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Analysis of the Factors Influencing the Inflation Rate in Indonesia During the Covid-19 Pandemic

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ABSTRACT
One of Indonesia's most prevalent and problematic economic issues is inflation. Inflation has a big impact on the economy as a whole, including external balances, competitiveness, and income distribution. As a result of the government's adoption of the social distancing policy, the COVID-19 pandemic has had a detrimental impact on public consumption and economic growth in 2020. The purpose of this study is to look into the elements that influenced Indonesia's inflation rate during the COVID-19 pandemic. Secondary data in the form of a time series in the form of monthly data from January 2019 to December 2021 was acquired from numerous sources, including the Central Statistics Agency (BPS) and Bank Indonesia (BI). The ordinary least squares approach is used for analysis (OLS). The findings revealed that the variable Amount of Money in Circulation had a negative and insignificant effect on inflation. Bank Indonesia certificates with variable interest rates have a favorable and considerable effect on inflation. Meanwhile, the exchange rate, exports, and household consumption have a small but favorable impact on inflation.

Keywords: Inflation, Money Supply, BI Rate, Exchange Rate, Export, Consumption, OLS

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INTRODUCTION

In Indonesia, one of the most common economic issues is inflation. Inflation is a key indicator in examining a country's economy, especially because it has a significant impact on the aggregate economy, including economic growth, external balance, competitiveness, interest rates, and income distribution (Armantier et al., 2021). Inflation is defined as a broad and ongoing tendency to raise the prices of goods and services (Erdoan et al., 2020). Inflation is caused by the demand for and supply of goods and services; when the demand for goods and services increases faster than the supply of these goods and services, prices on the demand side rise. Meanwhile, an increase in the manufacturing cost element can cause price increases on the supply side.

Inflation management is critical because it is founded on the premise that inflation stability is a necessity for long-term economic growth, which will eventually benefit people's welfare. After all, a low and stable inflation rate will encourage economic growth and can also improve people's living standards. However, high and unstable inflation rates can bring down the economy, because the prices of goods or services are beyond the reach of the general public (Zahara & Sugianto, 2021).

Indonesia has experienced quite high inflation in 2018 with a rate of 8.36%. This was due to an increase in the price index for all expenditures including food ingredients by 3.22%, the processed food group, cigarettes and tobacco by 1.96%, housing, water, electricity, gas, and fuel by 1.45%, and transportation, communications, and financial services by 5.55% and other groups (Meyer et al., 2022). Therefore, a problem arises when the amount of money in circulation exceeds the needs of the community or the needs of the economy, the price of goods will move up and inflation will occur. So that inflation causes people's purchasing power to decrease, this is because when inflation the level of people's real income will decrease and result in price instability, so people will prefer to save money in banks and reduce personal consumption rather than invest because of uncertain conditions due to inflation rate fluctuations (Azzahra & Arianti, 2021).

In 2020 Indonesia experienced the Covid-19 pandemic, known as the coronavirus which is transmitted to humans. Because the government implemented a program of large-scale social restrictions (PSBB) that urged individuals to carry out all activities at home and keep their distance, the pandemic resulted in lower inflation in Indonesia. This resulted in a decrease in demand for goods and a decrease in people's purchasing power, followed by a decrease in supply of goods due to the neglect of community activities, resulting in people being unemployed, the national production level being low, and prices rising; additionally, the Covid-19 pandemic caused economic instability, resulting in price changes in trade (Toamain, 2020). Figure 1 depicts the movement of the inflation rate and the Covid-19 spread in Indonesia in 2019-2020.

