



Analysis of monetary policy mechanism in Indonesia through interest rate channels on the stock market

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ABSTRACT

This study examines how the interest rate channel of the monetary policy mechanism affects the Indonesian stock market. This study also seeks to estimate the amplitude of factors inside the interest rate channel in reaction to stock market changes, namely the Indonesia Stock Exchange Composite Index (IHSG). This study uses the Vector Error Correction Model (VECM) regression model to determine how much the interest rate channel of the monetary policy transmission mechanism affects the Indonesian stock market (IHSG). This study uses monthly secondary data from 2015 to 2022. The Bank Indonesia website's yearly reports provided this study's secondary data. This study examined the impact of the interest rate channel as a monetary policy transmission mechanism on the stock market (IHSG) using the BI rate, interbank money market interest rate (PUAB), deposit rate, Covid-19, and composite stock price index. The effective interest rate channel shows that Indonesia's monetary policy mechanism affects the stock market (IHSG). This phenomena works immediately and long-term. Interest rate shocks altered IHSG responsiveness. However, the Indonesian Stock Exchange Composite Index (IHSG) is affected by deposit rates and Covid-19 conditions throughout time. Deposit rates affect interest rates and the Indonesian Stock Exchange Composite Index (IHSG).

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1. INTRODUCTION

A study predicts Indonesia's economic stability and volatility, with phases of expansion and decline (Mukhlis et al., 2020). Several reasons could cause an unexpected economic crisis, and a sudden change could cause a financial disaster (Senbeto & Hon, 2020). The capital market and stock market affect the economy (Uddin et al., 2021); capital becomes more accessible as the capital market expands, boosting the economy. The stock exchange has various indices that track stock price variations and act as benchmarks for capital market operations (Lettau & Madhavan, 2018). The composite stock price index (IHSG) measures Indonesia's market conditions and stock price changes.

China's economic slowdown and interest rate cuts caused financial problems in 2015. The Composite Stock Price Index (IHSG) dropped 18% in the first quarter, according

to (Saragih et al., 2021). China's global economic pressure exacerbated the issue—this economic pressure caused political and financial instability. Crude oil prices fell, lowering other commodity prices and Indonesia's budgetary receipts. To avoid future risks, investors reallocate their wealth to lower-risk investments. Thus, investors' risk aversion increases.

The Indonesian capital market is susceptible to global economic situations. Global volatility doesn't hinder the capital market's growing demand (W. Li, 2021); global advancements gradually affect the company and its success. Investors can quickly spot economic patterns. Investors will assess the company's performance after these changes. These changes cause people to buy, sell, or keep shares. (Chen et al., 2021) explain stock price swings. The Composite Stock Price Index (IHSG) reached 6,300 in 2020. On March 24, 2020, the Indonesian Stock Exchange Composite Index (IHSG) dropped to its lowest level since 2015, 3,937, due to the COVID-19 pandemic. The COVID-19 pandemic in 2020 hampered the global and Indonesian economies more than usual. The outbreak has disrupted various industries, causing a global recession with negative growth.

On March 2, 2020, Indonesia confirmed Covid-19, raising market concerns (Nurcahyono et al., 2021). The subsequent increase in cases made containment difficult. This event halted economic activity and shook capital market investor confidence. Indonesia took several COVID-19 prevention measures. The first step was to approve Government Regulation Number 21 of 2020, which implements comprehensive measures for social restrictions on a large scale (PSBB) to combat the COVID-19 epidemic. These initiatives draw various community and economic responses. The Indonesian government has also implemented fiscal policies and granted tax incentives by easing the PPh Article 29 OP payment. The reporting of SPT PPh OP should help all economic entities in Indonesia maintain their optimism.

Bank Indonesia's monetary strategy addresses the effects of the Large-Scale Social Restrictions (PSBB) policy (Muhyiddin & Nugroho, 2021). Bank Indonesia uses the BI 7 Day Reverse Repo Rate (BI7DRR) and quantitative easing to boost economic growth and financial system stability. Liquidity easing initiatives aim to maintain banking sector liquidity and financial system stability. These policies also promote economic recovery following the COVID-19 epidemic by helping banks intermediate. The BI 7 Day Reverse Repo Rate (BI7DRR) strategy encourages company expansion, reduces unemployment, and maintains investment interest rates to boost national economic recovery. The interest rate channel transmits the interest rate reduction policy. This cause shows how interest rates can affect aggregate demand. In this scenario, money market demand and supply share short-term interest rate movements to medium/long-term rates. Interest rate variations affect capital costs, spending, investment, and consumption, which affect aggregate demand.

