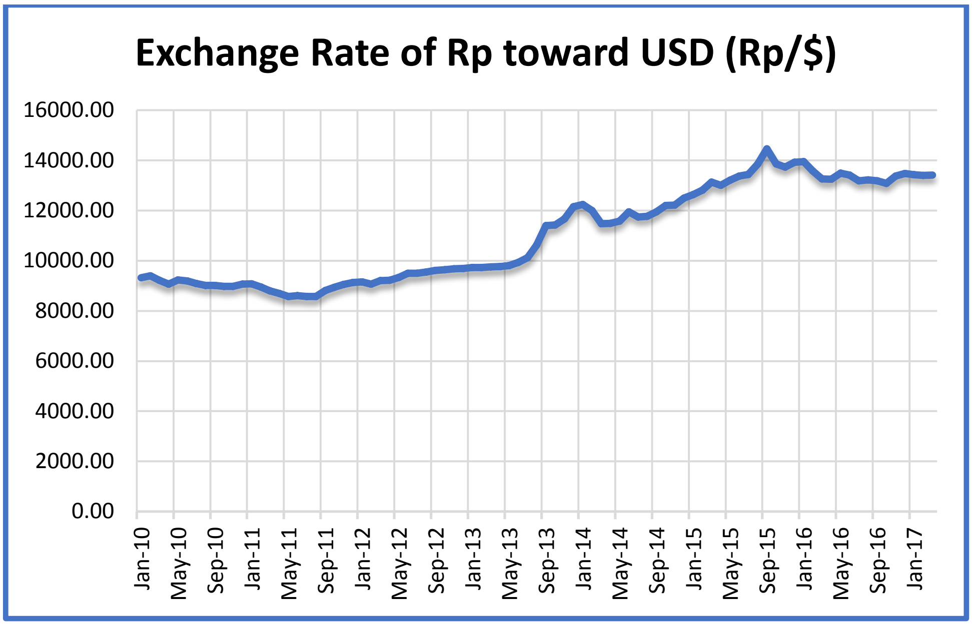
# CHAPTER I

# INTRODUCTION

## A. Background

Major changes in Indonesia's exchange rate system since the 1997/1998 crisis resulted in a consequence on the volatility of the rupiah against the US dollar larger than in the previous period. The volatility occurs both in nominal and in real terms. The growth of Rupiah value against US Dollar were still relatively stable in the era before crisis that hit Indonesia and other Asian regions. When compared to the pre-crisis period, the surge in US dollar made the Rupiah exchange rate to fluctuate between Rp6,700 - Rp9,530 while in the period 1981 – 1996, it was under Rp2.500 (Bank Indonesia, 2000).

Since the free-floating exchange rate policy implemented in 1997, the movement of exchange rate in the market becomes very vulnerable by the influence of economic and non-economic factors. Rupiah exchange rate fluctuates in the short run and tends to weaken in the long term. This phenomenon can be seen from the sample of exchange rate taken from 2010 to March 2017 as shown in the Figure 1.1.




*Resource: (Bank Indonesia)*
*http://www.bi.go.id/en/moneter/informasi-kurs/transaksi-bi/Default.aspx*

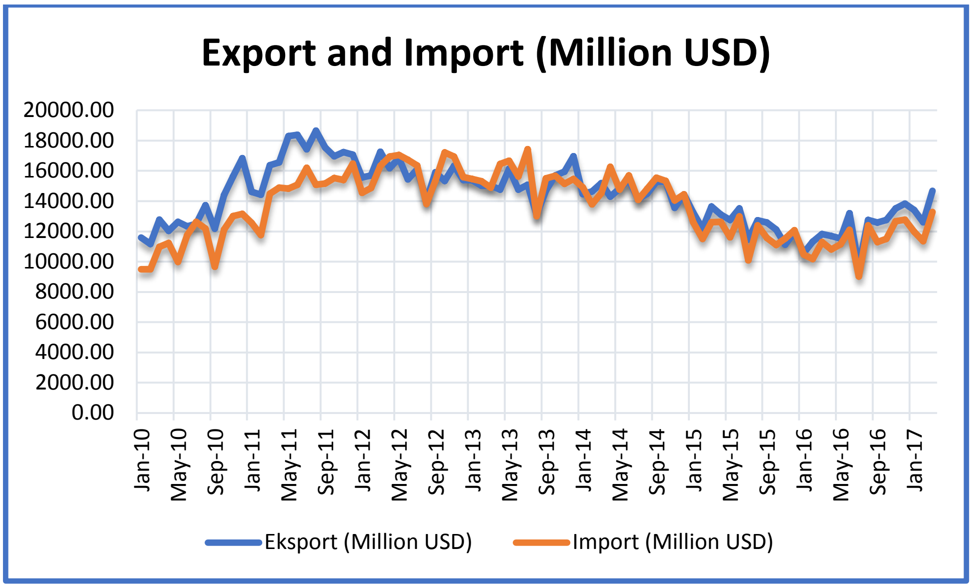
**Figure 1.1. IDR Exchange Rate toward USD (Jan 2010 – March 2017)**

In 2015, Indonesia exchange rate had been fluctuating upward before it reached its highest point in September. Among many factors which caused this, 2015 was the year where the new president of Indonesia was elected. Such a big event had a great impact not only in domestic policy, but also the expectation of foreign investors and international market stakeholders.

