**PLEASE SEE IMPORTANT DISCLOSURES IN THE APPENDIX**

## Summary

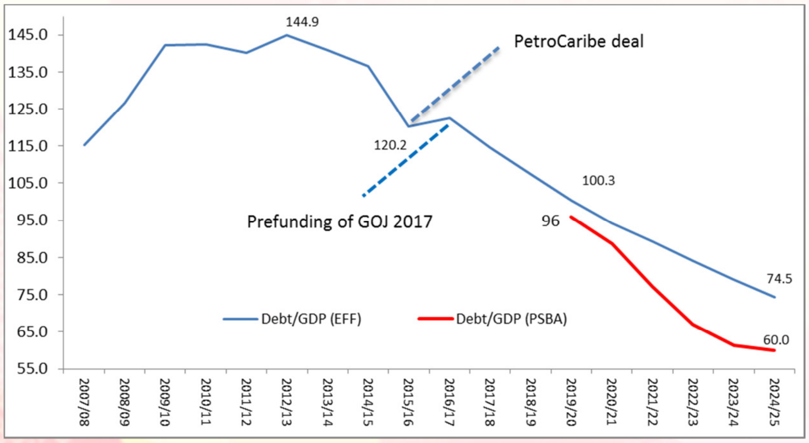
*Jamaica's debt-to-GDP ratio is expected to fall precipitously by end-FY2017/18 due in part to a change in the definition of debt which eliminates cross-holdings of securities by some public bodies. The debt ratio will continue to fall towards the targeted ratios at end-March 2020 and 2025, but may deviate because of non-realization of the growth rates envisaged by the authorities. It is expected that the main macroeconomic variables will remain stable in keeping with fiscal and monetary policies. However, a sustainable growth rate at or around 3% will remain elusive due to structural constraints.*

*Any shift in policies that deviate markedly from the current path and do not engender public confidence could negatively affect the expectation and outcomes of some the main economic variables, including inflation and exchange rates.*

*A rating upgrade for the sovereign is possible in the future if the authority continues with the fiscal reform programmes and reaps the reward of macroeconomic stability. This will usher in a period higher and sustainable growth and help to build buffers to reduce the impact of shocks.*

## Debt Operation

Figure 1: Jamaica's debt-to-GDP trajectory




Source: MOF, IMF and JMMBIR

Jamaica's debt-to-GDP ratio fell from 140.3% at end-March 2012 to approximately 122.5% at end-March 2017. The decline in the debt ratio reflects a combination of improvement in fiscal operations, lower deficits; an incremental increase in growth; and the execution of liability management programmes (LMPs), including two domestic debt exchanges. It is anticipated that the debt ratio will fall precipitously at the end of FY 2017/18 to approximately 103% of GDP.

What accounts for the significant shift in the debt ratio? Before answering this question we will digress and explore the fiscal accounts. For FY 2017/18, the GOJ is programming an overall deficit of $15.7 billion (0.8% of GDP) which is to be funded by excess cash carried over from the previous fiscal year arising from the global bonds issued to pre-fund the maturity of JAMAN 2017 (See figure 1). Assuming a normal depreciation rate in keeping with the average over the last 6 years, the debt ratio was expected to move to around 115% of GDP at the end of FY 2017/18. However, there is a noted shift downwards.

There are two working definitions of the public debt: One is the definition as per the GOJ and the other is the definition as per the International Monetary Fund (IMF) under the Extended Fund Facility (EFF) with Jamaica. The debt as defined by the GOJ includes Central Government, Bank of Jamaica and external guaranteed debt. The EFF definition includes all the items listed under the GOJ's definition plus net PetroCaribe[1] and domestic guarantee debt.

Subsequently, the definition of the public debt has changed which is consistent with the *Public Sector Debt Statistics Guide*. Under this new definition the public debt is the consolidated debt of Specified Public Sector (SPS) bodies net of any cross-holdings except those of the Bank of Jamaica. The SPS consists of the public sector, excluding any public body certified by the Auditor General as primarily carrying out functions that are of a commercial nature (Medium-term Debt Management Strategy FY2017/18 – FY2019/20).