The interest rate channel effectively addresses crises (Smets, 2018); analysis shows that the channel transmits monetary policy (Altavilla et al., 2018). However, the amount affects the financial system, risk variables, and inherent uncertainties. The BI 7 Day Reverse Repo Rate (BI7DRR) affects bank lending, deposits, and interbank money market rates (PUAB). Interest rate hikes allow Bank Indonesia to control monetary policy. As seen in Bank Indonesia's policy moves, this tool can reduce aggregate demand and inflationary pressures. The 7-Day Reverse Repo Rate (BI7DRR) affected macroeconomics. Stocks and other assets may lose value as interest rates rise, reducing individual and corporate wealth. Thus, this can hinder consumption, investment, and inflationary pressures.

A central bank interest rate cut could boost dividends and stock prices (Mayer & Schnabl, 2021). The idea claims that interest rate manipulation by monetary policy can affect stock values. The interest rate channel shows how financial market pricing dynamics affect real sector economic activity. Bank Indonesia's monetary policy will affect bank interest rates. Monetary policy targets natural production. Monetary transmission mechanisms show how much, how long, and how well monetary policy affects economic activity and achieves goals. Conversely, a lack of understanding of the monetary policy

transmission mechanism would render a financial policy ineffectual, both in its power to influence real economic activity and in its ability to achieve the desired goal (Van't Klooster, 2020).

Bank Indonesia's monetary policy will affect short-term interest rates in the rupiah money market, such as the SBI and PUAB rates. Interest rates from the financial sector to the actual industry depend on consumption and investment demand. PUAB (Pick-Up Artist Bootcamp) study has shown market leaders. It would affect monetary policy, particularly the banking sector's interest rate channel. The monetary policy transmission process, specifically The Stock Market Channel, discusses the near-term link between interest rates and stocks; these variables may have a negative association (Kashyap & Stein, 2023).

This analysis disagrees with (Huh & Lee, 2021) that interest rates are ineffective for monetary policy. (Teapon & Mustafa, 2018) found that monetary policy transmission in Indonesia has little effect on inflation but significantly impacts economic growth. (Alfarina & Aimon, 2020) Found that Indonesia's policy interest rate benefits long-term portfolio investment. "Monetary Policy and Its Impact on the Indonesian Capital Market," a study by (Putri, 2021), found a negative association between inflation and the Jakarta Composite Index (IHSG). The study found no statistically significant influence. (Herlina, 2018) discovered that credit and currency rates matter more than interest rate channels. The study implies that monetary policy affects actual output.

(Astuti & Hastuti, 2020) Found that interbank institutions responded quickly to interest rate reductions, proving that the interest rate channel may convey monetary policy. In Africa's economic policy mechanism, (Fuinhas et al., 2019) found a link between monetary policy and the money market. The study also shows how the monetary policy mechanism influences the money supply and stock market over time. Pre- and post-vaccine effects on the Indonesian stock market were significant. Before the nationwide immunization program, newly reported cases significantly affected the Indonesian stock market. COVID-19 affected the economy and IHSG in March 2020. Due to economic turmoil, stock market conditions plummeted. Ensure capital market stability to handle monetary policy issues. Interest rate manipulation can achieve this goal. These policies affect the stock market.

However, the current analysis has focused on the monetary policy mechanism's trajectory flaws. This study does not examine how this pathway affects the stock market. The work on pandemic monetary policy has primarily focused on its effects, overlooking the transmission mechanism. This study examines how the interest rate channel affects stock prices during the COVID-19 pandemic. Monetary policy strongly affects the economy. The central bank uses financial instruments like open market operations to achieve its monetary policy and start the monetary transmission mechanism (Wibowo & Mubarok, 2017). banking instability may result from firms consolidating to raise capital and lowering lending rates without increasing lending activity.

