

# Sany etc Indonesian Bond Yields

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# INDONESIAN BOND YIELDS: INFLATION, FED RATES, AND EXCHANGE RATE EFFECTS

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**Abstract.** This research aims to provide the effect of the Indonesian Inflation, the rise of the US Fed rate, and the exchange rate towards the yield of Indonesian government bond. This study used quantitative approach with secondary data where data was obtained from reliable sources, such as Bloomberg, Bank Indonesia's official website, and the Federal Reserve's official website. Sample is 132 monthly rate and prices of macroeconomic data within each month for each year covering the period of 10 years, starting from 2012 until 2022. Previous studies have analysed the effects of these factors on government bond prices. This study analyses the effect towards the government bond yield in Indonesia. The results show that inflation and exchange rate affect the Indonesian government bond yield positively. However, the rise of the US Fed rate does not affect the Indonesian government bond yield positively.

**Keywords:** Government Bond Yield; Inflation; US Fed Rate; Exchange Rate; Indonesia US

## INTRODUCTION

Macroeconomic factors like interest rates, inflation, Gross Domestic Product (GDP), and exchange rates play a significant role in the economy of a country. This research incorporates the US Federal Reserve's interest rate (US Fed) and inflation in Indonesia as independent variables. Recently, there has been high inflation in the US. Based on the USA inflation summary, it is shown that the inflation rate in the USA in June was 9.060%, which marked the highest rate over the decade (Trading Economics, n.d.). To respond to this issue, The Federal Reserve/ the Fed had decided to increase the interest rates by 75 bps or by 1.5%-1.75%. These conditions weakened the economy globally, including developing countries such as Indonesia. The Indonesian inflation rate reached its highest in July 2022 at 4.94% (Bank Indonesia, n.d.-b). That rate is more than expected, although it is still above the central bank's target rate. The high rate existed due to the difficulties in obtaining import raw materials after the war between Russia and Ukraine and the rise in fuel costs. Not only the cost of vehicle fuel but also the cost of airfares and household fuel because of the oil scarcity (Bank Indonesia, n.d). Because of these conditions, some investors worry about bond yield, which is the return to an investor.

A bond is a form of debt instrument that is used by the investor to lend money to the issuer. The issuers of bonds can be the government or company. The issuers use the bonds to fund the operations and offer returns in the form of coupon payments (Chiesa & Barua, 2019). Before selling bonds, investors should understand both the bond yield and bond price. Bond yield often signals to investors regarding the condition of the economy. The rise in bond yield can cause a short period of drop in the value of the bond because investors are willing to buy bonds with higher yields. Investors need to consider how much compensation they will get. The higher the yield, the higher they get. Bond yield is also as important as bond price. Bond yield is the return on the bond of investments that is expressed as a percentage. Meanwhile, the bond price is the present value that is received from the discounted value of future cash flows. Bond yield and bond price have opposite relationships. The bond yield will increase if the bond price decreases (Vayanos & Vila, 2023). There are many types of bonds in the economy. One of them is the government bond. Government bonds are considered less risky than others because the government guarantees they will meet the obligation. The government considered bonds to be the cost of issuance of new bonds. Investors pay attention to the government bond yield since this represents the return and risks that need to be evaluated (Trinh et al., 2020). This is perfect for the uncertain conditions that are happening in Indonesia right now.

As the US Fed increases the interest rates, the value of the rupiah decreases which causes the decreases of bond prices. If the bond prices decrease, bond yield increases because this situation increases the government's borrowing. In addition, inflation influent positively on government bond yield (Tjandrasa, Ariwibowo, et al., 2020). During inflation, the market condition is erratic. So, the investors need to be careful when they want to invest. However, despite the uncertain conditions, inflation still has a positive effect towards the yield of Indonesian government bonds. Since the risk is higher, the investors will demand higher returns. Therefore, it will increase the Indonesian government bond yield (Permanasari & Kurniati, 2021; Siahaan & Panahatan, 2020; Yusuf & Prasetyo, 2019).

This study aims to examine the impact of inflation, exchange rates, US Fed rate on the Indonesian government bond. This report contributes to various users, particularly the investors and government, as well as the theoretical background used. Investors can gain information regarding the current economic issues, which might be different compared to previous years and the impact of those issues on the yield of Indonesian government bonds. In addition, this report can also become a useful consideration when investors want to make investment decisions. Afterwards, this research can be a useful consideration when the government wants to make decisions regarding the funds for the operation and the required

policy in this uncertain situation. Finally, this paper also contributes to the fisher effect theory and the macroeconomic as well as monetary policy by connecting the related macroeconomic factors in Indonesia. The research gap between this study and previous studies is emphasised in the factors. This study uses three macroeconomic factors, while other studies use more elements. Furthermore, the previous study analysed the impact on the government bond prices. This study analyses the impact on the government bond yield in Indonesia.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Fisher Effect Theory is a theory that elucidates the relationship between interest rates and inflation. This hypothesis posits that the real interest rate is derived by subtracting the expected inflation rate from the nominal interest rate (Yusuf & Prasetyo, 2019). The nominal interest rate refers to the rate that excludes consideration of inflation. Conversely, the real interest rate encompasses inflation (Zhong, 2022), therefore, the interest rate falls when inflation increases. Fisher found that variations in the anticipated inflation rate will influence the nominal interest rate (Ongan & Gocer, 2020). This theory pertains to the macroeconomic issues, specifically interest rate and inflation. This is aligned with the current situation, which is high inflation in the world, with the policy applied by the US Fed. The increase in the US Fed rate can influence Indonesia's economy. This theory will help the government or related institutions in implementing monetary policy and investors in measuring the return

Macroeconomy is an overall study that covers the economic system of the country. There are several factors that influence the economy of a country. Those factors are inflation, interest rates, exchange rates, and many more. For example, if inflation happens, prices will increase, which will decrease. Next, if the interest rate is rising, it will be hard to borrow money because the amount will be more expensive. Fedorova & Meshkova (2021) maintains that one of the important objectives of macroeconomics is financial stability. Therefore, the government or the authority needs to implement monetary or fiscal policies.

