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THE IMPACT OF THE US-CHINA TRADE WAR ON THE STABILITY OF THE RUPIAH EXCHANGE RATE: A SHARIAH HEADING APPROACH

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Abstract

The trade war between the United States and China has created significant global economic uncertainty, affecting exchange rate stability in developing countries, including that of the Indonesian Rupiah. This study aims to analyze the impact of the US-China trade war on the stability of the Rupiah exchange rate and to explore the application of the Sharia hedging approach as a solution to manage exchange rate fluctuation risks. Using a qualitative method based on a literature review, this study found that in early 2025, the Rupiah exchange rate depreciated by 8% against the US Dollar due to global trade tensions and a domestic current account deficit. The widely used conventional hedging strategies have proven effective but are not in line with Islamic economic principles. On the other hand, Sharia-compliant hedging, such as wa'ad, salam, and murabahah mu'ajjal, offers a more ethical, inclusive, and Sharia-compliant solution. These instruments can mitigate exchange rate risk without involving elements of speculation, gharar, or riba. The implementation of Sharia hedging requires close collaboration between Islamic banks, business actors, and regulators to ensure its effective and appropriate application. This research concludes that the Shariah hedging approach can strengthen the stability of the Rupiah exchange rate while also supporting the principles of Shariah economics.

Keywords: ***Trade War; Rupiah Exchange Rate; Sharia Hedging; Islamic Economy; Economic Stability*.**

INTRODUCTION

International trade refers to economic activities involving the exchange of goods and services between countries worldwide. The trade sector plays a pivotal role in driving a country's economic growth by fostering international cooperation. Such cooperation through trade is crucial for enhancing economic development and generating mutual benefits among nations. However, developed countries often exert significant influence on developing economies. China, which holds a dominant position in global trade, serves as a central hub for international commerce, significantly impacting other nations, including ASEAN member states (Kusdiana & Hasijah, 2022). The relationship between the United States and China has increasingly been characterized by economic competition. This rivalry stems from both nations' ambitions to dominate the global economy. The US-China trade war officially began in March 2018, driven by the perception of China's economic rise as a threat to US economic dominance, as viewed by then-President Donald Trump. In response, the US administration imposed import tariffs on Chinese goods valued at approximately USD 50-60 billion, aiming to protect the domestic economy and address the trade deficit, wherein imports exceeded exports (Bariah et al., 2020). In response to this US policy, the Chinese government did not remain passive and subsequently implemented a policy to increase import tariffs on US products by 25% (Pujayanti, 2018). The trade war between the two countries that dominate the global economy and serve as major economic powers will undoubtedly impact the global economy as well as Indonesia's economy (Bariah et al., 2020). The trade war between the United States and China has generated significant global economic uncertainty, impacting the stability of exchange rates in emerging market currencies, including the Indonesian Rupiah. The depreciation of the Rupiah against the US Dollar in January 2025 was primarily driven by heightened global risks, particularly the possibility of a renewed trade conflict between the US and

China. In addressing exchange rate volatility caused by international trade tensions, hedging strategies play a crucial role in protecting currencies from harmful fluctuations. However, within the framework of Islamic economics, hedging practices must adhere to Sharia principles. Bank Indonesia issued Regulation No. 18/2/PBI/2016 concerning Hedging Transactions Based on Sharia Principles, which provides the legal framework for the implementation of Sharia-compliant hedging transactions (Bank Indonesia, 2016). The Fatwa issued by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) also provides guidelines concerning Sharia-compliant hedging transactions on exchange rates. This fatwa stipulates that Sharia hedging transactions may only be conducted when there is a genuine and unavoidable need for foreign currency, and not for speculative purposes (Fauzi & Fahreza, 2018). Against this background, this study aims to analyze the impact of the US–China trade war on the stability of the Rupiah exchange rate and to explore the application of the Sharia hedging approach as a solution for managing exchange rate fluctuation risks.