Thus, the banking, financial, and natural sectors must actively examine how well monetary policy transmission meets central bank objectives to manage inflation effectively. The interest rate channel transmits monetary policy through the BI rate, which is the operational aim. This rate affects the Interbank Money Market (PUAB) interest and deposit and lending rates. Understanding how money market interest rates affect retail banking interest rates, particularly deposits and loans, is crucial. (H. Li et al., 2021) ascribe interest rate swings to exogenous disturbances in the central bank's reference rate.

Monetary policy can affect money market interest rates, investment spending, and real GDP (Cecioni et al., 2019). Actual investment activity should increase when money market interest rates, particularly loan rates, fall. Expansionary monetary policy should boost real GDP. The transmission mechanism's complexity affects the economy's monetary transmission channels. An open economy also affects a nation's economic and financial success. Exchange rates, export and import volumes, and government fund movements all

influence these factors. Interest rates, credit constraints, and currency rates will become increasingly important in monetary policy transmission under these conditions.

The Quantity Theory of Money introduced the monetary policy transmission mechanism (Chaidir & Rois, 2022). The financial sector and economy have shaped the five channels of the monetary policy transmission mechanism. Literature discusses five monetary transmission channels: the Direct Monetary Channel, the interest rate channel, the asset price channel, the credit channel, and the anticipation channel (Teapon & Mustafa, 2018). The central bank's monetary policy will affect the rupiah money market's short-term interest rates, such as SBI and PUAB. These advances will affect bank interest rates for public deposits and borrowers. The prompt emphasizes that interest rate transmission is not instantaneous and influenced by internal banking considerations like asset and debt management.

Interest rates from the financial sector to the actual industry depend on consumption and investment demand. The income effect of including deposit interest in public income makes the substitution effect of using credit interest to impact consumption demand. Investment financing has lending rates in the cost of capital, bond yields, and stock dividends, which affects investment demand. Investment and consumption affect aggregate demand, determining inflation and actual production (Gong & Lin, 2018). This study analyzes transmission via the interest rate channel.

2. RESEARCH METHOD

The present study utilizes secondary data from collection agencies and then disseminates it within the data user community (Astutik & Gunartin, 2019). The study also used secondary data from many sources such as books, journals, the internet, previous research, notes, and other relevant references about the research problems. Secondary data refers to information obtained and analyzed by external entities through prior analysis.

The data collection methodology employed in this study was conducting library research, specifically by gathering data from various literature sources relevant to the research questions. Additionally, documentation techniques were utilized to supplement the data collection process. Secondary data can be acquired from several sources, such as the SEKI (Indonesian Economic and Financial Statistics) provided by Bank Indonesia North Sumatra, the Central Bureau of Statistics, and the Investment Coordinating Board of North Sumatra Province.

The study employed a quantitative descriptive approach, utilizing Regression Vector Autoregression (VAR) as the analytical tool. This method allowed for the examination of the association between variables and the assessment of the individual contributions of each variable to the fluctuations observed in other variables. Various ways exist to determine the relationship between variables, such as utilizing Ordinary Least Squares (OLS), which differs from VAR. In addition to its capacity for examining the interdependencies among variables, the Vector Autoregression (VAR) model can also capture the dynamics of responses and the variability exhibited by all variables throughout the study period. This method uses impulse response functions and variance decomposition, presented as graphical representations and tabular summaries.

The present analysis will examine the impacts and correlations between variables as outlined in the hypothesis presented in the preceding chapter. This examination will use empirical data and refer to the VAR (Vector Auto Regression) model. Applying this methodology is highly effective in examining the relationship between a variable's response and considering the percentage variation magnitude of the endogenous variable in response to changes (shocks) in other variables within the model. This approach establishes a boundary or constraint that aims to differentiate the movement of

endogenous variables into components related to underlying shocks, making it more convenient for estimation purposes.

The proposed analytical procedure will commence with the identification of research variables, followed by data description, stationarity testing, determination of lag length, the establishment of a VAR (Vector Auto Regression) model, testing for model stability, and conducting innovation accounting (impulse response function) to ascertain the simultaneous and dynamic response of the variables. The analysis of macroeconomic variables involves examining the impact of shocks from other variables and doing a forecast error variance decomposition to identify the underlying origins of variations in specific variables. Moreover, the authors employ the assistance of the Eviews 11 computer program to do the estimation and econometric analysis mentioned earlier.

