

CHAPTER I

INTRODUCTION

1.1 Background of Study

Along with the increasing of economy in the world, the existence of capital market holds important role as a place to seek and gather for funds; other than banks where the investors; as the individuals or entities that have surplus funds and the entity which need some capital to run are met. The existence of capital market is fundamental as it becomes the gate of investment which can boost the economy of a country. Many financial instruments can be found in capital market, such as stocks, bonds, equity, debt securities, promissory notes, commercial paper and treasury bills based on the perception, analysis, and the investment decision of investors. This market provides relevant information needed by the investor to invest such as information about stock prices, trends occur in the industry, information presented in the company's financial statements. All those information deemed relevant will be used by investors as consideration for making investment decisions.

Stock price as one of essential information provided in capital market is often used as consideration in making investment decision. The stock price can be used as an indicator of the success of the company in assuring the investors that the company is able to increase the wealth of the investors. Stock price itself is determined by the sale and purchase transactions in accordance with the law of demand and supply. The occurrence of these transactions is based on investors' observations of the company's achievements in increasing profits and investors' perception and speculation towards the return in the future, while the company achievements can be accessed from the company's financial performance through financial statements.

In fact, stock price in capital market is changing for every single time regarding with the supply and demand of the stocks. Changes in the company's stock price give an indication of changes in company performance over a certain period. Moreover, the market price of stocks cannot be used as the benchmark to find out the real value of the stocks. Thus, analyzing the stock price is compulsory for investment decision which to know the intrinsic value of the stock, whether the stock is mispriced and it affects the decision whether to hold, buy, or sell.

There are two ways to analyze securities, namely fundamental analysis and technical analysis. Technical analysis uses data of changes in past prices in effort to estimate the price of securities in the future (Musthafa, 2017). Technical analysis is based on:

1. Stock prices reflect relevant information
2. The information is addressed by price changes in the past
3. Price changes will have a certain pattern and trend

On the other hand, fundamental analysis seeks to identify the prospects of the company to be able to estimate stock prices in the future through an analysis of the factors that influence the stock price. Fundamental analysis tries to estimate stock prices in the future by estimating the value of fundamental factors that influence stock prices in the future and determine the relationship between these variables so that the estimated stock price is obtained. Because of the many factors that affect stock prices in fundamental analysis, several steps are needed, namely analyzing the state of the macroeconomic and markets, analyzing the industry, and the specific conditions of the company.

According to fundamental analysis, all those movements is affected by macroeconomics including Gross Domestic Product (GDP), money supply, employment, fluctuation of currency exchange rate, interest rates, and inflation (Ginting, Topowijono, & Sulasmiyati, 2016) (Chirchir, 2011). In portfolio approach, there are some factors influencing the

demand of securities including wealth, inflation, interest rate, and exchange rate. On the other hand, the supply of securities is influenced by profitability of the entity, inflation, and government interference (Mishkin, 2008).

There are several factors influencing the changes of stock price, and one of them is exchange rate. The continuous development in the world trade and capital movements has made the exchange rates as one of the main determinants of business profitability and equity prices. Fluctuation in exchange rate often bring anxiety for businessman but it does not always bring bad impact to all companies. Depreciation of exchange rates will add additional cost of imports and increase the value of exports. Changes in the exchange rate affects the international competitiveness of countries where exports are strong and fluctuations in foreign exchange rates can lead to substantial changes in the relative performance of equity portfolios, when expressed in a common currency. It is the same, when the deprecating in currency gives additional advantages to exporting companies, while the reverse happened for the companies which have more import. Accurate information on the relationship between exchange rates and stock markets is needed and important for economic and financial policy-makers and regulators as a basis to formulate appropriate policies (Morales, 2009).

Moreover, the unstable exchange rate gives bad impact to economy of the country. When the exchange rate keeps depreciating, the country will lose its credibility and affect capital flow of the country since it makes the return become small and make international investor to be less attracted with local stocks. As the effect, the investor will withdraw their investment to be invested again to other places and forms which offer more advantage and promising beneficial return to them. If the condition is happened, the demand of the stocks will be getting lower which cause declining in stock price.

Beside exchange rate, inflation also the factor to determine the healthiness of country's economy. Inflation rate will affect the purchasing power which makes goods and service become more expensive and affects the purchasing power of investor to buy the stock and invest in capital market. Inflation rate also a consideration in making investment decision for investor. High inflation rate will make production cost of company become higher and profitability of company become low. As the effect, the real return of stocks will be reduced which leads negative impact to the investment in the country. If the inflation is stabile, stock market still become a good choice to get more return compared to other financial securities (Heze).

