

CHAPTER III

THE FACTORS AND IMPACTS OF THE UNITED STATES' FINANCIAL CRISIS IN 2008

A. Indonesia's economic condition

The collapse of financial markets is now being matched up by the decline of the real economy. The world appears headed for a period of inevitable economic stagnation/recession (a period of negative economic growth). It crisis was effect to the Indonesian national economic condition. The impacts of the crisis was disturb several area such as the relation trade between Indonesia and United State, the trade among Indonesia, Asia and European, the increased of loan, appreciation of rupiah currency and the monetary policy of exchange rate from central bank in the United State. Although the crisis only caused by the housing credit and affected to the credit crunch but United States' financial crisis brought the big impacts toward several corporations and international financial market. Generally, financial crisis made Indonesian macro economic condition in the weaknesses situation. The bad condition could see from the still dominant investor domestic in using foreign product investment and foreign transaction. On the other side, the policy of inflation control through the increase of Indonesian banking rate has positive influence and it possibly did not destroyed national economic condition. However, the Indonesian financial market became the one of market alternative that did not secure from the damaged, but it also can potentially affected by the United States'

labour, politician, economist, etc) hope that government could anticipate the spread of the crisis from United State. Actually the government and Indonesian banking have implemented some strategies to overcome the impacts of the United States' financial crisis. For example, they took reformation in the banking sector, market fund and social safety net. It done to decreased the negative impacts of the crisis. However, the effects of the crisis still felt in some areas with the condition of open market. It could see from the condition of industry and Small Middle Enterprises which have relation with the foreign investor (export and import).

The effect of financial crisis from United States to the financial global made the decreased of Stock Exchange prices index in 2008. In the end of August 2008, Stock Exchange was closed. The weaknesses of Stock Exchange have caused by the external factors from the global stock exchange. In the domestic side, the decreased of Stock Exchange still in relatively stronger. It reason with the fundamental factors emitted and the effectively of Indonesia's Banking communication to the made market believes. At the same time global risk has increased, it proved by the decreased of Stock Exchange that as the impact of the available foreign investor. And several global Stock Exchange has decreased significantly. It's as the impact of transferring fund of foreign investor in the states emerging markets. It has been done to subtract asset exposure risk and the strong of global liquidity. In the domestic stock exchange, the adaptation of portfolio has reflected in the foreign selling pressure till the first week in August 2008. But, in the second week, foreign investors have buyback in the market

The weaknesses of stock exchange value became incentive for the foreign investor in the market stock exchange. Foreign investor have noted buyback net about Rp. 467 million or its increased from the net totally about Rp. 895,4 million in 2008.³² However, the huge of interest by investors have caused the decreased of foreign capitalization became about Rp. 667,7 trillion for August 2008 and Rp790,8 trillion for each December 2007. It means has totally decreased about Rp. 123 trillion. Proportionally, the owner of foreign investor in August 2008 have decreased on the level 63,2 percent or 66,3 percent on December 2007. In the last (2006) real income has increased about Rp8.319.000 and became Rp8.725.000 in 2007. The decreased of jobless in the worker sector about 10,3 percent (10,9 million people) in 2006 became 9,1 percent or (10,0 million people) in 2007.³³ The Indonesia's export oriented has been diversification, so it made the role of United State and European Union has decreased after affected to the impacts of United States' financial crisis. The market oriented for United States and European Union decreased.

Banking condition has significantly in the risk situation. Because, bank is the centre of Indonesian's economic that have strong fundamentally. It reflected by the credit ratio number (Non Performing Loan/NPL), liquidity, and capitalization that have problematic. NPL netto has decreased about 1,42 percent after it has subtracted over maximum number around 5 percent. Banking liquidity toward third party (Loan to Deposit Ration/LDR) up to 80 percent.³⁴ Indonesian economic condition in the middle of 2008 is still in the risk situation. The

to growth. Economic expansion was not balance with the society accumulation fund. The growth of economic not optimal yet but inflation and stabilization of rupiah increased by the price pressure. In the short term, the important of the priority and control toward inflation and rupiah should be done to increase the trust of society. When the external condition was not clear, the focused of policy in the government level and corporation would influence stability and public trust.

