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Detection of the Palestine-Israel Conflict on Economic Stability in Indonesia

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ABSTRACT

This research aims to detect the Palestinian-Israel conflict on economic stability in Indonesia. The variables used in this research are the inflation rate, the exchange rate against the dollar, the number of laid-off workers, foreign exchange reserves and the Composite Stock Price Index. The type and source of data uses a quantitative approach with secondary data in the form of time series data with an observation period from February 2023-April 2024. The data analysis method in this research uses the VAR (Vector Autoregression) model. The research results show that the Palestinian-Israeli conflict affects economic stability in Indonesia in the medium and long term, while it is not affected in the short term. The variables that contribute the most to economic stability in Indonesia are the inflation rate and the exchange rate.

Keywords: Economic Stability, Inflation, Exchange Rate, Layoffs, Foreign Exchange Reserves, Composite Stock Price Index

INTRODUCTION

The Palestinian-Israeli conflict occurred from the 19th century to the 21st century. The beginning was the desire of the European Jewish minority group to establish a Jewish Homeland in the Palestinian territories, this is the cause of the Palestinian-Israeli conflict. This desire arose when Palestine was taken over by the British in 1917, after previously being under Ottoman Turkish rule. In addition, with this shift in power, the Balfour Declaration was born on November 2, 1917. The Balfour Declaration was an agreement stating that the British government agreed and supported the Jewish people to establish a homeland in the Palestinian territories. After the British and the Jews made an agreement, the number of Jews who migrated to the Palestinian territories continued to increase every year. Palestinian Arabs who occupied the Palestinian territories made various rejections and even rebellions against the Jews and the British government (Solihin, et al., 2023).

October 7, 2023 Hamas counterattacked Israel. The Hamas group that opposes the Zionist occupation is a Muslim Brotherhood movement that aims to liberate Palestine (Muchsin, 2015). The Palestinian-Israeli conflict that has heated up again has shaken the world. The conflict affects various fields, one of which is in the economic field. Not only does it affect the Palestinian-Israeli economy, but also the world economy. The Palestine-Israel conflict has consequences that have an indirect impact on the world economy. This conflict can trigger anxiety in the market, which will have an impact on gold, bonds, equities, and oil (Yoganandham & Kareem, 2023). In addition, the world was recently shaken by the Russia-Ukraine conflict. The world economy, which has not really recovered after the Russia-Ukraine war, now has to face the impact of the Palestinian-Israeli Conflict. One of the countries affected by the Palestinian-Israeli conflict is India. According to the results of research by Yoganandham and Kareem (2023), the Indian economy has a significant impact on the Israel-Hamas conflict, namely causing increased import costs, a larger current account deficit, inflation, and supply disruptions. Trade and agriculture affected by the conflict can cause inflation.

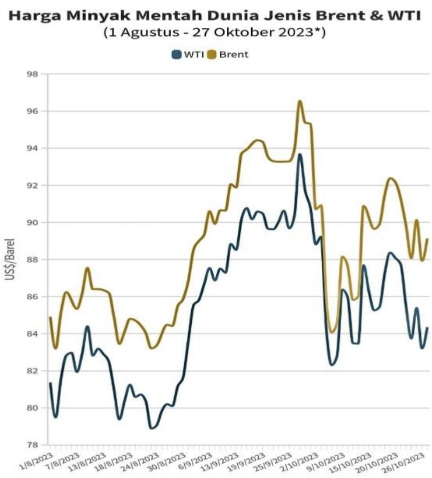

Figure 1. World Oil Price Chart (Investing, 2023)

Based on Figure 1., the world crude oil price fluctuates. Global oil prices have increased to $94 per barrel since Hamas counterattacked in October 2023. The occurrence of international oil price shocks affects exchange rates and inflation (Nizar, 2012). If these tensions continue to escalate, it could jeopardize central bankers' efforts to control inflation by blocking important transit routes and driving up oil prices. The conflict between Israel and Palestine could cause the global economy to contract by 1.7% by 2024, which is the lowest level since 1982. Rising oil prices will destabilize global prices and increase inflation to 6.7% in the coming year due to high fuel prices. Economies in the Middle East and North Africa are experiencing difficulties. The dispute between Israel and Hamas could also lead to a direct clash between Iran and Israel which could exacerbate global recession and inflation (Yoganandham, 2023). Amid the escalating Israel-Hamas war, crude oil prices increased by 4% in trading and instruments such as the US dollar and gold also increased. The Palestinian-Israeli conflict encouraged investors to switch to safer assets such as the US dollar, causing the rupiah exchange rate to weaken.

