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ANALYSIS OF THE CAUSES OF THE 1997 MONETARY CRISIS AND ITS INFLUENCE ON BANKING POLICY IN INDONESIA

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Abstract

There is no doubt that the US financial crisis has had an impact on the global financial landscape. Countries in the European region such as Iceland, the Netherlands, Russia, the United Kingdom, Germany, France, as well as those in the Asia-Pacific region, such as Taiwan, China, Singapore, the Philippines, Australia, and Japan were affected by the crisis. This study uses a descriptive analysis method, This is to look into certain situations and conditions, with the findings being reported as research reports. This research investigates the circumstances, conditions and results. The results are presented in the research report as is. Secondary data taken from Bank Indonesia (BI), Central Statistics Agency (BPS), Ministry of Trade, and Indonesian Bank websites were used to form opinion groups from each economic expert during the 1997-1998 crisis. The contributing factors are economic growth, money supply (JUB), interest rates, exchange rates, Debt Service Ratio (DSR), Gross Domestic Gross (GDB), Balance of Payment (BOP), and Inflation. In order to combat inflation brought on by the rupiah's depreciation versus the dollar, Bank Indonesia had to raise the BI rate as a result of the financial crisis. Conventional bank interest rates increased dramatically in response to the rise in the BI rate. However, this increase in interest rates does not affect Islamic banks directly. The economic crisis is caused by unstable markets, has an up-and-down conjuncture, therefore for better results the Government should intervene in the market through its policies.

Key Words : Economic crisis, exchange rate, and bank Indonesia.

I. INTRODUCTION

The storm of the monetary crisis seems to have succeeded in devastating the Indonesian economy. Indonesia has to pay for all the mistakes of the past at a very heavy price. Now before our eyes are alarming figures about rising unemployment, falling economic activity in all sectors and rising numbers of poor people.

There is no doubt that the US financial crisis has had an impact on the global financial landscape. Countries in the European region such as Iceland, the Netherlands, Russia, the United Kingdom, Germany, France, as well as those in the Asia-Pacific region, such as

Taiwan, China, Singapore, the Philippines, Australia, and Japan were affected by the crisis. Rising inflation, declining exchange rates, slowing economic development, collapsing stock indices, and a number of banks, financial institutions, and businesses going bankrupt are all effects of the crisis these nations are facing together.

The impact of the monetary crisis is that inflation becomes high. It can be seen in figure 2, in 1998 there was a drastic increase of 77.63% which was the peak of Indonesia's economic downturn. Similar to the rupiah exchange rate chart, in 1990 – 1996 it still showed a stable movement of around 9% despite a decline in 1992. And after the monetary crisis, in 1999 it plunged by about 2% but bounced back despite a spike in 2005 of 17.1% but not as severe as in 1998. Of course, this exchange rate and inflation will affect economic growth in Indonesia every year.

The weakening of the rupiah on a serious scale has put unfavorable pressure on the banking world. In connection with this interesting phenomenon, this study aims to examine the extent of the impact of the monetary crisis on banking policy in Indonesia.

II. LITERATURE REVIEW

Economic crisis

According to Arafat in (Keumala Sari and Fakruddin 2016) The global economic crisis is a phenomenon in which every area of the global market economy collapses (emergency) and has an impact on other sectors globally. In the words of economists, an economic crisis is essentially any circumstance in which the people of a country no longer trust their government, particularly when it comes to financial difficulties. The financial meltdown that hit many Western nations, including the US, had a significant effect on developing Asian nations.

Causes of the economic crisis

According to the Keynesian school with its various versions in (Karmeli 2008) said that the economic crisis is caused by unstable markets, has an up-and-down conjuncture, therefore for better results the Government should intervene in the market through its policies. Today the views on the causes of such a diverse crisis may be classified into two groups; The first to say that the main causes are:

1. Internal problems of the national economy, especially weak financial institutions (banking). (Paul Krugman, economist from Stanford University).

2. That this crisis arises from changes in market sentiment, external problems, which are reinforced by contagion effects. (Jeffrey Sachs, economist from Harvard University).

Inflation

According to Mankiw in (Ningsih and Andiny 2018) that while price rises are not always healthy, inflation is a normal occurrence. According to the journal, the high rate of inflation is a significant issue for the economy. According to Boediono (Boediono 2014) The widespread and ongoing tendency of prices to rise is known as inflation. Until an increase is widespread and has a positive impact on the pricing of other commodities, it is not appropriate to refer to a rise in one or two goods as inflation. When there are issues with inflation, economic activity usually adapts to the new circumstances.