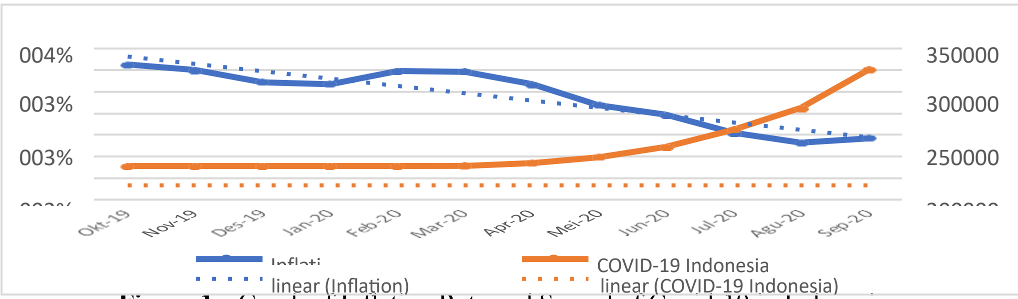

Figure 1. Graph of Inflation Rate and Spread of Covid-19 in Indonesia

Source: BPS Indonesia 2019-2020

According to Figure 1, since the commencement of the epidemic in Indonesia in early October 2019, inflation in Indonesia has declined from month to month, even falling to 1.32% in September 2020 and 1.54% in July 2020, the lowest inflation rate in the last 20 years. This demonstrates that the higher the number of confirmed cases of Covid-19, the lower the inflation rate in Indonesia. Consumer behavior such as hoarding things, improvisation, demanding shopping from home and working with digital technology, removing boundaries in the workplace, and reunions or meetings with friends or family without having to meet face to face are causing this problem (Susilawati et al., 2020). Furthermore, constraints on people's freedom of mobility have resulted in shifts in consumption habits (Jaworski, 2021). As a result of the increasing number of Covid-19 cases, the government is enacting laws to prevent the spread of Covid-19, which will also effect the inflation rate.

According to the quantity theory of money, inflation happens as a result of an increase in the money supply and public expectations about price increases, however Keynesian theory states that inflation develops as a result of an increase in expenditure above the value of output at a given price (Ojomolade & Oni, 2018). The structuralist theory also explains the main factors that can cause inflation, namely the inelasticity of export revenues and the inelasticity of domestic food production (Ramayah, 2020). According to Irving Fisher's thesis, inflation happens as a result of a rise in the amount of money circulating in society, which causes an increase in the price of goods and services (Lintangsari et al., 2018). The supply-side theory explains that inflation is caused by rising production costs caused by increases in input costs or production costs (Jelilov et al., 2020). Inflation is also caused by symptoms of a continuous rise in the general price level (Rando et al., 2021). Inflation is caused by continuously rising prices that affect individuals, businesses, and governments (Bresser-Pereira, 2020). Inflation happens when the value of money falls in relation to the value of goods and services in general (Hayat et al., 2021).

Inflation, according to Islamic economist Al-Maqrizi, is caused by a constant rise in prices. This assertion is supported by a variety of facts about the Egyptian famine, in which prolonged inflation resulted in a loss in purchasing power, resulting in a decline in the country's economy. Al-Maqrizi stated that inflation can also be caused by two factors, namely natural factors and human errors. Natural inflation is caused by natural disasters or crop failures, resulting in reduced supply and scarcity causing inflation. Meanwhile, inflation due to human error is caused by acts of corruption and bad administration (Suar Abi, 2020).

Adekantari and Amar B (2022); Chandra and Wahyuningsih (2021); Amaliyah and Aryanto (2022); and Ratnasari and Yeniwati (2019) discovered that the money supply has an effect on inflation. Herdiatama's (2022) research; Ningsih & Kristiyanti (2018); (Eka Riyanti & Syafri, 2022) also discovered that the money supply variable influences inflation. Budi Ramadhan (2021) discovers that the money supply has an effect on inflation in the long run but has no effect in the near term. Interest rates and exchange rates have been shown to have an effect on inflation in research (Darmawan, 2020); Martanto et al., (2021); (Al Makhrus & Priyadi, 2022); Wahyuningsih (2021); Rahmarisa & Husein Lubis (2021); Amaliyah & Aryanto (2022); Herdiatama (2022); Ratnasari & Yeniwati (2019); (Eka Riyanti & Syafri, 2022). Meanwhile, Budi Ramadhan's research (2021) discovered no short-term effect of the money supply (JUB), interest rates (R), and exports (EX) on inflation. Martanto et alstudy .'s indicated that the household consumption variable had no influence (2021).

