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Exploring Key Drivers of Economic Growth in Indonesia

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Abstract:
This study uses the Autoregressive Distributed Lag (ARDL) model technique to examine the factors impacting economic development in Indonesia between 1986 and 2023. The results show that the Menoter policy significantly hinders economic growth over the short and long terms. On the other hand, inflation significantly boosts economic growth throughout both periods. Furthermore, both in the short and long terms, financial development has a strong and favorable impact on economic growth. In a similar vein, exports have significantly boosted economic growth over both time periods. These findings emphasize the significance of strategic policymaking and draw attention to outside variables that significantly affect Indonesia's economic growth trajectory.

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1. Introduction

Indonesian authorities now place a high premium on stable and sustainable economic growth. Enhancing welfare and raising living standards is largely dependent on economic growth, which is frequently regarded as a key sign of a country's success. According to Presidential Regulation No. 12 of 2025, the Indonesian government wants to reach an 8% growth rate by the end of 2029. As part of the strategy shift towards "Indonesia Emas 2045," this objective is fully incorporated into the National Medium-Term Development Plan (RPJM) 2025-2029.

The economic growth of a country is influenced by various key factors, including the government’s monetary policies, inflation rates, the development of the financial sector, and the volume and diversification of exports. In this context, a comprehensive understanding of how these variables interact and influence economic growth is crucial, particularly for designing effective and sustainable policies. Based on various economic theories and empirical evidence, the relationships among these macroeconomic variables are often complex, ambiguous, and nonlinear. The

relationships between inflation, interest rates, and economic growth often exhibit non-linearity, which can be influenced by other moderating and mediating variables, such as investment levels, market expectations, and political stability.

The origins of inflation remain a subject of substantive debate among economists. Classical economists argue that inflation arises from an excessive money supply, whereas Keynesian approaches emphasize the role of aggregate expenditure and total demand in triggering inflation. Meanwhile, monetarist theory highlights the growth of the money supply as the primary factor driving inflation rates. A comprehensive understanding of these factors and the mechanisms through which they interact is crucial for developing macroeconomic policy strategies that foster high-quality, stable, and sustainable economic growth.

To this day, the economic literature continues to argue the connection between inflation, interest rates, and economic growth. For example, conclusions about the relationship between inflation and economic growth are very contentious. Inflation and economic growth are positively and persistently correlated, according to research by Ijaz (2021). On the other hand, a number of additional research find a negative association between the two variables, including those by Fischer (1983), Ayyoub, Chaudhry, and Farooq (2011), and Kibria et al. (2014). Furthermore, neither Johnson (1967) nor Manamperi (2014) discovered any solid empirical proof that inflation and economic growth are positively or negatively correlated in developing or BRICS countries.

Additionally, studies conducted in Ethiopia by Durevall and Sjo (2012), Wollie (2018), Yismaw (2019), Kayamo (2021), and Nguse et al. (2021) also yield inconsistent and inconclusive results regarding the interrelationship of these variables. Therefore, there remains no definitive theoretical or empirical consensus regarding the relationships among inflation, interest rates, and economic growth. This condition underscores the need for further research that examines explicitly the dynamic interactions among these variables, taking into account the role of exogenous variables such as exchange rates and other factors, particularly within the Indonesian context.

Policymakers and academics have shown significant interest in the development of the financial sector, particularly in economic growth. The role of the financial sector in driving economic growth has become an indispensable aspect, as finance facilitates various cycles of savings, investment, and productivity enhancements that contribute positively to long-term growth (Fry, 1978). The effect of financial development on economic growth was examined by De Long et al. (1989). They discovered that this influence is present in various nations at both the macro and local levels. There is ample evidence to support the favorable correlation between financial development and economic growth (King & Levine, 1993).

However, a skeptical view suggesting that financial development may have adverse effects on economic growth is also quite prevalent. An overly developed or large financial sector can divert resources away from productive investments in the real sector (Robinson, 1952). Lucas (1988) emphasizes that excess resources in the financial sector can potentially reduce productivity in the real sector, thereby hindering economic growth. Several empirical studies report inconsistent results, with some even finding no significant relationship between financial development and economic growth, as evidenced by research by Deidda and Fattouh (2002), Cecchetti and Kharroubi (2012), Law and Singh (2014), Arcand et al. (2015), and Zingales (2015). This inconsistency underscores the need for more in-depth and comprehensive investigations into the relationship between financial development and economic growth to support evidence-based and targeted policymaking.

