

# CHAPTER I

## INTRODUCTION

### 1.1 Background

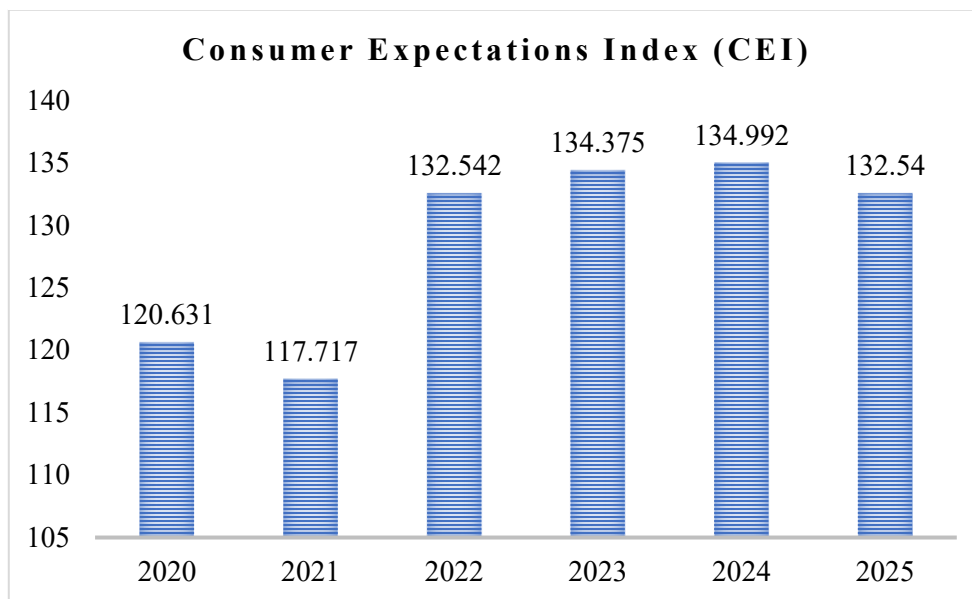
Public expectations are one of the important factors in maintaining economic stability because they affect decisions on consumption, investment, and other economic behaviors. In the context of macroeconomics, public expectations are related to how people view economic conditions in the future, especially towards inflation, interest rates, and exchange rates. When people expect inflation to increase, consumption behavior and demand for goods tend to change so that it can affect price stability. Therefore, public expectations are one of the indicators that monetary authorities pay attention to in formulating economic policies. Macroeconomic conditions are able to shape public perception and belief in future economic conditions (Hardi et al., 2024).

The period 2016–2025 is a period marked by quite complex economic dynamics in Indonesia. The COVID-19 pandemic, the Russia-Ukraine geopolitical conflict, global inflationary pressures, changes in the benchmark interest rate, and fluctuations in the rupiah exchange rate have caused increased economic uncertainty. These conditions can affect people's expectations and beliefs about future economic conditions. In a situation like this, public expectations are important to pay attention to because they can reflect the level of optimism and concern of the public about national economic conditions (Gomes et al., 2024).

Public expectations in this study were measured using the Consumer Expectations Index (CEI) published by Bank Indonesia through the Consumer Survey. The survey

was conducted every month on around 4,600 middle- and upper-economic households with a minimum income of Rp 1,000,000 who were randomly selected using the stratified random sampling method in 18 cities in Indonesia. Questions in the survey include current economic conditions and expectations of economic conditions in the next six months. The Consumer Expectations Index (CEI) is formed from an average of three main components, namely income expectations, job availability expectations, and business activity expectations. Thus, CEI can describe the level of public confidence or optimism about future economic conditions (Bank Indonesia, 2022).

