

CHAPTER I

INTRODUCTION

A. Research Background

Mankind created by Almighty God as a social creature. In order to fulfil needs, man asks for a hand. Starts from asking for a hand onto establishing solid communication, then solid communication becomes fulfilling needs intention; it has turned into trades. In the beginning, man trades for themselves, while today trades has larger aggregate numbers and possibly consisted of two or more countries. Moreover, it would possibility takes throughout the world to take part.

World has changed rapidly as we are living in globalization era. Globalization helps everything done in fingertip and bring positivity to all sector as well as economy. In the modern era of economy, often hear free-trade market. Free-trade market boosted as globalization in economy occurred. Today, trade is not what we known as it was as we know the existence of capital market. In capital market everybody has its own right to choose freely wherever and whenever to enter the market. Samsul (2006) states that capital market is a place or medium where demand and supply of longterm financial instruments meets.

The development of capital market reflects of one's economy (Husnan and Pudjiastuti, 2004). In order to understand of one's economy condition, the possible way is to look at the capital market. Capital market plays as a

key role of one's economy, first, as an instrument for companies to get funded by public either domestic or international investor. Later, as a market for public to invest in various financial asset like stocks, bonds, mutual funds. In capital market, public can choose freely any instruments with its own risks and characteristics respectively (Husnan and Pudjiastuti, 2004).

Before investing in capital market, investors should understand and consider the factors that can influence the investment price movements. According to Kwon, et al (1997) these factors include: (1) a microeconomic that tends to be controlled, (2) a macroeconomic such as movements in exchange rates and stock indices on the US market cannot be ignored as the impact of globalization on capital markets where factor is out of control by listed companies or by the exchange itself.

Indonesia Stock Exchange (IDX) as the official authority uses *Indeks Harga Saham Gabungan (IHSG)* or known as Jakarta Composite Index (JCI) in English (named prior era of disunited between Jakarta and Surabaya stock exchange) as a measureable metric for all stock movement by listed companies. Therefore, investors are able to understand the condition of all listed company as holistic. Remember, any changes either upside or downside, it doesn't always mean all listed stock goes as well, only some particular stocks might be, due to different market capitalization value of companies contribute to pooled market

capitalization of stock exchange and JCI measures all gather listed company in calculation.

Nowadays, the development of capital market has greater than ever. This may lead into an integration among capital market around the world from developed countries to developing countries. Moreover, a capital market can be influenced by another while influencing another. Capital market has integration connection where the risks and return not only considered by domestic factor, also determined by movement of capital market globally. In addition, if two separated market had similar movement and correlation of indices respectively it also counted as well (Click and Plummer, 2003)

Investors either personal or institutions should understand integration relation for every market they are into. By simply knowing integration relation, investors are able to decide more carefully. Hence, investors would take action precisely amidst either rapid surge rally or deeply down bearish and the most important thing is risk simply mitigate. Furthermore, when investors and investment managers want to diversify, in order to spread risk with the aim of minimizing the existing risk. In addition, if a country had strong integration to another it would decreasing level of international diversification. This concept released by Markowitz in 1952 (Suryandani et al., 2015).

Trade has been such human natural needs to fulfil supplies for life. Whether it's lucrative financial market like capital market or traditional

goods market like groceries. Trading has ruled in Islamic teaching as explained in the Al-Mulk: 15

هُوَ الَّذِي جَعَلَ لَكُمُ الْأَرْضَ ذَلُولًا فَامْشُوا فِي مَنَاكِبِهَا وَكُلُوا مِن رِّزْقِهِ وَإِلَيْهِ النُّشُورُ ﴿١٥﴾

“It is He who made the earth tame for you - so walk among its slopes and eat of His provision - and to Him is the resurrection.” (Surah Al-Mulk: 15)

In order to understand how much integration in capital market, the author took sample on some global capital market towards Indonesia Stock Exchange. The objects of study are the capital market of Indonesia biggest trade export and import.

TABLE 1.1
Export and Import Performances of Non Fuel Section

Years & Countries	US (Bil. USD)	China (Bil. USD)	Japan (Bil. USD)	Singapore (Bil. USD)
Export in 2016	16.14	16.79	16.09	11.86
Export in 2017	17.79	23.08	17.79	12.27
Export in 2018	18.43	27.13	19.46	12.91
Import in 2016	7.3	30.79	12.98	14.46
Import in 2017	8.12	35.76	15.23	16.49
Import in 2018	9.87	45,54	17,94	21,52
Balance of trade in 2016	8.84	-14	3.11	-2.6
Balance of trade in 2017	9.67	-12.68	2.56	-4.22
Balance of trade in 2018	8.56	-18,41	1.52	-8.52

Source: Ministry of Trade Indonesia

Table 1.1 depicts on value of export from Indonesia to USA had been increasing from 2016 until 2018 starts from 16.14 billion USD until 18.43 billion USD. However, along with increasing number in import starts from 7.3 billion USD to 9.87 billion USD hence made Indonesia's balance of

trade went static. Overall, due to larger amount of export over import made Indonesia surplus in balance for three years.

