Overcoming Obstacles to Building Public Debt Management Capacity

World Bank Debt Management Forum, Washington, October 29, 2012

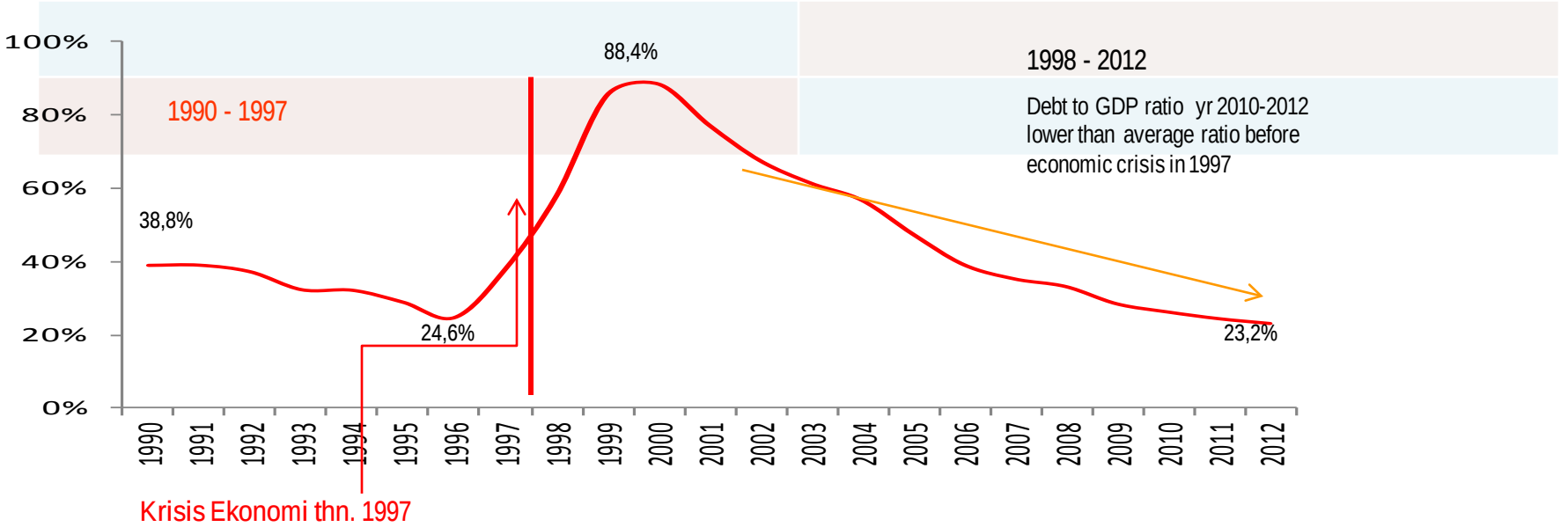
Ministry of Finance of the Republic of Indonesia
Direcrorate General of Debt Management

Topic of Discussion

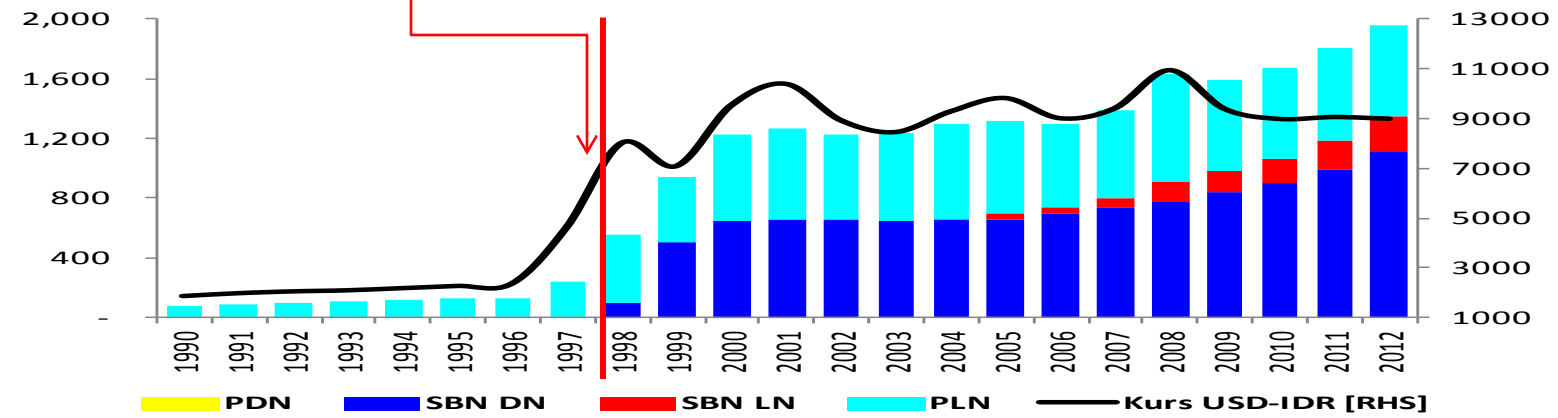
- Debt Management Reform in Indonesia
  - ✓ Asian Financial Crisis Implied a Sudden and Substantial Increase in Debt Levels;
  - ✓ Reasons for Establishment of DMO in MoF
  - ✓ Milestone of the Government Securities Management;
  - ✓ Milestone of the DMO Establishment ;
- The Role of External Support;
- 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



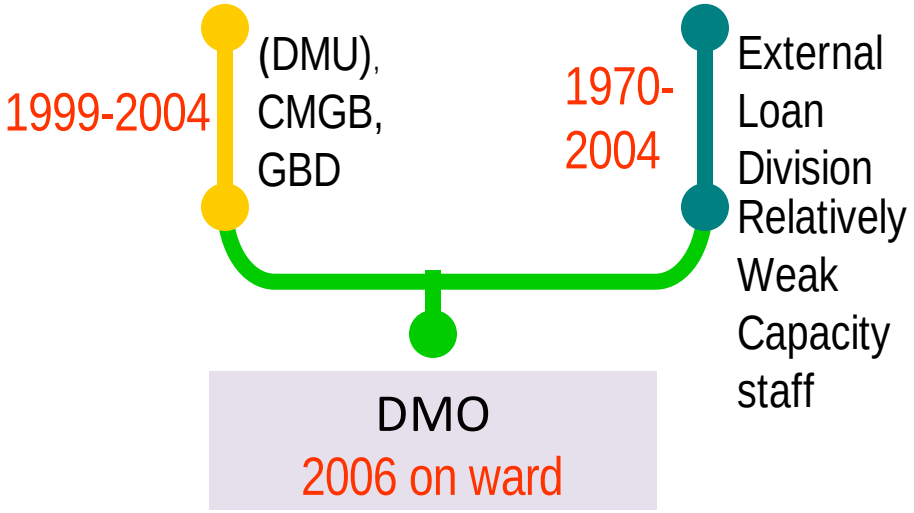
Debt Profile (trilliun Rupiah)



Reasons for the DMO Establishment in MoF

❖ Governance and Strategy Development ;

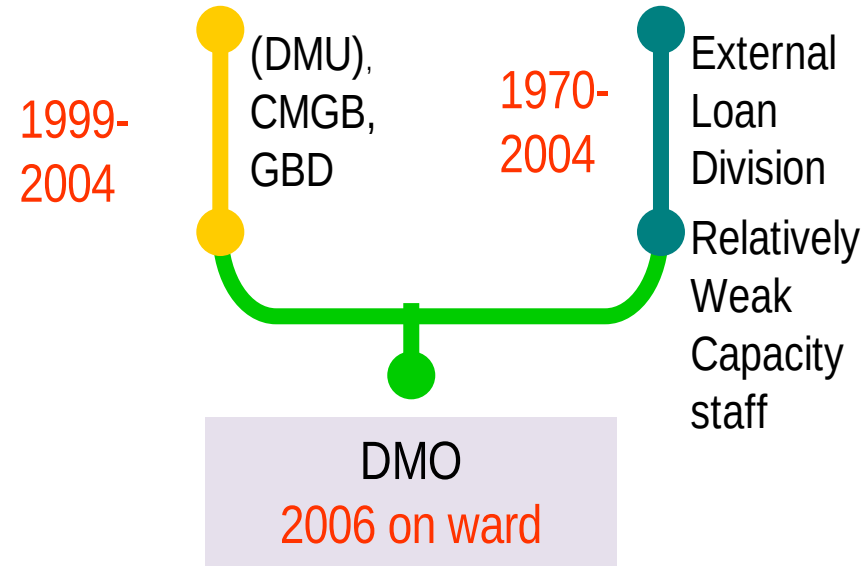
- ✓ Legal Framework (primary legislation) : Law 17/2003 on State Financial; Law 1/2004 on Treasury. Special Law 24/2003 on Government Securities;
- ✓ Managerial Structure. Central government debt is managed by to division that is separated and worked without standard guideline;



- ✓ 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.

