THE WORLD BANK
Treasury | IBRD • IDA

CASE STUDY

Proactive Financial Risk Management Helps Indonesia Manage Currency and Interest Rate Risks

Indonesia converted USD 700 million of outstanding IBRD loans to EUR with fully fixed interest rates in line with its financial risk management approach and debt management strategy. The currency conversions executed by the World Bank may save Indonesia USD 177[1] million.

Jakarta downtown skyline with high-rise buildings at sunset
Adobe Stock- By amadeustx

Background

After the Asian financial crisis in the late 1990s, the government of Indonesia adopted a conservative approach to public debt management to increase resilience to financial shocks and navigate future global crises.

Indonesia's debt management strategy focuses on i) managing its debt-to-GDP ratio at a safe level, ii) maximizing domestic financing sources and utilizing external financing as a complement, iii) developing financing instruments and deepening the investor base to fulfill financing needs, iv) using debt instruments to finance projects/programs that support national development programs, v) coordinating debt risk management through the Assets and Liabilities Committee, vi) using hedging or liabilities management mechanisms to manage debt service fluctuations or to achieve optimum portfolio management, vii) supporting infrastructure development through the PPP scheme and the guarantee mechanism, viii) increasing transparency of debt management and guarantee-liabilities through periodic publication and public dissemination.[2] A key directive of Indonesia's 2023-2026 Medium-Term Debt Strategy (MTDS) is to ensure that at least 80% of the debt is at a fixed rate.

Indonesia's debt portfolio is dominated by USD-denominated debt. Financial analysis conducted by the Ministry of Finance flagged opportunities to reduce vulnerabilities to currency risk, meet targets for currency composition, and achieve the desired balance between fixed and variable rate debt.

Financial Objective

Help the Government of Indonesia manage currency and interest rate risks on its debt portfolio.

Financial Solution and Outcomes

Indonesia is one of the largest borrowers of IBRD loans. As of June 2021, 95% of Indonesia's IBRD loans was denominated in USD. The World Bank Treasury assessed opportunities to convert a share of Indonesia's USD loans into EUR or JPY. At the request of the Indonesian Debt Management Office, the World Bank Treasury executed market transactions to convert two outstanding loans totaling USD 700 million from a variable rate denominated in USD to a fully fixed rate in EUR. The conversion primarily aimed to mitigate currency risk during a timely window of opportunity when the environment allowed. It reduced the share of Indonesia's USD obligations to the World Bank to 92%. To further reduce USD-denominated liabilities exposure, Indonesia

[1] The potential savings are based on the estimated interest to be paid over the life of the loans (based on forward FX and interest rates as of July 6th, 2023). The actual savings at final maturity may be higher or lower depending on the FX and interest rates trajectory.

[2] Source: Ministry of Finance, Indonesia

diversified the currency composition of its IBRD loan portfolio by opting for new loans in other currencies mainly in EUR or JPY. As of August 2023, Indonesia has decreased the share of USD-denominated obligations to 86%. The conversions also allowed the debt management office to reduce the share of variable rate IBRD loans from 93% to 90%.

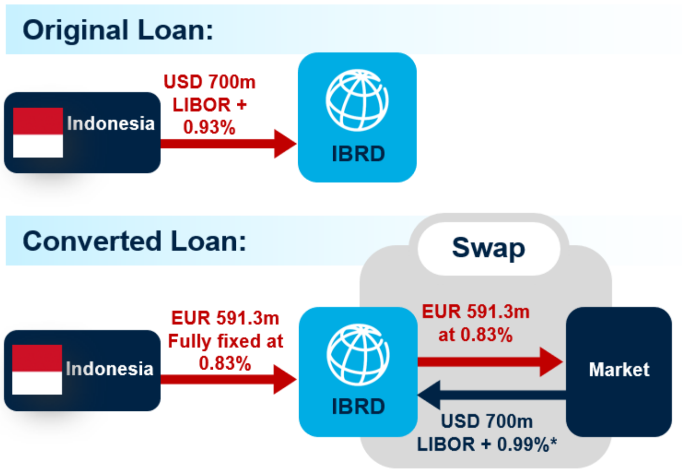
Conversion options between major currencies and select local currencies are embedded features of the IBRD Flexible Loan, making it possible for borrowers to manage currency and interest rate risks without entering into hedging transactions directly with market counterparties.

The loan conversions for Indonesia may generate potential savings of USD 177 million over the remaining life of the loans according to market projections as of July 2023, which can be reallocated towards development efforts.

The conversions helped Indonesia proactively manage currency and interest rate risk in accordance with its debt management strategy without facing market counterparties themselves, posting collateral, or exposing themselves to default, replacement, and settlement risk.

Transaction Structure

Variable rate USD 700 million IBRD loans converted into fully fixed rate EUR 591.3 million loans.



**includes 6 bps transaction fee for currency conversion*

World Bank Treasury's Role

- **Analyzed market projections for currency and interest rates and shared indicative quotes** in EUR and JPY to assist the Debt Management Office's financial analysis and internal discussions.
- **Provided scenarios and options for alternative risk management tools** such as full and partial maturity interest rate and currency conversions.
- **Led discussions with market counterparties and executed a series of currency swaps,** leveraging the World Bank's triple-A credit rating and relationship with international banks, to ensure the terms and price for Indonesia are as favorable as possible under prevailing market conditions.
- **Ensured the process was administratively cost-effective for Indonesia** by utilizing the pre-existing conversion feature within the loan agreement while hedging IBRD's own risk exposure.

For emerging economies such as Indonesia, proactive financial risk management is crucial for sustainable development. The World Bank Treasury helps borrowers manage interest rate and currency risks in their debt portfolios by sharing over 70 years of capital markets experience and providing access to hedging tools to mitigate risks.

Contact: **Miguel Navarro-Martin,** Manager, Financial Products & Client Solutions, The World Bank Treasury
✉ mnavarromartin@worldbank.org ✆ +1 (202) 458 4722 1225 Connecticut Avenue NW, Washington, D.C., 20433, U.S.A.