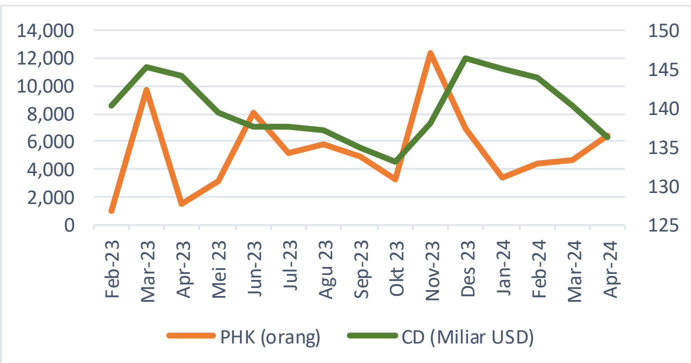

Figure 2. Laid Off and CD Chart (Kemnaker and BI, 2024)

Based on the graph above in November the number of people laid off increased dramatically to 12,347 people and foreign exchange reserves increased to 146.4 billion USD. This is thought to have occurred as a result of the Palestinian-Israeli conflict, which led to the division of two camps of defenders. Both the state and its people in various countries provide support for one of these countries, namely between Palestine or Israel. Indonesia is one of the countries that supports the independence of Palestine, as well as most of the Indonesian people. One form of support for Palestine is by boycotting products that support Israel. As a result of this boycott, there are negative and positive impacts. The negative impact is that it can increase the number of layoffs, because companies affected by the boycott experience losses, namely experiencing lost sales, cash flow, income and decreased stock prices (Farah & Newman, 2010).

The submission of a boycott action causes a significant negative reaction to the stock market according to (Pruitt and Friedman, 1986) and (Davidson, et al., 1995) cited in (Hamzah & Mustafa, 2019). According to research (Rahmani, 2023), of the 30 companies that supported Israel experienced a decrease in stock prices and public buying interest in their products. Insurance, household consumption, electronics, shoes, and clothing fall into this category. As the boycott by citizens caused investor concern, stock prices declined and companies experienced a decline during October-November 2023. According to (Harfikawati, 2016) the Jakarta Composite Index (JCI) can be influenced by macroeconomic conditions (exchange rate and inflation) and the global economy (world oil prices and world gold prices).

Based on the introduction above, the purpose of this study is to detect whether the Palestinian-Israeli conflict affects economic stability in Indonesia both in the short term, medium term and long term. Economic stability in this study is through the inflation rate, because inflation is closely related to prices and stable inflation reflects price stability.

LITERATURE REVIEW

Inflation

The inflation rate is one of the most concerned issues in every country. Indonesia is a developing country whose economic life is highly dependent on the framework related to money and the global economy (Rangkuty, et al., 2022). In general, inflation can be classified based on the factors that cause it, namely the supply side, the demand side or a combination of both. From the supply side, the cause is an increase in demand that is not matched by supply, while the cause from the demand side is for example due to an increase in production costs (Sarbaini and Safitri, 2022) and (Yanti, et al., 2022). Inflation cannot be defined as an increase in the price of just one or two goods. It only occurs when an increase in the price of one good causes a decrease in the price of another good. Inflation can be divided into four types based on severity: mild inflation (less than 10% per year), moderate inflation (between 10% and 30% per year), severe inflation (between 30% and 100% per year), and hyperinflation (more than 100% per year) (Sukirno, 2002).

Exchange rate

Exchange rate is the exchange between two different currencies. The exchange rate is a price or value comparison between the two currencies. The exchange rate is one of the important prices in an open economy because it is determined by the balance between demand and supply that occurs in the market (Muchlas & Alamsyah, 2015). Exchange rate is a key for a country or society to transact with other countries or each other (Cempakasari & Kuntadi, 2022). Countries with an open economic system pay attention to currency exchange rates because countries with this system conduct international trade (Dzakiyah et al., 2018) cited in (Rangkuty, et al., 2021).

Termination of Employment Relationship

Layoff is the termination of employment relationship due to a certain reason that results in the end of rights and obligations. Layoffs have an impact on social inequality and economic stability. There are several reasons for mass layoffs, such as economic recession, company restructuring, or technological developments resulting in job automation and also when economic recession and inflation spikes threaten. Layoffs can also be caused by the uncertain state of the world economy, difficulty in obtaining funds, and the inability of companies to maintain business operations. Layoffs are one of the alternative ways to reduce the company's operating costs. This is because 20-50% of the company's total operating costs are used for employee salaries (Solihah, et al., 2023).

