CHAPTER 1
INTRODUCTION

1.1 Historical Backgrounds

The first signs of a global financial crisis emerged in the second semester of 2007 when several banks and financial institutions in Great Britain and the United States began to publicize financial problems related to sub-prime mortgages. Monetary crisis at this united America evokes impact incredible globally. this matter can be seen from world investor panic in their effort rescued their money at stocks market. they are crowded sell share so that free fall stock market. since beginning 2008, stock market china plummet 57%, Indians 52%, Indonesia 41% (before the activity is stopped for temporary), and Europe zone 37%. temporary debt mail market plummet, developing countries currency is weak and commodities price plummet, even less after speculator oil commodities will evaluate that economic recession will decrease world energy consumption.

At axis, after see stock market wall street then decrease, final congress approves program rescuing financial sector (troubled asset recovery program - tarp) in the amount us$ 700 milliards that submitted by government. but, because the long policies negotiation between government and congress, disappointed investor see politicians at Washington doesn't has sense of crisis. Capital market crisis (share and debt mail) global basically only influence capital market investor. but global banking crisis can influence world economic real sector, belong Indonesia. story kernel that axis banking sector plummet, capital deficiency, and dislike to lend the dollar, belong to international banks at Europe and Asia.

Finally, dollar deficit international banking to lends to world entrepreneurs that want dollar for the investment (for engine import, basic commodity, and as it), belong in Indonesia. We have known that axis dollar has been kernel currency in the world of effort. finally, although axis central bank rate (or fed funds target rate) until is demoted to 1,5%, rate of interest London inter-bank offer rate, jump up sharp.

It turns out that such phenomenon was just the tip of the iceberg. Since then, it escalates at a faster rate and the impact gets wider and deeper. Before we know it, the sub-prime mortgages crisis has rapidly evolved into a global crisis. Cash flow loans eventually stopped since investors prefer to store their money in hard cash or gold rather than lending them out. Financial institutions in many countries came under intense pressure, and even forcing some into bankruptcy.

Governments in many countries are forced to implement a bailout plan and their central banks pump liquidity, in unprecedented amount. Ironically, the financial institutions are still under pressure. Governments and the central banks of many countries try whatever means they could think of, even some unconventional ways, to save the day. In order to halt the downward spiral process—i.e. the poor performance of financial sector affecting the real sector—the monetary authorities pump huge amounts of liquidity and virtually all governments launch fresh stimulus packages. In fact, many countries carry out intervention, such as issuing a blanket guarantee to all deposits in banks, taking over troubled assets, injecting bank capital, and even acquiring some of its banks.

If we look at all these negative signs, the situation and the prospect of the global economy are indeed gloomy. However, by looking at the world's economic trouble more objectively and as it is, we could take the necessary steps to overcome the crisis.

For Indonesia, the impact of the crisis was unavoidable. When we are at the height the global financial crisis which was marked by Lehman Brothers' bankruptcy and the domestic market psychology turbulence in November 2008, the government was forced to take over Century Bank. The Indonesian banks also suffered the impact of derivative product problems, even though such impact was relatively smaller compared to other countries, especially the developed ones.
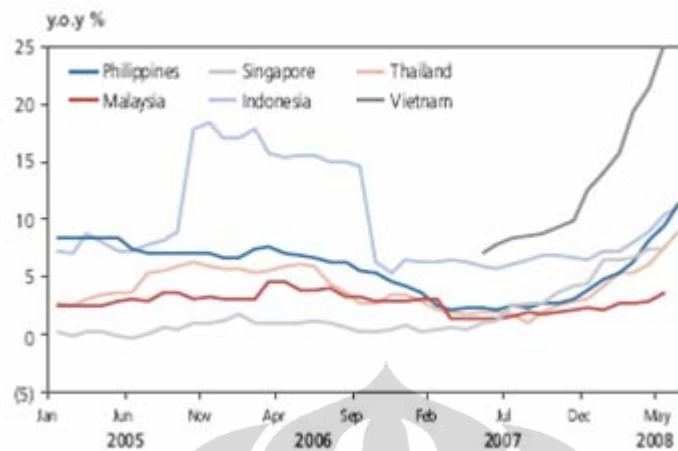
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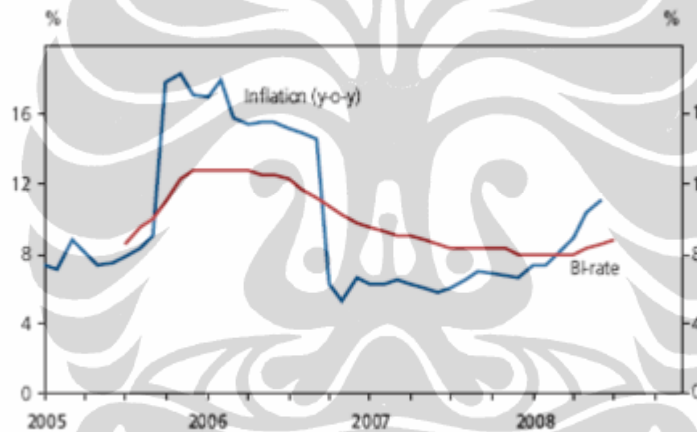**Figure 1.1 Inflation in ASEAN-5 and Vietnam**

Source : CEIC

Figure 1.2 Inflation an BI rate in Indonesia

Source : Central Statistical Bureau & Bank Indonesia

The impacts of inflationary pressures emanating from increasing oil and food prices were also experienced in Indonesia. Inflation in Indonesia (y-o-y) at the end of Semester-I 2008 was 11.03%, representing an increase of 5.26% compared to the same period in the previous year. Increasing inflationary pressures were anticipated by raising the BI rate to 8.50% in June 2008 (and subsequently to 9.0% in August 2008). However, the real interest rate in Indonesia remained generally more attractive than in that of other countries, therefore despite slight depreciation the rupiah stayed within the range of Rp 9,257 per USD. Meanwhile, the Indonesian composite index,

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notwithstanding a slight decline due to volatility in the global equity market, remained attractive to investors.

