ANALYSIS OF THE EFFECTS OF THE RUPIAH EXCHANGE RATE, INTEREST RATES, AND *THE FEDERAL FUNDS RATE* ON INFLATION IN INDONESIA

UNDERGRADUATE THESIS

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DEVELOPMENT ECONOMICS PROGRAM

FACULTY OF ECONOMICS AND BUSINESS

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EAST JAVA

2026

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UNDERGRADUATE THESIS

Submitted to the Faculty of Economics and Business, National Development University "Veteran" East Java, to Fulfill the Requirements for a Bachelor's Thesis in the Development Economics Program

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Acknowledged by
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FOREWORD

The author offers praise and thanks to the Lord Jesus Christ for His love, guidance, and grace, which enabled the author to successfully complete this thesis, titled **"ANALYSIS OF THE EFFECTS OF THE RUPIAH EXCHANGE RATE, INTEREST RATES, AND *THE FEDERAL FUNDS RATE* ON INFLATION,"** in a timely and satisfactory manner. This thesis was prepared as one of the requirements for obtaining a Bachelor's degree in the Development Economics Program, Faculty of Economics and Business, Universitas Pembangunan Nasional "Veteran" East Java.

The author acknowledges that the process of writing this thesis could not have been accomplished alone. For the successful completion of this thesis, the author extends his deepest respect and gratitude to Ms. Kiky Asmara, S.E., M.M., the thesis advisor, who devoted her time to the supervision process, thereby ensuring the thesis was completed successfully. The writing of this thesis would not have been possible without the assistance, support, motivation, and cooperation of various parties; for this reason, the author also extends his deepest gratitude to:

1. Allah S.W.T., the Giver of Strength and Blessings; without His intervention, the author would not have been able to complete this report in its entirety and on time.
2. Ir. Akhmad Fauzi, MMT, Rector of the "Veteran" National Development University of East Java.
3. Dr. Dra. Ec. Tri Kartika Pertiwi, M.Si, Crp, Dean of the Faculty of Economics and Business at the "Veteran" National Development University of East Java.

4. Mr. Riko Setya Wijaya, S.E., M.M., as Head of the Development Economics Study Program at the "Veteran" National Development University of East Java.
5. The faculty members of the Faculty of Economics and Business at the "Veteran" National Development University of East Java, who have imparted highly beneficial knowledge throughout the course of study.
6. The author's parents have always been a source of encouragement throughout the author's time studying far from home. They have never ceased to pray for the author, showering the author with love, attention, motivation, and support—both moral and financial.
7. Mr. Budi Purwanto, S.H., M.H., who has never ceased to pray for the author, showering the author with love, care, motivation, and support—both moral and financial.
8. Mr. Rifai Dyan Armananta, S.E., who has never ceased to pray for the author and shower the author with love, care, motivation, and support
9. My classmates from the Development Economics Program at the "Veteran" National Development University of East Java, Class of 2022, who have struggled alongside me throughout our academic journey.
10. Pristiasri Uswatun Hasanah, who has provided encouragement and stood by the author through thick and thin throughout the preparation of this proposal until its completion
11. My friends at Warkop Perak, who provided encouragement and assistance throughout the preparation of this proposal until its completion.

12. All those whom I cannot name individually who have helped in the completion of this thesis.
13. Finally, I would like to thank myself for working hard to overcome the challenges of college, for being able to rely on myself amidst various external pressures, and for choosing not to give up.

The author acknowledges that this thesis is far from perfect. Therefore, the author greatly appreciates any constructive suggestions and criticism. May this research provide useful understanding and insights, particularly in the field of development economics.

Surabaya, January 2026

Chanif Fadly

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Analysis Of The Effects of The Rupiah Exchange Rate, Interest Rates, And *The Federal Funds Rate* on Inflation in Indonesia

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This study analyzes the effect of the rupiah exchange rate, the Bank Indonesia (BI) Rate, and the U.S. Federal Funds Rate (FFR) on inflation in Indonesia during the 2020–2025 period, a span marked by considerable domestic and global economic turbulence. Using monthly secondary time-series data obtained from Bank Indonesia, the Federal Reserve, and the Central Statistics Agency (BPS), the data were analyzed with the Vector Error Correction Model (VECM), complemented by the Impulse Response Function (IRF) and Forecast Error Variance Decomposition (FEVD) to capture both short-run and long-run dynamics among the variables. The results show that the rupiah exchange rate has a significant effect on inflation in both the short run and the long run, as depreciation raises the prices of imported goods and domestic production costs; the BI Rate exerts a significant influence only in the long run, reflecting the time lag inherent in the monetary transmission mechanism; and the Federal Funds Rate has no significant direct effect on inflation but operates indirectly through movements in the rupiah exchange rate. The negative and significant Error Correction Term confirms an adjustment mechanism that returns inflation toward its long-run equilibrium following economic shocks. These findings underscore the importance of exchange rate stabilization, more proactive interest rate policy, and stronger coordination between the government and monetary authority in maintaining price stability amid global uncertainty.

Keywords: inflation, rupiah exchange rate, BI Rate, Federal Funds Rate, VECM