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DYNAMICS OF SUPPLY THEORY AND FACTORS AFFECTING THE RUPIAH EXCHANGE RATE IN INDONESIA

[1]Zuwardi, [2]Tiara Kasih, [3]Raudhati Rahman, [4]Arnika, [5]Nurfadilah Defitri, [6] Fitri Rahmi
Universitas Islam Negeri Sjech M. Djamil Djambek Bukittinggi
Email: [1]zuwardiiyzi84@gmail.com, [2]Tiarakasih.sma1ulbar@gmail.com, [3]raudhatirahman23@gmail.com, [4]arnikaa502@gmail.com, [5]diladefitri@gmail.com, [6]Fitrirahminew@gmail.com

Abstract
This research is intended to explore supply dynamics and factors that influence the Rupiah exchange rate in Indonesia. The presence of the Rupiah exchange rate has a significant impact in the Indonesian economic context, affecting export competitiveness, inflation levels and overall macroeconomic stability. Therefore, thoroughly understanding the factors that influence the Rupiah exchange rate is a necessity in designing effective and sustainable economic policies. The aim of this paper is to provide better insight into the crucial aspects that need to be considered to maintain the stability of the Rupiah exchange rate.
Keywords: exchange rate, Rupiah, supply dynamics, factors, Indonesian economy

INTRODUCTION

In the context of a country's economy, the currency exchange rate is one of the critical indicators that reflects the overall health of the economy. In Indonesia, attention to fluctuations in the rupiah exchange rate has become the center of attention for various parties, ranging from economic actors, the government, to the general public. Changes in the rupiah exchange rate not only create an impact on the level of people's purchasing power, but also affect the export and import sectors, as well as various other macroeconomic aspects.

The main factor that affects the rupiah exchange rate involves the dynamics of foreign exchange offers. Fluctuations in foreign exchange supply, which are closely related to the trade balance, capital flows, and foreign investment, can provide an idea of the availability of foreign currencies in the market. In addition, fundamental economic factors such as economic growth, inflation rates, and interest rates also play a role in shaping the dynamics of the Rupiah exchange rate.

The importance of an in-depth understanding of the factors that affect the Rupiah exchange rate is very crucial. Fluctuations in the rupiah exchange rate can have a significant impact on the competitiveness of Indonesia's

exports in the international market. In addition, changes in exchange rates can also affect the inflation rate, which is an important parameter in maintaining the stability of a country's economy. In order to formulate effective economic policies, governments and economic actors need to consider external factors that can affect exchange rates, such as changing global economic conditions and geopolitical uncertainty. Monetary and fiscal policies implemented by Bank Indonesia and the government also play an important role in shaping the direction of the Rupiah exchange rate.

Therefore, this paper aims to investigate in depth the dynamics of supply and the factors influencing the Rupiah exchange rate in Indonesia. Through a better understanding of these factors, it is hoped that appropriate solutions and policies can be found to maintain the stability of the rupiah exchange rate and promote sustainable economic growth.

RESEARCH OBJECTIVES

This study aims to investigate and analyze the dynamics of supply and factors that affect the Rupiah exchange rate in Indonesia. With a deeper understanding of the determinants of exchange rates, it is hoped that it can provide better insight in formulating effective economic policies.

RESULTS AND DISCUSSION

A. Exchange Rate Determination Theory

factors that affect or determine the exchange rate of a country's currency. Some of the main theories used to explain this phenomenon involve a variety of economic approaches and principles. Here are some significant exchange rate determination theories:

1. Purchasing Power Parity (PPP) Theory

The fundamental concept in economics highlights the linkage between relative inflation and the exchange rates of two countries. The basic principle behind Purchasing Power Parity (PPP) is that, in the long run, changes in currency exchange rates should reflect changes in relative purchasing power between the two countries. In other words, if one country experiences a higher inflation rate compared to another, its currency exchange rate should depreciate to maintain purchasing power parity.

An example of the application of the PPP theory can be illustrated simply. For example, if the inflation rate in Country A is higher than in Country B, then the price of goods and services in Country A will increase faster than in Country B. In the long run, this should be reflected in the change in the

currency exchange rate between the two countries. For example, if the price of goods in Country A increases by 10% due to the high inflation rate, while the price of goods in Country B only increases by 5%, then the purchasing power of Country A's currency decreases relative to the currency of Country B. To maintain purchasing power parity, the exchange rate of Country A's currency should depreciate by about 5%. Although PPP is often not fully achieved because there are many factors that affect exchange rates, including non-economic aspects such as market speculation, government policy, and political uncertainty, the concept of PPP remains fundamental to understanding the impact of inflation relative to currency exchange rates in the long term.

