

Analyzing the Interaction Between Monetary Aggregates (M1, M2) and Expenditure Components on GDP in Developing Economies: Evidence from Indonesia

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ABSTRACT: This study aims to examine the integrated impact of monetary aggregates and macroeconomic expenditure components on Indonesia's Gross Domestic Product (GDP) in 2025. By employing multiple regression models, the research evaluates the effectiveness of narrow money (M1), broad money (M2), consumption (C), investment (I), government spending (G), and net exports (X) in driving economic growth. The analysis is grounded in the aggregate expenditure framework and monetary transmission theory, offering a comprehensive empirical approach to assess the synergy between fiscal and monetary policy. The results reveal that consumption, investment, and M1 have a positive and statistically significant effect on GDP, with consumption emerging as the most dominant contributor. M1 also demonstrates strong transmission power in stimulating household consumption, while M2 shows no significant impact, indicating its limited role in short-term growth. Government spending and net exports contribute positively, though their effects are relatively moderate. The regression models exhibit high explanatory power, with R^2 values exceeding 0.99 and robust F-statistics, confirming the reliability of the integrated framework. These findings support the strategic direction of Indonesia's economic policy under President Prabowo, which emphasizes domestic demand and productive investment. The study validates the effectiveness of liquidity injections through M1 and fiscal repositioning in accelerating money circulation and boosting real sector activity. Academically, the research contributes to macroeconomic literature by constructing a simultaneous model that integrates monetary and expenditure variables. Practically, it provides a data-driven foundation for policy formulation in developing economies undergoing structural reform. The study recommends further research on long-term dynamics and cross-country comparisons to evaluate the broader implications of monetary instruments in achieving inclusive and sustainable growth. Overall, the integrated approach offers valuable insights for strengthening Indonesia's macroeconomic resilience and achieving its targeted 8% growth rate.

KEYWORDS: Gross Domestic Product, Money Supply (M1 and M2), Consumption, Investment

I. INTRODUCTION

Indonesia's economic growth in 2025 has demonstrated notable resilience amid global pressures. According to data from Statistics Indonesia, the country's year-on-year (YoY) economic growth reached 4.87% in the first quarter of 2025, with major contributions from the agriculture, trade, and financial services sectors. Household consumption remained the primary driver of growth, expanding by 4.89%, while investment (Gross Fixed Capital Formation) and exports of goods and services grew by 2.12% and 6.78%, respectively (BPS, 2025).

On the other hand, low inflation at 1.6% and the stability of the rupiah exchange rate reflect the effectiveness of monetary policy implemented by Bank Indonesia (Bank Indonesia, 2025). Data from CEIC indicates that M2 growth reached 5.9% YoY in January 2025, signaling a moderate yet stable monetary expansion (CEIC, 2025; Tempo, 2025). The fiscal policy adopted by Finance Minister Purbaya Yudhi Sadewa in 2025 marks a strategic shift in the management of national liquidity. One of the most significant measures was the withdrawal of IDR 200 trillion in government funds from Bank Indonesia to commercial banks, aimed at accelerating the circulation of money in the real sector. This policy, reported by *Tempo English* (2025), directly affects monetary aggregates, particularly M1 and M2, which serve as key variables in this study. With increased liquidity in the banking system, it is expected that household consumption and investment—two major components of macroeconomic expenditure—will rise and contribute significantly to Gross Domestic Product (GDP) (*Kompas.id*, 2025).

This move also reflects a critique of previous monetary and fiscal approaches, which were considered overly conservative and insufficiently responsive to domestic needs. In an interview with *Bisnis.com* (2025), Purbaya emphasized that over 90% of

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Indonesia's economic activity is driven by domestic demand, and therefore, fiscal policy must be directed toward supporting purchasing power and encouraging productive investment. In this context, research on the interaction between money supply and macroeconomic expenditure components becomes highly relevant, as it provides empirical evidence on whether such policies truly impact economic growth.

