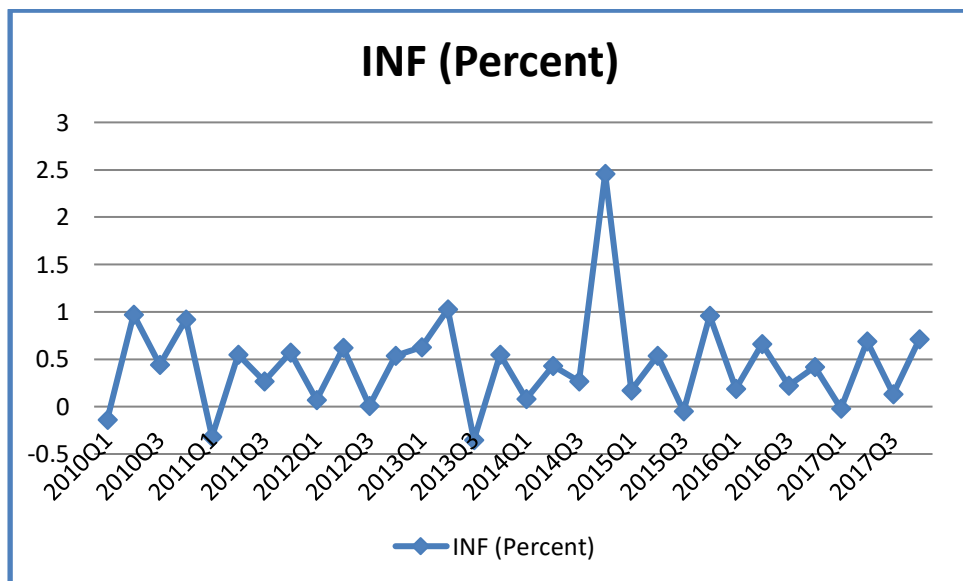


CHAPTER IV

BROAD IMAGE OF RESEARCH OBJECT

A. The Development of Inflation in Indonesia.

The inflation rate which drawn from Statistics Indonesia is very volatile during the observation period is shown in the graph below. Even though it is very volatile but gladly they are still within 3 percent range. The rate at the beginning of 2010 is started at -0.14 percent and closed at 0.71 percent during observation. The highest rate on the observation periods is in the fourth quarter of 2014 with number 2.4 percent and the lowest number is during the third quarter of 2013 with -0.35 percent rate. The rate is under Bank Indonesia supervision through their monetary policy.



Source : BPS (Statistics Indonesia)

Figure 4-1 Inflation Volatility Period 2010.I-2017.IV

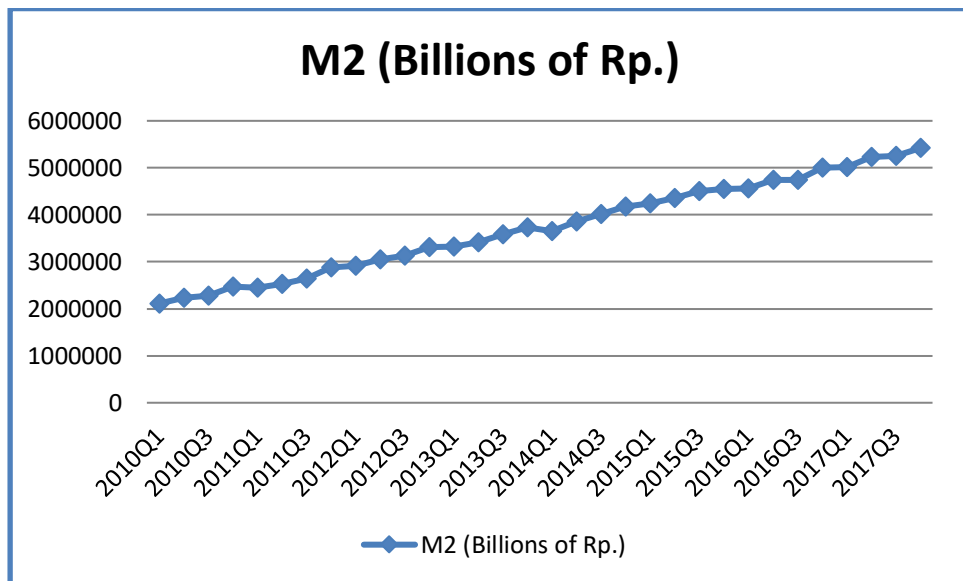
The highest rate of inflation during observation is a reaction of society on rise in the expected inflation caused by new policy on fuel and oil price issued by the government, rise of the exchange rate or depreciation in the rupiah's value, and the investor behavior that waits the formation of new cabinet and government work programs for the future. The rise of inflation caused by administered price is estimated therefore Bank Indonesia issued some policy to make sure the inflation is still under control and temporary through strengthening the coordination of controlling inflation with central and regional government. After the fourth quarter of 2014 Bank Indonesia believe that inflation conditions will be improve supported by the under control of core inflation, decreasing in the global oil price, and the improvement of foods supply (Divisi Kebijakan Moneter Bank Indonesia, 2014).

