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THE EXCHANGE RATE OF THE RUPIAH IN INDONESIA: VOLATILITY AND ECONOMIC STABILITY

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ABSTRACT

The exchange rate of the rupiah is inelastic, which means that changes in the exchange rate do not always lead to significant changes in the supply and demand for the currency. The objective of this research is to analyze the factors influencing the inelasticity of the rupiah exchange rate and its impact on the Indonesian economy. Using literature review and secondary data analysis methods, this study will identify factors such as inflation, monetary policy, and global economic uncertainty that contribute to the inelasticity of the rupiah exchange rate. The research methodology adopts a comprehensive literature review approach by examining the current conditions of the local currency exchange rate, key factors, and potential volatility. This study refers to a number of academic sources and central banks, including the latest academic papers. The research results show that although there is exchange rate volatility, the market's reaction to that volatility tends to be minimal, thus having a significant impact on economic stability.

1. INTRODUCTION

The exchange rate of the national currency is one of the important indicators in the economy. The exchange rate has a wide-ranging impact on both the national and international economies, considering that almost every country in the world engages in foreign exchange transactions. Forex is often referred to as Forex; it is actually foreign currency. Forex market forecasting is a very important strategy for the success of international business ventures (Puspitawati & Ahmad, 2021). Inaccuracy in exchange rate forecasts can eliminate the possibility of making a profit from international transactions (Beckmann & Czudaj, 2017). Thus, exchange rate forecasting is key to decision-making related to transferring funds from one currency to another over a specific period (Alam et al., 2019).

The issue that needs to be addressed when solving forex problems is the exchange rate. It is very easy to measure the rate of change in a currency's exchange rate, but difficult to explain the changes that occur or predict how the exchange rate will change in the future. To achieve both goals, it is necessary to understand the concept of equilibrium exchange rates and the factors that influence equilibrium exchange rates (Amuda, 2023).

The exchange rate of one currency and the exchange rate of another currency is called forex trading (Caö et al., 2021). There are two types of Forex trading: spot trading and forward trading. Spot trading usually consists of trading in the forex market, which is settled within a maximum of two days. Forward trading is a currency transaction where the currency is delivered on a specific date in the future. Forex forecasting is necessary to reduce trading risks in the forex market. Forecasting foreign exchange rates or forecasting future exchange rates (futures spot) is an important strategy for the success of an international business. Future forecasts are based on empirical predictions of spot and forward exchange rates. In general, any foreign currency can be used as a means of payment abroad. However, it turns out that only certain currencies can be used as currencies for paying international transactions. For this reason, the International Monetary Fund (International Financial Institution) has taken the following steps: USD (USA), € (Europe), ¥ (Japan), AUD (Australia), £ (UK), HK$ (Hong Kong), F₣ (France), BF (Belgium), SFr (Switzerland), Lit (Italy), DM (Germany), Skr (Sweden), Dkr (Denmark), $ (Austria), Esc (Portugal), and S$ (Singapore) (Weston 2004). Therefore, the exchange rate is an important indicator in a country's economy, reflecting the exchange rate between domestic and foreign currencies.

In Indonesia, the exchange rate of the rupiah often experiences high volatility, but the market's response to these fluctuations is inelastic. Inelasticity can be defined as a condition where the demand or supply of a currency does not change proportionally to changes in the exchange rate. This phenomenon can be influenced by various factors such as inflation, monetary policy, and global economic conditions. In this context, it is important to understand how the inelasticity of the rupiah exchange rate can affect the Indonesian economy as a whole, including economic growth and price stability and its impact on the economy in greater depth.

In this context, the impact on exports and imports. The inelasticity of the rupiah exchange rate can also affect Indonesia's export and import sectors. Fluctuations in unstable exchange rates can affect the competitiveness of domestic products in the international market. Fluctuations in unstable exchange rates can affect the competitiveness of domestic products in the international market. This can result in lower export volumes and higher import costs, which ultimately affects the country's trade balance (Maksum, 2015). Bank Indonesia's monetary policy often has to respond to fluctuations in the rupiah exchange rate through market interventions and adjustments in monetary policy. The instability of the exchange rate makes it difficult for the central bank to maintain inflation stability and economic growth. Therefore, it is important for monetary authorities to have the right strategy in dealing with exchange rate inelasticity.

Then Indonesian companies and investors need to pay attention to the inelasticity of the rupiah exchange rate when developing risk management strategies. The use of financial instruments such as futures contracts and options can help protect a portfolio from unfavorable exchange rate movements (Maf'ula & Mi'raj, 2022). By understanding the impact of exchange rate inelasticity, economists can take the necessary precautionary measures to maintain financial stability (Nugraheni & Muhammad, 2019).

