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<http://hrmars.com/index.php/pages/detail/publication-ethics> **Rupiah Exchange Rate Stability towards US Dollars In Indonesia by VAR Approach** Murtala, Chalirafi, Teuku Roli Ilhamsyah Putra, Eddy Gunawan, Irham Iskandar To Link this Article:

<http://dx.doi.org/10.6007/IJARBS/v9-i4/5833> DOI: 10.6007/IJARBS/v9-i4/5833

Received: 24 Feb 2019, Revised: 12 March 2019, Accepted: 1 April 2019 Published

Online: 24 April 2019 In-Text Citation: (Murtala, Putra, Gunawan, & Iskandar, 2019) To Cite this Article: Murtala, C., Putra, T. R. I., Gunawan, E., & Iskandar, I. (2019).

Rupiah **Exchange Rate Stability Towards US Dollars In Indonesia by VAR Approach**. **International Journal of Academic Research Business and Social Sciences**, 9(4), 174-191. Copyright: © 2019 The Author(s) Published by Human Resource Management **Academic Research Society** (www.hrmars.com) This article is published under the Creative Commons Attribution (CC BY 4.0) license. Anyone may reproduce, distribute, translate and create derivative works of this article (for both commercial and non-commercial purposes), subject to full attribution to the original publication and authors.

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<http://hrmars.com/index.php/pages/detail/IJARBS> JOURNAL HOMEPAGE **International Journal of Academic Research in Business and Social Sciences** Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 175 **Rupiah Exchange Rate Stability Towards US Dollars In Indonesia by VAR Approach** Murtala¹, Chalirafi¹, Teuku Roli Ilhamsyah Putra², Eddy Gunawan², Irham Iskandar³ ¹Lecturer of Faculty of Economics and Binsis -

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Abstract This research is carried out to analyze the causality and correlation of interest
rate shock, net foreign asset and money supply towards **rupiah exchange rate stability** in
Indonesia.

Data **used in this research is** time series data, which consist of net foreign asset variable,
interest rate variable, money supply variable and rupiah exchange rate towards US dollar
within 2001-2015. Data analysis used is Vector Autoregressive approach. The research
result shows that rupiah exchange rate process towards US dollar in Indonesia is based
on Cholesky Ordering that is obtained from Granger Causality test result which is net
foreign asset significantly effects money supply, then significantly effects the interest
rate and finally significantly effects rupiah exchange rate. There is causality among
interest rate, net foreign asset and money supply towards **rupiah exchange rate stability**
in Indonesia.

From VAR estimation, there is significant correlation on net foreign asset shock, money
supply and interest rate simultaneously on rupiah exchange rate in Indonesia. In Impulse
Response and variance decomposition analysis, the highest rupiah exchange rate
response towards US dollar is from money supply, net foreign asset and interest rate
respectively. Keyword: VAR Model **Rupiah Exchange Rate Stability**
Introduction The increase of US dollar exchange rate causes goods prices increase, and this problem is
experienced by many people. People purchasing power decreased and this situation
effects the low rate of market reserve power which slowing down the industry as there
are no consumers.

Production slowing down causes low tax income for government, whereas the
government obliged to return its debt in US dollars, and at the end there will be national
fund shortage which needs to be saved by having more foreign loans. Consequently,
severence of labors happen everywhere. About **International Journal of Academic
Research in Business and Social Sciences** Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990
© 2019 HRMARS 176 4,2 million people lost their jobs (Kompas April 3, 1999). Basic
needs prices increase, economic recession and economic crisis happens.

Rupiah exchange rate development towards US dollar in 2001-2015 can be seen in
Figure 1. Figure 1 shows the fluctuation **of rupiah exchange rate** towards US dollar from
2001- 2015. In January 2001 rupiah exchange rate was Rp.9.450,00/\$, in February 2001 it
depreciated to Rp.9.835, 00/\$. The reason of rupiah depreciation in 2001 was due to
politic instability then the president replacement from Abdurrahman Wahid to
Megawati and also because of national economic recovery which still couldnt eliminate

the wound from long crisis.