On the other hand, the deflation on third quarter 2013 is because the supply on volatile foods is higher than the demand domestically, and the movement to strengthen the coordination of Bank Indonesia and government policies in controlling inflation. During that time, Bank Indonesia saw that the global economy tends to slow down and is overwhelm with high uncertainty, in line with the weakening of the global economy, the performance of domestic economy shows a slowing trend. However, Bank Indonesia estimates that the inflation will rise due to the

fuel subsidy policy plan issued by the government after this third quarter (Devisi Kebijakan Moneter Bank Indonesia, 2013).

B. The Development of Money Supply in Indonesia.

The money supply predominantly has an increasing trend with small volatility is shown in the graph below. At the beginning of observation start with 2112082.7 billions of rupiah on first quarter 2010 and closed with 5419165.05 billions of rupiah on fourth quarter 2017 during observation. The money supply ever decreases in fourth quarter 2010 from 2274954.57 to 2471205.79 billions of rupiah and even decrease again on first quarter 2011 with 2451356.92 billions of rupiah. On first quarter 2014, the money supply decreases from 3730409.35 to 3730409.35 billions of rupiah.



Source : Bank Indonesia

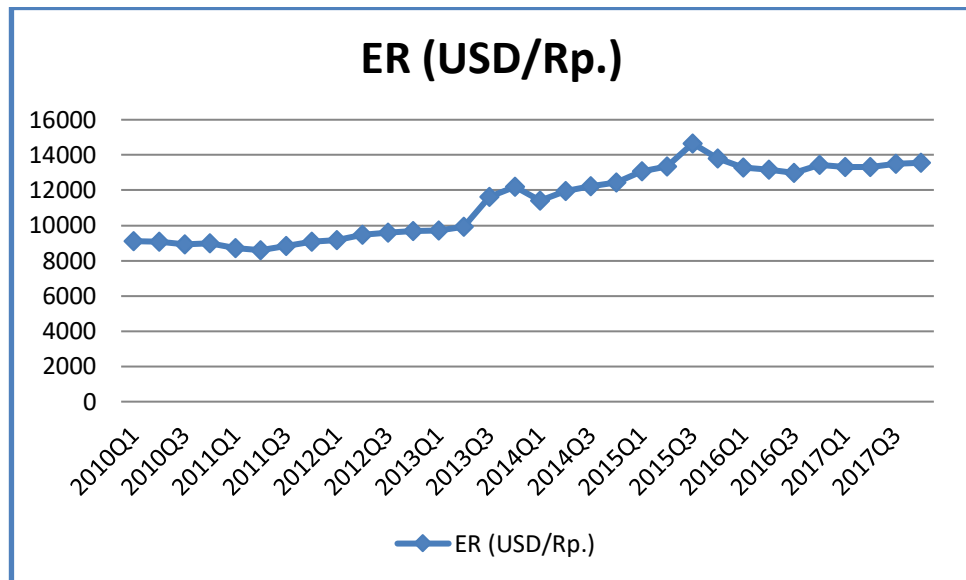
Figure 4-2 Money Supply (M2) in Indonesia Period 2010.I-2017.IV

The growth of money supply (M2) on first quarter 2014 is very slow. The slow growth is because of the decreasing in the growth of M1 and quasi-money. From M1 which consist of currency outside commercial and rural banks (real money), and rupiah demand deposits are decreasing. The conditions of M2 at that time also because it is in line with the slow of domestic demand and contractions of the government monetary operations in line with the low of government expenditure realization (Divisi Statistik Moneter dan Fiskal, 2014).

C. The Development of Exchange Rate in Indonesia.

Currently, the government of Indonesia has implemented 3 exchange rates since 1970. The first system on 1970-1978 is fixed exchange rate system with an official rate Rp.250,- / dollar. In the 1978-July 1997, the government then re-imposed the implement of a controlled floating exchange rates system with average exchange rate Rp. 2000,-/ dollar, but unfortunately, Indonesia face a monetary crisis in 1997 and the Rupiah value is broke, the value becomes Rp. 2650,-/ dollar. Ever since the government decided to write off the range of intervention with a purpose to secure the foreign exchange reserves through adopting a free-floating exchange rate system (Murtala *et al.*, 2017).

