CHAPTER I
INTRODUCTION

1.1. Background

Investment is a crucial point to reduce the probability for the economic growth to drop or increase the economic growth of Indonesia to drop as Indonesia country is more of a consumptive than a productive, according to Ardana Yasa (2012). Investment is proof to be effective to increase the economic growth in 1998 when there happen to be a financial crisis

Investment is an expenditure made now to make gains in future (Avram et al, 2009). Investment decision issue is discussed and dealt with international institution like World Bank, European Commission, European Bank for Reconstruction and Development and others at the present. These institutions are the one who formulate some specific methodologies to manage investment decisions (Avram et al, 2009).

According to Yasa (2012), the role of investment is a crucial point to be able to prevent a lower decline or even increase economic growth because Indonesia is a consumptive country not a productive country and considering that the trade balance in Indonesia has a deficit. According the research conducted by Yasa (2013), investment in Indonesia increased from Rp 205,6 Trillion in 1999 to Rp 983,9 Trillion in 2007. Indonesia is also able to rise after global crisis that greatly impacted the Indonesia economy in 2008. Based on data from the Investment Coordination Board, the total Investment realization from 2009 to 2012 increased by Rp 173.825 trillion. This caused Indonesia to become number three for the highest economic growth in Asia in 2011.

Individual saving has an Important role in the economy in maintaining the economy condition where it able to reduce the poverty. Investment is a means to contribute with intend to relocate some apportion of cash or different assets with the hope to increase value of the asset in the future. This increase on the value of the asset of investment is called ‘Return’. For a Financial specialist or the Investor expect to gain or create a higher return from their investment. Investment is divided into two avenues, the Financial Investment and Real Investment. For the present condition, Investor and Financial specialist is preferred for an investment tool that able to protect the value of the wealth than increase toe wealth

Indonesia's economic growth in 2014 is estimated to decline by0,3% from the economic growth rate in 2013 which reached 5,6%. The decrease can be seen in the Table 1.1. below.

Table 1.1. Projections for Indonesia's economic growth in 2014

Indicator	*R*			*December* IEQ		*Previous* (Oct)	
		2011	2012	2013p	2014p	2013p	2014p
Real GDP	(% *Change*)	6,4	6,2	5,6	5,3	5,6	5,3
Consumer Price	(% *Change*)	5,4	4,3	7,0	6,1	7,3	6,7
Current Account Balance	(%GDP)	0,2	-2,8	-3,5	-2,6	-3,4	-2,6
Major Trading Partner GDP	(% *Change*)	3,6	3,4	3,4	3,9	3,4	3,9

Source: *World Bank* (2013)

Monetary conditions were additionally questionable as observed from changes in the obtaining influence of cash will consistently changes as the cost of fundamental products increments. This change was brought about by swelling which diminished the individuals' buying intensity of products or administration because of the declining conversion scale people's purchasing power of goods or service due to the declining exchange rate.

According to Purnomo (2013), good investment is an investment that has a higher yield than inflation. According to Kurniawan (2013), the price of gold has increased from year to year exceeding inflation. This can be proven from the results of the research of Manurung and Silitonga (2009) which showed that the gold return rate was 13,59% higher than inflation rate of 10,08% in the period 1980 to 2008. Mieta (2013) was one of the financial researchers, stated that the increase in gold in 2010 – 2011 reached 25%, even though inflation occurred only at 5,38%. The difference shows almost 20%. So, gold is suitable to be a medium-risk or exceeds inflation even though the rate of return is not necessarily higher than stocks, bonds, mutual fund, and other investment tools as shown in the results of research by Manurung and Silitonga (2009) in table 1.2. as follow:

Table 1.2. Rate of return of various investment instrument

Tahun	IHSG	Deposit	*Money Market*	*Property*	Reksadana			Emas	*Index Bond*	CPI	Kurs Dollar
					Obligasi	*Mixed*	Saham				
1980	-5,90%	6,00%	12,87%	17,50%				101,33%		17,11%	631,80
1981	-3,17%	6,00%	16,26%	16,80%				-25,20%		7,32%	631,80
1982	-5,25%	6,00%	17,24%	16,10%				-15,43%		10,03%	653,70
1983	-9,87%	6,00%	13,17%	15,50%				75,95%		11,97%	1020,00
1984	-20,95%	16,00%	18,63%	14,80%				-7,93%		9,07%	1103,00
1985	-1,70%	18,00%	10,33%	14,10%				-11,31%		4,37%	1114,00
1986	4,75%	15,39%	13,00%	13,40%				33,66%		9,15%	1282,60
1987	18,50%	16,78%	14,52%	13,50%				55,67%		9,26%	1643,80
1988	269,48%	17,72%	15,00%	13,00%				0,25%		5,59%	1685,70
1989	30,99%	18,63%	12,57%	11,00%				-7,16%		6,11%	1795,00
1990	4,53%	20,99%	14,37%	9,50%				6,60%		9,53%	1901,00
1991	-40,79%	21,89%	15,12%	9,00%				-0,96%		9,52%	1994,00
1992	10,89%	16,72%	13,98%	9,50%				-1,67%		4,90%	2065,00
1993	114,61%	11,79%	12,00%	8,50%				6,92%		9,77%	2110,00
1994	-20,23%	14,27%	15,36%	8,50%				11,29%		9,24%	2200,00
1995	9,41%	17,15%	15,87%	8,00%				4,96%		8,64%	2308,00
1996	24,05%	17,03%	15,62%	8,50%	2,09%	8,38%	5,43%	4,21%		6,47%	2383,00
1997	-36,98%	23,92%	30,52%	9,00%	-1,87%	-16,74%	-36,92%	34,65%		11,05%	4650,00
1998	-0,91%	49,23%	64,08%	11,50%	-3,89%	27,64%	39,42%	87,50%		77,63%	8025,00
1999	70,06%	25,74%	23,61%	11,00%	26,96%	38,20%	85,28%	-20,00%		2,01%	7100,00
2000	-38,50%	12,46%	10,73%	10,50%	7,98%	-25,25%	-40,16%	16,67%		9,35%	9595,00
2001	-5,83%	13,78%	15,69%	9,85%	0,16%	-0,45%	-0,31%	21,43%		12,55%	10400,00
2002	8,39%	12,37%	13,73%	10,00%	-1,77%	12,75%	10,57%	0,00%	1,87%	10,03%	8940,00
2003	62,82%	10,39%	8,41%	10,25%	-10,47%	9,22%	70,61%	17,65%	25,18%	11,15%	8485,00
2004	44,56%	7,07%	7,43%	11,55%	4,08%	24,85%	75,06%	8,00%	12,51%	6,40%	9270,00
2005	16,24%	10,95%	12,75%	10,60%	-1,89%	11,46%	-22,51%	11,11%	-3,34%	17,11%	9830,00
2006	55,30%	11,63%	9,75%	9,85%	16,44%	-20,03	47,85%	37,50%	24,66%	6,60%	8994,00

						%					
2007	52,08%	8,40%	8,00%	11,65%	-6,68%	28,16 %	-7,88%	25,25%	9,93%	6,59%	9419,00
2008	-50,64%	8,71%	18,50%	12,25%	-9,80%	-34,73 %	-53,40 %	20,97%	0,26%	11,06%	10950,00