LITERATURE REVIEW

1. US-China Trade War

An important aspect of a country's economic growth is the performance of international trade. Countries engage in trade relations with external partners to meet the increasing and diverse needs of their populations. Moreover, participation in international trade can enhance income, economic growth, and overall economic development by expanding market access and improving the competitiveness of domestic production. However, increased trade intensity may also intensify competition among countries, making international trade relations vulnerable to conflicts commonly known as trade wars (Sari et al., 2021). A trade war is an economic conflict that disrupts a country's trade cycle through the imposition of high tariffs on countries that are otherwise considered friendly. Under international trade law, the General Agreement on Tariffs and Trade (GATT), established under the WTO framework, requires member countries to protect domestically produced goods by imposing tariffs on certain imported goods deemed harmful to domestic industries (Syahfitri et al., 2024).

The current trade war is between the United States and China. The relationship between these two countries is increasingly overshadowed by economic competition. This economic rivalry stems from both nations' ambitions to dominate the global economy. The US-China trade war began in March 2018 when China's economic rise was perceived by then-President Donald Trump as a threat to US economic power. Consequently, the US imposed import tariffs on Chinese products valued between USD 50 and 60 billion as an effort to protect the domestic economy and address the trade deficit, where the value of imports exceeded that of exports (Bariah et al., 2020). In response to this US policy, the Chinese government did not remain passive and subsequently implemented a policy to increase import tariffs on US products by 25% (Pujayanti, 2018). The trade war between the two countries that dominate the global economy and serve as major economic powers will undoubtedly impact both the global economy and, consequently, Indonesia's economy (Bariah et al., 2020). The trade war between the United States and China has generated significant global economic uncertainty, impacting the stability of exchange rates in emerging market currencies, including the Indonesian Rupiah. The depreciation of the Rupiah against the US Dollar in January 2025 was driven by escalating global risks, particularly the potential emergence of a Trade War 2.0 between the United States and China.

2. Stability of the Rupiah Exchange Rate

The exchange rate, or currency rate, is a crucial economic indicator, as fluctuations in exchange rates have far-reaching effects on various aspects of a country's economy. It represents the value of one country's currency relative to another. The Rupiah exchange rate is particularly influenced by broader economic conditions. A country's economic performance significantly impacts its exchange rate, making exchange rate stability essential for fostering a conducive business environment and promoting economic growth (Saputra & Dharmadiaksa, 2016). The stability of the Rupiah exchange rate refers to a condition in which fluctuations in the Rupiah's value against foreign currencies are controlled and do not undergo significant changes within a short period. Such stability is essential for fostering a healthy economic environment, reducing market uncertainty, and ensuring sustainable economic growth. Exchange rate stability is generally influenced by various factors, including inflation, foreign exchange reserves, monetary policy, and international trade dynamics. The US-China trade war impacts the Rupiah exchange rate through mechanisms such as heightened global uncertainty, declining export volumes, fluctuations in commodity markets, and US interest rate policies. This situation necessitates an adaptive policy response from Indonesia's monetary authorities to safeguard economic stability. A notable consequence of this trade war is the increasing tendency of global investors to withdraw their funds from developing countries and reallocate their assets to safer instruments, or "safe havens," such as the US Dollar, gold, and US government bonds. This shift has contributed to the depreciation of currencies in many developing countries, including Indonesia. According to data from the *Asian Development Bank Outlook* (2025), the Rupiah has depreciated by 7.3% against the US Dollar since the first quarter of 2025, making it one of the most vulnerable currencies in the Southeast Asian region. This exchange rate instability has far-reaching implications for the domestic economy. In the case of Indonesia, the depreciation of the Rupiah exacerbates the burden of foreign debt repayment, increases the cost of imported goods, and heightens the risk of inflation, particularly in the energy and food sectors, which are heavily dependent on imports. This aligns with the findings of Haryo Kuncoro (2020) in the *Journal of Central Banking Theory and Practice*, which indicate that exchange rate volatility is strongly correlated with the inflation rate in Indonesia in the short term.