The volatility of Indonesian Rupiah exchange rate from the first quarter 2010 until fourth quarter 2017 is shown in the graph as below:



Source : Bank Indonesia

Figure 4-3 Exchange rate in Indonesia Period 2010.I-2017.IV

The performance of Indonesian exchange rates throughout the observation periods is pretty volatile with a predominantly increasing trend. Starting with rate Rp.9115/ US Dollar on first quarter 2010 and the last rate on fourth quarter 2017 is Rp.13548/ US Dollar. On second quarter 2011, the exchange rate reach the lowest rate with Rp.8597/ US Dollar meaning that at that time the value of rupiah is appreciated against US Dollar at the highest point. The highest rate during observation is in third quarter 2015with rate Rp.14657/ US Dollar. After the third quarter 2015, the nominal exchange rate begins to depreciate until the third quarter of 2016 with rate Rp.12998/ US Dollar but eventually fluctuate again until closed with Rp.13548/ US dollar on the of observation.

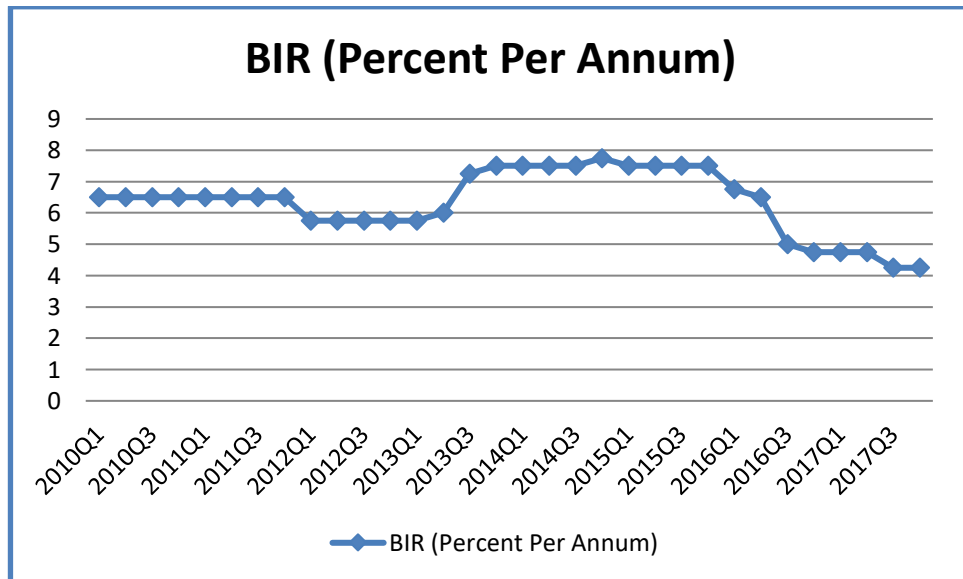
On second quarter of 2011 the strengthen of rupiah's value in line with the inflow of foreign capital, and Bank Indonesia's efforts on reducing inflationary pressure particularly from imported inflation while still considering the impact on economic growth. The strengthen of rupiah's value is still in the line with the trend of currency appreciation in the Asian region which it will not give pressure on export performance (Divisi Kebijakan Moneter Bank Indonesia, 2011)

The rupiah's value is depreciated in line with the strong external pressure. The sources of pressure are mainly stemmed from the impact of the Yuan's devaluation by the Chinese Central Bank as well as the uncertainty about the Fed's planned rate which worsened with higher demand for US Dollar due to repayment of foreign debt. In order to keep the macroeconomic and financial system stability, Bank Indonesia make efforts to stabilize the rupiah exchange rate including strengthening the monetary operations to control demand and supply of foreign exchange (Departemen Kebijakan Ekonomi dan Moneter, 2015).

D. The Development of Interest Rate in Indonesia.

BI rate is an instrument which implemented in the operation of monetary policy as an effort to achieve the operational and economic stability including inflation which issued by the central banks. Below is the graph of interest rate issued by Indonesian central bank on the period

of observation: first quarter of 2010 until on the fourth of quarter 2017, related to this research study.



Source : Bank Indonesia

Figure 4-4 Interest rate in Indonesia Period 2010.I-2017.IV

At the beginning of observation on 2010, the rate is at 6.5 percent and stagnant until the fourth quarter of 2011, the rate is decreased to 5.75 percent on first quarter 2012 and stagnant until the first quarter of 2013. In the second quarter of 2013 and the third quarter of 2013 the rate is 6 percent and 7.25 percent. During the fourth quarter of 2013 until fourth quarter 2015, the interest rate is pretty much stagnant at 7.5 percent except on the fourth quarter of 2014 with 7.75 percent rate. The first quarter of 2016 until the third quarter of 2016 the rate is on 6.75 percent, 6.5 percent, and 5 percent. From the fourth quarter of 2016 until the second quarter of

2017 the rate is on 4.75 percent and two last quarter of observation is on 4.25 percent.

