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## Indonesian Monetary Crisis in 1998 Impact, Casues and How to Overcome

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### Abstract

The Indonesian exchange rate crisis in 1997/1998 caused a very sharp decline in the exchange rate, thereby increasing the burden of foreign debt which was dominated by private companies and high inflation in Indonesia.. The aim of this research is to determine and analyze the exchange rate crisis in Indonesia in 1998, which includes the monetary situation before, during and after the monetary crisis, the impact of the monetary crisis, the causes of the monetary crisis and how to overcome the monetary crisis. The type and source of data uses a secondary data approach in the form of documentary data in various media around 1998.

**Keywords:** *monetary crisis, rupiah exchange rate, import exports, debt restructuring*

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### INTRODUCTION

The monetary crisis that hit in 1998 was a difficult period in Indonesia's economic history. The rupiah exchange rate weakened significantly, and this had an impact on various sectors: the economy, political affairs and security. This crisis began with the devaluation of the Thai currency, Bath and had an impact on the value of the rupiah which was originally in the range of IDR 2,600 to IDR 14,900. The depreciation of the rupiah makes it difficult for entrepreneurs to fulfill their overdue foreign payment obligations and import the raw materials they need. The exchange rate crisis has caused various very serious economic difficulties, economic activity has fallen sharply. The depletion of Indonesia's foreign exchange reserves is one of the reasons why Bank Indonesia adopted a policy to change its exchange rate system to a free floating exchange rate system.

This exchange rate system is used because Bank Indonesia finds it difficult to carry out market operations every time the exchange rate hits the intervention threshold. The impact of this policy shift is that the rupiah exchange rate is truly in free fall and continues to decline very sharply on an ongoing basis. So it can be said that the free floating exchange rate system had a significant role in the monetary crisis in Indonesia in 1997/1998. The economic order was seriously damaged, marked by the bankruptcy of banks, companies and other business entities. Many companies and other economic sectors were forced to lay off

workers, resulting in widespread unemployment. Soaring prices have made people anxious because they have lost purchasing power and have led to protests everywhere.

The causes of the 1998 monetary crisis included the decline in the rupiah exchange rate against the dollar. This decline was triggered by a free foreign exchange system without adequate supervision. As a result, many parties can participate in the forex market. This is because asset prices have decreased, businesses and consumers have difficulty paying debts, and financial institutions lack liquidity. The financial crisis was also accompanied by panic among investors who sold assets or withdrew money from savings accounts for fear of their value decreasing. Another cause of the monetary crisis is because the International Monetary Fund (IMF) continues to delay providing promised aid funds.

To overcome this monetary crisis, the Indonesian government finally requested assistance from the International Monetary Fund (IMF) in early 1998. The IMF provided loans and provided technical support and assistance to the Indonesian government in overhauling the country's banking and financial system.

## METHOD

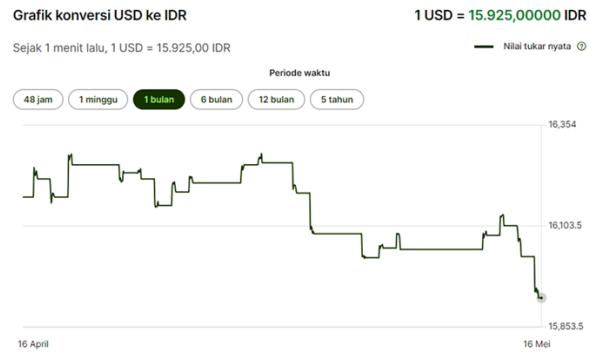
The type and source of data uses a secondary data approach in the form of documentary data in various media which reported on the handling of the 1998 monetary crisis as well as several research results discussing this problem.

## RESULTS AND DISCUSSION

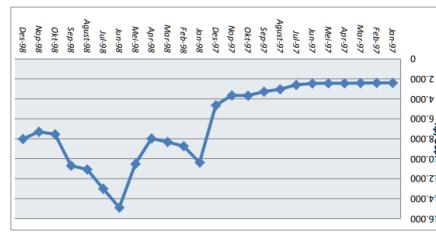
### Analysis of the 1998 Monetary Situation

In June 1997 Indonesia was still far from crisis, because several views stated that Indonesia was different from Thailand. Indonesia has low inflation, a trade balance surplus of more than US\$900 million, quite large foreign exchange reserves, more than US\$20 billion, and the banking sector is still stable. Many Indonesian companies borrowed in dollars because before 1997 the rupiah strengthened against the US dollar so loans in dollars were considered much cheaper.

