Overcoming Obstacles to Building Public Debt Management Capacity


Ministry of Finance of the Republic of Indonesia
Direcorate General of Debt Management
Debt Management Reform in Indonesia
- Asian Financial Crisis Implied a Sudden and Substantial Increase in Debt Levels;
- Reasons for Establishment of DMO in MoF
- Milestone of the Government Securities Management;
- Milestone of the DMO Establishment;
- The Role of External Support;
- The Impact of the Reform;
- Main Lesson from the Reforms
Debt Management Reform in Indonesia

Asian Financial Crisis Implied a Sudden and Substantial Increase in Debt Levels

Debt to GDP ratio yr 2010-2012 lower than average ratio before economic crisis in 1997

Krisis Ekonomi thn. 1997

Debt Profile (trilliun Rupiah)
Reasons for the DMO Establishment in MoF

- Governance and Strategy Development:
  - Managerial Structure. Central government debt is managed by a division that is separated and worked without standard guideline;

- Debt Management Strategy (2005-2009) was enacted in 2005 and need to be executed fully by two divisions;
- Need for evaluation the debt management operations.
Reasons for the DMO Establishment in MoF

- Audit. Lack of capacity in external loan division in terms of data base recording (integrity and reliability) and loan storage need to be enhanced for audit purpose;

- DMO is needed to intensify close coordination with:
  - Fiscal policy in providing accurate debt service forecast and its scenario;
  - Monetary policy in keeping the central Bank with the information of future debt transaction and government cash flow;

1970-2004
(DMU), CMGB, GBD

1999-2004
(DMU), CMGB, GBD

DMO
2006 on ward

External Loan Division
Relatively Weak Capacity staff

Relatively Weak Capacity staff
Borrowing and Related Financing Activities.

- Domestic Market Borrowing. DMO is needed to develop domestic bond market and broadening bond instrument in order achieve the goal of debt management strategy (2005-2009) that consists of optimum portfolio management and market development;

- Support is needed for external loan division that have to resolve the classical issue of low disbursement among other creating Internal procedure document, and professional legal adviser.
Reason for the DMO Establishment in MoF

- Borrowing and Related Financing Activities.
  - Need to include Loan Guarantees on debt management strategy, clarity for lending policy; and execution of the derivatives operations.

- Cash flow Forecasting and Cash Balance Management;
  - Need to have a reliability of cash forecasting, and the procedure to invest the idle cash in the market.

- Operational Risk Management;
  - Debt Administration and Data Securities. Need to strengthen a readily accessible procedure manual for external loan concessional recording, debt service payment, and storage agreement.
Reasons for the DMO Establishment in MoF

- **Operational Risk Management;**
  - Segregation of Duties, Staff Capacities; and Business Continuity.
    - Need to have clarity in the functionalities of the debt manager of the External Loan Division - act to negotiate loan and should not service the debt;
    - Need to have a monitoring for risk of external loan;
    - Clarity for those who record and make payment of debt service, and accounting system.
  - Operational Risk Management;
    - Need to enhance the single data base of the government debt through conversion of two data recording in the similar systems (DMFAS);
    - Need to enhance the Bulletin of central government debt.

(DMU), CMGB, GBD

DMO
2006 on ward

External Loan Division
Relatively Weak Capacity staff

1970-2004
1999-2004
The Role of External Support

AusAid
- Capacity Building on: Cost and Risk Analysis Concept;
- Debt Management Office (DMO) Concept;

World Bank
- Diagnostic Report and Implementation

SECO Switzerland
- DMFAS Enhancement Version 6.0;
- Contingent Liability Concept;
- Risk Cost Analysis

AusAid
- 1970-2004 External Loan Division
- 1999 Debt Management Unit (DMU), Central Management Government Bond
- 2001 Government Bond Division
- 2004
- 2006 on ward

UNCTAD
- Debt management Conference
- Enhancement of DMFAS

World Bank
- ALM
The Impact of Reform

- Better Governance and Strategy Development:
  - Enhancement of Debt Management Strategy formulation (2010-2014);
  - Easier coordination among FO, MO and BO to execute Debt Management Strategy goal and target;
  - More efficient and effective debt management operation and evaluation.

