

CHAPTER 1

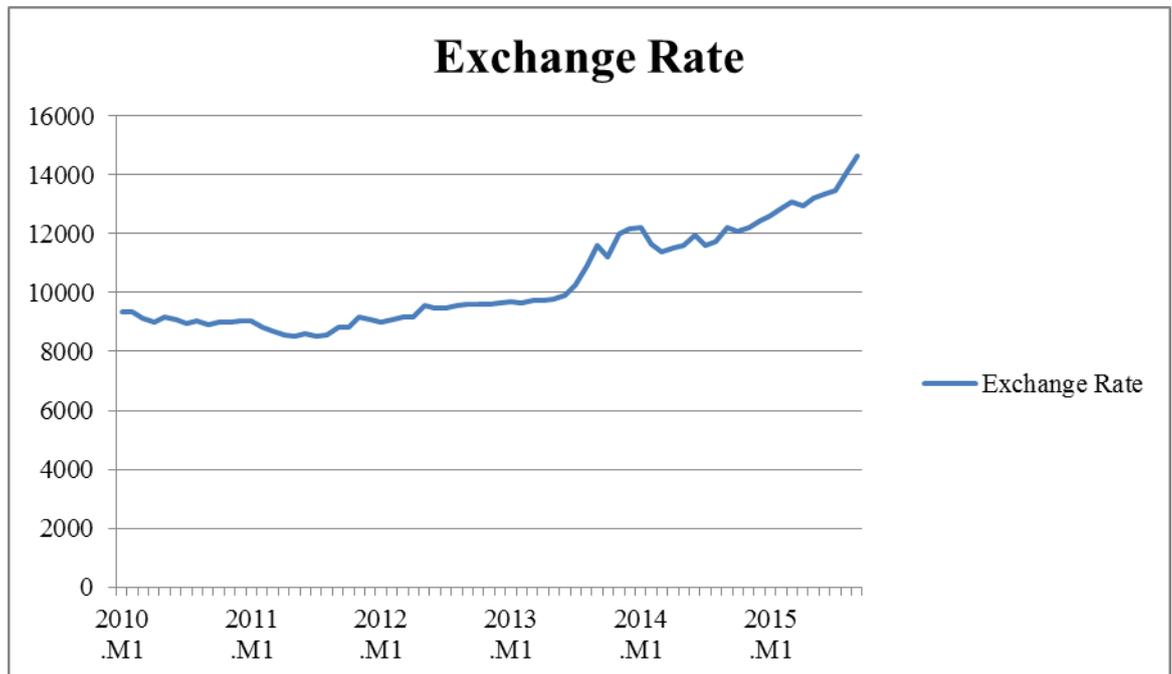
INTRODUCTION

A. Background

Two thousands and fifteen is the year when exchange rate of Indonesia fluctuated more fluently in the high point. We can't deny the existence of international market that influences the changes of the exchange rate. Especially, when we talk about the upcoming of Asean Economic Community in the end of that year, it should relate to the export and import between countries. The instability of exchange rates will affect the flow of capital or investment and international trade (Ulfa and Aliasaddin, 2011).

Such a strong currency is needed to face the obstacles that may occur in the middle of the event. Cause it will not just affect the country but also the citizens even the one who stays in the villages. Even the slightest change can make people suffer or delight. The change of currency value is affected by trade balance with other countries which using the big amount of money especially using US Dollars as its trade's money. A stable currency value indicates that the country has a relatively good economic condition or stable. (Muchlas and Agus R, 2015).

The changes of exchange rate in these last years can be seen in the graph bellow as its value fluctuated in the high point through 2013-2015 around Rp12.000-14.000 as before it just fluctuate around Rp8.000-10.000.



Resource: Bank Indonesia (calculated)

Figure 1.1 Exchange Rate Fluctuation

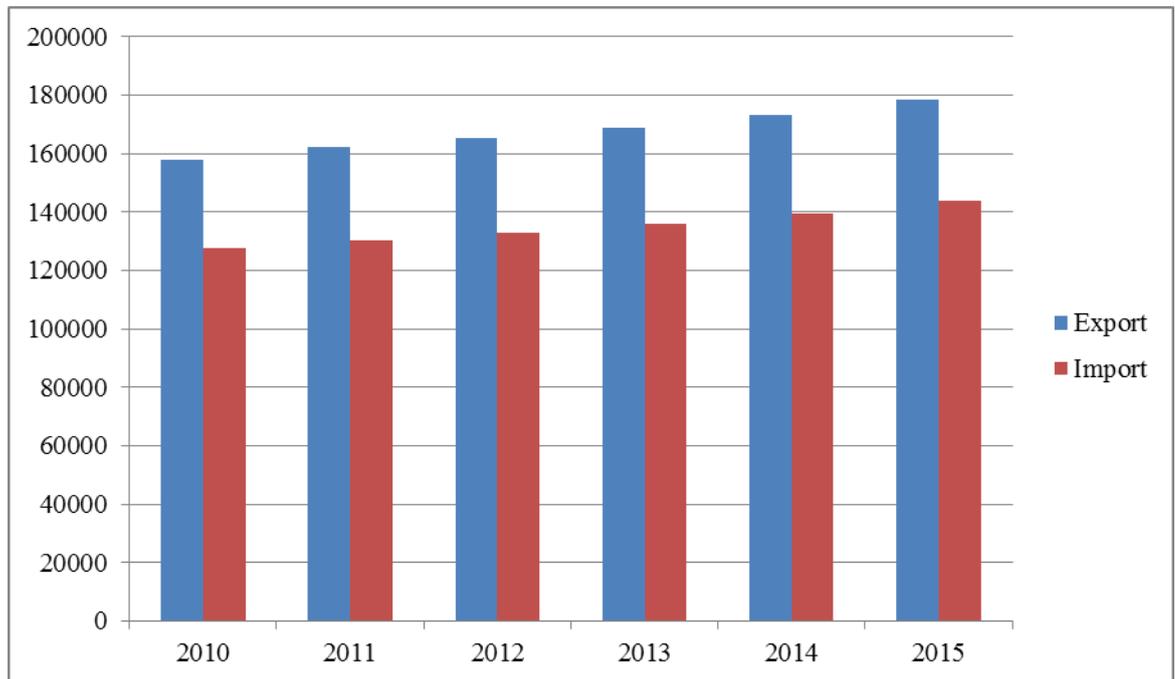
Rupiah exchange rate fluctuations influenced by both monetary policy and fiscal policy. In line with the implementation of Law No. 23 of 1999 concerning the Central Bank regarding the effectiveness of monetary policy in the floating exchange rate system the monetary authorities have changed the system monetary policy operations of the operating system based on the intermediate targeting applied during the implementation of floating exchange rate system under control into an operating system based on inflation targeting. (Imamudin, 2007).