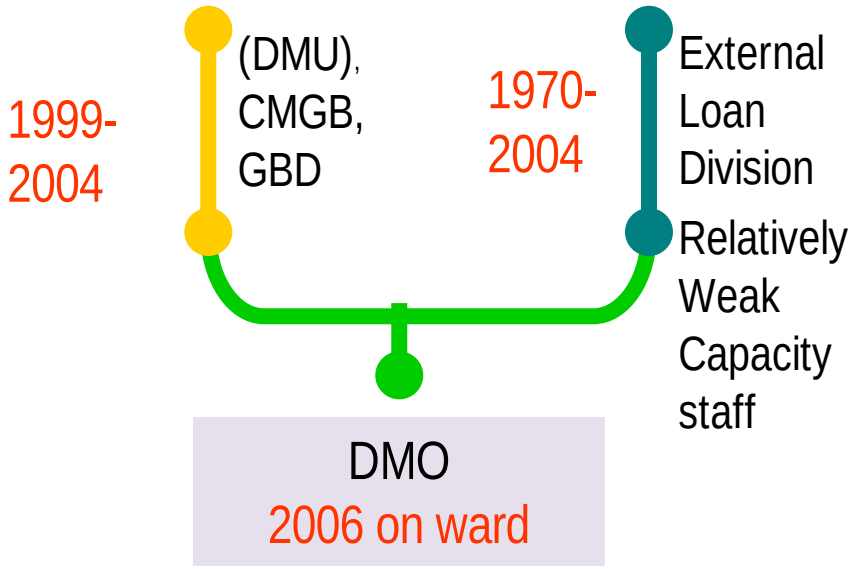
Reasons for the DMO Establishment in MoF

- ✓ Audit. Lack of capacity in external loan division in term 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;



Reasons for the DMO Establishment in MoF

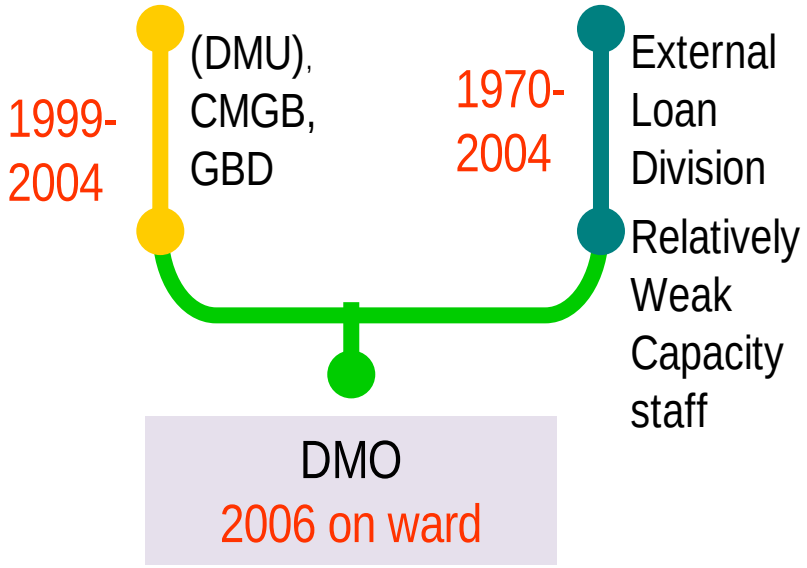
- Borrowing and Related Financing Activities.
  - ✓ Domestic Market Borrowing. DMO is needed to develop domestic bond market and broadening bond instrument in order achieve the goal of debt management strategy (2005-2009) that consists of optimum portfolio management and market development;



- ✓ 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 on lending policy; and execution of the derivatives operations.

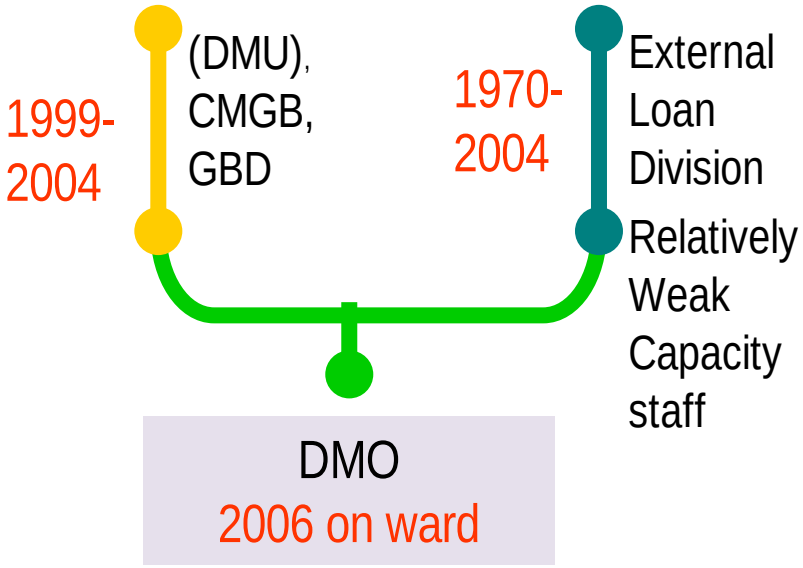


- Cash flow Forecasting and Cash Balance Management;
  - ✓ Need to have a reliability of cash forecasting, and the procedure to invest the idle cash in the market.

- 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.