Given the dynamic policy landscape and the focus on strengthening the real sector, this study is not only academically significant but also practically valuable in evaluating the effectiveness of recent fiscal and monetary strategies. The analysis of the relationship between M1, M2, consumption, investment, and GDP can serve as a foundation for formulating more targeted and data-driven policies. Moreover, this research contributes to the development economics literature, particularly in the context of developing countries undergoing structural reform toward inclusive and sustainable growth (*Mathematics Journal – MDPI*, Amaral *et al.*, 2022).

President Prabowo Subianto has set an ambitious target to raise Indonesia's economic growth to 8%, a figure well above the historical average of around 5%. In various forums, including the National Development Planning Meeting (Musrenbangnas) for RPJMN 2025–2029, he emphasized that high growth is essential for Indonesia to escape the middle-income trap and achieve developed country status (*CNBC Indonesia*, 2025; *Kompas.id*, 2025). This target is not merely symbolic but serves as the basis for more aggressive and focused fiscal and monetary policy formulation. In this context, your research becomes highly relevant as it examines whether monetary instruments and macroeconomic expenditure can significantly drive GDP.

To achieve this goal, President Prabowo has instructed Finance Minister Purbaya Yudhi Sadewa to accelerate money circulation and enhance the effectiveness of government spending. A concrete step was the repositioning of government funds from Bank Indonesia to commercial banks, aimed at boosting liquidity and stimulating consumption and investment (*Tempo.co*, 2025). Your study, which investigates the relationship between M1, M2, consumption, and investment and their impact on GDP, can serve as an empirical evaluation tool for the effectiveness of this policy. If it is proven that M1 and consumption significantly influence GDP, then the liquidity injection policy can be considered well-targeted.

Furthermore, Prabowo has stressed the importance of high-multiplier sectors such as housing, construction, and MSMEs as engines of growth. Expenditure components like government spending (G) and investment (I) are central to this strategy. Your research, which integrates variables C, G, I, and X into an aggregate expenditure model, can provide a comprehensive picture of how fiscal and monetary policies interact to drive growth. Thus, this study not only addresses academic questions but also contributes directly to supporting the national development agenda set forth by President Prabowo (*Kompas.id*, 2025; *Bisnis.com*, 2025).

There is limited empirical research that simultaneously integrates M1 and M2 with macroeconomic expenditure components in developing countries. Few studies link Indonesia's 2025 fiscal liquidity injection to changes in consumption and investment behavior, nor do they quantify the monetary transmission from money supply to household consumption. Additionally, there is a lack of comprehensive models combining monetary and expenditure variables, and no academic evaluation of Indonesia's 8% growth target from a policy readiness perspective.

Research Objectives:

1. To analyze the impact of macroeconomic expenditure components (consumption, government spending, investment, and net exports) on the growth of Gross Domestic Product (GDP) in Indonesia.
2. To examine the contribution of monetary aggregates (M1 and M2) in influencing GDP both directly and through the consumption variable.
3. To evaluate the relationship between money supply (M1) and household consumption as a monetary transmission channel to the real sector.
4. To develop an empirical model that integrates monetary and expenditure variables to explain the dynamics of economic growth in developing countries.

Using a quantitative approach and macroeconomic data analysis of Indonesia, this study is expected to provide both academic and practical contributions in strengthening the foundation of national economic policy toward the vision of Indonesia as a developed country by 2045.