Exports constitute a key macroeconomic variable with a strategic role in fostering sustainable economic growth. Numerous empirical studies indicate that exports positively contribute to economic growth; however, an over-reliance on export-led strategies can potentially hinder broader economic progress. Research by Kurniawan and A'yun (2021), utilizing data from 1970 to 2020, reveals that exports generally promote short-term economic growth, supporting the export-led growth hypothesis.

Nonetheless, findings regarding long-term impacts are inconsistent, with exports not exhibiting a significant influence on GDP sustainability over time. Conversely, Fitriyanto (2023), through an ARDL analysis of quarterly data from 2011 to 2019, identifies a long-term cointegration relationship between exports and GDP. Similar results are reported by Millia et al. (2023), employing ARDL and ECM models, which demonstrate that exports directly contribute to economic growth in the short term. Recently, Fadhlani et al. (2024) examined the impact of export diversification on GDP using ARDL, finding that diversification significantly exerts a positive effect on economic growth.

However, other research indicates that economic growth is not necessarily significantly impacted by trade openness, including export activities, especially in poor nations that should prioritize investments in industrialization and export-based development (Zaman et al., 2021). Additionally, research by Murshed (2022) suggests that Saudi Arabia's long-term economic growth may be slowed when fossil fuel exports are mixed with environmental pollution levels. These results highlight how a nation's particular economic environment and sustainability policies greatly influence how exports affect economic growth.

Building on these insights, this study aims to address gaps in the literature and clarify the persistent uncertainties surrounding the relationships among primary macroeconomic variables, such as monetary policy, inflation, financial development, and exports, regarding economic growth. Prior studies report conflicting perspectives and findings, ranging from positive to adverse effects, as well as inconsistent relationships across different economic contexts and geographical regions. The ongoing debates regarding the roles of monetary policy, inflation rates, financial sector dynamics, and export functions in stimulating growth require more in-depth analysis. The Autoregressive Distributed Lag (ARDL) model is used in this study to help identify and comprehend short- and long-term correlations between these variables. This paper contributes significantly to the development of macroeconomic theories and policies that encourage sustainable, evidence-based growth by presenting a novel and strong analytical technique using data from 1978 to 2023.

2. Literature Review

2.1. Monetary and Economic Growth

Monetary policy is often regarded as a crucial instrument for influencing economic growth, primarily through the management of interest rates, inflation control, and exchange rate stabilization. According to Bernanke (2020), effectively managed monetary policy can enhance investment and consumption, ultimately driving long-term economic growth. This study highlights the significance of monetary policy responses in addressing both domestic and global economic conditions, thereby promoting macroeconomic stability and sustainable growth. Additionally, research by Iddrisu et al. (2025) reveals that carefully implemented expansionary monetary policies can serve as a primary driver of economic growth, particularly in developing countries facing investment shortages.

However, this relationship is not without challenges. Over-expansion of monetary policy can trigger market volatility and economic imbalances, potentially hindering long-term growth. De Graeve et al. (2008) argue that monetary policy must continually adapt to dynamic macroeconomic conditions while considering the risks of imbalance. Excessive monetary easing can lead to asset bubbles and inflation. Youndi and Nafla (2019) suggest that imbalances in monetary policy can slow economic growth and exacerbate financial instability.

