

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF STUDY

Inflation persistence is one of the focus parameters for adjusting monetary policy. It can be described as the tendency of the degree of inflation rate in long term average following monetary shock experienced in the economy.¹ “Inflation is always everywhere a monetary phenomenon” statement below is the basic theory of inflation phenomenon, according to friedman (1976). This theory related to the amount of money in circulating which are the caused of level price changes and inflation². In the case of inflation, the rate of change of the price level tends to be persistent. The fluctuations in energy price have significant impact on economic activity. The characteristics of the energy prices which have an important place in the dynamics of inflation.³

Inflation today is a long run persistent problem whose cure requires a combination of reordered priorities on demand side and the supply side, national or international cooperation to increase the quantity of goods and services on a global scale.⁴ Inflation persistence incates a strong and positive correlation between current inflation and that from preceding periods. This phenomenon poses a problem for monetary authorities concerning inflation persistence. Economic development indicates that a stable inflation if the inflation targets of central banks do not modify and where the consumer perception of this inflation targets in the degree of inflation persistence is

¹ Jeffrey C. Fuhrer, Inflation Persistence, *Working Papers Federal Reserve Bank Boston*, 30 November 2009, p. 2

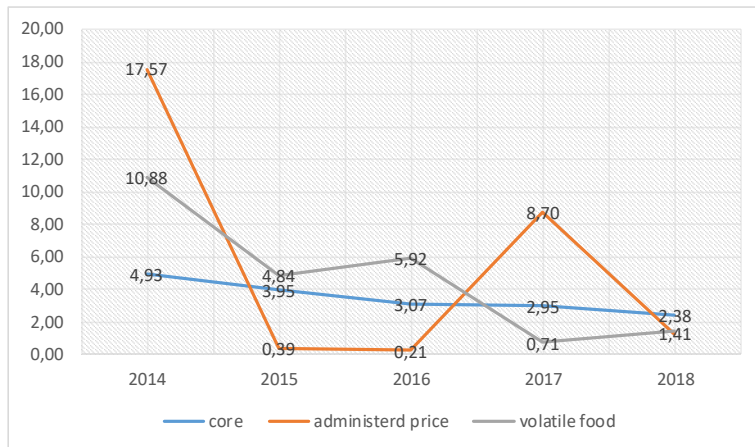
² Suseno Dkk, *Inflasi*, Seri Kebanksentralan, Jakarta:Bank Indonesia, Maret 2009, p. 8

³ Selim Yildirim et. al. “Is There A Persistent Inflation In OECD Energy Price? Evidence From Panel Unit Root Test”, *International Conference On Applied Economics* (ICOAE), Procesa Economics And Finance (ELSEVIER), 2013, p. 810

⁴ Friedman, Irving S, “Persistent Inflation A New Way Of Life”, *Record Of Society Of Actuaries*, Vol. 1, No. 1, March 1975. p. 2

relatively low.⁵

Inflation persistence can be analyzed with both micro and macro data. Analysis data micro is based on the statistical of product level consumer price index while macro data analysis is based on time series univariate and structural modelling.⁶ Figure Below shows the movement of the General Index, Core, Administered Price, and Volatile food Inflation in Indonesia 2014 - 2018.



Source: Central Statistic Agency of Indonesia

Figure 1.1 General Index And Components

Based on observations in the figure 1.1 the group of administered price is driven by the number of energy subsidies. Along with the decline in government revenues that lead to fiscal becomes limited. Then made the government to raise the price of some commodities in the energy group that has an impact on the rise inflation. In the group of volatile food inflation slowed down due to the inflation of beef, chicken, and onion lower compared

⁵ Piotr Misztal, "The Investigation Of Inflation Persistence In Croatia In The Period Of 2005-2013", *Economic Research Ekonomska Istrazivanja*, Vol. 30, No. 1, 2017, p. 274

⁶ Aleksandra Nojkovic, "Inflation Persistence In Central And Southeastern Europe: Evidence From Univariate And Structural Time Series Approaches", *Journal PANOECOMICUS*, 2012, p. 237

to last year. The tendency for high persistent inflation.⁷

Controlling inflation in Indonesia is regulated by Bank Indonesia policy in Inflation Targeting Framework (ITF)⁸ which set an inflation target as the end of the monetary policy is calculated through the Consumer Price Index (CPI)⁹. CPI reflects the movement of inflation persistence that occurs by volatile food¹⁰ and administered price¹¹. In theory on famine food prices will increase and will be revised again after the harvest to come. But the fact that domestic food prices tend to be persistent continues and continues as the harvest.¹² For knowing the good policy of persistence inflation in Indonesia by identifying determinant of inflation.

