Economy

The Globalisation of Risk

The sub-prime mortgage, a once esoteric term known only to the investment community and a few homebuyers in the US, has in recent weeks become headline news. As interest rates continued to rise in the US, many poor Americans with these loans were unable to make repayments and their houses were repossessed. But when the value of the repossessed houses dropped, the banks could not recover their initial outlay and suffered massive losses.

This US-based problem became a global concern because investment funds and banks worldwide had bought into the high-returning sub-primes. As these exposed banks suffered losses, international financiers panicked at the thought of a restriction on credit and sold their assets. The result was that trillions of dollars were wiped off stock markets across the world and hundreds of billions of dollars were pumped into financial markets by central banks in an effort to stabilize currencies.

In Indonesia, the immediate impact of this correction caused some consternation because it recalled the sudden downward lurches preceding the 1997 economic crisis. The Jakarta Stock Exchange fell by 15 percent - almost double the rate of other stock markets in the region. In tandem, the rupiah tumbled from around 9,000 to the US dollar to 9,500 in the space of a few days.

Since then, international markets have calmed somewhat after the mid-August height of the panic, and bourses, including the JSX, have begun to rebound. Nevertheless, in a recovering economy as fragile as Indonesia's, there continues to be concern about possible reverberations.

The *Report* met with two experts on August 22 to discuss the sub-prime issue and its effects in Indonesia. Harry Su gave the private investor's perspective, while Dr. Raden Pardede spoke from his experience working with the government's financial and economics ministries.

Each man noted that, despite the immediate impact of the crisis, the country is relatively well-insulated from such global market jitters. With tight regulations on the banking sector, Indonesia's banks are discouraged from making risky investments in sub-primes, which means they suffered no direct hits. The stock market is also small, so that losses from a slide in share prices are confined to a small segment of society.

The fall in the value of the rupiah against the US dollar is more of a concern, but according to Su and Pardede anything below the 9,500 level is still something markets could accept. Inflation, however, could be a future problem if imports become more expensive, especially at this time of year when food prices begin to rise in anticipation of *Idul Fitri*.

If, in the worst-case scenario, the US economy slid into recession, the impact in Indonesia would not be as bad as in other countries. This is because most

Indonesian consumption still takes place domestically. Then again, if the demand for commodities declines, the knock-on effect on prices would undoubtedly hurt economic growth here.

Su and Pardede admit that no-one really knows when the current jitters are likely to calm down. Global investment funds and banks have yet to declare their full losses, and until that happens, the depth of the problem will remain unknown.

At the moment, all eyes are on the US central bank in the expectation that it will cut interest rates to help alleviate the credit crunch. These expectations may prove to be misplaced as the new Federal Reserve chairman, Ben Bernake, seems to be more concerned with keeping inflation down and interest rates up than his predecessor, Alan Greenspan.

Many observers agree that it may be more valuable to let the recent problems serve as a cautionary reminder to imprudent lenders; that there is also a downside to becoming involved in such risky propositions as sub-primes. With the experience of the 1997 banking debacle behind it, this is a lesson that Indonesia already seems to have internalised.