**Figure 1. 1 Indonesian Consumer Expectations Index for 2020-2024**



Source: Bank Indonesia, 2026 (data processed)

Based on Figure 1.1 of the Consumer Expectations Index (CEI) in Indonesia over the past five years, it can be seen that people's expectations have fluctuated influenced by national and global economic conditions. In 2020, the CEI was recorded at 120,631

then decreased to 117,717 in 2021. The decline occurred due to the COVID-19 pandemic which caused a slowdown in economic activity, increased uncertainty, and decreased public optimism about future economic conditions. However, in 2022 the CEI experienced a significant increase to 132,542 in line with the national economic recovery and increasing community economic activity. The increase in public expectations continues in 2023 by 134,375 and in 2025 by 132,540. The increase shows that people are starting to have better confidence in economic conditions even though they are still faced with global challenges such as inflation, interest rate changes, and rupiah exchange rate fluctuations (Bank Indonesia, 2022).

In general, the way to read CEI is that if the index value is above 100, it shows that the public tends to be optimistic about economic conditions in the coming period, while the index value below 100 indicates that the public tends to be pessimistic. Therefore, the high value of CEI in the 2022-2025 period indicates that the level of public optimism about Indonesia's economic conditions has increased. The use of CEI in this study was chosen because the index is an official indicator from Bank Indonesia which directly represents public expectations of future economic conditions. In addition, CEI is considered relevant because it is able to describe people's responses to changes in macroeconomic variables such as inflation, interest rates, and exchange rates, so it is suitable to be used as a dependent variable in this study (Bank Indonesia, 2022).

In various previous studies, public expectations have generally been placed as independent variables or intervening variables that affect inflation, consumption, and

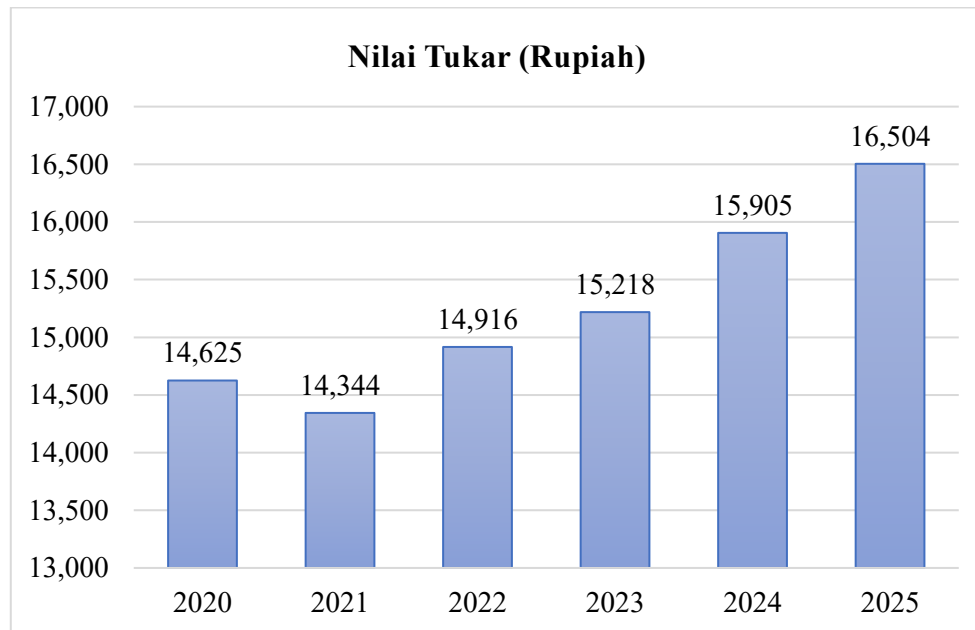
the effectiveness of monetary policy. However, in this study, public expectations are used as a dependent variable because the research focuses on how macroeconomic conditions, especially interest rates, inflation, and exchange rates, affect the formation of public perception and confidence in future economic conditions. The placement of people's expectations as a variable Y is based on adaptive expectation theory and rational expectation theory which explains that people form expectations based on received economic information, past experiences, and actual economic conditions. Thus, changes in macroeconomic variables can affect changes in people's expectations (Gomes et al., 2024).

