DEFAULT STUDY

2019 – 2021

Abstract

Default Study 2019 – 2021 Report is a portrait of default rate of debt notes or companies rated by PT Kredit Rating Indonesia in the year of 2019 – 2021

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I. GLOBAL AND DOMESTIC ECONOMIC CONDITION

Global economic improvement continued in 2021 despite divergence across regions and persistent financial uncertainty. Economic recovery in advanced economic countries, the United States in particular, progressed more quickly on the back of a faster vaccination rollout, coupled with extraordinary fiscal and monetary policy stimuli. In contrast, most emerging countries, excluding China, struggled to restore domestic economic recovery. Beyond limited supply and access to vaccines, weaker fiscal and monetary stimulus also impeded economic recovery in most emerging countries. Meanwhile, the global financial market uncertainty persists in response to emerging market risks such as transmission of the Delta variant, market anticipation of tapering by the FED, and concerns stroked by continuing inflationary pressure.

Domestic wise, the 2021 economic recovery in Indonesia was strongly influenced by COVID-19 pandemic developments. COVID-19 infections in Indonesia increased during 2021 to peak at more than 50,000 daily cases in the middle of July, caused by the highly contagious Delta variant. The spike in daily cases, in July 2021, compelled the Government to strengthen localised community activity restrictions (PPKM), accompanied by activity restriction that were specific to administrative regions (level-based). However, the surge of COVID-19 cases was brought under control in line with policies implemented to contain and manage the pandemic. Such development allowed the Government to relax the intensity of mobility restrictions, thus spurring economic activity. The Indonesia's Balance of Payment (BOP) continued to post gains in line with stronger export performance, as proved by USD 4.5 billion surplus in the third quarter of 2021. The capital and financial account recorded a larger surplus in the third quarter of 2021, despite a surge of COVID-19 cases and early global monetary policy normalisation in the light of higher international inflation. The value of the Rupiah was maintained with low exchange rate volatility. Inflation remained low until the end of 2021 on the back of compressed domestic demand, and consistent policy synergy between Bank Indonesia and the central and local governments.

II. BACKGROUND

Given the above developments of global and Indonesia's economic conditions, PT Kredit Rating Indonesia (KRI) believes that although the economic conditions were recovering but the uncertainty was still lingering due to higher than expected inflation in the global market and COVID-19's effects that still felted in Indonesia. These has affected some of the companies in Indonesia, particularly in their ability to punctually pay their financial obligations, including loan from banks and debt notes issued.

Several countries reopen their door for global trading activities, triggering demand of several products. This has resulted increasing prices, particularly commodities, including coal, crude palm oil, etc., and has put pressure on many central banks to increase their benchmark interest rates, which will jeopardize the recovery process. In this crossroad, many central banks choose to keep the benchmark interest rates to maintain the recovery process in their countries, causing prices of goods to rise.

In Indonesia, the daily cases of COVID-19 dropped in January – June 2021 which contributed to Indonesia's economic growth to grow faster in this period. However, such growth was curbed with the raising daily cases of COVID-19 in July 2021 causes by Delta Variant. As such, the domestic demand of goods was once again decreased as proved by the GDP growth in third quarter of 2021 to just 3.51% YoY. This has affected many corporations in Indonesia, particularly in the transportation, hotel and tourism as travel bans imposed, and causing difficulties to pay loan from banks or debt securities that the companies' issued.

Given this background, KRI has analysed all of the companies as well as debt notes that have been rated by KRI related to their default events that takes place after the ratings have been issued. Such events, especially in 2021, may have a high degree of relationship to the conditions occurred in domestic as well as global economic conditions.

III. Definition

III. 1. Population:

KRI uses two types of data population for this default study research report:

- Company rated: The cumulative number of companies rated by KRI. We do not recount one company that already being rated by KRI, if this company resubmit a company rating mandate.
- Debt instrument rated: We refer this as the sum of all debt instruments value rated by KRI. We count not only the cumulative amount of debt instruments that have been successfully rated and issued by the companies, but also debt instruments that have been rated but not successfully issued.

III. 2. Observation Period:

KRI uses the latest ratings for the companies or the debt instruments each year during the 2019 – 2021 periods. Therefore, if a company or debt instrument rating has an upgrade or downgrade rating during this periods, the we use the latest rating at the year when the rating changed.

Example: If Company A had "irBBB+" rating in 2019, and KRI upgraded its rating to "irA-" in 2021, then we use "irBBB+" rating in 2019 and "irA-" in 2021. If this Company defaulted its financial obligations in 2021, then we count this event as a default for "irA-" rating only.

III. 3. Rating Classfication:

KRI diversifies its rating classification with letters and plus (+) or negative (-) signs. The rating classifications as well as their definitions are as follow:

Rating	Definition
$_{ir}$AAA	Obligor classified in the $_{ir}$AAA rating has the highest level of certainty to honor its financial obligations.
$_{ir}$AA	Obligor classified in the $_{ir}$AA+ rating has the a very high level of certainty to honor its financial obligations. There is, however, a slight difference in the rating scale with the highest qualification level of obligor.
$_{ir}$A	Obligor with $_{ir}$A rating has a high level of certainty to honor its financial obligations, but it can be affected by adverse changes in business and economic conditions, relative to Obligor with a higher rating."
$_{ir}$BBB	Obligor with ,BBB rating have an adequate level of certainty to honor its financial obligations. However, this certainty is more likely to diminish in the future than with the higher rating categories.
$_{ir}$BB	Obligor with $_{ir}$BB rating, although the Obligor's capacity to meet its financial obligations has not been declared problematic, the Obligor is vulnerable to uncertainty and adverse changes in business, financial or economic conditions, which can cause the Obligor to be unable to meet its financial obligations.
$_{ir}$B	Obligor with irB rating has a lower capability level to meet its financial obligations than an Obligor with a credit rating scale above it, even though currently the Obligor is still able to meet its financial obligations. However, adverse changes in business, financial and economic conditions will be able to reduce the Obligor's ability and willingness to fulfill its financial obligations as promised
$_{ir}$CCC	Obligor with irCCC rating has several uncertainties about the Obligor in fulfilling its financial obligations, and is highly dependent on changes in business, financial and economic conditions that can support its capability to meet its financial obligations, so there is a possibility of default
+	The plus sign (+) indicates that the rating given is closer to the rating scale above it.
-	The minus sign (-) indicates that the rating is still higher than the rating category below, although it is closer to the lower rating than it is to the higher rating category.

