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STUDY OF REGIONAL DIMENSION AND MONETARY POLICY IMPACT ON ECONOMIC GROWTH, INCOME INEQUALITY AND INFLATION STABILITY IN THE THREE ECONOMIC CORRIDOR OF INDONESIA

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ABSTRACT

The slow-down of international financial markets performance have strightly affect to the domestic financial sector growth in Indonesia. To be extended, some macroeconomic targets might be difficult to be realized. On the other hands, Indonesia still faced the problems of financial development process that needs to be more liberalized to adjust with the structure of the international financial system.
This study focuses on the impact of monetary policy on macroeconomic performance in the regional contexs, focuses on regional dimension of monetary policy based on the performance of the financial markets, so that its can be seen the dynamics of the structure of financial markets in different regions as an indicator of the monetary shock variable that transmissed the flexibility of the financial sector to the real sector, including the expansion of investment and export trade area.
This research found that the real GDP growth of the three economic corridor have difference performance innovation compared between Java corridor, non Java with mineral and forest production (Sumatra, Kalimantan, Sulawesi, Papua) and non Java tourism and Food production (Bali, NTB, NTT).

INTRODUCTION

The global crisis of world economy that have been impact to Indonesian economy in 1997. In this case, Indonesia and some ASEAN Member countries were less anticipations in preparing the role of financial structure strategies for managing the world economy crisis impact to ASEAN countries. Many factors that were remain uncertain even today including how the fiscal and monetary will be stimulate that many governments have hurriedly crafted are working to revive afflicted economies. At the economy crisis conditions, while there have been possible daily reports of firms shutting down and laying off workers, and in some cases it is still uncertain how these have affected jobs that have been out of local and national firms. The current crisis is leading many people to believe that the phenomenon of slowdown growth of global economy in many parts of the world is come to be learning how Indonesian economy will be organized domestically to have more resistence from the global impact of economic crisis.

Our focus study do believe that the sixth corridor economy of Indonesia must be fully organized and now connecting with monetary policy stance as monetary policy orientation in the coming year will see a stabilization and regional based growth.

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This study focused tends to believe that regional dimension comprehensive approaches at the 6 economic corridors will be starts as regional potential economic sources of the country.

While it is still too early to accurately gauge the full impact of the global economic crisis on Indonesian economy after the year of crisis in 1997, but it is clear that earlier trends will not be sustained because of worsening economic conditions in major destination countries. All indications point to a deepening crisis that will further cut back international trade and foreign investments, the two important economic pilar would be propellers of growth in this region. While the economic crisis perhaps the learning process for monetary policy stance and is is expected to see much challenges for formulating and renewed the regional dimension target in job creation, finance market development, trade-related industries such as export manufacturing and shipping, and international capital mobility.

The hope is that current efforts to restore confidence and stimulate investments will work quickly and bring everything back to where some aspects of financial market development is take fubction properly (Gurley dan Shaw, 1960). However some plocies restrictions were unlikely to happen. Restrictive policies on financial market and banking industry admission and restrictions adopted in response to open financial market will likely be sticky and stay even when negatively impact to economic growth (McKinnon and Shaw, 1973).

It has been clear that countries, the benefit from liberalizing the financial market will be almost improving banking

industry intermediations and therefore open more opportunities for entrepreneur and investors to achieve some capitals they need to finance their operational cost, investment expansions and other productive activities. Marcelin and Mathur, (2013) states that the slow process of financial market development would be impact to banking intermediation The strategic issues that how monetary policy would be impact to real economic activity with the same policy but with the different outcomes (Carlino and DeFina, 1998) will be continue heatedly debated within a large body of literature. (Owyang and Wall, 2009); Duran and Edim, 2014). Based on conventional theory of monetary economics that monetary policy is primarily designed to discuss for national purposes, such as price stability, money aggregates instrument, interest rate policy, but its might be impact slightly different across regions and sectors (Carlino and DeFina, 1999); Anagnostou and Papadamou, 2012; Goodness and Ragan, 2012) and as we continueing to search that Indonesia monetary policy decisions may have strong effects in some regions and have just a little effects into others regions, wille be further impact to be consequently of the increasing income inequality between regions in Indonesia.

