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The Role of Monetary Policy in Stabilizing Inflation: An Islamic Economic Perspective

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Abstract. *Monetary policy plays a very important role in stabilizing inflation and maintaining economic balance. In the perspective economics, monetary policy must be based on the principle of justice, prioritize welfare, and avoid usury. This article examines the role of monetary policy in stabilizing inflation from the perspective of Islamic economics. This research uses a descriptive qualitative method with a literature study approarch, where data collection employs secondary data taken from books, journals, and articles that support the theme of this research.*

Research result indicate that in Islamic economic, stabilizing inflation is achieved through monetary policies that are just and free from usury. However, several sharia economic experts believe that there are some some conventional monetary policy instrumensts that can still be applied, such as reserve requirements, overall and selective credit ceilings, moral suasion, and chages in monetary policy

Keyword: *Monetary, inflation, Islamic Economi*

INTRODUCTION

Inflation is a condition where the prices of goods/services increase continuously over a period of time. Something is said to be inflationary if the price increase can have an impact on increasing the prices of other goods. Based on a report from the Ministry of Finance of the Republic of Indonesia, Indonesia saw a declining inflation trend until the end of the first semester of 2023. In June 2023, it was recorded that the inflation rate reached 3.5%, which is a decline from 4.0% in May. This is due to the consistent implementation of monetary policy as well as the good cooperation between Bank Indonesia and the government which is formed into the Central and Regional Inflation Control Team. The central bank, Ban Indonesia, has confidence that inflation will be under control and stable at 3.0±1% until the end of 2023.

There has been a downward trend in the inflation rate in Indonesia over the last 15 years, although there are changes in the increase and decrease that continue to occur. This explains that Indonesia has the ability to keep the money market in Indonesia from experiencing soaring increases. But in reality the inflation rate is driven through an increase in the money supply which can cause an increase in inflation. This is in contrast to the theory described by Milton Friedman. In the theory of monetarism developed by Milton Friedman, inflation is primarily triggered by an increase in the amount of money in circulation in the economy. According to this view, if the central bank produces too much money or sets low interest rates, this can cause inflation (Riadina, 2024).

In an effort to control inflation and maintain currency stability, the government and monetary authorities implement various policies, including monetary, fiscal, and involving the real sector (Harahap et al., 2021). In monetary policy, the Central Bank will increase interest rates and tighten bank liquidity, evaluate the effectiveness of monetary instruments, and set the ultimate goal of monetary policy (Kebanksentralan, t.t.). However, in this context, the authorities only touch on the technical aspects or symptoms, and the combination of policies used will exacerbate the crisis.

Monetary policy aims to set and achieve inflation targets over the short and medium term, and is committed to price stability as the primary objective over the long term (Syahrir Ika, 2016). Monetary policy has the main task of achieving macroeconomic stability, which is realized through the availability of broad employment. Economic stability can be realized through the implementation of policies at the macro level, focusing on monetary and fiscal policies. Monetary policy, as the authority of the monetary authority or central bank, involves controlling the monetary amount in order to achieve the desired development of economic activity (Natsir, 2018).

In this context, monetary policy can also be interpreted as an effort made by the monetary authority (central bank) to influence the amount of money in circulation and credit, which in turn will affect the economic activities of the community (Nopirin, t.t.). Monetary policy instruments include open market policy, which includes the buying and selling of securities; discount policy, which changes the interest rate that commercial banks must pay to the central bank; minimum reserve policy; margin requirements, to limit the use of credit in the purchase of securities; and moral suasion.

Ibn Taymiyyah during the Bani Mamluk era warned about poor quality currency, stating that poor quality currency can replace good quality currency from circulation (Gunawan et al., t.t.). Inflation can be caused by non-monetary factors such as natural disasters or slow government response to inflation.

In dealing with this problem, human daily life, including the decline in the value of currency and monetary crisis, must be based on religious norms, especially Islam, which has regulated all aspects of life, including economic issues (Ramadhani et al., 2024).