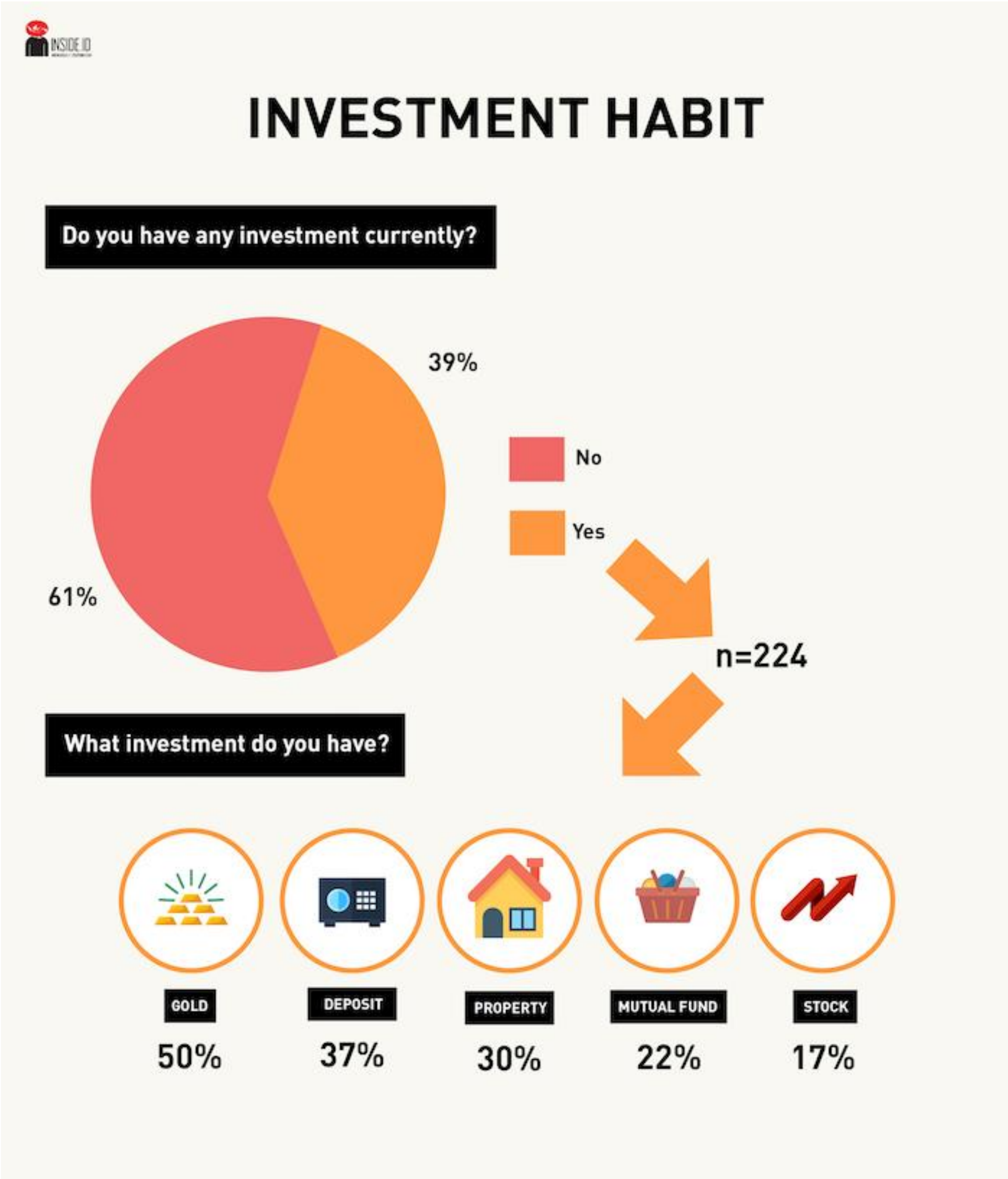
Source: Manurung and Silitonga (2009)

Table 1.2 above shows that stock return are on average 9,04% during the study period. In the eyes of foreign investors, the average return on shares is -1,18%, which means that foreign investors will not be fortunate to invest in Indonesian shares. However, stock investment in Indonesia can also provide the biggest profit reaching 269%. Property yield during the study period averaged 11,53%. Gold has an average rate of return of 13,59% during the study period. Bonds have an average rate of return of 9,65% during the period 2002 to 2008. Mutual funds have a rate of return 1,17%; 2,38%; and 4% for each bond, mix and stock mutual fund during the research period 1995 to 2008. Inflation during the study period was 20,80%. The community began to feels the use of gold wealth protection tools. Antam's gold sales showed an increase in the first quarter of 2014, which amounted 2,323 kg from fourth quarter of 2013 amounting to 1,756 kg. The increase was a reaction from gold investors to predictions of a decline in economic growth in Indonesia.

