ABSTRACT

Factors Affecting The Indonesian Rupiah Exchange Rate Behavior with Respect to the American Dollars in Indonesia in The Periods of 1986 – 1997: Synthesis of Monetary and Portfolio Approaches

Based on synthesis of monetary approach and portfolio approach, this study has two main objectives: first, to prove the exchange rate of Rupiahs with respect to American dollars has undergone *overvalued* during managed floating period; second, to prove and to analyze the determinants of exchange rates. Variables used in the study comprise national income, money supply, interest rate, inflation rate, and country risk. The first four variables were calculated in relative term with respect to the same variables for the United States.

Empirical model developed in this study is dynamic model of Error Correction (Error Correction Model, ECM hereafter). This model is selected because this model compared with other dynamic models produces 2 benefits at the same times: first, to prevent the analysis from the possibility of spurious regression; second, by utilizing the model, the study will obtain short and long terms coefficients for exchange rate determinant variables. In addition, the scope of analysis covers exchange rate behavior at managed floating regime of 1986-1997 periods.

The findings of the study suggest that (1) Exchange rate of Rupiahs with respect to American Dollars has been highly overvalued during the periods of study. Accordingly, in those periods the Indonesian Rupiahs with respect to the American Dollars have been deviated from their parity exchange rate. The deviation occurred because the covered interest rate parity and Fisher effect did not work perfectly. (2) In the short-term, all variables have significantly influenced the Indonesian exchange rate of Rupiahs. Meanwhile, the elasticity calculations of the variables are as follows. Relative national income was minus 0.1507, relative aggregate money supply was 0.0885, difference of interest rate was 0.0006, and difference of inflation rate was 0.0017. The increase in the Indonesian national income relative to that of US will cause appreciation of the value of Rupiahs, whereas the increase in the Indonesian aggregate money supply relative to that of US will lead to the depreciation of Rupiahs. Meanwhile, the increase in both the differences of the interest rates and the price rates will depreciate the Indonesian Rupiahs. The same result will be obtained as well if there is an increase in country risk. (3) In the long run, fundamental economic variables significantly affecting the Indonesian exchange rates were relative aggregate money supply, the differences both of interest rates, price rates, and the country risk. The elasticities for the first three variables are 0.8679, 0,0104 and 0.0035 respectively. The study suggests that a country risk is a significant non economic factor, both in the short run and in the long run. These variables are important variables in macroeconomic policy stabilization.

Keywords: *the Indonesian exchange rate with respect to the American Dollars, Synthesized approaches of monetary, Keynesian and Portfolio, ECM, Monetary Magnitude and macro economic stability.*