GOVERNMENT OF JAMAICA

# MEDIUM-TERM DEBT MANAGEMENT STRATEGY 2014/15 - 2016/17

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## FOREWORD

The Government of Jamaica (GOJ) is pleased to publish its annual Medium-Term Debt Management Strategy (MTDS) for FY 2014/15 - FY 2016/17 which was guided by the Toolkit developed by the International Monetary Fund (IMF) and the World Bank.

In an environment requiring increased accountability and transparency, this document, governed by the Public Debt Management Act, 2012, (PDMA), represents the GOJ's unwavering commitment to developing and executing feasible strategies designed to reduce the public debt to a sustainable level. These carefully developed strategies involve ensuring that the Government's overall borrowing requirements are met at minimum cost with prudent levels of risk. The Annual Borrowing Plan outlined in the MTDS gives investors time to plan and configure their portfolios to accommodate new Government issuances.

Additionally, the Fiscal Responsibility Framework governs continued strengthening of the overall fiscal policy framework that will facilitate the achievement of objectives outlined in the MTDS.

In keeping with the objective of inclusiveness and open dialogue with stakeholders, the GOJ welcomes your comments at: pdr@mof.gov.jm

Peter D. Phillips PhD, MP
Minister of Finance and Planning
April 17, 2014

Devon Rowe
Financial Secretary
April 17, 2014

**ACKNOWLEDGEMENTS**

The Government of Jamaica (GOJ) continues to implement critical strategies and reforms to return the public debt to a sustainable level. Accordingly, the Debt Management Branch (DMB) in the Ministry of Finance and Planning remains steadfast in its efforts to pursue prudent avenues to fund the needs of the Government at minimal cost and risk.

Sincere thanks must be given to the DMB team for their valuable contributions and dedication to the process, ensuring that the contents and quality of this document meet international standards.

I would also like to express special thanks to Miss Darlene Morrison, the Deputy Financial Secretary, Economic Management Division; Mrs. Michele Robinson, Debt Management Consultant; staff of the World Bank, and the Public Debt Management Committee for their support, guidance and input which contributed to the development of this publication.

Dian Black
Principal Director (Acting)
Debt Management Branch

## 1. Introduction

The annual update of the Medium-Term Debt Management Strategy (MTDS) outlines the Government of Jamaica's (GOJ) objectives, strategies and plans for the management of the public debt over the medium-term. The GOJ is committed to maintaining fiscal discipline and achieving a stable macroeconomic path. This includes reducing the debt-to-GDP ratio to more manageable levels in order to engender sustainable economic growth and development. Consequently, a comprehensive set of reforms have been completed or are in the pipeline to assist in this process. These reforms are geared towards, *inter alia*, improving the competitiveness of the domestic economy and fostering economic growth, while maintaining a sound and viable financial system. In addition, the reforms encompass greater transparency in the country's fiscal affairs and public debt management.

The MTDS is designed to minimise cost in the portfolio while maintaining risks at prudent levels. Debt operations are also informed by the debt strategy guidelines as shown in **Box 1**. Towards this end, the maintenance of prudent risk levels in relation to the average time to maturity (ATM), proportion of fixed- and variable-rate debt and proportion of foreign currency debt relative to total debt are important in structuring the debt portfolio. Consideration is also given to minimising the cost of the debt to assist with management of the fiscal balance. When financed through loans, a fiscal deficit contributes to a nominal increase in the debt stock. The specifics of the MTDS entail issuing securities along all segments of the domestic yield curve with emphasis on fixed interest-bearing instruments with long tenors. This will be complemented by the issuance of bonds in the international capital markets (ICMs) to rollover maturing bonds while simultaneously sourcing foreign currency loans from official creditors to meet cost/risk objectives.

The annual and medium-term targets are presented in **Table 2**. Achieving these targets is subject to the convergence of several factors that are not necessarily mutually exclusive. These include, but are not restricted to, prudent debt management practices, sustained fiscal discipline, favourable market conditions and continued support from multilateral partners. The rationale for achieving these targets is to reduce the vulnerability of the portfolio to market (interest rate, exchange rate and inflation) and rollover risks.

This paper is divided into seven sections including the introduction. Section II provides a cost-risk analysis of the debt portfolio including an overview of the actual achievements in FY 2013/14. Section III gives an overview of the macroeconomic scenarios and implications for the strategy as well as risks to the strategy. Section IV looks at the Medium-Term Debt Management Strategy, including a brief description of cost/risk analyses undertaken, description of the selected strategy and targets for the medium-term. Section V looks at the development of the

domestic debt market. Section VI sets out the annual borrowing plan which includes financing needs for the fiscal year, detailed strategy issuances and targets as well as the schedule of issuances. Section VII addresses special topics relating to the Public Debt Management Act and sovereign rating developments.

**Box 1: Debt Strategy Guidelines**

- Mitigate foreign exchange risk;
- Gradually increase the proportion of fixed rate debt to floating rate debt;
- Maintain or increase the average maturity of the outstanding debt;
- Smooth the maturity structure, with special emphasis on the domestic debt; and
- Promote the development of the domestic capital market.

## 2. Cost-risk Analysis of the Current Debt Portfolio

The stock of debt at end-March 2014 stood at $1,946.0 billion which was $133.4 billion or 7.4% more than the outturn for end-March 2013. The increase in the debt stock was due primarily to depreciation of the domestic currency vis–à–vis a basket of currencies, including the US dollar which added approximately $108.6 billion or 6.0% to the debt stock. In addition, the Government's assumption of contingent liabilities of Clarendon Alumina Production Ltd. (CAP) and Wallenford Coffee Company Ltd. (WCC) added US$258.3 million (approximately $28.3 billion) to the debt stock. **Table 1** shows a breakdown of the debt by creditor category.

Table 1: Total Debt Stock by Creditor

| | end-March 2013 | | end-March 2014 | | Change | |
|---|---|---|---|---|---|---|
| | J$ Billion | % total debt | J$ Billion | % total debt | J$ Billion | % |
| **Total Debt** | **1,812.6** | **100.0** | **1,946.0** | **100.0** | **133.4** | **7.4** |
| **Total domestic debt** | **1,008.3** | **55.6** | **1,024.5** | **52.6** | **16.2** | **1.6** |
| ***Marketable Securities*** | ***896.0*** | ***49.4*** | ***871.2*** | ***44.8*** | ***-24.8*** | ***-2.8*** |
| Bonds | 892.0 | 49.2 | 867.2 | 44.6 | -24.8 | -2.8 |
| Treasury bills | 4.0 | 0.2 | 4.0 | 0.2 | 0.0 | 0.0 |
| ***Loans*** | ***112.4*** | ***6.2*** | ***153.3*** | ***7.9*** | ***40.9*** | ***36.4*** |
| **Total external debt** | **804.3** | **44.4** | **921.5** | **47.4** | **117.2** | **14.6** |
| ***Marketable Securities*** | ***361.3*** | ***19.9*** | ***396.7*** | ***20.4*** | ***35.4*** | ***9.8*** |
| Bonds | 361.3 | 19.9 | 396.7 | 20.4 | 35.4 | 9.8 |
| ***Loans*** | ***443.0*** | ***24.5*** | ***524.7*** | ***27.0*** | ***81.7*** | ***18.4*** |
| Bilateral | 79.3 | 4.4 | 93.0 | 4.8 | 13.7 | 17.3 |
| Multilateral | 318.9 | 17.6 | 386.5 | 19.9 | 67.6 | 21.2 |
| IMF | 82.5 | 4.6 | 88.7 | 4.6 | 6.2 | 7.5 |
| IDB | 124.1 | 6.8 | 157.0 | 8.1 | 32.9 | 26.5 |
| IBRD | 63.9 | 3.5 | 83.7 | 4.3 | 19.8 | 31.0 |
| Other | 48.4 | 2.7 | 57.1 | 2.9 | 8.7 | 18.0 |
| Private creditors | 44.8 | 2.5 | 45.2 | 2.3 | 0.4 | 0.9 |

Source: Ministry of Finance and Planning

The Government programmed a set of annual quantitative targets and benchmarks to meet its cost/risk objectives over the medium-term (FY 2013/14 - 2016/17). The FY 2013/14 outcome compared to the targets for FY 2013/14 as well as the FY 2016/17 targets are outlined in **Table2.**

**Table 2: Debt Targets and Outcomes**

| | Outcomes | | | Targets | | |
|---|---|---|---|---|---|---|
| | Mar 2013 | Mar 2014 | Change | Mar 2014 | | Mar 2017 |
| Indicators | | | | Min | Max | |
| ***Profile (%)*** | | | | | | |
| **Domestic Debt:** | | | | | | |
| Fixed-rate | 66.2 | 67.0 | 0.8 | 65.0 | 68.0 | 70.0 |
| Floating rate* | 33.8 | 33.0 | -0.8 | 32.0 | 35.0 | 30.0 |
| Inflation-linked | 2.0 | 2.1 | 0.1 | - | 2.0 | 2.0 |
| **External Debt:** | | | | | | |
| Fixed-rate | 67.8 | 63.8 | -4.0 | 65.0 | 75.0 | 70.0 |
| Floating rate | 32.2 | 36.2 | 4.0 | 30.0 | 35.0 | 30.0 |
| *Total Foreign currency debt* | *55.5* | *58.7* | *3.2* | - | *56.5* | *61.0* |
| Proportion of foreign currency in domestic debt | 20.0 | 21.5 | 1.5 | 20.0 | 22.0 | 17.0 |
| **Cost Structure** | | | | | | |
| Average Interest Cost (Total): | 7.4 | 6.8 | -0.6 | 7.0 | 7.8 | <10.0 |
| Domestic | 9.2 | 8.6 | -0.6 | 8.0 | 9.0 | - |
| External | 5.1 | 4.5 | -0.6 | 5.0 | 5.8 | - |
| **Maturity structure** | | | | | | |
| Average Maturity (years) | 11.9** | 10.8 | -1.1 | 8.2 | 8.7 | ≥9.0 |
| % Maturing in 1 year: | 5.0** | 5.0 | - | - | 8.0 | ≤10.0 |
| Domestic | 3.5 | 0.5 | -3.0 | - | - | - |
| External | 1.5 | 4.5 | 3.0 | - | - | - |
| Contingent Liabilities (% of GDP) | 12.6 | 11.8 | -0.8 | - | - | 8.0 |