According to Kurniawan (2013), the reason why gold is used as an investment tool, among others, is immune to inflation, global currency, easy to maintain, moderate risk, easy to move durable, liquid, only requires minimal capital for beginners.

Gold as the most popular from among the precious metal and commodities that used as an investment is also one of the most common investment tool that used by the Indonesia population that have an investment or create their portfolio policy statement. According to the article from marketers.com Indonesia people prefer to make an investment expenditure on gold than stocks. From the article, it mention the research from the 'Inside ID', if the asset allocation and the investment habit of the Indonesia people that take from 600 sample taken through online survey. The survey mentions that around 40% of the respondents already have investment at this time. Inside ID data is analyze to show growth of the number of people that have an investment where it mention that the number of people that attracted to create an investment is increase 0,25 from the average number of the previous years with most of the asset allocation 79% on the Bank savings and 21% for the financial investment .

Picture 1.1 Inside ID research data of Indonesia "Investment Habit"



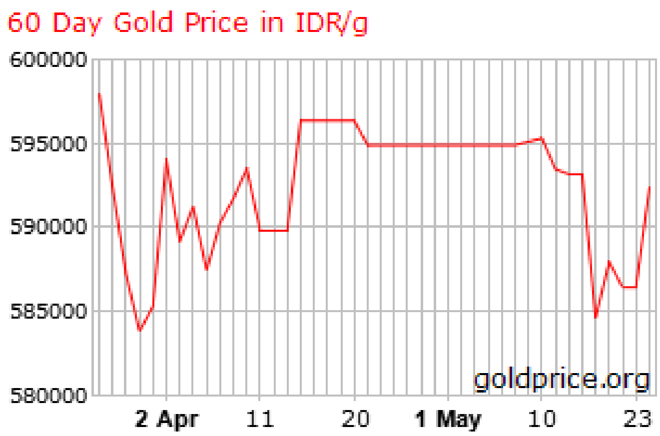
Source: http://marketeers.com/orang-indonesia-lebih-senang-investasi-emas-ketimbang-saham/

From the Picture 1.1 of the Inside ID research data of Indonesia "Investment Habit" (source: marketers.com), from the 40% of the respondent that have taken the survey for the investment habits, shows that more than 50% have an investment using Gold, and the following numbers are 37% on Deposit, 30% on Property, 22% on mutual fund, and 17% on the Stocks. From the Picture 1.1 of the Inside ID research data of Indonesia “Investment Habit”, it shows the that Indonesia Population prefer make an investment whit lower risk as it shows that the top three investment type that they have is on Gold, Deposit and Property, where this type of investment have lower risk, where Stock is on the lower number for the type of investment that the people have in this certain condition.

Gold is a kind of trusted precious metal that can maintain its value and is used in transactions (Baur and Mc Dermott, 2010: 1887).. As the price of gold depends on the conditions of the world economy, Gold is used as a “Barometer of fear”, able to maintain the value of the property of the investor when the economy of the country is unstable as it able to maintain it value. As gold is the most stable and liquid instrument in capital fixation and future savings. According to Suharto (2013: 80), gold is one of the most stable and effective principal savings (investment) instruments. In addition, gold is often referred to as a measure of capital and the oldest and most effective dimension of wealth. Since gold is superior to other metals and traded more frequently in the financial system, prices and relationships with various financial variables are often monitored by economic units.

Gold as one of the globally known investment has a high fluctuation for the short term condition as you can see the graph below the gold price change for gold price per gram on the present 60 days taken from goldprice.org.