The conventional theory of inflation targeting formulated by Bernanke and Gertler, (1995), and Taylor (2000) as policy recommendation for Central Bnk of Indonesia and its policy implication as one monetary policy for all regions, will be continue heatedly debated within the reasons of why some regions may respond more strongly or little respond is the policy challenging topic both theoretically and empirically as some study selected found (Carlino and DeFina, 1999); Anagnostou and Papadamou, 2012; Goodness and Ragan (2012), Agus M Ridwah (2012).

Indonesia have more than 240 billion population, with Jakarta as the center of government and also the center of trade and industries distributed alongside of Java, otherwise there are some regions outside Java were less developed areas. As presented in Figure 1, Masterplan MP3EI defined Indonesia with sixt economy corridor that devided by corridor 1 od Sumatra, corridor 2 of Java, corridor 3 of Kalimantan, corridor 4 Sulawesi, Corridor 5 Bali Nusra and corridor 6 Papua (see figure 1.). The sixth economy corridor were devided based on the stages of development, natural resoorces and some priorities strategies and potential connecting each-others in the long-run (see Masterplan MP3EI Bappenas, 2015).

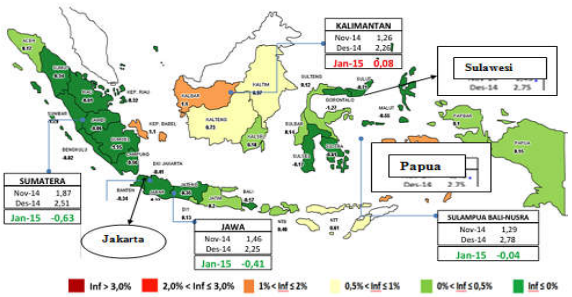

Figure 1 The `Sixth Indonesia Economy Corridor

LITERATUR REVIEWS

The macroeconomic modeling is developed in this reasearch based on some literature that more focused on interest rates sentitives rather than the monetary aggregates instrument policy. Bernanke and Gertler, (1995), Taylor (1993), Anagnostou and Papadamou, 2012) that summarized the interest rates channel as the instrument for supporting economic growth via credit channel and its macroeconomics impact at the next periods to the form of regional income redistribution and inflation.

Regional Dimension of Monetary Policy

The initial development monetary policy theory would be hypothesis that the *interest rate policy as one monetary policy stance to many regions (the sixth regions), than* responsiveness of a region to a monetary policy shock depends on its industrial structure. (Carlino and DeFina, 1998; population density (Carlino and DeFina,1999). Some regions that become the centre of manufacturing industries have more responsive of interest rates instrument sensitives to output (Ridhwan *et al*. 2010).

The second channel that interest rates instrumens is sentitives to make different outcome in regional setting is the credit channel that might be slightly differs between regions is that according to the fact that the regions look very sensitive to the related firms sized and banking sizes that performs different service and access to financial resources. The cooridor Java is the central of manufacturing with large firms generally have greater financial access resources compared with other regions outside Java.

The third channel would be different perform in some regions will be concerns with the transmission of monetary policy via exchange rate, as we assumes that regions cannot closed to internasional trade market, however, exchange rates play important role in supporting export–import activities (Jalil, 2012); Mah *et al*, 2010). In this cases, the trade sensitives to exchange rates is depend on competitiveness based of the regions.

The Fourth channel would be the role of financial deepening that might be perform in different outcome. As Levine and Zervos (1996) states that financial development empirically have strong relation with economic growth. Gordon dan Winton (2001) argue that the financial reform and development in some countries since 1970's empirically improved economic growth of the nations. The financial reform and liberalization of Singapore was improved financial structure more effectively (Yong and Nah (2012. Another study of financial deepening reported by Ang (2005) for Malaysian financial liberalization that successly support the better condition for the country financial marjet structure.

In the case of financial deepening channel, Francis *et al.* (2011) have found that the impact of *monetary shock* is slightly different between regions in United Kindom. The differencies respond in monetary shocks mainly caused by regional density of population and the scale of government service of that regions.

Cortes and Kong (2007) reported the centralized monetary policy stanch of China have different impact and outcome between regions. These differencies would be occurs because of different geographic of industrial activities and agricultural area. In industrial sector, transaction is more gradual and crowd rather then in agricultural region.