The pre-Estimation Testing model used in this study is VAR (Vector Auto Regression) which is a development of the VAR model. An essential assumption in the VAR (Vector Auto Regression) model is that all variables are treated as endogenous variables. According to (Lenza & Primiceri, 2022), VAR analysis can be used to:

1. Granger Causality Test is a step toward knowing the causal relationship between variables.
2. Forecasting needed extrapolating all variables' current and future values using all past information on variables.
3. Impulse Response Function (IRF), namely by detecting the response of each variable at present and in the future due to a change or shock of a particular variable.
4. Forecast Error Decomposition of Variance (FEDV), namely by predicting the contribution of the percentage variance of each variable to changes in a particular variable.

This study's observed variables consisted of five, so the research model was called multivariate VAR. The interdependence of variables includes the variables IHSG (IHSG), Bank Indonesia Interest Rate (BI Rate), the latest Covid Case (Covid), PUAB Interest Rate (PUAB), and Deposit Interest Rate (Deposit), which are specified in the equation:

$$Z_t = c + \sum P + B_i + Z_{t-1} + \epsilon_t \quad (1)$$

Where:

Z_t = Observed variables

c = Vector Constant

P = number or length of lag

B_i = Coefficient Matrix

ϵ_t = Interference Vector

3. RESULTS AND DISCUSSIONS

Structural impulse response function (SIRF) analysis is used to determine the dynamic behavior of the VECM model. IRF analysis determines how long the dependent variable takes to respond to changes in the independent variable.

This study looks at the effectiveness of the monetary policy mechanism on the interest rate channel for the IHSG, where the paths analyzed include the Covid19 course for the BI.

The response of Covid-19 to the BI. Rate shock from period 1 to entering the 30th period has been stagnant, and the 31-50 period has increased (Himmawan & Firdausi, 2021). Furthermore, the PUAB response to the deposit rate shock was positive (+), where from period 1, it tended to rise sharply until the 50th period, the deposit rate response to the IHSG shock in periods 1 to 5 was positive (+) and managed to be stagnant, but in period 5 up to the 50 periods, the response tends to be negative (-). Still, the answer tends to decrease very sharply.

Structural variance decomposition analysis is used to compile forecast error variance of a variable, how much of the error variance of a variable is explained by the

shock that comes from the variable itself or other variables. The more significant the proportion of a variable in explaining the error variance, the more influential the role of that variable for other variables in the system.

Table 1. Variance decomposition results
Variance Decomposition of IHSG

Period	SE.	IHSG	BI_RATE	COVID	DEPOSIT	PUAB
1	288.3532	100.0000	0.000000	0.000000	0.000000	0.000000
2	396.2640	99.69002	0.149012	0.020170	0.038649	0.102150
3	484.2654	99.52739	0.100961	0.042666	0.109496	0.219483
4	556.9343	99.54833	0.084690	0.054259	0.132780	0.179942
5	621.9922	99.51807	0.091725	0.091094	0.153563	0.145550
6	682.4955	99.45794	0.091998	0.148148	0.181020	0.120896
7	738.8817	99.36797	0.102353	0.208370	0.215975	0.105328
8	791.9448	99.28278	0.110769	0.262668	0.247831	0.095954
9	842.2668	99.18944	0.117895	0.321307	0.278346	0.093013
10	890.4022	99.09319	0.123997	0.381624	0.305996	0.095197

Variance Decomposition of BI_RATE

Period	SE.	IHSG	BI_RATE	COVID	DEPOSIT	PUAB
1	0.186411	0.674318	99.32568	0.000000	0.000000	0.000000
2	0.296493	1.410956	97.47932	0.015687	0.231846	0.862192
3	0.411470	2.283522	96.11361	0.075764	0.629442	0.897663
4	0.517270	2.946229	95.20488	0.089069	0.777841	0.981982
5	0.614205	3.402052	94.56792	0.143988	0.927877	0.958159
6	0.703302	3.634904	94.22960	0.205690	1.034634	0.895174
7	0.784966	3.759693	94.00413	0.269352	1.135651	0.831177
8	0.860327	3.813241	93.86242	0.331421	1.224905	0.768009
9	0.930300	3.827419	93.76618	0.394319	1.302967	0.709118
10	0.995713	3.814062	93.70004	0.458113	1.372811	0.654973

