*SOVEREIGN*: **Jamaica**

**Summary**

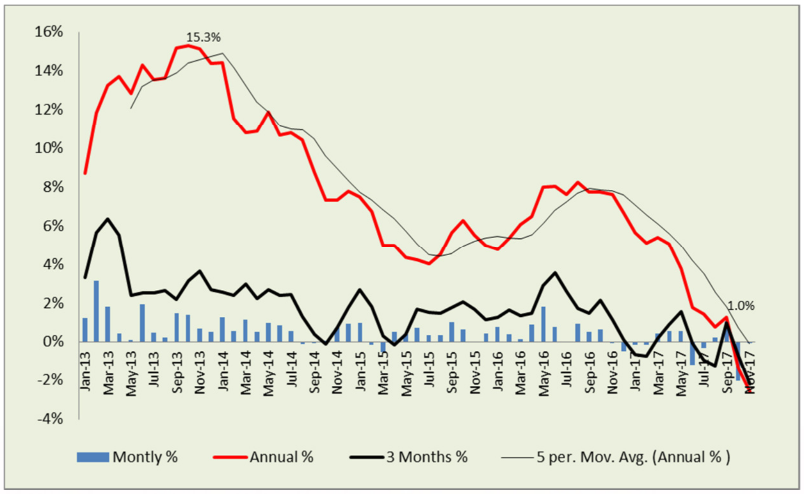
Historically the Jamaican dollar has followed a path of depreciation since the challenges of the 1990's. However, of late, improvements in the fiscal, reduced oil prices and its pass through effect to the balance of payments (BOP), the NIR and inflation have led to less aggressive depreciation and even appreciation. This piece takes a truncated view of recent happenings and seeks to highlight how the central bank has improved the process via improved information flow to the market.

We also take a look at the recent performance of the fiscal numbers. Jamaica is definitely on the right track in terms of the fiscal. Successive administrations have, to their credit, stuck to the IMF's recommendations and consequently the country's debt has declined from its lofty heights to more manageable levels. The deficit has been significantly narrowed and in some instances a surplus has been recorded for a few fiscal years. The greatest challenge currently is likely wage demands from public sector workers. If wage increases are not managed it could represent a challenge for the fiscal gains made so far.

**How symmetric information is helping to shape the foreign exchange market**

At the end of December 2016, against expectations, the Jamaica dollar depreciated year-on-year (y/y) by 6.7% relative to the US dollar. For the first 9 months in the CY the Jamaica dollar lost 7.2%, but clawed back some of its value in the last 3 months. The pace of depreciation in 2016 did not reflect developments in the balance of payment (bop) accounts. The current account recorded a deficit, inflows into the capital account were sufficient to offset it and add to net international reserves, which increased by US$282 million (11.6%) to US$2.7 billion. This begs the question: Why was there such a wide movement in the value of the local currency during the year despite positive developments in the BOP accounts? One possible answer is information asymmetry, which simply put refers to information failure in the foreign exchange market. The Bank of Jamaica (BOJ) has taken steps to address this problem through the ***Foreign Exchange Intervention & Trading Tool, or B-FIXIT***. It is early days yet, but so far the Tool is having a positive effect on the market.

Figure 1: JMD/USD foreign exchange rate movements




On the one hand there are persons/corporates that purchase US dollars to buy goods and services, to invest in US-dollar assets, or to hold and preserve wealth. On the other hand there are persons/corporates that receive US dollars via the sales of goods and services, receipt from US dollar investments, or remittance flows. Banks and cambios act as conduits to facilitate transactions between buyers and sellers, and they too fall on either side of the transactions. In perfectly functioning markets where information flow is symmetric, the forces of demand and supply work together to determine price; volatility is often contained except in circumstances where there are market events, or shocks.

Throughout most of 2016 the foreign currency market was characterised by lumpy flows inwards that were sufficient to cover demand however information in relation to said flows was not transmitted to the market in a timely manner. In addition, at times excess demand was not met in full by intervention from the central bank resulting in increases in the price of the Jamaica dollar relative to the USD over a number of days. End-users and speculators looking on, and armed with limited information with respect to inflows, form expectations about one-way movement in the local currency, which becomes a self-fulfilling prophecy. This resulted in gradual depreciation of the Jamaica dollar throughout the period. As prices are sticky downwards, the dollar fails to claw back lost ground during periods where there is excess supply of US dollars in the market.

