

SUMMARY RECORD OF THE SEVENTEENTH OECD GLOBAL FORUM ON PUBLIC DEBT MANAGEMENT

11-12 December 2007, Amsterdam

I. Introduction

The *Seventeenth OECD Global Forum on Public Debt Management* was held on 11-12 December 2007, in Amsterdam. As an innovation to the forum, this year's programme included a session with a focus on government debt management and bond markets in Asian countries 10 years after the crisis of the late 1990s. The OECD was honoured to have Mr. Tadao Chino, formerly president of the Asian Development Bank and currently a senior adviser at Nomura Research Institute, as a special speaker at the forum. The meeting was chaired by Mr. Ove Sten Jensen, chairman of the OECD Working Party on Debt Management and head of government debt management at the Danish Central Bank.

The OECD Global Forum on Public Debt Management brings together debt managers from all over the world to discuss viewpoints and experiences relating to public debt management. Its focus is on policies, techniques, and experiences in the field of government debt management. The forum is organised under the aegis of the OECD Working Party on Debt Management, in co-operation with the OECD-Italian Treasury Network for Public Debt Management, and is sponsored by the government of Japan. The working party is a policy forum for senior government debt managers from OECD member countries to exchange views, experiences, and policies in the field of government debt management and development of government securities markets. With its unique and up-to-date pool of knowledge in this specialised field of government policy and operations, the working party has achieved singular international status in the global community of public debt managers and financial policymakers more generally. The leading practices identified by the working party serve, therefore, as a global standard.

Global forums are round-table meetings where public debt managers from the OECD area discuss in an in-depth fashion OECD practices, experiences, and policies in the field of government debt management and the development of government securities markets with their counterparts from non-OECD countries. Often forum meetings serve as opportunities for follow-up discussions of key topics that have been discussed by the OECD Working Party on Debt Management by extending and deepening the earlier or initial policy dialogue. Examples from the recent past include the assessment of auction methods; the management of market, credit, and operational risk; the role of the debt manager in managing guarantees; the role of electronic trading systems; and cash management. The interface of debt management operations with primary and secondary government securities markets is also covered by discussions in global forums.

The relevance of global forums has increased over the years, as debt managers from emerging market economies increasingly face challenges similar to those of their counterparts from advanced markets due to pressures from global finance and the related need to implement OECD leading practices in this policy area. Moreover, emerging markets have become more important from an international perspective, both as suppliers of debt instruments and as sovereign and private investors in OECD markets. At the same time,

OECD governments, investors, and financial intermediaries stand to gain from emerging market countries making progress in these areas by adopting the leading practices from the OECD area.

II. Agenda and participants

The forum included three principal discussions (refer to annotation 1, agenda): (i) price discovery in government bond markets, (ii) government debt management and bond markets in Asia 10 years after the crisis of the late 1990s, and (iii) credit risk management from the perspective of government debt managers.

The forum was attended by over 90 participants (refer to annotation 2, participants). Of them, 31 were officials from 20 OECD member countries. A further 45 were debt managers and central bankers from 24 non-member economies, including from three countries identified for enhanced engagement with the OECD: Israel, Russia, and South Africa. Among other large non-member countries, India and Indonesia participated in the forum. In addition, there were representatives from the IMF, World Bank, African Development Bank, and other international organisations.

III. Highlights of the policy dialogue

Mr. Hans Blommestein (OECD) provided opening remarks and an overview of the agenda (refer to annotation 3, OECD opening remarks).

Session 1 examined price discovery in government bond markets. The session identified the main mechanisms for price discovery in government bond markets and the related policy issues from the perspective of government debt managers. These included the roles and influences of (i) various issuance techniques, (ii) primary dealers and officially appointed market-makers, and (iii) when-issued markets and other pre-auction mechanisms. An important objective of the session was to identify structural trends and differences in the OECD area and to discuss recent policy issues and leading OECD practices. Primary market issues included the role of futures markets in Europe and when-issued markets in the United States and Japan; the influence of being a small market on price discovery and issuance strategy; and the set-up of, and the use of the results from, auctions. Secondary market issues included the role of electronic trading platforms for price discovery in both wholesale and retail segments.

Mr. Greg Horman (OECD) and Mr. Ove Sten Jensen (Denmark), who also chaired the session, presented an introduction to the main policy issues. This was followed by a panel discussion with debt managers from the OECD area and emerging market countries: Mr. Matthew Rutherford (United States), Mr. Shuichi Sonoda (Japan), Mr. Neil Hyden (Australia), and Mr. Alexis Milo Caraza (Mexico). The insights from the OECD experience facilitated the policy dialogue with debt managers from emerging markets, including identifying the additional challenges or complexities associated with price discovery in emerging markets.

Main conclusions regarding price discovery in government bond markets

Yield curves. Government officials often express a goal of “developing” the yield curve of government securities. In considering the policy issues involved, it is useful to clarify whether this refers to (i) methodologies for estimating the yield curve, given the observable prices of existing securities, or (ii) sound practice in extending or back-filling the tenors in the yield curve. Often they are interested in both aspects. Regarding the first aspect, there are many different estimation techniques for connecting the discrete observed points in the yield curve and evaluating whether a particular security is rich or cheap. It is impossible to mandate the universal use of a single methodology. In other words, the estimated yield curve is simply an

analytical tool, not an authority. Each market participant will use its own methodology, if not several, as appropriate for its business requirements. Similarly, different government agencies (debt management offices, central banks, and so on) will apply different approaches, given the purpose for which they use the information embedded in the yield curve. Regarding the second aspect, there are trade-offs to be considered. They include the length (longest tenor) and density (distance between tenors) of the securities in the yield curve, as well as the number of securities and the volume of outstandings per security. This has implications for market liquidity, as well as the management of interest-rate and refinancing risk for the government.

