How do internal and external shock effect debt crisis? a time series analysis on Indonesia case

Ebi Junaidi, author

Abstrak

The year of 1997s witnessed a depreciation of domestic currency in many countries in Asia, including Indonesia. Finally in 1998, Indonesia got debt repayment ability problems and the economic crisis at the same time. Some economists found that the economic crisis caused by shocks in 1997 has been the major cause of the debt repayment inability. Meanwhile others argue that the debt problems in Indonesia have been the major cause of the economic. This invites question: Which of these contrary hypotheses are relevant for Indonesia case? Furthermore, how do Internal and External Shocks Effect Debt Crisis? For the case of Indonesia, this study found that shocks in exchange rate, domestic income and foreign income influence the loan demand and loan supply of Indonesia that finally caused the debt crisis. Defining Debt Crisis as a condition of excess demand (Loan Demand > Loan Supply) and use a rescheduling under duress as the working definition, this paper try to see what factors determined the loan demand and supply. Using Balance of Payments equation, this paper found identity equations determine loan demand. Any shocks over the variables determined these factors will finally be transmitted to loan demand and cause pressure to debt crisis. Using Vector Autoregression Model, this paper found significant relationship among the exchange rate, domestic income and foreign income and Export of goods and services, import of goods and services and direct foreign investment. The Impulse Response Function (IRF) provides further evidence that pressure for loan demand actually increased when depreciation occurred. It was caused trough its effect to export of goods and services, import of goods and services and direct foreign investment. The econometric results also show that there was a significant negative relationship between foreign income and loan demand, suggesting that an increase of foreign currency led to a lessening in pressure for debt crisis trough an increase in loan supply and a decrease in loan demand. Another finding is that an increase in domestic income will create pressure on debt repayment ability. This conclusion is supported by the positive relationship between domestic income and import showed by Impulse Response Function.