**Foreign Exchange Intervention & Trading Tool, or B-FIXIT**

Prior to B-FXITT, the BOJ would inform the market of the intention to sell an undisclosed quantum of US currency. Bids would be invited and trades settled at the previous day weighted average rate, which may be above or below the spot price. This in and of itself was not efficient as at times it perpetuated elevated demand when the domestic currency is on an aggressive depreciation path. Under the B-FXITT regime, settlement is effected the next day based on bid prices and the BOJ publishes the result. The new regime reduces information asymmetry through the timely publication of comprehensive market data and a four week advanced calendar outlining the quantum of foreign currency that the Bank intends to sell. It therefore gives the market available information regarding liquidity flows, and allows for market participants to communicate more frequently, which helps to limit information gap and reduce the propensity of market players to hoard currency. ***This approach has helped to stabilize the movement of the currency.***

## Fiscal Operation

| | Prov Apr-Oct | Budget Apr-Oct | Diff | Diff (%) |
|---|---|---|---|---|
| **Revenues and Grants** | **297,586.7** | **285,794.3** | **11,792.4** | **4.1%** |
| Tax Revenues | 271,855.0 | 260,274.6 | 11,580.4 | 4.4% |
| **Expenditure** | **315,364.2** | **322,596.4** | **(7,232.2)** | **-2.2%** |
| Recurrent Expenditure | 292,266.3 | 299,331.2 | (7,064.9) | -2.4% |
| Programmes | 98,803.8 | 99,372.2 | (568.4) | -0.6% |
| compensation of employees | 110,216.4 | 114,472.3 | (4,255.9) | -3.7% |
| Interest payments | 83,246.1 | 85,486.7 | (2,240.6) | -2.6% |
| Capital programme | 23,097.9 | 23,265.2 | (167.3) | -0.7% |
| **Fiscal deficit** | **(17,777.5)** | **(36,802.1)** | 19,024.6 | -51.7% |
| **Loans** | **175,667.3** | **122,187.4** | **53,479.9** | **43.8%** |
| **Divestment proceeds** | **11,400.1** | **11,701.3** | **(301.2)** | **-2.6%** |
| **Amortisation** | **188,377.4** | **129,325.7** | **59,051.7** | **45.7%** |
| **Overall Balalnce** | **(19,087.4)** | **(32,239.0)** | **13,151.6** | **-40.8%** |
| **Primary Balance** | **65,468.6** | **48,684.6** | **16,784.0** | **34.5%** |

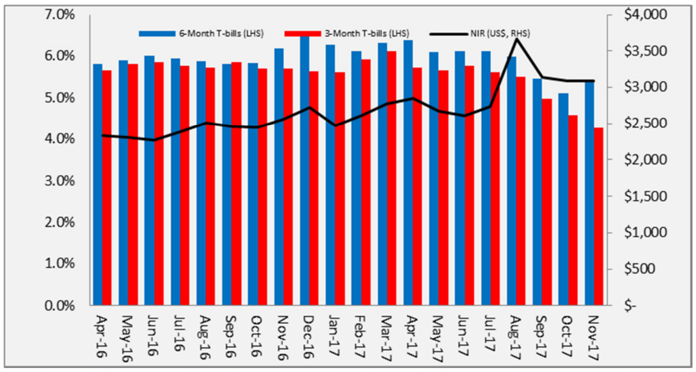
For the period April – October Central Government Operations generated a fiscal deficit of $17.8 billion, which was $19 billion (51.7%) better than budgeted. As per the similar period Revenues and Grants amounted to $297.6 billion, $11.7billion (4.1%) better than budget while expenditure of $315.3 billion was $7.2 billion (2.2%) lower than programmed.

Tax Revenues amounted to $271.9 billion which was $11.6 billion (4.4%) higher than programmed. Further breakout of tax revenues show that all categories of taxation recorded increases relative to budget. Collections from Income and Profits ($61.2 billion), Production and Consumption ($100.7 billion) and International Trade ($110 billion) were $1.7 billion (2.6%), $9.0 billion (9.8%) and $1.1 billion (1.0%) more than planned. ***The main factors informing higher tax intake were improvements in compliance and higher than programmed crude oil prices, as economic growth has been languishing below expectation***.