Benchmark securities. Related to the above is the question of how to achieve liquid benchmark securities. One approach is “big bang” issuance, where a security is launched with sufficient volume to achieve liquid benchmark status immediately. This would imply an approach of less frequent, but larger volume, instances of issuance. An alternative approach, widely adopted, is to re-open an existing security repeatedly. This enables the cost of issuance to be sampled over time, thereby diversifying funding risk, but it may take several months before a liquid secondary market in the security can emerge. Paradoxically, however, because the volumes offered in each auction are relatively small, market participants may perceive a lower risk that they would bid off-market prices, with the result that there is still good price tension at auctions. In addition, market participants may be able to use derivatives, such as futures contracts, to manage their interest-rate risk exposures.

Auctions. Other primary market considerations include (i) auction design (multiple-price versus uniform-price, price-based versus yield-based), (ii) auction calendars (frequency, timing lags, nature of information published), and (iii) auction rules (participation eligibility, allocation limits, reservation pricing). It is difficult to say which auction design (multiple-price, uniform-price) is superior, given the ambiguity of empirical evidence. Similarly, although it is difficult to measure empirically the benefits of being a predictable, consistent, and even-handed issuer, it is regarded as sound practice in OECD markets, especially in large markets or in those where the government is the dominant issuer of local-currency debt. Although debt managers in emerging market countries increasingly are implementing OECD practices, some of them continue to have unease with adopting a full commitment to market pricing at auctions. This would involve, for instance, always accepting bids up to the pre-announced issuance volume, regardless of price, except in rare instances of unambiguous mispricing or error. An argument in favour of a full commitment to market pricing is that government debt issuance is a multi-period game; investors will penalise issuer behaviour that they perceive as arbitrary or capricious.

Rationale for debt issuance. There is a need to be clear about the rationale for government debt issuance. Does the government issue debt to (i) fund a deficit and refinance maturing debt, (ii) provide securities for the central bank to use in order to implement monetary policy in open-market operations, or (iii) develop and maintain the wider financial market? An important message here is that if the rationale for debt issuance causes the objective of debt management to diverge from the usual objective of raising new debt and managing the stock of existing debt at the lowest cost, subject to a prudent degree of risk, it is necessary to develop a transparent framework for the alternative objective.

When-issued markets and pre-auction price discovery. In when-issued trading, government securities are bought and sold between market participants in the period between an auction announcement and settlement of the securities issued at that auction. In other words, the secondary market can emerge before the security is actually issued, thereby improving price discovery and, in theory, encouraging better price tension at the auction itself. While attractive in theory, when-issued trading is not a common feature in government securities markets. In the OECD area, for instance, the when-issued market is significant only in the United States, although a when-issued market also exists in Japan but is not active. In practice, governments cannot “mandate” innovation, but they can create a neutral regulatory environment where

market innovations (when-issued trading, futures, swaps, and so on) can develop organically, as market participants judge useful for managing their business needs and risk. Similarly, approaches other than when-issued trading may be more effective for improving pre-auction price discovery and risk management for both the government and investors. Syndication, used by many countries when introducing a new instrument (such as inflation-linked bonds) or market segment (such as ultra-long tenors), is an “auction in slow motion.” Shortening the time lag between the announcement of auction details and the actual auction can reduce some uncertainty. With active derivatives markets, participants can extract pricing information and manage risk ahead of an auction.

Secondary market. A well-functioning secondary market for government securities is conducive to a healthy primary market. In some countries, however, notably a number of emerging markets, the secondary market is characterised by low trading liquidity and high participant segmentation, such that arbitrage opportunities may exist. The situation is sometimes attributable in part to a lack of co-ordination among regulatory bodies. In addition, investor incentives play a role.

Bond-stripping. Bond-stripping is not a feature in many OECD government securities markets. Generally, countries permit government bonds to be stripped, but market participants choose not to do so. A few countries, however, do impose restrictions on stripping because they fear that it would reduce liquidity. Where stripping is an important feature, an active repo market is typically a pre-condition. A standard policy prescription is to encourage the development of a derivatives market first, and perhaps a repo market or a securities-lending facility, before introducing stripping. Likewise, a successful strips market is often pre-conditioned on reforms regarding the taxation of coupon payments and gains or losses on principal.

Trading platforms. Most government securities trading in the OECD area is over-the-counter; typically, regulation does not require exchange-based trading. Electronic trading is becoming more important, however. In short, electronic trading is organised trading carried out off-exchange. Electronic trading platforms are generally self-regulated. Electronic trading has helped many European countries improve price discovery in the government securities market. Even so, the broker market and telephone-based trading remain important in many countries alongside electronic trading. For instance, primary dealers in Europe are required to quote prices on MTS, but they may trade however they choose.

Policy commitment. There is no single solution that alone can result in a robust government securities market. Developing the market takes time and requires a sustained high-level commitment to sound policies, including those in respect of improving transparency and predictability and adopting market-based funding practices. For emerging markets especially, it is important to tackle the root causes of slow market development or poor functioning. To that end, prioritisation and sequencing are important.

Session 2 took stock of government debt management and bond markets in Asia 10 years after the crisis of the late 1990s. In particular, the session examined (i) how government debt management and bond markets have evolved and been strengthened over the past decade, both in countries strongly affected by the crisis and also in those where the impact was less pronounced, and (ii) the contribution of public debt management practices toward creating a stronger financial infrastructure (including liquid local-currency government bond markets) so as to better deal with various shocks, such as the recent financial market turmoil.

