

# CHAPTER I

## INTRODUCTION

### 1.1 Background

Money demand has a very important role for monetary policy authorities in determining the appropriate policies to maintain economic stability. Analysis of the demand for money is an economic analysis of the quantities needed to support a policy adopted by the government in the monetary field. The government in this case is Bank Indonesia can take a monetary policy that aims to achieve monetary stability (Prawoto, 2010). Given the importance of the stability of money demand, then a lot of literature that discusses the aspects of theoretical and empirical about the demand for money in many countries, both developed and developing countries, has been the work of almost all economists to be able to predict the economy, both in the short term and long term.

Hwang (2002), who conducts the research on money demand in Korea, found that in the long-term equilibrium real income communities and a fixed interest rate affect the M2, while M1 variable is not too influential. Also in China, Chen (1989), Burton and Ha (1990), Chen (1997) and Huang (2000). Important conclusion from these studies is that M2 is closely related to income and interest tingkat and connectedness become a reference in the stability of money demand (Bahmani-Oskooe and Wang, 2007).

In addition to several studies in various countries, research is also widely practiced in Indonesia by Setiadi (2012), which examines the factors that influence the demand for money in 1999; Q1-2010; Q4, which found that inflation

in the short term and the long-term positive and significant impact on the demand for money, as well as the influence of the GDP, while interest rates in the long term have a negative and significant relationship to money demand. Likewise, a study conducted by Sahabudin Sidiq (2005) and Prawoto (2010) about the demand for money. Many empirical studies conducted in various countries regarding the demand for money resulted in the conclusion that there are several variables that significantly influence the demand for money. Among these variables are: income, tingkat interest rate and currency exchange rate and some other macroeconomic factors. Thus, economists in many countries feel the need to control variables were significantly associated demand for money. Given the economy, one factor will influence each other to any other factor, even some of the many economic factors beyond which come into effect for the economy of a country.

Moreover, Ousama Ben-Salha, Zied Jaidi (2014) examines the influence of some expenditure components such as consumption, investment and export of goods and services. In his research Ben-Salha examines based on the annual data from 1979 to 2011 and ARDL bounds testing approach. The results reveal the evidence of integration between the broad money demand and its determinants items, namely the final consumption expenditure, the expenditure on investment goods, the export expenditure and interest rate. The error correction model shows that the demand for money is only affected by the interest rate and the expenditure on investment goods in the short-run while in the long-run the final consumption expenditure and the interest rate represent the major money demand determinants. As a review, this finding is robust to a variety of alternative money demand

specifications and estimation methods. The Saikkonen-Lütkepohlco-integration test with structural shifts and the Johansen-Mosconi-Nielsen structural break co-integration tests are performed in order to control for structural change.

The explanation above is not much different from the researcher that has been done. It is still based on the method of research conducted by Ben-Salha, Zied Jaidi (2014), but there are differences that quartal the researcher uses data from 1997 to 2014 and find the different results from previous research. The thing that makes this study becomes important that is the small number of studies used the method Autoregressive Distributed Lag (ARDL) in Indonesia. The study is important because many studies that look at the effect of broad money demand method Error Correction Model (ECM). This thesis tries to find the effects of macroeconomic variables in money demand to developing countries when this thesis was conducted to try to find the effect of macroeconomic variables on the demand for money in Indonesia.

Based on above explanation, it is the thought of the impact of macroeconomic variables on the demand for money in Indonesia, especially seen through broad money demand. Therefore, researchers raise the title **“The Determinants of Money Demand in Indonesia: From Autoregressive Distributed Lag (ARDL) Approach”**

## **1.2 Problems**

Based on the description that has been described in the background thus the broad money demand, expenditure components, interest rate, which affects new evidence of the demand for money in Indonesia within the factors that

influence the money demand will be covered in this research. Then it can be argued the main problems of research as,

- a. How to determinants of money demand in Indonesia from ARDL Approach?
- b. How to analyze the determinant of money demand in Indonesia by short term and long term?

### **1.3 Research Objectives**

Based on some of the issues that have been formulated above, this study aims to find empirical evidence about the relationship between the dependent variable and several independent variables. The objectives to be accomplished authorin this study was,

- a. To describe the determinants of money demand in Indonesia.
- b. To analyze the determinants of money demand in Indonesia by short term and long term.

### **1.4 Research Advantages**

This research is expected to provide advice and information as follows:

- a. As consideration about the determinants of money demand in Indonesia.
- b. As a reference for the Government and the parties concerned, this study is expected to provide an overview and knowledge about the influence and the determinants of money demand in Indonesia, and then it can be served as a point of comparison to determine the direction of policy in promoting economic growth in Indonesia.

- c. As a source of information, studies and additional reference materials for students of the Department of Economics Faculty of Economics, University of Andalas, especially for students who want to do further research.

### 1.5 Limitation of Study

For more orderly study, the framework used in this study will be limited, among others:

- a. This study focuses only about the determinants of money demand in Indonesia.
- b. The data used in secondary data obtained from the International Monetary Fund (IMF) and World Bank.
- c. The data are broad money (M2), final consumption expenditure (FCE), expenditure on investment goods (EIG), expenditure on total exports of goods and services (EXP) and interest rate ( $i$ ) in Indonesia from 1997 to 2014 by quarterly data.

### 1.6 Systematic Writing

The results of this study are arranged in such a way that can be understood easily. Writing this thesis is divided into six chapters with each chapter details the following:

**Chapter I :** This chapter contains description of the background of the determinants of money demand in Indonesia. This chapter also describes about problems, research objectives, research advantage, limitation of study and systematic writing.



**Chapter II :** This chapter will provide the theory and the relationship between the determinants of money demand in Indonesia. To support the literature review some explanation from empirical studies in the past, as proven.

**Chapter III :** This chapter consists of several sub-chapters that include data and data sources, identification of variables, methods of data analysis and statistical analysis that consist of preliminary test, co-integration test, estimation of ARDL equation and classical assumption test.

**Chapter IV :** This chapter describe in general overview of the history and development of broad money demand in Indonesia, the history of final consumption expenditure (FCE), expenditure on investment goods (EIG), expenditure on total exports of goods and services (EXP) and interest rate ( $i$ ).

**Chapter V :** This chapter show the results of the research and analysis that has been obtained from the data processing. An explanation of the results initiated an explanation of test results stationary, co-integration test, ARDL estimates and assumptions of classical test.

**Chapter VI :** The last chapter is a cover consisting of conclusions and recommendations based on research and analysis of the results obtained from the data processing.