

Improving Public Debt Management in the OIC Member Countries - OIC Country Studies

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Overview

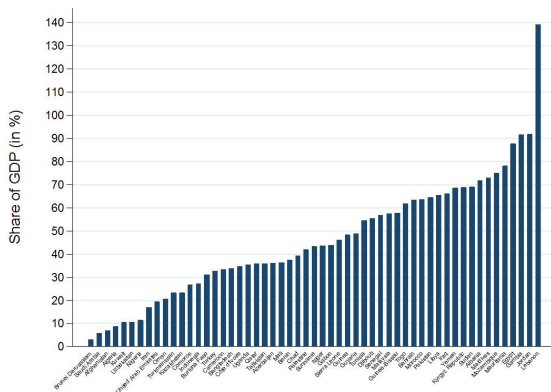
1 Public Debt Management in the OIC Member Countries

- Performance Indicators
- Institutional Frameworks
- Islamic Finance in Public Debt Management
- Lessons Learned

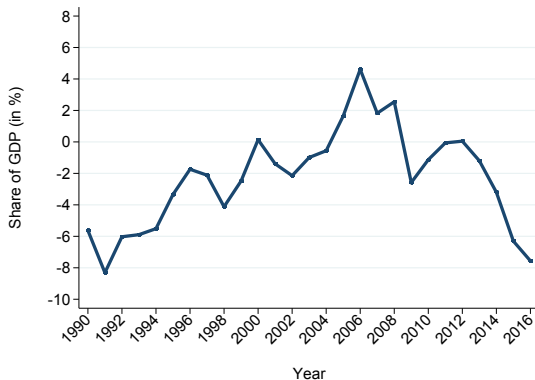
2 Selected Case-Study Countries

3 Policy Recommendations

Gross Public Debt-to-GDP Ratios in OIC Member Countries

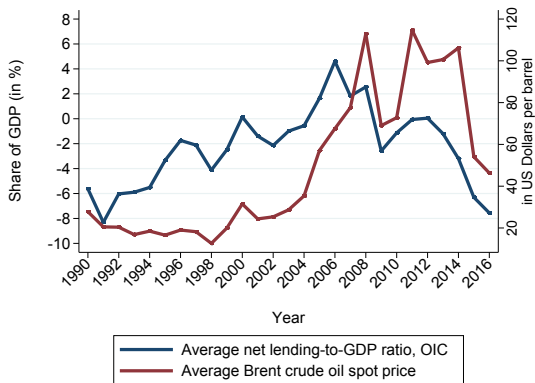


- Range of gross public debt-to-GDP ratios: from 3% to 139%
- Debt characteristics among OIC member states very heterogeneous



Almost constantly negative net lending rates, i.e. government deficits

Average Net Lending-to-GDP Ratio in OIC Member Countries



High correlation between net lending and oil price

Debt Management Strategies in OIC Member Countries

Formal debt management strategy?

yes: ca. $\frac{2}{3}$

no: ca. $\frac{1}{3}$



Main Institutions:
Debt Management Office, legal
frameworks, transparency

Use of strategic targets?

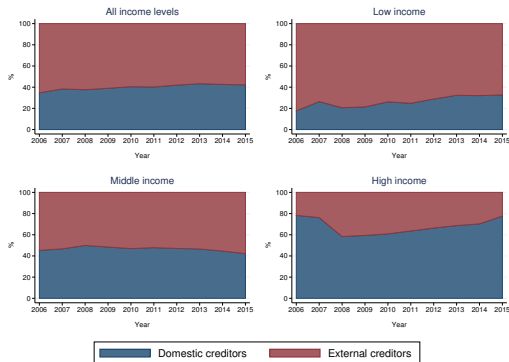
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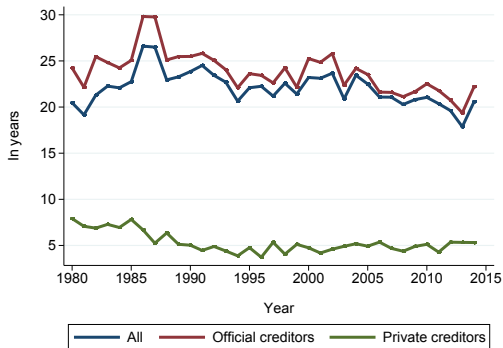
Main Targets:
currency risk, refinancing risk,
interest rate risk