2. Interest Rate Differential Theory

The Interest Rate Differentiation Theory emphasizes the role of interest rates in determining currency exchange rates. The basic principle is that interest rate differences between countries can be a major factor that determines whether a country's currency will strengthen or weaken. In the context of open markets, where capital can easily move across national borders, capital flows tend to move towards countries with higher interest rates. An illustration of this theory can be given through the following example: If interest rates in Country A are higher than in Country B, investors tend to be interested in transferring their capital to Country A in order to obtain a greater level of profit. This process increases the demand for Country A's currency, which in turn leads to a strengthening of the currency's exchange rate. In contrast, Country B's currency may experience weakness due to a lack of investor interest due to lower interest rates.

The theory of interest rate differentiation provides a strong framework, other factors such as macroeconomic conditions, government policies, and geopolitical events can also affect currency exchange rates. In practice, the combination of these factors often provides a more complete picture of exchange rate movements in the foreign exchange market.

3. Theory Expectations

The Expectations Theory, or Expectation Theory, states that the current currency exchange rate reflects the expectations or expectations of market participants for the future exchange rate. In other words, market behavior and investment decisions are based on anticipation about possible exchange rate movements. Factors that contribute to the formation of these expectations include expectations of inflation rates, economic growth, and political stability.

The application of this theory can be illustrated with the following example: If market participants, such as investors or traders, anticipate that a country's currency exchange rate will appreciate in the future, they may be inclined to buy the currency today. This increase in demand can cause the exchange rate of the currency to strengthen. Conversely, if the market's expectation is a future depreciation of the currency, market participants can try to sell the currency now to avoid potential losses.

Market participants' expectations can be influenced by various factors such as economic indicators, government policies, or geopolitical events. Therefore, the analysis of market expectations is important in understanding the dynamics of currency exchange rates. In this context, government policies, central bank statements, and macroeconomic factors are key in shaping and understanding the expectations underlying exchange rate movements.

4. Capital Availability Theory (Asset Market Model)

The Asset Market Model focuses on the characteristics of currencies as financial assets. This concept teaches that the exchange rate of a currency is not only influenced by economic factors, but also by the demand and supply of currency as an investment or store of value. Factors that affect such demand and supply involve consideration of interest rates, monetary policy, and the economic situation of the country.

In practice, if the demand for a country's currency increases, its currency exchange rate can strengthen. For example, if an investor believes that a country's currency will provide a good or promising level of profit, they may buy the currency as an investment. This increase in demand tends to lead to the appreciation of the exchange rate of that currency against other currencies.

It is important to note that this theory views currencies as a form of financial asset, and exchange rate movements can be understood through the dynamics of demand and supply in the foreign exchange market. Factors such as market sentiment, risk perception, and monetary policy can play an important role in shaping market participants' expectations of currency exchange rates, thus influencing demand and supply.

Dynamics of Foreign Exchange Supply

1. Trade Balance

A trade balance is an accounting record that records the value of a country's exports and imports of goods and services over a specific period,

usually one year. In the Indonesian context, the trade balance records the value of exports and imports of goods and services carried out by this country with other countries. The direct impact of the trade balance is seen on foreign exchange offerings. When a country has a trade balance surplus, it indicates that the value of its exports is greater than the value of its imports. Such surplus can increase foreign exchange supply in the market because the country receives payments in foreign currency more than it needs to pay for imports. An increase in foreign exchange supply can strengthen the value of the national currency, in this case, the Rupiah.

In contrast, a trade balance deficit occurs when the value of a country's imports is greater than the value of exports. This deficit could lead to a decline in foreign exchange supply as the country has to pay more in foreign currency to meet its import needs. As a result, the exchange rate of the national currency, in this case, the Rupiah, can weaken.

Suppose Indonesia has a trade balance surplus due to the high export value of goods and services (such as agricultural products, textiles, or tourism services) compared to the value of imports (such as machinery, technology, or consumer goods). With a surplus, Indonesia gets more foreign currency from its trading partners compared to how much Rupiah has to be paid for imports.

