

CHAPTER I

INTRODUCTION

A. Background

The capital market is one of the important instruments in a country's economy. Its existence in a country has the potential to contribute to welfare leading to economic improvement. The capital market has two functions, namely an economic function and a financial function. In an economic function, the capital market bridges the government or companies as parties who need funds with investors as capital providers. People who have capital or excess funds (investors) can invest their capital in parties who need funds (companies). The capital obtained from the capital market is used by companies for various company purposes, be it for expansion, business development, additional working capital, and so on. Meanwhile, in the financial function, the capital market provides an opportunity for investors to benefit (return) through investment in the form of capital gains or dividends according to the investment characteristics chosen by the investor.

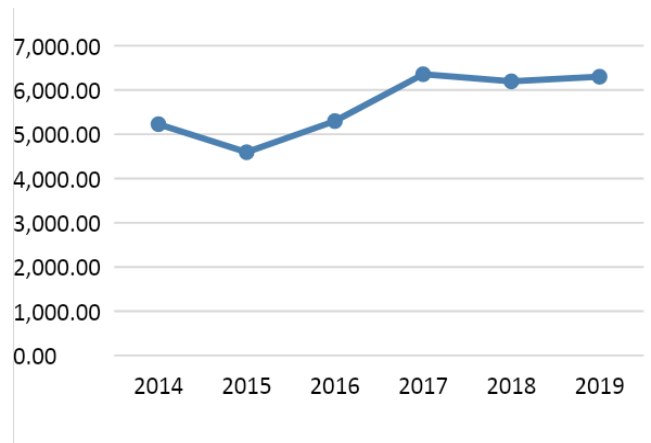
Investing in the capital market can create a trickle down-effect, which benefits from large economic activities that can impact on smaller economic activities. Religion Islam also recommends to vigorously invest for the future because it has many positive benefits, this suggestion is contained in the words of Allah:

يَأَيُّهَا الَّذِينَ ءَامَنُوا اتَّقُوا اللَّهَ وَلْتَنْظُرْ نَفْسٌ م

"O you who believe, fear Allah and let everyone pay attention to what he has done for the next day (hereafter), and fear Allah, Allah knows best what you are doing." QS. Al-Hasyr (18-19)

Instruments that can be traded on the capital market include stocks, bonds, warrants, and so on. For investors who apply sharia principles in their transactions, currently there is also an Islamic capital market available. The Islamic capital market is a capital market that uses sharia principles in its transaction activities and is limited to prohibited things, such as usury, gambling, speculation and so on. (Nurhayati and Wasilah, 2015: 348)

Submission of information about the state and development of transactions on the stock exchange is indispensable for capital market players, especially investors. From this information, capital market players can make reference material, considerations and input in the decision making process. Thus the Indonesia Stock Exchange (IDX) as the capital market regulator continues to strive to improve the performance of periodic information delivery. One of the information needed by capital market players is the stock price index. Indonesia has a stock index, namely the Composite Stock Price Index (IHSG) or familiarly called Jakarta Composite Index (JCI). Jakarta Composite Index (JCI) is one of the main indicators that reflects the performance of the capital market Indonesia whether it is experiencing an increase (bullish) or a decrease (bearish) (Mie & Agustina, 2014).



Source: Indonesia Stock Exchange, Investing, 2014-2019

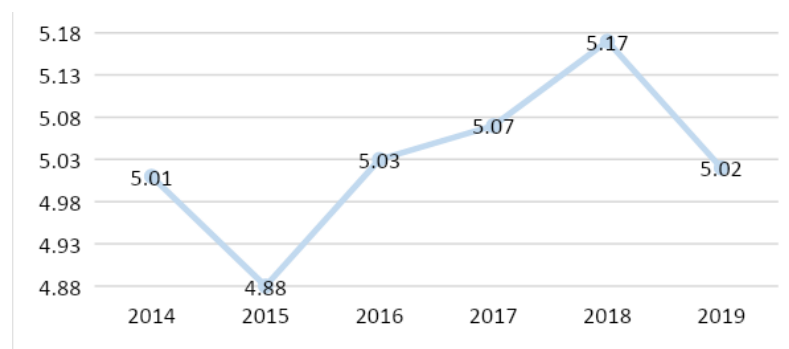
Figure 1. 1

Graph of JCI Movement on the Indonesia Stock Exchange

According to (Mie & Agustina, 2014) when a country's economic conditions are good, the JCI will show an increasing trend. However, if the economic condition of a country is in a downturn, it will also affect the JCI. From this theory, it can be seen in Figure 1.1 that the JCI movement tends to be sluggish. The JCI seems to be trying hard to maintain its position at the level of 6000 points amidst the uncertain global economic situation throughout 2018 until the end of 2019. Despite the sluggish movement of the JCI in the last 3 years, in 2019 the JCI closed at the level of 6,299.54 with a growth of 1.7 % (Year to date). This slight growth was partly due to global sentiment, namely the peak of the trade war between the United States and China, the aggressiveness of the Fed to raise the benchmark interest rate by 6x which resulted in the JCI experiencing significant capital outflows.