In December 2002 rupiah exchange rate appreciated to Rp.8.867,00/\$. It was due to positive market sentiment regarding several Asian Regional currency appreciation. The appreciation factor was influenced by central bank policy in establishing monetary program through foreign currency sterilization, the raise of positive market sentiment towards rupiah. Treaty of Paris Club and London Club for rescheduling government debt payment and capital inflow addition through IMF loan agreement and nation assets sale. In 2003, 1 rupiah exchange rate was Rp.8.876,00/\$ while in January 2004 rupiah exchange rate was appreciated to Rp.8.441,00/\$. During 2004-2015 rupiah exchange rate kept on fluctuating but it was depreciated until December 2015 where rupiah exchange rate was Rp.13.795,00/\$.

US dollar has replaced gold as world economic liquidity source and became world financial system base. Consequently, each country developed its net foreign assets in US dollar. US dollar reserve is needed so that a nation currency can be converted to US dollar. Net foreign asset in US dollar become essential for a nation economic stability and sustainability process, it was experienced by Indonesia during economic crisis. During crisis and low export activities, net foreign assets increase was committed by releasing new debt and withdrawing idle loan.

At the end it was expected that increasing net foreign asset by having new debt can stabilize rupiah exchange rate, however the economic condition got worse. Other indicator which highly influenced exchange rate is interest rate. Interest rate is one of the factors which influences currency exchange rate changing. If interest rate increases and foreign more interesting return and foreign investors will offer US dollar to be invested in rupiah. Source : Indonesia Financial Statistic, (2016) Figure 1. Rupiah Exchange Rate Fluctuation towards US Dollar in Indonesia 2001 - 2015 International Journal of Academic Research in Business and Social Sciences Vol. 9 , No.

4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 177 Hsieh, (2009), interest rate increase will cause rupiah depreciation, moreover Indonesia reduces interest rate. Hsieh, (2009), becomes interesting to re-examine in Indonesia by using different model (Fadli at all, 2011), long term interest rate influences significantly and negatively towards exchange rate in Malaysia. (2013), there are two ways causality between real exchange rate and real interest rate in Turkey.

(Dorothy and Sabina, 2014), stated that mooty pd'thinfce stilizg pd anrate N Frenkel, (1979), Sargent and Wallace (1981), Cumby and Obstfeld (1982), interest rate distinction among countries determines exchange rate. In other researches, Hooper, and Morton,

(1980), Woo (1985), Feldstein, (1986) and Hakkio (1986), Campbell and Clarida, (1987), (Meese and Rogoff, 1988), there is no correlation **between interest rate and** exchange rate. Literature of Related Review Exchange Rate Exchange rate is defined as foreign currency price in domestic currency price unit (Salvatore, 1999:49). According to Krugman, (2011), exchange rate is price of a nation currency which is measured in other currency.

Price of a currency towards other currency is usually called as bilateral exchange rate or nominal exchange rate. We often only want to recognize a country currency exchange rate towards other country currency in a single number, than oversee other money separately. Exchange rate index measures average nominal exchange rate effectively. However in order to recognize whether our goods relatively cheaper or more expensive than foreign goods, we must also consider what happen to domestic and foreign prices. Therefore real effective exchange rate or real exchange rate is used.

This measurement is stated in foreign goods prices ration, stated in our currency, relatively towards domestic goods and services prices. This real exchange rate measures a nation competition in international trade (Dornbusch and Fishr, 2008:173). Economic Fundamental Factors that Effect Exchange Rate Interest Rate Distinction Karahan, (2012) analyzed correlation between exchange rate and exchange rate uncertainty by using GARCH specification and Granger causality test and Impulse-Response Function Analysis Variables used in this model are : ERUNC = f (INTER). Which is: ERUNC = Exchange Rate INTER = Interest rate Kayhan (2013) analyzed exchange rate and interest rate by using causality test and make model specification which is $ER = f (IR)$.

Which is: ER= Exchange Rate **International Journal of Academic Research in Business and Social Sciences V** ol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 178 IR= Interest rate Money Supply Money supply is often distinguished between money supply broadly and tightly. Money supply broadly often referred as economic liquidity or M2. While money supply tightly is also referred as money supply, or M1 (Widodo, 2009:47) Monetary authority has major role as initial source from the establishment of money supply.