Indonesia has historically been a member of OPEC, although it is withdrawing as of 2008 as it is no longer a net exporter of oil. Indonesia's high population and rapid industrialization present serious environmental issues, which are often given a lower priority due to the high poverty levels and weak, under-resourced governance. Issues include large-scale deforestation, exploitation of marine resources and environmental problems associated with rapid urbanization and economic development. Indonesia's estimated Gross Domestic Product (GDP) for 2007 is US\$408 billion (US\$1,038 bn PPP).³⁵ In 2007, estimated nominal per capita GDP is US\$1,812, and per capita GDP PPP was US\$4,616 (International Dollars).³⁶ Indonesian major industries include petroleum and natural gas, textiles, apparel, and mining. Major agricultural products include palm oil, rice, tea, coffee, spices, and rubber. The country has extensive natural resources, including crude oil, natural gas, tin, copper, and gold. Indonesia's major imports include machinery and equipment, chemicals, fuels, and foodstuffs. Indonesia has to be the majority of the development on economic industry. And since economic system in Indonesia going to the capitalistic and liberalistic, several state assets

³⁵ <http://www.indonesia.com/Accessed from 4/11/2008/15:53PM>

foreign were decrease and Indonesian's import products were constant, automatically it would became the big deficit.

So, the financial difficulties in United States will be the matters to the weakness of the financial stranger because theirs import fee will minimum and it would be make less export for Indonesia. So, financial crisis that happen in 2008 is global financial crisis and it to be the common sign to the world. But, this problem has brought serious impact to the figure and strategy which would Indonesian government takes to solve that impact.

B. The relations between Indonesia and United States

The United States has a significant interest in an economically prosperous, politically stable, and democratic Indonesia. Indonesia was the 31rd largest bilateral trading partner of the United States.³⁹ Helping Indonesia's economic recovery will also revive U.S. and Indonesia trade, which will decline precipitously this year. Helping Indonesia's recovery also could assist broader economic recovery in Asia, which is in the interest of the United States as well. There are estimates that the economic downturn in Asia will have a negative effect on the U.S. economy.

Indonesia is important as well to the security of the United States. Indonesia sits astride strategic sea lanes connecting the Indian and Pacific Oceans through which passes 40 percent of the world's shipping, including 80 percent of Japan's oil supply and 70 percent of South Korea's.⁴⁰ Indonesia has been suspicious of

³⁹ <http://www.antara.co.id/view/?i=1179806284&c=EKB&s>. (Accessed on October 01, 2009).

⁴⁰ John T. Dardis, *Foreign Research Association in The Asian Gulf Cooperation Council*, p. 11.

China's intentions in the region and has worked within ASEAN to convince China to modify its claims to most of the South China Sea. In recent years, the United States and Indonesia have affirmed their interest in regional security by engaging in military exercises, some in Australia. And, as the world's largest Muslim state, Indonesia has been a welcome moderating force in the Islamic world.

Indonesia has been devastated by an economic crisis compared to the U.S. Great Depression and U.S. financial crisis in 2008. At the same time, Indonesia is beginning a political reform process that many Indonesians hope will reverse the effects of years of strict political authoritarianism and economic autocracy. By offering targeted assistance, the United States can help Indonesians to emerge from the crisis that come from United States itself and perhaps to build the world's third-largest democracy. By helping in Indonesia's economic recovery, the United States can lessen the impact of financial crisis on the U.S. economy. Although offering humanitarian food assistance and necessary economic, economic reforms should promote the transparency in the financial sector.

Just as United States financial crisis has caused tremendous suffering, it also has presented the prospect of a far better economic and political order. Indonesia has tremendous potential in its resources, educated workforce, and large consumer market. As a strategically located country with the world's fourth-largest population, an economically reformed and democratic Indonesia would be a

worthy strategic partner for the United States.