Figure 1.3 Real interest rate in Indonesia

Source : Bloomberg

Figure 1.4 Rupiah exchange rates against US Dollar

Source : Bloomberg

Stock market and capital market in Indonesia also experienced a decline. Due to deteriorated stock price, losses experienced by investors in capital markets, as reported Infobank, have reached Rp 457 trillion only in October 2007- September 2008 because the market capitalization fell from USD $ 1,464 to $ 1,007 trillion. Within a year (end of 2008 compared with the end of 2007), losses reach Rp 912 trillion (Kompas, April 4, 2009).
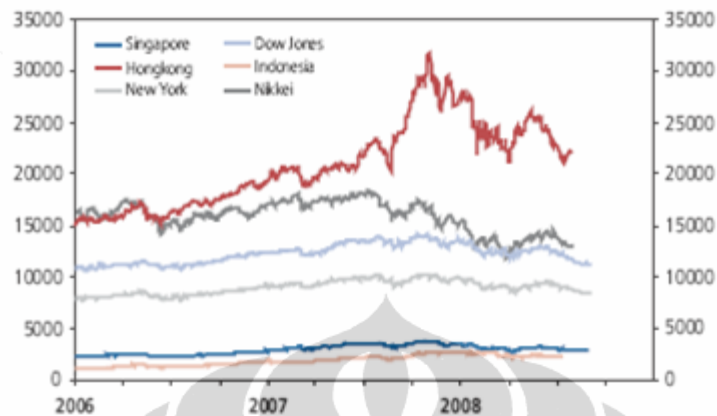
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Figure 1.5 Global stock prices index

Source : Bloomberg

However, in the midst of this trouble situation, Indonesia's position is faring better than most other nations. In fact, the macro-economic condition is really not bad at all. The banking industry is just as good as ever. In fact, Indonesia is lucky because its banks have very low exposure to sub-prime mortgages.

Previously, many people have considered Indonesia as being incapable of integrating it financial sector to the global financial networks. Today, however, this failure proves to be a blessing in disguise, since it saves us from being affected as seriously as other countries.

1.2 Problem Identification

Crisis in the financial sector in 2008 related directly or indirectly with the various activities commonly conducted by the banking industry especially state owned banks and private national banks. From the collection of funds, the amount and composition of customer deposits in the banking system has a great influence to the stability of the banking industry. Withdrawal of public funds in large-scale in a short time have a negative effect on aspects bank liquidity. Performance comparison between state owned bank and private national banks in this research were evaluated with specific CAMELS ratio.

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Beside that, the study of macro-indicators that can be used as the initial information of the potential banking crisis also needs to be evaluated so that preventive measures could be predicted before the existing problems in the economy as a became general banking crisis. There are two indicators used in this research which were Indonesia Government Securities (SUN) rates and Jakarta Composite Index (JCI) during 2007 – 2009 period.

1.3 Objectives of Research

- To analyze the banking performance on subprime crisis era during 2007 – 2009, represented by some basic financial performance and structural characteristics to evaluate a bank, namely CAMELS ratio and analyze the connection of state owned and national private bank performance.

- To examine the correlation of non performing earning assets (APB) ratio of state owned banks, private national banks and overall banking industry with the evolving environment which in this research represented by the Indonesia Government Securities (SUN) balance and Jakarta Composite Index (JCI) especially during the subprime crisis in 2007 - 2009.

1.4 Research Contribution

This research try to provide adequate information for:

- Investors and creditors

  For creditors and investors can use the study results as information to make their investment actions, either in the form of loans, the deposits, or purchase of shares so that the potential losses they face can be minimized.

- Regulator (Bank Indonesia)

  For Bank Indonesia, one of the bank's tasks supervisor / investigator are getting the belief that the bank has operate with caution in order to safeguard the interests of depositors in order to maintain public confidence. In order to more sharply in the analysis relating to the duties above the supervisor / investigator

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bank can using indicators of bank's performances as one of the tools to assess the quality of bank's.

- Bank Management and Investors

  Bank Management can use the study results as information to make investment action to related sector real. So they can predict the potential and threat of related sector toward macroeconomic indicators.

1.5 Thesis Outline

The thesis consist of six chapters, which are:

Chapter 1. Introduction

This chapter describes the background, objectives, methods and systematic plans of the study.

Chapter 2. Theoretical Background

The chapter covers all theoretical materials used in the study including financial performance analysis of the bank, some basic financial performance and structural characteristics to evaluate the banks, namely profitability, efficiency or productivity, quality of assets, growth and aggressiveness, liquidity, size, capital adequacy, income diversification, and dependence on affiliates.

Chapter 3. 2007 – 2009 Financial Crisis Towards Indonesian Financial Sectors

The chapter describes the industrial analysis and macroeconomic condition of Indonesia during 2007 – 2009 period or subprime crisis era.

Chapter 4. Research Methodology

The chapter describe the research framework and model, hypothesis development, variable definition, statistical analysis, data and population sample of the research.

Chapter 5. Results Analysis

The chapter describes result analysis of the research and the evaluation of the objectives of the study.

Chapter 6. Conclusions and Recommendations

The chapter gives the conclusions as a result of bank's performance trend in 2007 - 2009 or in the era of subprime crisis and the correlation between bank's performance and evolving environments. In this chapter recommendations are propose to the banks that could enhance the company performance in the future. Some limitation of the research also disclosed in this chapter.