To answer the question posed above, **the sharp decline in debt ratio owes much to the change in the definition of public debt which eliminates the cross-holdings by some public sector entities**. The question which flows from this is whether or not the GOJ is still obligated to repay the full nominal debt outstanding, to which the answer is in the affirmative. This however does not negate the progress made by the fiscal authorities in recent years under the aegis of IMF to cauterize the deficit, place fiscal operations on a sustainable path, and reduce the debt ratio.

**Refinancing Risk**

Significant strides have been made by the GOJ in reducing the proportion of debt falling due in 5 years and under. The standard assessment of refinancing risk is to look at the proportion of debt that falls due in one year and under, then simultaneously assess market conditions and appetite for government debt. Post-NDX, the proportion of debt in this bucket was relatively high, a little over 50%, which was a major cause for concern. It signals not only refinancing risk in the portfolio but also the continued engagement by the GOJ in the domestic capital market for a large quantum of funding and intense competition with private investors for loanable funds.

As a consequence of the LMPs (Liability Management Programs) that have been undertaken by the GOJ, a key part of the debt strategy, refinancing risk, has been greatly reduced. **Data as at June 2017 indicates that $394.3 billion or 20.3% of the total debt falls due in 5 years or under, which is a marked decline from prior years.**

[1] Under the PetroCaribe Accord between the GOJ and the Bolivarian Government of Venezuela, the PetroCaribe Development Fund (PDF) was established by the GOJ to manage the process of the shipment of crude oil to Jamaica and payments to Venezuela. Part of the payments due to Venezuela was converted into long-term loans at concessionary rate. The GOJ barrowed from the PDF to help finance the budget.

Jamaica does not face a balance of payment problem at this time, nonetheless the GOJ engaged the IMF and signed a precautionary Stand-by Agreement to 1) provide US$1.6 billion liquidity buffer in the event of external shocks that could affect the balance of payment accounts; 2) continue to receive advice and guidance from the Fund team of technocrats; and 3) continue to receive favourable write-ups from the Fund and other multilateral partners that speak to the ongoing positive developments taking place with the sovereign's macro-fiscal programme. This story has a positive impact on how the sovereign is viewed by external investors and has in part contributed to the buoyancy in GOJ global bond prices.

**Ratings Action**

Jamaica is currently rated B and B3 by Standard and Poor's (S&P) and Moody's, respectively. Both rating agencies view the outlook as stable. In September 2017 S&P reaffirmed the sovereign's single B credit ratings and stable outlook. The ratings agency is of the opinion that the GOJ fiscal reform effort will continue apace. Like us however S&P noted that structural impediments to growth will take long to dissolve. The general thesis from S&P, like Moody's, is that macroeconomic fundamentals have improved and some of the leading indicators are expected to remain stable over multiple periods. S&P shares the view that debt and high interest rate burdens will continue to impair a possible rating upgrade despite the progress made by the authorities. The ratings agency expects the fiscal accounts to shift to a surplus, the primary balance to over-perform and the government to meet the debt target in 2020.

**We are of the opinion that the external accounts remain highly susceptible to shocks** – bad weather, including hurricanes and sharp upward adjustments in external prices, particularly crude oil prices while the growth outturn lags projections. Having weighed the macro-fiscal path and institutional strength of the sovereign, no shift is expected in ratings in the short to medium term. A rating upgrade for the sovereign is possible in the future if the authorities continue with the fiscal reform programmes and reap the reward of macroeconomic stability. This will usher in a period of higher and sustainable growth and help to build buffers to reduce the impact of shocks.

**Growth and Unemployment**

Economic performance was tepid during the first half the year, but is expected to improve during the second period. The resumption of bauxite production at the local plant at Nain, St. Elizabeth, is expected to drive output in Mining and Quarrying with some spillover effect on other sectors. Year on year growth in Q1:17 and Q2:17 were 0.1% and 0.3%, respectively. The Service Industry expanded in both quarters while the Goods Industry declined. Growth in the Service industry was led by Tourism, up (1.1%) and (8%) in the respective quarters. Despite contraction in the Goods Production sector, growth was observed in Construction and Manufacturing during both quarters.

Looking ahead, we are expecting the economy to grow above one percent per annum, but lower than the 3% growth rate outlined in the Fiscal Policy Paper. Expansion in output from Tourism, Construction and Agriculture is expected to lead the way. Higher growth rates over the short- to medium-term in the absence of a 'new sector' to push the growth momentum will be difficult and constrained by elevated crime levels and a large unskilled labour force with weak spending power.