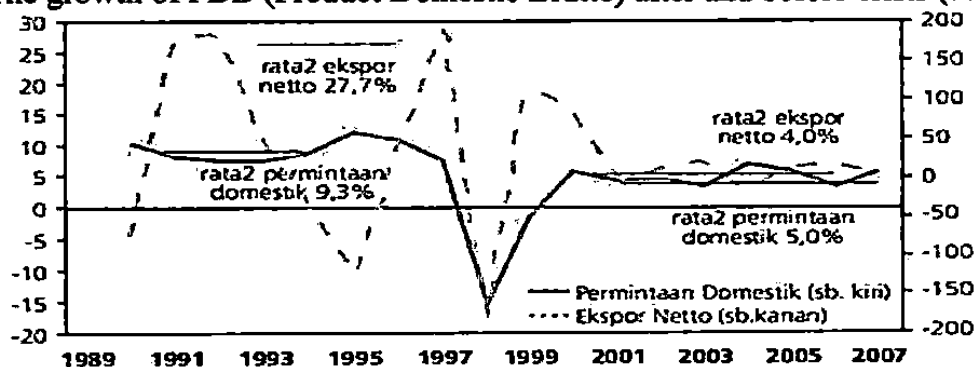
consumer market. As a strategically located country with the world's fourth-largest population, an economically reformed and democratic Indonesia would be a worthy strategic partner of the United States in East Asia.

C. The influence of United States' financial crisis to the Indonesia's economic growth

The development of Indonesian's National Economic Indicator after financial crisis in the United States 2008, the growth of Indonesian's economic more supported from the domestic demand. It viewed from the growth of economic in 2001-2007 that reached up to 5 percent. Percentage is smaller than the growth rate of export netto that around 4 percent only. On the other side, the gap demand between domestic and export netto after crisis smaller than before crisis happened. Look at graphic 3.

Graphic. 3

The growth of PDB (Product Domestic Brutto) after and before crisis (%)⁴¹



The financial sector key to Indonesia's eventual recovery is the reform and

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much smaller number of large banks. That was too many banks for Indonesia's market to sustain, and many were managed poorly and prone to making risky and politically motivated loans. Lack enforcement of central bank rules pointed to a lack of transparency and disguised the fact that many banks were undercapitalized or insolvent even before the onset of the financial crisis. The credibility of the banking system suffered. On the other side, Investors from America need many dollars to cover their bankruptcy. One way to save their economic was through selling the firms that have developed in Indonesia. The investors create such '*discount*' toward their own firms. On the other wise, the prices of firms in Indonesia have to be decreased. That case has affected to the decreased of stock exchange and brokers became panic. And also it caused for the decreased of rate of exchange. That rate of exchange would influence to the demand and bargain of rupiah. It means that, rupiah has to be weakness because the demand of rupiah in the form of rate of exchange as the transaction in the world trade also decreased. And, the assets such as obligations letters has lost. Accordingly, to anticipate the effects of United State's financial crisis to the national economy, Indonesia should do big changing for their economic growth.

D. The factors that creates financial crisis in United States 2008

Actually, the background that make crisis happened in the United State's in 2008, it could see from the several causes as follows:

The big motivation to combat terrorist that has attacked World Trade Centre of the United State on September 11 2001, the government of the United States has a mission to combat that terrorist. Then, American has assumed that Iraq and Afghanistan were the place where the terrorist stay. That terrorist got a fund and group recruitment from Iraq and Afghanistan and then Iraq and Afghanistan became the target of invasion for United States. That case has caused a war and the war need a fund and weapon to fight the enemies in the war it self. State need much money, so the budget of the state should be concentrated to paid the war.