Source: Ministry of Finance and Planning

*Include inflation-linked debt

**Figures revised

## 2.1. Foreign Currency Denominated Debt

The Government projected that the proportion of foreign currency denominated debt to total public debt would be no more than 56.5% at the end of the fiscal year. The outturn for end-March was 58.7%, 2.2% greater than programmed. Deviation from the target was due to the assumption of debts from CAP and WCC. The debt assumption relating to CAP and WCC is reflected in the share of foreign currency debt in the domestic portfolio which increased to 21.5% or 1.5% relative to end-March 2013, and is within the programmed range of 20.0%-22.0%.

### 2.2. Interest Rate Sensitive Debt

The proportion of variable-rate domestic and external debt in the portfolio at end-March 2014 amounted to 33.0% and 36.2% respectively. The outcome for domestic variable-rate debt was within the targeted range of 32.0%–35.0%. However, the external variable-rate debt exceeded the upper band of the target (35.0%) by approximately 1.2 percentage points (See **Table 2**). The deviation was due to the Government contracting convertible-rate loans from multilateral sources to take advantage of low London Interbank Offered Rate (LIBOR) to replace maturing fixed-rate domestic US dollar-denominated bonds. The Government intends to reduce the proportion of variable-interest rate debt in the portfolio to no more than 30.0% over the medium-term.

### 2.3. Inflation-linked Debt

The outturn for the proportion of inflation-linked debt to total public debt was 2.1%, which remained relatively flat over the last three fiscal years. This is just minimally over the target of 2.0% at end-FY2013/14.

### 2.4. Cost Structure

At end-March 2014, the average interest cost for the total public debt (interest payable over the period as a percentage of the average outstanding debt) was 6.8%, below the targeted range of 7.0% - 7.8%. Average interest costs for domestic and external debt were 8.6% and 4.5% respectively, which were lower than and within the targeted ranges (See **Table 2**). Contributing to the lower average domestic interest costs and consequently to lower average total interest costs is the Government's assumption of contingent liabilities amounting to US$258.3 million ($28.3 billion) in the latter half of the fiscal year on which no interest was paid as well as the lower than projected outturn on domestic Treasury Bill yields up to the third quarter. Treasury Bill yields and LIBOR are the main reference rates used to compute domestic and external variable interest cost. The lower-than-planned outturns for Treasury Bill yields contributed to domestic interest cost and consequently to average interest cost falling below target.

Average yields on the 1-, 3- and 6-month Treasury Bills were 6.76% p.a., 8.35% p.a. and 9.11% p.a., at end-March 2014. The rates increased by 1.39, 2.53 and 2.89 percentage points, respectively, relative to end-March 2013. Conversely, LIBOR trended down over the period; however, both were within the targeted range.

### 2.5. Maturity Profile

The average time-to-maturity (ATM) refers to the average life of all debt in the portfolio. It is a relatively good measurement of the combined level of refinancing and interest rate risks embedded in the portfolio. A short ATM indicates that a significant proportion of the debt will have to be refinanced over a short span of time. Debt that becomes due is subject to both rollover and interest rate risks. The Government intends to maintain a relatively long ATM to help mitigate these risks.

At end-March 2014, the ATM of the total debt portfolio was 10.8 years, showing a slight decrease over the figure of 11.9 years[1] at end-March 2013. The portfolio benefited in FY 2013/14 from loans contracted from official sources and the PetroCaribe Development Fund (PCDF), which had tenors greater than 10 years. The ATM for domestic and external debt was 10 years and 12 years, respectively. The strategy over the medium-term is to maintain an ATM of 9 years or more in the portfolio, to mitigate refinancing risk.

### 2.6. Risk Assessment

The Government's Medium-Term Debt Strategy is geared towards the design of a portfolio which will minimise costs and mitigate risks[2]. Risk mitigation plays a pivotal role in sound debt management practice, as it helps the debt office to design an optimum portfolio to curtail the potential impact of volatility in financial markets and negative changes in macroeconomic variables. The domestic economy is susceptible to exogenous shocks and adverse changes in the macroeconomic environment which pose significant downside risks to debt management. It is not possible to structure a debt portfolio that is fully insulated from risks. However, it is possible to put in place mechanisms to mitigate risks. The portfolio is exposed to two main types of risks: market and refinancing risks.

### 2.7. Market Risks

Market risks speak to changes in macroeconomic or financial variables, such as exchange rates, interest rates, and inflation that have a direct impact on the cost of debt. Depreciation of the Jamaica dollar increases debt servicing cost and the debt stock. Inflation directly impacts the debt stock and debt servicing costs through inflation-linked bonds which move commensurately with the Consumer Price Indices (CPI). Movements in short-term interest rates and/or a shift in

[1] The ATM was revised for end-March 2013.

[2] The Government decides on an acceptable cost-risk trade-off suited to Jamaica's fiscal context and the Government's risk tolerance.

the yield curve have implications for debt servicing costs for existing variable-interest rate and newly contracted debt instruments.

### *2.7.1. Interest Rate Risk*

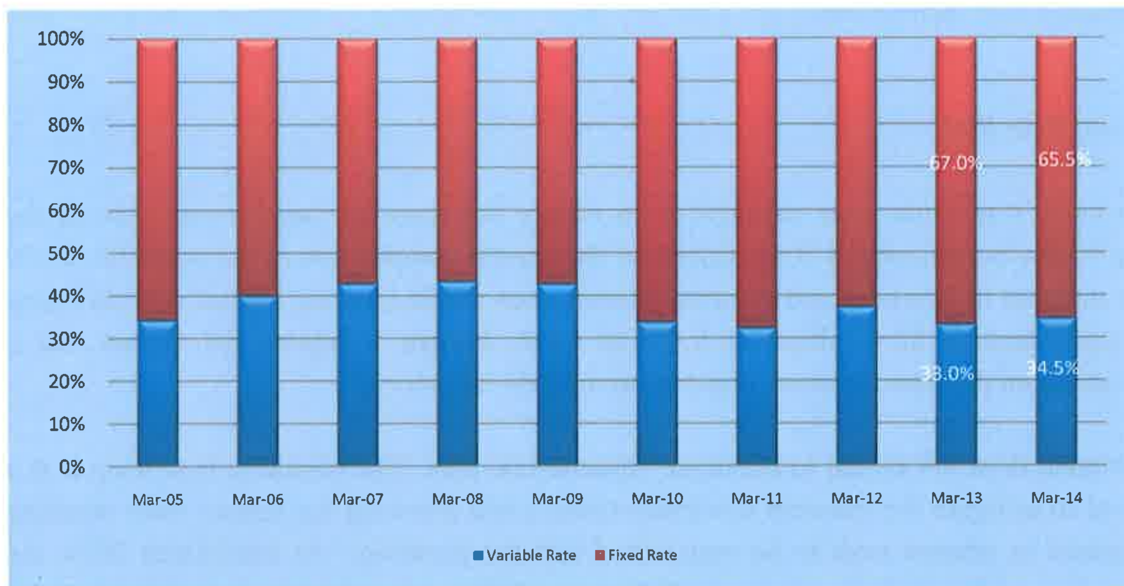
The Government's medium-term objective is to reduce the share of variable-rate debt in the portfolio to 30.0% by end-March 2016. Based on the current composition of the portfolio, a 100 basis-point increase in domestic and external interest rates would increase annual debt servicing costs by approximately $6.4 billion or 0.4% of GDP. **Figure 1** depicts the impact that a permanent shock on domestic interest rates has on the debt trajectory.

The Government does not intend to eliminate variable-rate debt. The objective is to keep it at a prudent level to mitigate the inherent downside risks, while allowing for upside risks resulting from a decrease in interest rates to be transmitted into the portfolio. At end-March 2014, the proportion of variable-rate debt in the portfolio was 34.5%, representing an increase of 1.5 percentage points relative to end-March 2013.