Variance Decomposition of COVID:

Period	SE.	IHSG	BI_RATE	COVID	DEPOSIT	PUAB
1	130390.3	0.087209	0.022557	99.89023	0.000000	0.000000
2	187315.2	0.099388	0.025800	99.61101	0.086174	0.177627
3	206581.9	0.181323	0.021272	98.50051	0.556123	0.740770
4	220069.2	0.169975	0.025355	97.68910	0.653848	1.461727
5	238718.2	0.264530	0.026616	97.14789	0.582131	1.978831
6	257331.2	0.295556	0.022908	96.86483	0.524258	2.292452
7	272185.8	0.310701	0.022161	96.48076	0.508718	2.677660
8	285325.0	0.359523	0.020806	95.98118	0.494198	3.144289
9	298397.7	0.440777	0.019454	95.49190	0.467918	3.579951
10	311134.1	0.521517	0.019064	95.05281	0.441426	3.965187

Variance Decomposition of DEPOSITO

Period	SE.	IHSG	BI_RATE	COVID	DEPOSIT	PUAB
1	0.222015	5.377505	0.025018	6.633442	87.96404	0.000000
2	0.284966	4.687793	0.768187	4.045345	90.14604	0.352630
3	0.351651	3.346965	1.685643	7.364648	86.22941	1.373331
4	0.431526	4.209138	1.870172	13.09268	75.52755	5.300465
5	0.517936	5.902662	1.830054	16.14449	67.46576	8.657037
6	0.605510	7.656202	1.908751	17.65170	61.68835	11.09500
7	0.693771	8.981579	2.002966	19.05777	56.84564	13.11205
8	0.783452	10.09703	2.056655	20.40387	52.66031	14.78214
9	0.873351	11.09780	2.083757	21.41544	49.22586	16.17713
10	0.962041	11.96986	2.100853	22.14122	46.46676	17.32131

Variance Decomposition of PUAB

Period	SE.	IHSG	BI_RATE	COVID	DEPOSIT	PUAB
1	0.272790	1.997948	3.709220	0.122030	0.794386	93.37642
2	0.331466	2.898148	7.616964	0.847999	1.152112	87.48478
3	0.409967	2.278290	26.41431	1.360882	1.109022	68.83750

4	0.479577	1.768413	35.71579	2.647533	0.810616	59.05765
5	0.547797	1.428129	43.20486	3.972816	0.665691	50.72850
6	0.611100	1.185445	48.38121	5.129381	0.609912	44.69405
7	0.670114	0.993058	52.17879	6.409286	0.628798	39.79007
8	0.725705	0.847495	55.01331	7.704480	0.682345	35.75237
9	0.778060	0.750573	57.07940	8.974823	0.768815	32.42639
10	0.827626	0.697945	58.61355	10.18407	0.870733	29.63371

Table 1 shows that four factors influenced the IHSG, particularly the BI. This study explores the relationship between the COVID-19 pandemic, deposit rates, and the PUAB program. BI variables' origins are known. Rates explain the IHSG better than deposit rates, the COVID-19 epidemic, and the PUAB variable. The third period shows the Indonesian Stock Exchange Composite Index (IHSG) variance percentage versus the Bank Indonesia (BI) rate at 0.100961%. The IHSG grew 0.667183% from the 4th to 50th periods due to the deposit rate. The deposit interest rate affects the IHSG more than the BI. We'll discuss rate, Covid-19, and PUAB in this discussion.

Table 1 lists IHSG, Covid-19, deposit rates, and PUAB as BI Rate factors. During the beginning phase of the fifth period, PUAB had a more significant impact on clarifying the BI Rate than IHSG, deposit rates, Covid19, and PUAB itself. The IHSG decomposition variance was 0.605945% until period 5, indicating the outcome. The deposit rate constantly adds 2.201534% to the BI Rate from the 6th to 50th periods. The deposit interest rate significantly affects basic income.