II. METHOD

This study adopts a quantitative approach supported by macroeconomic data from authoritative national sources. It aims to empirically examine the relationship between monetary aggregates and macroeconomic expenditure components in driving Indonesia's GDP growth, as outlined in the following methodology.

a. Design and Data

The research design is explanatory, aiming to analyze causal relationships between monetary aggregates (M1 and M2), macroeconomic expenditure components (C, G, I, X), and Gross Domestic Product (GDP). This study utilizes secondary data obtained from several authoritative sources. Macroeconomic indicators such as Gross Domestic Product (GDP), household consumption, investment, government spending, and exports are sourced from Statistics Indonesia (BPS). Data on monetary aggregates, specifically M1 and M2, are collected from Bank Indonesia and CEIC Data, which provide comprehensive financial

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statistics. Information related to fiscal policy actions, including the repositioning of government funds and liquidity management strategies, is derived from official publications and press releases issued by the Ministry of Finance. These data sources ensure the reliability and relevance of the empirical analysis conducted in this research.

b. Variables and Models

The study uses three interrelated regression models:

1. Monetary transmission to consumption: $C = a + b_1 M1 + e_1$
2. GDP based on macroeconomic expenditure: $GDP = a + b_1 C + b_2 G + b_3 I + b_4 X + e_2$
3. GDP with integrated monetary variables: $GDP = a + b_1 M1 + b_2 M2 + b_3 C + b_4 I + e_3$

All models are estimated using the ordinary least squares (OLS) method, with diagnostic tests conducted to ensure statistical validity and robustness

c. Hypothesis Structure

1. H1: M1 has a significant positive effect on household consumption.
2. H2: Consumption, government spending, investment, and exports positively influence GDP.
3. H3: M1 and M2 have a significant positive direct and indirect effect on GDP through consumption and investment.

III. RESULT

1. Monetary Transmission to Household Consumption

This section presents the results of the first regression model, which analyzes the influence of narrow money (M1) on household consumption. Given that consumption represents the largest component of Indonesia's GDP, this model serves to evaluate the effectiveness of monetary expansion and fiscal liquidity policies implemented in 2025, as reflected in the following equation.

$$C = 647928 + 0.898 M1^{***} \quad R^2: 0.948 \quad F_{\text{stat}} = 1066.91 \\ (t_{\text{stat}}: 14.59) \quad (32.662)$$

The regression results reveal that the variable M1 has a positive and statistically significant effect on household consumption (C), with a coefficient of 0.898. This implies that every one-unit increase in M1 leads to a 0.898-unit rise in consumption, holding other factors constant. The strength of this relationship is supported by a t-statistic of 32.662, which far exceeds the critical threshold at the 99% confidence level (***), confirming the high statistical significance of M1's influence on consumption.

The coefficient of determination (R^2) is 0.948, indicating that 94.8% of the variation in household consumption can be explained by changes in M1. This demonstrates the model's strong explanatory power and empirical relevance. Furthermore, the F-statistic value of 1066.91 reinforces the overall validity of the regression model, confirming its robustness and suitability for policy-oriented analysis.

These findings suggest that increased liquidity through monetary instruments such as M1 has the potential to significantly stimulate household consumption. In the context of Indonesia's 2025 economic strategy, the results support the effectiveness of monetary expansion and fiscal liquidity injections in strengthening domestic demand. Accordingly, managing M1 emerges as a strategic tool for promoting economic stability and growth through the consumption channel.

From a theoretical standpoint, the results align with both Keynesian and monetarist frameworks, which posit that increased liquidity enhances purchasing power and drives consumption (Keynes, 1936; Friedman, 1968). In Indonesia's case, the findings affirm that monetary transmission via M1 is highly effective in boosting domestic demand. This also validates fiscal and monetary policies that channel government funds into commercial banks to accelerate money circulation.

The findings are particularly relevant to the economic agenda of President Prabowo, who emphasize domestic demand as the primary engine of economic growth. With household consumption contributing over 50% to Indonesia's GDP, expanding M1 becomes a strategic lever to achieve the targeted 8% growth rate. This study provides empirical evidence that liquidity-driven policies can directly and effectively influence household consumption.