Monetary policy

According to (Dini Abdianti, Anisa Restu, and Sholahuddin Al Ayyubi 2023) Monetary policy is one of the ways used by the state in controlling and directing appropriate or better macroeconomic conditions by controlling the amount of money circulating in a country. The goal of monetary policy is to manage the quantity of money in circulation in the economy in order to maintain desired macroeconomic circumstances. These efforts are made so that there is price stability and inflation as well as an increase in equilibrium output (Nur Aini Latifah 2015). Monetary policy serves as the key to obtaining a good macroeconomic strategy in a country to overcome inflation. Monetary policy is divided into two:

1. An expansive monetary policy
2. Contractive Monetary Policy

Banking policy during crisis

1. Banking deregulation
   BI issued a package of banking deregulation policies, under the name of the Policy Package of October 27, 1988, better known as Pakto 88 or Pakto 27. This policy is aimed at encouraging the growth of the banking industry by facilitating licensing in the establishment of new banks.
2. Asian Monetary Crisis

The monetary crisis in Asia prompted BI to take crisis response policy measures, such as the implementation of floating exchange rate policy for exchange rates, the closure of troubled banks, and the restructuring of unhealthy banks (Indonesia 20AD).

III. RESEARCH METHODS

This study uses a descriptive analysis method, which is to investigate circumstances, conditions, the results of which are presented in the form of research reports as they are. The results of the article review were used to form a group of opinions from each economist in the crisis period of 1997-1998 and used secondary data taken from Bank Indonesia (BI), the Central Bureau of Statistics (BPS), the Ministry of Commerce, and the website of the Indonesian bank. The results will be used to map differences in banking policies in each period. In this study, the author examines the identification of the causes of the monetary crisis and central bank policies in Indonesia in the 1997-1998 crisis year. The variables used are money supply (JUB), Inflation , interest rate, exchange rate, Debt Service Ratio (DSR), Balance Of Payment (BOP) and Gross Domestic Gross (GDB).

IV. RESULTS AND DISCUSSION

Analysis of the causative factors of the monetary crisis

1. Economic Growth

Research conducted by (Nazhicul Amin et al. 2023) that before the monetary crisis, Indonesia's GDP per capita experienced growth as in 1980 of 489.1601963 to 1981 of

563.7833647 which experienced growth of 74.6231684. Then it continued to experience growth until in 1997 amounting to 1054.347358. In 1998 Indonesia's GDP was 459.1918631 and in that year Indonesia experienced a monetary crisis which caused a decrease in GDP per capita by 595.1554949. Then after the crisis, Indonesia's GDP per capita began to improve and continued to experience growth as in 2018 it reached 3902.661675.

2. Exchange Rate (Exchange Rate)

in the rupiah exchange rate which was around Rp2,600 to reach Rp14,900, around 1998 experienced a drastic increase or what is often known as rupiah depreciation which exacerbated economic difficulties.

3. Money Supply

According to Nosihin in (Lily Prayitno, Heny Sandjaya, and Richard Llewelyn 2002), it is said that the revenue received by the government in the form of foreign exchange which is then exchanged for rupiah, then in this exchange process, will increase Bank Indonesia's asset reserves and the money supply increases with the same amount of money. So between foreign exchange reserves and the money supply the relationship is quite close, where the amount of foreign exchange reserves exchanged adds to the money supply in the same amount.

4. Inflation

According to Soesilo in (Susmiati, Giri, and Senimantara 2021), during the crisis, especially in 1998, Indonesia experienced the highest inflation reaching 77.6%. The increase in inflation rate was mainly due to rupiah depreciation, economic crisis and expectations of high inflation. Previously, Indonesia had experienced hyperinflation at the end of the old order, namely in 1966. So psychologically inflation is a crisis for the Indonesian people.

5. Interest Rate

Research conducted by Nematnejad in (Keumala Sari and Fakruddin 2016), the result is that economic enforcement errors cause large and high differences in interest rates between countries. Since July 1997, the rupiah exchange rate has continued to decline sharply, the government has taken measures to tighten the rupiah through very high interest rate hikes and the transfer of state-owned funds/foundations from banks to BI (SBI) as well as tightening the government budget. It turned out that the strategy led to a sharp increase in money market interest rates and a dry up of bank cash, which resulted in liquidity issues for banks. As a result, people experienced panic and their trust in banking began to decline. As a result, there was a significant outflow of bank cash, which once more resulted in issues with liquidity throughout the financial system. Ultimately, the national economy's sustainability is questioned and the payment system faces the risk of halting.