Monetary policy is one of the main pillars in the management of a country's economy, especially in the midst of increasingly complex global dynamics. In Indonesia, Bank Indonesia (BI) as the monetary authority has implemented various instruments to maintain economic stability, including through interest rate adjustments, exchange rate interventions, and inflation control. The period 2016-2025 marks an era full of challenges, starting from relatively stable economic growth before the COVID-19 pandemic, to the post-crisis recovery phase influenced by external shocks such as interest rate hikes by the US Federal Reserve and the geopolitical conflict in Ukraine. This phenomenon affects not only macroeconomic indicators, but also the expectations of the Indonesian people, which include expectations for growth, employment, and welfare. This expectation is often reflected in BI's consumer surveys, where household behaviors such as consumption, which accounts for around 60% of the Gross Domestic Product (GDP), play an active role in shaping national economic patterns. In the

context of emerging markets such as Indonesia, monetary policy through exchange rates and interest rates is a crucial instrument to respond to global volatility, but it also poses a risk to public sentiment that is vulnerable to external changes (Sembiring, 2025).

The exchange rate is also an important variable in this study because the exchange rate reflects the conditions of a country's economic stability, especially in international trade and financial relations. The movement of the rupiah exchange rate against the United States dollar is often influenced by global economic conditions, foreign capital flows, interest rates, and domestic inflation conditions. Exchange rate fluctuations can affect the price of imported goods, production costs, and inflation rates, thus having an impact on purchasing power and public perception of future economic conditions. In addition, the weakening of the rupiah exchange rate can cause economic uncertainty that affects the level of public confidence in national economic conditions. Conversely, exchange rate stability tends to provide a positive signal to the public because it reflects more controlled and conducive economic conditions. Furthermore, exchange rate movements can also influence investor sentiment in both domestic and international financial markets. This makes the exchange rate an essential indicator in assessing macroeconomic stability and future economic expectations (Falih et al., 2025).

**Figure 1. 2 IDR to USD Exchange Rate 2020-2024**



Source: Bank Indonesia, 2026 (data processed)

The development of the rupiah exchange rate against the United States dollar during the 2020–2025 period shows a depreciation trend accompanied by fluctuations due to global and domestic economic pressures. In 2020, the rupiah exchange rate was at the level of Rp14,625 per US dollar due to the impact of economic uncertainty due to the COVID-19 pandemic. Furthermore, in 2021 the rupiah exchange rate had strengthened to Rp14,344 per US dollar in line with the recovery of economic conditions and increasing financial market stability. However, in 2022 the exchange rate weakened again to Rp14,916 per US dollar due to increasing global inflationary pressures and interest rate hikes by the United States Federal Reserve. The weakening of the rupiah will continue in 2023 to Rp15,218 and in 2025 to reach Rp16,504 per US dollar (Bank Indonesia, 2020). This condition shows that the rupiah exchange rate is