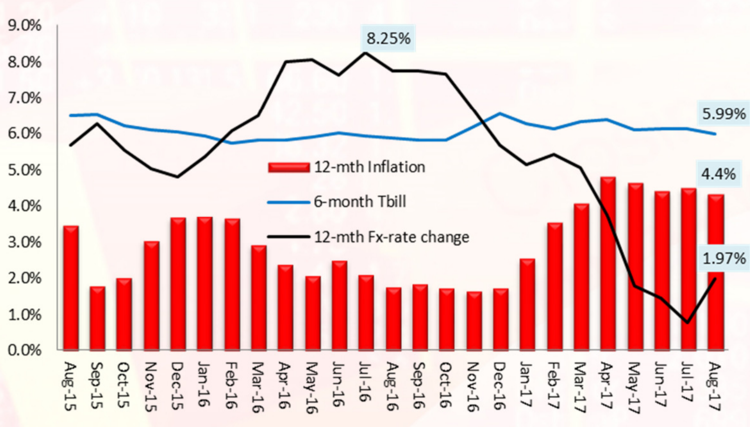
In June the employed labour force increased by 35,800 persons to 1,204,800 persons relative to April 2016. Overall unemployment was down to 12.2% in April 2017 when compared to 13.7% in April 2016. Incremental reductions in unemployment is expected over the medium-term in keeping with expected expansion in tourism and construction as well as Business Process Outsourcing (BPO) operations.

**Opinion**

**Jamaica's debt trajectory has fallen over the last two fiscal cycles and is expected to continue to move towards the levels embedded in the Public Debt Management Act of 96% and 60% by end-March 2020 and 2025, respectively**. However, based on our expectation of real GDP growth and the fiscal balance, we are projecting marginally higher debt levels when compared to the targets.

We do however maintain the view that the leading macroeconomic variables will remain stable over multiple periods in keeping with prudent fiscal and monetary policies. Any shift in policies that deviate markedly from the current path and do not engender public confidence could negatively affect the expectation and outcomes of some of the main economic variables, including inflation and the exchange rate. Given the risk associated with any sudden policy shift that could have negative consequences, we do not envisage any major change in monetary and fiscal policies over multiple periods.

Figure 2: Selected macroeconomic variables




Source: BOJ, STATIN, JMMBIR

Real economic growth at or above 3% per annum on a sustainable basis is unattainable in our opinion at this time. Despite the economic reforms being undertaken by the Government, the economy remains in a transitory state; its capacity to grow organically is weak; and linkages with the rest of the economy from high growth sectors like tourism is not very strong. The income of the vast majority of persons employed is supressed, particular those in the Agriculture and Wholesale & Retail sectors which account for 34.4% of the labour force. Disposable income is supplemented by remittance flows and no major shift is envisaged given the growth trajectories for the main source countries – USA, Canada and the UK. Investment flows continue to improve but is relatively subdued while the government's capacity to spend more is constrained by fiscal austerity. In the absence of any new sector in the domestic economy, the prospect for accelerated economic growth is severely constrained by the factors cited above.

**Source:** ***Bloomberg, Bank of Jamaica, Jeffries, Ratings Direct, STATIN***

# 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.

## *COPYRIGHT INFRINGEMENT*

*The investments referred to in this report may not be suitable for you should consult your licensed investment advisor. Nothing in this report constitutes investment, legal, accounting or tax advice or a representation that any investment or strategy is suitable to your individual circumstances or otherwise constitutes a personal recommendation to you.*

## *Disclosure Under The Securities Act*

*This disclosure is being provided pursuant to section 39 of the Securities Act. This research report is prepared by Jamaica Money Market Brokers Limited (JMMB) and the information and views expressed are those of JMMB. JMMB is a subsidiary of the JMMB Group Limited (JMMBGL). Associated persons of JMMB include JMMBGL and its subsidiaries and affiliated companies, including JMMB Fund Managers Limited, a licensed securities dealer and manager of collective investment schemes.*
*As at the date of this report, JMMB and its affiliates, directors, officers, employees and other associated persons may from time to time buy or sell, or act as principal or agent in, the securities mentioned in this research report. JMMB or its affiliates, directors, officers and employees have no interest in or interest in the acquisition or disposal of the securities other than expressed above. No part of their compensation is or will be related to the recommendations or opinions in this report.*