**Figure 1: Domestic Debt Interest Payments to GDP**

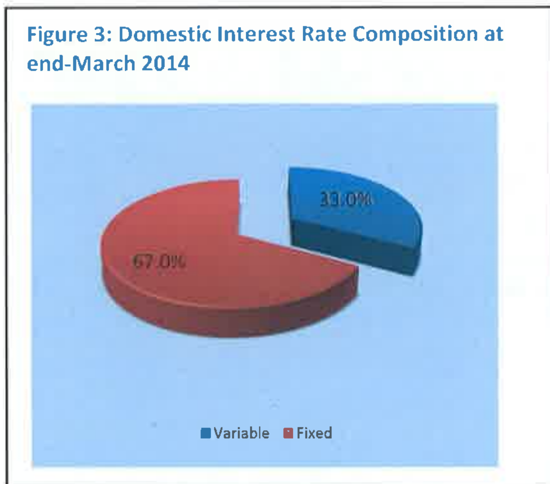
Source: Ministry of Finance and Planning

Figure 2: Variable- and Fixed-rate Debt as a Proportion of Total Debt



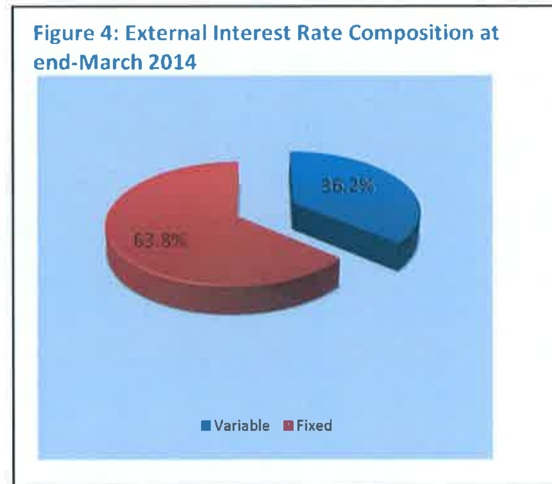

Source: Ministry of Finance and Planning

Figure 3: Domestic Interest Rate Composition at end-March 2014




Source: Ministry of Finance and Planning

Figure 4: External Interest Rate Composition at end-March 2014

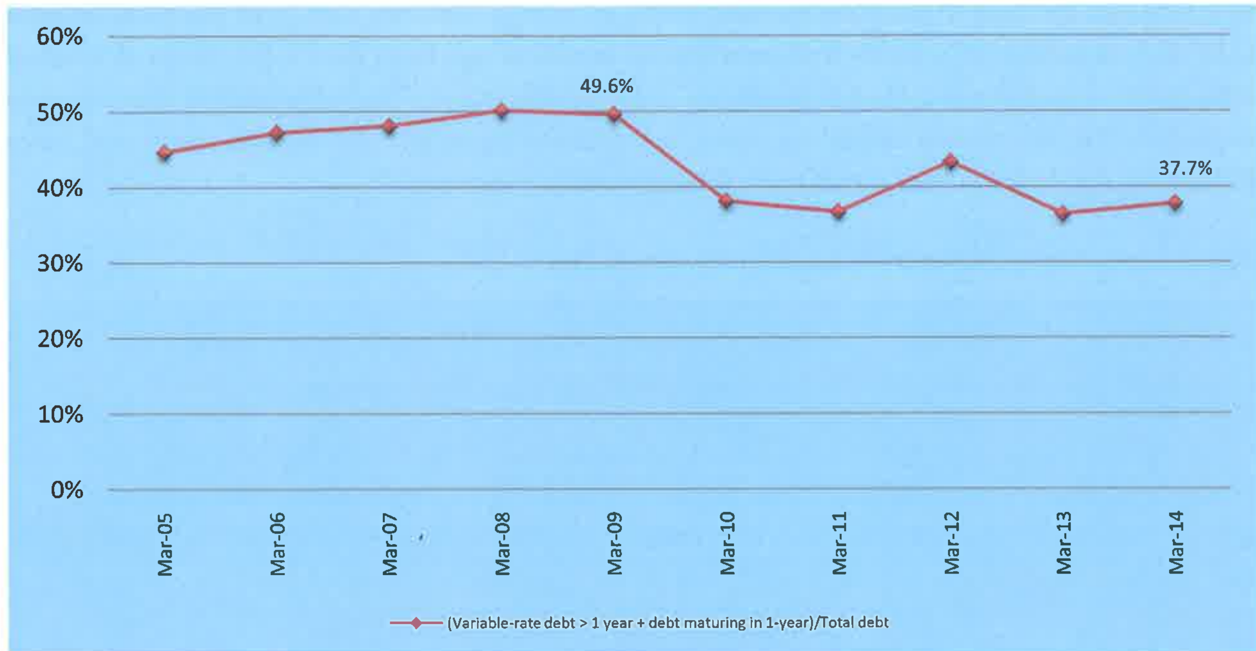



Source: Ministry of Finance and Planning

**Figure 5** shows the evolution of variable-rate debt with maturities greater than one year and debt maturing in one year or less as a proportion of total debt. The measure is a good indicator of the total risk in the portfolio as a result of interest rate changes on debt due to be refinanced in 12 months or less, as well as interest rate resets on existing variable-rate debt. The ratio has consistently declined since March 2008, except in March 2012 when it increased as a result of the Government re-opening benchmark domestic bonds with maturities of less than one year to

meet financing requirements. Consistent with the strategy to smooth the maturity profile over the medium-term and reduce the proportion of the variable-rate debt, the ratio of variable rate debt in the portfolio should continue to trend downwards.

Figure 5: Debt maturing in 1-year and Variable Rate Debt with Maturities Greater than 1 year as a Percentage of Total Debt




Source: Ministry of Finance and Planning

### *2.7.2. Foreign Exchange Risk*

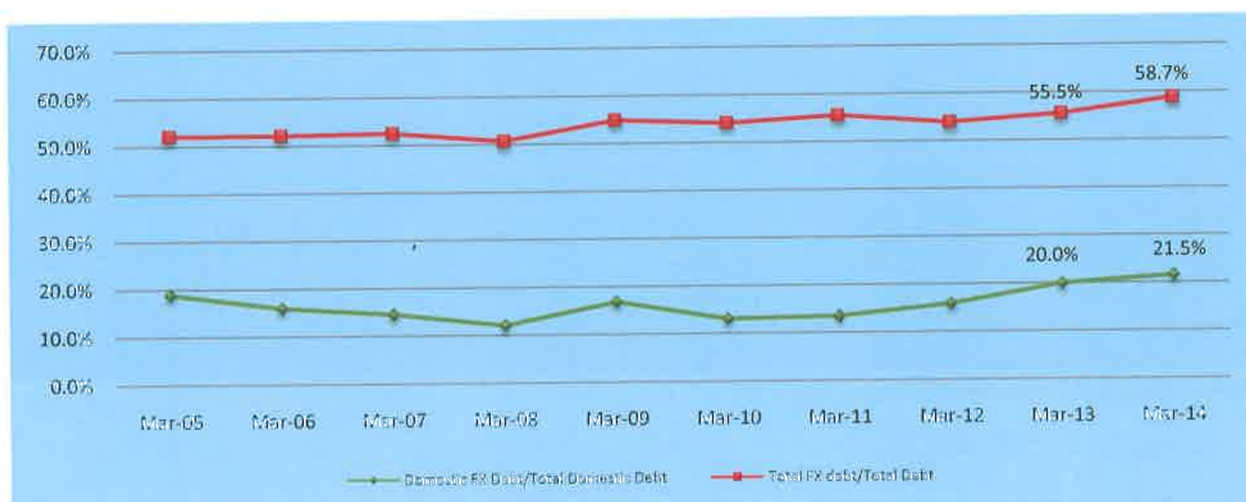
Depreciation of the Jamaica dollar has had a negative effect on debt servicing costs as well as on the debt stock, as a significant proportion of the debt portfolio is denominated in foreign currency. During the review period the domestic currency depreciated by 10.8% relative to the US dollar. In order to insulate the debt portfolio from exchange rate movements, it would be ideal to have the public debt denominated solely in domestic currency. However, the local capital market is not sufficiently deep and liquid to absorb the Government's demand for financing without causing adverse movements in domestic interest rates and/or crowding out of the domestic private sector. Consequently, the Government has secured budgetary financing from external sources. In addition, some domestic investors have a desire to hold foreign-currency local debt in their investment portfolio.

It is impractical to eliminate foreign currency debt over the medium-term. Foreign currency debt allows for portfolio diversification and external foreign currency debt often is more concessional

than similar financing sourced domestically. The Government will maintain the foreign currency debt target at or below 61.0% over the medium-term and will continue to issue debt instruments in the international capital markets and source loans from official creditors to complement domestic market issuances.

The strategic decision to maintain the proportion of foreign currency debt over the medium-term is to take advantage of inflows from multilateral creditors and from the PCDF, at lower interest rates relative to domestic market issuances with similar tenors. Notwithstanding the currency exposure, the favourable terms on these instruments outweigh the current risks and have influenced the decision to contract more foreign currency loans.