Table 1 lists the Indonesian Stock Exchange Composite Index (IHSG), Bank Indonesia's policy rate (BI Rate), deposit rates, and the Public Works and Public Housing Development Acceleration Program (PUAB) as factors in the COVID-19 pandemic. Among the variables studied, PUAB contributed the most to the spread of COVID-19 from the second to the fiftieth period. Compared to IHSG, deposit rates, BI Rate, and PUAB. Perceived Usefulness of Adopting Behaviors (PUAB) accounts for 10.53565% of the overall variation in Covid19 up to the 50th period. The PUAB interest rate affects the BI Rate more than the IHSG, BI Rate, and deposit rates.

Table 1 shows that four variables affect deposit rates. IHSG, BI Rate, Covid19, and PUAB. Covid-19 outperformed IHSG, BI Rate, and PUAB in explaining deposit rate changes from 2 to 50. The Covid19 variance decomposition for deposit rates is 28.13290% in the first 50 periods, indicating the outcome. The IHSG, BI Rate, and PUAB have less impacted deposit rates than Covid-19.

In Table 1, IHSG, BI Rate, Covid-19, and deposit rates determine PUAB interest rates. The IHSG, Covid-19, BI Rate, and deposit rates explain PUAB interest rates less than the BI Rate for the period from 1 to 50. The Business Index (BI) variance decomposition shows the result. Assess PUAB's 60.30996% interest rates through period 50. The BI is visible in its entirety. Compared to IHSG, Covid, and deposit rates, the speed affects the PUAB interest rate.

A short-term analysis shows that monetary policy affects the effective interest rate channel for the Indonesian Stock Exchange Composite Index (IHSG) by correlating deposit rate changes with IHSG fluctuations over the past two quarters. Alfian (2011) says VAR modeling coefficient analysis is complex. Thus, researchers prefer Impulse Response Function (IRF) and Structural Variance Decomposition alternatives.

This study examines monetary policy transmission through the interest rate channel to the Indonesian Stock Exchange Composite Index (IHSG). The analysis uses Impulse Response Function (IRF) and Structural Variance Decomposition. IRF testing evaluates how quickly a variable responds to a shock from another variable.

Through the effective interest rate channel, monetary policy affected the Indonesian Stock Exchange Composite Index (IHSG) from January 2015 to March 2022. This channel raises IHSG after two quarters. The IHSG shocks two periods after variable indicators react to the interest rate channel. The IRF test's IHSG Structural Variance Decomposition table

shows the result. The second-period interest rate channel variable responds to the IHSG. How does the variable's interest rate channel contribution affect the IHSG's rise till the 10th period?

The interest rate channel includes Covid-19, BI, PUAB, and deposit rates. Consider the evolution of the Structural Impulse Response Function (SIRF) test and structural variance decomposition. This situation delays interest rate transmission to the Indonesian Stock Exchange Composite Index (IHSG). Thus, Covid-19 outbreaks will affect the IHSG. As widely accepted, the COVID-19 pandemic is a surprise that can hit anyone. Most nations experience this. Suddenly, everyone's life changes. The event necessitates reducing all social activities. The worldwide population maintained social distance and limited socio-economic activity even when they stopped.

The reported effects include significant business sector changes and economic and financial disruptions. Due to a slowing economy, Covid-19 prevention regulations must continue. However, the economic sector must take unique risks. Indonesia's 2020 economic growth fell 2.07% due to the COVID-19 epidemic. According to BPS data, the Covid-19 coronavirus pandemic affected 82.85% of enterprises. Accommodation and food/drink lost the highest income, 92.47%. Other services lost 90.90%, the second-most. Transportation, storage, building, processing, and trade followed suit.

The most significant impact was on Indonesia's industrial sector. Manufacturing fell 2.93 percent. The processing industry, which employed 128.45 million people in August 2020, lost 13.61 percent of its manufacturing workers. Manufacturing employment fell 1.3 percent over the previous year. The COVID-19 epidemic hurt manufacturing, which contributed to the growth of unemployment. The pandemic has hurt the economy and job prospects. The epidemic affected 29.12 million people, according to the Ministry of Labor. 2.56 million people were unemployed due to COVID-19. Due to the pandemic, 0.76 million people are unemployed. 1.77 million individuals are unemployed owing to COVID-19. Finally, 24.03 million workers have cut their hours.