The session began with an introductory address during lunch by Mr. Chino (refer to annotation 4, address by Mr. Chino), who provided a general financial markets retrospective on developments since the crisis. This intervention served as a backdrop for the more technical debate on public debt management and

market infrastructure issues, which was chaired by Mr. Adrian Blundell-Wignall (OECD). Mr. Greg Horman (OECD) presented an introduction to the main policy issues. This was followed by a panel discussion with Ms. Harun Setiawati (Indonesia), Ms. Rosalina Tan (Philippines), and Mr. Tada Phutthitada (Thailand).

Issues considered during this session included the following: (i) How have local-currency government bond markets in Asia developed? Are there still major structural imbalances in the public and private sectors that make those financial markets (including the banking system) vulnerable to changes in exchange rates and foreign interest rates? How did Asian financial markets, in particular government bond markets, fare during the latest (still ongoing) crisis? (ii) How important is the role of OECD public debt strategies and practices for managing specific risks associated with outstanding public debt (interest-rate, exchange-rate, refinancing, credit, and operational risks)? How do the issuance and risk management strategies and practices of government debt managers contribute to more stable funding costs and the development of a broader and more robust financial market for the corporate sector? (iii) Do governments now have in place better mechanisms for controlling their exposure to explicit and implicit contingent liabilities, thereby avoiding a similar rapid build-up in government debt, as in the 1990s, in the event of a future crisis? (iv) Concerning the outlook, what is the importance of government issuance strategies in the future development of local-currency bond (both public and corporate) markets in individual countries? Similarly, what role should government debt managers play in promoting or developing derivatives markets in individual countries? (v) What are the additional challenges for Asian debt managers, central bankers, and financial policymakers brought about by greater global and regional financial market integration? What are the prospects for further integration?

**Observations regarding government debt management and bond markets
in Asia 10 years after the crisis**

The crisis of the late 1990s marked a break in the trend of dramatic real GDP growth in East Asian countries.

Since the crisis, reserve accumulation by East Asian countries has been significant. Local-currency bond markets in these have grown in importance and size.

Local-currency debt currently dominates East Asian government debt portfolios. Local-currency government is skewed toward shorter maturities, however.

East Asian sovereign credit ratings, both during and since the crisis, tell a varied story.

Local-currency government yield curves over 2007 show a diverse experience. Asian yield spreads, however, have not blown out during the recent market turmoil.

Local-currency government bond trading in East Asian countries has risen in step with volumes outstanding. Turnover ratios have increased in some markets, but not all.

Session 3 considered key policy and operational issues in managing credit risk from the perspective of government debt managers. The discussion built on and extended recent discussions of this topic by the OECD Working Party on Public Debt Management. In particular, the session focused on policy frameworks and practices adopted by OECD debt managers for controlling the credit risk associated with (i) derivatives, (ii) cash management, (iii) on-lending, and (iv) guarantees.

Mr. Hans Blommestein (OECD) chaired the session and presented an introduction to the main policy issues, based in part on the recent work in this area by the working party. The session then proceeded with

a panel discussion with Mr. Magnus Thor (Sweden), Ms. Cigdem Aslan (Turkey), Mr. Gerhard Schleif (Germany), and Mr. Phakamani Hadebe (South Africa).

A key question considered during the session was the extent to which different sources of credit risk can, or should, be managed in an integrated fashion. Another question was whether debt managers have sufficient expertise to assess the credit risk related to on-lending or guarantees, especially when projects concern infrastructure and the like. An important objective of the session was to identify the additional challenges or complexities faced in emerging markets for managing the different sources of credit risk.

Main conclusions regarding credit risk management

To manage the credit risk associated with derivatives, most debt managers use collateral. They also set overall limits for certain categories of counterparties, which are usually set by the middle office. Ratings play an important role in this process, but delays in responsiveness of ratings to changes in fundamentals or the market environment may make it necessary to have the capacity to produce internal ratings. Many debt managers do not disclose publicly their exposure to credit risk.

Over-the-counter (OTC) derivatives enable the tailored management of interest rate and currency risk, but they are usually more exposed to credit risk than exchange-traded derivatives. Collateral arrangements simplify credit risk management.

Recent financial turmoil had an impact on the pricing of swaps, prompting an assessment on the possible use of other derivatives such as futures. The crisis has also demonstrated how liquidity risk can quickly transform into credit risk.

Contingent debt is a latent form of direct debt. Debt managers are typically well-placed to manage the credit risk of associated with guarantees. The involvement of debt managers facilitates the centralised management of credit risk within government.

Guarantees are justified only in cases of market failure. Risk-sharing arrangements with lenders are essential.

On-lending is likely to be less expensive and more transparent than guaranteed debt. On-lending also avoids possible conflicts-of-interest with market lenders and enables more straightforward credit risk management.

Almost all OECD countries have a control framework for managing the credit, market, and liquidity risks associated with cash management operations. In terms of credit risk, counterparty exposure limits, often based on ratings by the international credit rating agencies, are common, as is restricting exposures to only highly rated counterparties. Collateral arrangements are used as well. Countries often regard credit risk as nil from the perspective of the debt management office, when the credit exposure is to the central bank. The central bank, however, may face credit risk when managing the government's cash that is deposited with it.

IV. Further information

Questions regarding this summary record may be directed to Mr. Greg HORMAN, Consultant, DAF/FIN (email: greg.horman@oecd.org; telephone: +33 1 45 24 96 60).