6. Balance of Payments

According to (Tarmidi 2003) The government's improper implementation of the 50 points of agreement was the reason the IMF did not provide full assistance and kept delaying the release of the aid monies it had pledged. Even though Indonesia's economic condition was becoming worse, friendly nations that had vowed to help likewise withheld money from Indonesia in order to wait for indications from the IMF. Singapore, which pledged $5 billion, is asking for higher interest payments than IMF loans, while Brunei Darussalam, which has pledged $1 billion, will only disburse the funds as the last after all those who pledged to help have disbursed the funds and have been used up. Many parties believe that the IMF itself has not succeeded in enacting its reform agenda in Indonesia, but rather has exacerbated and extended the crisis.

7. Debt Service Ratio (DSR)

Indonesia has implemented the external debt strategy since the Old Order government. Initially, the use of external debt was only as a matching fund to cover the lack of development funds that could not be met from domestic funding sources. However, in its development, external debt has transformed into the main source of funds for fiscal deficit. As a result, the amount of external debt from year to year increased significantly in line with the increasing fiscal deficit. Meanwhile, rapid development requires the support of large sources of funds. On the other hand, the government's ability to bear all development costs has been increasingly limited since the world oil price crisis in the 1980s, so the government carried out a number of deregulations in the field of development. The amount of external debt borne by a country will certainly affect the economy both positively and negatively. Here are some indicators of measuring debt burden to see how far a country's situation is related to the external debt burden borne. Debt Service Ratio (DSR) which is a comparison between debt payment obligations and foreign debt installments with foreign exchange proceeds from exports. The safe threshold for DSR figures is usually 20% according to economists. More than that, debt has been considered to invite quite a lot of vulnerability. According to Drehmann in (Keumala Sari and Fakruddin 2016) in 5 countries namely Britain, Italy, Korea, Australia, Finland and America in his research found that DSR is an accurate early warning signal of crisis in the upcoming banking systematics, because this study concludes that DSR is a helpful gauge of growing vulnerability in the real economy and financial industry.

Impact on the financial sector

Significant quantities of cash were repatriated as a result of this financial crisis, which led to the selling of significant quantities of debt securities and shares. The price of debt and stock securities will decline as a result of this circumstance, causing the stock price index to plummet precipitously. The calculation of interest rates for fixed income securities will rise. A decrease in the price of securities will cause losses (capital loss) so that the company's capital and capital adequacy ratio (CAR) are depleted. The decline in confidence in the domestic market caused demand for the dollar to rise significantly, which resulted in the value of the dollar against the rupiah rising.

Rupiah depreciation is not only caused directly by the withdrawal of funds mentioned above, but also has the potential to be exacerbated because it is greater than the depreciation rate of currencies outside the dollar. Depreciation of nearly all non-dollar currencies when the dollar appreciates in order to support the liquidity of US corporations. Because of the increasing scarcity of dollars and the resulting rise in demand, the dollar is becoming more costly in this scenario. Exchange rate fluctuations will have an impact on price increases or high inflation, as well as a rational basis for the continued emergence of expectations of high inflation which in turn will be realized in price increases or inflation continues to rise and exchange rate fluctuations. This situation raises the desire to make currency substitution from rupiah to dollar. Moreover, this trend is associated with inflation expectations in Indonesia which are quite high in double digits. Under these conditions, all economic possibilities can potentially result in rupiah fluctuations against the dollar. Currency substitution, or the flight of public funds to foreign institutions, both locally and abroad, can be triggered by exchange rate volatility and forecasts of significant depreciation of the rupiah. Also, as a result of the unrest, bank debtors would face difficulty in running their businesses, which will make it impossible for them to pay the bank's principle and interest.

Consequently, banks have challenges with liquidity and raise funding costs, making it impossible for them to meet their commitments to Third Party Funds (DPK). Indonesia's non-oil and gas exports have the potential to be depressed and decline. This potential is related to the weakening of the US economy and industrialized countries, as result of the US financial crisis. In the U.S., the continued impact of the subprime mortgage crisis has and will continue to limit financing from the banking industry to the real sector and financial sector businesses, as well as suppress consumer spending.

Impact on banking policy

A decrease in the value of productive assets (earning assets) in the form of loans and securities purchased by banks, as well as a decrease in capital adequacy ratio (CAR) primarily due to losses resulting from reserves for a decline in the quality of productive assets and loan defaults on interest, were the effects that the withdrawal of funds by foreign investors in various Indonesian companies had on Indonesian banks. The Indonesian banking industry survived the 2008 financial crisis thanks to its experience in the 1998–2003 financial crisis. This is because the 1998 crisis has affected improvements in several aspects, including transparency that meets accountability effectiveness and accountability, professionalism competence and professionalism, fulfillment of banking regulations and prudential principles. Likewise, banks no longer act as cashiers of certain companies and groups of companies, the maintenance of long or square foreign exchange net open positions contained in bank balance sheets, the atmosphere of healthy interbank competition both characterized by oligopoly for large banks and monopolistic competition for middle to lower banks.