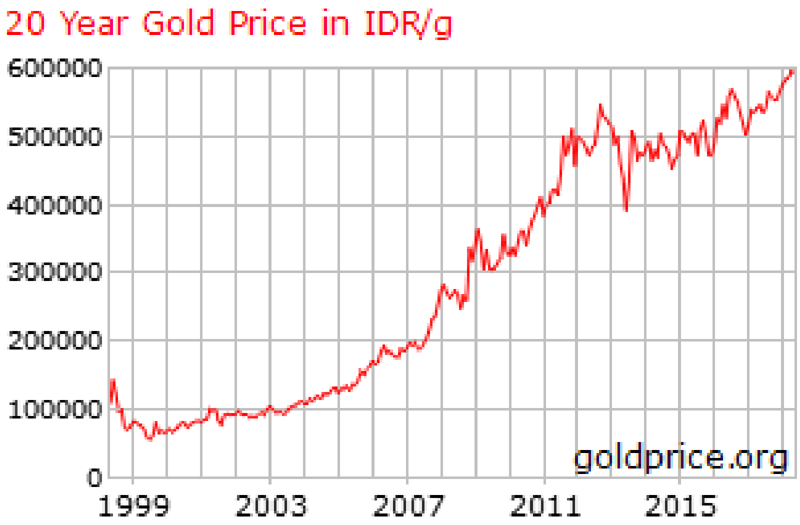
Graph 1.1 The 60 days gold price movement in IDR to gram



source https://goldprice.org/gold-price-indonesia.html

The price of the Gold is fluctuate greatly for the short period of time, and with the characteristic of high liquidation, it able to be use as a short term investment. But gold as an investment shine the most when in used as a Long term investment as you may able see the gold price growth for the past 20 years taken from goldprice.org.

Graph 1.2 The 20 years gold price movement in IDR to gram



source https://goldprice.org/gold-price-indonesia.html

From the Graph above we can see that the gold price trend in the past 20 years is to grow upward. The gold price have a high fluctuation and have a big drop in the range of the year 2011 to 2015 but in the present the price of the gold is growing higher and higher. The Gold price as a long term investment has a high return if you see from the graph the gold price is the year 1999 is below 100.000 rupiah per gram, but now the gold price already close around 600.000 rupiah per gram, it already increase more than 6 times from the initial value. Gold as an investment tool create value for the Investor but in The investment there is something called as the “risk”. In investment the risk taken by the investor affect the value of the return. For gold as investment tool, the risk comes from gold investment is the change in the price of the Gold. In this case the investor is looking for the factor that able to affect the gold price in Indonesia.

Investor must pay attention to the determinants of fluctuation in gold prices so they can profit. These determinants are raising inflation (Suharto 2013), rising oil prices (Purnomo 2013), the effect of prices of other goods on gold (Yahya 2012), stronger dollar exchange rate and gold demand (Pratama 2012), and bank interest rates (Apriyanti 2012) and according to Witjaksono (2010) and Wardani (2016) found that the price of gold had a negative effect on the stock price index while Purnamasari and Sukmana (2017) and Handayani (2014) found that the price of gold had a positive effect on the stock price index.

In 2008 and early 2009 most metal prices fell and the global economy was in recession. Many mining companies had difficulties surviving during this period. Some reduced their production rates and postponed projects while others switched to hedge instruments or long-term contracts to guarantee commodity prices. The price and production behavior of gold differs from most other mineral commodities. In the 2008 financial crisis, the gold price increased by 6% while many key mineral prices fell and other equities dropped by around 40%. The unique and diverse drivers of gold demand and supply do not correlate highly with changes in other financial assets (WGC, 2009).

Unlike paper money, the increase in the value of gold is always directly proportional to the increase in commodity prices including oil (Pratama 2012). As Paper currencies have come and gone through the ages but gold has always maintained its value. While cultures have cherished gold for its beauty and viewed it as a symbol of wealth, investors today buy gold to diversify their portfolios, as a hedge against inflation, and for protection against currency devaluation. Gold will be able to protect investor assets when the US dollar exchange rate weakens (Apriyanti 2012). Apriyanti (2012) stated when interest rates rise, Investor prefers deposit rather than gold that has no interest. This will weaken the price of gold. Conversely, when interest rates fall, the price of gold will tend to increase.