Communities are last consumers from money that they use to ease production, consumption and exchange activities. If money offer in the communities is too high then it will create inflation, inflation is a money exchange rate depreciation process and is showed by goods and services price increase continuously. If the circulation of money in the communities is too low, then it will create deflation. Net Foreign Asset Net foreign asset is an important indicator among other monetary indicators.

It is not only as indicator for a nation economic but also as an assurance for nation stability, so sufficient net foreign asset is a requirement for a nation. In free floating e have obligation to intervene, sufficient net foreign asset is not so important. In accordance to that situation Kemre, (2002) used a model by having fundamental factor which is: Which is: ER = exchange rate CR = Net foreign asset CF = cash flow IRD = interest rate distinction CAB = current transaction balance RDF = fiscal deficit ratio with industrial output Logical Framework The impact of interest rate to Exchange rate Kayhan (2013) there is two ways causality between **real exchange rate and real interest rate in Turkey.**

Alimi & Ofonyelu, (2013), there is long term correlation between nominal interest rate, inflation, exchange rate and foreign interest rate. The government must urge and support real sector by having subsidy, investment and infrastructure as the ways to limit the inflation by reducing interest rate and this will give impact to economic growth increase. (Zahid & Anwar, 2011), exchange rate change influences the interest rate and at the end will effect aggregate demand for goods and services through real interest rate change.

On supply-side, exchange rate depreciation brings negative effect as domestic companies must adjust their prices to adapt with foreign companies effective prices changing **International Journal of Academic Research in Business and Social Sciences V ol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 179** The Impact of Money Supply to Exchange Rate Agustin (2009), money supply (M2) has one-way relation to exchange rate, this means that the growth on money supply variable causes growth on rupiah exchange rate with the same direction (depreciated exchange rate) on the assumption that other variables are constant.

This condition is in accordance to money offering theory as between money supply and exchange rate has positive correlation, the increase in domestic money offering cause depreciation on domestic currency. Money supply variable has dominant influence among other free variables. The Impact of net foreign asset to exchange rate Kemre (2002), the higher net foreign asset the stronger and stabil the exchange rate will be. Agustin (2009), the increase on number of net foreign asset will strengthen exchange rate (appreciated exchange rate). Net foreign asset and exchange rate have negative correlation.

The higher number of net foreign asset, the higher foreign trust on our nation capability in overcoming external shocks so that it can pressure speculation on domestic currency and at the end the exchange rate will be appreciated. Other opinion which explain the correlation of net foreign asset with exchange rate is presented by (Alper & Saglam,

2007), every net foreign asset increase will cause appreciation on Turkey currency. Based on the above opinions, we can describe logical framework for this research as follows: Figure 1.

Logical Framework Based on the above logical scheme concept it can be explained that exchange rate fluctuation is one of the causes having current economic problems in Indonesia which is unstable economic when exchange rate fluctuate, therefore to manage rupiah exchange rate stability, a test on interest rate variable, money supply and number of net foreign asset need to be performed by using vector auto regression (VAR) analysis, then with this model causality correlation among interest rate variable, net foreign asset variable and money supply variable towards rupiah exchange rate also will be tested.

Research Methodology This research was conducted in Indonesia and limited only to rupiah exchange rate towards US dollar variable, money supply variable, interest rate variable and net foreign asset variable. Data used was monthly time series data during 2001 2015. To analyze the shock interest rate, net foreign asset and money supply on rupiah exchange rate stability towards US dollar in Indonesia, multivariate vector autogression (VAR) was used. The Net Foreign Asset Money supply Rupiah Exchange Rate towards US Dollar Interest Rate International Journal of Academic Research in Business and Social Sciences V ol. 9 , No.