Moreover, another factor that needs to be concerned is interest rate. The movements of interest rate also affect the decision of investor to invest. According to study conducted by (Ginting, Topowijono, & Sulasmiyati, 2016), there is reserve relationship between interest rate and stock price. So, high interest rate will become negative signal to stock price. When the interest rate is high, it means that the return is also high which make investor to invest in form of currency rather than in form of financial securities. In order to attract the investor to buy the stocks, the price of stocks will be getting lower as the adjustment of supply and demand. In Indonesia, Central Bank of Indonesia is the entity which has authority to determine the interest rate that called as BI rate. Since 19th August 2016, BI rate was replaced by the rate called 7-days Repo Rate. Repo Rate is used as the new policy interest rate because it can quickly affect the money market, banking and the real sector. The BI 7-Day Repo Rate instrument as a new reference has a stronger relationship to money market interest rates, whether transactional or traded on the market, and encourages financial market especially the use of repo instruments.

Table 1.1 Interest Rate, Inflation, Exchange Rate, and Stock price During 2007 - 2018

Period	Interest Rate	Inflation	Exchange Rate	Stock price	
				PT. Bank Central Asia, Tbk	PT. United Tractors, Tbk
2007	8	6.59	9,419	3650	10027
2008	9.25	11.06	10,950	3250	4230
2009	6.5	2.78	9,400	4850	14902
2010	6.5	6.96	8,991	6400	22882
2011	6	3.79	9,068	8000	26350
2012	5.75	4.3	9,670	9100	19700
2013	7.5	8.38	12,189	9600	19000
2014	7.75	8.36	12,440	13125	17350
2015	7.5	3.35	13,795	13300	16950
2016	4.75	3.02	13,436	15500	21250
2017	4.25	3.61	13,548	21900	35400
2018	6	3.13	14,481	26000	27350

Source: Prepared by writer (2019)

Table 1.1 presents the movement of stock price of PT. Bank Central Asia, Tbk and PT. United Tractors, Tbk during the year of 2007 – 2018. The table above shows that the movement of stock price of these two companies is fluctuating along with the changes of Interest Rate, Inflation and Exchange Rate. The year of 2008 become a tough year for business in Indonesia because of the unstable economic condition in international and local market. Symptoms of the weakening of the capital market began to be seen from the continuing effects of the subprime mortgage crisis which then reached its peak in mid-September when one of the largest investment banks in America, namely Lehman Brothers, declared bankruptcy which lead to global recession. As the result, the inflation is increased up to 11.06%. Moreover, the government also increased its interest rate to 9.25% and exchange rate is depreciated to 10.950 per US dollar. As the effect, the company in Indonesia experience decreasing on stock price. PT. United Tractors, Tbk experience rapid declining on stock price becomes 4.230 per stock. Although the sales of the company is increase compared to last period, but the company also recorded the loss caused by depreciated exchange rate. Moreover, the company also has short term debt which due in one year, which makes the

investor to sell off their stocks. As the result, the stock price of the company decline up to -57.81% (Atmaja, 2017).

On the same period, PT. Bank Central Asia, Tbk experience declining on stock price by -10.99% becomes 3.250 per stock. The decline in of the company's stock prices was a market reaction because the bank put considerable investment in sovereign debt instruments whose prices were under pressure at that period. Furthermore, the investors are cautious to invest since the composite index continues to decline (Fokus Kinerja Perbankan Menurun Namun Masih Memiliki Ketahanan, 2018).

In the next ten years, Indonesia faced uncertainty economic condition. At the period, The Federal Reserve of United States increase their interest rate and trade war with China cause the exchange rate of many countries, including Indonesia to depreciate. Rupiah, as the currency of Indonesia decline up to 15,000 during 2018, which make Indonesia citizen cautious if the economic will fall down like what happened in 1998. In accordance with that situation, government of Indonesia increases its interest rate to 6%. In that such period, many stocks are impacted, including stock price of PT. Bank BCA, Tbk and PT. United Tractors, Tbk.

Although in uncertainty economic condition, stock price of PT. Bank BCA showed an increase to 26,000, increase by 18.72% compared to last period. The increasing of stock price of Bank BCA is supported by the speculation of investors that the company could give better prospect in the future including expectations of loan growth in line with economic development, the level of Loan to Funding Ratio and Current Savings Accounts are adequate to accommodate higher loan requests, the principle of careful lending, and increase fee-based income and Current Account Savings Accounts through the development of digital banking and partnerships with financial technology companies. In addition, the increase

in the stock price of PT. Bank Central Asia due to the policy of Bank Central of Indonesia which loosened averaging statutory reserves from 2% to 3%. The company also recorded the increasing of profitability by 10.9% year on year. By the support of those factors, it stimulates the investor to buy the stocks, which increase the demand and affect the stock price. (Caesario, 2019).

