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Review of Literature: The Impact of Inflation on Indonesia's Economic Growth

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Abstract

This article's literature assessment attempts to address theoretical gaps about Indonesian inflation. A phenomenon known as inflation occurs when the cost of goods and services typically rises. The value of a nation's currency can fluctuate due to inflation, as can the supply and demand for products and services. Growth in the economy and inflation are closely associated. An essential measure of a nation's economic progress is its rate of economic growth. Economic growth in the nation is boosted by low and stable inflation. Conversely, unstable or too high inflation will impede the nation's economic expansion. The Indonesian economy is still developing, which reflects the way the inherent instability of the global economic scene is balanced. Indonesia must continue to go in the right direction by accelerating structural change, protecting vulnerable groups, fostering sustainable growth, and maintaining stability. Despite ongoing difficulties, the Indonesian economy is prepared to respond to changes in the world economy by taking sensible and quantifiable action. The Indonesian economy is predicted to be able to withstand the storm of internal and international problems in 2024 and the years that follow, as well as sustain a robust rate of economic growth based on stability, quality, and sustainability, with the right plans and strict yet flexible policies.

INTRODUCTION

The two most important ideas, inflation and economic growth, remain the focus of discussion and analysis due to the complexity of the contemporary global economic order. Inflation, to put it simply, is the general and ongoing rise in the cost of goods and services. Economic growth is the long-term capacity of a nation to generate a variety of goods for a growing population, whereas economic growth indicates the increase of economic activity in a country or region (Simanungkalit, 2020). These two ideas have significant effects on the welfare and stability of society, and they have a number of ramifications that call for careful thought and comprehension.

Basically, an imbalance between supply and demand in the country's economy is reflected in inflation. Price increases that are excessively large might harm consumer purchasing power, interfere with resource distribution, and create uncertainty in economic planning, even while the economy is still under control for inflation (Fadilla and Purnamasari, 2021). In addition, a nation's fiscal and monetary policies may be impacted by inflation, which calls for careful management in order to preserve price stability and balanced economic growth.

Conversely, economic growth denotes the increase in a nation's or region's economic production over a specific time frame. Benefits from sustainable economic growth include higher employment rates, higher per capita income, and more investment opportunities. However, there can be drawbacks to economic expansion as well, particularly in regards to equitable wealth distribution, environmental effects, and social inequalities (Khabibi et al., 2020; Purba, 2020).

It is critical to realize that, in the context of the global economy, inflation and economic growth are inextricably linked. When supply outpaces demand, higher economic growth frequently results in inflation, although inflation control measures can occasionally slow down the rate of economic growth (Wiriani and Mukarramah, 2020). Therefore, striking the correct balance between controlled inflation and sustainable economic growth is essential to a healthy economy.

Examining the intricate connection between inflation and economic expansion is the goal of this essay. We look at the driving forces, how they affect industry and society, and how government and central bank policies have shaped these trends. A thorough knowledge of the connection between inflation and economic growth is crucial for society and policy makers in the face of quickly shifting economic dynamics.

An economic phenomena known as inflation occurs when prices in a nation steadily rise over a certain length of time. A country's currency loses purchasing power due to inflation, requiring consumers to spend more money on products and services. Excessive demand, rising production costs, rising salaries, and changes in global prices are some of the factors driving inflation. While low inflation might stimulate spending, large inflation can lead to economic instability. Deflation, on the other side, is a decline in general prices that might impede investment and consumption as well as cause a recession. Adequate fiscal and monetary policies are necessary to control inflation (Pujadi, 2022).

The study "Factors that Influence Indonesian Inflation (Study During the Covid-19 Pandemic)" by Simon (2023) then goes on to demonstrate that, in terms of larger monetary policy, inflation is the outcome of the interaction of numerous complicated factors. The discrepancy between the amount of money in circulation and the demand for goods and services by the general public is one of them. Cash, demand deposits, fictional money, money, and securities are all considered narrow money (M1) and broad money (M2) in Indonesia, according to Bank Indonesia. A notable expansion of the money supply in this category may be a sign of impending inflation and currency devaluation.

It is well recognized that the degree to which the prices of products and services in the economy rise can be used to categorize inflation. The term "mild" is one of the characteristics used to categorize inflation into multiple groups. "Inflation is the term used to describe a rise in goods prices of less than 10% annually. The term "medium" inflation refers to price increases that range from 10% to 30% annually. A year-over-year price increase of between thirty and one hundred percent is considered "high" inflation. Inflation hits "hyperinflation" levels at the same moment if annual price rises surpass 100%. In order to preserve price and economic stability, monetary and fiscal policy must take into account the economic effects of varying inflation rates, and this classification offers a framework for doing so (Riyono et al., 2022).