In 2019 was a tough year for economic players, especially investors, so they applied a “wait and see” system in making investment decisions. This is

because the movement of the Composite Stock Price Index can be caused by two factors, namely internal factors and external factors. Factors originating from within the country (internal) such as currency exchange rates, interest rates, economic growth and so on. Meanwhile, factors originating from abroad (external), one of which is the stock market which has a strong influence and belongs to developed countries such as America, and world oil prices also affect the performance of the Composite Stock Price Index.



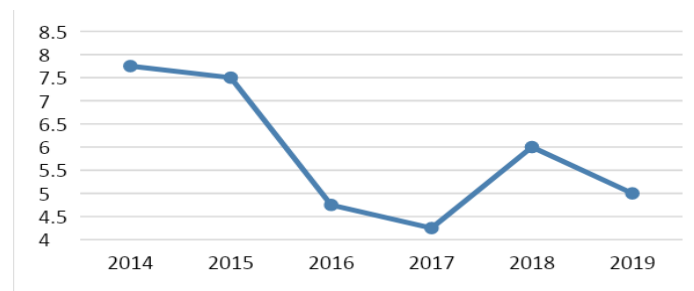
Source: World Bank, 2014-2019

Figure 1. 2

Graph of Indonesia's Economic Growth

On the internal side, according to (Hismendi, 2013) theoretically, the growth in stock investment in a country can be influenced by the country's economic growth. If the economic performance deteriorates, the stock price and stock price index will decline due to a lack of investor confidence in the country's economic conditions, and vice versa. From this, based on figure 1.2 GDP Growth has fluctuated in the last five years. After successfully increasing in 2018 with the acquisition of 5.17%, in 2019 there was a significant decrease at the level of 5.02%. Meanwhile, the highest GDP in the last five years occurred in 2018 with a percentage of 5.17%. The increase in 2018 was

supported by an improvement in the economy with increased private and government consumption. The decline in 2019 occurred due to several factors that affected fundamentally, ranging from the slowdown in global economic conditions, the trade war sentiment between the United States and China, to financial turmoil in several developing countries experiencing recession. On the internal side, the household consumption trend is declining, Indonesia is experiencing a significant capital outflow, and the share of exports to growth has also decreased due to global uncertainty. This economic growth condition is believed to also influence the movement of the Composite Stock Price Index.



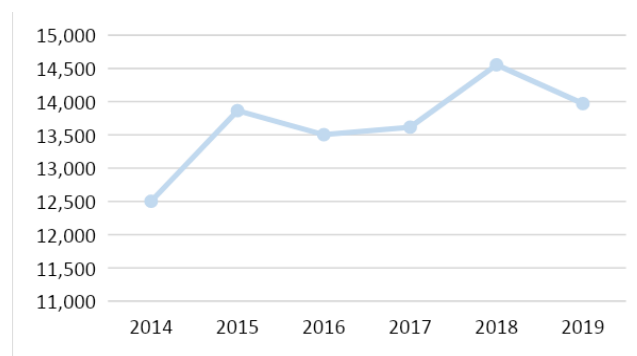
Source: Bank Indonesia, 2014-2019

Figure 1. 3

Graph of Interest Rates in Indonesia

One of the determining factors for economic stability is the benchmark interest rate. Usually the interest rate will also determine whether people will invest or save. In Figure 1.3, the highest increase occurred in 2014, which was at the level of 7.5%. Then the reference interest rate was at the lowest level in 2017, namely 4.25%. In 2019, Bank Indonesia raised the BI-7 days Reverse Repo Rate to 6.00 basis points. The main trigger for this increase was the aggressiveness of the Fed, which raised its benchmark interest rate up to 6x in

one year. When interest rates are high, investors tend to choose to place their funds in banks because interest rates are more profitable and are reduced for investing. Therefore, investors must also pay attention to economic conditions and the country's macroeconomic variables as a consideration in making investment decisions. Macroeconomic indicators that are often associated with the capital market are gross domestic product, exchange rate (exchange rate), inflation, interest rates, and money supply.