Monetary policy is a policy that controls the country's money supply and economic growth to manage demands. This usually relates to the interest rate. Meanwhile, fiscal policy is a policy that uses government spending and taxation to manage the economic situation. It usually relates to tax (Afonso et al., 2019). However, the macroeconomy policy will be used in this study. Mehar (2023) stated that monetary policy is useful for economic development. Therefore, the changes in the macroeconomy and the policy will affect the economy of a nation. For example, the policy that has been done by the US Fed rate in setting the interest rate. Through this theory, the investor can be aware of the policy in the country, which will influence the decision-making process. Besides, this theory can help the government manage the stability of the country's economy to provide welfare for society.

## Inflation

Inflation is a situation where the price of goods and services increases. When the price level rises, the demand to buy goods and services decreases due to a reduction in the purchasing power of money (Ilmas et al., 2022). Inflation is mainly influenced by three factors, which are 1) Demand-pull effect, 2) Cost-Push Effect, and 3) Built-in Inflation. The demand-pull effect is a condition when there is an increase in the aggregate, which causes the prices of goods and services rise at a faster pace than the economy's ability to produce them. This can be a rise in the money supply or the government purchases. The Cost-push effect occurs due to increases in market power or a decrease in aggregate supply. This phenomenon is marked by increasing unit labor costs, elevated prices of imported intermediate inputs, and either temporary or systemic shortages or productive resources, potentially resulting from droughts, conflicts, or other disruptions (Wollie, 2018). Lastly, Built-in Inflation is the idea

from society who think that inflation rates are expected to persist in the future. Since the goods and services' price rises, individuals may anticipate a continued increase in the future (Roncaglia de Carvalho et al., 2018). Aside from those 3 main factors, inflation can happen due to structural factors, such as the condition of the weather and the protective policies in the industry from the government (Opolot & Mpagi, 2017).

The US Federal Reserve, serving as the central banking system of the United States, is responsible for carrying out five primary functions. Firstly, conduct the monetary policy for maximum employment and stable prices. Secondly, manage the financial system stability to minimise risk through active monitoring in the United States and various other nations. Thirdly, encourage the safeness of the individual financial institutions and evaluate the impact towards the financial system. Next, the efficiency of the payment and settlement system should be maintained by means of services to the banking industry. Lastly, maintain consumer protection and community development (The Federal Reserve, 2023).

Since one of the Fed's duties is to manage the financial system's stability, the Fed has the right to set the interest rates. Central banks such as US Fed have concentrated on the interest rate to be used as an instrument (Taylor, 2019). There are several conditions that can affect the interest rates. First, Supply and demand for money. When the demand for money increases, the interest rates tend to rise. Conversely, when the money supply expands, interest rates are likely to decline. Second, inflation. If inflation occurs, the Fed might decide to increase the interest rates to reduce the purchasing power of the society and keep the financial stability. Third, fiscal deficit and government borrowing. A fiscal deficit is the condition when government expenditure exceeds government revenue. Therefore, government borrowing exists to fund the deficit. The higher the fiscal deficit, the higher the government borrowing and interest rates.

## Government Bond yield

Bond is a form of debt instrument that is used by the investor to lend money to the issuer. The issuers of bonds can be the government or company (Nneka et al., 2022). The issuers use the bonds to fund the operations and offer returns in the form of coupon payments. Bonds have several advantages compared to stocks, such as being less risky and less volatile (Shahzad et al., 2017). Bonds can be in the form of short-, medium-, or long-term bonds.

Bonds are generally categorized into four types: government bonds, corporate bonds, mortgage bonds, and municipal bonds. Firstly, Government bonds. Government bonds are the government's debt to third parties, which are used to fund operations and construction. The interest rate in government bonds is considered a risk-free rate. Government bonds are considered less risky because the government guarantees payment (Robiyanto, 2018). Secondly, Corporate bonds. A corporate bond is a debt security that the company issues and, later on, is traded in the market. Thirdly, mortgage bonds. A mortgage bond is a debt security issued by companies using real estate as a warranty. Lastly, municipal bonds. A municipal bond is a debt issued by the local government. Therefore, the risk depends on the guarantees of the bond from the state government-owned corporation (Tjandrasa, Siagian, et al., 2020).

Bond yield is a measurement of the return of a bond to investors (Pratiwi & Mustafa, 2021). Although Bond Yield and Bond price are related, both have the opposite relationship. When the price of a bond rises, its yield declines, and conversely, when the price falls, the yield increases (Qisthina et al., 2022). Bond yield has two basic concepts, namely coupon yield and current yield. Coupon yield (rate) is the annual interest rate formed when an issued bond does not change during the bond's life cycle. Next, the current yield is the yield that changes when the bond price changes. Based on the previous study, it was stated that the yield of a

bond could be different from another due to default risk, the value of coupon rate, the ability of the government to pay the debt before maturity, and so forth.

