Abstract

This thesis examines the relationship between the real exchange rate, level of net capital inflow, money supply, and interest rate differentiation for the Indonesia economy for the period 2000Q1 to 2009Q3. We use Vector Autoregression (VAR) approach to estimations impact capital flow to the exchange rate with exchange rate channel approach. Our empirical findings are that effects of net capital inflow shocks have a delayed and gradual effect on exchange rates. The generalized variance decompositions show that the real exchange rate in Indonesia, in descending order of importance include net capital inflows, interest rate differentiation and the money supply.

Keywords: capital flows, real exchange rate, Vector Autoregression, and exchange rate channel approach