Macroeconomic Modeling

Regional dimension of monetary policy will be developed based on Dow dan Montagnoli (2010) that evaluating the monetary policy instrument as suitable for financial market development in the regions. The first model developed is to design the financial market formulation in thase regions, and at the second steps is to examine the monetary shocks of using interest rates as monetary policy instrument, and for any reason of open economy that currently updates, so that the monetary shocks also come from the movement of fluctuation of exchange rate dynamics.

While it is both of interest rate and exchange rates are monetary policy instruments and conducted as one policy for many regions, and we tends to believes as Dow and Montagnoli (2010), Cortesd and Kong (2007) that the centralized monetary policy stanced have different outcome because of different in economic industrial structure of the regions (Ridhwan *et al*, 2011); Francis *et al*, 2011). The model can be formulated as in Figure 1.

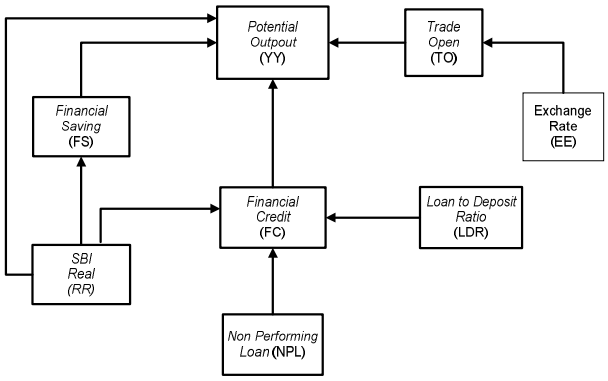

Figure 1 Monetary Policy Model of Regional Dimension

(4)

We used VAR methods to solve structural equation model as figured in eq (1) as the regression model and eq(2), eq(3) and eq(4) can be seen as simultaneous process (see Pyndick & Rubinfeld, 1994), Gujarati (2004).

METHODOLOGY

Data Sources

The data used of this research is come from regional time-series data pubished by Statistical office Jakarta (BPS, 2015). The time series data available is depend on the macroeconomic variable that design for. We used 25 series data from 1989 to 2015, which that devided into three economic corridor of Indonesian economy. The first economic corridor is the trade and manufactured centered Java economic corridor. The second economic corridor includes Sumatra, Kalimantan, Sulawesi and Papua as known potentially in mine and mineral sources production. The Third economic corridor is Bali, NTB and NTT that can be identified as the tourism and food adplantation production. We believe the three type of economic corridor will be take as the similarity of economic sourves, social problems and manpower available for economic development process.

Data Analysis

The limitation of data series that less than 30 years of data sample, because of that data sources limitation, than TSLS methods impossible to use (see Pyndick and Rubinfeld (1994). Another method that possible to develop is VAR methodology as that each variable is treated as endogenous and is modeled as a function of its lagged values and other variables.

Therefore, the advantage of the VAR is that all variables are treated as endogenous to avoid the criticism associated with the specification of structural models. To be expanded, that the vector autoregression technique is appropriate for examining the response of regional economic growth to the unexpected shock in interest rate and exchange rates instruments. The impulse response functions which trace the magnitude of the response of four block macroeconomertic models can be estimated. The vector autoregressivion technique also allows for getting an indication of the dynamic importance of the pass-through effect through variance decompositions.

Research Hypothesis

Based on Figure 1, we can design in detail the quantitative model as below,

$$YY_t = \alpha_1 + \beta_1 FS_t + \beta_2 RR_t + \beta_3 FC_t + \beta_4 TO + e_1$$

$$FS_t = \alpha_2 + \beta_5 RR_t + e_2 \quad (2)$$

$$FC_t = \alpha_3 + \beta_6 RR_t + \beta_7 NPL_t + \beta_8 LDR_t + e_3 \quad (3)$$

$$TO_t = \alpha_4 + \beta_9 EE_t + e_4$$

Finding

To achieve the core objective of this paper of analyzing the macroeconomic impact of the three economi corridor of Indoinesia, sucah as Java corridor, Non Java mine production (Sumatra, Kalimantan, Sulawesi and Papua), and non Java tourism (Bali, and Nusa Tenggara), this macroecomic of corridor is design to adopted a Vector Autoregression (VAR) model to investigate the impact of economic growth and inflation as the key macroeconomic variables that injected by centralized monetary policy.