## Gross Domestic Product (GDP)

Gross Domestic Product (GDP) represents the total monetary value of all goods and services produced and sold within a specific time frame. GDP can be a good indicator for measuring whether monetary policy works well or not. In other words, GDP can be an indicator for evaluating the country's economy (Gonzalez et al., 2022). The positive real rate of GDP is a sign that the monetary policy is effective (Nababan, 2019). GDP is the amount of added value that is resulting from the business units in a specific period.

GDP can be calculated using two main methods: the expenditure approach and the income approach. The expenditure approach measures GDP by accounting for all goods and services purchased and consumed (Nababan, 2019). For example, consumers spend their income to acquire goods, investors use their money to invest in business activities, the government spends their money to purchase equipment, and so on. On the one hand, the latter approach considers all the factors of production, such as the wages/compensation of the labour, rent, return on capital in the form of interest rate, and many more.

## Exchange Rate

Bank Indonesia (BI) is the central banking system of Indonesia. BI has the duty to maintain rupiah stability by managing the monetary sector and maintaining the stability of the financial system (Bank Indonesia, n.d.-a). Just like the US Fed, since the duty of the BI is to manage the resilience of the financial system, the BI also has the right to set interest rates. BI Rate is the base rate. The Central Bank of Indonesia uses the base rate to establish the monetary policy and represents the rise or fall of the interbank rate. The rate set by the bank is usually changing after a period of time. The changes in BI Rate affect the interest rates in loans or saving accounts.

An exchange rate represents the price of one currency in terms of another currency. The exchange rate is useful for managing trade and money movements. The rate is divided into two components, which are the domestic currency and foreign currency. In this paper, the domestic currency is the rupiah, and the foreign currency is the USD (Jamil et al., 2023). The appreciation and depreciation of a currency against foreign currencies show that country's vital condition and market sentiment. The fall of the exchange rate is good for the domestic economy because exports look cheaper to foreign buyers, while imports look more expensive. Conversely, a rise in the exchange rate results in higher import costs, which increases the domestic inflation rate (Erdal & Pinar, 2019). The exchange rate can be in the form of a free-floating or fixed exchange rate. Free-floating exchange rate increases and decreases because of the changes in the foreign exchange market. Meanwhile, the fixed exchange rate is wedged to the value of another currency. Regimes with fixed exchange rates are less volatile. As a result, this condition encourages the inward of foreign direct investment. Conversely, regimes with free-floating exchange rates limit the external imbalance to boost the growth of the economy (Cushman & De Vita, 2017).

## US Fed Rate and Indonesian Government Bond Yield

Based on the Fisher effect theory, the real interest rate is determined by subtracting the inflation rate from the nominal. This implies that when inflation increases, the nominal interest rate typically rises as well in the long run to maintain a relatively stable real interest

rate. Similarly, interest rate falls when inflation increases. Therefore, the interest rate declines when inflation rises. This corresponds with the situation in the U.S., where the country had the highest inflation rate last July. During the inflation, the government can implement monetary policy to solve the problem. In addition, Nakamura & Steinsson (2018) stated that monetary policy is active when the monetary authority has a strong reaction towards inflation. In the case of the U.S., the FED applied the policy by increasing the interest rates to push inflation. The Fed based the policy on an enormous amount of data. Therefore, the policy made by the FED influences the policy and economy of other countries at different times. For example, sharp changes in commodity prices and the financial crisis (Nakamura & Steinsson, 2018). As a result, that condition worsens in countries with low currency values, like Indonesia. The decrease in the value of the rupiah leads to a fall in Indonesian government bond prices. Bond yield and bond prices have opposite relationships. If the bond prices decrease, bond yield increases because this situation increases the risk of the government's borrowing. Higher government borrowing will affect the economy. In this situation, the government must sell out higher rates to sell the bonds.

H1: The rise of the US Fed Rate affects the Indonesian government bond yield positively.

## Indonesian Inflation and Indonesian Government Bond Yield

Inflation is one of the macroeconomic factors that influence Indonesian government bonds. Inflation is everywhere and will always be the monetary symptom (Sharma et al., 2023). As stated in many studies, inflation is harmful to economies, especially when the rate is high. Based on the Bank of Indonesia's official website, Indonesian inflation is getting higher. High inflation can cause a redistribution of income and wealth, uncertainty about the value of money and prices, changes in the cost of resources, and so on. In Indonesia, high inflation is due to supply-side factors and shocks (Bank Indonesia, n.d.-c). For example, the war between Russia and Ukraine made it hard to get oil resources since the source of oil was from Ukraine. The market is struggling to produce the oil. Consequently, the price of oil has increased in the world, including in Indonesia. According to the Fisher effect theory stated above, the real interest rate is calculated by subtracting the inflation rate from the nominal interest rate. Interest rate falls when inflation increases. This condition raises questions among the investors. They will be confused about whether they want to invest. They will become worried about the return on bonds. Since the condition is risky, investors will expect a higher return rate on bonds from the government because they consider the inflation rate that can reduce their return. Therefore, this situation will increase Indonesian government bond yields.

H2: Indonesian inflation affects the Indonesian government bond yield positively.