In June 1997, the rupiah exchange rate against the dollar was around Rp. 2,380 per dollar. The development of the rupiah exchange rate against the US dollar was relatively stable in January - July 1997. The value was in the range of Rp. 2,400 to Rp. 2,600 per US dollar. In August 1997, the rupiah currency began to move negatively, then in August the exchange rate depreciated to IDR 3,035 per US dollar. Finally, on August 14 1997, the government removed the range of intervention and completely handed over the determination of the rupiah exchange rate to market mechanisms. September 1997, the Jakarta Stock Exchange (currently the Indonesian Stock Exchange) was at its lowest point. Companies that borrow in dollars face higher costs to repay debt. Suddenly in January 1998, the dollar strengthened to reach the level of Rp. 11,000.



Then in July 1998, the rupiah continued to decline, US\$1 was equivalent to Rp. 14,150. The drop in confidence to zero caused the rupiah to slide rapidly to a level of around Rp. 17,000/US dollar on January 22 1998, or depreciate by more than 80 percent since the currency was floated on August 14 1997.



### Impact Of The 1998 Monetary Crisis

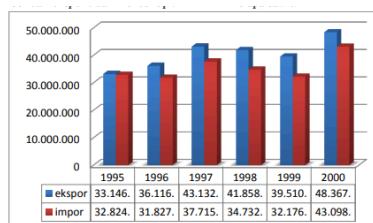
Monetary developments in the 1997/1998 crisis period were characterized by an alarming situation as a result of the rupiah exchange rate crisis which then quickly expanded into a very deep financial crisis. The heavy pressure on capital outflows triggered by the financial crisis in Thailand has caused the rupiah exchange rate to decline. The trigger for this turmoil was the contagion effect of the financial and monetary crisis in Thailand. This is related to the actions of foreign investors to divert investment funds out of ASEAN because they think that ASEAN countries have the same problems. The increasing demand for dollars was related to the large foreign obligations of the private sector that were due and reduced investor confidence in the prospects and ability of the Indonesian economy to face the financial turmoil at that time. The risk is that the rupiah will float, apart from being a result of increasing demand for dollars to pay debts, it is also a reaction to the figures for the 1998/1999 RAPBN which was announced on January 6 1998. The RAPBN is considered unrealistic. The crisis, which indicated the fragility of economic fundamentals, quickly spread to all sectors, including the following:

#### *Economy*

Data from the Central Statistics Agency also shows that the economy, which was still recording positive growth of 3.4 percent in the third quarter of 1997, turned to zero percent in the last quarter of 1997. The figure continued to shrink sharply to a contraction of 7.9 percent in the first quarter of 1998, a contraction of 16.5 percent in the second quarter of 1998, and continued to contract by 17.9 percent in the third quarter of 1998. Likewise, the inflation rate up to August 1998 had reached 54.54 percent, with the February inflation figure reaching 12.67 percent

### ***Export Import***

On the other hand, the export sector, which was expected to be a savior in the midst of the crisis, turned out to be in the same slump, meaning unable to take advantage of the momentum of the rupiah's depreciation. Because the business world is suffocating due to debt burdens, heavy dependence on imported components, difficulties in trade financing, and intense competition in the global market. During the January-June 1998 period, oil and gas exports fell by around 34.1 percent compared to the same period in 1997, while non-oil and gas exports only grew 5.36 percent



Gambar 4. Perkembangan Nilai Eksport dan Impor Indonesia Tahun 1995-2000  
Sumber : SEKI Bank Indonesia, data diolah

### ***Rupiah Exchange Rate Against Dollar***

The first impact that occurred as a result of the monetary crisis was the decline in the Rupiah exchange rate. With the decline in the Rupiah exchange rate, all banks in Indonesia experienced serious bad credit. Therefore, during the reform era, B.J. Habibie liquidated several problematic banks during the crisis, so that the value of the rupiah could stabilize again. This is in accordance with Law Number 25 of 1999 concerning Revocation of Business Licenses, Dissolution and Liquidation of Banks, there is the definition of bank liquidation. In Law Number 25 of 1999 Article 1 paragraph (4), bank liquidation is the act of settling all bank rights and obligations as a result of the revocation of the business license and dissolution of the bank's legal entity.

### ***Banks Experiencing Bad Credit***

The dramatic fall in the rupiah caused the money market and capital market to also collapse, and national banks were suddenly in big trouble. The international ratings of these large banks worsened, including government debt securities. The 1998 monetary crisis which caused the rupiah exchange rate to decline ultimately caused all banks to face a credit default situation. This bad

credit was detrimental to banks, so the government decided to merge several financial institutions to save the Indonesian economy.