2. Subprime mortgage in the housing credit sector

Firstly, the words "*Mortgage*" came from French.⁴¹ It means there was the collapsed of a credit or 'credit crunch'. But, it is different with the credit in the housing sector. In mortgage, everyone could get credit. They took a house from that credits. The house would be given to the parties who give a credit it self. Loaners or creditor could pay the credit in installment. However, the house was not belonging to loaner, when mortgage got stuck so automatically they could not replace the house again. Eventually, there were many aggressive banking investors (the corporations same like Bank, because that corporations have accepted some kind of deposits, but they did not involved with the regulation from banking system). In otherwise, at the past time people who fulfilled the

... .. could not get mortgage, but people who had not fulfilled the

requirement or sub-prime) also could accept housing credits. In the United States, every person has a rating. The low and high rating depends on the big or small of their life style. The people with the rating over 600 are called prime.⁴² In every year, everyone could predict their rating self, whether it's increased or decreased. But, if their rating over 600, they could get a housing credit through mortgage. However, if they under 600, they should reach it to get a credit. The effort to reach credit could through hard work in order to get big salary and unending life.

On the other side, many corporations want to grow the corporate bigger and higher profit with the pressed increasing market. So, the people who have rating in 500 got offering to take mortgage. Actually, it should not happen because in some time the credit would fail to pay. Then the house would be confiscation. The houses were seizure, they could sell the house with the higher prices than the value of loans but they never thought about the long term of credit could make collapsed.

Ten years later, the failure of credit payment would become burst. Many of housing were seizure. Many if houses were sold that emerged for the decreased of the housing prices in the lower level. So, banking or investment banking who give loans should rent their houses to other banking or other investment. After,

3. Unhealthy situation in the financial sector

The worst working of the United State's financial institution made a crisis happened. This case added by the report of independent institution which should give objective analyses about economic sector in United State, but there is a manipulation act to create positive sentiment about housing credit sector. Unfortunately that mechanism was not followed by strong economic safeguards. So, many credits failed being paid by the creditors. As the domino effects, many third parties as the standing credits (private financial sectors) which invest for millions dollars were bankruptcy. The submitted fund or invest which could not be moved for United State's economy, it has been stopped and it could not recycle investment. This matter made a crisis for United State and it made the slow economic growth and potentially for the breakdown of United State's economic foundations.

4. Overconfidence in the credit circulation

The people who have over confident about credit circulation movement especially to the housing sector have caused the credits to be problematic for creditors. It would cause the credit crunch. The stuck of credit in the housing sector (sub prime mortgage) made a stuck in the banking world and it has forced for FED (Central Bank of America) to decrease the stock rate till 2%.⁴³ The beginning of the financial crisis in 2007 was the result of the housing market's overconfidence in the credit circulation movement.

fuel oil. It reach till the higher level about 147 USD/barel.⁴⁴ Eventually, crisis not yet is ending. The increased of world fuel oil prices made the world business became weaknesses and the demand of consumer were decreased. It also made the consumer did not believe in the market. The failure credit has involved the two big banks (Lehman Brothers and Merrill Lynch) as the financial institution. The prices of stock exchange in the Wall Street (USA) and the prices of stock exchange in the world became decreased. The crisis has affected to the collapse of investment banking and corporations of assurance. Finally, the United State's government have realized if that crisis could not be avoided, then they ask to the USA congress to inject some fund about US\$ 700 million in order to save their financial sector. Unfortunately, that was not an effective way, because the panic situation in the market fund has affected to the world including to Indonesia.

The present crisis that is sweeping across the world economy has left serious damage at its epicenter in the United States (US). The stock market collapse that took place on Monday, 29 September 2008 a loss of 778 points off the Dow Jones Industrial Average (DJIA) was the largest single-day loss in the history of the DJIA. In a single day, US\$1.2 trillion of wealth, equivalent to nearly 7% of the market's value, was wiped out. Globally, equity markets were hammered in the aftermath and the seizure of credit has become severe.⁴⁵ The credit squeeze was reflected in the sharp rise in the London Inter Bank Offered Rate (LIBOR) the rate of interest banks charge one another for short-term

⁴⁴ [www.DahlanIskan.wordpress.com//Krisis Ekonomi Global](http://www.DahlanIskan.wordpress.com//Krisis_Ekonomi_Global). (Accessed on August 12,2009//12:21PM)