Based on the description of the problem above, the formulation of the problem can be obtained, namely how the role of monetary policy in stabilizing inflation in the perspective of Islamic economics?

METHOD

This type of research is a descriptive quantitative research. Menuiruit (Raihmain, 2022) the purpose of this descriptive quantitative research is to interpret and explain the data related to the current situation, the attitude of the pain of the situation, the conflict between the two, the irrigation of the situation, and the other conditions. For this descriptive quantitative research, the researcher uses a research design of a research library (librairy research) which aims to collect information through books, science journals, science clippings, and others as relevant and related to the object under study.

FINDINGS AND DISCUSSION

Monetary Policy in Stabilizing Inflation

Firmansyah argues that monetary policy has an important role in controlling inflation in Indonesia (Firmansyah, 2022). Bank Indonesia plays an important role as the monetary authority in Indonesia, having the main responsibility to maintain price stability through appropriate monetary policy. Setting the benchmark interest rate is one of the main instruments used by Bank Indonesia to control inflation. Bank Indonesia aims by raising interest rates it will reduce the amount of money circulating in the community, which in turn this policy will suppress the rate of inflation. Conversely, by lowering interest rates, Bank Indonesia is able to encourage economic growth by increasing the amount of money in circulation, but has the risk of inflation also becoming greater. In addition to interest rate setting, Bank Indonesia also uses other monetary policy instruments, such as open market operations and mandatory bank reserves, to control inflation.

The inflation rate in Indonesia is influenced by various factors, both internal and external. Internal factors include aggregate demand, production costs, and fiscal and monetary policies. High aggregate demand can push up prices of goods and services, while an increase in production costs, especially raw material and labor costs, can also push up prices. In addition, fiscal and expansionary policies, such as an increase in government spending without an accompanying increase in revenue, can also cause an increase in inflation (Mujasmara et al., n.d.). On the other hand, external factors such as international commodity prices, exchange rates, and global economic conditions also influence the inflation rate in Indonesia. Rising international commodity prices, especially oil and food, can cause an increase in the price of goods and services in the country, while depreciation of the rupiah exchange rate can also push up the price of imported goods.

Suhardi et al argue that the monetary policy implemented by Bank Indonesia has proven to be quite effective in controlling inflation in Indonesia. by using various effective in controlling inflation in Indonesia. by using various monetary policy instruments, such as interest rate setting, open market operations, and mandatory bank reserves, Bank Indonesia has managed to keep inflation within the set target range. Since the adoption of the inflation target in 2005, Bank Indonesia has managed to achieve the inflation target consistently. Nevertheless, there are several challenges faced in maintaining price stability, especially due to fluctuations in international commodity prices and the rupiah exchange rate (Suhardi & Tambunan, 2022).

A. Factors Causing Inflation

According to (fadilla, 2017) several factors cause inflation, including:

1. Based on Cause

   a. Demand-Pull Inflation

   This inflation stems from an increase in aggregate demand, while production is already at or near full employment (Nopirin, 1997).

   b. Cost-Push Inflation

   It is different from demand pull inflation. Cost-pull inflation is usually characterized by rising prices and falling production. Thus, inflation is accompanied by a recession. This increase in production costs can arise due to several factors including:

   1). A successful labor union struggle to demand a wage increase;

   2). A monopolistic industry;

   3). Increase in the price of industrial raw materials;

   4). Mixed Inflation.

   In practice, it is rare to find inflation in its pure form, i.e. inflation due to demand-pull and inflation due to supply-decline occurring alone. Inflation that occurs in various countries in the world is generally a mixture of the two types of inflation above, or what is commonly called mixed inflation.

2. Based on Origin
   a. Domestic Inflation

      This is inflation that comes from within the country. This inflation occurs due to the influence of economic events that occur in the country. For example, there is a continuous deficit in the state budget which is overcome by printing money.

   b. Imported Inflation

      This inflation is inflation that is contracted from abroad. This inflation occurs because of the increase in prices of export goods such as tea and coffee abroad.