A complicated economic phenomenon, inflation has many origins and effects in different nations. When a nation's currency loses value in relation to goods like gold or foreign money, inflation takes place. For the sake of preserving economic stability and long-term prosperity, this phenomenon needs to be observed and managed. Inflation significantly affects a number of facets of life in Indonesia. In general, rising costs for products and services cause disruptions to society and economic decision-making. People's decisions about short-term and long-term investments, which have an impact on wealth creation and overall economic growth, can be influenced by inflation. Due to its potential to impair capital budgets, lower manufacturing efficiency, and disturb company planning, inflation also affects the world of business. In addition, the social effects of inflation are linked to income factors, like the persistence of the value of money, which can have an impact on people's purchasing power and lead to economic inequality. In order to preserve a balance between price stability and economic growth, monetary and fiscal policies are necessary for controlling inflation (Salam, 2020).

The macroeconomic framework places a great deal of importance on tracking and managing inflation rates. It is critical to regulate inflation because it has the potential to undermine social welfare and economic stability, particularly when it rises to high and unstable levels. Reduced consumer purchasing power, lower investment, and uncertainty in financial planning are some of the factors that have an influence. The central bank and the government must work together to manage inflation through monetary and fiscal policy. In order to ensure long-term economic stability and enhance the community's quality of life, cooperation between the two is crucial in creating an economic climate that supports equitable community welfare and sustainable growth (Martanto et al., 2021).

Aside from that, Muslimah and Indrawati (2022) looked at how the local economy grows and highlighted "The Influence of Inflation, Exports and Inflation, Exports and Labor Absorption on Economic Growth (Domestic Regional)." One of the achievements of regional economic development is the speed of economic growth, which demonstrates expansion in production across a number of sectors. This growth may be precisely and meticulously quantified using the gross regional domestic product based on fixed prices. Because data on the growth rate of gross domestic product may be used to determine regional economic growth outcomes based on fixed prices, gross regional domestic product serves as a representation of economic growth. There is a direct proportionality between regional economic activity and economic growth. A region's economic activity is deemed positive if it is growing quickly (Hodijah and Angelina, 2021).

The government is working to promote economic growth, particularly through exports. The money made from these exports can be used to pay for the import of capital goods and raw materials. Purba (2020) asserts that exports serve as a "engine of economic growth" in underdeveloped nations. The robust performance of domestic economic activity is indicated by the increasing growth in export operations. The business community is encouraged to boost its output by the inflation-related pricing increases. Because it can raise the nation's gross regional output, this rise in production has a favorable effect on economic growth. (Simanungkalit, 2020). People who were previously able to purchase goods and services are now unable to do so or have reduced their use of goods and services as a result of inflation-related price increases. (Purnamasari and Fadilla, 2021). The worth of the nation's economy is diminished by slow economic activity, which also leads to economic instability, (Mukarrah and Wiriani, 2020)

RESEARCH METHOD

The author employs qualitative research techniques in this piece. In qualitative research, phenomena are explored and understood through the process of data filtering and collection. The description of phenomena is more descriptive when using this strategy. Document analysis is the method utilized in this study to acquire data. Document analysis, according to Adlini et al. (2022), can be done by going through a variety of documents or literature, including books and magazines, as sources of research data.

RESULTS AND DISCUSSION

The occurrence of persistent price increases over a predetermined length of time is known as inflation. When most goods and services see price increases—rather than just one or two—it is referred to as a "overall price increase" in this context. A country's currency's value fluctuates due to inflation when it tends to lose purchasing power relative to the products and services it can buy. Deflation, on the other hand, is the exact reverse of inflation and describes a widespread decrease in prices (Pujadi, 2022).

According to monetarist theory, the money supply as a percentage of the total amount of demand drives inflation. Bank Indonesia divides the money supply into two categories for the Indonesian government: narrow (M1) and broad (M2). Demand deposits and cash are included in M1, whereas practically all cash and securities are included in M2. A rise in the money supply suggests that inflation may rise and the value of money may decline. Inflation is influenced by the currency rate in addition to the money supply. The stronger the home currency, the tendency for import prices to decline, and the rise in people's purchasing power, the closer the exchange rate is to inflation. However, there are financial dangers associated with the indigenous currency's decline. Inflation can also be attributed to growing interest rates, which in turn have an impact on the nation's rising inflation rate (Simon, 2023).