The demand and supply of money was always intersects with the price of money itself. The law of demand and supply for all goods and services was stated that when supply increase the price will decrease and when demand increase the price will increase as well. It applied for the demand and supply of money which

refer to the trade balance of a country. 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)

International trade is a must in this era because and the need of people can only be fulfilled by this trade as the country still lack of resource. With the rapid development of the international economy, the economic relations between countries will become intertwined and lead to the increasing of trade flows of goods, money, and capital between countries. Changes in macroeconomic indicators in other countries, will indirectly impact on the indicators of a country. (Tri Wibowo and Hidayat A, 2005).

The flow of trade balance can indicate how well the fluctuation of exchange rate which have a direct impact toward it and vice versa. As our trade balance was surplus in these last years as we see in the graph below so the exchange rate was fluctuate more fluently than before.



Resource: Bank Indonesia (calculated)

Figure 2.1 The Development of Export and Import

Some researcher has conducted their research and published their finding about the influences of variables such as export, import, money supply, Bank Indonesia rate, inflation rate, and others toward exchange rate. Some findings were significant and others not. Such as RR Suci Palasari (2015) in her research about the Influence of exports, imports, inflation rate, and the Interest Rate toward Exchange Rate explain the multiple linear regression method that partially exports negative effect significantly, import significant positive effect, interest rates positive and significant on the rupiah. While the inflation rate does not significantly affect and the interest rate is the dominant variable.

By those backgrounds the researcher wants to analyze some variables that can influence the fluctuations of exchange rate, there are export, import, money

supply, and Bank Indonesia rate in the period of the data from January 2010 until September 2015. With the title of “**Analysis of Exchange Rate Fluctuation Using Vector Error Correction Model (VECM) From 2010 To 2015**”

B. Problem Limitation

There are many factors that may influence the value of exchange rate, export, import, money supply, and bank Indonesia rate from January 2010 till September 2015 to be examined. Study limitation aim to restrict the analysis problem may occur. This study restricted to the following limitation:

1. The dependent of this research is exchange rate of Rupiah towards Dollar.
2. The study period is limited from January 2011 till September 2015, used monthly time series data.
3. The study case are limited of four independent variables are export, import, money supply (M2), and Bank Indonesia rate.

C. Research Question

Based on the explanations that have been described above therefore, the problems in this research are:

1. How does the effect of long-run and short-run relationship between export, import, money supply, and Bank Indonesia rate influence exchange rate?
2. How does the dynamic pattern between export, import, money supply, Bank Indonesia rate, and exchange rate?
3. How does the forecasting shock of export, import, money supply, and Bank Indonesia rate to exchange rate?

D. Research Objectives

The specific purpose of this research is to study of macroeconomic variables including export, import, money supply, Bank Indonesia rate, and exchange rate. Based on research question, thus the objective of this paper is:

1. Analyze the long-run and short-run relationship between export, import, money supply, and Bank Indonesia rate to exchange rate.
2. Analyze the dynamic pattern of export, import, money supply, and Bank Indonesia rate to exchange rate.
3. Analyze forecasting shock of macroeconomic variable export, import, money supply, and Bank Indonesia rate to exchange rate.

E. Research Benefits

This study contributes useful information for parties which are interested in exchange rate sectors or any other fields that require exchange rate in it. The focus benefits of this research are followings:

1. To government: it can be a base for choosing a regulation to maintain the stability of exchange rate.
2. Scholar and Academics: It is expected this study can be provide additional information for further research.

F. Research Plan

To understand this research, the researcher will explain and divided this study into some of chapter in systematic and clearly, the systematic as follows:

Chapter I, Introduction in that chapter will explain the purpose and objective of this research, the background of this research and aims to explore the objects of research.

Chapter II, Literature Review this chapter include the theory related with this study, theory of Export, theory of import and so on, chapter two also include the previous research from the expert who was conduct similarly this research before with the difference object, chapter two include the hypothesis to conjecture the analysis of the study.

Chapter III, Data Research and Methodology chapter three explain in briefly the data which conduct in this research, and explain VECM methodology step to analysis in this study.

Chapter IV, Overview on Chapter four will explain the general description and overview the growth of exchange and the macroeconomic variable.

Chapter V, Research Findings in this chapter will explain in detail the result of analysis which conducts by VECM model.

Chapter VI, Conclusion in this chapter will conclude the result of test in chapter four and recommendation for the next research and the policy in Economic Indonesia.