4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 180 VAR analysis approach includes three major analysis tools which are granger causality test, impulse response function (IRF) and forecast error decomposition of variance (FEDV). Before we reach VAR analysis, there are several estimation steps that will be used in the analysis, which are: 1. Data stationarity and integrity degree test 2. Lag length determination 3. Granger causality test 4. VAR estimation 5. Impulse Response Function 6. Variance Decomposition Discussion Stationarity Test The result of stationarity test can be viewed in Table 1. Tabel 1. Unit Root Test using Augmented Dickey-Fuller (ADF) Level 1th Difference 2nd Difference Variabel Prob. Prob.

Prob. CDV 0.9069 0.0000 0.0000 JUB 0.9998 0.6219 0.0000 KURS 0.8464 0.0000 0.0000 SB 0.2855 0.0007 0.0000 Source: Data Processing Result, 2017 From stationarity test result there are three variables that have become stationarize in I (1) stationarized in I (1). Therefore it is no need to do cointegration test in I (1). As the consequence VAR model can be used in second difference. Optimal Lag Determination The chosen length of optimal lag showed in Table 2. International Journal of Academic Research in Business and Social Sciences V ol. 9 , No.

4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 181 Table 2. The Length Of Optimal Lag Based On Several Criteria Lag LR FPE AIC 0 NA 3.37e+20 58.61932 1 250.2171 8.94e+19 57.29109 2 173.7884 3.67e+19 56.39990 3 63.55054 2.96e+19 56.18335 4 37.09094 2.80e+19 56.12916 5 44.35063 2.52e+19 56.01974 6 49.27178 2.17e+19 55.86817 7 40.39753 1.98e+19 55.76990 8 38.26085* 1.82e+19* 55.67886* Source: Data Processing Result, 2017 Based on Table 2, LR, FPE and AIC criteria chose lag order 8 while SC criteria chose order 2 and HQ chose order 3. As the result, in this research the length of optimal lag **that will be used** is 8.

VAR Stability Test The result of VAR stability can be seen in Table 3. **International Journal of Academic Research in Business and Social Sciences V** ol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 182 Tabel 3. VAR Stability Condition Check Root Modulus -0.486613 - 0.855808i 0.984479 -0.486613 + 0.855808i 0.984479 0.016736 + 0.919873i 0.920025 0.016736 - 0.919873i 0.920025 -0.846724 - 0.356349i 0.918655 -0.846724 + 0.356349i 0.918655 0.509604 + 0.703343i 0.868555 0.509604 - 0.703343i 0.868555 0.628812 - 0.581443i 0.856435 0.628812 + 0.581443i 0.856435 0.234776 + 0.810579i 0.843895 0.234776 - 0.810579i 0.843895 0.692063 + 0.476356i 0.840159 0.692063 - 0.476356i 0.840159 -0.834320 0.834320 -0.523876 - 0.644744i 0.830748 -0.523876 + 0.644744i 0.830748 0.370558 - 0.742678i 0.829991 0.370558 + 0.742678i 0.829991 -0.304303 + 0.725140i 0.786402 -0.304303 - 0.725140i 0.786402 -0.553881 - 0.546470i 0.778084 -0.553881 + 0.546470i 0.778084 -0.659798 + 0.376794i 0.759807 -0.659798 - 0.376794i 0.759807 -0.718454 - 0.198500i 0.745371 -0.718454 + 0.198500i 0.745371 -0.111101 - 0.731144i 0.739537 -0.111101 + 0.731144i 0.739537 0.306006 - 0.479702i 0.568994 0.306006 + 0.479702i 0.568994 -0.170532 0.170532 Source: Data Processing Result, 2017 Based on VAR stability test result in Table 3, it showed that the VAR equation has modulus value less than 1 on lag 8, Therefore **it can be concluded that** VAR model has become stabile on its optimal lag which is lag 8. **International Journal of Academic Research in Business and Social Sciences V** ol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 183 Granger Causality Analysis Causality analysis shows cause and effect relationship.

In order to acknowledge the characteristic of causality relationship where the changing of one variable which give more impact to other variable, Granger Causality is needed. Causality test result can be seen in Table 4. Tabel 4. Granger Causality Test Lag 8 Variabel Pemprediksi DDCDV DDJUB DDKURS DDSB DDCDV 0.0012** 0.6788 0.3904 DDJUB 0.0003** 0.1631 0.6913 DDKURS 0.0560* 0.0003** 0.0961* DDSB 0.0387** 0.0606* 0.1319 Source: Data Processing Result, 2017 From Granger Causality Test result in Table 4, it can be described that CDV has two-ways causality (Grager Cause) towards JUB and has one-way causality towards SB and KURS.