Creditor Structure of Public Debt in OIC Member Countries



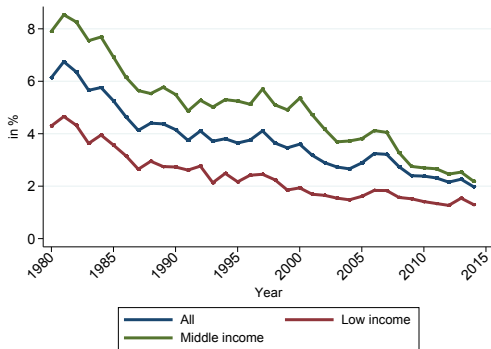
- Relatively stable creditor composition, slight increase of domestic investors
- Foreign-denominated external debt: U.S. Dollar (ca. 65%), Euro (ca. 20%)

Maturity of New External Debt Issuances in OIC Member Countries



- Average maturity fluctuating around 22 years
- But: credit extension period by private investors on average only 4-5 years

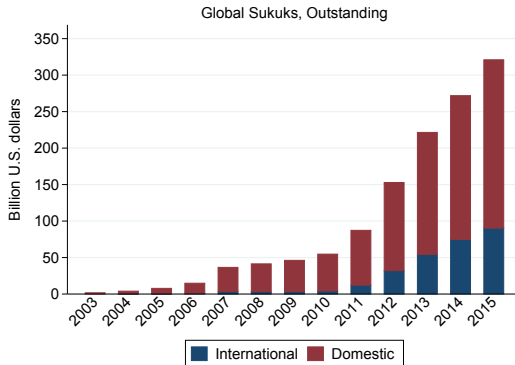
Nominal Interest Rates on Public Debt in OIC Member Countries



- Strongly declining nominal interest rates
- Decreasing spreads between different income groups

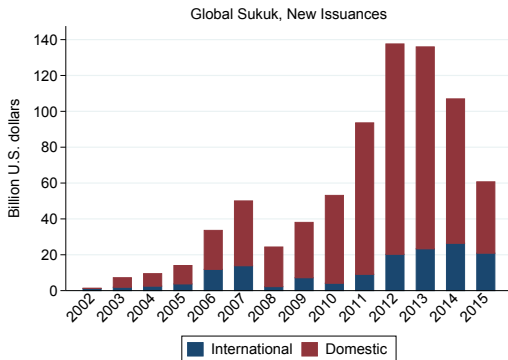
ISLAMIC FINANCE IN PUBLIC DEBT MANAGEMENT

Global Sukuk Outstanding



Exponential growth of outstanding sukuk volume during last 15 years

Global Sukuk Issued



- Significant increase in this decade
- Greater participation of international investors

The chart shows a significant increase in Sukuk issuance starting around 2006, peaking in 2012 and 2013 at nearly 140 billion U.S. dollars, followed by a decline in 2014 and 2015. Sovereign issuers are the dominant category throughout the period.