3. The Hedging Approach from a Sharia Perspective

Resiko Risk and trade are inherently interconnected, as risk is an unavoidable aspect of conducting business. In fact, higher risks are often associated with greater potential returns, and vice versa. The issue of risk management remains a critical challenge for both conventional and Sharia-compliant financial industries. Among the various types of risk management strategies, hedging stands out as a key instrument designed to address the financial needs of individuals and businesses in the modern era. Hedging is a risk management approach that employs financial instruments to mitigate systematic risks associated with price or cash flow fluctuations. A hedge involves investments made specifically to minimize or eliminate the risks associated with other investments. This strategy serves to reduce exposure to business risks while simultaneously enabling businesses to benefit from investment opportunities. A hedger is an individual or entity that enters the market not to profiting from price movements but to effectively manage and minimize risk (Mauizotun Hasanah, 2022).

Hedging is an integral part of the risk management process. Based on this understanding, hedging does not contravene Sharia principles, as Islam prohibits its adherents from exposing themselves or their wealth to any form of harm or calamity. Although such disasters or calamities may occur in the future and are not yet certain, Islam not only recognizes the existence of risk but also encourages Muslims to take preventive measures to avoid or mitigate losses arising from such risks. This principle is substantiated by evidence found in the Quran, Hadith, and Islamic jurisprudence (fiqh), which address the protection of value both explicitly and implicitly. Verses 282-283 of Surah Al-Baqarah in the Qur'an instruct Muslims to document every debt-related transaction and to appoint witnesses for such transactions. These records and testimonies serve as evidence in the event of disputes between the involved parties. Islam further provides guidance on the selection of scribes and witnesses to ensure transparency and accountability in debt matters. Moreover, even if the transaction occurs during travel, Allah permits the provision of collateral as security for the creditor. Although the term "hedging" is not explicitly mentioned in these verses, the underlying elements of preventive measures to manage debt-related risks are present.

This principle is further reinforced in Surah Al-Baqarah, verse 195, where humans are commanded not to destroy themselves. Such destruction encompasses harm to oneself, family members, or wealth. Generally, this verse emphasizes spending in the way of Allah and discourages stinginess to the extent that it results in loss. However, this principle can also be applied to hedging practices. Hedging requires individuals or corporate entities to incur certain costs for purchasing financial instruments used to protect investments or trades against unforeseen risks. In other words, refusing to bear the costs associated with hedging increases the likelihood of facing future financial losses. The hedging fatwa serves as a guideline for the community, business actors, and financial institutions in conducting hedging transactions in compliance with Sharia principles. This fatwa details the provisions of forward agreements as outlined in the National Sharia Council MUI Fatwa No. 96/DSN-MUI/IV/2015, which provides guidelines for implementing Sharia-compliant hedging transactions. The fatwa stipulates several conditions and limitations to ensure that hedging transactions are not conducted for speculative purposes, including the following:

a) Sharia-compliant hedging on exchange rates may only be conducted when there is a genuine future need for foreign currency that cannot be avoided, and the transaction is lawful by applicable laws and regulations.
b) The right to execute *wa'd* (promise) within the hedging mechanism must not be subject to trading.
c) The object of Shariah hedging on exchange rates is the exposure to risk arising from imbalances in asset or liability positions denominated in foreign currencies, obligations or receivables in foreign currencies resulting

from transactions compliant with Shariah principles, and the principal of loans when hedging is conducted on loan obligations received by non-financial institutions.

d) The objects of Shariah hedging against exchange rate fluctuations include foreign currency deposits, obligations arising from transactions using foreign currencies, foreign currency requirements for organizing Hajj/Umrah, and travel expenses abroad, all by Shariah principles.

The National Shariah Council of the Indonesian Ulema Council (DSN-MUI) has established three types of Shariah-compliant hedging contracts on exchange rates, each with its mechanism:

a) *ʻAqd altahawwuth albasith* or Simple Hedging Transaction. This contract employs a scheme based on *wa'd bi al'aqd fi almustaqbal* (forward agreement), followed by a spot foreign currency transaction at maturity. The settlement involves the exchange of currencies.
b) *b) 'Aqd altahawwuth almurakkab* or Complex Hedging Transaction is a hedging transaction with a scheme consisting of a series of spot transactions and *wa'd bi al'agd fi al-mustaqbal* or forward agreements, followed by a spot contract at maturity and settlement in the form of currency exchange.
c) *'Aqd al-tahawwuth fi suq alsil'ah* atau or Hedging Transactions through the Shariah Commodity Exchange. In this contract, hedging transactions are conducted through a series of buy and sell transactions of commodities priced in rupiah, followed by buy and sell transactions of commodities denominated in foreign currency. The settlement occurs through currency exchange at maturity (DSN-MUI, 2015).