However, for this default study report we do not divide the rating classification with the plus or minus sign. We classify the rating based only on its rating signs, which are AAA, AA, A, BBB, BB, and CCC.

III. 4 Terminology of default:

- Debt instrument default: At the due date, the issuer of the debt instrument failed to pay the interest as well as the principal of the specific debt instrument issued and rated by KRI.
- Company default: A condition where a company failed to pay the debt instruments issued or other financial obligations.

IV. Default Rate Analysis

IV. 1. Default Rate Based on Observation Period

To calculate the default rate based on observation period, or during 2019 – 2021, first we have to determine the definition of debt instruments default rate and company default rate. The terminology of debt instrument default rate uses in this report is the percentage of total cumulative value of defaulted debt instruments that have been rated by KRI up to time t, divided by the total cumulative value of debt instruments that have been rated by KRI up to time t. The formulation is as follows:

$$DIDR_t = \frac{\sum_{n=1}^{t} TDI_n}{\sum_{n=1}^{t} VIR_n},$$

Where:
$DIDR_t$ = Debt instrument default rate at time t
TDI_n = Total value of default instrument from 2019 – 2021
VII_n = Total value of instrument rated from 2019 – 2021
n = Observation period, or from 2019 – 2021
t = Cut of observation period or at the end of 2021.

The terminology of company default rate is the cumulative number of companies that have been rated by KRI and evidently failed to pay its debt instruments principal or coupons payment punctually, or other financial obligations. The calculation formula for this company default rate is as follows:

$$CDR_t = \frac{\sum_{n=1}^{t} CD_n}{\sum_{n=1}^{t} CR_n},$$

CDR_t = Company default rate at time t
CD_n = Cumulative number of defaulted companies from 2019 – 2021
CR_n = Cumulative number of companies rated by KRI in 2019 – 2021
n = Observation period, or from 2019 – 2021
t = Cut of observation period or at the end of 2021.

The cumulative number of companies and cumulative amount of instruments rated by KRI during 2019 – 2021 periods is as follows:

Year	Cumulative Number of Companies Rated by KRI	Cumulative Value of Instrument Rated by KRI (IDR, billion)
2019	15	12.76
2020	33	23.78
2021	45	35.11

Based on the above cumulative number of companies rated by KRI and cumulative value of instruments rated by KRI during 2019 – 2021, the cumulative number of companies that failed to pay its financial obligations were only two companies which both happened in 2021. The cumulative amount of defaulted debt instruments rated by KRI were IDR 1,080,000,000,000,-. Given these, the company default rate and debt instrument default rate were 2.2% and 3.1%, as calculated below:

$$CDR_{2021} = \frac{1}{45} = 2.2\% ;$$

$$DIDR_{2021} = \frac{IDR\ 1{,}080{,}000{,}000{,}000{,}-}{IDR\ 35{,}111{,}500{,}000{,}000{,}-} = 3{,}1\%$$

IV. 2. Default Rate Based on Rating Classification

To calculate the default rate based on rating classification during 2019 – 2021, first we calculate the total rating mandate and completed by KRI for each rating classification. And, during such period, KRI has received and rated 77 companies as well as debt instruments. From this cumulative mandates and completed rating, we have calculated the default rate for each rating classification as shown in the table below:

Rating	Number of default case
$_{ir}$AAA	-
$_{ir}$AA	-
$_{ir}$A	-
$_{ir}$BBB	2
$_{ir}$BB	-
$_{ir}$B	-
$_{ir}$CCC	-

Based on the gathered data, we notice two rating assignments with the rating classification of $_{ir}$BBB has defaulted during 2019 – 2021 periods.

IV. 3. Default Rate Based on Sector

To calculate the default rate based on sector during 2019 – 2021, first we divide our sector classifications into three categories, namely CORPORATES for non-financial institutions companies, FINACIAL INSTITUTIONS for financial institutions companies, and OTHER for other types of debt instruments besides bond and medium-term notes rated by KRI, such as asset-backed securities, DIRE, etc. From the cumulative 87 mandates and completed, we calculated the default rate for each sector based on the following formula:

$$DRS_{rc} = \frac{\sum_{n=1}^{t} Sec_n}{\sum_{n=1}^{t} MR_n},$$

DRS_{rc}= Default rate based on each sector during 2019 - 2021
Sec_n = Default rate based on each sector in 2019 - 2021
MR_n = Cumulative mandates received and completely rated in 2019 - 2021
n = Observation period, or from 2019 – 2021
t = Cut of observation period or at the end of 2021.

Based on the data gathered, we noticed only two assignments from Corporates that have defaulted in 2019 – 2021 periods, and one assignment from Other sector that has defaulted in 2019 – 2021 periods. As such, the default rate for CORPORATES was 4.3%, and for OTHER sector was 2.1%.

$$DRS_{CORPORATES} = \frac{1}{46} = 2.2\%,$$

$$DRS_{OTHER} = \frac{1}{46} = 2.2\%$$