### ***Bankrupt Company***

During the New Order, many business people depended on foreign debt to facilitate production activities. In the end, business companies that are unable to pay debts then go bankrupt. In addition, the falling value of the Rupiah hampers the process of purchasing raw materials for production activities. Hundreds of companies, ranging from small scale to conglomerates, collapsed. Around 70 percent of companies listed on the capital market suddenly became insolvent, aka bankrupt.

### ***Increased Unemployment***

The construction, manufacturing and banking sectors were sectors that were hit quite hard, causing a large wave of layoffs. Unemployment soared to levels not seen since the late 1960s, namely around 20 million people or more than 20 percent of the workforce. Many companies and other economic sectors were forced to lay off workers (PHK) resulting in widespread unemployment

### ***Poverty Increases Sharply***

Companies that are unable to pay their debts eventually go bankrupt. The soaring decline in the rupiah exchange rate meant that companies were unable to buy raw materials and carry out production activities, so they were forced to lose their business. This situation means that many workers have lost their source of income or been laid off. As many people have been laid off and prices of goods have soared, the number of people below the poverty line has also increased. At that time, the figure was recorded at around 50 percent of the total population. Per capita income which reached 1,155 dollars/capita in 1996 and 1,088 dollars/capita in 1997 shrank to 610 dollars/capita in 1998. Two out of three Indonesians, as recorded by the International Labor Organization (ILO), were in very poor conditions in 1999 if the economy is not immediately improved.

### ***Increase in Prices of Basic Materials***

After the monetary crisis, the number of unemployed due to bankrupt businesses increased. The Rupiah exchange rate has triggered an increase in the prices of basic commodities needed by the community. This created difficulties for the Indonesian people and massive protests which then sparked demonstrations.

### ***Inflation***

Monetary crises are often accompanied by high inflation. Currency depreciation can cause the price of imported goods to rise, which in turn increases the price of goods and services domestically. High inflation is detrimental to people because it reduces their purchasing power

### ***Demonstration***

People's protests, mostly represented by students, were carried out on a large scale. Reporting from Kompas.id, on May 4 1998, the government increased the price of fuel oil (BBM) and the basic electricity tariff (TDL), which triggered an increase in the prices of other goods. The day after, May 5 1998, students from various cities held demonstrations to protest the increase in fuel prices and basic electricity tariffs. The conditions of the demonstration became increasingly chaotic due to the Trisakti tragedy, to the point that demonstrators carried out acts of destruction and arson in several areas of Jakarta. The aim of the demonstration, which started as a protest, was to demand that Suharto immediately resign from his position as President.

### ***Security- Riot***

Indonesian public protests against the monetary crisis and the Soeharto government became increasingly violent since May 13 1998. Until May 14 1998, mass groups began burning, vandalizing and looting shops. The riots spread to Jakarta, Tangerang, Bekasi and surrounding areas.

### ***Foreign Countries' Trust Lost***

Before the monetary crisis occurred, Indonesia was open to foreign investors who wanted to invest in domestic companies. Unfortunately, the declining rupiah exchange rate and not matching market prices means that investors no longer have confidence in business in Indonesia. Investors no longer believe that money invested in Indonesia will provide good results so they choose to withdraw their capital.

### ***Politics - The Fall of the New Order***

With various pressures, problems, and never-ending demonstrations, Suharto's government was forced to resign. Since May 18 1998 at 09.00 WIB, a number of student delegations from dozens of universities and community delegates began to enter the DPR Building. At 11.00 WIB, the wave of students who came to the DPR Building had already reached thousands. Thousands of students demanded that the MPR hold a special session to revoke the MPR's mandate on President Soeharto. At 15.20 WIB, Chairman of the DPR/MPR Harmoko announced the results of the meeting which asked President Soeharto wisely and tactfully to resign. Finally, on May 21 1998 at 9.00 WIB, President Soeharto made a speech announcing his resignation from the position of President.

### ***Causes of the 1998 Monetary Crisis***

#### ***Deterioration of the Rupiah Exchange Rate***

The decline in the rupiah exchange rate against the dollar is believed to be the main factor causing the economic crisis at the end of 1997. The decline in the value of the rupiah was caused by the free foreign exchange system being implemented without adequate supervision. This makes many parties carry out foreign exchange transactions without considering the risks. The decline in the

rupiah exchange rate against the dollar was caused by several factors, one of which was the play of domestic and foreign speculators. These speculators also do not simply use their personal funds, but borrow from the banking system.

#### ***Private Debt Accumulation***

Another factor that caused the economic crisis at the end of 1997 was private debt. This is one of the factors that causes the value of the rupiah to be depressed because the availability of foreign exchange cannot meet maturing debts and interest. The accumulation of foreign private debt since the early 1990s has reached very large amounts, even exceeding the government's official obligations.