On the expenditure side recurrent expenditure of $292.2 billion fell below budget by $7.1 billion (2.4%). The lower outlay on Expenditure reflects shortfall in wages and salaries and interest costs of $5.0 billion (4.7%) and $2.2 billion (2.6%), respectively.

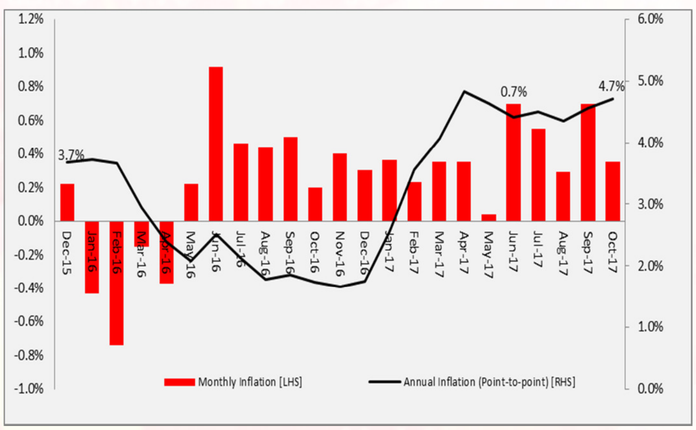
The fiscal deficit was financed in part by loan receipts and investment proceeds, which were not sufficient to cover amortisation resulting in an overall deficit was$19.1 billion, or $13.2 billion (40.8%) better than programmed. Cash carried over from the previous fiscal year was used to plug the gap. Notably the primary surplus for the review period of $65.4 billion exceeded budget by $16.7 billion (34.5%).

Figure 2: T-bill yields and Net International Reserves




Source: BOJ and JMMBIT

Figure 3: Inflation




Source: Statin and JMMBIR

## Analyst's Opinion

The domestic currency has strengthened over the last three months but is not likely to continue along the same path going into Q1:18 as we expect the appreciation momentum to slow. Going forward economic fundamentals and market conditions will influence the movement of the currency. The fundamentals are headed in the right direction; the current deficit has narrowed, the fiscal deficit is broadly under control barring unexpected wage increases and capital inflows remain elevated. B-FIXIT has improved information symmetry consequently the currency should be well behaved for the upcoming fiscal year. This will allow the Bank of Jamaica to focus on targeting inflation.

The Government of Jamaica (GOJ) is expected to continue to implement the medium term fiscal policy and as such we are envisioning the primary balance target being met in FY 2017/18 and a fiscal surplus in FY 2018/19.

We do however foresee some challenges with the budget in FY 2018/19 where the GOJ is expected to reduce wage-to-GDP target to 9% of GDP, which is one of the main quantitative metrics under the precautionary Stand-by Agreement. New measures, including early retirement, have been announced however the financial impact has not yet been fully quantified.

Looking ahead, the macroeconomic environment is likely to be characterised by stability in some of the main economic variables including inflation, the exchange rate and interest rates.

# APPENDIX

## IMPORTANT DISCLOSURES

**ABSTRACT—**As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation **DEFINITIONS/RECOMMENDATIONS**.

**PLEASE NOTE** THAT NO INDIVIDUAL ASSET IN YOUR PORTFOLIO SHOULD HAVE A WEIGHTING GREATER THAN 5% UNLESS OTHERWISE RECOMMENDED BY YOUR PORTFOLIO MANAGER OR A SPECIFIC JMMB RESEARCH REPORT. CONSEQUENTLY THE FOLLOWING **DEFINITIONS** ARE PROVIDED FOR CLARITY.

**UNDERWEIGHT**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO LESS THAN 5% FOR THIS PARTICULAR ASSET

**SELL**—REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

**HOLD/MARKETWEIGHT**—EXPOSURE TO THE ASSET SHOULD BE EQUAL TO 5% OF YOUR TOTAL PORTFOLIO HELD AT JMMB.

**OVERWEIGHT/BUY**—EXPOSURE TO THIS ASSET SHOULD BE BETWEEN 5% AND 10% OF YOUR TOTAL PORTFOLIO HELD AT JMMB

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