the precautionary architecture required for Indonesia to operate a BSF without creating moral

hazard. The central message of the figure is that BSF effectiveness does not depend only on the availability of

funds. It depends on the institutional architecture surrounding the fund. A large fund without clear rules may be more dangerous than a smaller fund with strong governance, transparent triggers, and credible exit mechanisms. Therefore, the figure places “Effective BSF Without Moral Hazard” at the centre and connects it to six safeguards that should operate simultaneously.

The first pillar, crisis-based activation triggers, is the foundation of the entire architecture. A BSF should only be activated during acute market stress, not during ordinary yield movements. This requires policymakers to define measurable indicators before the crisis occurs. Possible indicators include abnormal changes in benchmark SBN yields, widening bid-ask spreads, failed or undersubscribed auctions, sudden foreign outflows, declining liquidity in the secondary market, or disorderly exchange-rate pressure linked to bond-market selling. The more objective these triggers are, the lower the risk that the BSF will be used for political convenience or short-term yield management.

The second pillar, adequate but limited funding, reflects the need to balance credibility and restraint. A BSF must be large enough to convince investors that the government can prevent panic dynamics. However, the fund should also have a clear ceiling to prevent open-ended commitments. In Indonesia’s case, the use of SAL and Special Mission Vehicles may provide operational resources, but the amount, source, and legal authority for intervention should be explicitly defined. A capped funding structure helps markets understand that the BSF is a finite crisis buffer, not an unlimited guarantee for bondholders.

The third pillar, penalty pricing and co-financing, is central to moral-hazard prevention. If BSF support is cheaper or easier than market financing, investors and issuers may change their behaviour in anticipation of public rescue. Penalty pricing ensures that the fund is unattractive in normal times and only becomes useful when market conditions are genuinely dysfunctional. Co-financing requirements also help preserve private-sector discipline by ensuring that market participants continue to bear part of the risk. For corporate or quasi-sovereign instruments, this could include requirements for private funding, collateral, recovery plans, or restrictions on dividend distribution. For sovereign bonds, the equivalent principle is that purchases should occur only at market-stress conditions and within predefined limits.

The fourth pillar, governance and Bank Indonesia coordination, addresses the risk of fiscal-monetary confusion. A BSF located within the fiscal authority can still affect monetary conditions, bond yields, liquidity, and exchange-rate expectations. Therefore, coordination with Bank Indonesia is necessary, but coordination should not become subordination. The central bank’s inflation and currency-stability mandate must remain intact. A clear governance framework should specify who decides

activation, who executes purchases, how risks are shared, how interventions are sterilised if necessary, and how the BSF’s actions are distinguished from monetary financing.

The fifth pillar, transparency and independent oversight, is necessary to maintain public trust. Because BSF operations involve public resources and can influence market prices, opacity would create suspicion and increase the risk of misuse. Regular reporting should include the size of purchases, instruments purchased, duration of holdings, funding source, valuation changes, and exit progress. Independent oversight—possibly through parliament, the Financial System Stability Committee, the Supreme Audit Agency, or an independent fiscal council—would strengthen accountability. Transparency also reduces the risk that selected investors benefit disproportionately from government intervention.

The sixth pillar, the exit strategy and sunset clause, ensures that the BSF remains temporary. The exit plan should be designed before activation, not after the fund has accumulated a large portfolio. This plan should explain when purchases will stop, how assets will be unwound, whether losses will be absorbed by the budget, and how normal market functioning will be restored. A sunset clause is especially important because emergency instruments often become politically difficult to withdraw once market participants adapt to them. Without an exit strategy, a BSF may gradually evolve into a permanent buyer of government debt, weakening price discovery and increasing fiscal dominance risk.

Taken together, the six safeguards in Figure 3 show that the BSF should be understood as an institutional regime, not merely as a pool of money. Its success depends on rules, limits, credibility, and accountability. For Indonesia, the key policy challenge is not simply whether to create or activate a BSF, but how to design it so that it stabilises the bond market during extraordinary stress while preserving fiscal discipline, central bank independence, and investor responsibility. This architecture provides the minimum conditions under which the BSF can become a stabilising tool rather than a source of future instability.

### Synthesis of Findings for Indonesia

The overall result of the qualitative review is that Indonesia’s BSF can be justified only as a crisis-containment device, not as a routine tool for yield management. The strongest argument in favour of the BSF is that it may prevent panic selling, reduce disorderly liquidity spirals, and protect the government bond market from destabilising capital-flow reversals. The strongest argument against the BSF is that it may weaken price discovery, encourage speculative behaviour, blur fiscal-monetary boundaries, and shift private risk onto public balance sheets.