⁴⁵ http://www.jsic.com.my/db_2/features/file_upload/US_financial_crisis_Global_financial_and_developing_Asia. (Accessed on September 08,2009//12:03 PM)

(overnight) loans which rose to an astonishing 6% in September. Commercial paper, usually regarded as a safe investment by money market funds, suddenly became risky as blue chip firms' profit reports had worsened. Bankruptcy procedures involving large investment banks had also tied up funds of third parties. Then runs began on money market mutual funds that hitherto had been regarded as akin to deposits in commercial banks. Loan windows suddenly were slammed shut. Credit became impossibly expensive as bank spreads between deposit and loans grew astronomical and investors fled from equities into cash and US Treasuries, to the point that interest on the latter approached zero. A general collapse of confidence became contagious and credit conditions globally froze.

The financial problems of the US have their roots in monetary and fiscal policies, but are also a result of the irresponsible behavior of private lenders and borrowers and the excessive risks that were taken fueled by cheap and plentiful money, which made possible a decade-long housing boom. The proximate cause of the downturn in the US economy is the declining prices of housing, the major asset of US households. However, the downturn in housing prices alone cannot explain the recent turmoil in the financial markets as housing prices have been falling for almost 2 years. Fundamental structural problems are apparent and have to be considered in analyzing the crisis and the evaporation of confidence that accompanied the recent credit crunch. The US macroeconomic fundamentals are indicative of the policy shifts that occurred just after the turn of the century toward fiscal and monetary excess. "*Twin deficits*" have characterized the US

economy after 2001. The...

US national saving and investment, which takes into account both private and government saving and investment balances. Although the US has experienced a structural imbalance between savings and investment that has led to a persistent current account deficit, this deficit was usually a small percentage of gross domestic product (GDP) and was to some extent offset by fiscal surpluses during the 1990s. The past 10 years have seen a persistent deepening of the US current account deficit, which reached the critical level of 5% of GDP or more than US\$600 billion in each of the past 4 years to 2007.⁴⁶ The component of the current account deficit that is explained by private investment in excess of private saving was partially offset by positive net government savings (fiscal surpluses in the consolidated government account) in the years 1998–2001 but since then the fiscal balance has deteriorated. In 2008 the consolidated US fiscal deficit is expected to surpass the US\$400 billion mark. The degree of fiscal proclivity is reflected in net consolidated government borrowing ranging from over 2% to nearly 5% of GDP between 2002 and 2007 (Figure 3), as a combination of tax cuts, war expenditures, and absence of any sacrifice of other expenditure categories resulted in cumulative borrowing of over US\$2.5 trillion over the past 7 years. The fiscal imbalance (government sector dissaving) is thus contributing to the rise in the current account deficit. The current account imbalance also reflects the decline in US private saving, which is largely attributable to falling household savings. Corporate private sector saving on the other hand has been relatively steady.

⁴⁶ William, James E. *The US Financial Crisis: Global Financial System*

E. The impacts of the United States' financial crisis to Indonesia 2008

After a year of financial shock and sharp economic loss, 2009 is likely to be extremely difficult for the global economy. The United States' financial crisis in 2008 is neither surprising nor unexpected. Indonesia institution has warned the potential crisis in Indonesia annual presentation of review and prediction of Indonesian economy. The report was presented in early January 2007, branded 2008 as *The Year of The Bubble* alerted the Indonesian government of the negative consequences of allowing the financial bubble to inflate.⁴⁷ The rise of the financial bubble was identified in the capital markets, commercial property and consumer credits. The report noted that the probability of a recession in the United States was very high and rising owing to the structural weaknesses apparent in the American economy. America's massive trade deficit (US\$ 850 billion), current account deficit (6 percent of GDP), and the threat of rising energy prices, all pointed to a correction in 2008.⁴⁸ Indonesia cannot escape the effects of a slowing US economy, particularly when the financial sector is weakened by a financial bubble and overexpansion of consumer credit. Unfortunately, Indonesian government did not heed these warnings as the top officials believed that Indonesia was not facing a threat of economic crisis. The government's stand was similar to its position when faced 1997/98 crisis as our institution predicted that Indonesian economy has serious problems in financial sector. When a shock hit the sector, the economy would be in turmoil. When the prediction that the

