CHAPTER I
INTRODUCTION

1.1 Introduction

This chapter contains information on the background of the research, the research problem, the research objectives, and the research questions. Moreover, this chapter will describe the research's significance, scopes, and limitations. In addition, this chapter includes the definition of key terms. However, these chapters will help the reader understand what is to be researched.

1.2 Background of Study

Coronavirus Disease-2019 (COVID-19) is a disease caused by a new type of coronavirus that was first detected in Wuhan City, China, in December 2019. World Health Organization (WHO) declared COVID-19 as a pandemic on March 9, 2020. In Indonesia, the first positive cases of COVID-19 were detected on March 2, 2020, and it continues to spread (Yuniarti et al., 2021). According to Goodell (2020), the Covid-19 pandemic causes direct global economic damage in every world region. The COVID-19 pandemic represents the largest global shock (Phan & Narayan, 2020).

The price of a currency in one country expressed in terms of another country's currency is known as the exchange rate (Ifa and Siti, 2021). According to Sukirno (2015), the foreign exchange rate or exchange rate is the quantity of local currency, in this case, the rupiah necessary to purchase one unit of foreign currency. According to Ramasamy and Abar (2015), the exchange rate is viewed as the relative value of a certain nation's currency to other currencies. There are two types of currency rates: flexible exchange rates and fixed exchange rates. In fixed exchange rates, the government sets the value of the currency, whereas in flexible exchange rates, the market sets the value of the currency and the government plays no part in maintaining the value of the currency (Semuel & Teddy, 2014).

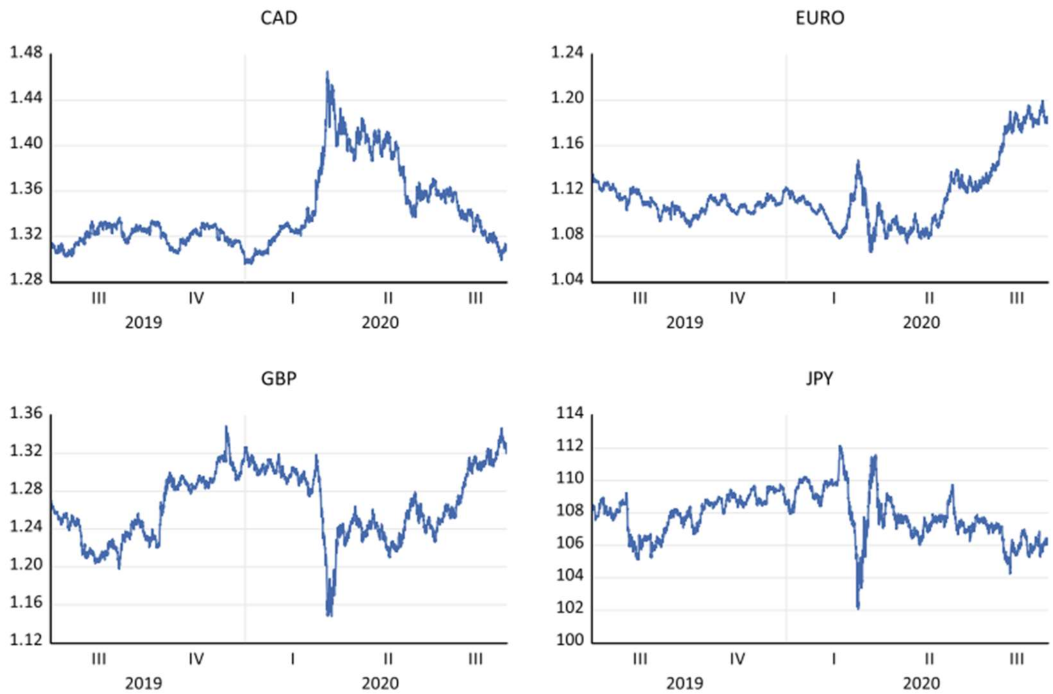

Figure 1.1 A plot of the exchange rate, 01/07/2019 to 04/09/2020

This figure plots the four exchange rates, namely the Canadian dollar (CAD), the EURO, the Great British Pound (GBP), and the Japanese Yen (JPY). The data are intraday from 01/07/2019 to 04/09/2020 hours from 01:00 am to 05:00 pm (17 hours per day).