We investigated The VAR impulse response function and granger causality test were used to analyze the effects of monetary policy of interest rate instrument and exchange rate

depreciation on output and prices. Mordi (2013) argue that VAR methods is an n-equation, n-variable linear model in which each variable is in turn explained by its own lagged values, and past values of the remaining n-1 variables. It is a simple framework that provides a systematic way to capture rich dynamics in time series data that as describes in Figure 1.

To test for the stationarity of the variables to ascertain their order of integration, we used Granger representation (Gujarati,2004). The results indicates all data series have cointegrated and stationair, so that the VAR methods is available to use.

VAR Estimation of Economic Corridor Indonesia

We estimated using an unrestricted VAR equation with two lag lengths, and proceeded that methods in order to find out the lag length criteria selection, residual tests and stability test for the model selection. Due to the sample size of data series to be used for analysis, we clarify for the first steps of the VAR methods using combined graphical presentation of impulse response, as presented in Figure 2. Using data periodsof 25 years, we carried out an an impulse response analysis of real GDP, and financial deepening model (Beck and Levine, 2000), the relation between output and interest rate as discussd in Taylor (1999), and the monetary policy regional dimension as discussed in Corina dan Defana (2001) can be postulated as three economic corridor modeling, as compared with each–other to have if there are different shock of monetary policy to those of regions.

The impulse response graphs shown in Figure 2 indicated short run and long run impact of four macroeconomic variables. As presented in Figure 2, the real GDP only respond to innovations from either macroeconomic variables values, but not for long-run periods.

The interest rate as monetary policy instrument also indiciates innovation at the same direction as the real GDP done. Based on figure 2, we have seen that regional credit performance and regional saving performance did not respond to innovations. In this cases, as we focus on the study of regional dimension of monetary policy, we can conclude that the financial market of FC and FS macroeconomic variables have slow speed to innovations.

We start to investigate in the first steps and compared with the three regional macroeconomic blocks and try to understand monetary policy impact to regional corridor condition of Indonesian economy. Figure 3 presented the impulse response of non Java mineral production as Sumtatra, Kalimantan, Sulawesi and Papua.

The impulse response graphs as shown in Figure 3, the real GDP have difference performance innovation compared with Java corridor. The Real GDP respond to innovations have short-run impact and look more stabilized to move to long-run response of innovations.

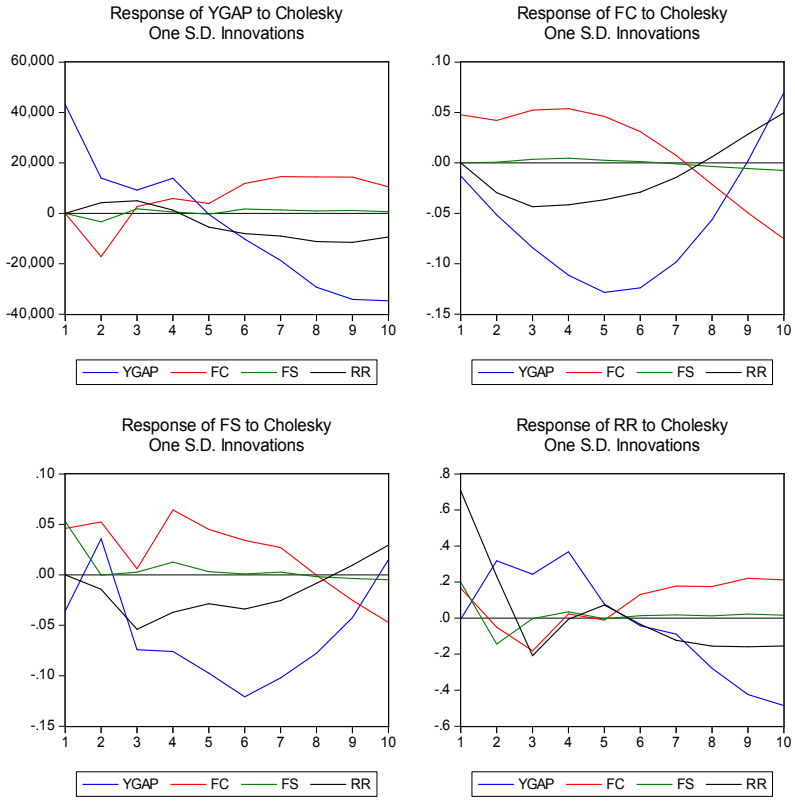

Figure 2 Var Impulse Response of Economic Corridor of Java

For financial market response, the credit market and saving mobilization at regional level, indicates more dynamic compared with Java corridor. This is the first indicator we start to investigate that regional condition has different response in conneting with centeralized monetary policy stance.