Annotation 1, agenda

SEVENTEENTH OECD GLOBAL FORUM ON PUBLIC DEBT MANAGEMENT

Amsterdam, 11-12 December 2007

Held under the aegis of the OECD Working Party on Debt Management
www.oecd.org/daf/publicdebtmanagement

*In co-operation with the OECD-Italian Treasury Network for
Public Debt Management in Emerging Markets*
www.publicdebtnet.org

Sponsored by the government of Japan

Forum chairman: Mr. Ove Jensen, Head of Government Debt Management, Danish Central Bank, and Chairman of the OECD Working Party on Debt Management

Monday, 10 December 2007

17 h 00 – 20 h 30	Registration and reception
17 h 00 – 19 h 00	Registration
19 h 00 – 20 h 30	Reception (hosted by the OECD)

Tuesday, 11 December 2007

8 h 00 – 9 h 30	Registration
9 h 30 – 9 h 45	Welcome and overview of programme <ul style="list-style-type: none">• Mr. Hans Blommestein, Head of Public Debt Management and Emerging Financial Markets Programmes, OECD
9 h 45 – 13 h 00	Session 1: Price discovery in government bond markets

9 h 45 – 10 h 15	Introduction of main issues
	<ul style="list-style-type: none"> • Mr. Ove Jensen, Head of Government Debt Management, Danish Central Bank, and Mr. Greg Horman, OECD
10 h 15 – 11 h 15	Panel discussion
	<ul style="list-style-type: none"> • Mr. Matthew Rutherford, Treasury Market Policy, Markets Group, Federal Reserve Bank of New York • Mr. Shuichi Sonoda, Director of Debt Management Policy, Japanese Ministry of Finance • Mr. Neil Hyden, Chief Executive, Australian Office of Financial Management • Mr. Alexis Milo Caraza, Deputy General-Director of Public Debt, Ministry of Finance of Mexico
11 h 15 – 11 h 45	Coffee and tea break
11 h 45 – 12 h 45	General discussion
12 h 45 – 13 h 00	Policy conclusions
13 h 00 – 17 h 45	Session 2: Government debt in Asia 10 years after the crisis
	<ul style="list-style-type: none"> • Moderator: Mr. Adrian Blundell-Wignall, Deputy Director, OECD
13 h 00 – 14 h 30	Lunch (hosted by the OECD)
	<ul style="list-style-type: none"> • Special lunch speaker: Mr. Tadao Chino, senior adviser at Nomura Research Institute and formerly president of the Asian Development Bank and vice minister of finance of Japan
14 h 30 – 14 h 50	Introduction of main issues
	<ul style="list-style-type: none"> • Mr. Greg Horman, OECD
14 h 50 – 16 h 15	Panel discussion with policymakers from the region
	<ul style="list-style-type: none"> • Ms. Harum Setiawati, Deputy Manager of Foreign Debt Management, Bank Indonesia • Ms. Rosalina Tan, Assistant Manager, Central Bank of the Philippines • Mr. Tada Phutthitada, Debt Securities Development Specialist, Public Debt Management Office of Thailand
16 h 15 – 16 h 30	Coffee and tea break
16 h 30 – 17 h 30	General discussion
17 h 30 – 17 h 45	Policy conclusions by the moderator

Wednesday, 12 December 2007

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| 9 h 00 – 12 h 45 | Session 3: Credit risk management |
| 9 h 00 – 9 h 30 | Introduction of main issues <ul style="list-style-type: none">• Mr. Hans Blommestein, Head of Public Debt Management and Emerging Financial Markets Programmes, OECD |
| 9 h 30 – 11 h 00 | Panel discussion <ul style="list-style-type: none">• Mr. Magnus Thor, Head of Guarantees, Swedish National Debt Office (on-lending and guarantees)• Ms. Cigdem Aslan, Head of Credit Risk Management Department, Undersecretariat of the Treasury of Turkey (on-lending and guarantees)• Mr. Gerhard Schleif, Managing Director, German Finance Agency (derivatives and cash management)• Mr. Phakamani Hadebe, Director General, National Treasury of South Africa (guarantees and cash management) |
| 11 h 00 – 11 h 30 | Coffee and tea break |
| 11 h 30 – 12 h 30 | General discussion |
| 12 h 30 – 12 h 45 | Policy conclusions by the moderator |
| 12 h 45 – 13 h 00 | Closing remarks <ul style="list-style-type: none">• Mr. Hans Blommestein, Head of Public Debt Management and Emerging Financial Markets Programmes, OECD |

Annotation 2, participants

OECD countries

- Australia: Neil Hyden (debt management office)
- Belgium: Herwig Smitsaert (central bank)
- Canada: Donald Belanger (ministry of finance), Harri Vikstedt (central bank)
- Czech Republic: Ivana Matalikova (central bank)
- Denmark: Jens Bay Christensen (central bank), Ove Sten Jensen (central bank)
- Finland: Mikko Maula (debt management office)
- Germany: Christian Holters (ministry of finance), Gerhard Schleif (debt management office)
- Greece: Stylianos Maravelakis (ministry of finance), Panagiota Spyroulopoulou (ministry of finance)
- Hungary: Zsolt Bango (debt management office), Tibor Erhart (ministry of finance), Adam Mohai (debt management office)
- Iceland: Sturla Palsson (central bank)
- Italy: Maria Cannata (ministry of finance), Stefano Iacobelli (central bank)
- Japan: Tadao Chino (Nomura Research Institute), Shuichi Sonoda (ministry of finance)
- Mexico: Alexis Milo (ministry of finance)
- Norway: Anne Smeby Evjen (ministry of finance)
- Slovak Republic: Alena Delincakova (debt management office), Tomas Kapusta (debt management office)
- Sweden: Magnus Thor (debt management office)
- Switzerland: Jean-Pierre Beaud (ministry of finance)
- Turkey: Aslan Cigdem (ministry of finance), Ergun Ermisoglu (central bank), Naciye Kaya (ministry of finance)
- United Kingdom: Sarah Ellis (debt management office)
- United States: Matthew Rutherford (Federal Reserve Bank of New York)