Source: Narayan (2022)

This graph shows an increase in the values of Yen and CAD implies a depreciation while an increase in EURO and GBP implies an appreciation of these two currencies (Narayan, 2022). With the COVID-19 shock In February/March 2020, nations started to close international borders, such as lockdowns, and As a result, the pandemic has had an impact on exchange rates for more than six months (Narayan, 2022). During Covid 19, the rupiah exchange rate against the dollar fluctuated greatly. Especially when Covid 19 arrived in Indonesia for the first time on March 2, 2020. This is illustrated in the graph below:

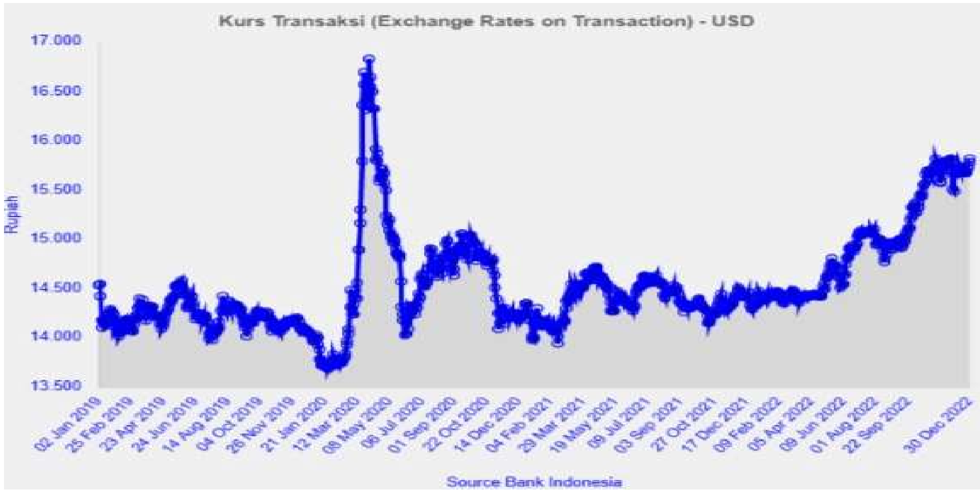

Figure 1.2 Exchange Rate in Indonesia 2019-2022

Source: https://www.bi.go.id, Data processed by the author (2023)

The graph above shows the trend of the rupiah exchange rate versus the dollar, which depreciated dramatically between March 9 and March 27, 2020, as the coronavirus epidemic expanded in Indonesia. According to Mahmoud, Bashir, and Ali (2015), inflation, interest rates, and the money supply all contribute to exchange rate volatility.

According to Morosan and Zubas (2015), inflation is a measure of whether government policies are monetary, fiscal, and coordinated, and whether they result in consumer price stability. Inflation is a hazard that, if not handled, can undermine economic prosperity. According to Cecchetti (2009), inflation impairs the purchasing power of fixed-interest ratepayers. Inflationary pressures can weaken the purchasing power of an economy's currency.

The price of money is defined as interest rates. Interest rates are defined as additional fees paid by the borrower for the use of borrowed funds. According to Hamid et al. (2017), the interest rate paid or charged for cash utilization is typically expressed as an annual rate. Long-term and short-term interest rates are both possible. The central bank has an impact on short-term interest rates. According to Semuel and Teddy (2014), the long-term interest rate reflects the current state of the economy.

