

CHAPTER I

INTRODUCTION

A. Background of Study

Monetary policy is the act of a monetary authority or central bank in the form of controlling monetary quantities to achieve the development of desired economic activities. In this practice, the development of the desired economic activity is macroeconomic stability, which is reflected in price stability (low inflation rate), improvement in the development of real output (economic growth), and sufficiently wide employment available.¹

The transmission mechanism of monetary policy is the process or channel that is passed by monetary policy determined by the central bank in influencing economic activity, both in the real sector and in the financial sector, to achieve the ultimate goal, such as economic growth or inflation.² Bank Indonesia (BI) uses six transmission channels of monetary policy, which is money, credit, interest rates, exchange rates, asset prices and expectations. BI uses the six channels to meet monetary policy targets, which is price stability, economic growth, employment opportunities and balance of payments. To meet the policy target, BI issued monetary policy instruments, which is open market operations (open market operations), discount facilities (discount rate), mandatory reserve ratio and moral persuasion.³

Historically the Indonesian economy has experienced a very high inflation condition, which is in the revolutionary period of 1965. In the next

¹ Warjiyo dan Solikin, "*Kebijakan Moneter di Indonesia*", (Pusat Pendidikan dan Studi Kebanksentralan (PPSK) Bank Indonesia, Jakarta, December 2003), p. 3

² Malia Hamzah dan Handri, "Analisis Interest Rate Pass Through Pada Mekanisme Transmisi Kebijakan Moneter Indonesia", *Ekonomis: Jurnal of Economics and Busines*, Vol. 1, No. 1 September 2017, p. 125

³ Warjiyo, "*Mekanisme Transmisi Kebijakan Moneter di Indonesia*", (Pusat Pendidikan dan Studi Kebanksentralan (ppsk) bank Indonesia, jakarta, mei 2004), p 14

journey, inflation can be controlled under two digits. However, with the onset of the economic crisis in 1997-1998, Indonesian inflation rebounded to a level of 78%. At present, the inflation rate is quite restrained below double digits, and even below 5% in 2015 and 2016. The inflation target in 2017 is 3-5%, and the target is tightened in 2018, ie 2,5 - 4,5%.⁴

As the executor of monetary policy, Bank Indonesia has a goal to maintain the value stability of the rupiah. To achieve this goal, BI implements a monetary policy framework with inflation as the main target of monetary policy (the framework of inflation targeting) by adopting a free floating exchange rate system.⁵ Operationally, the attitude of monetary policy is reflected in the determination of the policy rate (BI rate) which is expected to affect money market interest rates, deposit rates, and bank loan interest rates.

In 2016, Bank Indonesia strengthened its monetary operating framework by implementing a new policy rate or interest rate, the 7-Day (Reverse) Repo Rate, which became effective on 19 August 2016, replacing the BI Rate. Strengthening this monetary operating framework is a common practice in various central banks and it is an international best practice in implementing monetary operations. The monetary operations framework is constantly refined to strengthen the effectiveness of policies in achieving the inflation target.⁶ Therefore, the 7-day (Reverse) BI Repo Rate Instrument is used as the new policy interest rate because it can quickly affect the money market, banking and the real sector. The BI 7-Day Repo Rate instrument as a new reference has stronger relationship with the money market interest rates, is transactional or traded on the market, and encourages financial market deepening, especially the use of repo instruments.

⁴ Susilowati dan wahyuningdyah, "Efektivitas BI7DRR dalam kerangka Mekanisme Transmisi Kebijakan Moneter untuk pengendalian inflasi", *jurnal PRAXIS*, vol 1, no, 1, September 2018, p. 79

⁵ Zein, "Apa dan Bagaimana: Mekanisme Transmisi Kebijakan Moneter Syariah Di Indonesia?", *Jurnal At-Tijarah* Vol 1, No. 2, Januar-Juni 2015, p. 117

⁶ <https://www.bi.go.id/id/moneter/bi-7day-RR/penjelasan/Contents/Default.aspx>, (diakses pada tanggal 15 oktober 2018 pada pukul: 10.48)

Throughout 2016, Bank Indonesia (BI) has reduced interest rates with the BI Rate or BI 7 days Repo Rate by six times. The role of this benchmark interest rate is to encourage economic growth through lending and deposit rates. However, the monetary policy that has been carried out by BI as long as this has not been effective. The Indonesian Economic Reform Center considers that BI's current challenges are still weak monetary transfer policies in controlling bank interest rates.⁷

