ANALYSIS OF INTEREST RATE INFLUENCE ON MONETARY POLICY IN INDONESIA

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ABSTRACT

The monetary policy of a country is influenced by the economic policies of other countries. therefore many factors influence monetary policy in a country. one factor is the value of interest rates in the country. Interest rates also affect the inflation that will occur. This certainly affectsthe state of the country's economy, especially Indonesia. This study aims to determine the effect of interest rate factors on monetary policy in Indonesia. The method used in this research is to conduct a meta-analysis of three journals regarding monetary policy in Indonesia. From the analysis, it is found that the interest rate has an effect on inflation and will affect monetary policyin Indonesia. In the formation of bank interest rates, the element of inflation expectations is still considered small. Meanwhile, other factors are still bigger, such as: condition of banking liquidity, less efficient banking management, bank segmentation. The use of interest rates as an indicator of inflation expectations is in line with the need for an instrument that can effectively explain the phenomenon of inflationary movements as the ultimate target for monetary policy.

Keywords: interest rate, inflation, monetary policy

INTRODUCTION

At present the economic activity of a country is influenced by the economy of other countries. This is an external factor that affects the government in a country when setting fiscal policy and monetary policy. Monetary is a very important part of an economy, economic growth cannot be analyzed without involving monetary issues (Cioran, 2014). There are several domestic economic

indicators that influence economic growth in Indonesia, including interest rates, exchange rates (exchange rates), inflation, exports and consumption of fuel oil or BBM (Bank Indonesia, 2007). The exchange rate of a country's currency is able to indicate the state of the country's economy, because a relatively stable currency value describes the macroeconomic condition of the country that is still stable. It is different with countries that have unstable currency values, in other words, the exchange rate in a short time can occur quite large fluctuations, this will reduce the interest of investors to invest their capital in the country.

The monetary crisis that has occurred in Indonesia since July 1997 was marked by the depreciation of the rupiah against the US dollar. The fall of the Rupiah caused the Indonesian economy to heat up. This can be seen from the increase in the inflation rate. Various methods were used by the government to overcome the crisis, including using the SBI instrument and asking for IMF assistance. In overcoming the crisis that occurred the government most often used SBI to raise Indonesia's interest rates. The government considers that raising interest rates through increasing SBI rates can reduce inflation. According to the government, an increase in interest rates will reduce inflation. For this reason, interest rates are important, because they can be used to analyze inflation expectations.

Interest rates are an important factor in the economy of a country because they greatly affect the "health" of an economy. This not only affects consumers' desire to spend or save their money but also affects the business world in making decisions. Therefore, interest rates have a very broad influence, not only on the monetary sector, but also on the real sector, the employment sector, and even the international sector.

The rate of inflation is determined by the forces of supply and demand for goods and services that reflect the behavior of market participants or the public. One of the factors that influence people's behavior is the expectation of the inflation rate in the future. Expectations of a high inflation rate will encourage people to shift their financial assets into real assets, such as land, houses, and other consumer goods. On the other hand,

expectations of a low inflation rate will provide incentives for people to save and invest in productive sectors.

LITERATURE REVIEW

Interest Rate

According to Laksmono (2001), the value of domestic interest rates in Indonesia is closely related to international interest rates. This is due to domestic financial market access to international financial markets and the less flexible exchange rate policy. In addition to international interest rates, the SBI discount rate is also an important factor in determining interest rates in Indonesia. The increase in the SBI discount rate was immediately responded to by the interbank money market (PUAB) interest rate, while the response to the deposit rate only appeared after 7–8 months. Another factor that also influences the determination of interest rates in Indonesia is liquidity conditions which have an impact on interbank rates in the short term. However, in the long term, it will encourage capital inflows so that it will have a smaller impact on deposit rates and loan interest rates.

There are three theories that explain the relationship between interest rates of different time periods (Laksmono, 2001). The first, Segmented Market Theory, says that each instrument with a different maturity is determined by different markets with different market demand and supply. This theory assumes that borrowers and lenders have a preference for a certain period of time. In this theory it is assumed that borrowers and lenders do not move from one market to another so that instruments with different maturities cannot be changed. Revenue in each market is thought to be created from the demand and supply in that market.

Inflation

Inflation is a condition of rising prices of goods and services in general (Bodie and Marcus, 2001:331). Inflation is a monetary event that shows a tendency to increase the prices of goods in general, which means a decrease in the value of money. The main and only cause that allows this phenomenon to appear according to the quantity theory of money in the classical school is the occurrence of excess money in circulation as a result of increasing the amount of

money in society. Keynes in The General Theory Of Employment, Interest and Money, states that inflation is caused by a gap between the people's economic ability and their desire for a product (Shapiro, 2002). What is meant by the gap here is that public demand for goods is greater than the amount available, resulting in an increase in prices, which is then known as the inflationary gap.

Exchange rate

Currency The exchange of a currency with another currency is called a foreign exchange transaction, foreign exchange transaction (Kuncoro, 1996). The price of a currency against another currency is called the exchange rate or exchange rate (Salvatore, 1997). Foreign exchange rates can also be defined as the price of a country's currency in a country in commodity units (such as currency can be interpreted as a comparison of currency values.