Year	Sovereign (Billion U.S. dollars)	Quasi-Sovereign (Billion U.S. dollars)	Corporate (Billion U.S. dollars)	Total (Billion U.S. dollars)
2002	0.5	0.0	0.0	0.5
2003	1.0	0.0	1.0	2.0
2004	1.0	0.5	1.5	3.0
2005	2.0	0.5	2.5	5.0
2006	5.0	0.5	10.0	15.5
2007	8.0	0.5	25.0	33.5
2008	10.0	0.5	12.0	22.5
2009	22.0	2.0	12.0	36.0
2010	35.0	2.0	15.0	52.0
2011	68.0	5.0	22.0	95.0
2012	88.0	12.0	30.0	130.0
2013	92.0	5.0	35.0	132.0
2014	72.0	12.0	18.0	102.0
2015	28.0	10.0	22.0	60.0



Case Study: Malaysia - A Leader in Sukuk Financing

Past:

First modern Sukuk issuance worldwide in 1990 by Malaysia Shell
Early sovereign Sukuk issuance in 2002 by Malaysian government

Presence:

Accounting for over $1/2$ of global sovereign sukuk volume
A3 ("upper medium grade") rating by Moody's

Future:

Strategic targets specifically for Islamic public finance instruments
+19% projected average annual growth rate of the Islamic banking sector until 2019

LESSONS LEARNED

Lessons Learned

- ① Public balance ratios under pressure
→ Greater challenges for public debt management in the future
- ② Higher diversification in investor base and maturities reduces risks
→ Formal public debt management strategy beneficial
- ③ Accelerating growth in Islamic finance assets
→ Sukuk as promising financing instrument for public debt

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Case-Study Selection Procedure

Choice of 11 countries for **detailed desk-research**:

- The Gambia, Mozambique, Togo, Uganda, Egypt, Nigeria, Sudan, Albania, Lebanon, Turkey and Saudi Arabia

→ Representation of all OIC regional and income groups

Field visits to 4 countries for personal interviews and data checks:

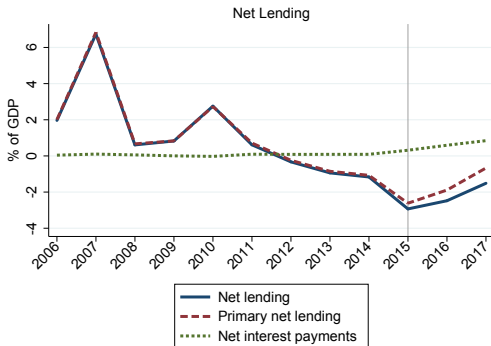
- Iran, Oman, Indonesia and Kazakhstan

→ Diverse opportunities and challenges for public debt management



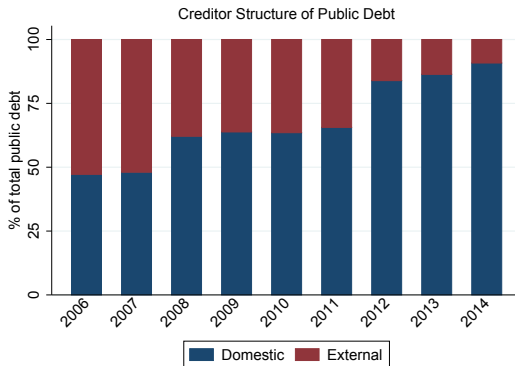
The Islamic Republic of Iran

Case Study: Iran - Innovator in Islamic Finance Instruments



- Almost no net interest payments due to low debt-to-GDP level of around 15%
- International sanctions impacting public debt management
- Financial system considered fully sharia-compliant

Case Study: Iran - The Impact of Sanctions



Rapid change of creditor composition following sanctions since mid-2000s

⇒ Strategy to external creditor shocks needed

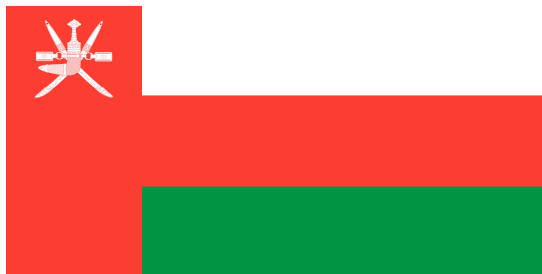
Case Study: Iran - Innovator in Islamic Finance Instruments

Islamic Treasury Bills:

- Zero coupon bonds with 1-year maturity sold at discount to face value
- Profit non-taxable, traded over-the-counter at Iran Fara Bourse
- Used for short-term cash management, securing government's liquidity