2. Macroeconomic Expenditure Components and Their Impact on GDP

This section presents the results of the second regression model, which evaluates the contribution of key macroeconomic expenditure components—consumption (C), government spending (G), investment (I), and net exports (X)—to Indonesia's GDP. By applying the aggregate expenditure framework, the analysis aims to identify which components have the most significant impact on economic growth, offering insights into the structural drivers of GDP in 2025, as specified in the following equation.

$$GDP = -99591 + 1.140 C^{***} + 0.582 G^{***} + 0.667 I^{***} + 0.510 X^{***} \quad R^2: 0.99 \quad F_{\text{stat}} = 12734, 60 \\ (-5.428) \quad (22.342) \quad (5.188) \quad (7.697) \quad (6.666)$$

The regression results indicate that all macroeconomic expenditure components—namely consumption (C), government spending (G), investment (I), and net exports (X)—have a positive and statistically significant effect on Gross Domestic Product (GDP). The coefficients for each variable are as follows: consumption (1.140), government spending (0.582), investment (0.667), and exports (0.510). This means that a one-unit increase in each variable will raise GDP by the corresponding coefficient value,

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assuming other variables remain constant (*ceteris paribus*). The variation in coefficient values among the expenditure components reflects their relative contributions to Indonesia's GDP growth. Consumption (C) holds the highest coefficient at 1.140, indicating that increases in household spending have the most substantial impact on national output. Investment (I), with a coefficient of 0.667, follows as a key driver of economic expansion through capital formation. Meanwhile, government spending ($G = 0.582$) and net exports ($X = 0.510$) also contribute positively, though their effects are more moderate compared to consumption and investment.

These findings suggest that development strategies prioritizing domestic demand and investment stimulation are likely to be more effective in accelerating economic growth. The dominant role of consumption underscores the importance of maintaining household purchasing power, while strong investment performance requires a conducive business environment. Government spending remains relevant for supporting public sector initiatives, and net exports should be enhanced through diversification and improved competitiveness. Overall, the regression results provide a solid empirical foundation for formulating targeted and data-driven fiscal and monetary policies.

All independent variables in this model demonstrate strong statistical significance (***), as reflected in their respective t-statistics: consumption (22.342), government spending (5.188), investment (7.697), and exports (6.666). These values far exceed the critical threshold at the 99% confidence level, confirming that each component contributes significantly to GDP.

The model yields a coefficient of determination (R^2) of 0.99, indicating that 99% of the variation in GDP can be explained by the four variables. The F-statistic of 12,734.60 further confirms the overall significance and explanatory power of the model. These findings reinforce the validity of the aggregate expenditure approach in explaining Indonesia's economic growth and provide a strong empirical foundation for formulating fiscal and investment policies aimed at strengthening aggregate demand.

3. Integrated Monetary Variables in GDP Determination

This section evaluates the direct and indirect effects of monetary aggregates (M1 and M2), consumption (C), and investment (I) on GDP, representing an integrated empirical framework that combines monetary policy and macroeconomic expenditure. The analysis is based on the following regression equation.

$$\text{GDP} = 161700 + 0.362 \text{ M1}^{***} + 0.012 \text{ M2} + 1.061 \text{ C}^{***} + 0.545 \text{ I}^{***} \quad R^2: 0.998 \quad F_{\text{stat}} = 6224,598$$

(4.288) (3.321) (0.226) (9.278) (7.288)

The regression model indicates that GDP is significantly influenced by the variables M1, consumption (C), and investment (I), with respective coefficients of 0.362, 1.061, and 0.545. These three variables are marked with ***, denoting high statistical significance at the 99% confidence level, supported by strong t-statistics: M1 (4.288), C (9.278), and I (7.288). This implies that a one-unit increase in M1, consumption, or investment leads to a measurable rise in GDP, with consumption exerting the greatest impact.