Non-member economies

- Bulgaria: Milena Boikova (ministry of finance)
- Cameroon: Jean Claude Assoo Emame (debt management office), Patrice Etoundi Ottou (debt management office), Pierre Ndenga Dimalla (debt management office)
- Cyprus: Michael Michaelides (central bank)
- India: Lopeta Vas (ministry of finance), Vridhagiri Sivasubramanian (ministry of finance), Jayakumar Yarasi (central bank)
- Indonesia: Muchamad Agung Hastowo (central bank), Yulvi Herman (central bank), Teguh Setiadi (central bank), Harum Setiawati (central bank)
- Israel: Michal Ohana (central bank), Yossi Steinberg (ministry of finance)
- Latvia: Agita Birka (central bank), Janis Pone (ministry of finance), Ieva Zilite (ministry of finance)
- Lithuania: Vaidas Augustinavicius (ministry of finance)
- Malta: Joseph Aquilina (central bank)
- Mauritius: Jaywant Pandoo (central bank)
- Moldova: Alexandru Chirtoca (ministry of finance), Victor Martinenco (ministry of finance), Armando Olortegui (ministry of finance), Lilia Razlog (ministry of finance)
- Mongolia: Khandsuren Purevsuren (ministry of finance), Batsukh Sukh-Ochir (ministry of finance)
- Montenegro: Nemanja Pavlicic (ministry of finance)
- Morocco: El Hassane Ennasr (ministry of finance)
- Nigeria: Funmi Ilamah (debt management office)
- Philippines: Rosalina Tan (central bank)
- Russia: Boris Alekhin (Academy of Budget and Treasury), Eddi Astanin (National Depository Centre)
- Slovenia: Barbara Stular-Zmuc (ministry of finance), Stanislava Zadavec-Capriolo (ministry of finance)
- South Africa: Phakamani Hadebe (ministry of finance), Johan Krynauw (ministry of finance)
- Tanzania: Judith Ndissi (central bank)

- Thailand: Tada Phutthitada (debt management office)
- Uganda: Stephen Kaboyo (central bank), Wasswa Kajubi (central bank), Stephen Ndhaye (central bank), Paddy Turyamwijuka (central bank)
- Ukraine: David Lucterhand (USAID, attached to ministry of finance), Volodymyr Vysotskyi (ministry of finance)
- Zambia: Richard Kumendo Chembe (central bank)

International organisations

- African Development Bank: Stefan Nalletamby, Samuel Mivedor
- BCEAO/BEAC Pole-Dette: Gabriel Ngakoumda
- Commonwealth Secretariat: Carilus Odumbe
- IMF: Udaibir Das, Allison Holland
- UNITAR: Babar Kamal
- World Bank: Philip Anderson, Gloria Grandolini, Francis Rowe
- OECD: Adrian Blundell-Wignall, Eimon Ueda, Hans Blommestein, Shinichiro Terada, Greg Horman, Elodie Pierre, Lars Kalderen (external consultant)

Annotation 3, OECD opening remarks

Ladies and gentlemen,

On behalf of the OECD, I welcome you warmly to this historical city, established in 1275 as the dam in the river Amstel and, therefore, called Amsterdam. Our meeting room for the coming days is a former Lutheran church, built in the seventeenth century, with excellent acoustics.

The global forum meeting is part of the work programme of the OECD Working Party on Debt Management and is sponsored by the Japanese government. The working party is an influential policy forum that brings together the senior debt managers from all OECD countries to discuss in a frank and open way the latest technical developments, to compare notes on best or leading practices and, more generally, to share experiences. For your convenience, we have circulated a pamphlet on objectives, strategy, and operations of the working party.

The OECD Global Forum on Public Debt Management is perhaps the most effective global platform for sharing and debating important insights and experiences from the OECD area with debt managers from non-OECD jurisdictions. It is a truly global forum and not just another emerging market forum. The relevance of global forums has increased over the years, as debt managers from emerging market countries increasingly face challenges similar to those of their counterparts from advanced markets due to pressures from global finance and the related need to implement OECD leading practices in this policy area.

Emerging markets have also become more important players, with OECD governments, investors, and financial intermediaries standing to gain from emerging market countries making further progress in implementing leading OECD practices. The ongoing financial turmoil provides testimony to that effect, a point to which I will return.

Like last year, the OECD Forum on African Public Debt Management is again held back-to-back with the global forum meeting. This organisational structure provides African participants with the opportunity to participate in the global forum, while global forum participants can participate in the discussions of the African forum.

Let me now turn briefly to the ongoing credit crisis so as to give a global bond market backdrop to our discussions in both the global forum and also the African forum. The credit crunch in financial markets that started this summer and is continuing to this day was a sharp reminder that in banking, or financial markets more generally, financial turbulence is usually not an isolated event. The emerging losses in subprime lending were not contained to specialist banks exposed to borrowers with poor credit histories. In August of this year, a wave of volatility spread across the globe as it became clear that many financial institutions (including bulge-bracket commercial and investment banks) around the world (in the United States, Germany, France, the United Kingdom, and so on) would suffer major losses from investments linked to the United States subprime market. Of special relevance to our meetings, even traditional safe-havens like government bond market did in the end not escape contagion. Repricing of risk spread to all markets, including government bond markets and debt issued by supranational and quasi-government agencies. Extreme risk aversion and lack of trust led to wider than normal spreads in the United States and European government bond markets in November and early December. In other words, even government bond markets were not immune to severe bouts of illiquidity, making it probably more difficult (or at least more expensive) for many OECD governments to raise funds in the near future.