Economic diversification can reduce Indonesia's dependence on certain sectors that are vulnerable to exchange rate fluctuations. By developing other more stable economic sectors, the negative impact of the inelastic exchange rate of the rupiah can be reduced (Hasyim, 2018). This is where foreign investment is needed, namely encouraging sustainable foreign investment, to offset the inelasticity of the rupiah exchange rate. Foreign investment brings new capital into the country and helps strengthen the domestic currency exchange rate. In addition, this can reduce exchange rate inelasticity by increasing public understanding of the importance of currency stability. Educating the public about the factors that influence exchange rates can prepare them to face market volatility (Ningsih & Suprayogi, 2017). And finally, through strong cooperation and international trade, Indonesia can strengthen its position in facing exchange rate inelasticity. Active participation in the World Economic Forum can help Indonesia maintain currency stability and sustainable economic growth.

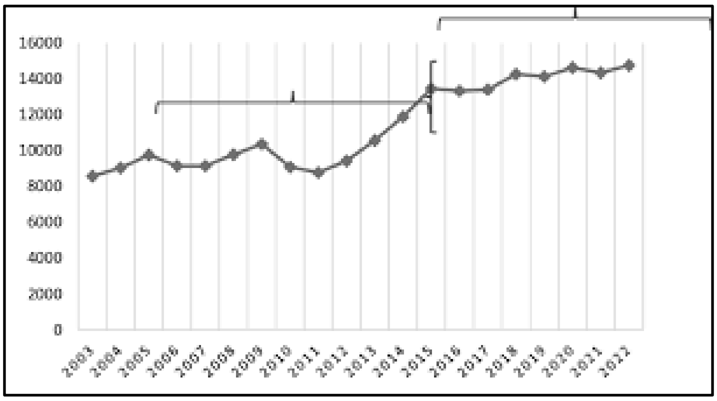

Figure 1. Exchange Rate of the Rupiah against the US Dollar
Source: Author (2024)

Figure 1 illustrate the trends in the exchange rate of the Indonesian Rupiah (IDR) against the US Dollar. It reflects the volatility and inelasticity of the currency over a specific period, highlighting its impact on the Indonesian economy.

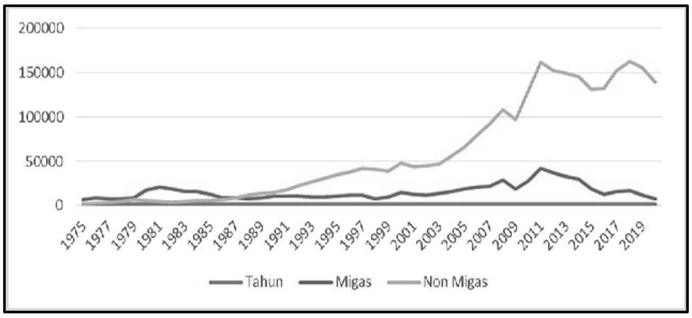

Figure 2. The Value of Indonesia's Exports from 1975-2019
Source: Author (2024)

Figure 2 present the trends in Indonesia's export values over the years 1975 to 2019. The data demonstrates the relationship between export performance and the fluctuating exchange rate of the rupiah.

Figure 1 and 2 shows the inelasticity of the rupiah exchange rate, which affects the overall Indonesian economy. This can be seen from Indonesia's export value versus the rupiah exchange rate against the US Dollar.

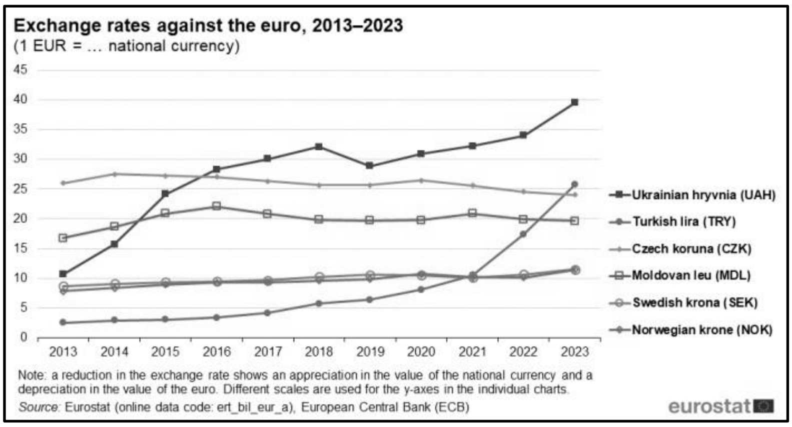

Figure 3. Exchange rates of European countries' currencies against the Euro
Source: Author (2024)

Several studies have examined the relationship between exchange rates and the economy. For example, Silaban (2023) shows that the exchange rate of the rupiah has a significant impact on economic growth in Indonesia, with a weaker rupiah causing lower GDP growth. Moreover, Kallon (2023) emphasizes the importance of exchange rate management within the broader context of economic policy, especially in facing global challenges; (Menkhoff et al., 2012) also note that exchange rate fluctuations affect investment and trade decisions, which in turn, there is no explicit reference to exchange rate inelasticity in Caö et al. (2021), hence we do not include this reference.