Based on the foregoing issues, this study will examine the impact of the money supply, Bank Indonesia interest rates, currency rates, export values, and public consumption spending on the inflation rate during the Covid-19 pandemic, namely from January 2019 to December 2021.

METHOD

The following econometric model was utilized in this study's Ordinary Least Squares (OLS) Regression Analysis:

$$INF_t = \beta_0 + \beta_1 JUB_t + \beta_2 BIRATE_t + \beta_3 KURS_t + \beta_4 EKS_t + \beta_5 KONS_t + \varepsilon_t$$

Information:

INF	=	Inflation (%)
JUB	=	Amount of Money in Circulation (Million Rupiah)
BIRATE	=	Bank Indonesia Interest Rate (%)
KURS	=	Exchange Rate (IDR)
EKS	=	Export Value (Million Rupiah)
KONS	=	Public Consumption Expenditure (Million Rupiah)
β_0	=	Constant
β_1-β_5	=	Regression coefficient
ε_t	=	Element of Error (Error term)
t	=	Time (Data period January 2019 to December 2021)

The above econometric model is a version of Jacobus et al. (2015), Rumondor et al. (2021), and Chandra & Wahyuningsih (2021). Interest rates and exchange rates are regarded to have a favorable effect on inflation in Indonesia. For the time being, the money supply is assumed to have no effect on inflation in Indonesia.

Secondary data (time series) in the form of monthly data from January 2019 to December 2021, gathered from numerous sources, including the Central Statistics Agency (BPS) and Bank Indonesia, were used in this study (BI). Inflation (INF), total money supply (JUB), Bank Indonesia interest rates (BIRATE), exchange rates (KURS), exports (EKS), and public consumption expenditure are among the data sources used (KONS).

The econometric model parameter estimation stage is used; the classic assumption test, which includes the Multicollinearity Test, Residual Normality Test, Autocorrelation Test, Heteroscedasticity Test, and Model Specification Test; the Model Goodness Test, which includes the Model Existence Test and Coefficient of Determination Interpretation (R2); and the Influence Validity Test (test t).

RESULT AND DISCUSSION

The estimation results of the econometric model above and their complementary tests are summarized in Table 1.

Table 1. Econometric Model Estimation Results

$\widehat{INF}_t$= -0,4609 – 1,4735 $Log(JUB_t)$ + 0,6647 $BIRATE_t$ + 2,1080 $Log(KURS_t)$ + 0,9995 $Log(EKS_t)$
(0,6559) (0,0151)** (0,4725) (0,1964)
+ 0,0557 $Log(KONS_t)$
(0,5694)
R^2 = 0,2484; DW = 1,3914; *F* statistic = 1,9169; Prob. *F* = 0,00000
Diagnostic Test
(1) Multicollinearity (VIF)
Log(JUB) = 1,6846; *BIRATE* = 1,4624; *Log(KURS)* = 1,0915; *Log(EKS)* = 1,2952; *Log(KONS)* = 1,2781
(2) Residual Normality (Jarque-Bera)
JB(2) = 0,5017; Prob. JB(2) = 0,7781
(3) Autocorrelation (Breusch-Godfrey)
$\chi^2(2)$ = 4,8909; Prob. $\chi^2(2)$ = 0,1924
(4) Heteroscedasticity (White)
$\chi^2(20)$ = 14,1428; Prob. $\chi^2(20)$ = 0,8232
(5) Linearity (Ramsey RESET)
F(2, 27) = 0,0312; Prob. *F*(2, 27) = 0,9693

Source: BPS, processed. **Remarks:**
*Significant at α= 0,01; **Significant at α= 0,05; ***Significant at α= 0,10. The number in brackets is the empirical probability (p-value) of the t-statistic.