## Exchange Rate and Indonesian Government Bond Yield

As stated in the conceptual theories, the Exchange rate is useful for managing trade and money movements. The domestic currency is the rupiah. The foreign currency is USD. Yusuf & Prasetyo (2019) and Qisthina et al. (2022) stated that the exchange rate is the main factor that influences the government bond yield. The appreciation and depreciation of a currency against foreign currencies show that country's vital condition and market sentiment. Fisher's effect theory states that inflation will influence changes in interest rates. In 2022, high inflation happened everywhere. Then, the US Fed responds to inflation by increasing the interest rate. Due to the monetary policy implemented by the US Fed, the financial stability in Indonesia is disrupted because the value of the rupiah towards the USD is decreasing. Consequently, some investors will take down their investment in rupiah-denominated assets and request higher returns from the government. This situation will decrease the bond price and increase the bond yield.

H3: Exchange rate affects the Indonesian government bond yield positively.

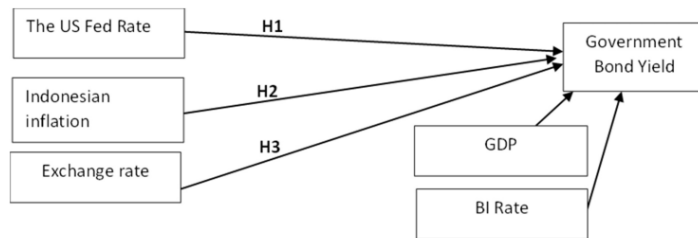
## RESEARCH METHOD

This study employs a quantitative research approach to examine the macroeconomic determinants of government bond yields in Indonesia. The dependent variable in this study is the government bond yield, while the independent variables consist of the US Federal Reserve (FED) rate and the Indonesian inflation rate. In addition, the exchange rate of IDR to USD, Bank Indonesia (BI) rate, and GDP are included as control variables to account for other macroeconomic influences. The research model is demonstrated in Figure 1.

The study utilizes secondary data collected from reliable sources, including Bloomberg, the official website of Bank Indonesia, and the official website of the United States Federal Reserve. The sample comprises monthly data over an 11-year period, spanning from 2012 to 2022, resulting in a total of 132 monthly observations for each variable. This time frame was selected to capture both long-term trends and short-term fluctuations in macroeconomic conditions and their impact on bond yields.

All data were compiled and processed using spreadsheet software prior to being analyzed using appropriate econometric techniques, as described in the subsequent section. The use of monthly data enables a higher resolution of analysis, allowing the study to more precisely identify the dynamic relationships between the variables.

Data sources are a way of gathering data for research purposes. Two types of data sources are primary and secondary data. This study used secondary data obtained from reliable sources, such as the official websites of Bank Indonesia, the Federal Reserve website, and datasets from Bloomberg.



**Figure 1. Research model**

$$GBY = \alpha + \beta_1 USFR + \beta_2 IINF + \beta_3 ER + \beta_4 GDP + \beta_5 BIRT + \epsilon \quad (1)$$

|                                               |                                    |
|-----------------------------------------------|------------------------------------|
| GBY                                           | = Indonesian Government Bond Yield |
| $\alpha$                                      | = The intercept (Constant)         |
| $\beta_1, \beta_2, \beta_3, \beta_4, \beta_5$ | = Regression coefficient           |
| USFR                                          | = US Fed Rate                      |
| IINF                                          | = Indonesian Inflation             |
| ER                                            | = Exchange Rate                    |
| GDP                                           | = Gross Domestic Product           |
| BIRT                                          | = BI Rate                          |

Population is the whole group of study that is used in the research. The population in this research is Indonesia. The sample is a part of the population that is selected according to the research's criteria and used as the representation of the whole population. The sample for this research is the monthly rate and price of macroeconomic data within 12 months for each year, starting from 2012-2022. Unit analysis is the number of observations that become the smallest object in the study. The total of the unit analysis in this research is 132 units for a monthly rate.

Table 1. Variable Operationalism

| Variable                    | Variable Definition                                                                                                                   | Source of data                   |
|-----------------------------|---------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|
| Government Bond Yield (GBY) | It is the return of a bond to investors                                                                                               | Bloomberg                        |
| US Fed Rate (USFR)          | The interest rate that is set by the US Federal Reserve Bank and used to lend reserve balances to another.                            | Federal Reserve official website |
| Indonesian Inflation (IINF) | Condition characterized by rising prices of goods and services, leading to a decline in purchasing power.                             | BI official website              |
| Exchange Rate (ER)          | A value of a currency that is exchanged for another currency (Rupiah towards USD).                                                    | Bloomberg                        |
| GDP                         | A financial indicator that quantifies the overall market value of goods and services produced and transacted within a defined period. | Bloomberg                        |
| BI Rate (BIRT)              | The base rate is used by the Central Bank of Indonesia to establish the monetary policy.                                              | BI official website              |

As for the data analysis techniques, this study uses Gretl software to examine the time series data. Firstly, the study used the classical assumption tests through 3 tests: the normality test, multicollinearity test, and heteroscedasticity test. Normality test examines whether the variables used in the regression model are a normal distribution. A normality test is conducted by applying a statistical test or graphical analysis. The condition is considered best if the data is normally distribution, which is indicated that the P value is more than 5%. Secondly, the multicollinearity test is conducted to show whether the independent variables used in this research are strongly correlate with each other. The condition is considered best if the independent variables do not comprise of the other independent variables. If the Variance Inflation Factors (VIF) is more than 10, the data is not multicollinear, which may indicate a multicollinearity problem. Thirdly, this study performed the heteroscedasticity test. This test is examined to check if the data has an error or residual variance that is normally distributed. The condition is considered best if homoscedasticity exists in the residual or error term variance. The test is performed with the help of the white test option to detect the existence of any heteroscedasticity in the model. If the significance level is more than 5%, the data is homoscedastic. However, if the result indicates any heteroscedasticity, the Autoregressive Conditional Heteroskedasticity test (ARCH) will be performed to see whether there is any ARCH reaction in the model. If there is any ARCH indication, the Generalized Autoregressive Conditional Heteroskedasticity model (GARCH) should be implemented.