Determinant of Inflation forming by two factors from demand side (Demand Pull Inflation) and the supply side (Cost Push Inflation). On explanation above the inflation persistence comes from supply side which raised production cost will increase the price of commodity caused by

⁷ Laporan Perekonomian Indonesia 2014, *Memperkokoh Stabilitas, Mempercepat Reformasi Struktural Untuk Memperkuat Fundamental Ekonomi*, Jakarta: Bank Indonesia, ISSN 0522-2572, p. 89

⁸ ITF (2005), that determination of inflation as the ultimate target of monetary policy, Bank Indonesia within its framework will announce inflation targets for each year. Law no. 23 in 1999 were still categorized under Inflation Targeting Lite. In Law 3 of 2004, (Rahman Hakim, 2013).

⁹ Consumer Price Index (CPI) is one of the economic indicators that provide information on prices of goods and services paid by consumers. Taken from (Metadata) Department of Statistics, March 2016.

¹⁰ Quoted (From Bank Indonesia Economic Report), Volatile food inflation is predominantly influenced by inflation shocks (shock) in the form of foodstuffs such as Harvest Fails Due to Natural Disasters, Drought And Flooded. And Can Be Seen Through Government Policy, Nuisance Distribution, Natural Disasters and Weather or factors of development of domestic food commodity prices and developments in international food commodity prices.

¹¹ Administered Price is predominantly influenced by shocks (shock) in the form of government pricing policies, such as subsidized fuel prices, electricity tariffs, fares and so on.

¹² Masagus M. Ridwan Dkk, "Analisis Persistensi Inflasi Komoditas Pangan Strategis Di Daerah", *Working Paper Bank Indonesia*, WP/7/2016, p. 2

government regulation, negative supply goods by natural disaster that led higher output price.¹³ On demand side inflation influenced by fundamental factor due to the interaction of supply and demand, expectation inflation and external factor.¹⁴

One of the monetary instrument of Bank Indonesia for control inflation in demand side its used SBI by interest rate policy to control inflation maintaining stable price level and controlling money in circulating.¹⁵ Critics of islamic economics thought according to Al-Ghazali about the prohibition of usury and hoarding money. He said the money only as a means of exchange and not as a commodity, which in turn will increase the money in circulation.¹⁶ In addition another thought by Al-Maqrizi state that inflation is a natural phenomenon occurring formerly until now. Inflation caused by monetary manipulation was not just a monetary phenomenon. A sick currency was the product of a morally sick society.¹⁷

The determinant of inflation persistence has relationship from historical of money and human. Some islamic scholar Al Ghazali, Ibn Khaldun, Ibn Taimiyah and Al maqrizi has similarity thought of human error inflation of corrupt, bad administration of government, high tax, and increasing circulating of the currency.¹⁸ According to Ibn Taimiyah excessive money printing will lower the value of money and led to inflation. The good

¹³ Boediono, *Ekonomi Moneter*, (Yogyakarta:BEFE), Oktober 1985, p. 164

¹⁴ *Buku Petunjuk TPID*, Kementrian Koordinator Bidang Perekonomian, Bank Indonesia: Jakarta Maret 2004, P. 5

¹⁵ Feri Wibowo Dkk, "Analisis Pengaruh Tingkat Inflasi, Suku Bunga SBI, Nilai Tukar Us Dollar Pada Rupiah, Jumlah Uang Beredar, Indeks Dow Jones, Indeks Nikkei 225, Dan Indeks Hangseng Terhadap Pergerakan Indeks Harga Saham Gabungan (IHSG) Periode Tahun 2010-2014", *Journal Of Accounting*, Vol. 2, No. 2, Maret 2016, p. 4

¹⁶ Sutopo, Pemikiran Imam Ghazali Tentang Ekonomi, *Jurnal Ummul Qura*, Vol. 3, No. 2, Agustus 2013, p. 70