2.2. Inflation and Economic Growth

Several studies have shown that inflation has a significant impact on economic growth, with varying results depending on the country’s context and the level of inflation. Research by Mandeya & Sin-Yu (2022) suggests that high inflation can diminish consumers’ purchasing power, increase economic uncertainty, and disrupt investment processes, collectively exerting an adverse effect on economic growth. Conversely, Azam and Khan (2022) find that moderate inflation may not have a significant impact on growth; however, when inflation surpasses a certain threshold, the relationship turns negative

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and statistically significant. Other macroeconomic factors, such as political stability and the efficacy of monetary policy, generally influence the effect of inflation on economic growth.
Furthermore, some studies highlight that inflation variables do not always have a direct effect on economic growth, but instead influence it indirectly through mechanisms such as price stability and investor confidence. Girdzijauskas et al. (2022) demonstrate that high inflation can reduce economic agents' confidence and impair market efficiency, thereby hindering long-term growth. Conversely, research by Ali and Asfaw (2023) highlights that price stability and controlled inflation are essential for creating a conducive environment for investment and innovation, ultimately promoting sustainable economic growth. These findings indicate that the relationship between inflation and economic growth is complex and affected by various economic factors and policy measures.

2.3. Financial Development and Economic Growth

According to international literature, financial development is considered a key factor driving economic growth. According to the study by Ofoeda et al. (2024), the degree of diversity and depth of the financial system positively influences economic growth by facilitating efficient resource allocation and increasing access to funding sources. They emphasize that the development of financial infrastructure, such as banks, stock markets, and non-bank financial institutions, strengthens funding mechanisms that support innovation and long-term investment, which are vital for sustainable economic growth. Additionally, Cheng et al. (2021) demonstrate that countries with advanced financial systems exhibit higher growth rates, as they are better equipped to provide more effective financial solutions and reduce transaction costs.

On the other hand, some studies suggest that the relationship between financial development and economic growth is not always linear and is influenced by other control factors such as political stability and market regulation. Shavshukov and Zhuravleva (2023) caution that rapid growth in the financial system must be complemented by adequate supervision and regulation to prevent systemic risks that could threaten economic stability. Furthermore, Zeqiraj et al. (2022) find that the quality of financial institutions and financial inclusion play crucial roles in amplifying the positive impact of financial development on growth. They conclude that institutional development and increased access to financial services can accelerate economic growth, particularly in developing countries that face significant barriers within their financial systems.

2.4. Export and Economic Growth

Numerous empirical studies suggest that exports play a significant role in driving economic growth, primarily through mechanisms such as increasing national income, facilitating technology transfer, and enhancing resource efficiency. Saleem et al. (2020) found that the successful expansion of export volume is significantly positively correlated with long-term economic growth rates. Furthermore, Adnan Bashir et al. (2023) suggest that a country's comparative advantage—evidenced by the export of high-quality, internationally competitive products—can drive growth acceleration through enhanced productivity and innovation. Additionally, Carrasco and Tovar-García (2021) demonstrate that access to international markets and low trade barriers can enhance growth by increasing export volume and diversification.

Beyond direct mechanisms, the impact of export variables on economic growth is also influenced by factors such as the quality and structure of exports, as well as external variables like globalization and international economic stability. Aggarwal et al. (2021) emphasize that exports supported by value-added activities and strategic industrial sectors exert a greater influence on growth compared to primary commodity exports. Moreover, Udeagha and Ngepah (2021) find that trade openness and export growth acceleration often reinforce each other within a dynamic relationship framework. In conclusion, the literature suggests that export variables serve as important catalysts for economic growth; however, their effectiveness heavily depends on the structure of the national economy, the quality of export products, and global market conditions.

3. Data and Methodology

The Central Statistics Agency (BPS), Bank Indonesia (BI), and the World Bank are among the official organizations that provided the annual time series data for Indonesia included in this study, which covers the years 1986 to 2023. Economic growth, as determined by the GDP per capita (GDP) yearly percentage growth, is the main variable of interest. The real interest rate (MP) is a proxy for monetary policy; the annual inflation rate in percentage terms (INF) is a representation of inflation; and the export volume as a percentage of GDP (EPT) is a measure of exports.