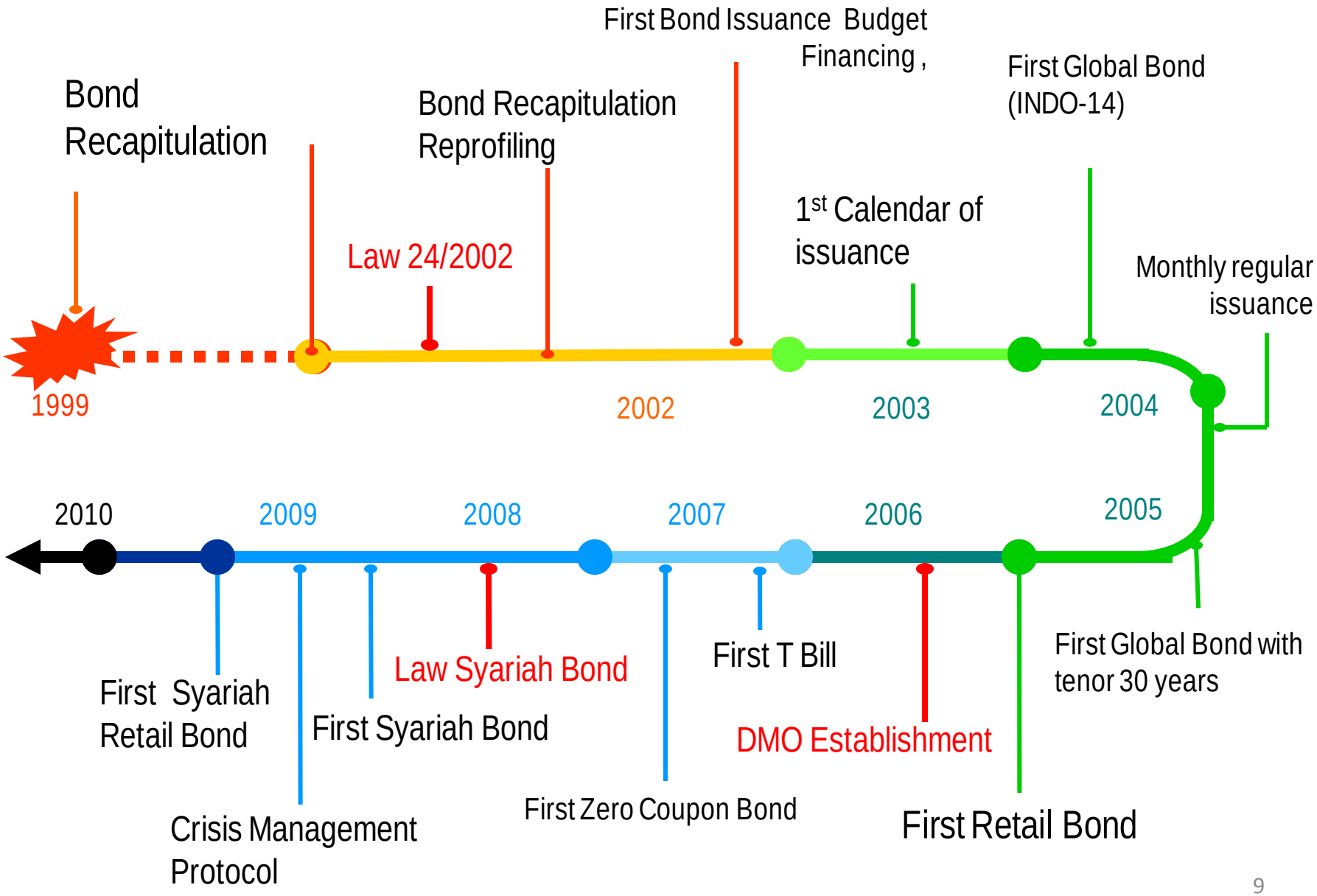
Reasons for the DMO Establishment in MoF

- 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.

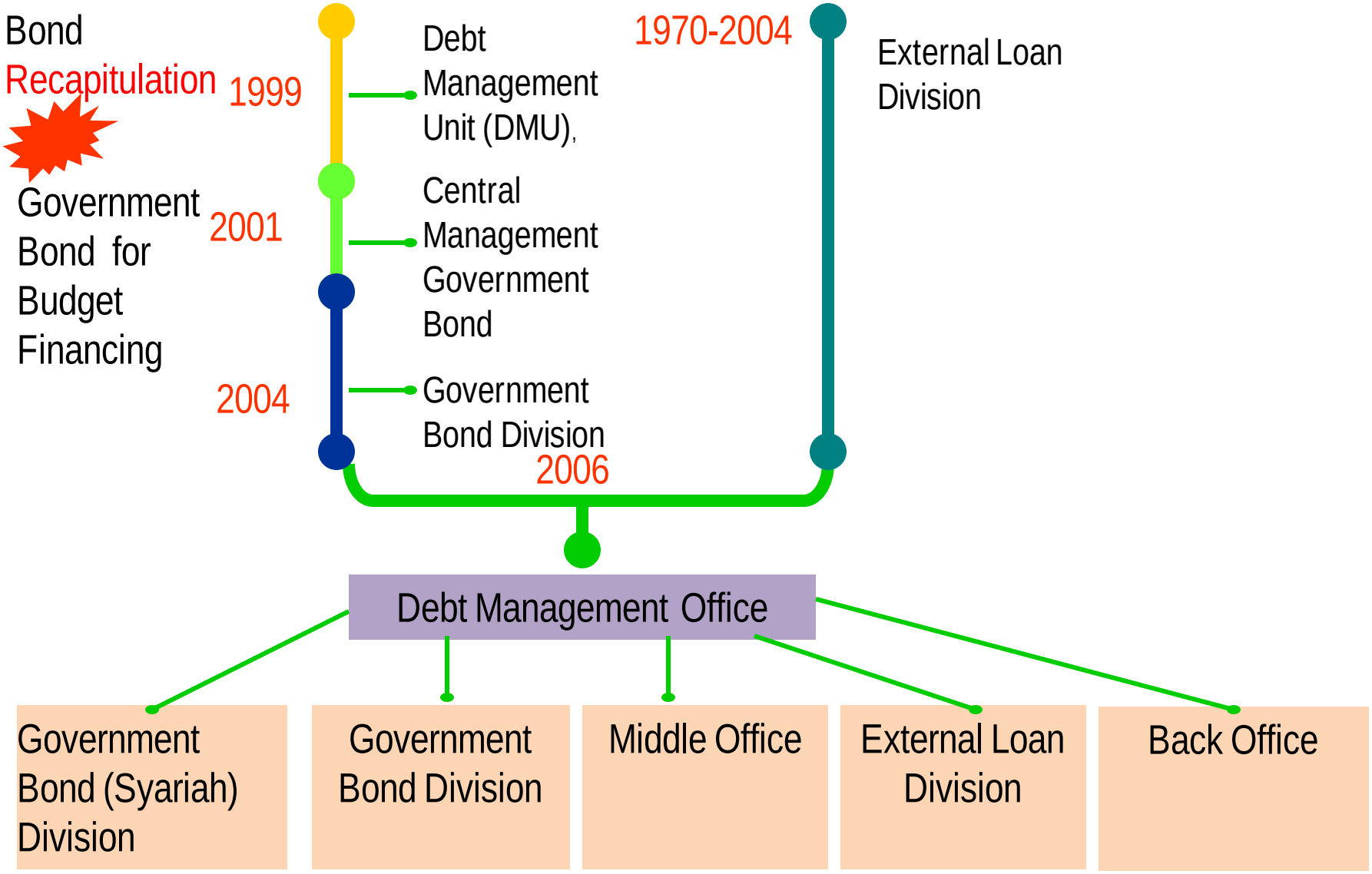


- Operational Risk Management;
  - ✓ Need to enhance the single data base of the government debt through conversion of two data recording in the similar systems (DMFAS);
  - ✓ Need to enhance the Bulletin of central government debt.

Milestone of Government Securities Management



Milestone of Indonesia Debt Management Office



The Role of External Support

AusAid

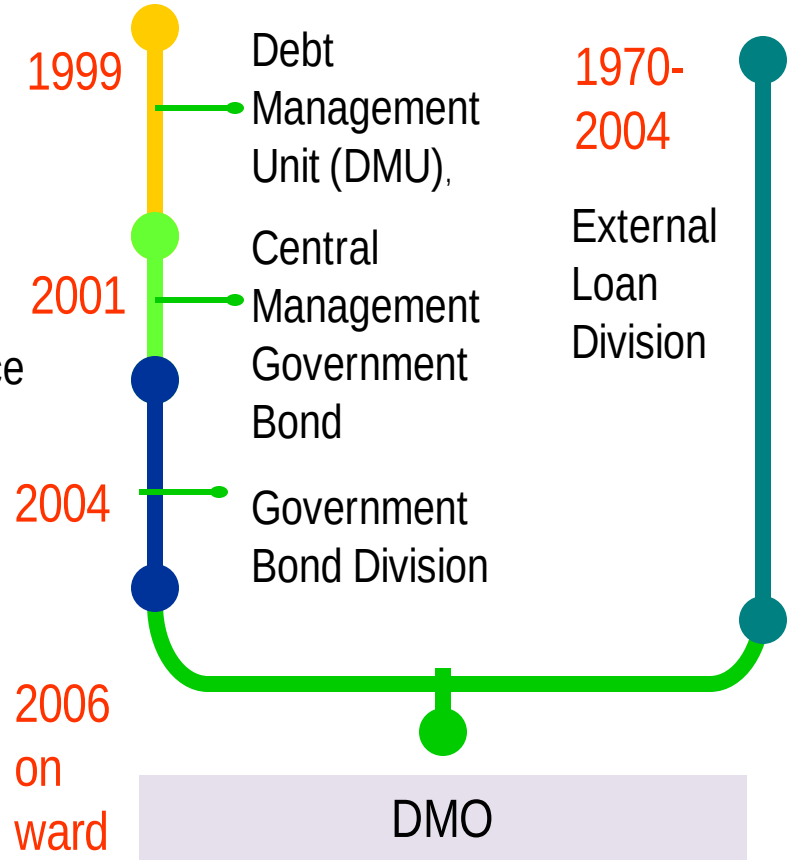
- Capacity Building on : Cost and Risk Analysis Concept;
- Debt Management Office (DMO) Concept;

World Bank

- Diagnostic Report and Implementation

SECO Switzerland

- DMFAS Ehancement Version 6.0;
- Contingent Liability Concept;
- Risk Cost Analysis



AusAid

- Concept on Foreign Aid Law
- IT gap;
- Data Library Concept.