The main problem that needs to be addressed in depth regarding with to monetary policy is whether the monetary policy process, particularly the transmission mechanism, has the positive relationship with the real sector economy, as far Islamic economics principles, the monetary sector must be related to the real sector. Because if the monetary sector does not have a direct impact on the economy of the real sector, it is certain that the economy develops in the ribawi circle.⁸

Based on Law Number 23 of 1999 concerning Bank Indonesia, BI is given new responsibilities as the dual monetary authority. Therefore, the transmission of monetary policy is also growing. This is as a result of changes in the variables that affect the transmission of conventional monetary policy (Bank Indonesia Certificate (SBI), conventional Interbank Money Market (PUAB), Credit, etc.) into variables that affect the transmission of Islamic monetary policy (Certificate Bank Indonesia Syariah (SBIS), Sharia Interbank Money Market (PUAS), Financing, Profit Sharing, etc.).⁹

Among the researchers, there were differences in results For example Ghofur wibowo and Ascarya, which in their research according to Ghofur is the SBIS Response as a sharia monetary instrument in Indonesia

⁷ <https://money.kompas.com/read/2016/12/20/171354326/kebijakan.moneter.bi.sudah.baik.tetapi.belum.efektif> (diakses pada tanggal 16 May 2019 pada pukul: 12.42)

⁸ Sugianto, Hendra Harmain, et.al, "Mekanisme Transmisi Kebijakan Moneter Di Indonesia Melalui Sistem Moneter Syariah", *Jurnal Human Falah*, Vol. 2, No. 1, Januari – Juni 2015, p. 50

⁹ Zein, "Apa dan Bagaimana: Mekanisme Transmisi Kebijakan Moneter Syariah Di Indonesia?", *Jurnal At-Tijarah*, Vol 1, No. 2, Januar-Juni 2015), p. 117-118

is not effective in promoting economic growth. And SBI as a conventional monetary instrument in Indonesia is not effective in encouraging economic growth.¹⁰

Different the case with the research conducted by Ascarya, the final result stated that the conventional variables which are primarily financial sector variables, naturally contribute to triggering inflation and inhibiting economic growth. On the other hand, sharia variables, especially real sector variables, naturally contribute to holding back inflation and encouraging economic growth.¹¹

Economic growth is one measure of the success of economic development. According to Sukirno in Abdullah, economic growth is a process of increasing the output annually that is continuous in the long run. Economic growth is one indicator of the success of development, thus the higher the economic growth, the higher the welfare of the people, even though there are other indicators.¹²

Looking at the differences in research above, researchers want to find out how the channel and effectiveness of transmission in Dual monetary policies system in Indonesia. Islamic variables have a positive or negative impact on growth and inflation or vice versa. Researchers also want to find out whether conventional variables have a positive or negative effect on growth and inflation.

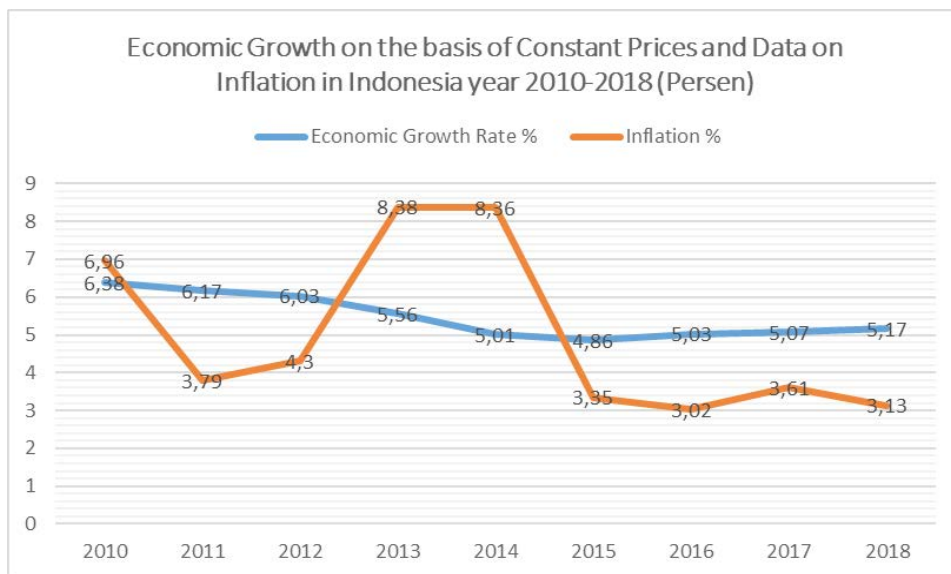
¹⁰ Wibowo dan Mubarak, "Analisis Efektifitas Transmisi Moneter Ganda Terhadap Pertumbuhan Ekonomi Indonesia", *Jurnal Ekonomi Dan Pembangunan*, Vol. 25, No. 2, 2017, p. 137