Foreign Exchange Reserves

Foreign exchange reserves are foreign means of payment in the form of foreign banknotes, gold and other bills in foreign currency to foreign parties. Foreign exchange reserves are external assets that meet the following criteria: they are liquid, denominated in major foreign currencies, under the control of the monetary authority, and can be used immediately to settle international transactions. Foreign exchange reserves include monetary gold, special drawing rights, reserve position in the Fund, foreign exchange reserves, and other claims (Hasyim, 2018). Thus, foreign exchange reserves are a means of payment in international trade in the form of foreign exchange managed by the central bank in the country that can be used to maintain monetary stability, national savings, and debt payments (Khusnatun & Hutajulu, 2010).

Composite Stock Price Index (JCI)

Stock prices are how the strength of the buying and selling offers in a stock on a dynamic market mechanism. Stock prices can be determined by market participants and are influenced by the law of supply and demand in the capital market. Stock prices are considered to increase if there is excess demand or an increase, conversely there is a decrease in stock prices if in the market there is an excess supply according to Suryana & Anggadini cited in (Rahmani, 2023). Fundamental factors that affect stock prices consist of two, namely internal fundamentals which include the state of issuers such as dividend distribution and strategy changes will be important information for investors in the capital market and external fundamentals including government policies, changes in exchange rates, interest rates, and inflation rates (Putri & D, 2011). The Jakarta Composite Index (JCI) is a stock price index that has been created and calculated by generating a trend (index number).

MATERIALS & METHODS

The data used in this study is secondary data obtained from Bank Indonesia (BI), Ministry of Trade, Ministry of Manpower, CEIC and from previous studies. The variables used in this study are inflation, exchange rates, layoffs, foreign exchange reserves and the Jakarta Composite Index (JCI) using a data analysis model, namely the Vector Autoregressive (VAR) model to determine the relationship between variables. With assumption tests, namely, Stationarity Test, Cointegration Test, VAR Structure Lag Stability Test, Lag Length Test. The next step is the Vector Autoregression (VAR) Estimation Test which is supported by the Impulse Response Function (IRF) Test and the Forecast Error Variance Decomposition (FEVD) Test.

RESULT

The first stage carried out is the stationarity test with the Augmented Dickey Fuller (ADF) unit root test, showing that all variables are stationary at the level or in the actual data. This means that the results of stationary testing with Dickey Fuller can be continued at the next stage of testing. The cointegration test results show that the trace statistic value and maximum eigenvalue at r

= 0 have a value greater than the critical value with a significant level of 5%, the five variables do not experience cointegration. This means that among the movements of Inflation, Exchange Rate, layoffs, Foreign Exchange Reserves and JCI have an equilibrium relationship or stability and similarity of movements in the long run, so that the analysis for the VAR model can be done. The VAR structure lag stability test through Root of Characteristic Polynomial explains the highest Modulus value has a value of less than one, thus the results of the test are already in the optimal state and the VAR model is in a stable state, meaning it is categorized in a stable state and can be used to conduct IRF and FEVD analysis. Testing the lag length by looking at the Akaike Information Criterion (AIC) shows that the AIC value of lag 1 is smaller than the AIC value of lag 0, meaning that the use of VAR at lag 1 will be more optimal than VAR at lag 0.

Table 1. VAR Results

Variable	Largest Contribution 1	Largest Contribution 2
INF	INF	RATE
RATE	RATE	IHSG
Laid Off	RATE	INF
CD	RATE	INF
IHSG	RATE	CD

Source: Output Eviews 2024

The variable that contributes the most to the inflation rate is the exchange rate. The movement of the exchange rate affects the inflation rate. The variable that contributes the most to the exchange rate is the Stock Price Index (JCI). The rise and fall of the stock price index affects the exchange rate of the rupiah against the dollar. The variables that contribute most to the number of workers laid off are the exchange rate and the inflation rate. When inflation is high, companies tend to lay off employees because goods become lower and demand for goods decreases, resulting in a decrease in production. The opposite is also true when inflation is low (Sasongko, et al., 2019). The exchange rate also affects the number of people laid off. The variables that contribute the most to the amount of foreign exchange reserves are the exchange rate and the inflation rate. When inflation increases, this has an impact on the amount of foreign exchange reserves. Likewise with the exchange rate, the exchange rate affects foreign exchange reserves. The variables that contribute the most to the Composite Stock Price Index are the exchange rate and the amount of foreign exchange reserves. The inflation rate affects the composite stock price index. The exchange rate also affects the JCI.