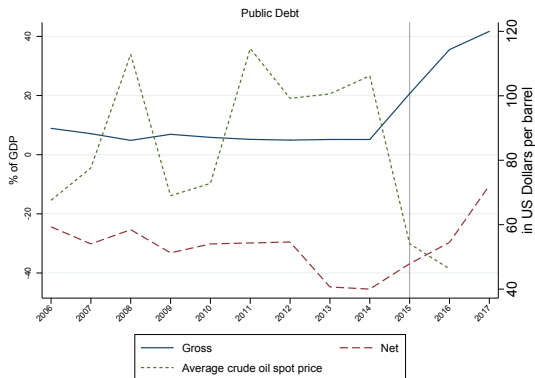
Operating Ijarah:

- 'Leasing contract' with right to use an asset for a specified period in return for a consideration
- Acquisition of the asset by state, no transfer of legal title to lessee



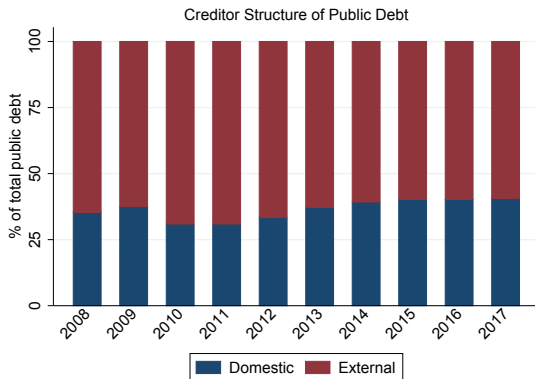
The Sultanate of Oman

Case Study: Oman - Impact of Oil Price Changes



- Negative correlation between oil price and net public debt
- Development of new medium-term debt management strategy

Case Study: Oman - Creditor Structure



Potential for more international investments

Case Study: Oman - New Medium-Term Public Debt Strategy

Revenue diversification

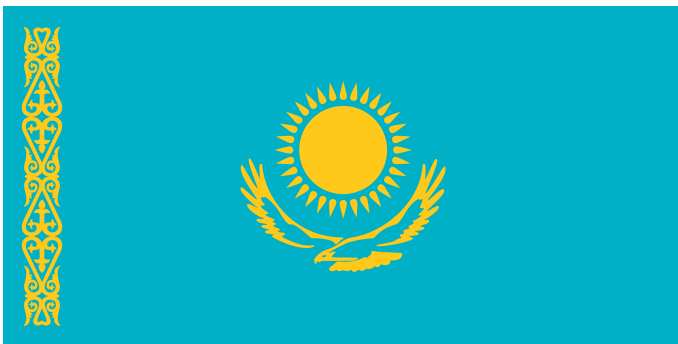
Strong dependence on oil industry ⇒ Promotion of 5 non-oil economic sectors
 Privatization of state-owned enterprises
 Introduction of value-added tax

Managerial structure

Cash management at Treasury ⇒ Centralized Debt Management Office
 Debt management at Loan Department
 Front office at Central Bank

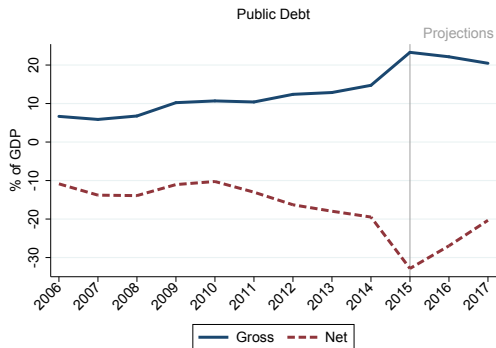
Information management

Internal documentation procedures ⇒ Modern data management system
 Improvable level of transparency Technical assistance program in cooperation with World Bank