⁴⁷ Beside the pre-requisite in selling the assets, there were 130 other conditions in the IMF letter of intent which determined Indonesian economic policy in trade, industry, finance, etc., in order to accelerate liberalization. By (Hendri Saparini, Ph.D. "Neoliberal Didn't Work in Indonesia, What Else?" International

financial bubble would burst proved to be accurate, government immediately panicked and open-close the Indonesian Stock Exchange. This unwise policy created panic within the business community, and undermined confidence in the financial sector and the economy.

Indonesian economic, within the last couple of years before the crisis 2008, underwent a contradiction between improving financial indicators and slowing growth of the real sector combined with accelerating deindustrialization, which is cause for concern. The financial sector is vulnerable to a sudden reversal of fortunes in the absence of productivity growth, improvements to competitiveness and investment in the real economy. When financial flows are not deployed to strengthen the real economy they result in bubbles. These financial sector bubbles can deflate quickly or slowly depending on a range of internal and external factors. If asset prices stabilize or lose value slowly the economy may experience a soft landing with minimal impact on the real economy. But the advent of an external or internal shock can result in a sharp drop in asset prices, financial instability and a resulting hard landing that can impose massive costs on society. The main reason for the emerging contradiction between the performance of the financial and real sectors is the inflow of hot money into developing Asia, including Indonesia. Through November 2007, the amount of foreign capital in financial instruments in Indonesia totaled Rp 891 trillion. The inflow of hot money has strengthened the rupiah against other currencies and bid up the prices of domestic assets. Jakarta Stock Exchange index has increased by 57 percent in 2007. The rupiah strengthened to an average of Rp 1,600 per US dollar in 2008. The rupiah strengthened to an average

rate against the US dollar of Rp 9,142 in 2007. The total value of hot money that has entered Indonesia since 2006 is thought to exceed Rp 140 trillion.⁴⁹ On the other side, it was also after the beginning of United State financial crisis, Indonesia Stock Exchange on November 8, 2008 was disturbed. Its financial crisis has affected to the bubble in financial sector. This caused Indonesian Stock exchange stopped their trading firms, it because of the big index over 10,30%.⁵⁰ Suspension of the trade has reported for stock exchange rate decreased till 168,052 point -1.451, 669. On the other side, the problem in the stock market, Indonesia's economic decreased because its financial crisis in America caused to the decreased of Rupiah and export product from Indonesia has stopped for sent. It was reported in the exchange value market that Rupiah reached Rp9.700 for each dollar of United State. The cases were affected indirectly to the Indonesian's economic toward the financial crisis in United State. The impact of this crisis for Indonesia, in trading and industry sectors is the falling value of the stock exchange rate in Bursa Efek Jakarta or (Jakarta Stock Exchange), exporter should reschedule the sending of the package to USA because of the demanding of the importer in America.

In this economic condition, an external or internal shock could reverse the flow of money and result in a bursting of the financial bubble. In general, there are some reasons why Indonesia susceptible to a shock. First about *price driven export growth* that in the last five years, Indonesia's economic performance was fairly good as indicated by the rate of economic growth, the balance of payments