The exchange rate shows the price of a currency, when it is exchanged for another currency. For example, the exchange rate of IDR/USD is 8000, meaning that to buy 1 USD, IDR 8000 is needed (Yulianti and Prasetyo, 1998).

METHOD

The research uses a meta-analysis method using 3 scientific journals with the theme of interest rate analysis as a factor in making monetary financial policy. The data used in this analysis is nominal interest rate data obtained from Bank Indonesia (BI) in the form of Indonesian Financial Statistics, and also inflation data from the Central Statistics Agency (BPS) in the form of Economic Indicator Reports. In addition, data were obtained from three journals that became the basis of this research.

The variables used in this research are Gross Domestic Product, Money Supply, Consumer Price Index, Import Price Index, SBI Interest Rate and Exchange Rate. TPF, ROA, Interest rate spread, Inflation spread

This study uses a literature study technique, namely exploring and analyzing various related information in 3 basic scientific journals of meta-analysis. As for monetary data, the authors process data from Bank Indonesia and BPS.

ANALYSIS

In this study, two tests were conducted on the inflation spread and the interest rate spread. From the two tests in this study, namely in the short term and long term between the inflation spread and the interest rate spread, the results obtained for the short term, the spread that is able to explain inflation expectations is the 12-1 month deposit rate spread; deposit spreads 12-3 months; deposit spreads 12-6 months; 6-1 month deposit spread; and 6-3 month deposit spreads. Meanwhile, for the long term, there is only one deposit spread that can explain the movement of inflation expectations, namely the 12-3 month deposit spread. This is in contrast to Laksmono's results for the 1992-1997 period in Indonesia, which shows that the 12-1 month interest rate spread is the most appropriate for explaining inflation expectations.

In the formation of bank interest rates, the element of inflation expectations is still considered small. Meanwhile, other factors are still bigger, such as: condition of banking liquidity, less efficient banking management, bank segmentation. The use of interest rates as an indicator of inflation expectations is in line with the need for an instrument that can effectively explain the phenomenon of inflationary movements as the final target for monetary policy. The results of previous studies state that interest rates are a fairly important channel for the case of Indonesia. However, this study places more emphasis on a certain nominal short-term interest rate on the inflation rate, and has not yet measured the content of inflation expectations in that interest rate.

In the second journal, Cointegration Test, Granger Causality Test, and Impulse Response Function were conducted. For the Cointegration Test between the SBI Interest Rate, Exchange Rate, GDP, CPI, IHI, and JUB there is a long-term equilibrium relationship, in this case it is in accordance with the initial hypothesis. For the Granger Causality Test, it was found that the SBI Interest Rate and GDP have a one-way causality relationship, where GDP is 5.01350 while SBI is 0.82629, in the sense that when GDP fluctuates, it will affect the development of SBI. From the results of the Impulse Response Function (IRF) it is stated that the IHI response to the CPI in the 3rd period has

increased by 0.192067 and in the 10th period it has decreased by -0.042911. Meanwhile, the CPI response to the IHI in the second period increased by 24,17029 and in the 10th period it decreased by 2.923876.

The financial sector is one group of companies that play an active role in the capital market because it is a supporter of the real sector in the Indonesian economy. This causes lending to increase every year. Thus, the SBI interest rate has a positive and insignificant effect because the SBI interest rate fluctuates which is not too high and cannot compensate for the increase in lending, causing the SBI interest rate to have a positive and insignificant effect on lending. The SBI interest rate has an effect on lending is that the economic conditions in Indonesia are increasing, one of which is in the real sector so that investors prefer to use foreign capital by applying for credit to banks to invest. The results of this study are in line with research conducted by Chauzi (2011) showing SBI positive and insignificant effect on commercial bank lending, similar results were found by Pratama (2010), Yuwono (2012), Chauzi (2011), Amalia.S (2013) and Anggraeni (2015), which stated that the SBI interest rate had a positive effect and not significant to lending. With the addition of interest rates will affect investors to invest and will affect the economy in Indonesia.

CONCLUSION

From the results of the research analysis conducted, it can be concluded that in the short term interest rate spreads can explain inflation expectations in Indonesia. In contrast to the long term. In the formation of bank interest rates, the element of inflation expectations is still considered small. Meanwhile, other factors are still bigger, such as: condition of banking liquidity, less efficient banking management, bank segmentation. The use of interest rates as an indicator of inflation expectations is in line with the need for an instrument that can effectively explain the phenomenon of inflationary movements as the final target for monetary policy. For producers and consumers as well as the wider community, if they can be guided by short-term interest rates to find out the characteristics of an increase in inflation that are useful for predicting the state of the economy in Indonesia, moreover, interest rates

for the 3 and 12 month periods are very high. significant and in the same direction as short-term and long-term movements with inflation expectations. This interest rate is very well used as a benchmark in doing business, while for the government it can be used as a truly reliable indicator to make a policy related to inflation expectations in Indonesia.

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