

CHAPTER V

CONCLUSION

5.1 Conclusion

Based on the results of this study on the Impact of the Federal Funds Rate, Exchange Rate, and Money Supply on Inflation in Indonesia using the ARDL method, The following conclusions can be constructed::

1. The Federal Funds Rate has a significant effect on Indonesia's inflation in the short run but not in the long run. In the short run, when the Fed raises its interest rate, it pushes Indonesian inflation up in both the following month and the month after, meaning the upward pressure on prices does not reverse but instead continues to build over two months. This happens because a higher Fed rate causes investors to pull their money out of Indonesia, which weakens the rupiah and makes imported goods more expensive, pushing prices up with a delayed but sustained effect. In the long run, however, this effect fades away, most likely because Bank Indonesia adjusts its own policies to counteract the pressure coming from US monetary decisions, preventing a permanent impact on domestic prices.
2. The exchange rate has a significant effect on Indonesia's inflation, but the effect takes time to show up. In the short run, changes in the rupiah exchange rate do not immediately affect inflation and only become significant after two to three months, both in a positive direction, meaning that when the rupiah weakens, the higher cost of imported goods and raw materials gradually passes through to consumer prices over the following months. In the long run, the exchange rate

remains weakly significant at the 10% level, confirming that persistent rupiah depreciation continues to exert upward pressure on inflation over time, even if the magnitude of that effect is relatively modest.

3. The money supply shows a significant positive effect on Indonesia's inflation in the short run, but not in the long run. In the short run, growth in broad money supply stimulates household spending and demand, which ultimately drives prices higher. In the long run, however, this effect disappears, suggesting that Bank Indonesia has managed liquidity effectively enough through its inflation-targeting framework that sustained money supply growth does not permanently translate into higher prices. This reflects the central bank's ability to absorb excess liquidity through open market operations and interest rate adjustments before it can accumulate into persistent inflationary pressure.
4. The Error Correction Model confirms the existence of a valid long-run relationship between the variables, meaning that whenever inflation is pushed away from its equilibrium level by a short-run shock, it will gradually correct itself and return to its normal path over a period of approximately 9 to 10 months. This relatively slow adjustment reflects the fact that prices in Indonesia tend to be sticky, meaning businesses and households do not change their behaviour instantly, and it therefore takes several months for the economy to fully absorb and recover from external disturbances.

5.2 Suggestions

Based on the results and conclusions above, the following suggestions are offered:

1. For Bank Indonesia

Since the exchange rate is the variable that shows the clearest connection to inflation in this study, Bank Indonesia should keep prioritizing exchange rate stability as part of its monetary strategy. Keeping the rupiah stable and predictable helps prevent sudden spikes in import costs that could push domestic prices up, especially during periods of aggressive Fed rate hikes like what happened in 2022 and 2023. Beyond that, Bank Indonesia should also work on communicating its monetary policy decisions more clearly to the public. When people understand what is happening with interest rates and liquidity, they tend to form more stable expectations about future prices, which itself helps keep inflation under control.

2. For Future Researchers

Future researchers are encouraged to add more variables to the model to get a fuller picture of what drives inflation in Indonesia. Variables such as aggregate demand, the BI interest rate, or even measures of public inflation expectations could be worth exploring. Using a longer observation period or trying different methods such as the nonlinear ARDL (NARDL) model could also be helpful, especially to test whether a weaker rupiah and a stronger rupiah affect inflation differently, since the standard ARDL model used in this study assumes the effect is the same in both directions.