On the other hand, if Indonesia experiences a trade balance deficit, this can happen if the value of imports is higher than the value of exports. For example, if Indonesia imports a lot of electronic goods or raw materials that are not widely produced domestically, the country will have to pay more in foreign currency, so that foreign exchange supply may decline, and the rupiah exchange rate may weaken.

2. Capital Flows and Foreign Investment

Indonesia's trade balance is a systematic record of the value of exports and imports of goods and services with partner countries over a specific period, usually one year. In the economic context, the trade balance has a significant impact on the Rupiah exchange rate. When Indonesia has a trade balance surplus, it indicates that the value of exports is greater than the value of imports. The surplus increases the supply of foreign exchange in the market, as the country receives more foreign currency from its trading partners than is needed to pay for imports. An increase in foreign exchange supply can result in a strengthening of the Rupiah exchange rate.

For example, suppose that Indonesia produces and exports a large number of agricultural commodities, such as palm oil, coffee, and rubber, which are in high demand in international markets. Meanwhile, imports of certain consumer goods or technologies may not be as much as exports. In this situation, a high export value and a lower import value can create a trade balance surplus, which then has a positive impact on the Rupiah exchange rate.

On the other hand, if Indonesia experiences a trade balance deficit, it means that the value of imports is greater than the value of exports. For example, if Indonesia imports a lot of high-tech goods or industrial machinery that is not produced locally, the country will have to pay more in foreign currency than it receives from exports. This deficit can lead to a decrease in foreign exchange supply in the market, which in turn can weaken the Rupiah exchange rate. Thus, the trade balance is one of the key factors that need to be considered in analyzing the dynamics of the Rupiah exchange rate, and successful economic policies must consider a balance between exports and imports to maintain exchange rate stability and national economic balance.

Economic Fundamentals

1. Economic Growth

Economic growth has a crucial role in shaping market perception of the Rupiah exchange rate in Indonesia. Stable economic growth signifies the health and sustainability of a country's economic activities. In the context of exchange rates, positive economic growth tends to support the strengthening of the national currency exchange rate, in this case, the Rupiah.

When a country experiences strong economic growth, investors and market participants tend to have higher confidence in the economic outlook. Investors can see promising investment opportunities, while foreign currency market participants may find the country's currency an attractive place to invest. As a result, increased interest in investors and market participants in the Rupiah could increase demand for the currency, which could ultimately result in a strengthening exchange rate.

Conversely, when economic growth slows or is uncertain, market perceptions of the sustainability of economic activity can become less optimistic. This can result in a decrease in investor and market participants' interest in the Rupiah, so that the Rupiah exchange rate can weaken.

Economic uncertainty is often associated with higher investment risk, and in response, investors may tend to seek out more stable assets.

A concrete example can be illustrated in the context of Indonesia's economic growth. For example, when Indonesia records significant economic growth, such as through increased infrastructure investment, increased production in the industrial sector, and increased exports of commodity products, international financial markets can respond positively to Indonesia's economic performance. Investors and foreign currency market participants can see the potential for higher profits, and as a result, the rupiah exchange rate can strengthen.

Conversely, if Indonesia faces economic challenges, such as slowing growth or significant political uncertainty, markets may respond with caution. Investors may feel greater risk, and the impact can be reflected in the decline in the Rupiah exchange rate. Therefore, in-depth research on how economic growth affects market perception of the Rupiah exchange rate can provide a better understanding of designing responsive and sustainable economic policies.

2. Inflation and Interest Rates

Inflation and interest rates are two key economic factors that have a direct impact on the Rupiah exchange rate in Indonesia. Inflation, which is a general increase in the price of goods and services, can affect the purchasing power of domestic currencies. If the inflation rate is high, then the purchasing power of the Rupiah can be reduced, and this can be detrimental to the exchange rate. On the other hand, the interest rate, which is the cost of borrowing or the return on investment, also affects the exchange rate. Appropriate monetary policy, especially those implemented by Bank Indonesia, can be an instrument to control inflation and influence interest rates.

Inflation can be measured by taking a comparison between the CPI in a given year and the CPI in the previous year, then multiplying the result by 100 to convert to a percentage. If the result is positive, it indicates the presence of inflation, while if it is negative, it indicates deflation.

An increase in the inflation rate could reduce the purchasing power of the Rupiah, while rising interest rates could make Rupiah-denominated assets more attractive to foreign investors, increasing demand for the currency and potentially strengthening the exchange rate. Conversely, low interest rates can reduce the attractiveness of domestic currencies. Therefore, a deep understanding of the balance between inflation and

interest rates as well as the prudent implementation of monetary policy are essential in maintaining the stability of the Rupiah exchange rate.