3. According to Severity
   a. Mild Inflation

      Inflation whose level is still below 10% a year.

   b. Moderate Inflation

      Inflation whose level is still between 10%-30% a year.

   c. Severe Inflation

      Inflation whose level is still between 30%-100% a year.

   d. Hyper Inflation

      Inflation whose severity is at or 100% a year.

B. The Impact of Inflation on People's Economic Activities

1. On Consumers

   Inflation causes the prices of goods consumed to rise. Meanwhile, people's income does not increase. This affects people's consumption patterns, among others:

   a. The quantity of goods consumed decreases
   b. Switching brands of goods consumed

2. On Production

   The impact of inflation on production is seen in the desire to produce which has decreased, this is due to:

   a. Increase in the price of raw goods
   b. The interest rate makes it difficult for companies to expand production
   c. The emergence of an attitude of speculative producers

3. On Distribution

   The impact of inflation on the distribution of people's income is disrupted, because fixed-income people in real terms experience a decline in income (Ghofur, 2007).

C. Monetary Policy in Islam

Demand for money in Islamic monetary policy is focused on completing profitable transactions and investments. Demand for money made for speculative purposes cannot affect actual industrial growth. Misallocation of finance and ineffective money demand for corporate operations that do not add value added to the real sector will be the only outcome of these speculative incentives.

Islamic monetary policy should technically be free from usury as well as bank interest. The use of bank interest as the main instrument of monetary management is not applicable in Islam. Instead, Islamic monetary policy is based on the principle of profit sharing. The economic activities of the Prophet's time were based on trade with the dinar and dirham money transaction tools that were familiar to the people at that time. Dinar dirham as currency circulated well, there was no prohibition on the import of dirham services, non-cash transactions were allowed, checks and promissory notes were used factoring or known as hiwalah was commonly used.

Broadly speaking, Islamic monetary policy imposes quantitative controls on lending and the application of credit limits. That is, the maximum credit limit that a commercial bank can offer to its customers for financial purposes. The government can then use current accounts to influence the reserves of commercial banks. It is almost comparable to the function of open market operations that the central bank has a direct impact on commercial banks (Insani et al., 2023).

In Islamic economics, the government has an important role in creating equitable income distribution, employment development, reducing poverty levels, and improving living standards. Expansionary and contractionary monetary policy becomes instrumental in order to control the amount of money circulating in the economy, with the aim of increasing economic growth, reducing unemployment, and maintaining price stability (Latifah, 2015). There are two ways that can be done by the Central Bank, including open market operations, discount facilities, and mandatory reserve ratios.

In the perspective of Islamic economics, the application of the discount rate policy by the Central Bank cannot be applied because of the interest system in it. to control monetary policy in the context of Islamic economics, the Central Bank requires an instrument that does not involve interest. However, a number of Islamic economic experts have the opinion that there are several conventional moneer policy instruments that can still be applied, such as reserve requirements, overall and selecting credit ceilings, moral susional, and charges in monetary.

According to Al-Maqrizi, one of the Islamic economics experts, inflation is divided into three, namely Natural Inflation, Human Error Inflation, and Expected Inflation. Natural Inflation occurs naturally without human intervention, such as natural disasters. Human Error Inflation is inflation caused by human error such as corruptors, high taxes, or excessive money printing, while Expected Inflation is inflation that can lead to an increase in demand and an increase in the amount of money in circulation. If individuals believe that inflation will be high this year, they will spend their money to buy and store various goods, especially property and gold in an attempt to prevent inflation.

CONCLUSION

Monetary policy functions strategically to control inflation, especially to maintain a balance between price stability and economic growth. From the perspective of Islamic economics, justice, benefit, and the prevention of usury are the pillars of monetary policy. Monetary policies such as yield-based policies, the prohibition of speculation, and the management of cash reserves (cash waqf) can be an effective alternative to control inflation without causing social inequality. Islamic economics emphasizes the importance of price stability as part of the moral responsibility to maintain public welfare. Therefore, cooperation between Islamic principles and conventional monetary policy can help realize inflation stability and sustainable economic growth.

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