Meanwhile JUB has two-ways causality (Granger Cause) towards CDV and has one-way causality towards SB and KURS. SB has one- Granger Cause) towards CDV and JUB. towards CDV, SB and JUB. Based on Granger Causality test result, the correlation among variables can be figured as follows: Source: Data Processing Result, 2017 Figure 2. Causality Correlation among variables tested by Granger Causality Test Based on Figure 2, Cholesky Ordering that will be used in Impulse Response analysis has possibility as follows: (1) DDKURS; or (2) DDKURS.

DDJUB DDCDV DDKURS DDSB International Journal of Academic Research in Business and Social Sciences Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 184 Vector Autoregression Estimates Analysis The estimation result of Vector Autoregression Estimated Difference (VARDD) towards as follows (statistik t [.....]): Equation
1 Lag DDKURS DDSB DDJUB DDCDV C (-1) -0.849723 -101.5568
 0.002148 -0.029405 2.054322 [-9.92245] [-0.59173] [2.36033] [-2.67188] [0.08752] (-2)
 -0.951336 -127.1687 0.002936 -0.024344 [-9.03437] [-0.46507] [2.12194] [-1.79794] (-3)
 -0.616324 -198.1258 0.000337 -0.019927 [-5.03051] [-0.60392] [0.19195] [-1.33480] (-4)
 -0.555803 -264.6127 0.000356 -0.024454 [-4.52332] [-0.78982] [0.18880] [-1.56402] (-5)
 -0.48976 -554.0621 0.001516 -0.037359 [-4.04371] [-1.71078] [0.80066] [-2.37091] (-6)
 -0.349446 -816.3456 0.000886 -0.036492 [-3.09554] [-2.81088] [0.47891] [-2.43280] (-7)
 -0.212843 -775.2591 -0.002669 -0.010482 [-2.25568] [-3.37225] [-1.72030] [-0.78600]
 (-8) -0.114746 -389.773 -0.003097 -0.005004 [-1.61537] [-3.01955] [-3.05231] [-0.44787]
 R-squared 0.59375 1 Schwarz SC 15.0634 8 Adj. R-squared 0.50022 6 Mean dependent
 3.57558 1 Sum sq. resid 130655 81 S.D. dependent 433.680 7 S.E. equation 306.589 3
 F-statistic 6.34857 9 Log likelihood - 1210.525 Akaike AIC 14.4596 0 Source: Data
 Processing Result, 2017 From the above VAR model estimation it is generated that
 F-statistic = 6,35 higher than F-table =5%;df1=32; df2=147 = 1,522.

This means that simultenuously interest rate variable (DDSB), money supply International Journal of Academic Research in Business and Social Sciences Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 185 variable (DDJUB) and net foreign asset variable (DDCDV) in the above equation 1 significantly give On equation 1 partially, there is negative and significant impact on average rupiah exchange rate (DDKURS(- 7th period (DDKURS(-7)) there is significant impact on average rupiah exchange rate towards US dollar in Indonesia and it also has negative correlation.

It means that every increase on rupiah exchange rate in previous month, it will influence to the depreciation of rupiah exchange rate in one month period after it, and on the contrary every increase on rupiah exchange rate in the previous month, it will influence to appreciation of rupiah exchange rate in one month period after it e rupiah exchange rate towards US dollar in Indonesia. It is showed by the amount of statistic t value wh n

if $a = \%$ however as $egatcorreion$ Starting period 6th and 8th, there is significant impact towards average rupiah exchange rate. An interest rate shows negative impact on rupiah exchange rate, which means that the increase on interest rate in the previous month gives impact toward rupiah exchange rate appreciation in Indonesia on one month after it.