The policy to decrease the interest rate on the first quarter of 2012 is issued by the Board of governors as a movement to the impact of global economic downturn and the impact of government policies in the energy sector to the Indonesian economy. In order to keep the inflation expectation move towards its target, Bank Indonesia is continue strengthening their policy through interest rate policy rate together with exchange rate policies, macroprudential policies, and including the policy coordination with the government (Direktorat Riset Ekonomi dan Kebijakan Moneter, 2012).

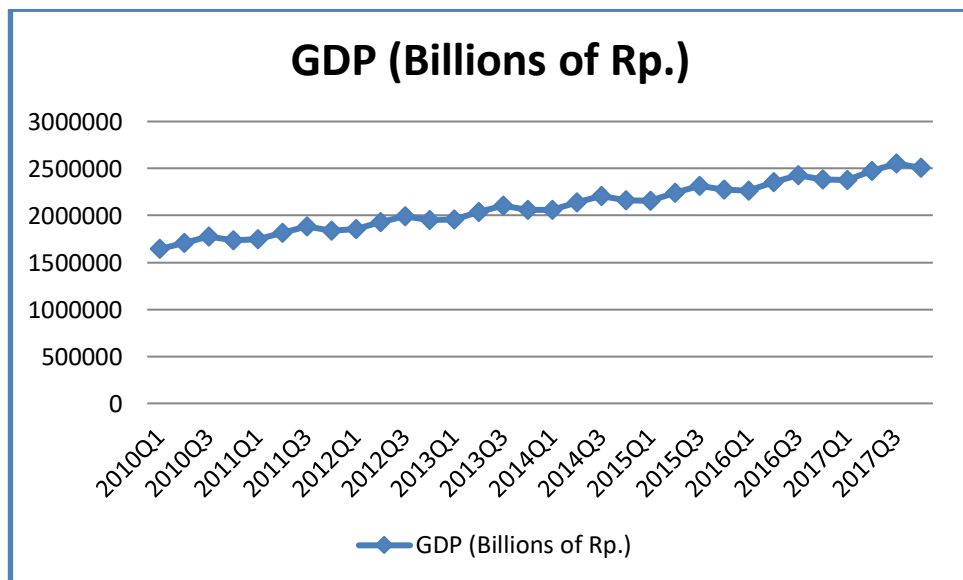
The decision to raise the interest rate on second until the fourth quarter of 2013 is a move on the continuation of the strengthening the Bank Indonesia polices in order to control inflation, the stability of rupiah exchange rate, and ensuring the ongoing adjustment of current account deficit at a sustainable level. Bank Indonesia considers that these policies and other various supported policies that have been taken will accelerate the adjustment of current account deficit and control the inflation movement within target 4.5 percent in 2014 (Departemen Kebijakan Ekonomi dan Moneter Bank Indonesia, 2013).

E. The Development of Gross Domestic Product in Indonesia.

Gross domestic product is basically the amount of added value generated by all business units in a particular country or is the sum of the value of final goods and services produced by all economic units. Gross domestic product at current prices illustrates the added value of goods and services calculated using the prevailing prices every year, while gross domestic product at constant prices shows the added value of goods and services that are calculated using prices that apply to one particular year as a basis. Gross domestic product constant prices (real) can be used to indicate the overall economic growth rate or each sector from year to year and also a useful tool for measuring the rate of growth in consumption, investment and foreign trade.

The gross domestic product in Indonesia during observation is base on the 2010 year basis with the period is begin on first at 1642356.3 billions of rupiah on first quarter 2010 which also become the lowest point of gross domestic product during the observation period. The gross domestic product is pretty much volatile with the predominantly increasing trend which closed with 2508931.5 billions of rupiah on the fourth quarter 2017. However, during fourth quarter of 2017 is not the highest point of gross domestic product point during observation, the highest point is in the third quarter of 2017 with 2552216.5 billions of rupiah. The predominantly increasing trend means that the number or volume of the goods and services produced in Indonesia has always increased from 2010

until 2017. But on the other hand, Indonesia's economic growth also experienced many changes and phenomena. During the observation, the development process experienced many obstacles from internal and external factors such as the changes in international crude oil prices and the other global economic conditions.



Source : Bank Indonesia and BPS (Statistics Indonesia)

Figure 4-5 Gross Domestic Product in Indonesia Period 2010.I-2017.IV