A number of factors affect a nation's inflation rate, some more than others. A minimum amount of inflation should be maintained, which is defined as the decrease in the value of a nation's currency relative to goods like gold or foreign money. In the Indonesian context as well, this economic phenomenon results in an increase in the general cost of products and services. Because inflation has negative effects including low production efficiency and productivity, increasing capital expenses, and uncertainty about future costs and income, it encourages people to focus more on work than investments (Salam, 2020). A key component of economic policy is keeping inflation under control since it has a negative impact on both the purchasing power of the populace and the nation's financial stability.

An important aspect of macroeconomics is managing the pace and degree of inflation. Because of the influence that inflation has on people's wellbeing, particularly when it is high and uncertain, effective inflation management is crucial to preventing welfare declines (Martanto et al., 2021). The government and central bank must manage inflation. To achieve equitable social welfare, the government and central bank must cooperate to bring inflation down to a low and stable level.

Economic growth, according to Halim (2020), can be defined as a nation's efforts to raise its gross regional product by 5–7% year over a reasonably annual period. A nation's gross domestic product is considered to be excellent for economic growth if it reaches a certain level. Assume the characteristics used to measure a nation's economic growth in order to assess its quality. When it comes to calculating economic growth, developed and developing nations differ from one another. While developing nations utilize it for gross national product, developing nations typically use it for gross regional domestic product.

One of the most significant measures of a nation's development and progress is its economic growth. In this instance, it has the potential to raise per capita income and hence enhance national welfare. Thus, a nation's performance in terms of economic development can be gauged by its rate of economic growth. Later on, additional macroeconomic issues like inflation, rates of poverty or unemployment might be linked to economic growth. (Angelina and Hodija, 2021).

Purba (2020) states that enhancing export activity is one way the government may contribute to economic progress. In actuality, the nation's economic growth must be supported by the state. A nation can add one unit to its productive capacity through exports. Furthermore, exchange value results from exporting goods and services, where money can be imported as capital goods and raw materials to raise the added value of the nation.

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Increasing export activity is one way the government may contribute to economic growth. In actuality, the nation's economic growth must be supported by the state. A nation can add one unit to its productive capacity through exports. In addition, money is made through exporting goods and services, which can be utilized to import capital goods and raw materials and raise the added value of the nation.

Sarbaini and Nazaruddin (2023) assert that maintaining stable and low inflation will boost economic growth. This number is a result of robust economic growth and stable, low inflation. Entrepreneurs are encouraged to boost their production by low and stable inflation (Simanungkalit, 2020). Because they anticipate more earnings, entrepreneurs are encouraged to boost production as a result of inflation-related price increases. Increasing production translates into an increase in economic growth as measured by the gross domestic product.

Growing costs motivate business owners to boost output. Nonetheless, the economy will suffer if inflation or price increases are excessive. People who were previously able to meet their daily necessities are now unable to do so because of price rises brought on by excessive price increases or inflation (Fadilla and Purnamasari, 2021). Economic instability and a deceleration in economic growth are the consequences (Wiriani and Mukarramah, 2020). Economic growth may also be negatively impacted by inflation that is too low and erratic (Suriyani and Sudiartha, 2018). The incentives for entrepreneurs to boost production are diminished by modest, inconsistent price rises. This has an impact on the GDP and the growth of the national economy.

CONCLUSION

We can conclude that inflation does not necessarily have a negative effect on a nation based on a variety of analyses and findings. But this is dependent on how much inflation a nation experiences. A nation's economic health is shown by low and stable inflation, which has a positive impact on the economy. Price stability is the result of low inflation. There will be some detrimental effects, though, if inflation is excessively high or has a tendency to be unstable. High inflation causes prices to rise quickly and become unstable. People's purchasing power may decline as a result, lowering their standard of living. Furthermore, a nation's economic growth is slowed by high inflation. By taking into account the nation's economic growth and price stability, the government can maintain low and steady inflation throughout the year. An annual inflation target of two to three percent may be set by the government. Furthermore, the central bank's duty of monetary management and interest rate setting are two more tools for controlling inflation. As a result, the government and central bank must work together to maintain low and steady inflation and promote strong economic growth.

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