The Republic of Kazakhstan

Case Study: Kazakhstan - Debt Level Control



- Debt levels under control, despite severe exchange rate turbulences
- Less sensitivity to oil price changes despite high natural resources dependency

Case Study: Kazakhstan - Division of Management Tasks

Short-Term Coordination and Debt Policies:

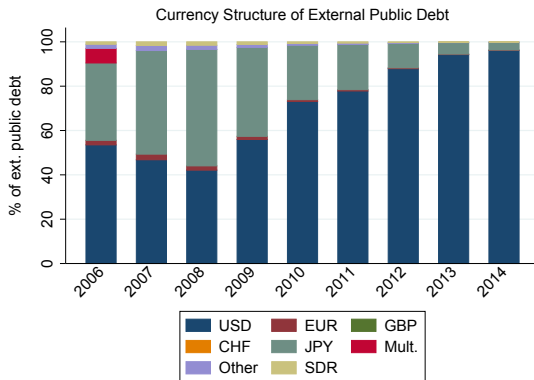
- High-level strategy development with President, Prime Minister, and concerned Ministers of Finance and Economic Affairs
- Representatives of international institutions invited as observers

Long-Term Debt Management:

- Division of operational functions between Ministries of Finance and Economic Affairs
- National Bank of Kazakhstan responsible for short-term lending, and administration of pension and national oil funds

⇒ Potential for centralizing back office capacities

Case Study: Kazakhstan - Currency Dependency



Very high share of US Dollar due to loans from international institutions

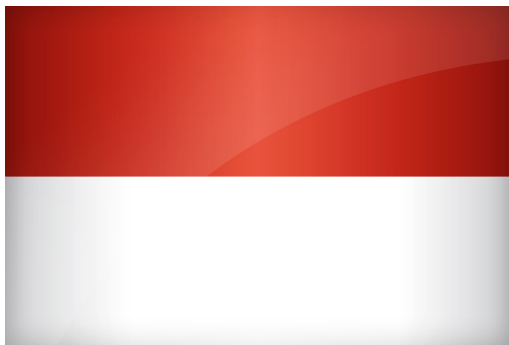
Case Study: Kazakhstan - Strengthening Public Debt Markets

Introducing Sovereign Sukuks:

- Introducing more vigorously Islamic finance instruments
- Expanding investment opportunities for additional finance resources

Further Development of National Oil Fund:

- Building up powerful financing source based on sustainable investment strategy
- Relieving the pension fund system from mandatory public debt financing



The Republic of Indonesia

Case Study: Indonesia - Profound Governance Structure

Legal framework:

- **Regulatory laws** on state finances, incl. sharia securities or fiscal responsibility
- Annual debt financing and medium-term **debt management strategy**
- Debt issuing bounded by budgetary process and **parliamentary approval**

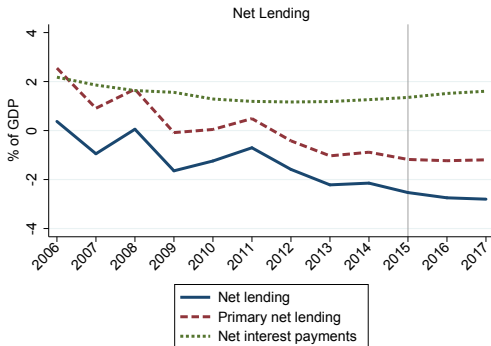
Managerial structure:

- **Centralized DMO** at Ministry of Finance
- **7 specialized departments** and additional office for general support
- Management targets in **performance contracts** for public debt managers
- **Policy coordination** with Ministry of Planning and central bank

Debt reporting:

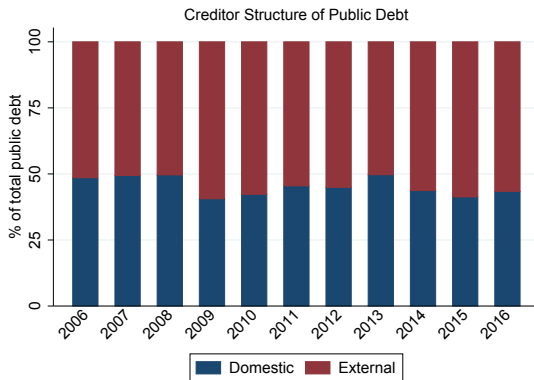
- Important **documents available online** in Indonesian and English
- Provision of **debt profile data** incl. maturity, external debt or securities trading

Case Study: Indonesia - Well Balanced Debt Portfolio



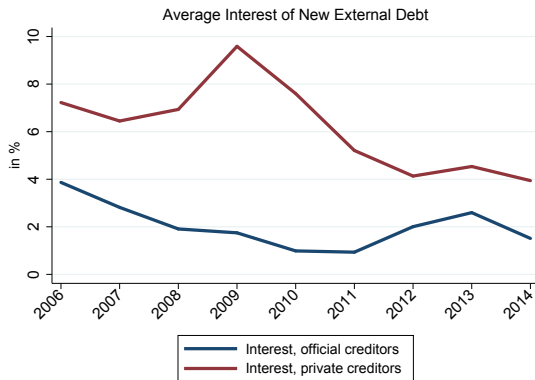
- All main public debt indicators not exceeding critical values
- Gross public debt less than 30% of GDP

Case Study: Indonesia - Well Balanced Debt Portfolio



Balanced share of domestically and externally funded debt

Case Study: Indonesia - Well Balanced Debt Portfolio

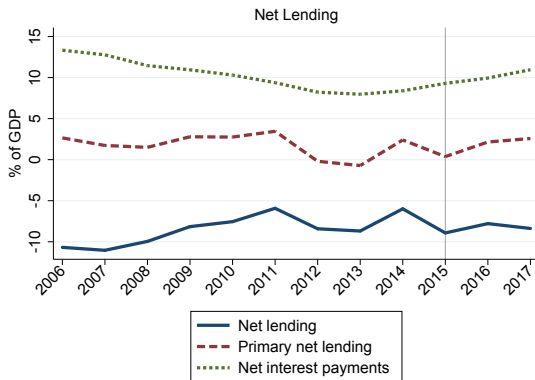


⇒ Good portfolio management paying off in low interest rates



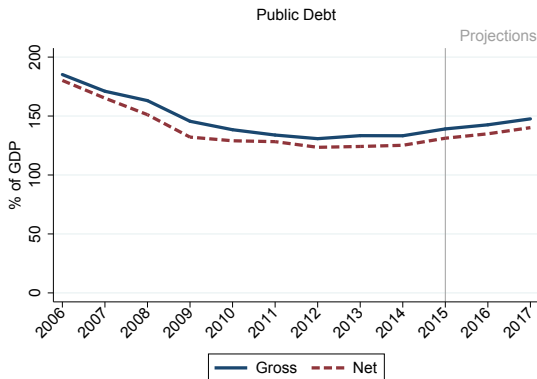
The Lebanese Republic

Case Study: Lebanon - Fiscal Sustainability



Mostly positive primary budget balance, but very high interest payments

Case Study: Lebanon - Fiscal Sustainability



- Lebanon with highest public debt-to-GDP ratio among all OIC member states
- Significant refinancing risk due to high roll-over of maturing debt

Case Study: Lebanon - Debt Currency Swap

In summer 2016: currency swap of public debt worth US\$3 billion

Procedure by Banque du Liban (BDL):

- ① BDL exchanged Lebanese Pound-denominated debt for US Dollar-denominated Eurobonds from Ministry of Finance
- ② Private banks asked to transfer US Dollars to BDL in exchange for new Eurobonds
- ③ BDL bought Lebanese Pound-denominated T-bills held by private banks at premium discount