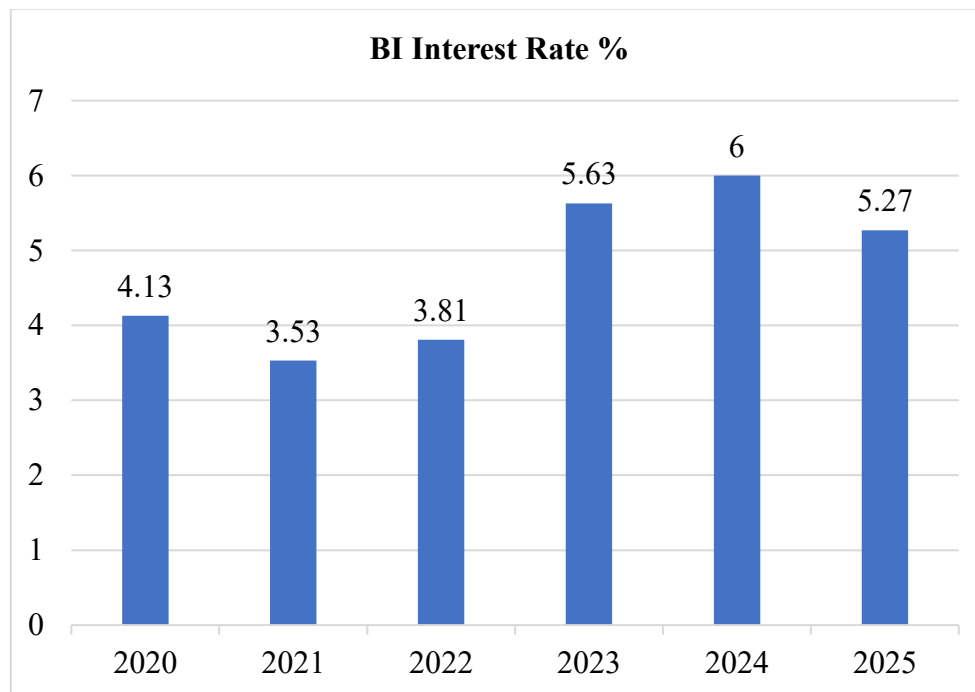
still vulnerable to external turmoil and global uncertainty. These exchange rate fluctuations can affect public perception of national economic stability because the depreciation of the rupiah tends to increase the price of imported goods, encourage inflation, and reduce people's purchasing power, thus potentially affecting public expectations of future economic conditions (Raja et al., 2025).

In the face of these shocks, Bank Indonesia (BI) has taken more active monetary policy steps. Interest rate instruments, exchange rate interventions, and inflation control are key to maintaining macroeconomic stability. This policy not only serves as a response to global conditions, but also as an effort to maintain public confidence in domestic economic resilience. Public expectations are an important element in the effectiveness of monetary policy, because positive perceptions can accelerate the recovery process, increase consumption, and encourage investment. Conversely, negative expectations can slow the recovery and trigger prolonged uncertainty (Ahmad & Badri, 2022).

The variable interest rate was chosen because interest rates are the main monetary policy instrument used by Bank Indonesia to control economic stability. Changes in interest rates can affect consumption, investment, and public perception of future economic conditions. During the 2016–2025 period, the BI-7 Day Reverse Repo Rate fluctuated in response to global and domestic economic conditions. The reduction in interest rates during the pandemic was carried out to encourage consumption and investment, while the increase in interest rates was carried out to maintain the stability of inflation and the rupiah exchange rate. These changes can affect the optimism and

prudence of the public in looking at economic conditions in the future (Sari et al., 2024).

**Figure 1.3 Bank Indonesia Interest Rate 2020-2025**



Source: Bank Indonesia, 2026 (data processed)

Based on Figure 1.3 during the period 2020 to 2025, Bank Indonesia's interest rate, or BI Rate, has fluctuated significantly as a direct reaction to global and domestic economic dynamics. At the beginning of this period, precisely between 2020 and 2021, the BI Rate was lowered from the level of 4.13% to 3.53%, with the main objective of providing stimulus for economic recovery that was hit hard by the COVID-19 pandemic. This step was taken to boost business and consumption activities amid widespread uncertainty. However, since 2022, the policy direction has changed drastically, where the BI Rate began to be raised gradually in response to increasing

inflationary pressures at the global level. This is also influenced by the process of monetary policy normalization carried out by central banks in developed countries, which ultimately forces Bank Indonesia to adjust its measures. In 2024, the BI Rate will finally reach its peak at 6.00%, as a proactive strategy to maintain inflation stability and maintain the rupiah exchange rate so that it does not depreciate too much.

This research needs to be conducted because the expectations of the Indonesian people are not only passive indicators, but also actively shape economic dynamics, especially in the context of developing countries that are vulnerable to external shocks. With household consumption dominating GDP, negative expectations due to ill-targeted monetary policy could slow the post-COVID-19 economic recovery and exacerbate social instability. Moreover, the 2016-2025 period shows that BI's monetary policy, while responsive, has not been fully effective in managing the risk of exchange rate fluctuations, and the impact of low interest rates on public sentiment. This urgency is reinforced by the fact that uncontrolled inflation expectations can create an inflation spiral, while weakening exchange rates can increase the cost of living and reduce investor confidence. On a global scale, where Indonesia is integrated with the world economy, this research is needed to provide an empirical foundation for BI in designing more responsive policies, thereby preventing the risk of stagflation or deeper recession. Without in-depth analysis, monetary policy risks failing to build long-term confidence, which is essential for sustainable growth and people's well-being (Hardi et al., 2024).