Figure 6: Foreign Currency Domestic and Overall Foreign Currency Debt

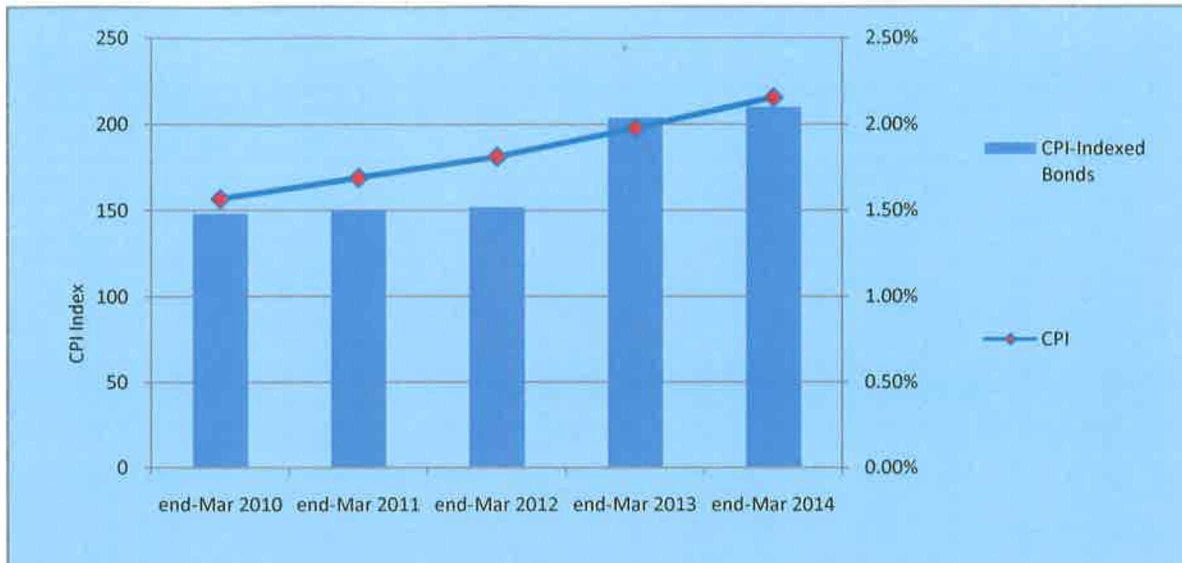



Source: Ministry of Finance and Planning

### *2.7.3. Inflation Risk*

Inflation risk is the probability that the country will face higher debt servicing costs arising from increases in the price of inflation-linked bonds in the debt portfolio due to changes in the price levels. As depicted in **Figure 7**, the level of inflation risk in the portfolio remained low up to end-March 2014, as only 2.1% of total debt was inflation-linked. Despite the relatively high risk inherent in these bonds, the portfolio derives some benefit from the ATM of these bonds of more than 20 years. The Government will, however, continue to curtail the level of inflation-linked bonds by not issuing new instruments during the medium-term.

Figure 7: The Consumer Price Index and the proportion of Index-linked Bonds Relative to Total Debt at end-March 2010 – end-March 2014

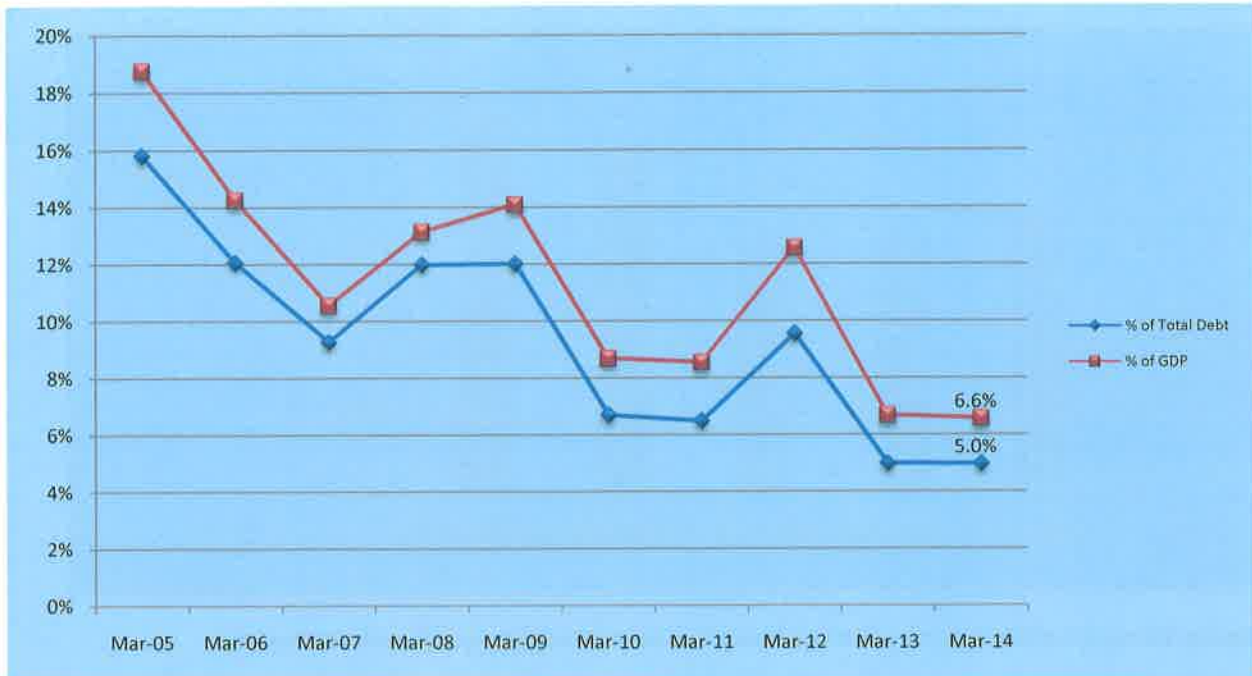



Source: Statistical Institute of Jamaica (STATIN), Bank of Jamaica and the Ministry of Finance and Planning

## 2.8. Refinancing Risk

Refinancing risk is the probability that the Government will experience difficulties rolling over maturities. Three measures of the level of refinancing risk inherent in the debt portfolio are: (i) the proportion of debt that becomes due in one year or less, (ii) the average time-to-maturity (ATM) and (iii) duration.

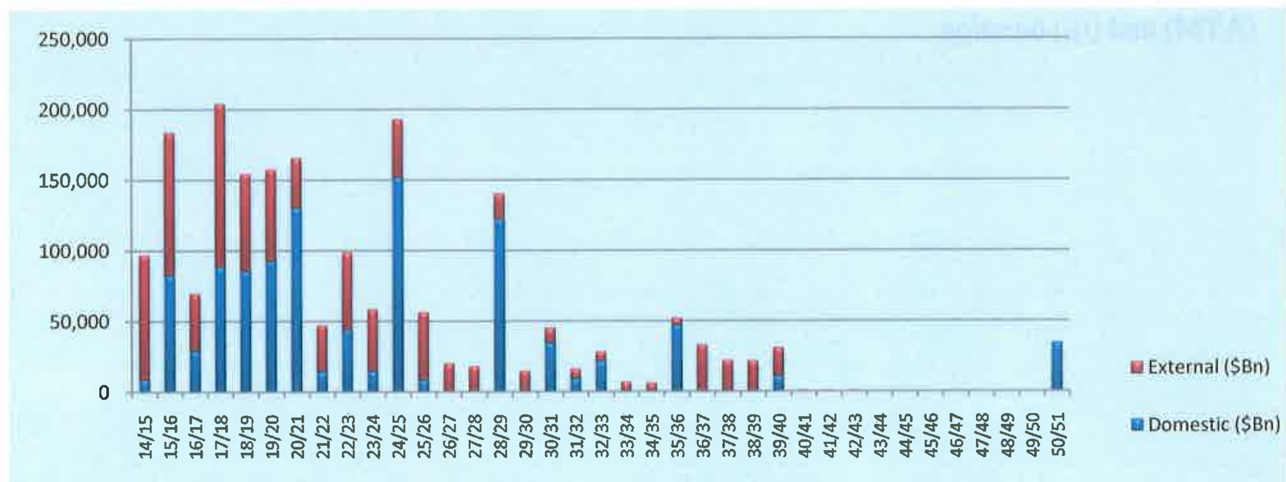
Figure 8: Debt maturing in 1-year as a Percentage of GDP and Total Debt




Source: Ministry of Finance and Planning '

## 2.9. Maturity Structure

Figure 9: Maturity Structure of Total Debt (in J$ million)




Source: Ministry of Finance and Planning

At end-March 2014, the proportion of total debt that amortises in one year or less was 5.0%, as indicated in **Figure 8**. Over the past 10 years, the proportion of debt maturing in one year or less as a percentage of GDP and total debt has trended downwards. The ratios are expected to remain low over the medium-term in keeping with the Government's effort to smooth the maturity profile. The current maturity profile is depicted in **Figure 9**.

Duration is a widely used indicator of refinancing risk and also of interest rate risk. It is defined as the weighted average maturity of fixed income securities, where the weights are the present value of the cash flows. It is also a measure of how sensitive debt service is to changes in interest rates. Bonds with higher duration carry less risk for sovereigns compared to those with lower duration. Higher duration signifies that changes in interest rates will have a gradual impact on debt payments. Conversely, lower duration indicates that debt payments will be more immediately impacted by changes in interest rates. The GOJ will strive to maintain a portfolio with relatively high duration.

As at 31 December 2013, the duration of the portfolio was approximately 10 years. This indicates that on average, the Government's debt obligations, including principal and interest payments, become due within 10 years.

**Figure 10: Average Time to Maturity (ATM) and Duration**

Source: Ministry of Finance and Planning

## 2.10. Indicators of Vulnerability

Debt service generally refers to the amount of cash that is needed to cover the payment of interest and principal on debt over a particular time period. Events that could jeopardize the servicing of the debt, specifically those events that impact the availability of funds which could severely challenge the Government's ability to meet its obligations present a risk to debt service. These include shortfalls in tax revenues, demand-side and liquidity risks (See **Box 2**). Therefore, the Government will focus on ways to minimise the debt portfolio's exposure to market risks and exogenous shocks that could impair the ability to service debt.