The second benefit of gold is to differentiate prestige, because gold has a high selling value so gold is used as a symbol of one's wealth and position. The last benefit of gold is as accessories, because by using gold, someone will appear more comfortable and confident in public. When viewed from the benefits of gold, it is not surprising that the demand for gold, especially in Indonesia has always increased from year to year.

One of the factors that influence the price of gold is inflation. Inflation has a relationship with the price of gold (Saira Tufail and Sadia Botool: 2013). The price of gold has attracted attention to the effect of their potential on inflation. Like other assets found to predict inflation behaviour because their profits infuse inflation expectations, the price of gold can also serve as a leading indicator of inflation. According to research conducted by Dr. Sindhu (2013) in India, there is a positive relationship between inflation and the price of gold. This means that if the inflation rate rises then the price of gold will rise. Cengiz Toraman, Çağatay Başarır and Mehmet Fatih Bayramoğlu (2011) also get the same results from the results of their research that there is a positive relationship between inflation rates and gold prices in the USA.

Other than that in the research conducted by Siti Nurulhuda Ibrahim, Nurul Izzat Kamaruddin and Rahayu Hasan (2014) in Malaysia, there was a negative relationship between the inflation rate and the price of gold. This means that if the inflation rate increases, then the price of gold will decline. This result is supported by research conducted by Laurence E. Blose (2010), that changes in inflation rates will cause a direct change in the price of gold.

In addition, another factor affecting the price of gold is the dollar exchange rate (Fergal O'Connor: 2012). The dollar exchange rate has a negative relationship to the price of gold. According to B Mills (2010), if the dollar price decreases, we should buy gold by selling dollars that we have, as both have an inverse relationship. This is because if the dollar exchange rate falls, more dollars are needed to buy gold so that the price of gold rises. Conversely when the dollar value rises, fewer dollars are needed to buy gold so the price of gold falls (Bullion Mall: 2010).

According to research conducted by Cengiz Toraman, Çağatay Başarır and Mehmet Fatih Bayramogğlu (2011) in the USA, there is a negative relationship between the USA exchange rate and the price of gold. The argument that the decline in the price of the dollar lowers the price of gold is not always true. With the decline in dollar prices, investors will be more interested in investing in gold. But according to Suharto (2013: 93), the exchange rate has a movement pattern similar to the price of gold. When the price of gold rises, the exchange rate of the rupiah "should" also rises against the US dollar. And conversely if gold falls against the dollar, the rupiah exchange rate also "must" fall against the dollar. This statement is supported by the results of research conducted by Massimiliano Marzo and Paolo Zagaglia (2010) found that the exchange rate and the price of gold have a positive relationship. Because all test statistic results have a positive sign using the vector-autoregressive (VAR) model.

Another factor that affects the price of gold is interest rates. Suharto (2013: 120) stated that if interest rates were likely to fall, gold would be easily seen by buyers and prices would increase. Apriyanti (2012) argues that when interest rates rise, investors prefer deposits rather than gold that has no interest. This will weaken the price of gold. Conversely, when interest rates fall, the price of gold will tend to increase. This indicates that interest rates have a negative influence on the price of gold.

Based on a report from the World Gold Council (WGC), Indonesia was ranked 3rd as the country with the largest growth in gold demand in the world during the third quarter of 2013. In the report, global gold demand was explained to decline. Gold demand in Indonesia has increased in 2013 by 68 tons compared to the previous year which was only 52.9 tons. But the demand for gold declined in 2014 to 51.8 tons and in the first quarter of 2015 gold demand was only 18.3 tons. According to the theory of demand, if prices rise then demand will decline, and vice versa, if prices fall then demand will increase. However, there are exceptions to gold demand. If the price of gold increases, the demand for gold will also increase and it is an indication that gold is not only a commodity at the moment, but it has become a promising investment tool because its value tends to be stable and will continue to increase in the future.