China has become Indonesia's biggest trade partner since 2013 surpassed Japan. Supported by monstrous economic growth no wonder how China got today. As table 1.1 shows above, growth of import seemed unstoppable during 2016 until 2018 starts from 30.79 billion USD until 45.54 billion USD. The growth of export couldn't run in same pace as well as import even there were increasing export starts from 16.79 billion USD up to 27.13 billion USD. Therefore, Indonesia's balance of trade goes negative due to greater number of import surpass number of export. Higher deficit comes as a year goes by.

Aside of USA and China, Japan comes to second-rank of Indonesia's biggest trade partner. The data above shows export has increased not so significant from 2016 until 2018 starts from 16.09 billion USD until 19.46 billion USD. Import also increasing from 2016 until 2018 starts from 12.98 billion USD until 17.94 billion USD makes balance of trade goes narrower from 3.11 billion USD to 1.52 billion USD.

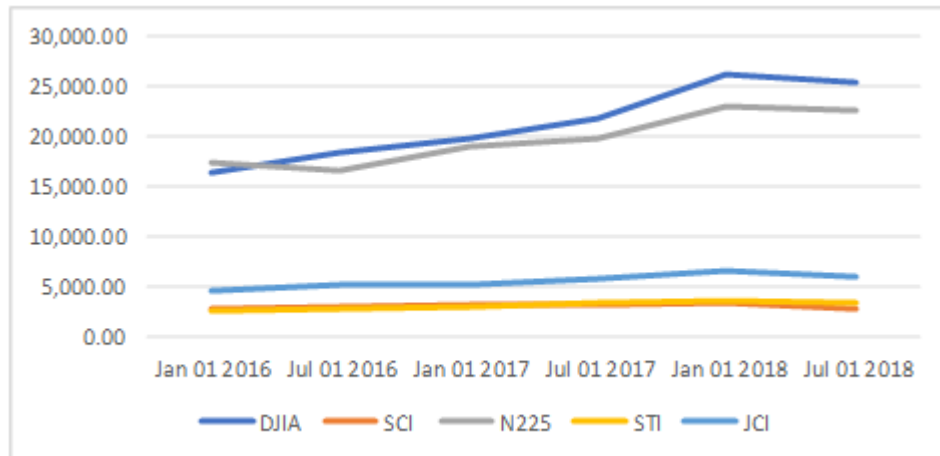
As Indonesia's neighbour country, Singapore has largest number of trade among ASEAN countries. Increasing in export can be described as evidence of strategic partnership on two countries in ASEAN from 2016 to 2018 starts 11.86 billion USD up to 12.91 billion USD. However, bigger number of import in 2016 to 2018 starts from 2.6 billion USD until 8.52

billion USD makes Indonesia's balance becomes negative towards Singapore greater from time to time.

In table 1.1, it can be looked that Indonesia's linkages to trading partners like US, China, Japan and Singapore are enormous, as reflected in the very high trade value. Thus, making US, China, Japan and STI have a relatively high influence on Indonesia. Karim, et, al (2009) finds, that there were exists a long-run equilibrium relationship amongst the Indonesia's stock markets and its trading partner. Consequently, the economic changes that occur in these countries, both directly and indirectly, will affect the Indonesian economy.

In addition, when shocks occur to a country's economy it will also have an impact on the performance of the capital market in that country, because the capital market is a reflection of the real and monetary sector.

All in all, all countries above have strong relation toward Indonesia, reflected by value of trade which increasing over years and crowned as top four biggest trade partner. Then, any economic disturbance either directly or indirectly will cost Indonesia. Also, when it comes to disturbance will bring negativity as well for capital market.



Source: Yahoo Finance

FIGURE 1.1

Indices Movement of DJIA, SCI, N225, STI, and JCI

Picture 1.1 shows Dow Jones Industrial Average (DJIA), Shanghai Composite Index (SCI), Nikkei 225 (N225), Straits Times Index (STI), and Jakarta Composite Index (JCI) from 2016 until 2018. Starts from 2016, DJIA went sky-rocketing and continue in January 2017 then its peak reached in January 2018, right before slightly down July 2018. Next, N225 also went high and continue in 2017 goes fluctuating down little bit prior get higher level then reached its peak in January 2018, right before down in July 2018.