In contrast, the variable M2 shows a very small coefficient (0.012) and a low t-statistic (0.226), indicating that its effect on GDP is not statistically significant within this model. This suggests that in the context of 2025, narrow money (M1) is more effective in driving economic growth than broad money (M2), particularly through the channels of consumption and investment. The model's coefficient of determination (R^2) is 0.998, meaning that 99.8% of the variation in GDP is explained by the four variables. The F-statistic of 6,224.598 confirms the overall strength and reliability of the model. These findings reinforce an integrated approach to monetary and expenditure policy, providing a robust empirical foundation for designing targeted fiscal and monetary strategies to achieve national growth objectives.

IV. RESULT

The first regression findings confirm that narrow money (M1) plays a critical role in stimulating household consumption, reinforcing the effectiveness of monetary transmission through the liquidity channel. This aligns with the theoretical expectations of both Keynesian and monetarist schools, which argue that increased money supply enhances purchasing power and aggregate demand. The high statistical significance of M1 (t-statistic = 32.662) and the model's strong explanatory power ($R^2 = 0.948$) suggest that monetary expansion—particularly through instruments that increase M1—can be a powerful lever for boosting consumption. Nirmala *et al.* (2022) support this view, finding that monetary shocks in Indonesia significantly affect consumption, especially when liquidity is channeled through the banking sector to households and small businesses.

However, the effectiveness of M1 as a transmission mechanism also depends on the responsiveness of economic agents and the structure of the financial system. As noted by Herlina *et al.* (2023), the money supply channel in Indonesia has shown varying degrees of effectiveness depending on macroeconomic conditions and institutional readiness. In the context of 2025, where fiscal liquidity injections and government transfers are expected to be substantial, the synergy between monetary and fiscal policy becomes crucial. The empirical evidence from this study supports the policy direction of prioritizing domestic demand. By ensuring that liquidity reaches the real sector—particularly households—through M1, policymakers can enhance the velocity of money and sustain consumption-led growth.

The second regression results affirm that consumption, investment, government spending, and net exports are all statistically significant drivers of Indonesia's GDP, with consumption exerting the strongest influence. This supports the aggregate expenditure

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framework, where household consumption plays a central role in economic expansion. According to the World Bank (2024), Indonesia's growth resilience in recent years has been largely buoyed by domestic demand, particularly private consumption, which consistently contributes over 50% to GDP. The high coefficient of consumption (1.140) in this model reinforces the importance of maintaining purchasing power through inclusive fiscal policies and inflation control.

Investment emerges as the second most influential component, highlighting its strategic role in long-term productivity and employment creation. The OECD (2025) notes that Indonesia's investment climate has improved due to regulatory reforms and infrastructure development, which are essential for sustaining growth amid global uncertainties. The regression coefficient of 0.667 for investment, along with a strong t-statistic, suggests that capital formation remains a robust channel for GDP enhancement. This finding aligns with Herlambang *et al.* (2023), who argue that investment-led growth in Indonesia is particularly effective when supported by stable macroeconomic conditions and targeted incentives.

Government spending and net exports also contribute positively, though their coefficients are relatively lower. This indicates that while fiscal expenditure and trade performance are important, their short-term impact on GDP is less pronounced compared to consumption and investment (Purba *et al.*, 2025). Nonetheless, government spending remains vital for public service delivery and infrastructure, especially in times of economic recovery. As highlighted in Bank Indonesia's SEKI data (2025), fiscal transfers and capital expenditures have played a stabilizing role during periods of external volatility. Similarly, net exports—despite global trade headwinds—can be leveraged through diversification and value-added strategies to enhance competitiveness.

Overall, the model's high explanatory power validates the aggregate expenditure approach as a reliable tool for policy formulation. The findings suggest that Indonesia's growth strategy should prioritize strengthening domestic demand and investment while maintaining prudent fiscal management and export competitiveness. These insights are consistent with the medium-term policy priorities outlined by the World Bank and OECD, which emphasize inclusive growth, structural reform, and resilience against external shocks. By aligning fiscal and monetary policies with these empirical drivers, Indonesia can more effectively pursue its 2025 growth targets.