**Box 2: Definitions: Demand-side and Liquidity Risk**

Demand-side Risk

Market conditions can alter the supply of funds available from investors desirous of participating in sovereign debt issues. If conditions are unfavourable to lenders they may show a preference for alternative investments available to them. *Ceteris paribus*, the sovereign may face increased interest rate premium on new issues in order to attract investors, and even then, may still find it extremely challenging to attract the desired level of financing.

Liquidity Risk

Liquidity risk is the probability that the Government may not raise adequate financing to satisfy budgetary requirements. The risks may be due to insufficient liquidity or the investing community deeming the security to be unattractive. The attractiveness of the securities to investors may be negatively affected by the following:

(a) return on investment not reflecting the appetite of the investors along the yield curve;
(b) uncertainty among investors arising from the socio-political environment; and
(c) instability created by geo-political events in the global environment which could disrupt the credit market.

However, this risk may be mitigated through the building of cash buffers, using designated reserves.

Interest payment is the second largest expenditure category in the Budget. In FY 2013/14, this represented 27.4% of total expenditure and this ratio is projected to remain relatively flat throughout the medium-term (See **Table 3**). The reduction in interest payments over the previous fiscal year was due primarily to execution of the National Debt Exchange (NDX).

Over the period FY 2008/09 to FY 2012/13, the average debt service payment relative to total budgetary resources was 51.0%. While debt service costs were 44.0% of total budgetary resources for FY 2013/14, the ratio is expected to be 50.0% in FY 2015/16, influenced mainly by maturities. In FY 2016/17, debt service as a percentage of budget resources should decline to 36.9% (See **Table 3**).

The Government has demonstrated the capacity to fund the Budget. It is anticipated that there will be gradual increases in resources available to meet budgetary needs over the medium-term, as measures to reduce the overall debt continue to be implemented. These include maintaining high primary balance surpluses, sustainably eliminating the fiscal deficit, and reducing contingent liabilities as well as other remedial measures. Already, the Government has pursued two market-friendly liability management exercises in the domestic debt portfolio. Fiscal operations have benefited significantly consequent on lower interest costs and an improved maturity profile across a relatively longer time horizon.

At end-March 2014, total foreign currency debt in the total portfolio was approximately 59.0%, while external debt was 47.4% of the total portfolio. External debt servicing cost increased by 0.5% in FY 2013/14 relative to FY 2012/13. This was due to depreciation of the domestic currency and increased amortisation. During the review period, the domestic currency depreciated by 10.8% which accounted for approximately one-fifth of the increase in external debt servicing cost. Higher amortisation and a real increase in the debt stock accounted for the remaining portion. The stock of external debt denominated in US dollar increased by 3.4% in FY 2013/14 when compared to FY 2012/13.

For FY 2008/09 to FY 2012/13, external debt service as a percentage of exports of goods and services and current transfers averaged 14.7% per annum. The outturn for FY 2013/14 was 16.3%. However, it is anticipated that in FY2014/15 and FY 2015/16 the ratio will increase to 17.3% and 17.8% respectively, due mainly to the repayments of maturing Eurobonds. The ratio is expected to decline to 10.4% in FY 2016/17.

Total interest in relation to tax revenue is projected to be flat over the medium-term, settling below 30.0% in FY 2016/17. However, overall debt service as a percentage of tax revenue is projected to average approximately 63.6% over the medium-term.

The Government under the Extended Fund Facility (EFF) with the IMF has a debt-to-GDP target of 96.0% by end-March 2020. The current decline in the debt-to-GDP is expected to continue over the medium- to long-term as the Government maintains high primary balance surpluses, achieves fiscal balance surpluses and reduces contingent liabilities. The reduction in the debt and strengthening of the macroeconomic environment bodes well for debt servicing costs.

Since FY 2011/12, interest payments relative to GDP have been less than 10.0% and the ratio is expected to improve over the medium-term. Supporting the effort to meet the debt reduction targets developed under the EFF arrangement with the IMF are: enhancement of the Fiscal Responsibility Framework through the introduction of additional fiscal rules recently approved by Parliament; and the extensive public financial management reform that is currently being effected under the Public Financial Management Action Plan.

Deterioration in key variables which signal that a country is vulnerable and/or insolvent could restrict or impair its ability to access the capital markets. The Government is cognizant of this and has therefore taken steps to strengthen fiscal and debt sustainability. The indicators outlined in **Table 3** provide the Government with early warning signals as it relates to vulnerability.

**Table 3: Vulnerability Indicators and Debt Service Ratios, FY 2008/09 to FY 2016/17**

| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Proj. | Proj. | Proj. |
| Debt/GDP | 118.6% | 131.6% | 133.9% | 131.9% | 135.6% | 131.9% | 129.3% | 122.7% | 114.5% |
| Debt/GDP* | - | - | 146.0% | 146.0% | 149.4% | 144.9% | 142.8% | 140.8% | 128.4% |
| Debt service/GDP | 27.1% | 32.8% | 19.7% | 19.8% | 16.1% | 14.7% | 14.4% | 17.9% | 10.4% |
| External Debt/GDP | 54.2% | 62.0% | 64.9% | 59.5% | 60.2% | 62.5% | 61.5% | 60.2% | 58.3% |
| Debt service/Budget | 56.1% | 59.7% | 43.6% | 51.3% | 44.0% | 44.0% | 43.3% | 50.0% | 36.9% |
| Debt service/Tax revenue | 111.3% | 134.7% | 82.4% | 85.9% | 67.3% | 63.0% | 63.0% | 80.3% | 47.5% |
| Total interest/Tax revenue | 50.9% | 71.0% | 45.9% | 41.6% | 39.7% | 32.0% | 35.8% | 32.7% | 27.9% |
| Total interest/GDP | 12.4% | 17.3% | 10.9% | 9.6% | 9.5% | 7.5% | 8.2% | 7.3% | 6.1% |
| Interest Cost/Total Expenditure | 35.6% | 44.8% | 33.0% | 29.9% | 31.8% | 27.4% | 29.5% | 29.1% | 26.2% |
| External Debt Service/Exports of Goods and Services, Current Transfers | 14.8% | 12.6% | 12.2% | 18.5% | 15.4% | 16.3% | 17.3% | 17.8% | 10.4% |

Source: Ministry of Finance and Planning /Bank of Jamaica/PetroCaribe Development Fund

Notes:
Total debt as defined by the GOJ here includes Bank of Jamaica, Central Government and external guaranteed debt.
All ratios in the table above utilize the debt as defined by the GOJ.

*Total debt as defined under the EFF includes Central Government debt, net PetroCaribe debt, and external and domestic guaranteed debt.

## 2.11. Hedging

The Government will adopt a strategic approach to mitigating foreign currency risk in the portfolio by hedging its exposure to currencies that are volatile and/or represent a significant proportion of the foreign-currency debt stock. There is no natural Central Government revenue hedge to reduce the risk that currency exposure poses to debt servicing costs. Consequently, hedging will be used over the foreseeable future to help mitigate currency risk.

At end-March 2014, 58.7% or US$10.4 billion of total public debt was denominated in foreign currency. Of this total, 90.2% or US$9.4 billion[3] was denominated in US dollars and 9.8% or US$1.0 billion in other currencies, including the Renminbi yuan, Japanese yen and Pound sterling.

## 2.12. Contingent Liabilities

Contingent liabilities are obligations that materialise if a particular event occurs. They can be explicit, if the sovereign contractually acknowledges its responsibility to cover the beneficiary under specific circumstances, or implicit, when the government is expected to do so because it has a "moral" obligation to act, in most cases related to a high opportunity cost of not intervening.[4] Contingent liabilities pose significant risks to the Budget, as well as to the stock of debt if they are not properly monitored and provisions are not made in the Budget to accommodate them.

The Government of Jamaica has been called upon in the past to assume loans related to guarantees on behalf of state-run entities as well as to rescue failed financial institutions because of the systemic risk that they pose to the wider economy. This resulted in significant costs to the Jamaican public in the form of higher taxes, and to the Government in terms of increased expenditures and debt stock. Consequently, the Government has established a stringent regulatory framework to facilitate improving and enhancing the prudential operations of the financial sector to help contain systemic risk. The Bank of Jamaica (BOJ) and Financial Services Commission (FSC) have regulatory oversight for deposit-taking institutions and cambios and non-deposit taking institutions, respectively. The Public Enterprise Division in the Ministry of Finance and Planning monitors the operations of public bodies.

