

Chapter I

INTRODUCTION

1.1. Background

Indonesia's economic performance in recent years is affected by changes in the pattern of global economic dynamics. The global cyclical pattern changes affect the performance of the domestic economy through trade channel, as well as through markets financial market channel. Besides global influences, domestic structural factors also become one of the roots that cause economy.

Structural problems that are more prominent in the center of the instability, together with global challenges are pressing domestic economic performance. In the midst of the domestic economic downturn, high inflation increases as the impact of subsidized fuel price increases and the increase on food prices.

As we know, every people fulfill their life in various way, such as working and owning businesses, to enjoy it people will need services and goods which is called consumption. Consumption can be defined as a total to achieve goods and services on economics and in a specific time (Hasoloan, 2010)

As a human being, people need goods and services to fulfill their life and achieve satisfaction while consuming whole things in their life. But what happen to their consumable things if there is a change in price due to the weakening of Rupiah on United States (U.S) Dollars which has impact on price to some goods and services. Both trade and nontrade goods prices can be sensitive to exchange rate movements.

According to Campa & Goldberg (2006), there are a number of forces that contribute to less than complete pass through of exchange rates into the final

consumption prices of imported goods. First, pass through prices at the border is incomplete and varies considerably across goods and across countries. Second, distribution services, like local storage, transportation, and retail costs, provide some insulation of consumption prices of traded goods, both by diluting the import content of the final consumption goods and because distributors may actively adjust profit margins to absorb currency fluctuations.”

Undeniably, recently Rupiah rises against United States (U.S) Dollar, but the value of the Rupiah tends to weaken against United States (U.S) Dollar. There are several factors that triggered rupiah exchange rate against the US United States (U.S) Dollar, and is often shrinking. One of which is due to the strengthening of the United States (U.S) Dollar until speculations companies take action to buy United States (U.S) Dollars before the end of 2014.

Some foreign investors are also recorded withdraw funds provided by more than 10 trillion rupiah from rupiah-denominated bonds this month since December 11. The phenomenon is interesting to be followed. Basically, every country must require a stable currency value against the currencies of other countries, including Indonesia. However, to achieve this, it is not easy, there are many factors, such as; economic policy conditions, the economic conditions of other countries into trading partners, as well as security and political conditions (Department of Strategic Studies Universitas Gajah Mada, 2015).

According to Nasrillah (2014), Indonesia's currency weakened to its lowest level in more than six years against the United States (U.S) Dollar. Underscoring the reality that consumers in Southeast Asia's largest economy are facing after a harrowing summer slide: Inflation is taking hold and prices are rising. The

rupiah currency has been in decline since last year, but an exodus of cash in the recent emerging-markets selloff led to a 6% slide in August. Meanwhile, prices were already beginning to increase after the government raised the cost of fuel this year, and a weaker rupiah has compounded the trend by making the country's many imports more expensive.

The government has tightened monetary policy, making concessions on growth in order to reduce inflation. To solve this, the foreign investment needed to counter the trillion- United Stated (U.S) Dollar economy's trade imbalance and stabilize the currency. In the past few years, Indonesia has brought in records the amount of foreign investment—much of it in the key mining sector.

After several years, inflation is suddenly at its highest level since the height of the global financial crisis in 2009. The rupiah has slid 13% against the United Stated (U.S) Dollar this year and crashed Tuesday through the 11,000 threshold to 11,050, making it one of the worst-performing currencies in the world (The Wall Street Journal, 2013).

The weakening of the rupiah against the United Stated (U.S) Dollar has a negative and positive impact. The negative impact of the rupiah weakening exchange rate is an increase in the price of imported goods. Most of Indonesia's foreign trade is executed by the hand of the U.S Dollar, thus the high U.S Dollar will keeps the price of imported goods which are more expensive, and the more incriminate state and private debt. Apart the negative impact that many perceived because the rupiah weakens, there is also a positive impact.

The positive impact is perceived in the sector tourism industry because most tourists prefer domestic tourism. Depreciation makes product prices

relatively cheaper for other countries. As an illustration, one U.S Dollar is equivalent to Rp 10, 000.00 and 10 precious marbles Rp 10, 000.00. Then, the rupiah depreciated by the U.S dollar thus 1 U.S Dollar equals Rp 11.000, 00. Thus, if the traders in the U.S imported marbles, by releasing one Dollar traders can gain more marbles.

Based on the illustration above, it can be concluded that the depreciation of the rupiah may give opportunities on Indonesian export product prices that will become more competitive in order to increase revenue from the export sector (Department of Strategic Studies Gajah Mada University, 2015).

Another fact at malls across Jakarta, a small café Americano at Starbucks goes for 22,000 rupiah (\$2), increased 9% since early August. The city's premier taxi group raised minimum fares this week by more than 16% to 7,000 rupiah following similar increases by budget taxi groups last month. Beside that, Trisanyoto (2009), marketing director of Toyota Astra Motor in Mosley, said that it would likely raise prices for cars next month, if the exchange rate increase to 11,000 rupiah (per U.S Dollar), because Toyota had it set at 9,700.