Economic Policy

1. Monetary Policy

Monetary policy refers to the measures taken by monetary authorities, including central banks such as Bank Indonesia, to control the money supply, interest rates, and liquidity conditions in an economy. In this context, monetary policy can have a direct impact on the exchange rate of the country's currency, including the Rupiah. This study aims to evaluate the extent to which Bank Indonesia's monetary policy is effective in managing the Rupiah exchange rate.

Bank Indonesia uses a number of monetary policy instruments to achieve its objectives, including maintaining exchange rate stability. These instruments involve setting interest rates, currency intervention, open market operations, and regulating the money supply. This evaluation of the effectiveness of monetary policy involves an analysis of how each instrument affects the factors that contribute to the Rupiah exchange rate.

First, the study will look at the influence of interest rates. Bank Indonesia may change the benchmark interest rate to affect interest rates in the financial market. Higher interest rates could make investing in the Rupiah more attractive to foreign investors, increase demand for the currency, and potentially strengthen the Rupiah exchange rate. Conversely, lower interest rates can stimulate domestic lending and investment, but it can also make the rupiah less attractive to foreign investors.

Furthermore, currency intervention is a policy instrument by which Bank Indonesia can buy or sell the Rupiah in the foreign exchange market to influence the exchange rate. These interventions can be used to maintain stability or overcome excessive market turmoil that can harm the rupiah exchange rate. Open market operations involve buying or selling government securities to control the money supply. If Bank Indonesia wants to encourage the appreciation of the Rupiah exchange rate, they can conduct open market operations to withdraw money from the market, reduce liquidity, and in turn, increase the Rupiah exchange rate.

This study will assess the extent to which each monetary policy instrument affects the rupiah exchange rate, as well as measure its effectiveness in achieving the goal of exchange rate stabilization. Thus, a deep understanding of Bank Indonesia's monetary policy and its impact on

the Rupiah exchange rate will provide important insights for the formulation of economic policies that are more effective and responsive to changing market conditions.

2. Fiscal Policy

Government fiscal policy includes measures to regulate the level of government spending and revenue, including spending on public spending and revenue from taxes. These decisions can have a direct impact on the rupiah exchange rate and the national economic balance. This study will examine how fiscal policy plays an important role in shaping the Rupiah exchange rate.

First of all, the research will explore the relationship between the level of government spending and the Rupiah exchange rate. If the government increases public spending, especially for infrastructure projects or economic stimulus programs, this can increase the demand for goods and services in the country. This increase in demand can create inflationary pressures, which in turn can affect the Rupiah exchange rate. Rising inflation can make domestic currencies lower in value, leading to exchange rate depreciation. Furthermore, the research will examine the impact of government tax policies. If the government enacts changes in tax policy, such as lowering corporate tax rates or providing tax incentives for investments, this could increase the attractiveness for foreign investors. Increased foreign investment can increase demand for the rupiah currency and potentially strengthen the exchange rate. Fiscal policy can also affect the government budget and its deficit or surplus. If the government experiences a budget deficit, meaning that spending exceeds revenue, the government must borrow to cover the shortfall. These loans can increase the level of government debt and affect investor confidence in economic stability. If investors are worried about high debt levels, the rupiah exchange rate could weaken.

Conversely, conservative fiscal policy, with the government maintaining a balanced budget or surplus, can create economic stability. Prudent fiscal policy can provide positive signals to investors and market participants, increase confidence in the rupiah, and potentially strengthen the exchange rate. This research will provide in-depth insights into how government fiscal policy plays a role in shaping the Rupiah exchange rate, and the results can provide the basis for the formulation of more effective and sustainable economic policies.

CONCLUSION

The main purpose of this study is to investigate and analyze the dynamics of foreign exchange supply and the factors that affect the Rupiah exchange rate in Indonesia. By presenting an in-depth insight into the foreign exchange offering mechanism and the factors that play a key role in determining the national currency exchange rate, this study is expected to provide a better understanding of the complexity of the foreign exchange market in Indonesia.

The results of this study are anticipated to make a significant contribution to economic policy at the national level. These findings can be a solid foundation for more precise and effective economic decision-making. In addition, a better understanding of the factors that affect the rupiah exchange rate can be the basis for designing policies that can improve economic stability, manage inflation, and increase export competitiveness.

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