The Indonesian Ministry of Finance also stated that investment has dropped from 3.25 percent to 1.94 percent. The downturn hurts Indonesia's economy. The COVID-19 epidemic has affected several investment operations, including the stock market, which has declined. Securities—stocks—are crucial to financial markets. The composite stock price index tracks stock exchange price changes for these stocks. This indicator helps measure capital market progress and changes. The IHSG index assesses market conditions and stock price trends. The IHSG index covers all stock exchange prices.

Both short-term and long-term, the Covid-19 shock affects the IHSG. The government took steps to limit the infection. However, policyholders, notably in Indonesia, must judge based on perceived impact while tackling this worldwide catastrophe. The IHSG fell at the time. This issue would hurt economic activity if ignored. The outbreak has caused macroeconomic disruptions. Macroeconomic considerations gradually affect company performance over time. Investors react quickly to macroeconomic changes, which affect stock prices. Investors will evaluate the company's future performance after these macroeconomic developments. They will then decide whether to buy, sell, or keep the shares.

Supporting this modification, Tanjung, Ruslan, Lubis, and Pratama (2022) found that COVID-19, monetary policy, and other macroeconomic variables affect stock market movements. Before immunization, Covid-19 affected the Indonesian stock market. After vaccination efforts began, the virus had no statistically significant effect on the Indonesian stock market. Covid vaccinations are expected to reduce the number of people infected with Covid, boosting economic activity. Maintaining economic stability is essential. Bank Indonesia, which holds financial stability, helps solve this problem. Bank Indonesia uses the interest rate channel in monetary policy. The transmission mechanism's interest rate channel shows how interest rate changes might affect aggregate demand. In this scenario,

money market demand and supply forces transmit short-term interest rate swings to medium/long-term rates.

These interest rates will affect the cost of capital, which involves expenditure, investment, and consumption, which make up aggregate demand. The central bank's policy interest rate (BI rate) affects the interest rate channel. The Public Unsecured Overnight Borrowing (PUAB) rate changes due to the 7-day reverse repurchase agreement (7DRR), which affects deposit and bank lending rates. Bank Indonesia can raise interest rates to tighten monetary policy. The BI would change due to this measure's impact on aggregate demand, reducing inflationary pressures. The 7-day reverse repurchase (7DRR) interest rate affects asset prices and the macroeconomy. Stocks will lose value as interest rates rise, reducing financial resources for individuals and businesses. Thus, their wealth will decrease, making consumption and investment harder.

The Indonesian Stock Exchange Composite Index (IHSG) and the monetary policy mechanism have an inverse association. The causality test shows that deposit rates affect the IHSG. The interest rate channel in the IHSG's monetary policy mechanism works better when policymaking improves the skill sector. This study matches Harahap et al. (2017)'s 1998 pre- and post-monetary crisis research. Their investigation showed that the interest rate channel transmitted monetary policy, but its amplitude was affected by economic conditions—financial system risk and uncertainty. Academics study financial accelerators in monetary policy, especially after a crisis. PUAB interest rate policy variables produce similar impulsive responses. SBI rate variations tend to be more significant than PUAB rate swings.

Astuti and Hastuti (2020) found a link between IHSG and PUAB interest rates. Stocks' greater yields make them more attractive than other financial assets when interbank money market interest rates fall. Syarif and Asandimitra (2015)'s Gordon's growth model theory explanations match these observations. This hypothesis states that lower interest rates lower investment returns, which raises stock values. The line of causality suggests that monetary policy shocks will affect the stock market, specifically the composite stock price index (IHSG). The analysis shows that the COVID-19 outbreak prompted Bank Indonesia, the monetary authority, to adopt an interest rate-based monetary policy mechanism. This channel includes BI, PUAB, and deposit rates. Interest rate shocks have caused IHSG volatility. The pandemic's impact on economic stability and revenue streams explains this situation. Debtors choose credit accessibility over interest rates. Banks needed to transmit monetary policy since deposit rates rose, increasing capital acquisition. Adjusting deposit rates helps the IHSG maintain value. Given low investment returns, the method reduces deposit rates to encourage fund holders to invest in deposits. The IHSG reacts to the deposit rate shock, which measures interest rate policy. The IHSG index shows rising share prices. Thus, investors choose capital market investments during this time.