UNCTAD

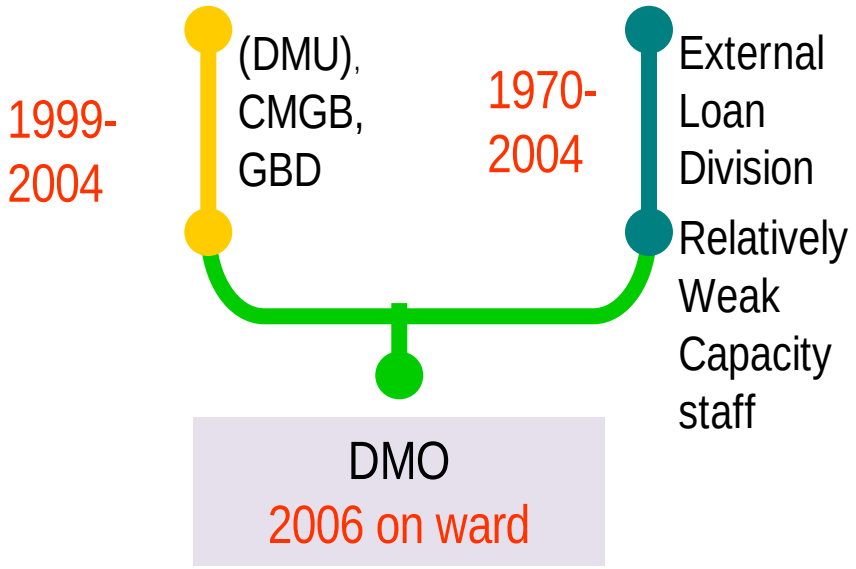
- Debt manegement Conference
- Ehancement of DMFAS.

World Bank

- ALM

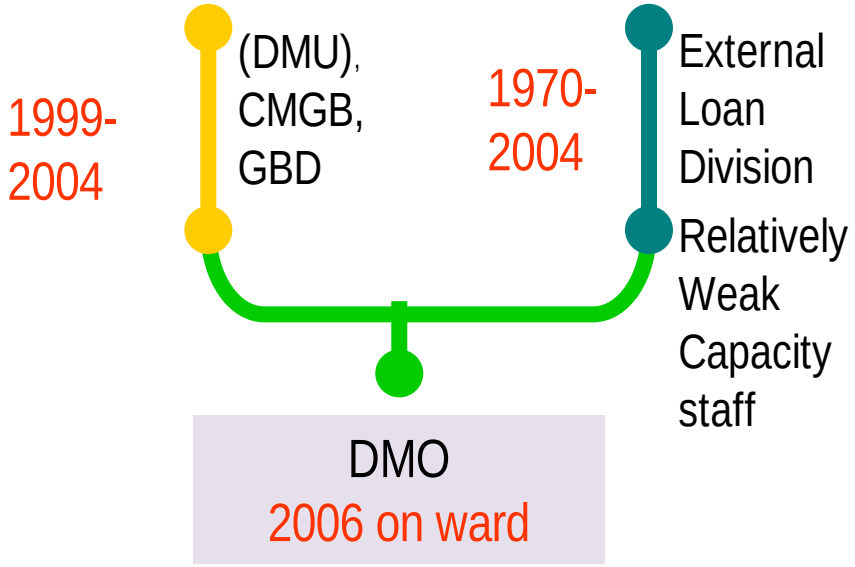
The Impact of Reform

- 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.



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;



- ✓ Better recording in the External Loan Division;
- ✓ More data reporting on cenrtal 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