This study employs the Autoregressive Distributed Lag (ARDL) model to effectively analyze the key factors driving economic growth in Indonesia from 1986 to 2023. The advantage of this method lies in its ability to produce consistent and unbiased estimations, particularly when the variables employed are integrated of different orders (Pesaran & Shin, 1999; Pesaran et al., 2001). Additionally, the ARDL approach is more efficient in identifying both short-term and long-term relationships, even with relatively small sample sizes, making it suitable for macroeconomic studies involving extensive and complex time series data (Pesaran & Shin, 1999). This approach offers flexibility in addressing issues related to data stationarity and enhances the reliability of the estimation results. The ARDL model equations for analyzing short-term and long-term relationships can be formulated as follows:

$$GDP_{i,t} = \alpha_{i,t} + \alpha_1 MP_{i,t-1} + \alpha_2 INF_{i,t} + \alpha_3 FD_{i,t} + \alpha_{14} EPT_{i,t} + \alpha_{14} ETC_{i,t-1} + \varepsilon_{i,t}$$

$$\Delta GDP_{i,t} = \alpha_{i,t} + \alpha_1 \Delta MP_{i,t-1} + \alpha_2 \Delta INF_{i,t} + \alpha_3 \Delta FD_{i,t} + \alpha_{14\Delta} EPT_{i,t} + \varepsilon_{i,t}$$

Before estimating the Autoregressive Distributed Lag (ARDL) model, a series of preliminary tests must be conducted. These include tests for data stationarity among variables, cointegration tests, and assessments of model stability. According to Pesaran et al. (2001) and Haruna et al. (2023), alternative methods exist that restrict the order of integration, differing from the ARDL approach. In this alternative method, data are allowed to be non-stationary at level zero (0), provided that all variables become stationary after first differencing (1). Furthermore, the ARDL model is applied using a single-equation, reduced-form specification, in contrast to other methods that employ a system of equations (Pesaran et al., 1999). This advantage makes the cointegration testing and stability analyses proposed by Pesaran particularly relevant for ensuring the appropriateness of ARDL models in this analysis.

4. Result and Discussion

Table 1 presents the descriptive statistics for the independent variables, namely economic growth (GDP), as well as the dependent variables, including monetary policy (MP), inflation (INF), financial development (FD), and export (EPT), which are utilized in this study.

Table 1. Descriptive Statistics

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
GDP	38	22214955	23094304	602590.6	74299839
MP	38	6.277632	7.050500	-24.60000	18.80000
INF	38	8.340789	9.082230	1.500000	58.40000
FD	38	3350.895	1192.828	1816.000	6082.000
EPT	38	2725.395	688.8109	1733.000	5297.000

Source: E-views 12, processed (2025)

The average annual economic growth (GDP) over the period is 22,214,955, with a standard deviation of 23,094,304. The minimum and maximum values are respectively 602,590.6 and 74,299,839. These figures indicate substantial variability in GDP growth. The monetary policy variable (MP) has a mean of 6.28, a standard deviation of 7.05, with minimum and maximum values of -24.60 and 18.80, respectively, reflecting considerable fluctuations in monetary policy stance. The inflation (INF) variable records an average of 8.34, with a standard deviation of 9.08, and extremum values

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ranging from 1.50 to 58.40, indicating significant inflation volatility during the study period. Meanwhile, the financial development (FD) variable has a mean of 3,350.89, with a standard deviation of 1,192.83, and values spanning from 1,816 to 6,082, suggesting variability in financial development growth. The export (EPT) variable exhibits an average of 2,725.40, a standard deviation of 688.81, and minimum and maximum values of 1,733 and 5,297, respectively, reflecting fluctuations in export growth over the observation period.

The initial step before conducting ARDL model testing involves performing stationarity tests on all data used in this research to confirm their integration order. This testing is crucial to prevent spurious relationships among variables, ensuring that the regression results have valid economic interpretations. According to Pesaran et al. (2001), a key advantage of the ARDL model lies in its ability to assume that variables can be integrated at different orders, thereby allowing for greater flexibility in modeling variables with mixed stationarity properties.