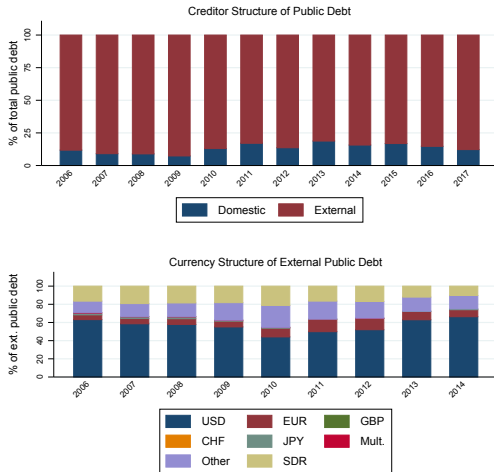
Results:

- Increase of foreign currency debt by +7%
- Lower interest rate on Lebanese Pound-denominated bonds
- Stronger foreign currency reserves of BDL
- Profits for banks in local currency, usable for higher capital adequacy ratio



The Republic of Mozambique

Case Study: Mozambique - Foreign Funding Dependency



Sources: World Bank International Debt Statistics (2016), IMF World Econon

Case Study: Mozambique - Importance of Transparency

Early April 2016:

Restructuring of US\$700 million so-called 'Tuna Bond' yielding ca. 14%

Mid April 2016:

US\$1.4 billion (10.7% of GDP) in previously undisclosed government debt discovered

→ Immediate -6.5% drop of bond price, +4 basis points on interest rate

→ IMF, World Bank & major bilateral donors questioning financial aid programs

August 2016:

IMF calling for independent, international debt audit

October 2016:

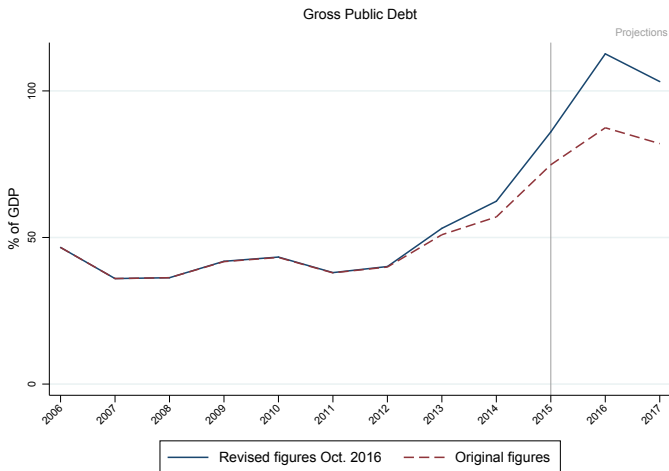
-60% depreciation of local currency against US\$

Interest rates reaching 21% due to fiscal uncertainty

Mid January 2017:

Default on 'Tuna Bond', high fiscal stress

Case Study: Mozambique - Importance of Transparency



Case Study: Mozambique - Importance of Transparency

Lessons learned

- ① Communication and transparency as key aspects for foreign investors
- ② Up-to-date data recording system vital for public debt management
- ③ High exchange rate risk if strong dependency on foreign currency-denominated debt

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Bundling Competencies, Institutional Arrangements and Transparency

Centralize and strengthen institutional framework



Develop a medium-term **public debt management strategy** incl. quantitative targets

Create a centralized **Debt Management Office**

Increase **transparency** incl. debt data and reports, issuance procedures, strategies

Strengthen domestic debt markets



Establish profound **legal and regulatory frameworks** with clear accountabilities

Improve **information availability** on debt operations and strategies

Strengthen (domestic) **Islamic finance**

Reduce reliance on the private domestic banking sector

Investor Relations and Risk Management

Diversify investor base



Grant **pension funds**, **insurance companies**, **retailers** and strategic investors access to local debt market

Balance creditor structure by issuing Eurobonds or foreign currency-denominated Sukuks

Mitigate refinancing risk



Increase the share of **long-term bonds** over short-term bills

Realize swaps of domestic-currency to **foreign-currency debt** with longer maturity

Implement **macroeconomic risk management** based on early warning indicators

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