¹¹ Ascarya. "Alur Transmisi Dan Efektifitas Kebijakan Moneter Ganda Di Indonesia", (Jakarta: Pusat Pendidikan Dan Studi Kebanksentralan (PPSK) BI, 2012), p. 311-312

¹² Syukry, Darwanis, dan Mawarni, "Pengaruh Pendapat Asli daerah dan dana alokasi umum terhadap belanja modal serta dampaknya terhadap pertumbuhan ekonomi daerah". Vol. 2, 2013, p. 83

The existence of a balance in an economy is one of the targets in the context of increasing a country's economy. This can be achieved through the involvement of economic variables that affect the balance, then during the period 2010-2018 the rate of economic growth in Indonesia has decreased.

Figure 1. Economic Growth on the basis of Constant Prices and Data on Inflation in Indonesia year 2010-2018 (%)



Source: Central Bureau of Statistics, taken from www.bps.go.id returned

The data from the Central Statistics Agency taken in 2018 above shows that in 2010 to 2015 the rate of economic growth declined, which is in 2010 amounting to 6,38%, in 2011 amounting to 6.17%, in 2012 amounting to 6.03%, year 2013 amounted to 5.56%, in 2014 amounted to 5.01%, in 2015 amounted to 4.86%. And in the following year the rate of economic growth began to rise, which is in 2016 amounting to 5.03%, in 2017 amounting to 5.07%, and in 2018 amounting to 5.17%. As for the inflation rate itself rose and fell, which is in 2010 amounting to 6.96%, in 2011 year 3.79%, in 2012 amounting to 4.3%, in 2013 amounting to 8.38%, in 2014 amounting to 8.36%, in 2015 amounting to 3.35%, 2016 amounting to 3.02%, 2017 amounting to 3.61%, and 2018 amounting to 3.13%.

Looking at the data above, the writer wants to know how government policies to prevent inflation from happening too high so that they remain stable and can support economic growth in Indonesia. By looking at the theory, data and previous research, the researcher takes the limits regarding the effect of the transmission of dual monetary policies systems through interest rates for conventional banking and Profit Loss Sharing for islamic banking on inflation and its effect on growth / IPI (Industrial Production Index). So on the basis of this explanation, this study takes the title “THE CHANNEL AND EFFECTIVENESS OF TRANSMISSION MONETARY SYSTEM UNDER DUAL BANKING SYSTEM IN INDONESIA PERIOD 2014-2018.”

B. Problem formulation

Based on the background above, the research questions in this study are as follows:

1. How was the channel and effectiveness of the transmission mechanism in conventional monetary policy on interest rate channel concerning inflation and economic growth in Indonesia?
2. How was the channel and effectiveness of the transmission mechanism in conventional monetary policy on profit loss sharing channel concerning inflation and economic growth in Indonesia?

C. Purpose of Study

Based on formulation of the above problems, the purpose of this research is:

1. To find out, how was the channel and effectiveness of the transmission mechanism in conventional monetary policy on interest rate channel concerning inflation and economic growth in Indonesia.
2. To find out. how was the channel and effectiveness of the transmission mechanism in conventional monetary policy on profit loss sharing channel concerning inflation and economic growth in Indonesia.

D. Scope of Study

The researcher takes the limits regarding the effect of the transmission of multiple monetary policies through the interest rate channel or Profit Loss Sharing on inflation and its effect on growth / IPI (Industrial Production Index). So on the basis of this explanation, this study takes the title “The Channel and Effectiveness of Transmission Dual Monetary Policies System in Indonesia in January 2014 - December 2018.”

E. Significance of Study

1. For Academic,

It is expected to contribute to the development of scientific insights and also provide benefits to readers and can be used as a reference for future research.

2. For Practical,

The results of this study are expected to be used as references in determining and implementing effective monetary policy and in accordance with the channel.