Table 2. Stationarity Test Results

Variable	Level		First Difference	
	Statistic	Probability	Statistic	Probability
GDP	-3.1066	0.0347*	-4.3973	0.0013*
MP	-5.1503	0.0001*	-6.8539	0.0000*
INF	-0.9628	0.7555	-8.8049	0.0001*
FD	-1.8489	0.3519	-4.3918	0.0013*
EPT	-2.2322	0.1988	-7.8669	0.0000*

Information: *significant 5%
Source: E-views 12, processed (2025)

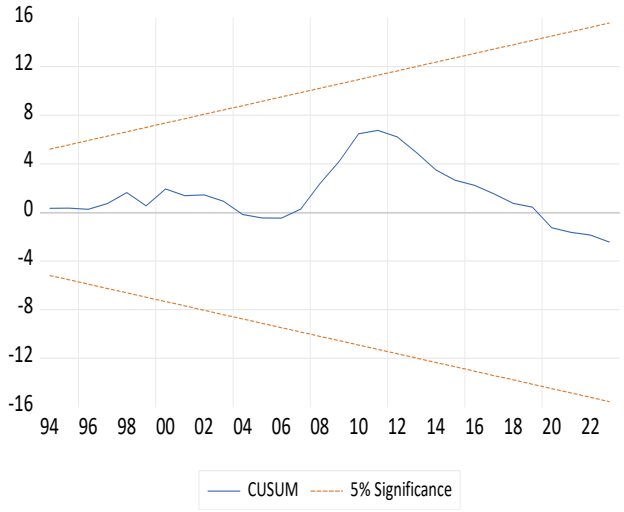
Only the economic growth (GDP) and monetary policy (KM) variables are stationary at level zero, according to the findings of the stationarity test using the Augmented Dickey-Fuller (ADF) test at a 5% significance level. The export (EXP), financial development (FD), and inflation (INF) variables, on the other hand, are non-stationary since their p-values are greater than 5%. As a result, stationarity testing was carried out at the first-difference level. The results showed that all of the study's variables are stationary, with p-values less than 0.05, validating their appropriateness for cointegration testing.

Table 3. Bound Test of Cointegration

F-Bounds Test	**Nilai**	**signifikansi**	**I(0)**	I(1)
		10%	69.81889	4.06
F-Statistic	31.2264	5%	47.85613	4.57
K	4	2.50%	29.79707	5.07
		1%	15.49471	5.72

Source: E-views 12, processed (2025)

Table 3 displays the limits cointegration test findings, with an F-statistic value of 31.2264 that is not significant at the 10%, 5%, 2.5%, and 1% significance levels and surpasses the upper bound (I(1)). The null hypothesis is rejected as a result, showing that each model has long-term cointegration. The CUSUM and CUSUM SQ graphs were then used to visually corroborate the long-term relationship's stability and validate the model's structural stability.



The stability test results, as illustrated by the CUSUM and CUSUM SQ plots, indicate that the residual variance remains within the critical boundaries at a 5% significance level. This suggests that the cumulative residuals are relatively stable within the 95% confidence interval, thereby confirming the ARDL model's stability and its resistance to structural changes over the study period. The trend observed from this test supports the conclusion that the employed model is valid for estimating both short-term and long-term relationships. Furthermore, the overall testing outcomes demonstrate that the ARDL model satisfies all required diagnostic criteria, rendering it suitable for estimation.

Based on the ARDL estimation results presented in Table 4, it was found that the monetary policy variable (MP) has a significant negative impact on Indonesia's economic growth. The short-term coefficient is -0.0458, while the long-term coefficient is -3.8952, both of which are significant at the 1% level. Specifically, a one basis point increase in monetary policy (KM) results in a 0.04% decrease in short-term economic growth and a 3.89% decline in the long term. These findings are consistent with those of Song et al. (2021) and Jordà et al. (2024). This adverse effect can be attributed to several factors, such as the implementation of tight monetary policies to curb inflation or stabilize prices, which indirectly may hinder economic activity and investment. Moreover, rising interest rates or monetary policy tightening typically increase borrowing costs, thereby reducing consumption and investment, and slowing overall economic growth. Therefore, policymakers must consider the long-term effects of monetary policy in promoting sustainable growth in Indonesia.

The estimation results for the inflation variable (INF) reveal a different impact. In the short term, the inflation coefficient is 0.0277, and in the long term, it is 2.3555, both of which are significantly positive at the 5% level. Specifically, a one basis point increase in inflation will cause a 0.0277% rise in short-term growth and a 2.36% increase in the long term. These findings align with the studies by Girdzijauskas et al. (2022) and Uddin and Rahman (2023). This indicates that, within certain limits, inflation can stimulate economic growth in Indonesia. The results suggest that controlled inflation levels can facilitate smooth business productivity and economic activities, thereby positively impacting Indonesia's economic growth. The Indonesian government has implemented appropriate regulatory policies to intervene in the market and control inflation, contributing to stability and sustainable growth. Stabilized inflation plays a crucial role in asset appreciation, boosting savings, and influencing citizens' purchasing power, thereby serving as a primary driver of overall economic growth.