Hedging is generally permitted under Shariah law because it aligns with the fundamental objectives of Shariah, namely the protection of wealth. Therefore, Islam permits hedging as it provides benefits and upholds the principles of *maqasid al-Shariah*.

METHODS

This study employs qualitative research conducted through descriptive analysis using a library research approach, with secondary data sources. Through this library research, relevant documents and data concerning the impact of the global trade war on the Rupiah exchange rate were collected. Data collection techniques involved reviewing various references, including books, journals, articles, and other pertinent sources. The collected data were then analyzed in depth to produce conclusions regarding the impact of the US-China trade war on the Rupiah exchange rate. In the analysis process, the researcher compared Indonesia's economic conditions before and after the escalation of the trade war in early 2025. The primary focus was to assess how the Rupiah exchange rate responded to global pressures and whether significant changes occurred in the structure of the domestic foreign exchange market. Subsequently, the researcher examined the potential implementation of Shariah-compliant hedging instruments such as *wa'd*, *salam*, and *murabahah mu'ajjal* as alternative solutions that are not only technically effective but also ethically sound and compliant with Shariah principles.

RESULTS AND DISCUSSION

1. The Condition of the Rupiah Exchange Rate in 2025

At the beginning of 2025, Indonesia's economic situation was adversely affected by the ongoing US-China trade war. The Rupiah exchange rate fluctuated, depreciating by more than 8% against the US Dollar, indicating significant economic instability. This depreciation was driven by several interrelated external and internal factors. External factors, such as global trade tensions, caused volatile capital flows as global investors favored safe-haven assets like the US Dollar and gold, while avoiding emerging market currencies, including the Rupiah. Furthermore, rising inflation in many developed countries exacerbated negative market sentiment worldwide. On the internal side, Indonesia continues to face a significant current account deficit. The country's dependence on imports of raw materials and capital goods is a primary factor undermining exchange rate stability. Rising prices of imported goods, often influenced by fluctuations in foreign currencies, have exacerbated Indonesia's trade deficit. This situation has prompted business actors, particularly micro, small, and medium enterprises (MSMEs), to seek medium- to long-term risk mitigation strategies. Significant exchange rate volatility affects production costs as well as the selling prices of goods and services, which, in turn, may reduce the competitiveness of Indonesian products in the international market. Therefore, protecting the exchange rate has become a critical issue, necessitating the development of more effective and Sharia-compliant approaches to manage this uncertainty.

2. Challenges of Implementing Conventional Hedging

In addressing exchange rate fluctuations, many business actors rely on conventional hedging instruments such as forward contracts, currency swaps, and options to lock in future currency prices. Although these instruments have proven effective for large companies, they present significant challenges when applied to the micro, small, and medium enterprise (MSME) sector and conflict with Sharia principles. For instance, forward contracts involve an agreement to buy or sell a specific currency at a predetermined price in the future. Such contracts contain elements of *gharar* (uncertainty) and *maysir* (gambling), which are inconsistent with Sharia principles due to their speculative nature. Moreover, the use of these instruments requires substantial financial capacity, often rendering them inaccessible to small business operators. Therefore, there is an urgent need to explore more inclusive alternatives that are accessible to all levels of business actors and, importantly, comply with Sharia principles. This presents opportunities for the development of more appropriate Shariah-compliant hedging instruments, such as *wa'd*, *salam*, and *murabahah mu'ajjal*, which offer greater safety, transparency, and fairness.

3. Effectiveness of Shariah Hedging Instruments

In this study, various Sharia-based hedging instruments have demonstrated their relevance and practicality for business actors in Indonesia. The instruments examined include:

(a) *Wa'ad*: A unilateral promise that does not impose mutual obligations between the two parties, making it more flexible and free from elements of *gharar* (uncertainty). The practice of *wa'ad* has proven effective in providing exchange rate protection without causing harm to either party, as only one party makes the commitment. This renders it a more appropriate choice according to Sharia principles, which prioritize transparency and justice.