¹⁷ Louis Baeck, The Economic Thouht Of Classical Islam, *Research Paper In Economic Development*, Louvain University Of Louvain, 1961, p. 111

¹⁸ Ambok Pangiuk, "Inflasi Pada Fenomena Sosial Ekonomi", *Jurnal Kontekstualita*, Vol. 28, No. 1, 2013, p. 166

quality of money will be looser with a bad quality money.¹⁹ The influence of the flood of copper money its effect on the distribution of income wealth between social classes.²⁰

There were no fundamental differences between the conventional and islamic system in the way of direction monetary policy affects economics variables that are external and internal equilibrium to defend money stability, economic growth, and economic welfare.²¹ Chapra's thought as a solution in suppressing inflation. Chapra's strategy intended to suppress inflation was the first, moral improvement (pursued not only in material but spiritual dimensions). The supply of money so as to increase the rate of inflation.²² The wealth country it's not coming from the amount of money but determined by level of country's production a positive balance of payments. Export described that countries have greater in domestic production.²³

Research into monetary policy preference has largely based islamic scholar. Indonesia used fiat money and interest rate to be inflation control policy. This has a correlation between determinant of high persistence inflation in Indonesia with islamic thought. In this research, the persistence of national inflation will be measured by disaggregation of inflation (Core Inflation, Administered Price, and Volatile Food). Determinant inflation will be measured to prove inflation persistence. This research takes years 2014-2018 to analyze the phenomenon of inflation persistence to support the formulation of effective monetary policy based on islamic scholar that ultimately the formulation of strategies aimed at controlling inflation.

¹⁹ *Ibid*, Louis Baeck, "The Economic Thought Of Classical Islam...", p. 102

²⁰ Hiroshi, Kato, "Reconsiderng Al-Maqrizi's View On Money In Medieval Egypt", *Journal Article*, Hitotsubashi University Repository, 2012, p. 36

²¹ Abdel Hameed, The Walefare Effects Of Inflation And Financial Innovating In A Model Of Economic Growth, *Journal Of Economic Studies*, Vol. 29, No. 1, 2002, p. 22

²² Dahlia Arikha, Monetary Policy In Perspective Of Umer Chapra, *MPRA Paper*, 2018, p. 4

²³ Spengler, J. Economic Thought Of Islam: Ibn Khaldun, *Comparative Studies In Society And History*, 1963, p. 269

1.2 PROBLEM FORMULATION

From the introduction above the factors that cause it can be formulated in a formulation of the problem, namely:

1. How does inflation persistence and determinant that could affect in inflation rate 2014-2018?
2. How does the implication of inflation persistence estimates for controlling policy based on islamic scholar?

1.3 PURPOSE OF STUDY

From the formulation of the above problems can be seen several research objectives are:

1. Analyzing the inflation persistence and determinant that could affect in inflation rate 2014-2018.
2. Identifying the implication of inflation persistence estimates for controlling policy based on islamic scholar.

1.4 LIMITATION OF STUDY

1. Analyzing the many factors that cause the persistence of inflation seen through the CPI contributor component that is volatile and administered prices. Were analyzed in 7 expenditure groups based on (the Classification of individual consumption by purpose) COICOP namely namely foodstuffs (BAMA), processed foods, beverages, and tobacco (MAJADI), housing (Perum), clothing (SAND), health (KES), education and sport (PENDIDI), and transportation and communication (TRANS). In addition analyzing determinant of inflation to affirm persistence inflation with the variable M2 and SBI.

2. Knowing the inflation control policy in the present which is in line with the concept of Islamic economics according to the thought of islamic scholar Perspective.

1.5 BENEFITS OF RESEARCH

The benefits of this research are as follows:

1. To academic benefit

Expected as the output from the research and useful for intellectual treasures of Islamic studies science research about inflation.

2. The practical benefits

expected as additional scientific insights and knowledge for the author and additional information as well as additional literature for the public and students who want to do further research. As the input material and the material comparative study in decision making by the authorities. And can be used as a reference in similar research. To be a signal for economic authorities development The government should observe and make the formulation for the government policy. Beware to take or do the policy or new regulation, he must be adapt to every region in indonesia. Becase all region has a different condition of geography, economy, culture, and others.