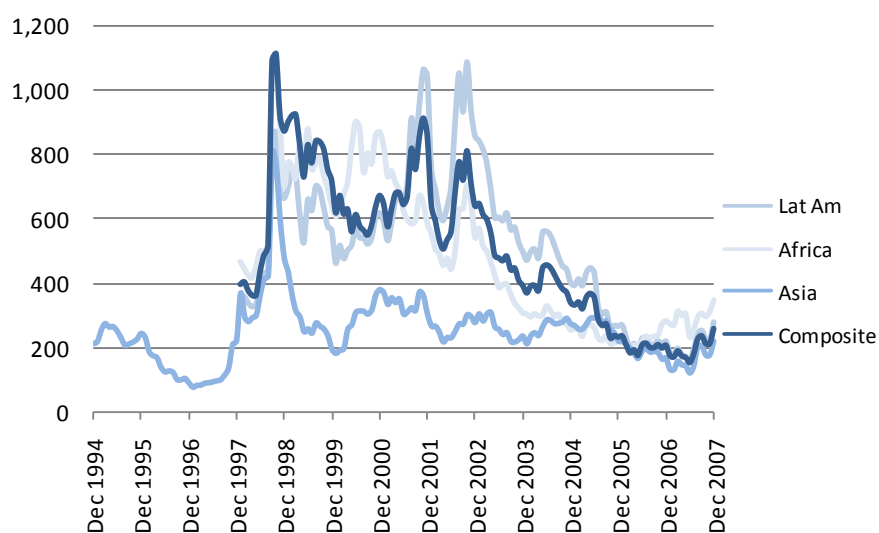
Turning now to emerging markets, the following remarkable features can be observed.

First, the impact of the global credit crisis shock on emerging markets seems to have been less dramatic than similar global shocks from the past. Although emerging markets have also been affected, this was by relatively less than in previous episodes of global financial market turbulence, while asset prices remain high by historical standards.

Second, even more surprisingly, many emerging markets have felt the impact of the credit crisis less than more advanced or mature markets. Indeed, already robust capital inflows to emerging market economies accelerated as the turmoil worsened (perhaps an indication that the flight to quality has found new safe-havens?).

Third, a closer look at different regions gives the following picture. The experience of emerging market East Asian countries during the financial market turmoil of 2007 is interesting to compare against that of previous years, in particular the Asian crisis of the late 1990s. (As you can see on the agenda, we have scheduled a separate session on this topic.) Although yield spreads have widened since the middle of the year, they are still below their levels of only a few years ago. Compared to emerging markets as a whole, yield spreads in Asian emerging markets continue to be tighter, although the difference is less dramatic than in the past, when very wide spreads in Latin American and African markets skewed the all-emerging market composite. But during the ongoing crisis, the yield spreads in Latin America, and also in Africa, have widened less thus far than during past bouts of financial turbulence.

Yield spreads, all emerging markets and individual regions, in basis points



Note: JP Morgan Emerging Market Bond Index Global Composite and Global Asia series. Data for Global Composite series not available prior to January 1998. *Source:* JP Morgan.

There is an opportunity to come back to the forces driving these spreads, including their resilience, during session of the global forum and sessions 1 and 3 of the African forum. For example, to what extent are recent inflows motivated by short-term portfolio incentives or by better fundamentals? It is from this perspective that we suggest to discuss improved debt management policies and the role of more developed local-currency bond markets. In this context, I welcome Mr. Tadao Chino's address, in which he will discuss government debt management and the need for further bond market development in Asia. I also

wish to draw your attention to the interesting retrospective on the Asian crisis by Mr. Glenn Stevens, governor of the Reserve Bank of Australia, circulated at this forum with the governor's permission.

Finally, Mr. Chairman, a few additional observations on the content and structure of the programme. As in previous years, the global forum focuses on state-of-the-art issues closely linked to recent work by the OECD Working Party on Public Debt Management, such as credit risk management. Price discovery, touching on mechanisms such as issuance techniques, primary dealers and pre-auction markets, was also recently discussed. The follow-up policy dialogue in this forum on these topics provides opportunities for extending and deepening the earlier discussions in terms of technical detail and also by addressing possible additional complexities and perspectives in an emerging market context.

We have structured the discussions so as to have an interactive, focused debate preceded by short presentations. The main issues papers provide information about suggested issues for discussion, while moderators lead the debate and extract operational policy conclusions at the end of each session. Each session has a general discussion, which all participants are invited to join. Another organisational point concerns a suggestion for panel members of the different sessions to contact the moderator of your session.

Thank you for your attention.

Hans Blommestein

Annotation 4, address by Mr. Chino

Distinguished Guests, Participants, Ladies and Gentlemen,

Thank you for providing me with the opportunity to address the Seventeenth OECD Global Forum on Public Debt Management today. I am very happy to be present at this important event.

My presentation will highlight how bond markets have evolved and been strengthened in Asian countries, 10 years after the 1997 Asian financial crisis. I will also briefly discuss the development of public debt management in emerging Asia since the crisis.

Since the financial crisis, Asia has addressed underlying structural weaknesses in its economic and financial fundamentals. Today, Asia has again become one of the world's fastest growing regions. Although much has been achieved, Asia still needs deeper and more liquid financial markets.

In 1997, crisis-affected Asian countries, such as Indonesia, Malaysia, Thailand, and Korea, were faced with steep currency depreciations and sharp hikes in domestic interest rates, thereby raising debt service obligations of corporate borrowers. The rapid rise in nonperforming loans led to severe banking crises and output contractions, with recoveries taking several years. As the size of the regional bond markets were very small, corporate borrowers were highly dependent on bank financing. The underdeveloped bond markets in Asia and heavy dependence on bank financing made Asian economies highly vulnerable and even facilitated the 1997 crisis.

Another important factor behind the crisis was the “double mismatch” problem: currency and maturity mismatches that most Asian borrowers faced when they tried to raise funds abroad. Corporations and some banks borrowed abroad in foreign currency and on a short-term basis; the result was that money went out of the respective countries quickly, causing steep currency depreciations, inflating the domestic currency value of external debt, and driving many corporate and bank borrowers into repayment difficulties. Clearly developing domestic–currency bond markets is a means of reducing the double mismatch.