BI has tightened liquidity drastically by stopping Money Market Securities (SBPU) transactions and raising interest rates on Bank Indonesia Certificates (SBI). The stranglehold of monetary tightening made the banks full of ulcers gasp.

With funds from BI stopped, interbank lending rates soared. Banks must compete fiercely for public funds by hoisting deposit interest rates. As a result, more and more banks have liquidity difficulties and debit balances in the Bank Indonesia clearing system.

Under the leadership of Soedradjad Djiwandono, BI paved the way for banks with liquidity difficulties. On August 15, 1997, the central bank allowed banks to continue operating and received dispensation to remain clearing participants, despite debit balances. The policy could not be separated from President Soeharto's directive which asked for no bank liquidation ahead of the 1998 MPR General Session.At that time, BI was indeed authorized in the scope of monetary policy set by the Monetary Board. Thus, every BI action cannot be separated from coordination with the Monetary Board and the President's Direction. BI's action did not help much. At the end of August 1997, the number of banks with debit balances had reached 20 banks.

Banking conditions in the country are increasingly precarious, like eggs on the edge, because public trust continues to evaporate. The public began to secure its deposits, and continued to withdraw its funds from banks that had liquidity difficulties. In fact, at the same time, such banks have overdue letters of credit (L/C), and it is impossible to fulfill their obligations. Finally, they requested liquidity assistance from Bank Indonesia.

Bank Indonesia had to raise the BI rate due to the financial crisis in order to combat inflation brought on by the rupiah's depreciation in relation to the US currency. A significant rise in conventional bank interest rates followed the BI rate increase. However, Islamic banks are not immediately impacted by this increase in interest rates. The system of buying and selling (bai') in Islamic banks, where margin payments are based on fixed rates where provisions based on contracts cannot change at any time such as only with interest. However, for profit sharing products, it is possible that this financial crisis will have an impact on Islamic banks' return because it will have an impact on how firms share their revenues in order to maximize profits. The appeal of keeping money in conventional banks rises in response to rising interest rates, but these rate increases will not appeal to investors who will get higher interest charges. Meanwhile, the increase in interest rates will reduce the interest of people who deposit money in Islamic banks as the interest rate on these deposits is lower than that of traditional bank deposits. However, because Islamic banks charge their investors a smaller margin than traditional banks, investors will benefit more from Islamic banks. In maintaining liquidity, the interest rate is still a standard by which Islamic banks can measure their margin levels and profit-sharing proportions. Islamic bank financing is more appealing to investors than conventional bank financing because it has a smaller financing margin than the fee/profit sharing level in savings and deposits. This situation will cause an increase in funds coming out for financing from incoming third party funds (DPK) so that consequently the financing deposit ratio (FDR) of Islamic banks increases. Different conditions exist on the part of savers who will run in comparison to Islamic banks, to regular banks as they will receive greater interest advantages. The Islamic banks' exposure to liquidity risk will rise as a result of the rise in outgoing money. Increased bonus, fee, and profit sharing rates for current accounts, savings accounts, and deposits are necessary for Islamic banks to get out of this predicament).

V. CONCLUSION

The economic crisis is caused by unstable markets, has an up-and-down conjuncture, therefore for better results the Government should intervene in the market through its policies. Today the views on the causes of such a diverse crisis may be classified into two groups; The first to say that the main cause is:1. Internal problems of the national economy, especially the weakness of financial institutions (banking). 2. That this crisis arises from changes in market sentiment, external problems, which are reinforced by contagion effects. Monetary policy is one of the ways used by countries in controlling and directing macroeconomic conditions that are appropriate or better by controlling the amount of money circulating in a country. Monetary policy serves as the key to obtaining a good macroeconomic strategy in a country to overcome inflation. Monetary policy is divided into two:1. Monetary expansive policy. 2. Monetary Contractive Policy. central bank policy in Indonesia in the crisis year 1997-1998. The contributing factors are economic growth, money supply (JUB), interest rates, exchange rates, Debt Service Ratio (DSR), Gross Domestic Gross (GDB), Balance of Payment (BOP), and Inflation. Bank Indonesia had to raise the BI rate due to the financial crisis in order to combat inflation brought on by the rupiah's depreciation in relation to the US currency. A significant rise in conventional bank interest rates followed the BI rate increase. However, this increase in interest rates does not affect Islamic banks directly. The system of buying and selling (bai') in Islamic banks, where margin payments are based on fixed rates where provisions based on contracts cannot change at any time such as only with interest. However, for profit sharing products, it is possible that this The financial crisis will have an impact on Islamic banks' returns because it will have an impact on how firms share their revenues in order to maximize profits.

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