According to Siregar et al. (2024), there is a complex relationship between monetary policy and exchange rate volatility. They concluded that central bank interventions in the foreign exchange market can affect exchange rate stability, but more research is needed on their long-term effects. Furthermore, Putra (2022) emphasizes the importance of coordinated monetary and fiscal policies in managing corporate foreign exchange risks, which can have implications for the overall economic health. Thus, a comprehensive understanding of exchange rate dynamics and related policies is crucial for maintaining a country's economic stability.

2. RESEARCH METHODS

This research uses a qualitative approach with literature review and secondary data analysis. The data used includes economic reports, journal articles, and relevant publications that discuss the exchange rate of the rupiah and the factors influencing its inelasticity (Echchabi & Ayedh, 2015). The analysis will be conducted by identifying patterns and relationships between variables that contribute to the inelasticity of the rupiah exchange rate and its impact on the Indonesian economy (Sunarsih & Fitriyani, 2018).

This study emphasizes the importance of understanding the dynamics of the foreign exchange market and the role of the rupiah exchange rate in the Indonesian economy. In addition to analyzing literature and secondary data, an in-depth study of monetary and fiscal policies can provide more comprehensive insights. Involving economists and financial practitioners in discussions about strategies that can be implemented to reduce the inelasticity of the rupiah exchange rate is also a valuable step. In addition, further research, including direct surveys of foreign exchange market participants, will provide a more direct and relevant picture of the factors influencing the movement of the rupee's exchange rate.

A holistic and collaborative approach can enhance the understanding of the complexities of the foreign exchange market and support Indonesia's economic stability. For example, encouraging economic diversification to reduce dependence on certain sectors. Investing in the development of non-oil and gas industries to create a more stable source of income. In addition, strengthening financial market regulations is also necessary to reduce speculation risks that affect the exchange rate of the rupiah. In addition, strengthening regional cooperation in facing the turbulent global financial market. Equally important is providing more comprehensive economic and financial education to improve the financial literacy of the community and their understanding of the foreign exchange market so that they can better manage the risks associated with fluctuations in the value of the rupiah.

3. RESULTS AND DISCUSSION

The analysis results show that there are several main factors influencing the inelasticity of the rupiah exchange rate. First, the high inflation rate in Indonesia tends to reduce the purchasing power of the public and affects the demand for currency (Silaban, 2023). Second, the monetary policies implemented by Bank Indonesia, such as interest rates and market interventions, also play a role in determining exchange rate stability (Menkhoff et al., 2012). The inelasticity of the rupiah exchange rate can have negative effects on the economy, such as increasing import costs and reducing the competitiveness of domestic products in the international market. There is a risk that the exchange rate of the rupee may not be elastic. This can lead to slower economic growth and higher inflation, which in turn can affect the welfare of society.

The persistence of the inelasticity of the rupee exchange rate can be influenced by other factors that need to be considered. Fourth, domestic and international political events can cause economic disruptions that affect the value of the rupee. Political tensions and major conflicts can create uncertainty that negatively impacts the stability of the domestic currency. Fifth, technological changes and economic digitalization also play a role in exchange rate fluctuations. Changes in the payment and international trade systems can affect the liquidity and trust in a country's currency.

In addition, social factors such as the level of education and the wealth of the population can also affect the exchange rate. People with higher levels of education tend to have a better understanding of the importance of economic and financial stability, which can contribute to confidence in a country's currency. On the other hand, social and economic disparities can create instability that leads to unfavorable exchange rate fluctuations.

In addition to the social factors mentioned earlier, the political situation in a country can also significantly impact the exchange rate. Political instability, civil unrest, and unexpected changes in government policy can cause turmoil in the foreign exchange market, leading to significant currency fluctuations. In today's global world, international relations also affect exchange rates. Trade agreements, economic cooperation, or international sanctions can be external factors that influence a country's exchange rate.

Changes in technology are a significant element in setting exchange rates, in addition to internal and external considerations. Technologies that affect how exchange rates are seen and exchanged include blockchain, e-commerce, and the digitisation of financial systems. Additionally, technological developments make it simpler and faster to obtain information about international markets, which can hasten currency movements and significantly alter the dynamics of exchange rates.

Considering all these factors, the Government and monetary authorities can design better policies to maintain the stability of the rupee and reduce the negative impact of exchange rate inelasticity on the overall economy.

4. CONCLUSION

The exchange rate of the Rupiah is inelastic and is influenced by various factors including inflation, monetary policy, and global economic uncertainty. This inelasticity can have a negative impact on the economy, including economic growth and price stability. Therefore, it is important for policymakers to consider these factors when designing policies that can support exchange rate stability and the overall economy.

External factors such as trade wars and changes in the global economic situation, such as the global financial crisis, can have a significant impact on the value of the rupee. Fluctuations in global commodity prices can also be external factors that affect the value of the local currency.

Monetary policy through central bank interest rate policies can influence foreign investors' desire to invest in Indonesia, which in turn can affect the exchange rate of the Rupiah. Direct intervention by the central bank in the foreign exchange market can also impact exchange rate stability.

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