Indonesia's consumer-growth story, fed by a burgeoning middle class amid a population of 240 million people, has drawn global retailers like Ace Hardware, Uniqlo and, soon, IKEA. Until recently, consumption kept the country humming, cushioning it even when Chinese demand for exports waned. Now, growth is slipping below 6%. Another deterrent for investors is Indonesia's struggles to fight corruption. For ordinary Indonesians, the view is increasingly on how far their money will stretch. A mobile-phone seller at a mall in Jakarta, said customers were passing up his Apple iPhone 5 for less-expensive brands after he

raised prices by more than 10% in August to around \$725. (The Wall Street Journal, 2013).

Based on the explanation above, it can be concluded that despite price shocks occur, two different opinions appeared in the analysis of volatility exchange rate effect. In the domestic side, rising incomes and optimism tendency of consumers showed an improvement in purchasing power, but another opinions, exchange rate could decrease the tendency to consume.

The goods released to market tend to have always positive response that indicates the strength of the average purchasing power. In the other hand, it gives the continuing impact (second round effects) of the fundamental factors (core inflation). Besides being able to change the domestic consumptions, it is possible that exchange rate caused changes in consumption or another factor (i.e) possible interest rate, Income or measured as GDP.

Observing the phenomenon of the rupiah against the United States (U.S) Dollar over the past few years and the number of its impact, especially in the association with the Indonesian National Consumption ability, the writer did a research entitled "The Effect of United State America (U.S) Dollar to Indonesian Rupiah Exchange Rate Volatility toward National Consumption (Study case In Indonesia for the period 1986-2014) ".

1.2. Problem Identification

Problem identification is significant factor of a formulation which is relevant to research (FBS UNY, 2009). The purpose of this research is to identify

the effect of exchange rate volatility of Rupiah on United State (U.S) Dollars toward National Consumption for the period of 1986-2014.

1.3. Problem Formulation

The Problem Formulation in this research is used solve the question and case. Problem formulation is a step to clarify the issues by making a question.

The problem formulations in this research are as follow:

1. Does Exchange Rate Volatility affect domestic National consumption in Indonesia for the period of 1986-2014?
2. Does Exchange Rate of Rupiah on U.S Dollar affect Domestic National Consumption in Indonesia in for the period of 1986-2014?
3. Does Saving Interest Rate affect Domestic National Consumption in Indonesia?
4. Does Income affect Domestic National Consumption in Indonesia?
5. What is the most significant result of Domestic National Consumption in Indonesia?

1.4. Problem Limitation

Each research certainly has limitations as a concept of research. There is no exception in this research. These limits considering that access of researchers fairly limited to the regional coverage research and data obtained. This research has independent variables; exchange rate, volatility exchange rate, interest rate, and GDP or Income, and dependent variable; Consumption. The research narrowed to the consumption in the domestic sector.

A research focus describes a significant effect among independent variables and the dependent variable. In this study, the researchers did not add another variable (intervening variable). The presentation of the research results are in the form of numbers or percentages. Therefore, these results could only be used on certain segments. The results of this research also confined to data found.

1.5. Research Objective

This study aims to help the investor, Indonesian government and also costumers to understand the impact of decreasing rupiah against United Stated (U.S) Dollar toward purchasing power in domestic sector. The specific objective of this research study is to identify whether the decreasing of rupiah and the volatility against U.S Dollar have significant impact on National Domestic Consumption.

1.6. Research Contributions

a. Theoretically

The findings will enrich the existing literature in the International economic realm related to the state economy, especially the rupiah exchange rate against the United Stated (U.S) Dollar and consumption. This study has provided insight into specific enough about the ability to buy in the domestic sector. Lecturers, students, and researchers in particular will find it useful to analyze the research findings. As in general studies, the results of empirical research adds information to lecturers and students

b. Practically

It is expected that the research findings will be useful and guide business practitioners as investors in conducting business activities by monitoring the value of currency. Further findings of the study are expected to motivate business practitioners in raising rupiah value against the United States (U.S) Dollar with healthy economic activity.

For the government it is expected that the findings of research may outcome a strategy in fixing the state economy and also push citizen to consume domestic products to fix trade balance.

1.7. Definition of Terms

a. Exchange rate

Exchange rate is the value of Rupiah currency paired and the comparison of the U.S Dollar currency exchange rate, for example: the Dollar, caused by factors, such as; economic policy conditions, and economic conditions of other countries with the trading partners, as well as security and political conditions.

b. Consumption Expenditure

Consumption Expenditure is determined by the value of goods and services used in the daily activity includes private and government. In other word, it describes the value spent to consume in this research the value stated in billion Rupiah.

1.8. Systematics of Writing

Chapter 1: INTROCDUCTION

This chapter explains about Background of Study, Problem Identification, Problem Formulation, Problem Limitation, Research Objectives, Research Contributions, Definition of Terms and Systematics of writing.

Chapter 2: REVIEW OF RELATED LITERATURE

This chapter explains about Theoretical Review, Theoretical Framework and Hypothesis Formulation.

Chapter 3: RESEARCH METHOD

This chapter explains about the Type of Study, Population and Sample, Data Collection Method, Research Variables and Analysis Technique.

Chapter 4: DATA ANALYSIS AND DISCUSSION

This chapter explains about the Statistic Descriptive, Reliability and Validity Test, Hypothesis Testing and Discussion.

Chapter 5: CONCLUSION AND RECOMMENDATION

This chapter explains about the Conclusion, Research Limitation and Recommendations.