Secondly, this study conducted stationary testing, which was performed to determine

whether the data used was stationary or not. The results of the study from the stationary data test can be used to predict the future and prevent counterfeit regression. In this test, this study will do the unit test root by utilising the Augmented Dickey-Fuller Testing method (ADF-Test). The best condition for the ADF Test is if the significance value exceeds 5%. That means the data is non-stationary. Next, this study continued to use cointegration testing. The non-stationary variables must be tested with cointegration testing to see if there is a long-term connection between the independent variables. If there is a problem with the stationary testing, data transformation needs to be performed by utilising The Engel-Granger test. The criterion for this test is that the probability value should be less than 5%, which means that the variable has a high level of cointegration.

After conducting all the tests above, this study performed hypothesis testing to determine whether the analysed hypothesis is accepted or not through three phases. Firstly, this study should see the F-statistic test. The purpose of this test is to assess the aggregate effect of every single independent variable on the variation in the dependent variable. Then a T-statistic test is conducted to estimate the effect of each individual independent variable on the variation in the dependent variable.

For prediction purposes, this study used the ARMA model. ARMA combines Auto-Regressive (AR) and moving average (MA). ARMA can only be used if the time series is stationary. There are several steps needed in building the ARMA model. The first one is identifying the most appropriate specification from PACF and ACF. The next step is to estimate the ARMA model from the identification process. The model should be free from serial correlation and heteroscedasticity problems. At last, comparing the Schwarz Information Criterion (SIC) and choosing the smallest value (Hatane, 2012).

## RESEARCH RESULTS AND DISCUSSION

This study employs a quantitative research approach to examine the macroeconomic determinants of government bond yields in Indonesia. The dependent variable in this study is the government bond yield, while the independent variables consist of the US Federal Reserve (FED) rate and the domestic inflation rate. In addition, the exchange rate (IDR/USD), Bank Indonesia (BI) rate, and gross domestic product (GDP) are included as control variables to account for other macroeconomic influences.

The descriptive statistic consists of five aspects: mean, median, minimum, maximum, and standard deviation. Table 2 presents summary statistics of the raw data, while Table 3 displays the summary statistics after applying differencing to the variable. The differencing was employed in this study to enhance visibility of volatility effect. Initially,

Before using the difference, all variables in this study do not have a volatility effect. The volatility will be shown through the time series plot of the variables. Here, this study shows the time series plot of the dependent variable which is the log government bond yield. The plot looks less volatile before this study adds a difference.

Table 2. Summary Statistics (without difference)

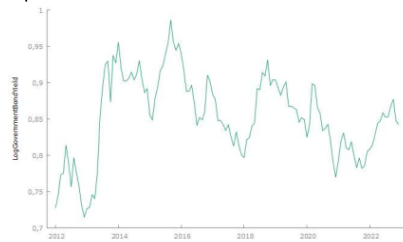
| Variable              | Mean   | Median | Minimum | Maximum | Standard Deviation |
|-----------------------|--------|--------|---------|---------|--------------------|
| US FED Rate           | 0.7268 | 0.1600 | 0.0500  | 4,1000  | 0.9034             |
| Indonesian Inflation  | 0.0411 | 0.0359 | 0.0030  | 0.0879  | 0.0195             |
| Government Bond Yield | 0.8536 | 0.8524 | 0.7153  | 0.9864  | 0.0578             |
| Ind Exchange Rate     | 4,1132 | 4,1339 | 3,9540  | 4,2125  | 0.0633             |
| BI Rate               | 0.0549 | 0.0563 | 0.0350  | 0.0775  | 0.0139             |

|     |        |        |         |        |        |
|-----|--------|--------|---------|--------|--------|
| GDP | 0.0431 | 0.0506 | -0.0700 | 0.0707 | 0.0291 |
|-----|--------|--------|---------|--------|--------|

**Table 3. Summary Statistics (With difference)**

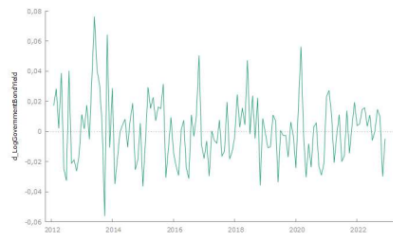
| Variable              | Mean     | Median | Min     | Max    | Standard Deviation |
|-----------------------|----------|--------|---------|--------|--------------------|
| US FED Rate           | 0.0307   | 0.0100 | -0.9300 | 0.7000 | 0.1661             |
| Indonesian Inflation  | 0.0001   | 0.0001 | -0.0283 | 0.0271 | 0.0064             |
| Government Bond Yield | 0.0009   | 0.0005 | -0.0562 | 0.0763 | 0.0222             |
| Ind Exchange Rate     | 0.0018   | 0.0013 | -0.0398 | 0.0566 | 0.0106             |
| BI Rate               | -3,8E-05 | 0.0000 | -0.0125 | 0.0050 | 0.0020             |
| GDP                   | -4,8E-05 | 0.0000 | -0.0829 | 0.1407 | 0.0156             |