Table 4. Short-term and long-term ARDL Estimation Results

Short-term	Coefficient	Standard-Error	T-Stat	Prob
MP	-0.0458	0.0046	-9.7620	0.0000
INF	0.0277	0.0089	3.1135	0.0180
FD	0.0318	0.0066	4.7874	0.0045
EPT	0.0385	0.0152	2.5255	0.0180
ECT	-0.0117	0.0008	-13.4221	0.0000

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C	-0.0182	0.0426	-0.4273	0.6717
Long-term	**Coefficient**	**Standard-Error**	**T-Stat**	**Prob**
MK	-3.8952	0.8703	-4.4753	0.0001
INF	2.3555	0.7648	3.0799	0.0188
FD	2.7031	1.0784	2.5065	0.0048
EXP	3.2779	1.6371	2.0022	0.0558
R-squared	0.9998			
Adjusted R-squared	0.9998			
F-statistic	35722.68			
Prob(F-statistic)	0.0000			

Source: E-views 12, processed (2025)

At the 1% level, financial development significantly boosts Indonesia's economic growth. A one-basis-point improvement in financial development is linked to a 0.03% boost in economic growth in the near run. Its long-term effects are more significant, affecting Indonesia's economic growth by about 2.7%. These results align with studies conducted by Ahmed et al. (2022) and Erdoğan et al. (2020). The findings demonstrate that financial development significantly and favorably influences Indonesia's economic expansion. The positive correlation suggests that better financial system efficiency and more access to financial services directly boost real sector productivity and national economic competitiveness, which in turn boosts economic activity. The development of the financial sector facilitates the flow of funds, serving as a crucial catalyst for accelerating and sustaining Indonesia's economic growth sustainably.

Regarding the export (EPT) variable, the results differ between the short-term and long-term analyses. In the short term, the export coefficient of 0.0385, with a p-value of 0.0180, has a significant effect on economic growth at the 5% level. In the long term, the coefficient is 3.2779 with a p-value of 0.0558, significant at the 10% level. These findings are supported by studies from Islam (2021) and Nouira and Saafi (2022), indicating that an increase in exports in Indonesia significantly drives economic growth during the initial period, while the cumulative effects of increased exports are likely to reinforce sustainable economic growth over the long term. Therefore, expanding and increasing export volumes is a highly relevant strategy to support the consistent and sustainable growth of Indonesia's economy. The negative and significant coefficient of the Error Correction Term (ECT(-1)) indicates the presence of cointegration among the variables. In the short run, the growth adjustment is approximately -0.0117, while in the long run, the convergence towards the equilibrium point occurs more rapidly. The model's specification test yields a significant F-statistic of 0.0000 and an R-squared value of 0.9998, indicating that the independent variables have a strong and valid influence on the dependent variable.

5. Conclusion

This study aims to analyze the key factors that have influenced Indonesia's economic growth from 1986 to 2023. The empirical results indicate that monetary policy has a significant negative impact on economic growth in both the short and long term, reflecting the need for a reassessment of monetary instruments to enhance their effectiveness. Conversely, controlled inflation, financial development, and increased exports demonstrate positive and significant contributions to accelerating Indonesia's economic growth across both short-term and long-term horizons. These findings underscore the importance of synergizing fiscal, monetary, and trade policies implemented by the Indonesian government to promote inclusive and sustainable economic growth.

Based on these findings, several policy implications are proposed to foster Indonesia's economic growth. The government should assess the effectiveness of monetary policy, taking into account its potential adverse effects on economic growth. Additionally, efforts should focus on strengthening policies that support inflation control, financial sector development, and export expansion, all of which

have a significant impact on economic growth. This research has limitations; therefore, future studies could incorporate variables such as corruption indices or institutional quality as moderating factors.

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