Table 2. IRF Results

Variable	Time Period	INF	RATE	Laid Off	CD	IHSG
INF	Short	+	(0,00)	(0,00)	(0,00)	(0,00)
	Medium	-	+	+	-	+
	Length	-	+	-	-	+
RATE	Short	-	+	(0,00)	(0,00)	(0,00)
	Medium	-	+	-	-	+
	Length	+	-	-	+	-
Laid Off	Short	+	-	+	(0,00)	(0,00)
	Medium	+	-	-	+	-

	Length	+	-	+	+	-
CD	Short	+	-	+	+	(0,00)
	Medium	-	+	+	-	+
	Length	-	-	-	-	-
IHSG	Short	-	-	+	-	+
	Medium	-	+	+	-	+
	Length	+	-	-	+	-

Source: Output Eviews 2024

The table above shows that in the short term inflation is responded positively by inflation itself, while other variables do not respond. In the medium term inflation is responded positively by the exchange rate, layoffs and JCI, while the inflation variable itself and foreign exchange reserves give a negative response. Then in the long run inflation responded positively by the exchange rate and JCI, while inflation itself, layoffs and foreign exchange reserves gave a negative response. In the short term, the exchange rate responded positively by the exchange rate itself and responded negatively by inflation, while other variables did not respond. In the medium term, the exchange rate responded positively by the exchange rate itself and JCI, while the variables of inflation, layoffs and foreign exchange reserves gave a negative response. Then in the long run the exchange rate responded positively by inflation and foreign exchange reserves, while the exchange rate variable itself, layoffs and JCI gave a negative response. In the short term, layoffs are responded positively by layoffs itself and inflation, the exchange rate variable responds negatively, while other variables do not respond. In the medium term layoffs are responded positively by inflation and foreign exchange reserves, while the layoffs themselves, exchange rates and JCI variables give a negative response. Then in the long term layoffs responded positively by layoffs itself, inflation and foreign exchange reserves, while the exchange rate and JCI variables gave a negative response. In the short term foreign exchange reserves responded positively by the foreign exchange reserves itself, inflation and layoffs, the exchange rate variable gave a negative response, while the JCI did not respond. In the medium term, foreign exchange reserves responded positively by the exchange rate, layoffs and JCI, while the variables of foreign exchange reserves itself and inflation responded negatively. Then in the long term no variable responded positively to foreign exchange reserves, all variables responded negatively. In the short term JCI is responded positively by JCI itself and layoffs, while the variables of inflation, exchange rate and foreign exchange reserves respond negatively. In the medium term JCI responded positively by JCI itself, exchange rate and layoffs, while inflation and foreign exchange reserves responded negatively. Then in the long term JCI is responded positively by inflation and foreign exchange reserves, while the JCI variable itself, exchange rates and layoffs have a negative impact.

Table 3. FEVD Results

Variable	**Time Period**	**Policy Recommendations**	
		Largest Contibution I	Largest Contribution II
INF	Short	INF	-
	Medium	INF	Laid Off
	Lenght	INF	CD

RATE	Short	RATE	INF
	Medium	INF	RATE
	Lenght	INF	RATE
Laid Off	Short	Laid Off	RATE
	Medium	Laid Off	RATE
	Lenght	Laid Off	RATE
CD	Short	CD	RATE
	Medium	CD	Laid Off
	Lenght	CD	INF
IHSG	Short	RATE	IHSG
	Medium	INF	CD
	Lenght	INF	CD

Source: Output Eviews 2024

To control the inflation rate in the short term, the government is recommended to control the inflation variable itself. In the medium term, it is recommended that inflation itself and layoffs. While in the long term, inflation itself and foreign exchange reserves. In controlling the exchange rate against the dollar in the short, medium and long term, it is recommended to control the exchange rate variable itself and inflation. In an effort to control the number of people laid off in the short, medium and long term, it is necessary to control the layoff variable itself and the exchange rate. To control the amount of foreign exchange reserves, it is recommended to control, namely in the short term through the foreign exchange reserves themselves and the exchange rate, in the medium term through the foreign exchange reserves themselves and layoffs, then in the long term through the variables of foreign exchange reserves themselves and inflation. Controlling the composite stock price index, in the short term it is recommended to control through the JCI itself and the exchange rate. While in the medium and long term, it is recommended through inflation and foreign exchange reserves.

CONCLUSION

The Palestinian-Israeli conflict affects economic stability in Indonesia in the medium and long term, while in the short term it is not affected. The variables that contribute the most to economic stability in Indonesia are the inflation rate and the exchange rate.

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