The third regression results demonstrate that M1, consumption, and investment are the most influential variables in determining Indonesia's GDP, while M2 shows no significant impact. This finding highlights the effectiveness of narrow money (M1) as a transmission channel for monetary policy, particularly in stimulating real economic activity through household consumption and capital formation. According to Alam *et al.* (2021), M1 has a stronger and more immediate effect on GDP than M2, especially in economies where cash-based transactions and liquidity-sensitive sectors dominate. The high coefficient of consumption (1.061) further reinforces the central role of domestic demand in Indonesia's growth structure.

The insignificance of M2 in this model suggests that broader monetary aggregates, which include time deposits and savings, may not directly influence short-term output. This aligns with the findings of Vebiola and Aulia (2024), who argue that M2 tends to affect GDP indirectly through interest rate channels and long-term investment behavior, rather than immediate consumption. In contrast, M1—comprising currency in circulation and demand deposits—has a more direct impact on spending decisions. The low t-statistic of M2 (0.226) in this study confirms that its contribution to GDP is statistically negligible in the 2025 context, where liquidity injections are primarily aimed at boosting household and business activity.

The model's exceptionally high R^2 value and F-statistic indicate that the integrated framework combining monetary and expenditure variables offers a powerful tool for policy analysis. As noted by Metekohy *et al.* (2022), combining monetary aggregates with real sector indicators enhances the predictive accuracy of macroeconomic models, especially in emerging economies. The strong statistical significance of M1, consumption, and investment suggests that coordinated fiscal and monetary strategies—such as government transfers through commercial banks and incentives for private investment—can effectively drive GDP growth.

The empirical evidence supports a policy mix that prioritizes liquidity management through M1 and reinforces consumption and investment as growth engines. This integrated approach is consistent with the recommendations of Maipita and Fitrawaty (2024), who emphasize the need for harmonized macroeconomic instruments to avoid policy misalignment and maximize growth outcomes. For Indonesia in 2025, ensuring that monetary expansion translates into real sector activity—rather than being absorbed into savings or speculative assets—is crucial. The regression model provides a robust foundation for designing targeted interventions that align monetary supply with productive economic behavior.

V. CONCLUSION

This study successfully demonstrates that the variables of consumption (C), investment (I), and narrow money (M1) have a positive and statistically significant impact on Indonesia's Gross Domestic Product (GDP). Consumption emerges as the most dominant contributor, reflecting the strength of domestic demand as the primary engine of economic growth. Investment plays a crucial role in driving the real sector and expanding production capacity, while M1 proves to be an effective monetary instrument for transmitting liquidity policies to the consumption sector. In contrast, M2 shows no significant effect, indicating that long-term monetary instruments are not yet optimal for supporting short-term real economic growth.

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These findings directly address the research objective of evaluating the effectiveness of integrating monetary policy and aggregate expenditure within an empirical framework relevant to Indonesia's 2025 context. The exceptionally high coefficient of determination and large F-statistic values reinforce the validity of the regression models used, highlighting the strategic importance of M1, consumption, and investment in economic policymaking. The government's policy of repositioning public funds into commercial banks, led by Finance Minister Purbaya Yudhi Sadewa, aligns with these findings, as increased M1 contributes directly to GDP. Moreover, the results support President Prabowo Subianto's vision of achieving 8% economic growth by focusing on strengthening domestic demand and productive sectors.

Academically, this research contributes significantly to the macroeconomic literature in Indonesia by constructing a multiple regression model that simultaneously integrates monetary and aggregate expenditure variables. Practically, the findings provide a data-driven foundation for formulating economic policies, particularly in developing countries undergoing structural reforms. The study also opens avenues for more comprehensive future research, including long-term analysis, cross-period policy evaluations, and cross-country comparisons on the effectiveness of monetary instruments in promoting inclusive and sustainable economic growth.

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