This analysis result is in line with (Szakmary and Mathur, 1997), (Fadli et al, 2011), Alimi & Ofonyelu, (2013), Kayhan (2013), (Scott, and Karlsson, 2014), (Murtala et al, 2017) which stated that there is negative impact on interest rate towards exchange rate, the higher interest rate the more appreciated exchange rate will be and on the contrary the lower interest rate, the more depreciated exchange rate will be. **On the other hand**, this research result is also in line with 1980s researches that were conducted by (Frenkel, 1979), Sargent (1981) and Cumby and Obstfeld (1982) which stated that interest rate really determines exchange rate.

Money supply (DDJUB) in one or two months prior has significant impact on rupiah exchange rate in Indonesia. It is showed by the amount of statistic t value which is significant t has positive correlation. Starting the 3rd and 7th month prior there is no significant impact on average positive impact towards interest rate in Indonesia which means that every increase on money supply it will make rupiah exchange rate depreciated and on the contrary every decrease on money supply then **the rupiah exchange rate** will be appreciated.

This finding is in line with Szakmary and Mathur (1997), Agustin, (2009) and Vidyamukti, (2013), money supply has positive impact towards exchange rate, the higher money supply the more depreciated the exchange rate will be and on the contrary the lower money supply, the more appreciated exchange rate will be. Net foreign asset (DDCDV) in the previous month has significant impact towards rupiah exchange rate in Indonesia. impact towards rupia significantly impact and has negative correlation towards rupiah exchange rate in Indonesia, until 7th xchange rate in Indonesia.

However net foreign asset has negative impact towards rupiah exchange rate in Indonesia which means an increase of net foreign asset will give influence towards appreciation **of rupiah exchange rate** in Indonesia. This finding is in line with (Agustin, 2009), Emre and Ismail (2001), who concluded that every additional net foreign asset will cause appreciation to domestic currency. **International Journal of Academic Research in Business and Social Sciences** Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 186 Impulse Response Analysis Impulse Response analysis is conducted in order to acknowledge the impact sensitivity changing of one endogenous variable towards other endogenous variable.

The result analysis will show the impact of current and future shock of a variable towards other endogenous variable. Rupiah Exchange Rate Response towards Interest rate Changing Shock Impulse Response Function gives figure on how the response of future variable whenever To ease the interpretation, analysis result is presented on graphic figure.. How is the exchange rate response on shock from interest rate towards exchange rate can be seen in Figure 3 as follow: Figure 3. Impulse Response Function DDKURS towards DDSB In Figure 4.6

it is shown that the impact of interest rate changing (DDSSB) amounting to one standard deviation towards rupiah exchange rate (DDKURS), by having 40 months horizontal time. At the impact on interest rate shock (DDSB) amounting to one standard deviation. In the second month average interest rate changing (DDSB) gives negative response towards exchange rate changing (DDKURS). In the third month average interest rate changing (DDSB) gives positive response towards exchange rate changing (DDKURS). Starting the 4th month and forth it has up and down movement and tend to reach the balance after the 15th month Rupiah exchange rate response towards money supply shock Exchange rate response on money supply shock towards rupiah exchange rate can be seen in Figure 4 as follows [International Journal of Academic Research in Business and Social Sciences V](#) ol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 187 Figure 4.

Impulse Response Function DDKURS Towards DDJUB Figure 4 shows the impact on money supply changing (DDJUB) amounting to one standard deviation towards rupiah exchange rate changing (DDKURS), by having 40 months horizontal time. At shock (DDJUB) amounting to one standard deviation. In the 2nd month average shock money supply changing (DDJUB) give positive response towards exchange rate changing (DDKURS). In 3rd and 4th month the average shock money supply changing (DDJUB) give negative response towards exchange rate changing (DDKURS). Starting the 5th month and forth it has up and down movement and tend to reach the balance or close to balance.

Rupiah exchange rate response towards net foreign asset shock Exchange rate response to shock or fluctuation from net foreign asset towards rupiah exchange rate can be seen on Figure 5. Figure 5. Impulse Response Function DDKURS Towards DDCDV Figure 5 shows the impact of net foreign asset changing (DDCDV) amounting to one standard deviation towards exchange rate (DDKURS), by having 40 months horizontal time. At the beginning amounting one standard deviation. In the second month the average shock on net foreign asset changing gives negative response towards exchange rate changing (DDKURS).