ABSORPTION CAPACITY

- Widening Investor Base
- Market Deepening

EFFICIENT PRICE / YIELD

- Facilitating Efficient Price Discovery Mechanism
- Market Making

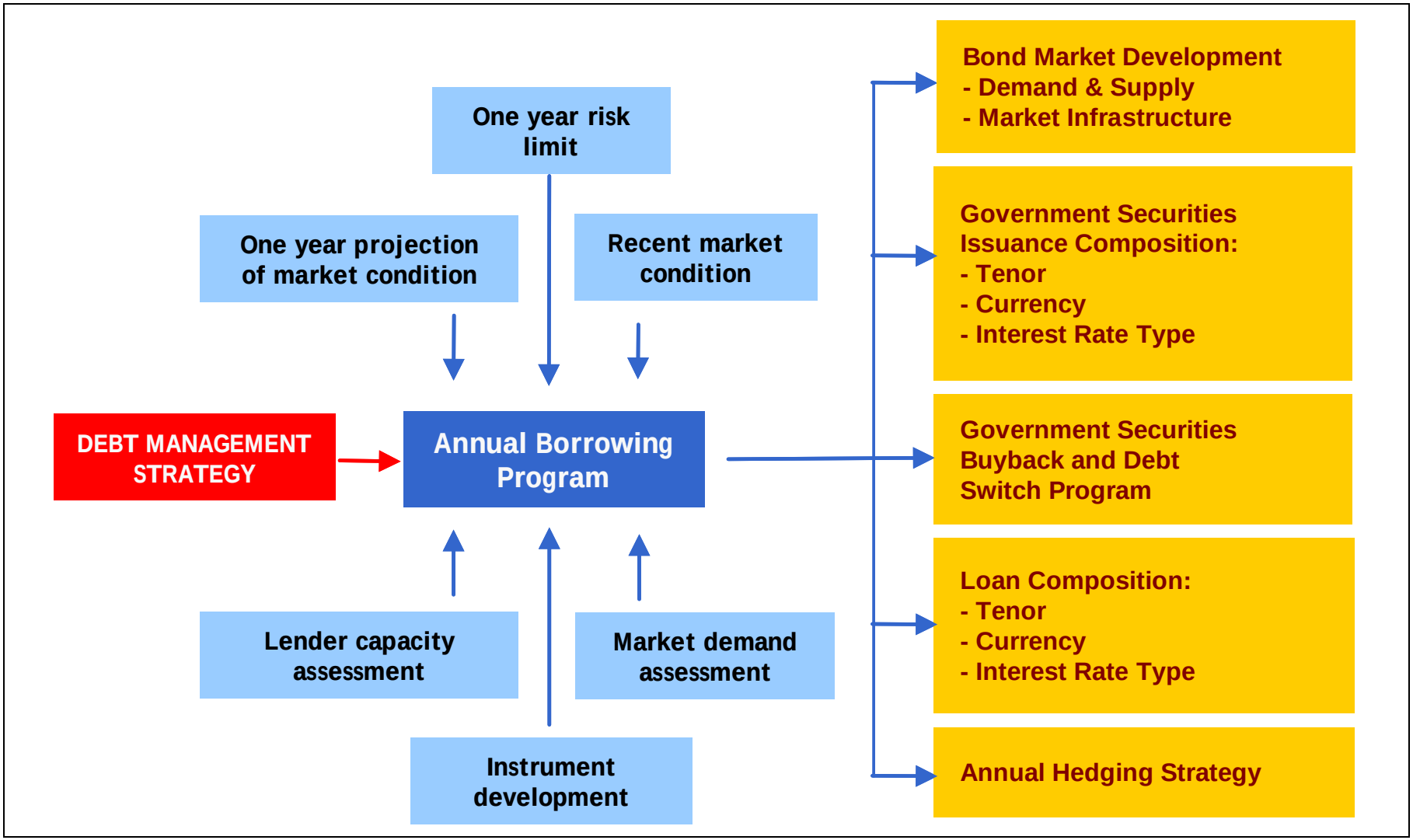
Demand & Supply

- 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

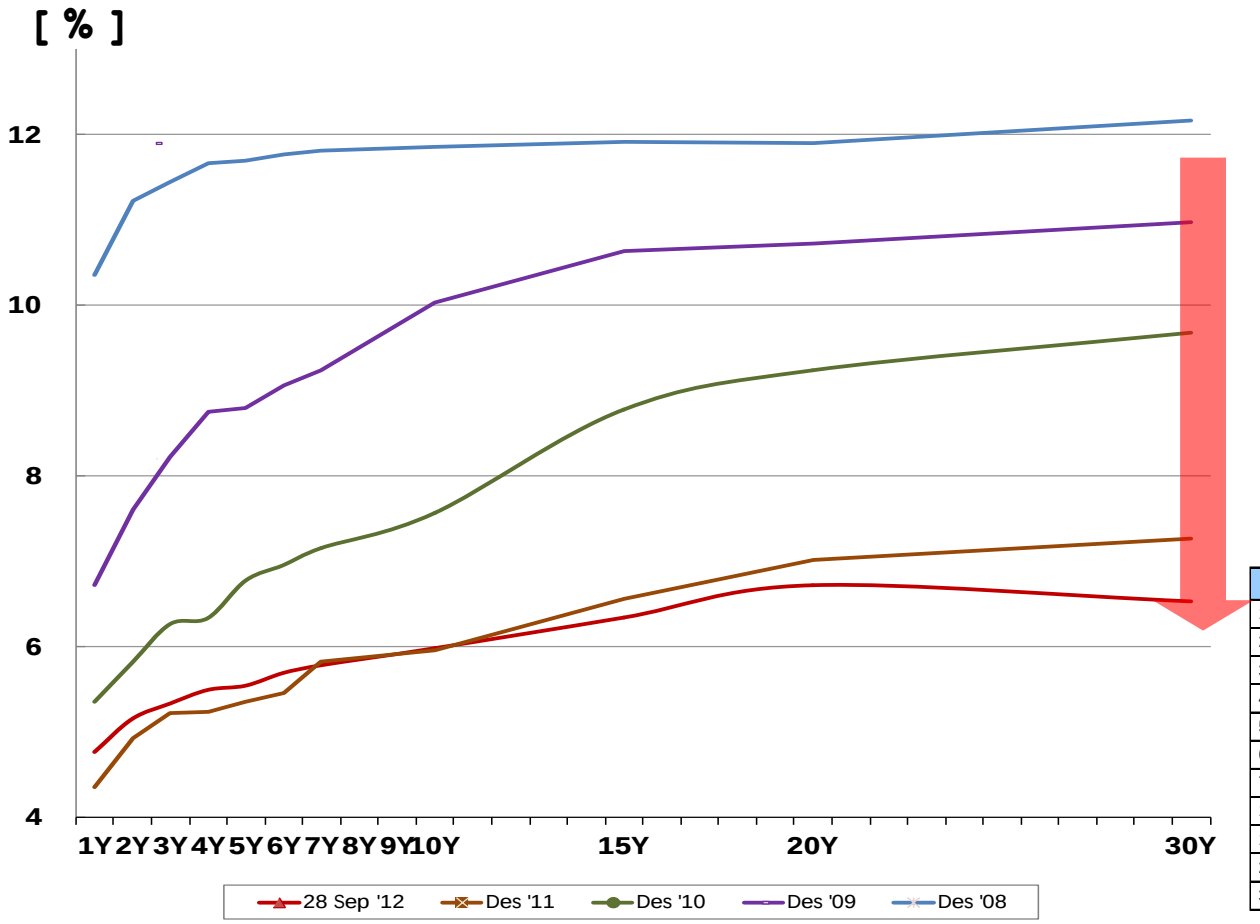
Market Infrastructure

- Transparency
- Trading platform
- Borrowing & lending facilities,
- Repo window
- Primary dealership system
- Clearing & Settlement
- Market surveillance

Formula of Annual Financing Strategy



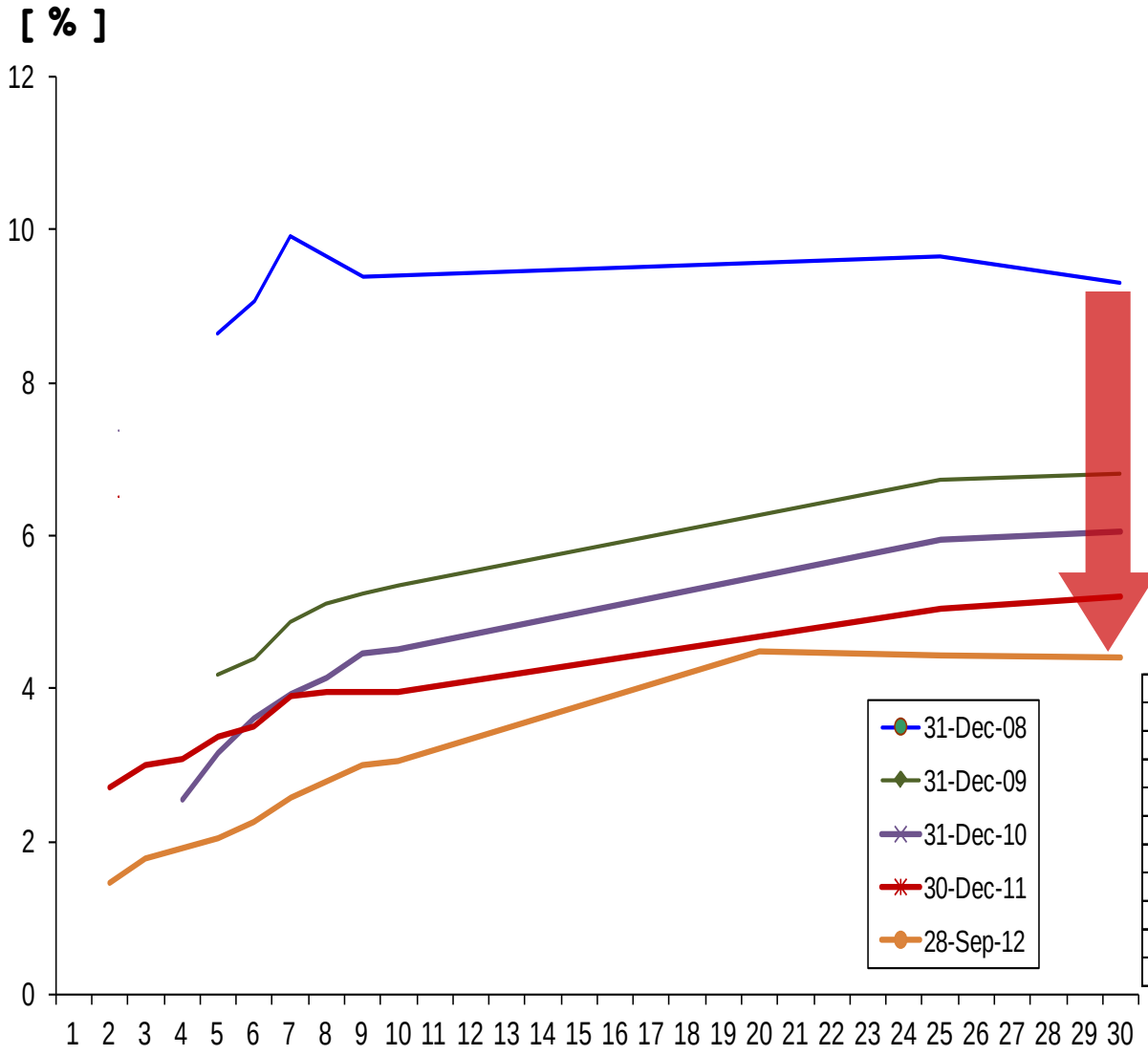
Domestic Government Debt Securities Yield Curve



Declining cost of fund of Domestic Government Securities reflects increasing market confidence as a response of prudent fiscal policy and debt management.