Rousseas' (1985) marginal cost pricing model explains this. This model states that bank interest rates will reflect changes in a bank's cost of funding. The bank's marginal cost changes justify this transfer. According to rational expectations, expectations affect stock prices. According to Muklis (2016), the Indonesian capital market is a developing market, making it vulnerable to macroeconomic factors, global economic conditions, and international capital market dynamics. Macroeconomic considerations affect company success slowly over time. Investors react quickly to macroeconomic changes, which affect stock prices. Investors will evaluate how macroeconomic trends affect corporate performance.

4. CONCLUSION

Based on the comprehensive analysis and extensive debate conducted in the preceding chapter, it is possible to derive the following conclusions: (1). The present study aims to

investigate how monetary policy is transmitted to Indonesia's stock market through the effective interest rate channel. The efficacy of this phenomenon is observable both in the immediate and extended periods. The observed fluctuations in the IHSG response were driven mainly by the effects of shocks originating from the interest rate channel. It is essential to acknowledge that the Covid-19 pandemic substantially impacted the Indonesian Stock Exchange Composite Index (IHSG) over an extended period, with deposit rates being a subsequent effect factor. (2). The efficacy of the interest rate channel in transmitting monetary policy is resilient when influenced by the stock market (IHSG). The deposit rate shock significantly impacts the IHSG through the strong interest rate channel. The observed phenomenon can be attributed to fluctuations in deposit interest rates. Subsequently, upon encountering alterations, it will catalyze motivation. The change observed in the Indonesian Stock Exchange Composite Index (IHSG) can be attributed to the anticipation of future events triggered by the sudden shock in deposit interest rates. Based on the findings and conclusions outlined in the preceding chapter, there are several potential directions for future research and development in the realm of monetary policy transmission and its impact on Indonesia's stock market. Here are some suggestions: The significant impact of the COVID-19 pandemic on the Indonesian Stock Exchange Composite Index (IHSG) and its subsequent effects on deposit rates, further research could delve into understanding the prolonged effects of such a crisis on monetary policy transmission mechanisms. This could involve analyzing how the relationship between monetary policy instruments and stock market responses evolves over time as economies recover from the pandemic. Explore broader macro-financial linkages beyond the interest rate channel. Investigate how other macroeconomic indicators, such as exchange rates, inflation expectations, and credit availability, interact with monetary policy changes and subsequently affect the stock market. This could provide a more comprehensive understanding of the multifaceted transmission mechanisms. Investigate the role of behavioral factors and investor sentiment in amplifying or dampening the effects of monetary policy shocks on the stock market. How do psychological biases and market participants' perceptions influence their reactions to interest rate changes? Understanding these factors could provide insights into the dynamics of stock market responses. Conduct a comparative analysis between Indonesia and other emerging economies to assess the uniqueness of the observed transmission mechanisms. Different countries might exhibit varying degrees of sensitivity to interest rate changes, influenced by factors like market structure, regulatory environment, and economic fundamentals. Employ high-frequency data to analyze the intraday or intraweek dynamics of monetary policy transmission to the stock market. This could help capture more nuanced reactions and provide insights into how quickly information and shocks are absorbed by market participants. Investigate the impact of central bank communication and forward guidance on stock market responses to monetary policy changes. Assess how effectively central banks can influence market expectations and whether the anticipation of future policy actions plays a role in shaping market behavior. Explore the role of financial intermediaries, such as banks and non-bank financial institutions, in transmitting monetary policy to the stock market. Investigate how changes in interest rates affect these intermediaries and subsequently impact stock market performance. Analyze how different sectors within the stock market respond to monetary policy changes. Certain sectors might be more sensitive to interest rate fluctuations due to their specific characteristics and dependencies on borrowing costs. Extend the research to provide practical policy implications. How can policymakers use the knowledge gained from the study to design more effective monetary policies that achieve desired outcomes in terms of economic growth, financial stability, and market resilience. Utilize advanced techniques such as machine learning and predictive modeling to forecast stock market responses to monetary policy changes. Incorporating a wide range of economic indicators and market data could enhance the accuracy of predictions.

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