In Figure 3, after this study adds the difference, the plot of the dependent variable looks more volatile. This means that the data is not constant. Aside from this, the descriptive statistic shows better results in the variables that use differences. Table 2 shows the dependent variable's mean value (government bond yield) is 0.8536. While the maximum and minimum values are 0.9864 and 0.7153. Meanwhile, in Table 3, the mean of the government bond yield is 0.0009. While the maximum and minimum values of this variable are 0.0763 and 0.0562. As presented in Table 2, the mean value of Indonesian inflation rate is 0.0411, while the highest recorded value is 0.0879, and the lowest is 0.0030. In Table 3, the mean value of the Indonesian inflation rate is 0.0001, and the maximum and minimum values are 0.0271 and -0.0283, respectively. In addition, the mean value of the control variable (BI Rate) is 0.0549 in Table 2 and -3.82E-05 in Table 4. Most of the results from Table 3 show a smaller percentage compared to Table 2. The smaller the percentage, the better the result because this indicates that the data prediction is close to the real one.



**Figure 2. Log of Government Bond Yield (Without difference)**

Source: Researcher Analysis



### Figure 3. Log government bond yield (With difference)

Source: Researcher Analysis

Classical assumption aims to ensure the reliability of hypothesis testing by performing various tests, such as normality, multicollinearity, and heteroskedasticity test. The results of these tests were obtained using the GRETL software.

**Table 4. Classical Assumption Test Result**

| Test               | Variable             | P-Value | VIF    |
|--------------------|----------------------|---------|--------|
| Normality          |                      | 0.0910  |        |
| Multicollinearity  | US Fed rate          |         | 1.1400 |
|                    | Indonesian inflation |         | 1.0360 |
|                    | Exchange rate        |         | 1.0470 |
|                    | BI rate              |         | 1.1530 |
|                    | GDP                  |         | 1.0080 |
| Heteroskedasticity |                      | 0.5232  |        |

Table 4 shows the result of classical assumption test result. Based on the table, the normality test result is 0.0910, which is above 5%. As a result, the data is normally distributed. A multicollinearity test is performed to determine whether the independent variables have a strong correlation with one another. In this test, the VIF (Variance Inflation Factors) should not be more than 10; otherwise, it will indicate a problem. Based on the result from Table 4, the VIF of the independent variables and control variables (US Fed Rate, Indonesian inflation, Indonesian exchange rate, BI Rate, and GDP) is less than 10. This indicates that there is no sign of multicollinearity. A heteroskedasticity test is conducted to examine whether the data has an error or residual variance that is normally distributed. This study used the white test method to test the heteroskedasticity. Table 4 presents that the significance value is 0.5232 this is greater than 5%, indicating no heteroskedasticity issue, and the data is homoscedastic.

The purpose of stationary test is to investigate whether the data is stationary or not. This study used an augmented dickey-fuller Test (ADF Test). A stationarity time series means that the time series data we have does not have a trend or seasonality and has a constant variance. Because of that, the best result for this test is for the data to be non-stationary. As shown in Table 5, the value of most of the variables is below 5%, except for the US Fed rate, means that all the variables other than the US Fed Rate are stationary. Therefore, we need to do the cointegration testing.

**Table 5. Stationary Testing Result**

| Variables             | With a constant and trend |          |
|-----------------------|---------------------------|----------|
|                       | With constant             |          |
| Government Bond Yield | 4.21E-21                  | 2.91E-22 |
| US Fed Rate           | 0.4055                    | 0.2768   |
| Indonesian Inflation  | 1.56E-21                  | 1.34E-22 |
| Exchange Rate         | 1.25E-25                  | 1.09E-28 |
| BI Rate               | 0.0001533                 | 0.00128  |
| GDP                   | 1.26E-18                  | 5.54E-19 |

Cointegration testing examines whether there is a long-term connection between the variables. The data is investigated through the Engle-Granger test with a significance value of 5% in this test.

**Table 6. Cointegration Testing Result**

| Cointegration        | Value    |
|----------------------|----------|
| US FED Rate          | 0.04698  |
| Indonesian Inflation | 0.01707  |
| Exchange Rate        | 0.01024  |
| BI Rate              | 0.003813 |
| GDP                  | 0.02491  |

As portrayed in Table 6, the value of the independent variables (US Fed rate and Indonesian inflation) is less than 5%. This indicates that the independent variables have a long-term effect on the dependent variable.

**Table 7. Summary of ARMA Models**

| ARMA MODEL         | AR (1) MA (1) | AR (2) MA (2) | AR (3) MA (3) | AR (4) MA (4) | AR (7) MA (7) |
|--------------------|---------------|---------------|---------------|---------------|---------------|
| Adjusted R-squared | 0.3626        | 0.3996        | 0.4569        | 0.4507        | 0.4904        |
| Akaike criterion   | -674.3850     | -676.5269     | -687.1881     | -683.8597     | -681.0207     |
| Hannan-Quinn       | -663.8701     | -663.6754     | -671.9999     | -666.3348     | -656.4859     |

This study uses 1.1 to 7.7 for the AR and MA period. Then, the result from the adjusted R-squared, Akaike Criterion, and Hannan-Quinn should be assessed. For the adjusted R-squared, the biggest value will be selected. Meanwhile, for the Akaike criterion and Hannan-Quinn, the smallest value will be chosen. Based on the result from Table 7, the best ARMA model is 3.3 because it fulfils most of the requirements. The adjusted R-squared of ARMA 3.3 is 0.4569. Meanwhile, the Akaike criterion and Hannan Quinn results are -687,1881 and -671.9999. Although the adjusted R-squared is smaller than Arma 7.7, the results of the Akaike Criterion and Hannan Quinn are still smaller compared to the others.