The correlation between IHSG and Gold price can be seen when the stable level of gold prices has encouraged investors to switch markets when the stock transaction is sluggish. Gold is one of the commodities that combats losses that occur during periods when stock prices fall inevitable. The increase in gold prices is seen by investors as an advantage in making investments in mining sector companies. With the increase in gold prices will certainly push the price index of mining companies rise. This condition can be explained by the comparison of the decline in gold prices in 2014 of US $ 1195.25 / oz to US $ 1062.25 / oz in 2015 followed by a decrease in the Jakarta Composite Index by 12.74%.

From previous studies that proved different results in various countries, the authors were motivated to analyze changes in Indonesian gold prices using Asian data sources presented by www.goldpricenetwork.com which show reports of local gold prices for more than 100 currencies categorized by region . Each report contains detailed information about the current price of gold per ounce, grams and kilograms of carats differently from 24k to 10k in the selected country. This research is a follow-up study on how the influence of inflation, the dollar exchange rate and interest rates on the price of gold in Indonesia. This study is a replication of the research of Aclan OMAG (2012) conducted in Turkey by eliminating the independent variable namely the Stock Index. The author wants to know the factors that influence the price of gold in Indonesia. For this reason, the author will examine further about **"Analysis of Factors Affecting Gold Prices in Indonesia."**

1.2. Research Problems

Based on the research background above, therefore the research problem for this particular thesis is :

1. Does Interest Rates on Bank Indonesia Certificate, Inflation rate, Oil Prices, Dollar Exchange Rate and Gold Demand have a significant effect on Gold Price in Indonesia?
2. Does Inflation Rates on Bank Indonesia Certificate have a significant effect on Gold Price in Indonesia?
3. Does Bank Indonesia Interest rate have a significant effect on Gold Price in Indonesia?
4. Does Oil Prices have a significant effect on Gold Price in Indonesia?
5. Does IHSG have a significant effect on Gold Price in Indonesia?
6. Does Dollar to Rupiah exchange rate have a significant effect on Gold Price in Indonesia?

1.3. Research Objectives

Based on the research problem above, therefore the research objectives for this particular thesis is :

1. To examine if Interest Rates on Bank Indonesia Certificate, Inflation rate, Oil Prices, Dollar Exchange Rate and Gold Demand have a significant effect on Gold Price in Indonesia
2. To examine if Inflation Rate have a significant effect on Gold Price in Indonesia
3. To examine if Bank Indonesia Interest Rate have a significant effect on Gold Price in Indonesia
4. To examine if Oil Prices have a significant effect on Gold Price in Indonesia
5. To examine if IHSG have a significant effect on Gold Price in Indonesia
6. To examine if Dollar to Rupiah exchange rate have a significant effect on Gold Price in Indonesia

1.4. Research Contribution

The result of this research is expected to provide enrich, deepen the existing theory and benefit, namely:

1. For investors:

   This research is useful as an insight into investing gold.
2. For academics

   This research is useful as a source of literatures on gold commodities and the development of its investments.

1.5. Research Limitation

This research is based on gold investment along with BI interest rates, Inflation rate, world crude oil prices, the dollar exchange rates, and IHSG as the factors that influence it. Research uses secondary data collected in each month from January 2008 - December 2018.

1.6. Research Outline

Chapter I – Introduction

This chapter breifly describe the background of the research, research problem, research objectives, research limitaiton, and the research outline. It provides what are the current problems which has significane to the readers.

Chapter II – Literature Review

This chapter describe the previous studies, variables, theoritical framework, hypothesis, and research model

Chapter III – Research Methodology

This chapter explain how the research is conducted which contains : types of research, variables and operational definitions used in the study, research variables, types and sources of data, method of data collection and method of data processing.

Chapter IV – Data and Analysis

This chapter intepret the result of the research and discuss the findings on the research objectives. The chapter provide how the data gathered are reliable

Chapter V – Conclusion

This chapter discusses the counclusions of this research that has been done, the implication of the research that has been conducted, and further recommendation for future research.