1999-2004
(DMU), CMGB, GBD
External Loan Division
Relatively Weak Capacity staff
DMO
2006 on ward
The Impact of Reform

- Better Operational Risk Management;
  - Clear segregation of duties, among FO, MO and BO;
  - Check and balance mechanism for those who verify and arrange payment of debt service;
  - Enhancement of risk monitoring and complaince;

1970-2004

1999-2004

DMU, CMGB, GBD

DMO
2006 on ward

External Loan Division
Relatively Weak Capacity staff

- Better recording in the External Loan Division;
- More data reporting on central government debt, public sector debt, produced to several stake holder including the rating agencies.
Lesson Learned from the Establishment of DMO

**Benefits**
- Improvement in the debt profile
- Better portfolio and risk management
- Improvement in debt data consolidation
- Supporting Government debt management objective of lowering down Debt/GDP ratio
- Generating synergy in managing debt financing to cope with market dynamics
- Promoting efficiency in debt management
- Reducing bureaucratic process in terms of financing the budget

**Achievements**
- Established risk committee to supervise market volatility and its impact on the Government Debt market and to supervise daily operational risks of the DMO
- Established integrated debt service settlement for loans and Government securities
- Established integrated portfolio and risk management
- Developed effective communication with lenders, investors and credit rating assessors which led an upgrade in sovereign rating to investment grade and an improvement in Country Risk Classification
- Established monitoring systems and legal framework for contingent liabilities management
- Improvement in human capital development
Attachment
Government Bonds Market Development Strategy

DEEP, ACTIVE, AND LIQUID BOND MARKET

Widening Investor Base

Market Deepening

Facilitating Efficient Price Discovery Mechanism

Market Making

ABSORPTION CAPACITY

EFFICIENT PRICE / YIELD

Demand & Supply

• Regular calendar of issuance
• Product diversification
• Methods of sale of bonds (private placement, bookbuilding, auction)

• Bond reopening
• Tax incentive
• OMO instruments
• Secondary reserve
• New market, e.g., retails

Market Infrastructure

• Transparency
• Trading platform
• Borrowing & lending facilities,
• Repo window

• Primary dealership system
• Clearing & Settlement
• Market surveillance
Formula of Annual Financing Strategy

DEBT MANAGEMENT STRATEGY

Annual Borrowing Program

- One year risk limit
- One year projection of market condition
- Recent market condition

Lender capacity assessment

Market demand assessment

Instrument development

Bond Market Development
- Demand & Supply
- Market Infrastructure

Government Securities
- Issuance Composition:
  - Tenor
  - Currency
  - Interest Rate Type

Government Securities Buyback and Debt Switch Program

Loan Composition:
- Tenor
- Currency
- Interest Rate Type

Annual Hedging Strategy
Declining cost of fund of Domestic Government Securities reflects increasing market confidence as a response of prudent fiscal policy and debt management.
Positive trend on average daily trading activity shows increasing market liquidity.
Notes: Non-Bank including Government institution
Long end Government Debt Securities dominates foreign holding which reached by 69.86% as of September 28, 2012.
## Indonesia Credit Rating Performance 1999 - 2012

<table>
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<th>Year</th>
<th>S&amp;P</th>
<th>Fitch</th>
<th>Moody’s</th>
<th>R&amp;I</th>
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On March 30, 2012, OECD upgraded CRC of Indonesia from classification 4 to 3.