In the third and fourth month the average shock on net foreign asset changing (DDCDV) gives positive response towards exchange rate changing (DDKURS). Starting the 5th month and forth it has up and down movement and tend to reach the balance

International Journal of Academic Research in Business and Social Sciences Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 188 Rupiah exchange rate response towards rupiah exchange rate shock Exchange rate response to shock on rupiah exchange rate towards rupiah exchange can be seen in Figure 6. Figure 6.

Impulse Response Function DDKURS Towards DDKURS Figure 6 shows the impact of **rupiah exchange rate** changing (DDKURS) amounting to one standard deviation towards rupiah exchange rate changing (DDKURS), by having 40 months horizontal time. At the beginning of the first month the exchange rate (DDKUR) has positive impact on rupiah exchange rate shock amounting to one standard deviation. In the 2nd month average shock of exchange rate changing (DDKURS) gives negative response towards exchange rate changing (DDKURS).

In 3rd and 4th month the average shock of exchange rate changing (DDKRS) gives positive response towards exchange rate changing (DDKURS). Starting the 5th month and forth it has up and down movement and tend to reach the balance or close to the balance. Variance Decomposition Analysis Variance decomposition provides estimation on how high the contribution of a variable towards the changing of that variable itself and other variables in several upcoming periods. By using this analysis, we can estimate which variable that has the highest contribution towards certain variable. Variance Decomposition analysis often called as forecast error decomposition variance (FEDV) analysis.

FEDV analysis result on rupiah exchange rate variable for 40 periods can be seen in Table 7. *International Journal of Academic Research in Business and Social Sciences* Vol. 9 , No. 4, April, 2019, E-ISSN: 2222-6990 © 2019 HRMARS 189 Figure 7. Variance Decomposition of DDKURS Figure 4.1 shows that in the first period 100 percent rupiah exchange rate variance is explained by the average of exchange rate itself, while the interest rate, money supply and net foreign asset variables is zero percent. In the second period rupiah exchange rate variance is explained by the average of exchange rate itself as 94,77 percent, while interest rate variable is 0,00295 percent, money supply is 2,095 percent and net foreign asset is 3,097 percent.

In the next period until the 40th period **the rupiah exchange rate** variance is explained by the average of exchange rate itself as 75,37 percent, while interest rate variable is 2,724 percent, money supply is 14,49 percent and net foreign asset is 7,409 percent.

Until the 40th period rupiah exchange rate variance is explained by the average of exchange rate itself become lower, while the interest rate variable slightly decreases, money supply variable is getting increase and net foreign asset also slightly decreases.

From three variables, money supply variable give the greatest contribution towards rupiah exchange rate stability, the second variable is net foreign asset and the last one is interest rate. Conclusion 1. Rupiah exchange rate process towards US dollar in Indonesia is based on Cholesky Ordering that is obtained from Granger Causality test result. The Ordering process was conducted as follows: net foreign asset significantly impact money supply, then significantly will impact interest rate and significantly will impact rupiah exchange rate in Indonesia. 2.

There is causality among interest rate, net foreign asset and money supply towards stability on rupiah exchange rate in Indonesia. 3. Based on VAR estimation, there is significant impact on net foreign asset, money supply, interest rate shock simultaneously towards rupiah exchange rate in Indonesia. 4. Based on Impulse **response and Variance decomposition** analysis, **it can be concluded that the** highest rupiah exchange rate response towards US dollar is from money supply, then net foreign asset and finally interest rate. Suggestion 1.

It is suggested that the government pays more attention to monetary sector policies, in this case Bank Indonesia must concentrate on the determination of interest rate, money supply, net foreign asset resource as these are factors that will give impact to rupiah exchange rate stability. 2. It is needed to have effective and pure monetary policy application and use interest rate indicator as economic control in order to keep the exchange rate stability, manage money supply and create net foreign assets resource, as well as the government must avoid creating new money which can vanish interest function or role as economic control. **International Journal of Academic Research in Business and Social Sciences V** ol. 9 , No.

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