⁴⁹ <http://www.idn.com/indonesia/2008/11/08/08110801.htm>

and foreign exchange reserves. However, its performance was very vulnerable as the improvement of indicators has been only supported mostly by the rise in export revenues resulting from high commodity prices and inflows of short term capital (hot money) not by economic fundamental development. From 2006-2008, Indonesia's foreign exchange reserves increased from about US\$ 35 billion at the end of 2005 to US\$ 57 billion at the end of 2007 and US\$ 60,5 billion in July 2008.⁵¹ Nevertheless, the accumulation of foreign exchange was not supported by a rise in productivity and export competitiveness, or even an increase in direct investment. The rise in reserves was not supported by export competitiveness or an increase in foreign direct investment. Foreign exchange reserves were built up on the basis of high prices for minerals and agricultural commodities. This was export price driven growth, not productivity driven growth. As Indonesian exports are mainly primary products, so the international price hike up of the commodities like mineral has pushed export growth higher. In 2007, when booming of international prices of commodities occurred, shares of primary commodities, such as nickel, copper, coal and palm oil, were the biggest, very dominant. Secondly, in share prices increase exceeded the fundamental in which situation of the Jakarta Stock Exchange index rose by 52 percent in 2007.⁵² Indonesian stock prices have followed world commodity prices, which have increased company profits in sectors including plantation crops and mining. Investors no longer appear to heed fundamentals and have driven up price-earnings ratios to extremely high levels. One of the examples cited in early 2008 was the fact that 51 listed

⁵¹ Ibid.,

⁵² Ibid.,

companies posted price-earnings ratios (PER) in excess of 50, and PERs for a further 26 companies were higher than 100. Incredibly, 11 companies recorded PERs of over 300.⁵³ The rise of share prices far beyond levels justified by the performance of the companies concerned signaled the formation of a financial bubble. Soaring stock prices not supported by economic performance reflects the formation of a financial bubble. Before 1997/98 crises, Composite Indexes of JSE has experienced the highest growth among Asian stock exchanges, and when the capital out-flow occurred after the US financial market collapsed JSE indexes dropped at the lowest rate. Third, it is about *the artificial growth of banking sector* that the growth of the banking sector was largely an illusion. Over the last year, the banking industry recorded sharply higher profits. The Net Interest Margin (NIM) for 2007 was 5.7 percent, one of the highest in the world.⁵⁴ The wide gap between interest rates on loans and savings generated profits, which attracted investors into the banking industry. The banks' share prices skyrocketed as a result. Yet profitability in the banking sector was not supported by strong fundamentals, for example credit growth. In 2006, bank credit by only 14 percent, followed by 25 percent in 2007. But consumer credit was the fastest growing sector.

Since 2007 the financial bubble has grown quickly and consistently, it extending in early 2008 to the property consumer credit such as motorbike loans and credit cards. One among others was credit on commercial property. The boom in commercial property investment has not been met by an accompanying increase

in demand. Occupancy rates have fallen as result of the slow growth of investment. In 2007, gross investment 15 increased by only 8 percent from the low levels of the year before. If a correction comes in the property market, we can expect rapid consolidation as smaller investors lacking financial muscle and possessing less diversified portfolios are taken over by the bigger players.

Another model of subprime loan is the huge of motor cycle loan. Poor public transportation has caused high cost transportation. This condition has encouraged families of the middle-lower class to prefer using motor cycle. It was inexpensive and practical. As a result, motor cycle loan was booming. Until 2007 at least there were 5 millions motor cycles in Indonesia, of which three fourth were sold through leasing companies. Motorcycle sales were very loose as often executed without down payment and to the lower income group of society. Nearly half of the motorcycle loan was subprime credit.

Sharply rising asset prices slowed down the development of the real sector. The high rate of return on financial assets drew capital out of productive investment and into speculative investments in shares and properties. The economy became increasingly unbalanced, with the financial sector forming a bubble amidst a sinking real sector. The relationship between the real and financial sectors became increasingly strained.

Theoretically, deindustrialization will take place when the share of manufacture to GDP is nearly 50 percent. The role of manufacture industry will be replaced by services. However, it does not occur in Indonesia as

the share of manufacture to GDP is still less

than 30 percent. It means that decreasing role of manufacture sector is not caused by industry transformation from manufacture sector into services sector, but because the industry is not competitive. This is also the root of poverty problems and increasing unemployment.

The contradiction between the strong financial sector performance and slow real sector growth including the acceleration of de-industrialization is a dangerous development. Rising asset prices are vulnerable if not supported by increases in productivity, competitiveness and investment in the real sector. If unsupported by improving fundamentals, rising asset prices will form financial bubbles that will eventually deflate slowly or burst. If the bubble deflates slowly the economy will experience a soft landing with minimal long term effects. If the bubble bursts suddenly as a result of an external or internal shock, the economy will suffer a hard landing with far-reaching and complex consequences.