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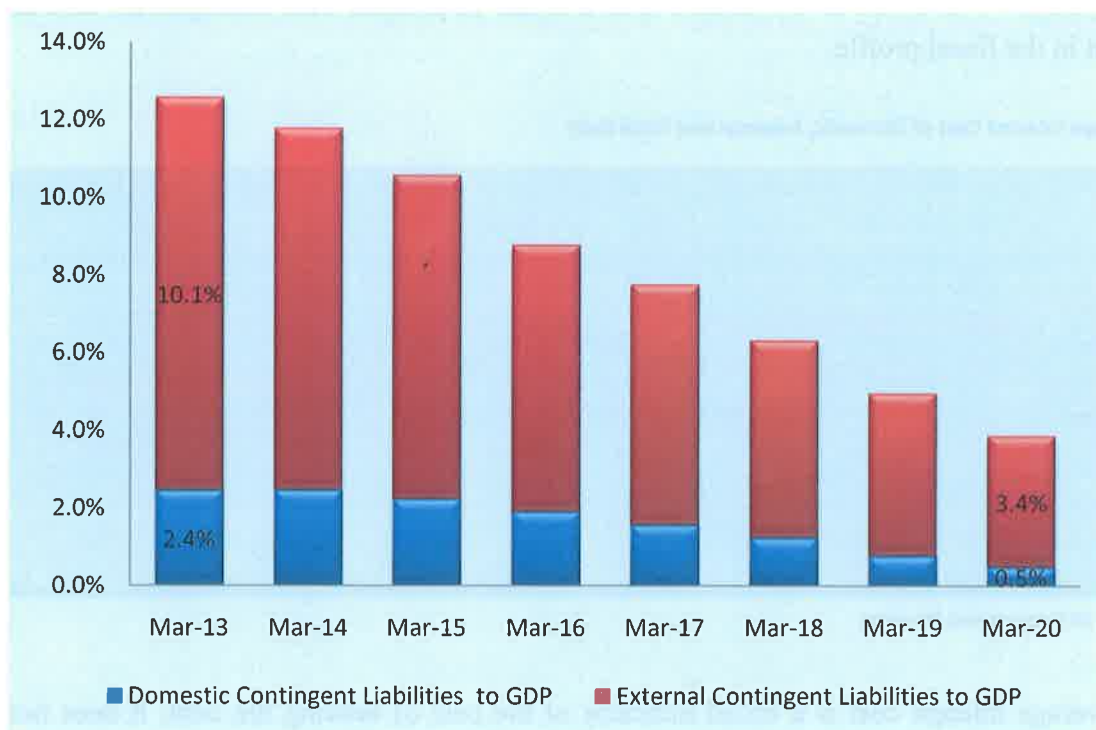
[3] Figure includes Special Drawing Rights (SDR) amount of US$497.0mn

[4] Elizabeth Currie and Antonio Velandia (2002). "Risk Management of Contingent Liabilities Within a Sovereign Asset-Liability Framework". (World Bank, Washington, DC)

The Government has however, been called upon to honour some payment obligations on behalf of public bodies. For the period January 2010 to March 2014, the Government assumed loans on behalf of state entities amounting to US$1,307.7 million ($143.3 billion) or 9.7% of GDP. In light of these developments and in keeping with the wide range of fiscal and other reforms being undertaken by the Government, explicit contingent liabilities will be limited to no more than 8.0% of GDP by end-March 2017 and 3.0% by end-March 2027, as promulgated in the Public Debt Management Act (PDMA). A comprehensive framework is being developed in respect of the monitoring of guarantees. Towards this end, public bodies are required to provide a monthly report to the Minister with responsibility for Finance with details on the status of all their debt and liabilities, whether or not they have been guaranteed.

Figure 11: Contingent Liabilities (CL) to GDP




Source: Ministry of Finance and Planning

## 2.13. Cost Minimisation

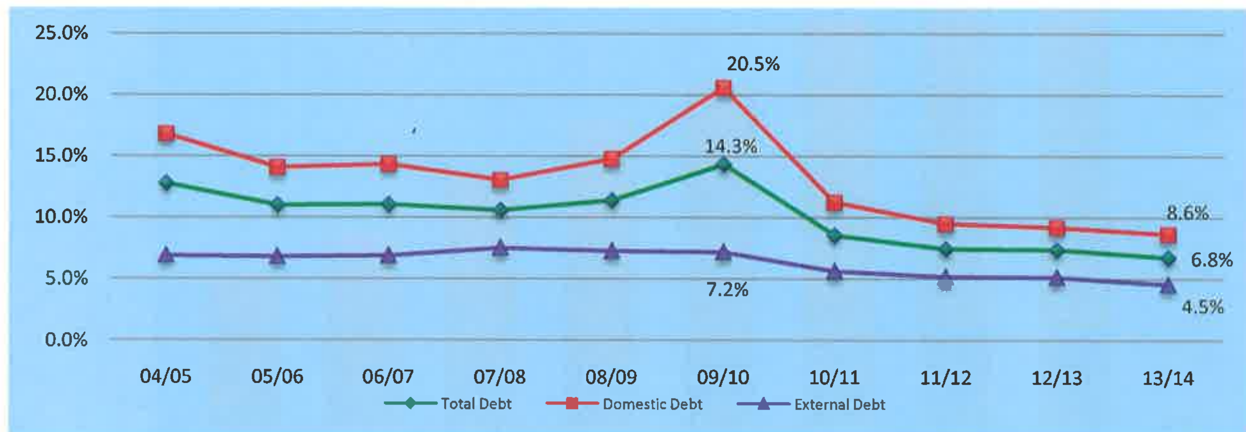
In addition to risk mitigation, cost minimisation is also a major objective of the Government. As noted previously, adverse movements in exchange and interest rates impact debt servicing costs. However, there are inherent gains from contracting debt in foreign currency and variable-interest rates. For example, foreign currency debt contracted in FY 2013/14 with 10 year maturity was on average approximately 8.0% lower than the yield on domestic market bonds with comparable

tenor. The portfolio also benefits from reductions in base interest rates as interest costs on existing variable rate debt decreases. For example, weighted average Treasury Bill yields decreased after the Jamaica Debt Exchange (JDX) in 2010 and LIBOR decreased after the world financial crisis of 2008-2009.

Both developments resulted in significant cost savings. The aim over the medium-term is to design a portfolio that will meet the strategic objective of minimising costs at an acceptable level of risk.

**Figure 12** shows the average interest cost of the debt–domestic, foreign and total–which is defined by interest costs as a proportion of average debt[5]. Average costs have trended down over the past 10 years, FY 2004/05 to FY 2013/14, as a result of prudent debt management and an improvement in the fiscal profile.

Figure 12: Average Interest Cost of Domestic, External and Total Debt



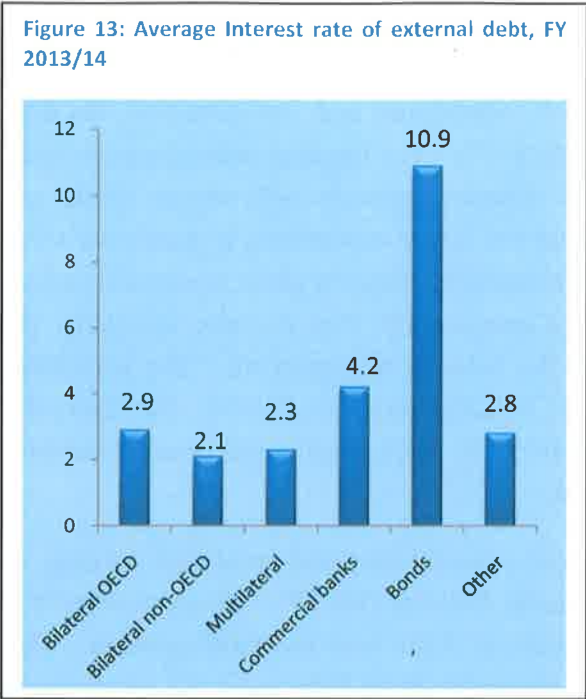

Source: Ministry of Finance and Planning

While the average interest cost is a broad indicator of the cost of holding the debt, it does not categorically detail the variation in the interest terms and tenors of loans and securities contracted and issued in the domestic and international capital markets which have varying levels of risk. As highlighted in **Figures 13** and **14**, bilateral and multilateral loans are nominally the cheapest source of external funding, while US dollar denominated loans are the cheapest source of domestic funding. Overall, loans in foreign currency are cheaper relative to loans denominated in domestic currency. However, foreign currency loans carry foreign exchange risk. The Government will continue to pursue cost minimisation by contracting loans and issuing securities in both markets which are consistent with meeting its cost minimisation objective

[5] Average $Debt_T = (Debt_T - Debt_{T-1})/2$

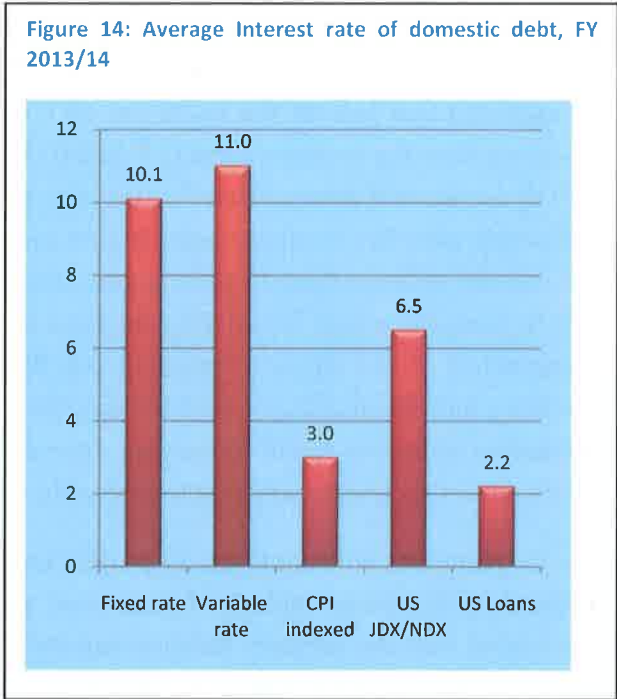
while giving careful consideration to risks. Details of the menu of instruments that will be issued this fiscal year are highlighted in the Issuance Strategy in Section VI.