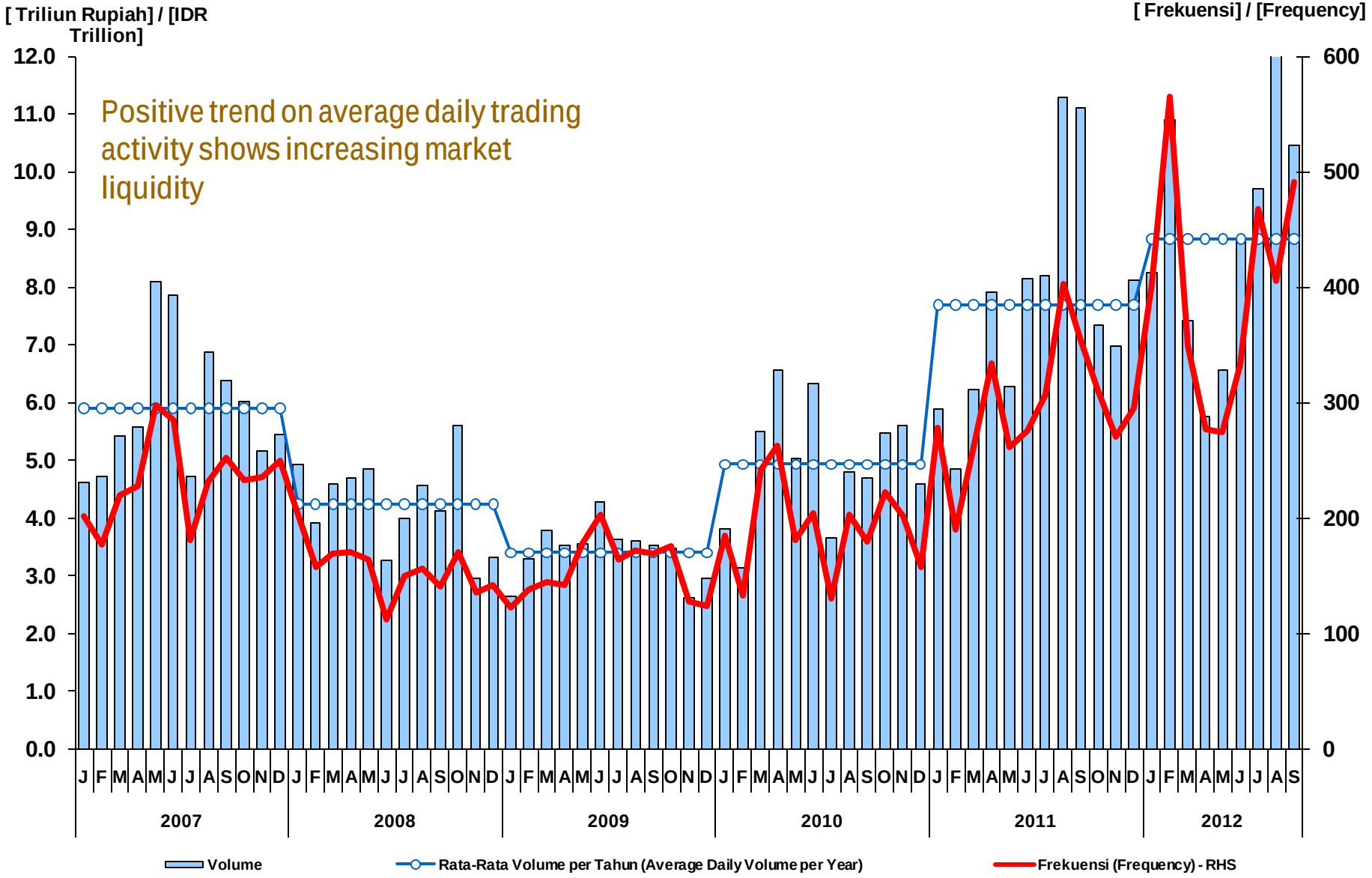
Tenor	28-Sep-12	Des '11	Des '10	Des '09	Des '08
1Y	4,76	4,35	5,36	6,72	10,36
2Y	5,15	4,92	5,82	7,61	11,22
3Y	5,33	5,22	6,27	8,23	11,45
4Y	5,49	5,24	6,34	8,75	11,67
5Y	5,54	5,35	6,78	8,80	11,70
6Y	5,69	5,45	6,96	9,06	11,77
7Y	5,78	5,83	7,16	9,24	11,82
10Y	5,98	5,96	7,57	10,04	11,86
15Y	6,34	6,56	8,78	10,64	11,92
20Y	6,72	7,02	9,24	10,72	11,91
30Y	6,53	7,26	9,68	10,97	12,17

Indonesian Global Bond Yield Curve

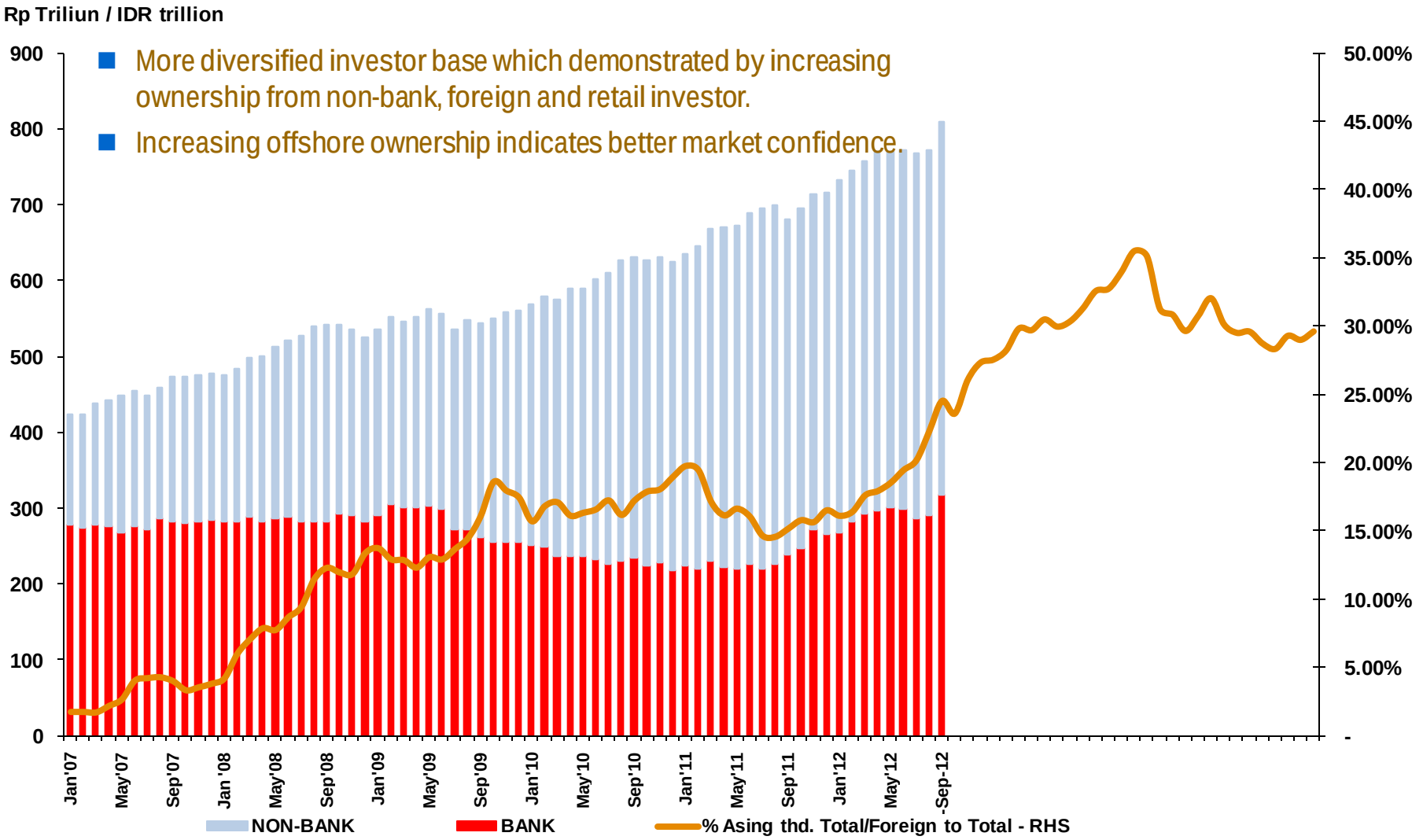


	31-Dec-08	31-Dec-09	31-Dec-10	30-Dec-11	28-Sep-12
2 Y				2,707	1,453
3 Y				2,991	1,79
4 Y			2,55	3,079	
5 Y	8,642	4,188	3,169	3,374	2,044
6 Y	9,057	4,387	3,608	3,515	2,263
7 Y	9,925	4,886	3,931	3,899	2,589
8 Y		5,107	4,146	3,955	2,788
9 Y	9,385	5,255	4,468		2,997
20 Y					4,486
25 Y	9,662	6,731	5,954	5,044	4,444
30 Y	9,321	6,806	6,065	5,201	4,402