At the same period, stock price of PT. United Tractors declined to 27,350, decrease by -22.74% compared to last period. The declining of stock price was caused by the stock sales made by top three brokers who sold the most stocks of United Tractors were *JP Morgan Sekuritas* (BK) worth IDR136.42 billion, then *Deutsche Sekuritas* (DB) IDR65.06 billion, and *Macquarie Sekuritas* (RX) IDR43, 21 billion. The sales value of the three brokers each contributed to the overall transaction value of UNTR stocks by 30.15 percent, 14.38 percent and 9.55 percent. Nevertheless, the declining of the stock price is not as significant as the declining in 2008. On 2018, the fundamental of company is recorded in good state and recorded its sales of heavy equipment increased by 36.72 percent compared to last year, which supported by the demand from mining industry (Budiman, 2018).

There are several researchers emphasized that stock price is indeed influenced by several factors. The research conducted by (Novasari, 2013) cites that stock price is influenced by internal factor and external factor. These internal factors are related to the income that investors will get in the form of dividends and capital gains. External factors are usually macro-fundamental factors such as the political and security situation, changes in currency exchange rates, fluctuations in bank interest rates and intentional rumors by speculators or people who want to profit from the situation. Those factors will affect demand and supply of stocks traded in the capital market. As the result, it affects the stock price of the company, whether there will be an increase in stock prices or vice versa.

The research conducted by (Ginting, Topowijono, & Sulasmiyati, 2016) with the title *Pengaruh Tingkat Bunga, Nilai Tukar, dan Inflasi terhadap Harga Saham* states that interest rate and inflation do not affect the stock price significantly, while the exchange rate does affect the stock price significantly. Furthermore, the research conducted by (Ulandari, 2017) with the title *Pengaruh Inflasi dan Nilai Tukar Rupiah terhadap Harga Saham di Sektor Industri Barang Konsumsi pada Indeks Saham Syariah Indonesia (ISSI) Tahun 2012-2016* mentioned that the inflation and exchange rate does have significant impact to the changes of stock price.

Based on background above, the study of the impact of exchange rate, inflation, and interest rate to the stock price is compulsory to conduct since the emerging markets have been a great importance to the worldwide investment community especially the increasing in international trade and the integration of the global financial markets. This research will focus on exchange rate, inflation, interest rate and its impact to stock prices which contributes to the existing literature as well as providing updated evidence on this relationship for Indonesia companies, especially for those which are listed in LQ-45. This study therefore sought to fill the knowledge gap that exists on **the Impact of Exchange Rate, Inflation, and Interest Rate to Stock Price of Companies Listed on LQ-45 Index.**

1.2 Problem Formulation

Based on the background above, it can be concluded the problem formulations as follows:

1. Does exchange rate affect the stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially?
2. Does inflation affect the stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially?

3. Does interest rate affect the stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially?
4. Do exchange rate, inflation, and interest rate affect the stock price of companies listed on LQ-45 index for the period of 2007 – 2018 simultaneously?

1.3 Problem Limitation

The limitation of the study is:

1. The factors focused in this study are limited only to exchange rate, inflation, and interest rate.
2. The exchange rate used in this study is limited only to US dollar and Indonesia rupiah.
3. The sample used this study is limited to the company listed on LQ-45 index during 2007-2018.

1.4 Research Objective

Based on the above problem formulation, the objectives of this research are:

1. To identify the impact of exchange rate to stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially.
2. To identify the impact of inflation to stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially.
3. To identify the impact of interest rate to stock price of companies listed on LQ-45 index for the period of 2007 – 2018 partially.
4. To identify the impact of exchange rate, inflation, and interest rate to stock price of companies listed on LQ-45 index for the period of 2007 – 2018 simultaneously.

1.5 Research Benefit

The benefits of the research are:

1.5.1. Theoretical Benefit

1. Future researcher

This research could become a reference for conducting research in the future.

1.5.2. Practical Benefit

1. Investor

This study could become reference and recommendation in making investing decision about the company that should be invested when there is changes in exchange rate, inflation, and interest rate.

2. Company

This study could become the evaluation for the company to maintain the stock price and make sure to keep the stock price in stabile rate while those factors in this study occur.

1.6. Systems of Writing

This paper comprises five chapters. The structure of this paper is as follows:

CHAPTER I INTRODUCTION

This chapter discusses about the background of study, problem formulation, problem limitation, research objective, and benefit of the study.

CHAPTER II LITERATURE REVIEW

This chapter provides the literature and theories that support this research. It includes the grand theories, prior research, hypothesis development, research model, and framework of thinking.

CHAPTER III RESEARCH METHODOLOGY

This chapter develops research method, population and sample of research, and basic assumption regarding the effect of exchange rate, inflation, and interest rate to stock price.

CHAPTER IV DATA ANALYSIS AND DISCUSSION

This chapter constructs data analysis and its discussion. It includes general view of research object and data analysis.

CHAPTER V CONCLUSION

This chapter discusses about the conclusion of study, the recommendation for future research and researchers, implication for the company, and the limitation of this research.