There was another variable in macroeconomic which affect the demand and supply of money or even the policy of government which influence directly to the demand and supply. The rupiah exchange rate is influenced by a number of macroeconomic factors, which are based on the strength of demand and supply of money (William Theo and Ratna J, 2014). That is one big consequent that Indonesia face because of the free-floating exchange regime policy.

The difference among currencies exchange rate is basically determined by the magnitude of supply and demand of that currency (Levi, 1996:129). While the law of demand and supply for all goods and services stated that when supply increase the price will decrease and when demand increase the price will increase as well, it is also applied for the demand and supply of money which refer to the trade balance of a country.

While observing trade balance, at a glance, export and import show a long run relationship with exchange rate development. When IDR exchange rate began to devaluate in the end of 2011, in fact, both Indonesia export and import were also decreasing since the end of 2011. This indicates a relationship between export, import, and exchange rate that may be analyzed more.




*Resource: Badan Pusat Statistik*

**Figure 1.2. Export and Import Development (January 2010- March 2017)**

Higher exchange rate (depreciated currency) makes domestic product and tourism become cheaper for overseas importer and tourist. Such condition should attract more export and tourism entrants which will make US Dollar inflow, appreciating the Rupiah currency exchange rate. However, Indonesia still experienced decrease of export (import as well) during the depreciation period of

Rupiah in recent years. As a country that imports many industrial raw materials, the rise of imported materials increases the production cost, causing the price of Indonesian owned goods to increase as well. Lower export makes fewer foreign exchange stocks which lower the capacity to import. Thus, during recent years, import and export were decreasing along with Rupiah depreciation.

Exchange rate can be used as a tool to measure economic condition of a country. The steady growth in the value of the currency indicates that the country has relatively good or stable economic conditions (Salvator, 1997: 10). With the weakening of Rupiah, the Indonesian economy may vulnerable against economic crisis and may loss of confidence in the domestic currency.

Based on that background, this paper tries to analyze some variables that may influence the exchange rate fluctuations. This include independent variables which are export, Jakarta Composite Index, money supply, and Bank Indonesia rate, taken in the period between January 2010 and March 2017. Finally, this paper presents the analysis entitled "**Analysis of Rupiah Exchange Rate Fluctuation on Us Dollar".**

## *B.* Problem Limitation

Preventing analysis problem that may occur, this study is restricted to the following limitations:

**1.** The dependent of this research is exchange rate of Rupiah towards US Dollar.

**2.** The independent variables are limited to export, money supply (M2), Jakarta Composite Index, and Bank Indonesia rate.

3. The study period is limited from January 2011 until March 2017 using monthly time series data.

## *C.* Research Question

Research question aimed to answer is: how do export, Jakarta Composite Index, money supply (M2), and Bank Indonesia rate influence Indonesia exchange rate on US Dollar both in long-run and short-run?

## *D.* Research Objectives

The objective of this paper is: analyzing the long-run and short-run influence of some macroeconomic variables toward exchange rate.

## E. Research Benefits

This study contributes useful information for parties who needs information related to exchange rate.

4. For government, this finding can be a source of information in making regulation, especially in maintaining the stability of exchange rate.
5. For academics, this study can be used for further research.

## *F.* Research Plan

This research consists of some chapter, the sequences are:

**Chapter I, Introduction**

This chapter explains the background, purpose, objective, and aims to explore the objects of research.

**Chapter II, Literature Review**

Chapter two includes the theory related this study. This chapter also includes the previous researches findings that has relation with this research. Lastly, this chapter includes the hypothesis to conjecture the analysis of the study.

**Chapter III, Data Research and Methodology**

Chapter three explains briefly the data conducted in this research, methodology and analyzing steps in this study.

**Chapter IV, Overview**

Chapter four explains the general description and overview the growth of exchange and the included macroeconomic variable within this study.

**Chapter V, Research Findings**

This chapter consists of interpretation, explanation, and discussions regarding the data processing that shows finding result.

**Chapter VI, Conclusion**

Chapter VI concludes the result of data processing and gives recommendation for next research and policy consideration.