Average Daily Trading of Domestic Gov't. Securities



Government Debt Securities Ownership

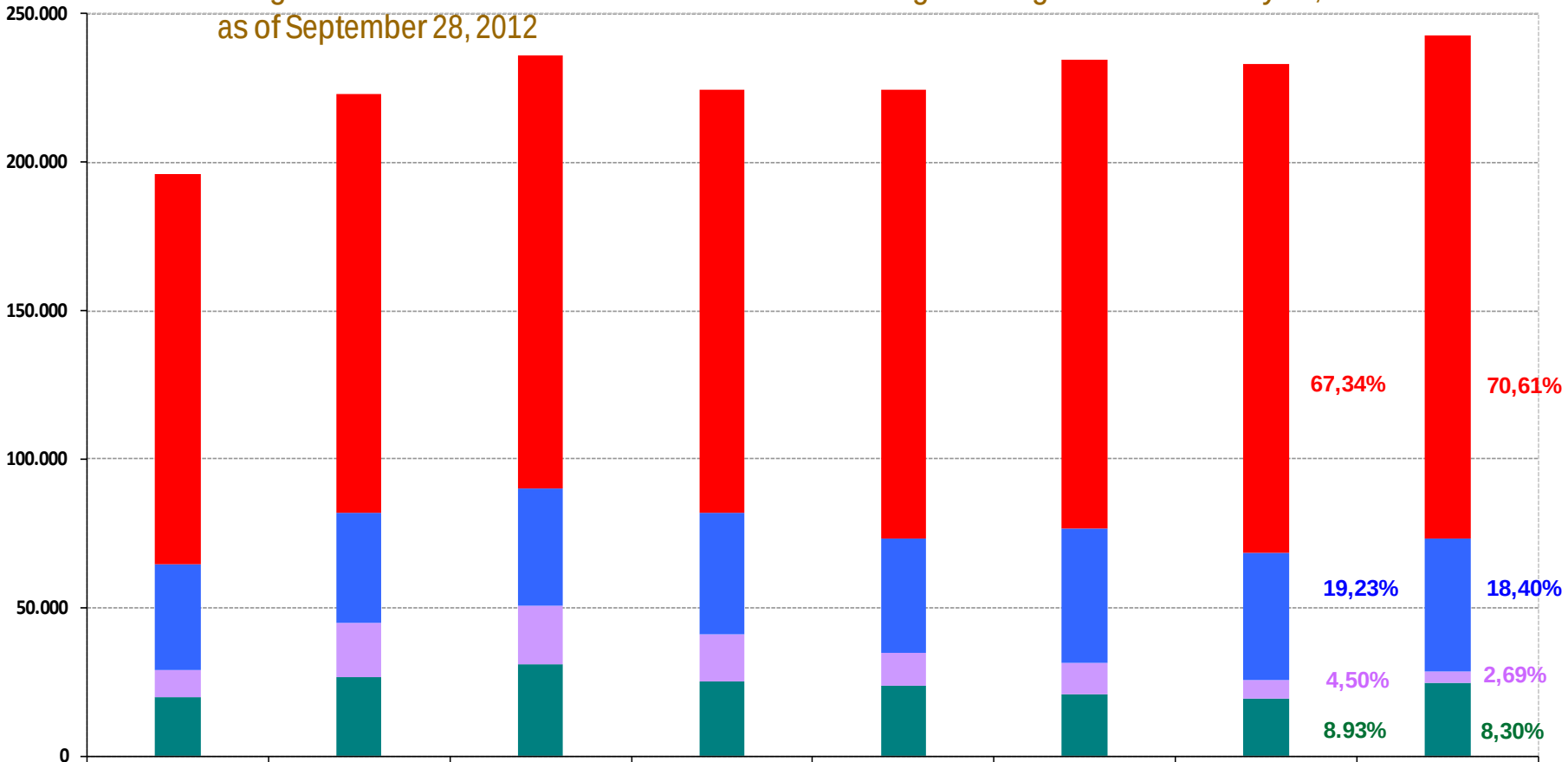


Notes: Non-Bank including Government institution

Foreign Ownership of Dom. Gov't. Securities by Tenor

[Rp miliar] / [IDR billion]

Long end Government Debt Securities dominates foreign holding which reached by 69,86% as of September 28, 2012



	December-10	December-11	January-12	May-12	June-12	July-12	August-12	28-Sep-12
Total	195.755	222.857	235.971	224.502	224.422	234.556	233.155	242.887
>5	131.232	140.762	145.759	142.470	150.943	157.951	164.624	169.691
>2-5	35.511	37.400	39.582	41.124	38.632	45.097	42.903	44.907
>1-2	9.077	18.252	19.606	15.596	11.026	10.561	6.264	3.549
0-1	19.935	26.443	31.024	25.311	23.821	20.946	19.363	24.740

Indonesia Credit Rating Performance (1)

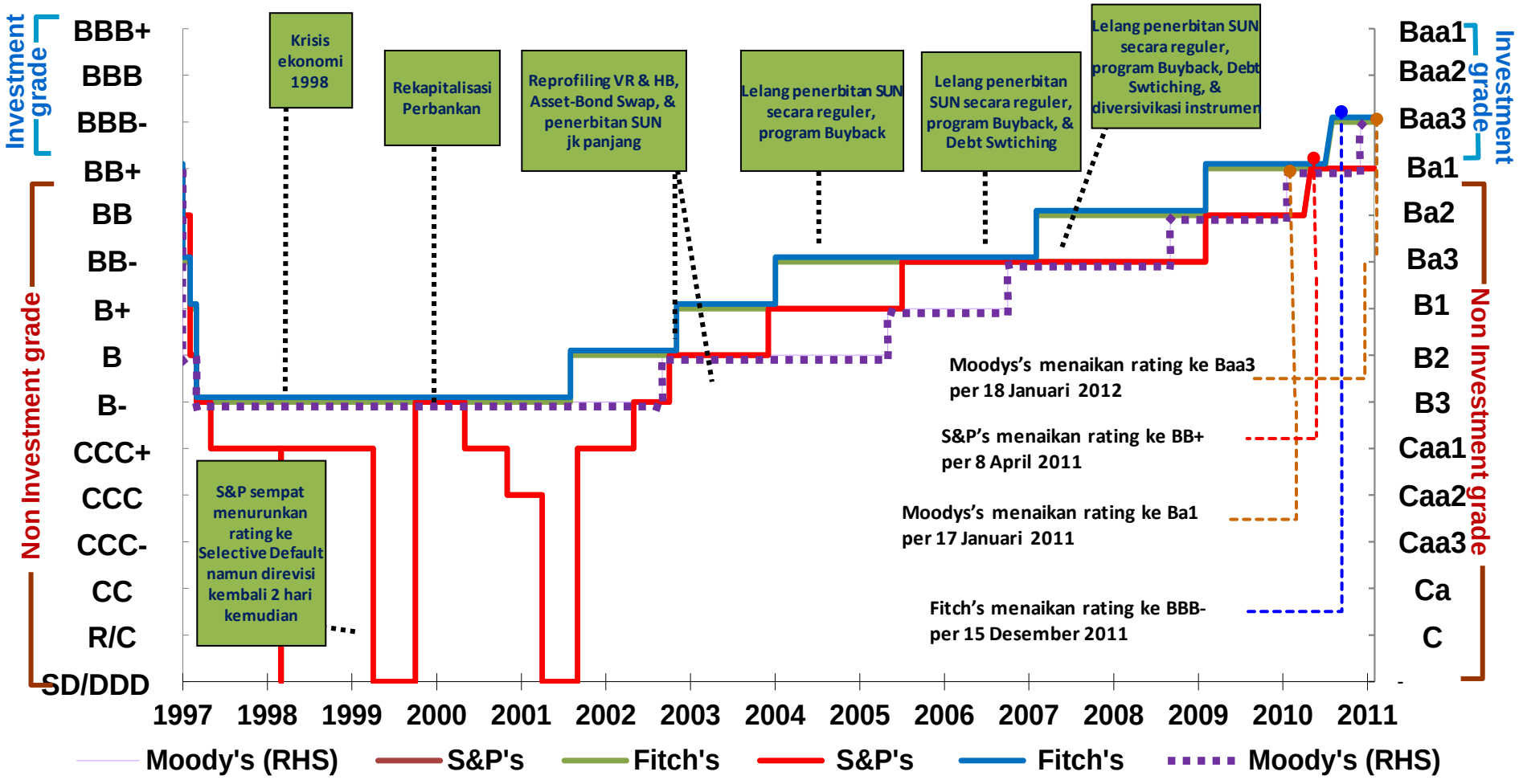
Indonesia Rating Performance 1999 - 2012