Figure 13: Average Interest rate of external debt, FY 2013/14




Source: Ministry of Finance and Planning

Figure 14: Average Interest rate of domestic debt, FY 2013/14




Source: Ministry of Finance and Planning

As highlighted in **Figure 14**, coupons on domestic variable interest rate bonds are approximately one percentage point more than fixed-rate bonds. The Government is nearing its goal of realizing the optimum mix between variable- and fixed interest rate debt of 30.0% variable and 70.0% fixed. Consequently, debt will be contracted with this in mind. Despite the higher coupon on variable-rate debt and the interest rate risk inherent in them, the portfolio benefits from lower costs when interest rates decline. In keeping with the strategy to minimise cost, an optimal mix of variable-to-fixed rate debt will be maintained to capitalise on favourable changes in interest rates.

# 3. Macroeconomic Overview

## 3.1. Economic Overview

The medium-term macroeconomic profile outlined in **Table 4** shows the key macroeconomic assumptions that inform the estimates of revenue and expenditure and, by extension, the debt trajectory over the medium-term (FY 2014/15 – FY 2016/17). The baseline scenario used in the MTDS assumes that conditions in the domestic and external economy will remain stable and favourable over the medium-term. It also assumes that the larger economies, in particular USA and Europe, will continue to show signs of recovery. No consideration is given to systemic crises in this scenario which could impede capital flows. Consequently, this scenario maintains the preservation of the current financing conditions of the balance of payments. The prevailing monetary and fiscal policies will be maintained in the baseline scenario. On the other hand, the alternative scenarios speak to varying degrees of volatility in the domestic and external markets which adversely impact key macroeconomic variables.

The Government will continue its programme of fiscal consolidation and structural reforms, as outlined in the Memorandum of Economic and Financial Policies (MEFP). Consequently, it is anticipated that the primary balance surplus will remain at 7.5% over the medium-term. This policy action is geared towards curtailing non-debt expenditure to help meet the overarching objective of reducing the debt-to-GDP to 96.0% by end-March 2020. Real GDP is expected to increase to 1.9% by the end of the medium-term. The growth momentum is driven by increases in mining and quarrying, agriculture, tourism and financial services.

Complementary to fiscal policy, the central bank will adhere to the policy of targeting single digit inflation in line with the programme objectives. Consequently, the monetary base will be allowed to expand at a rate consistent with meeting the inflation target. The monetary authority will preserve the current market mechanism used to determine the exchange rate of the domestic currency relative to its major trading partners' currencies and stands ready to attenuate any disorderly conditions that may develop, which could adversely affect the smooth functioning of the market.

The baseline real GDP growth forecast is 0.9%, 1.4%, 1.8% and 1.9% for FY 2013/14, FY 2014/15, FY 2015/16 and FY 2016/17, respectively. Inflation for FY 2013/14 is expected at 8.1%, which is within the Bank of Jamaica's targeted range of 7.5% - 9.5%. The inflation rate was 1.0% lower than the previous fiscal year. The inflation rate broadly reflected the pass-through effect of depreciation of the domestic currency on prices and increases in administrative charges, in particular the price of energy and transportation. The inflation rate is projected at 8.5%, 8.0%, and 8.0% for FY 2014/15, FY 2015/16 and FY 2016/17, respectively.

The alternative scenarios entail varying degrees of influence on the domestic and external economies and consequently exchange and interest rates. Consideration is given to adverse economic developments in major world economies that have implications for unfavourable balance of payments and growth outcomes as opposed to those in the baseline scenario. The ramification of the change in interest and exchange rates arising from exogenous shocks is modeled in the alternative scenarios hypothesised in the debt strategy.

Table 4: Medium-term Macroeconomic Profile

| | Fiscal Years | | | | | |
|---|---|---|---|---|---|---|
| **Macroeconomic Variables** | **2011/12** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
| | **Actual** | **Actual** | **Est.** | **Proj.** | **Proj.** | **Proj.** |
| Nominal GDP (J$ billion) | 1,260.0 | 1,336.3 | 1,475.4 | 1,617.0 | 1,784.1 | 1,967.2 |
| Nominal GDP growth rate (%) | 7.5 | 6.1 | 10.4 | 9.6 | 10.3 | 10.3 |
| Real GDP growth rate (%) | 0.9 | -0.7 | 0.9 | 1.4 | 1.8 | 1.9 |
| Inflation: Annual Pt to Pt (%) | 7.3 | 9.1 | 8.1 | 8.5 | 8.0 | 8.0 |
| **Interest Rates:** | | | | | | |
| 30-day repo rate (eop) | 6.25 | 5.75 | 5.75 | | | |
| 180-day Treasury Bill (avg) | 6.50 | 6.60 | 7.92 | | | |
| Avg. Exch. Rate (J$=US$1.00) | 86.37 | 91.17 | 103.87 | | | |
| Oil Prices (WTI) (avg. US$/barrel) | 97.3 | 92.1 | 98.4 | 93.0 | 93.0 | 93.0 |

Source: Ministry of Finance and Planning/Bank of Jamaica

## 3.2. Risk Factors to the Debt Strategy

The assumptions articulated in the MTDS are crucial in determining the strategy that the Government will pursue. The behaviour and outturn of key macroeconomic variables - exchange rate, inflation, and real GDP will undoubtedly impact the fiscal and debt trajectories and the way in which the capital markets will respond to existing Government of Jamaica debt and new issuances. Consequently, while noting that most macroeconomic variables are subject to exogenous factors, the Government will endeavour to minimise volatility in these variables

through continued prudent fiscal policy and economic reforms, supported by sound management of the financial system.

Analysis of the debt portfolio shows that the key macroeconomic risk factors are movements in exchange rates, interest rates, inflation and shifts in yield curves. The debt portfolio composition carries exposures such that a 5.0% depreciation of the domestic currency will result in an increase in the debt by $55.7 billion, equivalent to 2.9% of the total debt stock or 3.8% of GDP. An upward movement in domestic and external interest rates by 1.0% increases total interest cost by $5.7 billion or 0.4% of GDP (See **Table 5**). Inflation has a minimal direct effect on the debt stock, as only 2.1% of the portfolio is denominated in inflation-linked bonds.

**Table 5: Impact of Increase in Interest and Exchange Rates on Interest Payments and the Debt Stock**

Static Sensitivity Analysis of Interest Payments and Debt Stock using Stock of Debt at end-March 2014 ($millions)

| **Depreciation of Domestic Currency** | **Baseline** | **1.0%** | **5.0%** | **8.0%** |
|---|---|---|---|---|
| Debt Stock | - | 11,135.3 | 55,676.3 | 89,082.0 |
| Change | - | 0.6% | 2.9% | 4.6% |
| As a % of GDP | | 0.8% | 3.8% | 6.0% |
| **Interest Rate Increase** | - | **1.0%** | **2.0%** | **8.0%** |
| Interest Payments: Domestic | - | 3,037.4 | 6,074.8 | 18,224.5 |
| Foreign | | 2,631.5 | 5,262.9 | |
| **Total** | | **5,668.9** | **11,337.7** | - |
| As a % of GDP | | 0.4% | 0.8% | - |

Dynamic Sensitivity Analysis of Interest Payments and Debt Stock

| **Fiscal Year** | | **2013/14** | **2014/15** | **2015/16** | **2016/17** |
|---|---|---|---|---|---|
| Domestic Interest (% of GDP) | | | | | |
| Baseline | | 5.12% | 4.95% | 4.67% | 3.73% |
| Interest rate increase: | 1.0% | 5.12% | 4.95% | 4.68% | 3.73% |
| | 5.0% | - | 4.96% | 4.73% | 3.73% |
| | 8.0% | - | 4.96% | 4.76% | 3.74% |
| External Interest (% of GDP) | | | | | |
| Baseline | | 2.79% | 3.15% | 2.57% | 2.31% |
| Interest rate increase: | 1.0% | - | 3.31% | 2.73% | 2.48% |
| | 2.0% | - | 3.47% | 2.89% | 2.64% |
| Total Interest (% of GDP) | | | | | |
| Baseline | | 7.91% | 8.09% | 7.23% | 6.04% |
| External: 2.0%, Domestic: | 8.0% | - | 8.43% | 7.65% | 6.38% |
| Debt Stock (% of GDP) | | | | | |
| Baseline | | 131.9% | 123.00% | 119.00% | 112.00% |
| Depreciation of currency: | 5.0% | - | 127.00% | 123.00% | 116.00% |

Source: Ministry of Finance and Planning

The following are the potential risks to the macro-economic framework:

- Revenue growth rising at a slower pace than anticipated;
- Non-realisation of planned loan inflows from the multilaterals, which could result in the Government borrowing more from the domestic market;
- Exogenous shocks including natural disasters which could cause fiscal slippage;
- Increases in commodity prices that could drive the domestic inflation rate upwards;
- Sustained reduction in the net international reserves (NIR) occasioned by an accelerated deterioration in international trade balances; and
- Higher than anticipated depreciation of the local currency vis-à-vis the major international currencies.

## 4. Medium-Term Debt Management Strategy FY 2014/15 - FY 2016/17

Four strategies were assessed and analysed to determine the strategic path that the Government should take with respect to debt operations over the medium-term. The debt portfolio was subjected to exogenous shocks and the impact of these shocks was evaluated based on cost/risk analysis in order to select the most appropriate strategy.

The Medium-Term Debt Strategy analytical tool, developed jointly by the IMF and the World Bank, was used to assess the impact of cost and risks on the debt portfolio. This assessment informs the selection of a debt strategy.