#### ***Banking and Government System Errors***

The government's mistake which was the cause of the economic crisis at the end of 1997 was that they had taken inappropriate actions by making the value of the rupiah exceed what it should have been and interest rates continued to increase. This makes rupiah loans relatively expensive and loans in foreign currency cheaper. On the other hand, domestic interest rates are allowed to be high to restrain the flow of funds abroad and people are willing to keep rupiah currency deposits. This situation will benefit entrepreneurs as long as there is no devaluation. This has continued to happen for years, so that people continue to borrow large amounts from abroad. The government's mistake in not monitoring foreign debt at all was the trigger for the economic crisis. They only pay attention to debts related to government projects and ignore other circumstances.

#### ***IMF/Partner Countries Delay Aid***

The cause of the economic crisis at the end of 1997 was because the International Monetary Fund (IMF) continued to delay providing promised aid funds. The IMF stated that the reason for the delay was because the government had not implemented the 50-point agreement properly. Neighboring countries that promised to help Indonesia also postponed the distribution of aid funds because they were waiting for orders from the IMF. This made economic conditions in Indonesia even worse during the 1997 economic crisis.

#### ***Less Stable Political Situation***

Political uncertainty in the face of the previous election and other problems related to President Soeharto at that time were considered to be one of the causes of the monetary crisis. Finally, there were many large-scale demonstrations due to the scarcity of basic commodities throughout Indonesia. This condition is what makes Indonesia lose the trust of foreign investors. So, apart from the problem of the declining rupiah exchange rate, the cause of the economic crisis at the end of 1997 was the unstable political situation and caused investors to be reluctant to invest their capital.

#### ***Monetary Crisis Management***

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The main factor causing the economic crisis at the end of 1997 was because the government did not provide intensive supervision of foreign exchange transactions. To overcome this, they implemented several policies, including:

### ***Overhauling the State Banking and Financial System***

As is known, one of the causes of the economic crisis at the end of 1997 was the damage to the national banking system. When the monetary crisis came, handling the banking system became a top priority because this sector was the heart and source of economic obstacles at that time. Improving the banking system is carried out by taking preventive action by freezing business activities at banks that are 'sick' and could trigger system damage. Furthermore, the government provided a comprehensive banking restructuring package. The first package is a recapitulation and improvement of banking rules and regulations. Meanwhile, the second is accelerating restructuring. Apart from that, the government also formed the National Banking Restructuring Agency (BPPN) which is tasked with carrying out a comprehensive restructuring of the national banking system.

### ***Private Debt Restructuring***

Another problem that needs to be addressed in the context of economic recovery is through private credit restructuring. The government's way of dealing with this situation in 1997 was through the formation of a Private Foreign Debt Settlement Team (TPULNS). They succeeded in reaching the Frankfurt Agreement with foreign creditors represented by the Bank Steering Committee to restructure private debt. The Frankfurt deal covers settlement of interbank loans, trade financing, as well as private corporate loans. Through this restructuring, it is hoped that the company's liquidation position can be maintained and not disrupt the production system and avoid layoffs.

### ***Macroeconomic Policy***

The government's next way to overcome the economic crisis in 1997 was to implement macroeconomic policies. The economic crisis has affected all levels of society, including entrepreneurs, government officials and ordinary people. Therefore, the government has made various efforts, such as loosening the APBN so that it can provide assistance to the poor, seeking additional debt, and privatizing several state-owned companies. That's an explanation of the factors that caused the economic crisis in 1997 and how the government handled it. The cause of the economic crisis at the end of 1997 was due to the continued decline in the value of the rupiah and damage to the banking system in Indonesia. Therefore, the government is making efforts to restructure banking and implement macroeconomics to overcome the economic crisis.

## **CONCLUSION (Capital, 12 pts, bold)**

The monetary crisis that hit Indonesia in 1998 was a difficult period in the country's economic history. This crisis was characterized by a significant weakening of the rupiah exchange rate, which in turn had an impact on various sectors of the economy, politics and security, exports and imports, a weakening of the rupiah exchange rate against the dollar, people's purchasing power, inflation, and so on. The monetary crisis in Indonesia was caused, among other things, by the rupiah exchange rate against the dollar, the accumulation of foreign debt from the government and the private sector was swelling, errors in the banking system, the IMF/partner countries were delaying aid, and the political situation was less stable. Overcoming the monetary crisis can be done by increasing the role of the IMF/partner countries, the government issuing a Perppu, overhauling the country's banking and financial system, Bank Indonesia policy, restructuring private debt.

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