On January 18, 2012, Moody’s upgraded Indonesia’s Credit Rating from Ba1 to Baa3.
Indonesia Credit Rating Performance (2)

- Moodys's menaikan rating ke Baa1 per 17 Januari 2011
- Moodys's menaikan rating ke Baa2 per 15 Desember 2011
- Moodys's menaikan rating ke Baa3 per 18 Januari 2012
- S&P's menaikan rating ke BB+ per 8 April 2011
- S&P's menaikan rating ke Ba1 per 17 Januari 2011
- Fitch's menaikan rating ke BBB- per 15 Desember 2011

Krisis ekonomi 1998
Rekapitalisasi Perbankan
Reprofiling VR & HB, Asset-Bond Swap, & penerbitan SUN
Lelang penerbitan SUN secara reguler, program Buyback
Lelang penerbitan SUN secara reguler, program Buyback, Debt Switching, & diversifikasi instrumen
SD/DDD
R/C
CCC
CCC-
CC
BBB+
BBB
BBB-
BB-
BB+
B+
B
B-
CCC+
CCC
CCC-
SD/DDD

Rekapitalisasi Perbankan
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BB+
B+
B
B-
CCC+
CCC
CCC-

Moody's (RHS)  S&P's  Fitch's  S&P's  Fitch's  Moody's (RHS)
Debt Risk Indicators
2007-2011

**Interest Rate Risk**

- Variable rate ratio [%]: 30.2, 28.2, 28.2, 26.1, 25.9, 23.4
- Refixing rate [%]: 26.7, 22.9, 21.2, 20.3, 18.8, 16.5

**Exchange Rate Risk**

- FX Debt to GDP ratio (%): 52.1, 47.4, 46.2, 45.1, 44.8
- FX Debt to total debt ratio (%): 16.5, 17.2, 13.4, 12.1, 11.0

**Average Time To Maturity (ATM)-Years**

- Average Time to Maturity (in percentage): 10.4, 10.0, 9.7, 9.5, 9.3, 9.7

**Debt Maturing in 1, 3 and 5 Years**

- Maturity debt portion < 1 year (%): 6.8, 19.4, 18.6, 20.3, 20.8, 22.7
- Maturity debt portion < 3 year (%): 6.4, 18.6, 7.6, 7.1, 8.2, 8.0
- Maturity debt portion < 5 year (%): 30.6, 31.1, 33.2, 34.2, 34.6, 33.5

# Pending Matters of DMO

<table>
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<tr>
<th>Issues</th>
<th>Purposes</th>
<th>Remarks</th>
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| Developing a **reliable** debt database (mainly Loans)        | • Supporting the formulation of annual and medium term debt management strategy  
  • Supporting policy of budget financing                      | • An accurate and comprehensive loan database is still in the development process |
| Establishing the primary dealer system                       | • Managing Gov’t securities liquidity in secondary market                | Lack of incentives for primary dealers, for example prioritizing PDs members for global bonds JLM selection |
| Conducting direct transactions through DMO dealing room      | • Improving liquidity in secondary market during market turbulence      | Limited availability of funds for direct transactions and long & bureaucratic process to approve the transactions |
| Diversifying Gov’t securities instruments adding retail bonds and shariah compliance Gov’t securities | • Matching investors preference  
  • Managing portfolio  
  • Widening investor base                                  | • Regulations for new instruments need to be strengthened               |
| Improving business process and SOP for loan procurement (emphasizing on loan negotiation) | • Maintaining good governance on loan management                      | • There are some SOP for front office that overlapped with middle office |
| Developing benchmark rate                                    | • Providing comparison for loan effective rate                           | • There is a wide gap between loan effective rate and benchmark rate    |
Challenges and Future Developments

**Challenges**

- Moving towards IT based debt management
- Improving effective and efficient risk management
- Reducing impact of rising cost of debt
- Developing Government securities market
- Increasing resiliency of Government securities management
- Business process leads to inefficiencies in loan execution

**Institutional Development**

- Development of IT systems
- Integrated database to support effective and reliable database
- Establish consolidated ALM System
- Development of hedging mechanism
- Formulating derivative instruments infrastructures
- Continuous improvement on debt issuance and procurement mechanisms
- Instruments diversification to match financing needs and investors preference
- Development of organization capacity to support project-based Government shariah securities
- Developing crisis management protocol
- Matching calendar of issuance and cash projections to reduce idle cash
- Development of instruments to match financing needs and investors preference
- Close coordination with related parties to improve loan management efficiency