ABSTRACT

Since the year 2000, in order to maintain the inflation rate, Indonesian Bank has adopted the Inflation Targeting Framework (ITF) regime. In influencing the inflation rate, monetary policy must go through several monetary policy transmission channels (MTKM). There are six monetary policy transmission lines in Indonesia, namely interest rate channel, asset price channel, exchange rate channel, money channel, credit channel, and expectation channel. Among those six channels, interest rates channel is the most appropriate way to control the inflation rate in Indonesia. Therefore, this study aims to examine the effectiveness of the Inflation Targeting Framework (ITF) regime in Indonesia through the interest rate channel.

This study uses the Vector Error Correction Model (VECM) regression method to see short-term and long-term relationships between variables with inflation as the dependent variable and Indonesian bank certificate interest rates, interbank money market interest rates, time deposit interest rates, credit interest rates, and the level of output gap as independent variables. The data collected is taken from 2000 to 2016 from the BPS , Fred and Indonesian Bank's website.

The results of this study indicate that interest rates channel affects inflation significantly. In the short term, only the interbank money market rates, credit rates and output gap variables that have a significant effect. In the long-term, only interbank money market rates that affects inflation rate significantly. It takes seven quarters for the interest rate channel to influence the inflation rate since the changes in monetary policy is determined. The ITF regime through the interest rate channel proved to be effective in keeping the inflation rate indicated by the contribution of independent variables in affecting changes in inflation rates

Keywords: ITF, MTKM, VECM, interest rate channel, effectiveness