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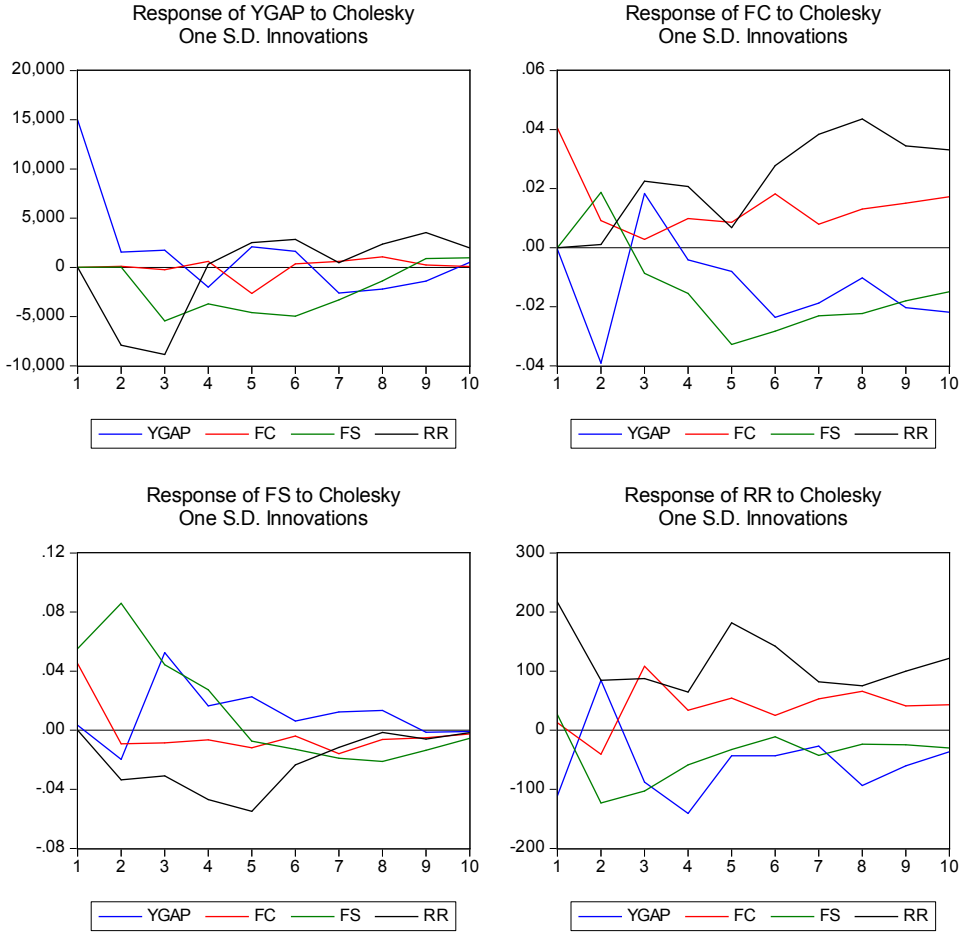

Figure 3 Var Impulse Response of Economic Corridor of non Java mineral and other natural resources (Sumatra, Kalimantan, Sulawesi, Papua)

This research is consistence with Carlino and Defina (1998), Duran and Edim,2014), Ridwan *et al* (2011), that monetary policy would be impact to real economic activity with the same policy but with the different regional outcomes, and we continueing to search that Indonesia monetary policy decisions may have strong effects in some regions and have just a little effects into others regions and for some reason, wille be further impact to be consequently of the increasing income inequality between regions in Indonesia.

The impulse response graphs shown in Figure 4 indicated short run and long run impact of four macroeconomic variables as before, but with non Java tourism and food and fishery area (Bali and Nusa Tenggara Corridor).