(b) *Salam*: Commonly used in international trade transactions, particularly import-export, where the buyer makes an advance payment for goods to be delivered in the future. Although similar to a futures contract, *salam* avoids speculative elements and ensures clarity in transactions, as both parties agree on the price and delivery time in advance. This provides legal certainty for the business actors involved.

(c) *Tahawwuth*: A fiqh based framework for managing financial risks in compliance with Sharia. This concept offers an alternative solution for business actors engaged in international transactions by mitigating exchange rate uncertainty through Sharia-compliant contracts. *Tahawwuth* emphasizes the principle of prudence, avoids speculation, and ensures that every transaction is grounded in tangible goods or services.

These three instruments can reduce dependence on conventional hedging tools that often contain elements inconsistent with Sharia principles, while still providing essential protection for business actors.

4. Integration Model of Islamic Banks and Business Actors

The role of Islamic banks is highly strategic in developing Sharia-compliant hedging instruments that address Indonesia's economic needs. Islamic banks can serve as facilitators by providing financial products that are not only profitable from a business perspective but also adhere to Islamic principles. To optimize the utilization of Sharia-compliant instruments, close collaboration between Islamic banks, business operators, and regulators is essential. With robust regulatory support from the National Sharia Council (DSN-MUI) and other regulatory authorities, Sharia-compliant hedging products can be introduced and widely adopted. For instance, Islamic banks can partner with small and medium enterprises (SMEs) to offer training and mentoring programs, enabling them to understand the practical application of instruments such as *wa'ad* and *salam* in their daily business operations. In addition, Islamic banks can also develop innovative products that make it easier for business actors to access hedging instruments without having to rely on overly complex financial instruments or those that do not comply with Sharia principles. This integration is not only beneficial for business actors but also for the overall economic stability of Indonesia, by reducing the negative impact of exchange rate fluctuations.

CONCLUSION

The trade war between the United States and China in 2025 significantly impacted the stability of the Rupiah exchange rate. The intensifying tensions between these two major economies led to substantial fluctuations in the foreign exchange market, resulting in a depreciation of the Rupiah against the US Dollar. Indonesia's reliance on imports and its persistent current account deficit further exacerbated this impact, rendering the exchange rate highly sensitive to global economic conditions. Consequently, managing exchange rate risk has become a critical priority in safeguarding Indonesia's economic stability.While the conventional hedging approach has proven effective in managing exchange rate risk in the short term, it is fundamentally inconsistent with the principles of Islamic economics. Instruments such as forward contracts, currency swaps, and options involve elements of *gharar* (uncertainty), *maysir* (gambling), and *riba* (usury), which contradict Sharia principles that emphasize transparency, justice, and balance in financial transactions. Moreover, these instruments are often inaccessible to small and medium enterprises (SMEs) due to their high costs and complexity. Conversely, Shariah-compliant hedging offers a more ethical, equitable, and sustainable solution. Instruments such as *wa'ad*, *salam*, and *murabahah mu'ajjal* are more consistent with Sharia principles as they avoid speculative elements and ensure the exchange of tangible goods or services. Additionally, these instruments are accessible to a broader range of business actors, encompassing not only large corporations but also small and medium enterprises (SMEs) that require protection against exchange rate risks.

With robust policy support from regulators and innovative product development by Islamic banks, Shariah-compliant hedging has the potential to emerge as a more inclusive and sustainable risk mitigation strategy. Therefore, the government, financial institutions, and business actors must collaboratein optimizing the adoption of Shariah hedging instruments. A broader implementation of this approach can enhance Indonesia's economic resilience to global economic turbulence and contribute to long-term stability in the foreign exchange market. Through this approach, Indonesia can reduce dependence on financial instruments that do not align with Islamic economic values and strengthen national economic resilience amid increasing global uncertainty. As a next step, further research and development in this field will be crucial to ensure the sustainability and effectiveness of Shariah hedging instruments in facing global economic challenges.

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