INVESTMENT AND SOVEREIGN RESEARCH

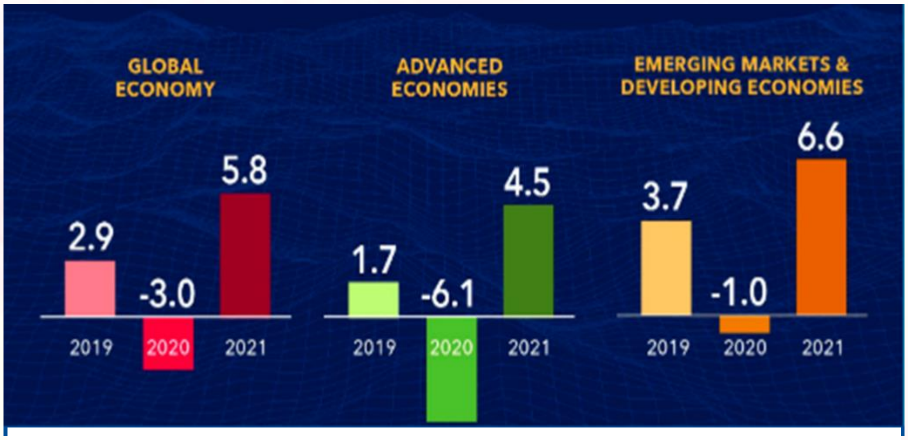
***SOVEREIGN*: Jamaica**

PLEASE SEE IMPORTANT DISCLOSURES IN THE APPENDIX

Assessment of the First Supplementary Budget

The Minister of Finance and Planning, Dr. Nigel Clarke, tabled in the Parliament in mid-May the first supplementary budget just two and a half months after tabling the Budget for FY 2020/21. In an opinion piece on the budget (**Jamaica Budget Opinion, March 2020**), we advised that there was a high risk that the budget would have to be recast due to the imminent threat of the novel coronavirus (COVID-19) and its potential impact on GDP growth and revenue flows. Our words were prescient as the virus has become a full-scale global pandemic infecting over 4.9 million persons and has so far caused the death of more than 321,000 individuals. Two of Jamaica's principal trading partners, the United States and the United Kingdom, are among the countries with the highest number of deaths at 91,500 and 36,300, respectively.

Figure 1: IMF Forecast



Source: IMF

The economies of these sovereigns, like there rest of the world, are likely to experience a recession in 2020. **The International Monetary Fund (IMF) is forecasting that GDP growth in the US and the UK will fall by 5.9% and 6.5%, respectively**. In addition, Canada's GDP is expected to contract by 6.2%. The US, UK, and Canada represents over 93% of the source marker for tourism and remittance flows to Jamaica. The IMF expects the global economy to contract by 3% in 2020 and recover to 5.8% in 2021. To contain the spread of the COVID-19 a number of countries, including Jamaica, closed their borders, while others imposed travel restrictions. These measures and an increase in unemployment in source countries have resulted in a decline in remittance flows and a precipitous fall in visitor and revenue flows to Jamaica. The net result of these and other developments in the domestic economy are a significant fall-off in economic activity across all sectors and a rise in unemployment. This signals lower potential revenue flows to the Government of Jamaica (GOJ).

Based on the Supplementary Budget, the government is programming to spend $838.2 billion, $15.3 billion, or 1.8% lower than the initial budget. The shift in the budgeted numbers represents, in part, an expected decline in revenues occasioned by a slowdown in the domestic and international economies.

On the revenue side, the government is expecting total inflows on $580.0 billion. This is a decline of $81.0 billion or 12.3% when compared to the $660.9 billion that was initially targeted. A Further breakdown of the numbers indicate that the government is now expecting inflows from Tax Revenue and Non-Tax Revenue of $510.1 billion and $65.0 billion, respectively. Juxtaposed against the original budget, these numbers highlight shortfalls of $78.7 billion (13.4%) and $2.3 billion (3.4%), respectively.

EXPENDITURE

Arising from the expected fallout in revenue, the profile of overall spending has shifted downwards. **The government is now expecting to spend $642.8 billion, $18.2 billion or 2.7% lower than the original budget**. However, Recurrent spending at $596.7 billion is $9.9 billion or 1.7% higher than the original budget. The jump mirrors higher spending on Programmes and interest of $4.7 billion (2%) and $4.9 billion (3.8%), respectively.

Table 1. Government of Jamaica Supplementary Budget, J$ millions

Item	Budget 2020/21	First Supp. 2020/21	Change	% Change
Revenue & Grants	**660,907.1**	**579,885.8**	**-81,021.3**	**-12.3%**
Tax Revenue	588,807.2	510,050.9	-78,756.3	-13.4%
Non-Tax Revenue	67,290.9	65,025.9	-2,265.0	-3.4%
Bauxite Levy	135.7	135.7	0.0	0.0%
Capital Revenue	336.0	336.0	0.0	0.0%
Grants	4,337.3	4,337.3	0.0	0.0%
Expenditure	**661,017.8**	**642,841.1**	**-18,176.7**	**-2.7%**
Recurrent Expenditure	586,814.6	596,740.2	9,925.6	1.7%
Programmes	232,802.7	237,478.5	4,675.8	2.0%
Compensation of Employees	221,357.6	221,611.8	254.2	0.1%
Interest	*132,654.2*	*137,649.8*	*4,995.6*	*3.8%*
Domestic	55,461.2	55,461.2	0.0	0.0%
External	77,193.0	82,188.6	4,995.6	6.5%
Capital Expenditure	74,203.3	46,101.0	-28,102.3	-37.9%
Fiscal Balance (Surplus + / Deficit -)	**-110.7**	**-62,955.3**	**-62,844.6**	**56758%**
Loan Receipts	**143,602.9**	**147,827.8**	**4,224.9**	**2.9%**
Domestic	109,224.4	111,224.4	2,000.0	1.8%
External	34,378.5	36,603.4	2,224.9	6.5%
Other Inflows	**32,193.0**	**22,805.8**	**-9,387.2**	**-29.2%**
Other Outflows	**37,260.8**	**37,260.8**	0.0	0.0%
Amortization	**155,189.7**	**158,048.2**	**2,858.5**	**1.8%**
Domestic	111,019.8	111,019.8	0.0	0.0%
External	44,169.9	47,028.4	2,858.5	6.5%
Overall Balance (Surplus + / Deficit -)	**-16,765.3**	**-87,630.8**	**-70,865.5**	**422.7%**
Primary Balance (Surplus +/Deficit -)	**132,543.5**	**74,694.5**	**-57,849.0**	**-43.6%**
Total Expenditure & Payments	**853,468.3**	**838,150.2**	**-15,318.2**	**-1.8%**

