ABSTRACT

The inflation rate in every country will continues to fluctuate, both booms and slumps occur. Monetary policy is one of the macroeconomic policies that aims to control inflation as a single target so that it stays within the targeted range. The effectiveness of monetary policy in influencing the inflation rate is determined by the performance of the monetary policy transmission mechanism in influencing the economy and finance so they can achieve the ultimate goal. Based on the background of this problem, this study aims to measure the influence of the money supply, interest rates, and exchange rates as channels of the monetary transmission mechanism in influencing inflation.

In order to fulfill the aim of the research, this study uses the Vector Error Correction Model (VECM). Through the VECM model, the lag of each channel mechanism in influencing the inflation rate will be identified. Through this deadline, the most effective channel mechanism can be determined. In addition, Variance Decomposition (VD) analysis tool's result will answer questions regarding which transmission mechanism channel is the most dominant in influencing the inflation rate. To measure the relationship of the transmission mechanism channel on inflation, Granger causality analysis tools will be used.

The results of the VECM analysis in this study found that all the channel mechanism variables analyzed, the money supply, interest rates, and exchange rates had a bidirectional causality relationship to the inflation rate. It was also found that the exchange rate channel is the most dominant channel among other channels, through a negative relationship in both the short and long run.

Keyword : Inflation, Money Supply, Interest Rate, Exchange Rate