Many governments utilize interest rates as a tool for monetary policy in order to control other macroeconomic factors. According to Hamid et al. (2017), higher interest rates cause the exchange rate to rise and attract foreign money. According to Hnatkovska, Lahiri, and Vegh (2013), high-interest rates stimulate demand for money, which causes currency appreciation and increases the fiscal deficit, which decreases national output. The central bank determines a country's interest rate.

1.3 Problem Statement

Currency rate volatility is a major worry for governments, investors, analysts, and other stakeholders since it causes uncertainty in employment, trade, investment, cash flows, profit, and economic growth (Musyoki, Pokhariyal, & Pundo, 2012).

Before the outbreak of COVID-19, the movement of the rupiah against the dollar was always in the range of Rp. 13,800 to Rp. 14,500. The rupiah currency rate against the USD fell to IDR 16,800 after COVID-19 arrived in Indonesia on March 2, 2020.

According to Khordehfrosh and Tehranchian (2015), interest rates and inflation were two macroeconomic factors that contributed to the rise in exchange rate volatility. This persuaded scholars to investigate the effect of inflation and interest rates on currency exchange rates.

1.4 Research Questions

The research conducted within this paper aims to solve the following research questions:

RQ1. What is the effect of Inflation on the Exchange Rate in Indonesia?

RQ2. What is the effect of the Interest Rate on the Exchange Rate in Indonesia?

1.5 Research Objective

1.5.1 General Objective

The general objective of this research is to examine the factors that influence of Exchange Rate in Indonesia. This study uses Inflation and Interest rate for measure influence of exchange rate.

1.5.2 Specific Objective

This paper aims to find out the inflation and interest rate effects on the exchange rate in Indonesia. The purpose of this research is to find out:

1. To examine the effect of Inflation on the Exchange Rate in Indonesia.
2. To examine the effect of the Interest rate on the Exchange Rate in Indonesia.

1.6 Significant of the Research

1.6.1 Theoretical Contribution

According to Musyoki et al (2012), Exchange rate volatility is a major concern for governments, investors, analysts, and other stakeholders because it causes uncertainty in employment, trade, investment, cash flow, profits, and economic growth. This research will provide more knowledge about interest rates, inflation, and exchange rates.

1.6.2 Practical Contribution

1. For Government/Policy Marker

   Government organizations responsible for formulating policies may utilize these findings as a foundation for their decisions by using them as a guide in the realm of policy. The findings of studies can also be used by institutions responsible for formulating policy to modify current policies and reduce the influence of inflation and interest rate changes on exchange rates.

2. Other Research

   This study will help in the development of this field's knowledge for other researchers. The results of this study will also serve as a foundation for subsequent research and identify potential areas for further study.

1.7 Limitation of the Research

The independent variables in this study are interest rates and inflation, while the dependent variable is foreign exchange rates. As a result, conclusions depend on the macroeconomic factors analyzed and are related only to that aspect. This study relies on secondary data that is quantitative in nature and does not include qualitative elements that affect exchange rates in the country. to measure the exchange rate of this study using the Indonesian rupiah against the US dollar. In addition, the conclusions of the research are based on the variables studied and not all macroeconomic factors. The findings are based on the period studied, which covered monthly data for a period of 5 years from 2018 to 2022.

1.8 Definition of key terms

1.8.1 Inflation

According to Sadono Sukirno (2015), Inflation is increasing in general prices applied in an economy from one period to another.

1.8.2 Interest Rate

According to Hamid et al. (2017), the interest rate paid or charged for cash utilization is typically expressed as an annual rate.

1.8.3 Exchange Rate

According to Sukirno (2015), the foreign exchange rate or exchange rate is the quantity of local currency, in this case, the rupiah necessary to purchase one unit of foreign currency.

1.9 Summary

In brief, this chapter contains information about the background of the research, the research problem, research objectives, research questions, significances, scopes, and limitations of the research, the definition of key terms, and also structure of the proposal. As a result, it will be easier for the reader to comprehend the motivation behind this study.