A diversified financial system, with deep and liquid bond markets, can reduce the problem posed by overdependence on the banking system and external financing. The growth of bond markets lengthens the maturity period of debt and facilitates the placement of local currency bonds, helping avoid corporate balance sheet currency mismatches. The well developed bond markets will encourage corporations to be more transparent, adopt international accounting practices, and enhance corporate governance. In view of this, national bond market development is of utmost importance.

Government Debt Management in Asia

In most Asian countries, the major holders of public debt have been largely banks. Financial intermediation has therefore been highly dependent on banks. As banks hold a very large proportion of their assets in government debt, prudent debt management becomes critical for financial stability. Government debt plays an important role as a benchmark for greater and deeper development of private sector bond markets.

Prior to the crisis, many Asian emerging market economies had no or very small bond markets. However, Asian emerging market economies, particularly those affected by the financial crisis, suddenly

witnessed high levels of public debt in the crisis period and immediately after (1998-1999) because they started to issue local currency government bonds to meet recapitalization needs of domestic banks affected by the crisis. In around 2000 when the economies started to restore stability and growth, the public debt/GDP ratio for crisis-affected countries began decreasing. The trend in public debt to GDP ratio clearly indicates these changes. The public debt to GDP ratio of Indonesia rose from 27% in pre-crisis 1996 to a peak of 87% in 1999, and then declined to 47% in 2005; in Malaysia it increased from 35% in 1996 to 64% in 1999 and then decreased to 46% in 2005; and in Thailand it rose from 9% in 1996 to 57% in 2000 and then declined to 46% in 2005.

The maturity structure of debt has improved in these countries, with declining short-term public debt.

Some crisis-affected countries have reduced their reliance on foreign currency debt (such as Thailand) and have been able to issue more fixed rate debt (such as Indonesia).

However, the public debt to GDP ratio in 2005 was still high for several developing Asian countries compared to the 1996-level. High debt levels may constrain the delivery of public services and the flexibility of fiscal policy, posing a risk for the future. Although the level of indebtedness is still manageable in view of the strong fundamentals and continued high growth environment, a strong focus on maintaining debt at sustainable levels is of utmost importance.

To effectively manage public debt and minimize the long-term cost of debts, governments of these countries need to improve market infrastructure, such as strengthening the legal and institutional structure of the bond market. A well functioning bond market is essential for financing budget deficits, for smooth refinancing of public debts, and for reducing the overall cost of public sector debt through professional debt management.

Need for Bond Market Development in Asia

Asia is witnessing an increasing demand for physical infrastructure to support economic growth and development. The sectors in need of infrastructure include transport, energy, telecommunications and water. The infrastructure investment requirement of developing Asia is estimated to be between \$300 billion and \$500 billion annually for the next ten years, greater than any other developing region.

Asia also faces the new challenge of recycling its excess savings for its own investment. Emerging Asian economies' foreign exchange reserves have risen to \$3.0 trillion (around \$4.0 trillion including Japan) as of end-August 2007, accounting for about two-thirds of the world's total. The bulk of these reserves are invested in relatively low-yielding, safe and liquid assets such as US Treasury securities.

Unless regional bond markets are fully developed, many Asian savers will continue to put their money in the international financial centers—in North America and Europe—and Asian borrowers will continue to turn to such international financial markets for financing.

The remedy for these problems lies in developing efficient national and regional bond markets in Asia. Vibrant local markets will help address the global imbalances by encouraging more of Asia's savings to be invested in the region, and reduce the reliance of many sovereign and corporate issuers on international capital markets. First, Asian bond markets can provide: (i) alternative sources of financing for public and private investment and (ii) alternative modes of wealth holdings for Asian households. This is very important for Asian economies, which are gravely in need of both viable funding schemes for infrastructure and fixed asset investment and attractive options for retirement financial arrangements and pensions in a rapidly ageing society.

Second, Asian bond markets can make the region's financial system more resilient by putting in place two balanced wheels: sound banking sectors and liquid bond markets. Bond market development creates a greater competition in the financial system and a greater diversification of financial risks across banking sectors and bond markets.

Third, Asian bond market development can reduce the "double" mismatch problem of currency denomination and maturity lengths.

Finally, mobilization of Asian savings for Asian investment can contribute to the reduction of global payments imbalances. Well-developed, liquid, transparent local-currency bond markets can help mitigate the "information asymmetry" that exists between investors and borrowers by identifying "bankable" projects and right investment opportunities in the region for potential investors.

Growth of Bond Markets in Emerging East Asia

Asian bond markets witnessed considerable growth since the financial crisis. According to ADB's estimate, total local-currency bonds outstanding in emerging East Asia increased from \$400 billion in 1997 to \$3 trillion in mid-2007 (more than a seven-fold increase) or from 11.5% to 57% of emerging East Asia GDP. The share of local currency bonds in emerging East Asia's financial system rose from 12% in 1997 to 19% in mid-2006, while the share of bank financing declined from 61% to 51%. Despite this growth, local-currency bond markets in emerging East Asia still remain small, only a fraction of total local currency bonds worldwide (more than \$40 trillion).

Governments remain major issuers of local currency bonds in emerging East Asia, though corporations and financial institutions are becoming more active, particularly in Korea and Malaysia, where non-government entities are the largest issuers. Bond holdings by commercial banks are still large accounting for over 50%, but have been declining while holdings by contractual savings institutions and fund managers—such as pension funds, life insurance companies, and mutual funds—have been rising. Though the issuer and investor base has expanded, more efforts are needed to further diversifying this base.