Mostly, Indonesian has over confidence to perceive that financial crisis in the United States did not affect significantly to Indonesia's economy. Actually, they could not ignore the cause effect of financial crisis. As it means that financial crisis in United State has affected the world states. Rationally, the United State's financial crisis would also affect Indonesia. It could be clarified as follows;

Firstly, Indonesia has been included to the open economy. In the capital liberalization, Indonesia has included to the state more liberal than country in Asia such as Japan and South Korea (Capitalist). Entails that, after the crisis in the United States happened, many foreign investors who developed and grown their

covered their investment by selling assets to the capital market. It was also proven from the value of stock exchange that continuously decreasing. It means that cash flow was huge, so it would disturb national economy. *Secondly*, the condition was not known as surely, how much than invest has been grown by Indonesia Businessman and financial institution of Indonesia in *New York Stock Exchange (NYSE)*. But, there were many investors from Indonesia who have obligation letter from the United States collapsed financial institution. So, their capital or assets to be insolvency. And *third*, in the structure export of Indonesia that the United State is the one of major market Indonesian products. There were about 20% for United State and 30% to Europe.⁵⁵ Many of small industries and textile product has claimed their production to United States. Because, there has many requested from buyer reback their delivery goods. Therefore, if exports product have decreased and Indonesian import in stagnant condition, there would became deficit and it deficit would be decreased for exchange rate.

The United States' financial crisis has affected to the drought of Banking liquidity sector and financial Non-Banking institution with the decreased of financial transaction. The decreased of liquidity in financial institution forced the investors from financial institution in United State withdraw their own firms in Indonesia's market fund. It was done to strengthen their financial liquidity in own firms. However, their action would be dropped the value of firms and the decreased of sold firms volume in the Indonesia's market fund. In other side, several Indonesia's financial institution which invest their fund in the United

State's financial institution would also be affected by the decreased value of firms. The United States' financial crisis has affected other countries, but also it would affect the trading export products in the market of United States, Japan and European Union. This case has disturbed Indonesia's market which many of Indonesian's export products depend on the other countries. On the other hand, the domestic product did not have a capability to compete with China's import products. Those Chinese products were cheaper than domestic products.

The impacts of the United States' financial crisis have affected the financial condition in many countries like Asia and another emerging market. The crisis made the currencies value of Asia depressed toward the dollar of United States. United States' financial crisis has affected indirectly or directly to the growth of Indonesia's economy. The direct effect from that crisis was proved by the collapsed exposure that owned by investors. That exposure has assets that directly involved to the problematic financial institution in United States such as when Indonesia's financial institution has grown their fund in the Lehman Brothers. The indirect impacts of United States' financial crisis, such as the influences to the growth of Indonesia's economy in the form of the drought of liquidities, the jump up of interest rates, the decreased of the commodities prices and the weaknesses of fund resources. The decreased of the consumption level, trust, investors, and market toward every financial institution. Indonesia's market fund has been corrected because the weakness of Rupiah's currency and it has made worried for investors who have been handling their investment or liquid financial

of value firms. The decreased of liquidities serve in the financial institution made there were many global financial institutions collapsed especially for investment banking (*cash flow sustainability*) in the big corporations in Indonesia. And then the injection fund from capital market and global banking were disturbed such as the price of interest rate and availability. The decreased of demand level and commodities prices also became the example for the matter that major export in Indonesia didn't balance made the decrease of import activity. So, it made deficit on trade. The trade deficit would made difficulties for the serve of capital inflow in the big amount to cover deficit values and the drought of liquidities in global financial market.

Automatically, the financial crisis in America gives negative effect to the other countries. It has predicted only little impacts to Indonesia, because the net export from Indonesia to foreign only 10% from Product Domestic Brutto. But, it could not avoid that crisis also give the negative effect to Indonesia because the major market of Indonesia's export is Japan and Singapore. Actually, those are two countries have been affected by the crisis in America.