**Table 8. ARMA 3,3 Progression result**

| Arma 3,3             | Coefficient | Std. Error | z       | p-value    |
|----------------------|-------------|------------|---------|------------|
| USFedrate            | - 0.00531   | 0.0054     | -0.9831 | 0.3255     |
| Indonesian Inflation | 0.46889     | 0.20457    | 2.292   | 0.0219**   |
| Exchange rate        | 1.11346     | 0.11845    | 9.400   | <0.0001*** |
| BI Rate              | 1.86301     | 0.47877    | 3.891   | <0.0001*** |
| GDP                  | 0.06531     | 0.09636    | 0.6777  | 0.498      |

Notes: \*significant at 10% level of error; \*\* significant at 5% level of error; \*\*\*significant at 1% level of error

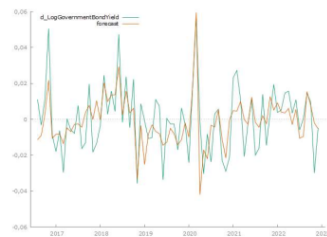
Table 8 shows the hypotheses results from the best ARMA model. US Fed Rate is insignificant to the Indonesian Government bond yield as the P-value is higher than 10%. In addition, Indonesian inflation and exchange rate are positively significant towards the government bond yield, since the P Value > 5% and > 1%. While the significant control

variables to increase the government bond yield is BI rate.

**Table 9. Forecast Evaluation Statistics**

|                                 |        |
|---------------------------------|--------|
| Mean Error                      | 0.0014 |
| Root Mean Squared Error         | 0.0100 |
| Mean Absolute Error             | 0.0070 |
| Mean Percentage Error           | 248.78 |
| dMean Absolute Percentage Error | 286.70 |

Based on the Table 8, ARMA model 3.3 is chosen as the best model. Therefore, this study analyses the forecast of that model. Table 9 shows the mean error is 0.0014, and the root mean squared error is 0.0100. As for the mean absolute error, the result is 0.0070. From the forecast evaluation statistics, the value of the mean error, root mean squared error, and mean absolute error are small. This indicates that the values of the forecast are close to the actual value. Therefore, the forecasting model is good. This also is portrayed in the graph of Figure 4.



**Figure 4. Forecasting graph**

Source: Researcher Analysis

US FED rate is the rate set by the US Fed. The US Fed is the central banking system of the United States, which has the duty to manage money supply and financial system stability (aligned with one of the macroeconomic goals), including setting the interest rate. The policy made by the US Fed influenced the world economy. According to the Fisher Effect theory, the real interest rate equals the nominal interest rate, less the inflation rate. Interest rate falls when inflation increases. Therefore, the interest rate declines when inflation rises. This corresponds with the situation in the U.S., where the country had the highest inflation rate last July. During the inflation period, the government/ institution can implement monetary policy to solve the problem. However, the result from the software shows that the rise of the US Fed Rate does not affect the Indonesian government bond yield positively. The coefficient value of the US Fed rate is -0.0053. This means that the US Fed has a negative effect on the Indonesian Government Bond Yield. After that, as shown in Table 9, US Fed Rate is insignificant to the dependent variable because the P-value is higher than 10%. Furthermore, the plot of the time series of the US Fed rate tends to be constant, meaning that there is only a small change within the period, which does not affect the government bond yield significantly.

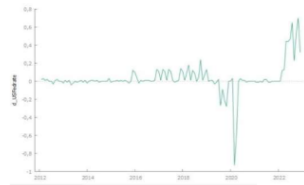


Figure 5. US Fed Plot Time Series

Source: Researcher Analysis

The analysis shows result for hypothesis 1 contradicts several studies. For example, Rosanti & Sihombing (2021) states that the US Fed rate positively affects the Indonesian government bond yield. The reason is that the gain in the Fed rate with the intervention from the government in the global will incite the yield of the government bonds. According to a study by Siahaan & Panahatan (2020), the US Fed rate has a negative effect on Indonesian government bond prices. This means that the rise of the US Fed rate will lead to the fall of the bond price. Bond yield and Bond price have the opposite relationship. If the bond price decreases, then the bond yield increases. Therefore, based on this study, the US Fed rate affects the Indonesian government bond yield positively, which contradicts the result from the test. In addition, the result also contradicts Permanasari & Kurniasih (2021) which stated there that the interest rate has a positive effect towards the Indonesian government bond yield. As a result, the first hypothesis in this research is dismissed.