Initially the government had planned to spend $232.8 billion on Programmes, but this has now shifted to $237.4 billion. The budgetary change in part reflects the reallocation of resources to help persons who have lost their income due to an increase in unemployment. It also includes spending on supplies, equipment, and measures associated with combating the spread of COVID-19.

Owing to an expected steep decline in revenues and increased recurrent expenditure, capital expenditure was cut by 28.1% from $74.2 billion to $46.1 billion. This comes as no surprise as the government tries to rein in the fiscal deficit and debt-to-GDP ratio despite the challenges being faced. Consequent on the cut in CapEx, a large portion of the works on the eastern section of the highway from Harbour View to St. Thomas has been suspended.

The government now envisages a fiscal deficit of $63 billion (approximately 3% of GDP) compared to an almost balanced budget when the minister made his original budget speech in March.

A combination of an increase in the overall deficit and a depreciation of the Jamaica dollar are likely to cause the nominal debt as well as the cost of servicing the debt to rise. As expected, interest cost has increased to $137.6 billion compared to the original estimate of $132.6 billion. ***The rise is due wholly to an increase in external interest payments to $82.2 billion, up from $77.2 billion***. The change in foreign interest rates indicates that the government is likely to stay the course regarding programmed debt take-up in the domestic market, and the additional resources to fill the budget gap will be sourced either from the multilaterals or international capital market, or through a combination of both.

Below the line

As there is an overall deficit of $87 billion, $70 billion more than programmed, the funding profile in the supplementary budget is incomplete. The authorities expect loan receipts of $143 billion, $4.2 billion (2.9%) more than the original budget. Other inflows, being receipts from the divestiture of government assets, is expected to fall by $9.4 billion to $22.2 billion while no change is expected in other outflows amounting to $37 billion.

The revised estimate for Amortization is now $158.0 billion, which is $2.9 billion (1.8%) more than the original budget. The change is the due wholly to an increase in external amortization, which now stands at $47.0 billion, a rise of 6.5% over the initial figures.

The primary balance is expected to shrink from $132.5 billion (5.8% of GDP) to $74.6 billion (3.5%) of GDP. We expect the debt to GDP to rise to 104% by the end of the fiscal year.

Analyst's Opinion

The government expects that real GDP will fall by over 5%, which is in line with the IMF's estimate. The IMF noted in its outlook on the global economy, amid the COVID-19 pandemic, that conditions are likely to normalize by the second half of the year (H2:20). This view in our opinion is optimistic in light of how the situation on the ground is evolving in Europe and North America. The number of daily deaths, although falling, is falling at a slow rate in the US and parts of Europe. In the absence of a vaccine, the possibility exists of second, if not third and fourth rounds of infections. **Recall that there is to date, no scientific evidence that contracting the virus once and recovering excludes individuals from catching the virus again**. Most recently the Chinese authorities had to close down townships close to the Russian border due to a new wave of infections, which is thought to have been imported. **This is a stark reminder of the risk that governments contend with when they open up their economies.**

Considering the challenges facing the global economy, we expect inflows from tourism and remittance to remain subdued for the rest of the year. This will negatively affect operations across all sectors, including Agriculture, Retail and Distribution, and Manufacturing. Steep cuts in capital expenditure by the government will have a negative effect on the Construction Industry. **Our view is that the economy is likely to contract in real terms far more than that envisaged by the fiscal authorities.**

Built into the GOJ fiscal profile is some amount of optimism regarding how the global economy will evolve over the next 7 months, which is congruent with the IMF's outlook. We are not as optimistic as the GOJ or the IMF. As the situation in various parts of the world is fluid and the risk tilted to the downside, it is probable that revenue flows may fall even lower than expected. Therefore, it is highly likely that a second and third supplementary budget will be tabled to take these likely shifts into account.

IMF Money

The Execute Board of the IMF approved a loan to Jamaica amounting to US$520 million under the Rapid Financing Instrument (RFI) to mitigate the impact of the shock arising from COVID-19 on the sovereign's Balance of Payment (BOP) position. Tourism and remittance flows have subsided while demand for foreign currency remains relatively robust, tempered somewhat by a significant reduction in oil prices. The funds have been made available to support the external sector to ensure that sufficient foreign currency is available to meet the normal purchase of goods and services externally. ***These resources are not for budget support and therefore will not be used for this purpose***. ***As noted earlier it is likely that the GOJ will engage the multilaterals – World Bank and Inter-American Development Bank-to finance the $70 billion gap in the budget.***

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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