Tourism and Foof production center (Bali, NTB, NTT) The real GDP only respond to innovations from either macroeconomic variables values, but not for long-run periods. The interest rate as macroeconomoic instrument also indiciates innovation at the same direction as the real GDP done. Based on figure 2, we have

The essence of monetary policy dimension is to investigate how the intererest rate policy impact to economic and development of the corridor. However, we do evaluate when certain limits of financial markets are reached further more deep or shallow that might be possible to hamper growth and even more development. This paper has investigate in the beginning to analyz the impact of economic growth of the three economic corridor as the monetary poliy stance will be done and some extended impact on some key macroeconomic variables in Indonesia. This study standing for erlier investigation to see the profile outcome for economic growth, financial market and monetary policy instrument (see equation (1)) using impulse response VAR analysis in the separate analysis of three economic corridor of Indonesia (see Figure 2, Figure 3 and Figure 4.).

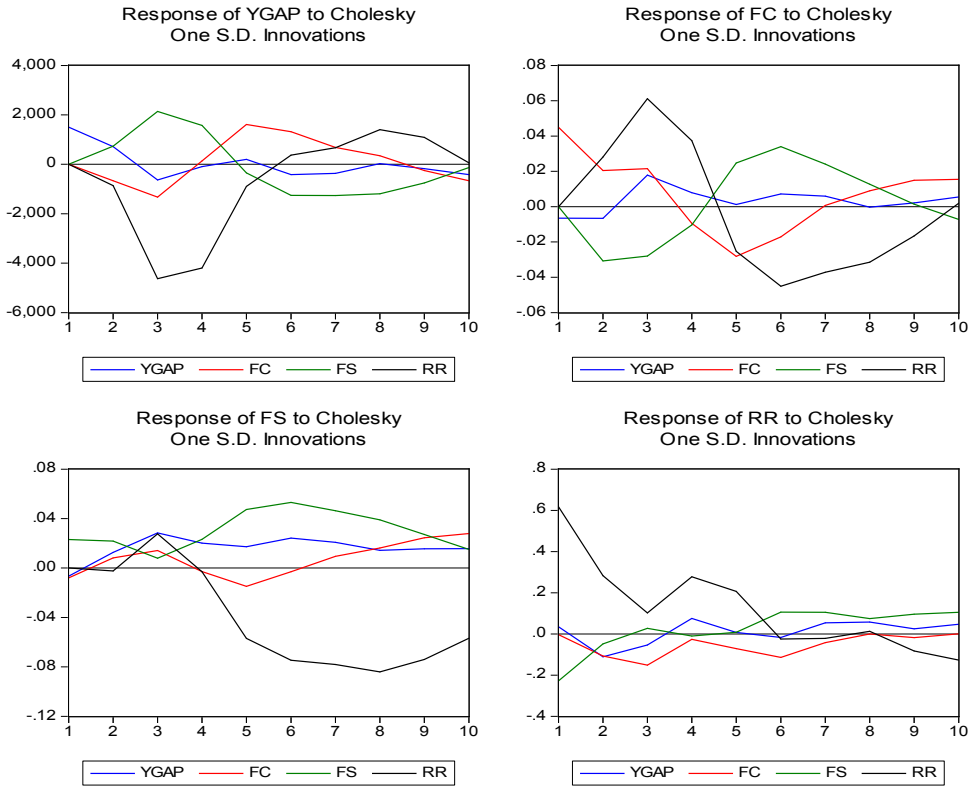

Figure 4 Var Impulse Response of Economic Corridor of non Java

CONCLUSIONS AND RECOMMENDATIONS

Bases on our findings and analysis, we than summarized the following research steps and policy recommendations.

1. The impulse response analysis indicated that the real GDP growth of the three economic corridor have difference performance innovation compared between Java corridor, non Java with mineral and forest production (Sumatra, Kalimantan, Sulawesi, Papua) and non Java tourism and Food production (Bali, NTB, NTT) as the GDP different response in =financial market respond to innovation have short-run and long run impact to economic development process and growth of the each corridor.
2. This research is report at the earlier steps of research investigation of economic growth performance, financial market and monetary policy stance of interest rate policy as design and analyzed using VAR impulse response indicated the first investigation result that financial market response, the credit market and saving mobilization at regional level, indicates more dynamic compared with Java corridor. This is the first indicator we have found that regional economic condition of the corridor have different response in conneting with centeralized monetary policy stance.

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