Year	Rating					
	S&P	Fitch	Moody's	R&I	JCRA	CRC
1999	CCC+	B-	B3	B-	-	6
2000	B-	B-	B3	B-	-	6
2001	CCC	B-	B3	B-	-	6
2002	CCC+	B	B3	B-	B	6
2003	B	B+	B2	B-	B	6
2004	B+	B+	B2	B-	B+	6
2005	B+	BB-	B2	BB-	B+	5
2006	BB-	BB-	B1	BB-	BB-	5
2007	BB-	BB-	Ba3	BB+	BB-	5
2008	BB-	BB	Ba3	BB+	BB-	5
2009	BB-	BB	Ba2	BB+	BB+	5
2010	BB	BB+	Ba2	BB+	BBB-	4
2011	BB+	BBB-	Ba1	BB+	BBB-	4
2012	BB+	BBB-	Baa3	BBB-	BBB-	3

on March 30, 2012, OECD upgraded CRC of Indonesia from classification 4 to 3

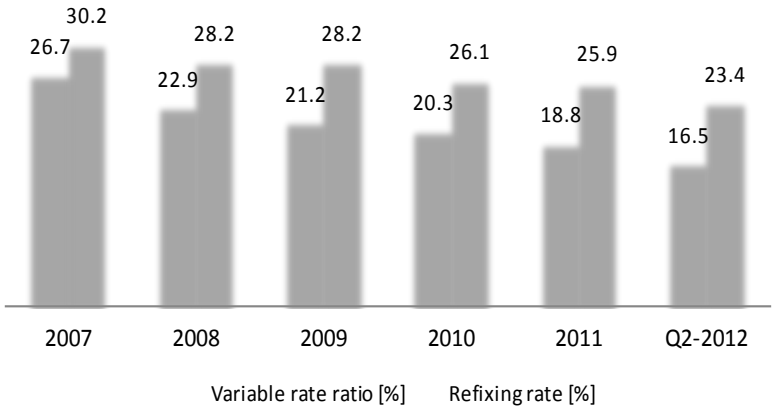
on January 18, 2012, Moody's upgraded Indonesia's Credit Rating from Ba1 to Baa3

Indonesia Credit Rating Performance (2)

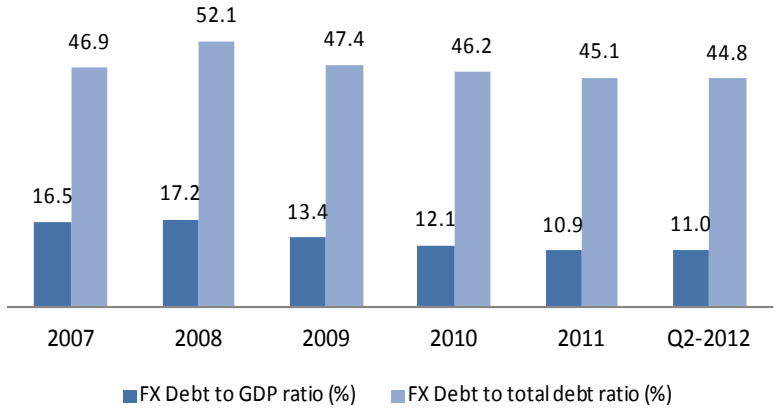


Debt Risk Indicators
2007-2011

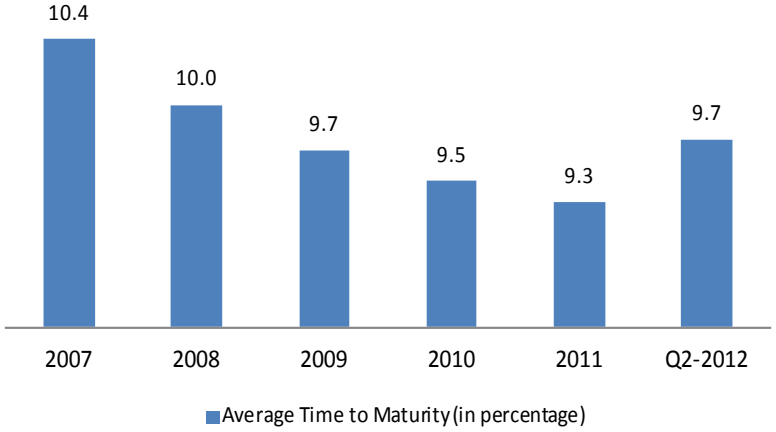
Interest Rate Risk



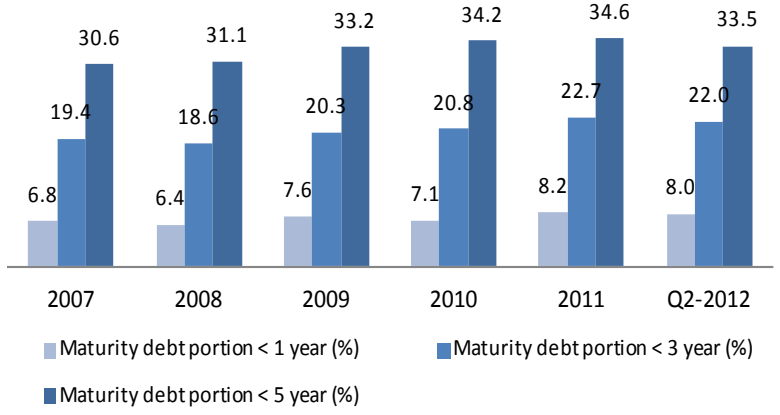
Exchange Rate Risk



Average Time To Maturity (ATM)-Years



Debt Maturing in 1, 3 and 5 Years



Pending Matters of DMO

Issues	Purposes	Remarks
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	Institutional Development
❑ Moving towards IT based debt management	❑ Development of IT systems ❑ Integrated database to support effective and reliable database ❑ Establish consolidated ALM System
❑ Improving effective and efficient risk management ❑ Reducing impact of rising cost of	❑ Development of hedging mechanism ❑ Formulating derivative instruments infrastructures ❑ Continuous improvement on debt issuance and procurement mechanisms
❑ Developing Government securities market	❑ 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
❑ Increasing resiliency of Government securities management	❑ Development of instruments to match financing needs and investors preference
❑ Business process leads to inefficiencies in loan execution	❑ Close coordination with related parties to improve loan management efficiency