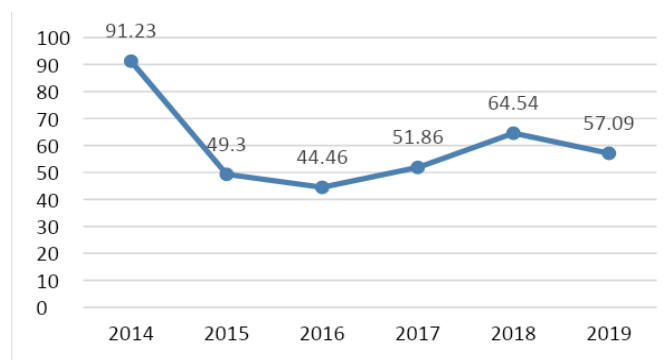
Source: Investing, 2014-2019

Figure 1. 4

Graph of Rupiah Exchange Rate against US Dollar

In theory, fluctuations in the rupiah exchange rate against the dollar will greatly affect the investment climate in the domestic capital market. This is explained in Figure 1.4, in 2014 the rupiah exchange rate against the US dollar was at the level of 12,000 but in 2018 the exchange rate increased sharply to reach the level of 15,200, this level is the highest in the last ten years. The depreciation of the rupiah against the US dollar certainly worsened Indonesia's economic climate. One of the causes of the depreciation was the aggressiveness of the Fed, which raised the US benchmark interest rate, so that when the dollar strengthened, there was a capital outflow in the capital market sector, especially

the JCI, because investors would choose to invest in the US stock exchange which was more profitable. According to 2018 Indonesia Stock Exchange statistics, the impact of this depreciation made investors withdraw 50 trillion from the stock market, which caused the JCI to have a deep correction to the level of 5831.65 points. This also supports that the exchange rate affects the Composite Stock Price Index (IHSG).



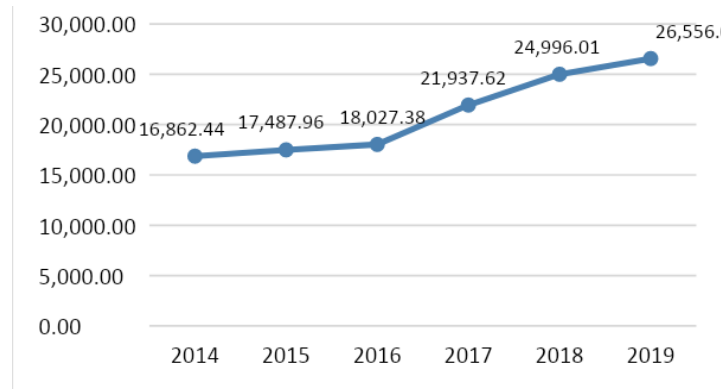
Source: Investing, 2014-2019

Figure 1. 5

WTI World Oil Price Chart in USD / Barrel

Apart from macroeconomic (internal) variables, stock index movements are also influenced by external factors such as world oil prices. Figure 1.5 shows that the WTI Oil Price was at its lowest level in 2016, namely 33.62 USD / Barrel and was at the highest position in 2014, namely 105.37 USD / Barrel. The movement of world oil prices in 2015 to 2019 is relatively stable, counting in the area of 33 USD / Barrel to 70 USD / Barrel. Basically, the stability of world oil prices can affect production costs because almost every industrial activity uses oil as fuel. If the price of fuel rises, it can trigger the price of other goods to rise so that it will reduce people's purchasing power. If the people's purchasing power decreases, the company's profit will also decrease. A decrease

in company profits can impact investors' buying interest in the company's shares. If stock prices fall, it is likely that the stock index will be sluggish.



Source: Yahoo! Finance, Investing, 2014-2019

Figure 1. 6

Dow Jones Index Movement

The next external factor that can affect the JCI is the stock index of other countries especially indexes of developed countries. If the country has good economic prospects it will encourage investors to invest in that country. The United States is one of the countries with a stock index that can be used as a reference for developing countries. The oldest stock index and most popular with investors is the Dow Jones Index. Table 1.6 shows that the movement of the Dow Jones Index has tended to experience an upward trend in the last five years. The highest movement in the last five years from the Dow Jones Index occurred in 2019 at 28,538.44 points, while in 2014 it showed the lowest movement of the Dow Jones Index at 15,698.85 points. The Dow Jones Index experienced a rapid increase in 2019 due to the Fed's policy of raising US interest rates to maintain economic stability. From this, of course, investors will flood US exchanges because the United States has sent a signal of economic

recovery. Similar to the JCI, the movement of the Dow Jones index also reflects the performance of the United States economy in general. With improved economic conditions, the United States can also move the Indonesian economy through export activities and through the capital market (Sunariyah, 2000). The inflow of capital into Indonesia through the capital market can certainly have an impact on the JCI.