Asian Bond Markets Initiative (ABMI)

In recent years national governments of Asian countries have made serious efforts to encourage the development and deepening of local-currency bond markets through (i) removal of policy distortions that affect the efficient allocation of domestic savings; (ii) providing sovereign and quasi-sovereign issues to establish benchmark yield curves; and (iii) strengthening the regulation and supervision of capital markets.

In addition, the actions of regional groups have also supported the development and deepening of Asian bond markets. Two such initiatives have been the Asian Bond Fund (ABF) initiative, under the aegis of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), and the Asian Bond Markets Initiative (ABMI), under the auspices of ASEAN+3 Finance Ministers. The Asia-Pacific Economic Cooperation (APEC) Finance Ministers' process and the Asia-Cooperation Dialogue (ACD) process have also been strongly supporting Asian bond market development.

The EMEAP-led central bank process established the ABF in June 2003 to facilitate bond issuance. The idea was to help expand bond markets through the purchase of sovereign or quasi-sovereign bonds issued by 8 EMEAP members by using all eleven members' foreign exchange reserves. The initial attempt was to purchase \$1 billion of US dollar-denominated bonds (ABF-1). Given the recognition that local-currency denominated bonds needed to be promoted in order to address the "double mismatch" problem,

the central bankers introduced ABF-2 in December 2004, which involved purchases of \$2 billion equivalent of Asian currency-denominated bonds, and introduced a Pan-Asian Bond Index Fund (PAIF) and a Fund of Bond Funds. PAIF is a single bond fund index investing in sovereign and quasi-sovereign local-currency bonds issued in 8 economies.

The main objective of ABMI launched by the ASEAN+3 finance ministers in August 2003 is to facilitate market access to a diverse issuer and investor base and to enhance market infrastructure for bond market development. This will create robust primary and secondary bond markets in ASEAN+3 countries. Under ABMI, currently four working groups are focusing on: (i) Issuance of new securitized debt instruments; (ii) Establishment of a regional credit guarantee agency; (iii) Exploration of possible establishment of a regional settlement and clearance system; and (iv) Strengthening of regional rating agencies.

ADB has supported this initiative by issuing local currency bonds to promote domestic bond market development. Starting in 2004, ADB completed 16 bond issues denominated in local currencies in China, Hong Kong, Malaysia, Philippines, Singapore, and Thailand. Total local currency bond issuance during 2004 to 2006 amounted to approximately US\$ 2.1 billion.

Conclusions

Public debt management is crucial for financial stability of Asia. A strong focus on maintaining debt at sustainable levels is of utmost importance. Governments of developing Asian countries need to develop a proper institutional program for effective public debt management. Further broad reforms, including the strengthening of the legal and institutional structure and the development of the secondary market, are required to effectively manage Asian public debt, particularly to minimize the overall economic costs.

Asian bond markets face many challenges and, therefore, a more strategic approach is required. Broadening the issuer base can help address the shortage of corporate investment paper in Asia but it is not the whole answer. Enabling environments need to be offered for corporate bond market development through removal of regulatory, legal, tax, and other impediments. Market infrastructure needs to be improved through the creation of an effective credit guarantee mechanism and an efficient settlement system directly linked to fixed-income exchanges and through the development of hedging and derivatives instruments. Corporate governance of firms should be improved through better accounting standards and disclosure requirements so that corporate issuers become subject to sufficient checks and balances.

Regional cooperation is a useful way of achieving these. The launch of Asian Bond Fund 2 is an excellent example. The listing of exchange traded funds and the creation of a well-structured Asian index has created a benchmark against which all investment vehicles can evaluate their performance in Asian bonds. It has also opened the markets to a wider class of investors. The Asian Bond Markets Initiative (ABMI) that attempts to focus on strengthening national and regional market infrastructure is another good example. I am pleased that the Asian authorities have been working on these initiatives in collaboration with the private sector.

Let me conclude my speech by my unforgettable memory related to the Asian Financial Crisis. Early 1998, when I was the chairman of the Board of Councillors of Nomura Research Institute, I was appointed the head of Japanese Government Delegation to visit Jakarta and to see President Suharto to discuss Japan's further effective financial assistance to Indonesia. In his private residence in Jakarta, we had hours of dialogue with the President. On the basis of our report, Japanese Government decided upon positive financial assistance. In that dialogue, I never forget when President Suharto told us: "I have been called by my people for these three decades Father of Development, and Father of the Nation. I have devoted myself

to the development and prosperity of this nation, bringing up the per capita income of Indonesia from \$100 to roughly \$1,000. In the past three decades, as the Father of the Nation, I have done all I can for the development and welfare of the people. Then suddenly drastic economic crisis assaulted us. This unforeseen crisis severely affected all segments of our economy. Let me take one example. Since Indonesian rupiah suddenly depreciated to only one quarter of the pre-crisis level, poultry farmers who grow mainly chicken faced sudden jump of import price of mixtured feeds four times. Poultry farmers cannot afford to buy imported mixture feeds and most of the poultry farmers have gone bankrupt. Egg production and chicken meat production had sharply declined. People cannot have chicken satay any more, and small children cannot have eggs which are important protein food for them. Children are now facing nutrition problem. After three decades of devotion to the welfare of my people, why do I have to be punished like this?" To my eyes, he was not what some people called Dictator. He was an honest serious man who has spent most of his life for his country and people and now suddenly distressed by the unexpected shock.

It was since then that I have devoted myself to the development of the poverty reduction strategy of the ADB, which is based upon pro-poor sustainable economic growth, social development and good governance, of which financial issues particularly bond market development are of basic importance. To reduce poverty and to avoid recurrence of financial crisis which brings mass poverty and to achieve a vision of more integrated, prosperous, poverty free, peaceful Asia, we need bond market in Asia.

Thank you.

Tadao Chino