Unfortunately, the good condition was not followed by other variables which are SCI and STI. Seen from 2016 until 2018, there were no significant movement as fair to be said sideways even a little drop shown on the July 2018, trends for both are sideways. For JCI, were not significant increasing compared to DJIA and N225 slight increasing little

bit over years eventually reached its peak at January 2018 and getting down at July 2018 so for major trend was sideways.

US commonly uses Dow Jones Industrial Average (DJIA) consist of top large market capitalization 30 companies as a one of metric in order to assess performance in capital market. In knowing the average capital market's movements, Shanghai Composite Index (SCI) regularly use in China due to popularity rather than Shenzhen Composite Index (SZCOMP). While NIKKEI 225 (N225) more popular in Tokyo Stock Exchange (TSE) and most respected in assessing performance rather than Tokyo Price Index (TOPIX) and J30 Index. Singapore uses Straits Times Index (STI) in order to assess performance of stock market. Indonesia Stock Exchange (IDX) as legal authority uses Jakarta Composite Index (JCI) as a mirror of all trade activity rather than LQ45 or JII. The phenomenon of pattern as shown in picture 1.1 means how one market responds to another, as market goes hassle-free the movement becomes more cohesive.

Plenty beneficial points are earned with integration market. Belke and Keil (2016) states that some of benefit obtained by integrated market seen from the point of view of a country, it can be a lower global risk, positive impact from foreign capital flows to investment and domestic growth, improve macroeconomic policies and efficiency with the stability of domestic financial policy. Furthermore, financial market integration will encourage specialization in production, improving the level of efficiency

in the financial industry and directing better economic policy (Babecky, et, al., 2017).

Integration market happens when market is liberated to all parties either domestic or international investors. Nguyen and Elisabeta (2016) found that strong empirical evidence that equity market liberalization gives rights to foreign investors to trade domestic securities and domestic investors can trade foreign securities, which then results in an average increase annual growth of market.

In prior research conducted by Pinem (2019) with multiple regression and data were taken January 2014-2015 , she found that FTSE, Exchange Rate of USD/IDR, Dow Jones Industrial Average (DJIA), STI (Straits Times Index), KOSPI Composite Index (KS 11), Hang Seng, inflation positive relation to CSPI. However, the interest rate does not affect the CSPI. In addition, Triyono (2017) conducted in multiple regression and data were taken January 2013-August 2015, he found that exchange rate of USD/IDR gave negative impact, while the other macroeconomics variables such as the interest rates and inflation do not have a significant impact. Astonishingly, none of foreign stock indexes have a significant impact toward JCI.

The author is interested in conducting research with the title **“INTEGRATION OF STOCK MARKETS BETWEEN INDONESIA AND ITS MAJOR TRADING PARTNERS Period of January 2016 – December 2018”**.

B. Limitation of Study

1. The capital markets are limited only Dow Jones Industrial Average (DJIA), Shanghai Composite Index (SCI), NIKKEI 225 (N225), Straits Times Index (STI), and Jakarta Composite Index (JCI).
2. The length of study period is limited starts from 2016-2018.
3. The analytical tools used is limited to integration analysis using VAR/VECM Model.

C. Research Problem

1. How is the integration and influence effect of a Dow Jones Industrial Average (DJIA) toward Jakarta Composite Index (JCI) in the short-run and long-run?
2. How is the integration and influence effect of a Shanghai Composite Index (SCI) toward Jakarta Composite Index (JCI) in the short-run and long-run?
3. How is the integration and influence effect of a NIKKEI 225 (N225) toward Jakarta Composite Index (JCI) in the short-run and long-run?
4. How is the integration and influence effect of a Straits Times Index (STI) toward Jakarta Composite Index (JCI) in the short-run and long-run?

D. Research Objective

1. Examine the effect of the integration and influence effect of a Dow Jones Industrial Average (DJIA) toward Jakarta Composite Index (JCI) in the short-run and long-run.

2. Examine the effect of the integration and influence effect of a Shanghai Composite Index (SCI) toward Jakarta Composite Index (JCI) in the short-run and long-run.
3. Examine the effect of the integration and influence effect of a NIKKEI 225 (N225) toward Jakarta Composite Index (JCI) in the short-run and long-run.
4. Examine the effect of the integration and influence effect of a Straits Times Index (STI) toward Jakarta Composite Index (JCI) in the short-run and long-run.

E. Research Benefit

1. The results of this study is expected to contribute for investors either personal or institutional as additional information especially international diversification issue.
2. The results of this study is expected to contribute for policy maker and government as additional information especially fiscal and monetary policies issue.
3. The results of this study is expected to contribute for academics as an evidence of economics study case in financial issue.
4. The results of this study is expected to contribute for researchers as reference for further study.

