ABSTRACT

ADJI SUBEKTI. Indonesian Inflation Dynamics at Provincial Level. Under supervision of HERMANTO SIREGAR and NOER AZAM ACHSANI.

Indonesia never experience any annual deflation for more than forty years. After being strucked by the 1998 economic crisis, Indonesia introduced two fundamentals policies, those are the exchange rate rearrangement in 1999 and the decentralization policy in 2001. Following the implementation of those policies, there are some changes of policy or non-policy variables that would be responded various level of inflation among regions in Indonesia. This research aim to examine the policy and non-policy variables affecting Indonesian inflation namics at provincial level. After utilizing the method of dynamic panel data th spatial and non-spatial approaches, this research found that during the period 2000-2009, inflation dynamics are likely affected by non-policy variables, such inflation inertia, exchange rate volatility, and the simultaneous changes of infrastructure conditions and trade openness. Some policy variables such as salary adjustment of government employee, adjustment of domestic oil price and interest rate adjustment are also affecting the inflation dynamics. It is suggest that central bank together with government develop system to support inflation-forecast targeting. In order to decrease exchange rate pass through, government can propose import substitution, nationality suasion to use domestic product and the obligation for proposing a new establishment’s permission to use a local base or mestic material in the most. It is also suggest that central government sets the domestic oil prices adjustment periodically to minimize bad impact of unanticipated expectation of the policy, beside that, salary adjustment of government employee must be set carefully to avoid higher inflation expectation. Further more, in the way of interest rate adjustment and targeting inflation, central bank should construct an accurately forecast to raise their credibility. Last, central and local government must concern about the improvement of the infrastructure condition and simplification of regulation which related to business environment.

Keywords : inflation volatility, dynamic panel data, policy and non policy variables

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