Inflation is one of the macroeconomic factors that influence the economy of a country. The test result shows that inflation affects the Indonesian Government Bond Yield positively. The coefficient value of the inflation is 0.468892. This value indicates that there is a positive relationship between Indonesian inflation and the Indonesian government's bond yield. The reason behind this is the risky conditions during inflation, which causes uncertainty. For example, the war between Russia and Ukraine was discussed in the previous chapter. As a result, the price of oil in Indonesia increased, followed by the rise in the price of gasoline. Fisher's effect theory assumes that the real interest rate is equal to the nominal interest rate, less the expected inflation rate. In accordance with the theory above, one of the macroeconomic goals is financial stability. If inflation gets higher, it will influence financial stability and cause uncertainty in the economy. The uncertainty in the risky condition raises questions among investors about what will influence their investment decisions. So, the investors will demand a higher rate of return. This is aligned with the result Tjandrasa, Ariwibowo, et al. (2020) where investors will expect a higher return rate on bonds from the government because they consider the inflation rate that can reduce their return. This also responds Siahaan & Panahatan (2020) which maintains that if the current rate and expected rates of inflation are higher, the government bond yield will rise. Then, the bond investors will demand higher yields in order to offset the inflation risk. Furthermore, the study results also aligns with (Ehling et al., 2016; Tjandrasa, Siagian, et al., 2020) Koroleva & Kopeykin (2022), and Wicaksono & Syarif (2022). However, the hypothesis's result contradicts Permanasari & Kurniasih (2021) study which found that inflation does not affect the Indonesian 10-year government bond yield positively.

On the other hand, based on the result from Bank Indonesia's official website, Indonesian inflation is rising each year. The higher the inflation rate, the higher the government bond yield. For example, In July 2022, the inflation rate was 4.94%, and the Indonesian government bond yield value was 0.07122. Next, in September 2022, the inflation rate rose to 5.95%. Here, the Indonesian government bond yield also increases, resulting in 0.07373. Therefore, Indonesian inflation positively affects the Indonesian government bond yield. So, the second hypothesis is accepted.

37 The exchange rate is the value of a currency that is exchanged with another currency, which is useful for managing trade and money movements. According to the outcome investigated earlier, the coefficient value of the exchange rate is 1.1135. This outcome shows that the exchange rate positively affects Indonesian government bond yields. Nowadays, the value of the rupiah in Indonesia is declining compared to the USD. The reason behind this phenomenon is due to the increase of the US Fed rate (monetary policy carried out by the US Fed) as a response to inflation. Fisher's effect theory found that inflation impacts the changes in interest rates. The depreciation of the rupiah leads to a decrease in bond prices. As a result, investors demand higher returns since the risk is higher. Therefore, this circumstance increases the government bond yield. The result of H<sub>3</sub> hypothesis is aligned with the study from Qisthina et al. (2022), which claimed that the exchange rate positively and significantly affects the Indonesian government bond yield. Yusuf & Prasetyo (2019) also supported this view by stating that the exchange rate is the main factor influencing government bond yield. Furthermore, Adiwibowo & Sihombing (2019) stated that the exchange rate does affect the Indonesian government bond yield positively because the weakening of the rupiah leads to a decline in bond price and a rise in bond yield. Therefore, the third hypothesis is accepted.

However, there is one study that contradicts this result. Meyer & Hassan (2020) stated that the exchange rate affects the government bond yield negatively because the volatility of the exchange rate does not encourage investment in the bond market.

### Managerial Implications

After knowing the result, the investors can see that the current economic condition is uncertain, such as the rise of the US Fed rate, the higher inflation rate in Indonesia, and the depreciation of the exchange rate. Therefore, investors should make their investment decisions carefully. Investors need to pay attention to their portfolio by checking the average duration, interest rate sensitivity, and how much return they will get for the benefit in the long term. Investors should also be able to invest in a more liquid investment. In addition, the government should attract more investors to issue government bonds to increase the economy and provide welfare for society.

### CONCLUSION

This research is established to test the impact of the rise of the US Fed rates, Indonesian inflation, and exchange rate on the government bond yield of Indonesia. Some of the macroeconomic factors in Indonesia are used in this study to test the goal. Those macroeconomic factors are the Indonesian inflation rate, BI Rate, growth domestic product, exchange rate, and US Fed interest rate. The population used in this study is Indonesia. The samples used in this study are the monthly rate and price of macroeconomic data for 12 months each year starting from 2010-2012. This research uses 131 units of observations to draw conclusions with systematic sampling. The research uses the US Fed rate, Indonesian inflation, and exchange rate as the independent variables and the Indonesian government bond yield as the dependent variables. In addition, BI rate and GDP are chosen as the control variables. Since the data is time series, this study used the ARMA model.

According to the outcome of the test, two of the independent variables, Indonesian inflation and exchange rate, have a significant relationship to the dependent variables. One control variable has a significant relationship, which is the BI rate. On the other hand, GDP has no impact towards the dependent variables. In conclusion, the rise of the US Fed rate does not affect the Indonesian government bond yield positively. Meanwhile, the Indonesian inflation and exchange rate positively affect the Indonesian government bond yield.

Although the purpose of this study is to assess the impact of the rise of the US Fed rate, Indonesian inflation, and exchange rate regarding the yield on Indonesian government

bonds, the macroeconomic factors are limited to these three factors because, according to the ARMA model, the adjusted R-Square value is around 46%. So, 54% of other factors, such as credit default swaps or volatility index, can still be used aside from these two elements in the future. Next, the population used in this research is only Indonesian. Every country has its characteristics. Therefore, this study is only applicable to Indonesia as the object. Future researchers can sample to other countries or compare Indonesia's data with others.

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