The diagnostic test demonstrates that the estimated model does not violate the classical assumption test at all. Because all VIF values are 10, the estimated model is devoid of multicollinearity issues. The empirical probability values of the Residual Normality, Autocorrelation, Heteroscedasticity, and Linearity tests are 0,7781 (> 0,10), 0,1924 (> 0,10), 0,8232 (> 0,10), and 0,9693 (> 0,10), indicating that the estimated model has a normal residual distribution, is free of autocorrelation and heteroscedasticity issues, and has precise (linear) model specifications.

The goodness of fit statistic shows that the model exists, as can be seen from the empirical probability F statistic, which is 0,0000 (< 0,01), with R^2 or medium predictive power, which is equal to 0,2484. That is, the independent variables, Money Supply (JUB), Interest Rates for Bank Indonesia Certificates (BIRATE), Exchange Rates (KURS), Exports (EKS), and Household Consumption (KONS), in aggregate, may explain 24,84 percent of the fluctuation or increase reduction in inflation (INF).

Separately, only the Bank Indonesia Certificate Interest Rate variable influences inflation, with an empirical probability t of 0,0151 (< 0,05). The variables of money supply, exchange rate, exports, and household consumption do not affect inflation, because they have an empirical probability of 0,6559 (> 0,10), 0,4725 (> 0,10), 0,1964 (> 0,10) and 0,5694 (> 0,10).

The regression coefficient of Bank Indonesia Certificate Interest Rate Variable is 0,6647. The link between the Bank Indonesia Certificate Interest Rate and the Inflation Rate is linear-logarithmic (lin-log), which means that a 1% increase in the Bank Indonesia Certificate Interest Rate reduces the inflation rate by 0,0151%. Conversely, if the interest rate on Bank Indonesia Certificates falls by 1%, the inflation rate rises by 0,015%.

DISCUSSION

The Influence of the Money Supply on the Inflation Rate in Indonesia During the Covid-19 Pandemic

Because of the low money supply during the Covid-19 epidemic, there is no link between the money supply and the inflation rate, hence it does not produce inflation. This is different from the situation where the money supply should always affect inflation. So the higher the amount of money circulating in society, the higher the inflation rate will occur. This study contradicts quantity theory, which asserts that changes in the money supply have a direct relationship with changes in the price level of products. Inflation happens when the volume of money increases; if the money supply does not expand, inflation will halt on its own. Meanwhile, Keynesian theory indicates that increasing the money supply will increase inflation, but there are times when increasing the money supply will not increase inflation. If the money supply rises to equal the real output, the price of products will remain constant, preventing inflation. This study's findings are consistent with Budi Eno's (2022) research, which found that the amount of money in circulation has no effect on inflation in Indonesia. This happens because data on the money supply increases every year and the inflation rate continues to fluctuate every year.

The Effect of the Bank Indonesia Interest Rate (BI Rate) on the Inflation Rate in Indonesia During the Covid-19 Pandemic

Inflation is affected by the Bank Indonesia Certificate Interest Rate; when the Bank Indonesia Certificate Interest Rate rises, so does the inflation rate. Banks will frequently raise deposit interest rates in order to increase Third Party Funds (DPK). The increase in deposit rates will absorb more money in circulation. In economic theory, the money supply will affect inflation. Inflation rises when more money circulates. In contrast, when the money supply shrinks, so will inflation. In this study, the interest rate is determined by the Central Bank, specifically the BI Rate. When the BI Rate has decreased, the public's interest in making loans at banks is high. When people's purchasing power increases, the demand for goods increases, and results in inflation. The development of the Covid-19 pandemic has no affect or relationship to interest rates in Indonesia since, prior to the occurrence of the Covid-19 pandemic, loan interest rates at Bank Indonesia began to fall by 5.75% on 18 July 2019, down from 6.0% on 20 June 2019. (Christie & Mareni, 2021). During the Covid-19 pandemic, Bank Indonesia also implemented a financial policy of lowering regular BI interest rates (BI 7-day reverse report), with the goal of keeping inflation low and preventing inflation.