Although there have been many studies that have discussed the influence of exchange rates and interest rates on various macroeconomic indicators, most of them

still focus on their impact on economic growth, inflation, or the financial sector in general. Meanwhile, studies that specifically analyze the relationship between these monetary variables and public expectations as measured operationally through the Consumer Expectations Index (CEI) are still relatively limited, especially in the Indonesian context. In addition, there have not been many studies that examine the relationship in a single integrated analysis framework in the period 2016–2025 marked by the COVID-19 pandemic, global pressures, and monetary policy dynamics. Therefore, it is important to fill the gap in the research by analyzing the influence of exchange rates and interest rates on the Consumer Expectations Index as an indicator of public expectations in Indonesia.

This research not only aims to determine the condition of public expectations, but is also directed to analyze the role of monetary policy as reflected through exchange rates and interest rates in shaping these expectations. The results of this study are expected to provide an empirical picture of the effectiveness of Bank Indonesia's monetary policy in managing public expectations as measured through the Consumer Expectations Index. Thus, this research can be used as a material for evaluation and policy recommendations for monetary authorities in formulating more responsive policies to maintain economic stability.

## **1.2 Problem Formulation**

Based on the background of the existing problem, the formulation of this research problem is as follows:

1. Does the exchange rate affect people's expectations as measured through the

consumer expectations index?

2. Does interest rates affect people's expectations as measured through the consumer expectations index?

### **1.3 Research Objectives**

Based on the above background, the main problem of this research is the instability of monetary policy caused by various factors. From the main issue, the objectives of this research are as follows:

1. To analyze the influence of exchange rates on public expectations as measured through the consumer expectations index.
2. To analyze the influence of rupiah interest rates on public expectations as measured through the consumer expectations index.

### **1.4 Scope**

This study is a quantitative descriptive study using secondary monetary policy data from Bank Indonesia, which includes the exchange rate of the Rupiah against the United States Dollar and the interest rate (BI-7 Day Reverse Repo Rate), on the expectations of the Indonesian people in the period 2016 to 2025. The scope of the research focuses on the mechanisms of these two macroeconomic variables in shaping public views on economic resilience, purchasing power, and future prospects. This analysis uses secondary data in the form of a monthly time series obtained from Bank Indonesia, the Central Statistics Agency, and international economic institutions. The dependent variable in this study is public expectations, which are measured through the Consumer Expectations Index from Bank Indonesia, while the independent variables

include exchange rates and interest rates. This study specifically highlights causal relationships within the framework of monetary policy, without examining fiscal policy or other external factors in depth. In addition, the study is limited to a national scale, with no analysis per region, and aims to provide an empirical picture of how monetary policy affects people's expectations amid global economic dynamics during the period.

### **1.5 Research Benefits**

In this study, the author hopes that the results of the research conducted can provide benefits for everyone. The benefits that can be obtained from this research are as follows:

#### **1. Theoretical Benefits**

- a. For the Author: This research is expected to add new knowledge and experience in the work process.
- b. For Universities: This research is expected to add references that can be used as information material for students who will research similar problems.

#### **2. Practical Benefits**

- a. For Central Banks: This study is expected to contribute information to Bank Indonesia as a monetary regulatory institution to better understand the impact of exchange rate fluctuations and interest rates on public expectations, so that it can provide policy recommendations that are implemented can be more accurate and sensitive to the psychological economic environment of the community.

- b. For Readers: This research is expected to be useful for all parties involved and interested in the problem being researched. And it can be used as a reference related to monetary policy, exchange rates, interest rates and public expectations.