Several studies have been conducted to determine the movement of the Composite Stock Price Index (IHSG) by variables that influence it, including in research conducted by IN Aryasta, et al (2019) showing that economic growth has a significant positive effect on the JCI. This is different from the results of research conducted by Michael Untono (2015) which shows that economic growth does not have a significant positive effect on the JCI. Then research by RC Gumilang et al (2014) shows that interest rates have a negative and significant effect on the JCI. While different results are shown by SS Kewal's research (2012), namely that interest rates have no influence on the movement of the JCI.

Exchange rates researched by Handiani (2014) shows that exchange rates have a positive and significant effect on stock index movements. This is different from the results of research conducted by Hismendi et al (2013) which showed that the exchange rate (exchange rate) had a negative and significant effect on the movement of the JCI. The world oil price researched by Kilian and Park (2009) shows that world oil prices have a positive effect on stock index movements, while research conducted by R. Rustam Hidayat et al (2014) states

that world oil prices have a significant negative effect on the JCI. The Dow Jones Index researched by SR Nidar et al (2017), shows that the Dow Jones Index has a positive and significant effect on the JCI, while research conducted by Pratama (2012) found that the Dow Jones Index has a negative and significant effect on the JCI.

From the findings of differences in previous studies, the authors are interested in further research. The difference between this study and previous research is (1) this study uses several selected variables which include all the variables from previous studies but are still relevant and adapted to the climate of the current situation. Namely the JCI variable, Economic Growth, Interest Rates, Exchange Rates, World Oil, and the Dow Jones Index (2) the previous research period still used data before the sluggish economic climate and heated trade wars, while the observation period in this study was January 2014 to December 2019, at which time the economic conditions both at home and abroad were plagued by global uncertainty. (3) Previous research did not use the ECM method, whereas this study used the Error Correction Model (ECM) method with long and short term analysis of the effects. From the above background, the author is interested in conducting research by taking the title **"Determinant Analysis of Composite Stock Price Index 2014: 1 - 2019: 12"**.

B. Limitation of Research

Based on the background of the problem above, it is necessary to limit the problem so that the scope of this research becomes clearer. The author limits the problem to:

1. The time to collect research data is January 2014 - December 2019.
2. Data is collected through the official website of the Indonesia Stock Exchange, Investing.com, Bank Indonesia, the Financial Services Authority, the World Bank, and Yahoo! Finance.
3. This research was conducted to determine the effect of Macroeconomics (Economic Growth, Interest Rates, Exchange Rates) and External (World Oil Prices, Dow Jones Index) on the Composite Stock Price Index in the Indonesia Stock Exchange.
4. This research focuses on looking at the short and long term relationships between economic growth, interest rates, exchange rates, world oil prices, and the Dow Jones index as independent variables in the volatility of the JCI movement as the dependent variable, from January 2014 to December 2019.

C. Research Question

Based on the background described above, several problems can be identified, including:

1. How does the variable of economic growth affect the movement of the Jakarta Composite Index (JCI) in the period January 2014 to December 2019?
2. How does the variable of interest rate affect the movement of the Jakarta Composite Index (JCI) in the period January 2014 to December 2019?
3. How does the variable of exchange rate affect the movement of the Jakarta Composite Index (JCI) in the period January 2014 to December 2019?

4. How does the variable of world oil price affect the movement of the Jakarta Composite Index (JCI) in the period January 2014 to December 2019?
5. How does the variable of Dow Jones Index affect the movement of the Jakarta Composite Index (JCI) in the period January 2014 to December 2019?

D. Objectives and Benefits of Research

1. Research Objectives

Based on the identification of the problem formulations above, the objectives of this study are:

- a. To analyze whether the economic growth variable has an influence on the Jakarta Composite Index (JCI) variable for the period January 2014 - December 2019.
- b. To analyze whether the interest rate variable has an influence on the Jakarta Composite Index (JCI) variable for the period January 2014 - December 2019.
- c. To analyze whether the exchange rate variable has an influence on the Jakarta Composite Index (JCI) variable for the period January 2014 - December 2019.
- d. To analyze whether the world oil price variable has an influence on the Jakarta Composite Index (JCI) variable for the period January 2014 - December 2019.

- e. To analyze whether the Dow Jones Index variable has an influence on the Jakarta Composite Index (JCI) variable for the period January 2014 - December 2019

2. Research Benefits

- a. For Investors (Investors)

For information for invest or potential investors so that they can provide an overview of current capital market conditions, especially the effect of economic growth, interest rates, exchange rates, world oil prices, and the Dow Jones index on the JCI, so investors can determine investment strategies.

- b. For the Government

Can be used as material for consideration, input from the government and related parties in determining future policies in connection with the movement of the JCI (Jakarta Composite Index)

- c. For Researchers

Can be used as input for further researchers with the same scope, as material reference, to broaden insight and understanding regarding the world of capital markets, especially the movement of the JCI (Jakarta Composite Index)