The findings indicate that Indonesia should aim for a middle ground between Thailand’s highly restrictive model and

Korea’s more active intervention model. A purely symbolic BSF may fail to calm markets, but an overly generous BSF may create dependency. The preferred model is a credible but constrained backstop: large enough to stabilise disorderly markets, but limited by strict triggers, penalty pricing, transparent reporting, independent oversight, and a binding exit strategy.

The key policy implication is that the BSF should be embedded in a wider framework of fiscal discipline and monetary credibility. It should not be presented as a substitute for tax reform, expenditure prioritisation, debt-management improvement, or domestic investor deepening. If these broader foundations are weak, the BSF may only buy time while increasing long-term vulnerability. If these foundations are credible, the BSF can serve as a useful shock absorber during exceptional periods of stress.

The literature supports a cautious but not dismissive view of BSF implementation. The instrument can be valuable when market dysfunction is real, temporary, and systemically relevant. However, the same instrument can become dangerous when used frequently, opaquely, or without a credible exit. Therefore, the effectiveness of Indonesia’s BSF will depend less on whether the fund exists and more on whether its governance architecture preserves market discipline while allowing timely intervention during genuine crisis conditions.

Finally, our analysis suggests that adopting the BIS’s “**backstop principle**” is wise. For example, the BIS report explicitly warns that once interventions become routine, markets lose their risk-sensing function (BIS, 2022a). This implies we should think of BSF triggers as ex-ante and last resort. A corollary is that complementary measures (better fiscal rules, counter-cyclical buffers, stress-testing the debt market) remain critical. The BSF cannot substitute for these structural policies; rather, it should provide breathing space when those fail to prevent a sharp market reaction.

## CONCLUSION AND POLICY RECOMMENDATIONS

This review concludes that Indonesia’s proposed BSF can enhance financial stability if and only if it is designed and used with extreme caution. Our main findings are:

- **Intervention Necessity:** A BSF should be **strictly temporary and exceptional**. Historical cases show that, used sparingly, backstops restore confidence. But if used liberally, they “distort” markets and foster moral hazard. Indonesia should therefore commit to law to trigger the BSF only during defined market emergencies (e.g. credit spread on SBN exceeds a threshold for a sustained period).
- **Funding and Pricing:** The use of the SAL and SMVs is appropriate, but the government must price BSF support above normal market terms. For instance, it could set the lending rate 100–200 basis points higher than current yields. This penalty

ensures that market forces prevail most of the time, preserving discipline.

- **Strict Eligibility:** To limit moral hazard, the BSF’s conditionalities should mirror Thailand’s regime: require co-financing by issuers, bar payouts to equity holders, and insist on viable business plans. Only issuers critically unable to roll over debt should qualify, subject to independent approval. Public-sector bonds (SBN) might have even fewer conditions if purchased by the BSF, since sovereign risk is the main concern.
- **Oversight and Transparency:** An independent oversight body (potentially within the Financial System Stability Committee) should monitor BSF operations. All transactions should be publicly reported. This builds trust that the fund is not a “slush fund” and allows quick adjustment of rules if loopholes appear. The BIS emphasises transparency as a key backstop measure.
- **Coordination with BI:** Bank Indonesia should remain focused on inflation and currency stabilisation. The BSF must avoid pressuring BI to monetise deficits. A clear separation—perhaps BI provides analysis but does not fund the BSF—is needed. One model is a joint government-BI “BSF management unit” that coordinates but respects central bank mandates.
- **Exit Strategy:** Finally, the BSF must have a well-defined wind-down plan. For example, assets purchased should be sold gradually once markets normalise, to withdraw excess liquidity. The possibility of taking losses on these sales should be budgeted for (perhaps via a small insurance fund). This exit discipline is essential to avoid the fund becoming a permanent market maker, which would severely undermine private markets.

In summary, Indonesia’s BSF could achieve its goal of stabilising the debt market **without destroying market discipline** if built with these safeguards. Global lessons and economic theory agree that lending to default risks should be a last resort, not a first line of defence. With careful design and strong oversight, Indonesia can use a BSF to weather extraordinary stress while avoiding the “spiral” into fiscal dominance and moral hazard warned against by the BIS and others.

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