The findings of this study are consistent with the findings of Martanto et al., (2021), who discovered that interest rates influence inflation in Indonesia. However, this research contradicts Jacobus' research (2021), which found that the SBI Interest Rate had a negative and minor effect on inflation. In theory, if the SBI interest rate rises, it will encourage the desire of economic actors and the public to use their money for speculative purposes, namely buying securities from using the money for consumption, so it will not cause inflation. However, the increase in SBI interest rates did not have much effect. Ratri's research (2022) shows that the BI Rate has a negative and minor influence on inflation in the near term, but a positive and significant effect on inflation in the long term. These findings suggest that the BI Rate's negative influence on inflation supports both the interest rate hypothesis and the Fisher Effect theory. Meanwhile, the BI Rate's small influence implies that it is not following the theory that the BI Rate has a substantial effect on inflation. Through monetary policy, the BI Rate or reference interest rate indirectly influences inflation. In general, an increase in the BI Rate will raise deposit and lending rates at the same time. Even though the inflation rate remained low throughout the Covid-19 pandemic, the government is still attempting to recover the national economy through fiscal and monetary policy stimulation.

The Influence of the Exchange Rate on the Inflation Rate in Indonesia During the Covid-19 Pandemic

The exchange rate has no effect on inflation, indicating that if the exchange rate rises, there will be no increase in inflation. In theory, the instability of the rupiah exchange rate during the pandemic did not produce an increase in currency prices because it continued to fluctuate owing to restrictions on all import activities, therefore this did not generate an increase in the costs of products and services (inflation). This contradicts studies by Rahmarisa and Husein Lubis, (2021), which claims that the exchange rate influences inflation. There is a negative link between the rupiah exchange rate and inflation. Inflation will grow if the rupiah falls in value relative to the US dollar. Inflation will fall if the rupiah increases against the US dollar. The rupiah exchange rate fluctuated and tended to decline against the dollar during the Covid-19 pandemic, therefore it had no effect on inflation. Supposedly when the exchange rate decreases it will have an impact on increasing inflation. However, if the exchange rate increases, it means that there is a decline in the value of the rupiah. This decline will cause the price of Indonesian export goods to fall thereby increasing competitiveness which will trigger an increase in exports. Furthermore, increased exports will increase the money supply in society because the earnings from export revenues will be spent domestically in the form of rupiah, eventually causing price increases (inflation) (Ilzetzki et al., 2020). The findings of this study are consistent with the findings of Faizin (2020), who found that in the near run, the exchange rate has no effect on inflation, but inflation affects the exchange rate. Both the exchange rate and inflation are causative in the long run. There are variances in currency rates and inflation in the short-term causation relationship. The results suggest that the exchange rate has little effect on inflation in the short run.

The Effect of Exports on the Inflation Rate in Indonesia During the Covid-19 Pandemic

Exports do not affect inflation, showing that if exports increase, they will not affect inflation. Theoretically, this mechanism occurs because exports have a trend line that is very difficult to predict, so it is difficult to influence inflation in Indonesia. Furthermore, the impact of Covid-19 on export activities in Indonesia caused a fall, with the greatest drop occurring between February and May 2020, as numerous countries confirmed that their nationals were afflicted with Covid-19, limiting export activity. Export activities must also be managed by health procedures to prevent the spread of Covid-19, which might cause ship delays or boat delays. As a result, export activities have little effect on overall products pricing. This study's findings are consistent with Ratri's (2022) research, which found that exports have no substantial effect on inflation. Abdullah et al. (2018) examined the influence of exports and foreign investment on Indonesian inflation rates using exchange rates from 1997 to 2016. The results reveal that exports have a negligible direct effect on inflation. Where exports to inflation there are indications of demand-pull inflation. Demand-pull inflation is a condition where high inflation encourages an increase in income (output) so that demand becomes high in full-employment conditions. However, in this study, the theory of demand-pull inflation is in the opposite condition. Inflation that occurred actually experienced a significant decline and then stabilized. This decline in inflation was accompanied by the phenomenon of massive layoffs (PHK), resulting in a decline in income and a greater unemployment rate than in previous years due to Covid-19.

The Effect of Household Consumption on the Inflation Rate in Indonesia During the Covid-19 Pandemic

Household consumption does not affect inflation, showing that if household consumption increases, it does not affect inflation. In theory, this mechanism arises because the Covid-19 epidemic has a negative impact on household consumption. With this regulation, workers and factory workers are forced to stay at home, their wages are reduced, and several companies are laying off workers, so this has an impact on reducing consumption which does not result in inflation. Because inflation occurs when people's income is used to buy goods in the desired quantity thereby increasing prices in general. This study does not follow the idea of Aggregate Demand Expansion-Pull Inflation, which argues that an increase in prices (inflation) will boost Aggregate Demand. According to this theory, an increase in consumption will lead to an increase in inflation. The findings of this study are consistent with the findings of Emmanuel Olusola's (2022) research, which shows that there is no long-term relationship between inflation and household consumption expenditure, implying that household consumption expenditure does not decrease during periods of high inflation more than during periods of low inflation. According to the findings, inflation expectations hurt household consumption spending attitudes, especially among consumers in highly favorable financial situations.

IMPLICATIONS

The findings of this study indicate that the relationship follows the Keynesian theory, which states that there are circumstances in which an increase in the money supply will not increase inflation because an increase in the money supply equals real output, so the price of goods will remain constant. This is inversely proportionate to the quantity theory, which holds that increasing the money supply raises the price level, causing inflation and ultimately affecting monetary stability. According to interest rate theory and the Fisher Effect theory, rising prices and interest rates cause consumers, who are savers rather than borrowers, to reduce their consumption in the first period in order to increase their consumption in the second period. It indicates that an increase in the real interest rate causes people to reduce their consumption in order to reap the benefits of an increase in interest rates, reducing their current consumption in order to boost their consumption in the future. So a high interest rate reduces spending, which has an impact on a country's sluggish economy, where production also decreases, resulting in a fall in national income since banks collect more funds from the public, reducing the money supply and, ultimately, not producing inflation. On the contrary, if the interest rate is low, people prefer to hold their own money for transactions and increase consumption so that the money supply increases and triggers inflation. The theory of the expansion of Aggregate Demand states that increased consumption has an impact on rising inflation. When consumption increases, the volume of imports will also increase resulting in changes in exchange rates. In this study, during the pandemic, the rupiah currency exchange rate fluctuated and tended to weaken against the US Dollar. This had an impact on the prices of Indonesian export goods which decreased, thus increasing the competitiveness of exporters and not causing price increases. Because the greater the export will increase the money supply which in turn triggers an increase in prices.

CONCLUSION

This analysis found that the Amount of Money in Circulation variable had a negative and insignificant effect on inflation. That is, as the money supply expands, inflation falls, and vice versa. The variable interest rate of Bank Indonesia Certificates has a positive and considerable effect on inflation. This is due to the fact that when interest rates fall, more individuals will hoard money, causing inflation. An increase in interest rates, on the other hand, will attract the public's money supply, allowing it to curb inflation. This conclusion contradicts the idea that holds that interest rates and inflation have a negative connection. Exchange rate variables have a beneficial impact on inflation. In other words, as the currency rate rises, so will inflation. However, this effect was not statistically significant. These findings show that if the price of the domestic currency rises, it will not cause an increase in the price of goods and services due to the policy of activities during the pandemic, despite the fact that Indonesia is a country that always imports goods and services from abroad, and that when the price of the Indonesian currency falls or depreciates, it will cause an increase in inflation. The export variable has a positive but small effect on inflation. This means that if exports rise, prices will not rise, and the household consumption variable has a positive but small effect on inflation. That is, when consumption rises, inflation also increases. The existence of a non-significant effect between consumption and inflation indicates that inflation is not affected by consumption. An increase in consumption will not lead to an increase in aggregate demand. Next, the researcher submits a suggestion that the government should do instability Inflation so that the economy remains stable and makes people more prosperous. For future researchers, it is hoped that they can conduct further research to be able to develop other factors that cause inflation during a pandemic.

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