**The stock of debt used in the model includes only central government direct debt.** The model has limitations regarding the number of loans that can be used to determine the debt trajectory over the medium-term. Consequently, the debt stock was aggregated into eight (8) stylized instruments to represent the portfolio. Foreign currency loans in the domestic debt portfolio were removed and added to the foreign debt. Foreign currency loans were either treated as market or concessionary.

### SCENARIOS

The Borrowing Strategies were subjected to stress testing under three (3) scenarios as outlined below:

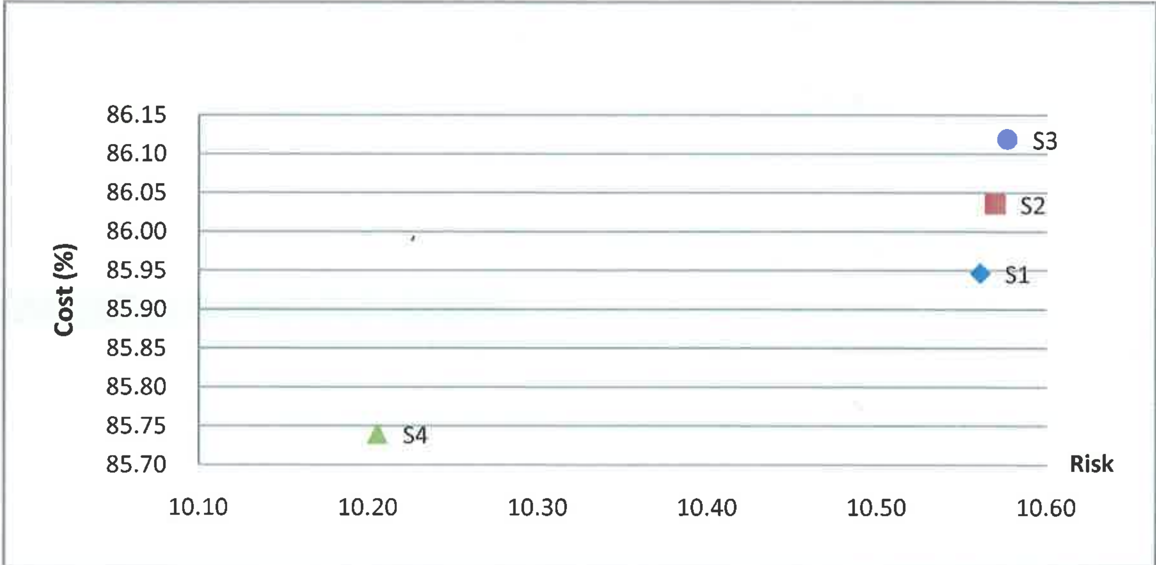
- Scenario 1: ***Country-specific depreciation of the Jamaica dollar***. Under this scenario in FY 2014/15 the Jamaica dollar depreciates by one standard deviation[6], or 21.8% relative to the US dollar. This is a permanent shock.
- Scenario 2: ***Parallel Shifts in domestic and US Treasury yield curves***. The cost of all market-based domestic borrowing increases by 800 basis points to realign interest rates with pre-JDX levels. In addition, the cost of all external market-based borrowing increases in all years by 200 basis points, which is permanent.
- Scenario 3: ***This is a combination shock.*** In this scenario the Jamaica dollar depreciates by 10.9% relative to the US dollar, domestic interest rates increase by 400 basis points and international interest rates increase by 100 basis points.

The strategy selected by the Government – Strategy III (**S3**) – is to issue 80.0% fixed-rate securities and 20.0% variable-rate securities in the domestic market and contract loans in the

[6]The annual standard deviation for the depreciation of the Jamaica dollar over a 20 year period from FY1993/94 - FY 2012/13 is 21.8%.

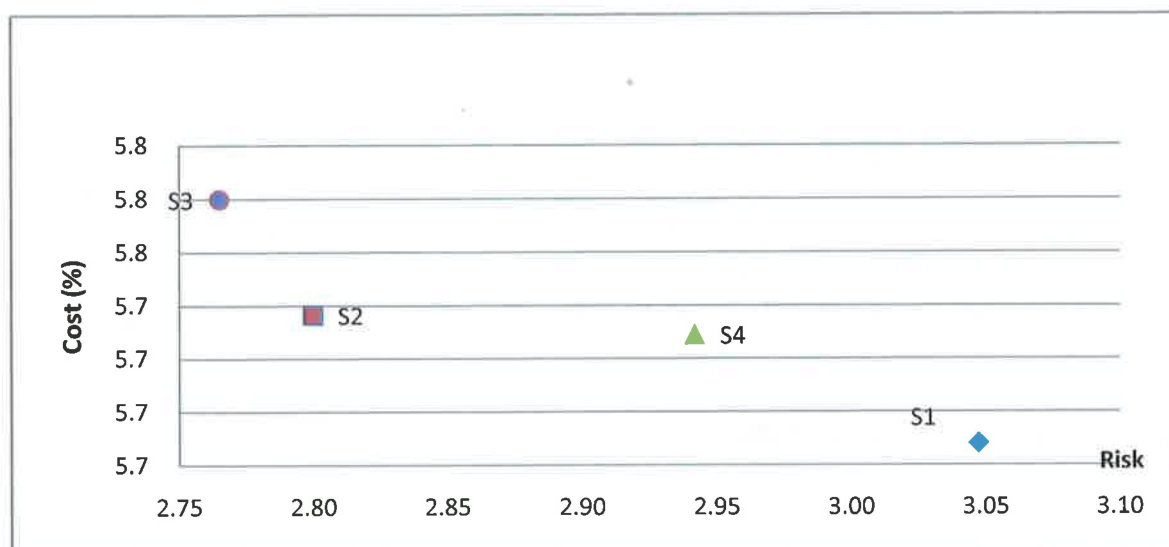
external market to meet amortisation and cost/risk objectives. The goals are to lengthen the maturity profile of the debt and take advantage of the relatively low interest rates that currently prevail in the domestic market, among other things. This strategy is geared towards minimising the impact of increased debt servicing costs resulting from higher domestic interest rates. It also entails greater levels of domestic market participation to help with the process of further developing the domestic market and mitigating foreign currency risk. As highlighted in **Figures 15, 16** and **Table 6**, the cost and risk indicators of the strategy are consistent with the medium-term objectives of minimising cost at an acceptable level of risk. At the end of the medium-term (2017), the Government expects that the portfolio will achieve the targets outlined in **Table 7**:

Figure 15: Projected Debt to GDP at end-March 2017




Source: Ministry of Finance and Planning/MTDS Toolkit

**Figure 16: Projected Interest Payments to GDP at end-March 2017**



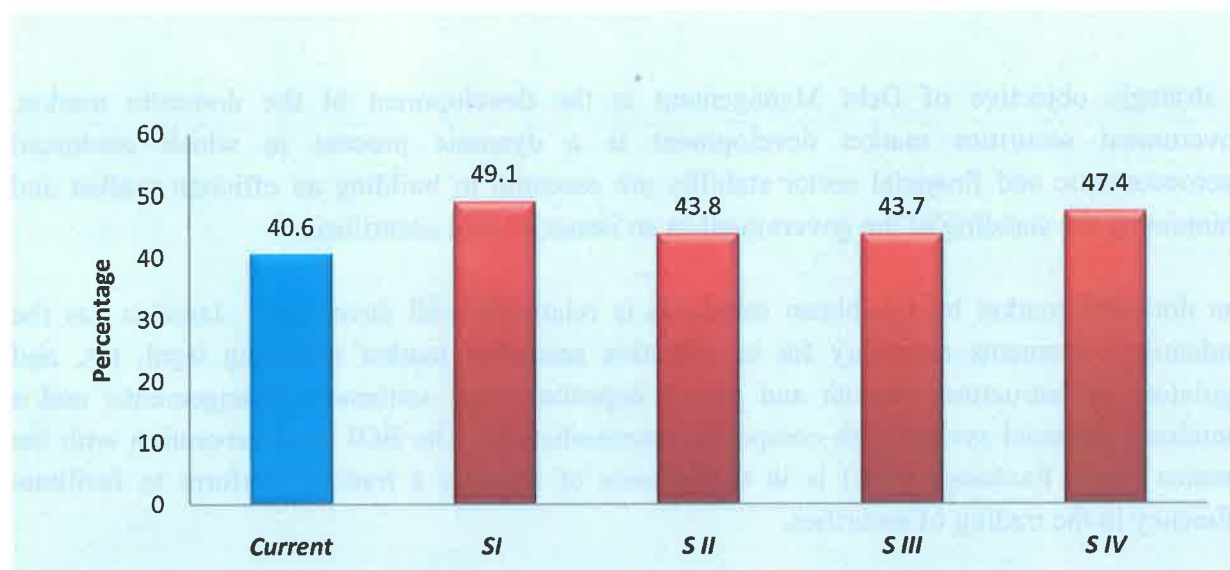

Source: Ministry of Finance and Planning/MTDS Toolkit

**Table 6: Cost and Risk Indicators at end March 2016**

| Risk Indicators | | 2014 | As at end-March 2017 | | | |
|---|---|---|---|---|---|---|
| | | Current | S1 | S2 | S3 | S4 |
| Nominal debt as % of GDP | | 105.7 | 85.9 | 86.0 | 86.1 | 85.7 |
| PV as % of GDP | | 101.5 | 78.6 | 78.4 | 79.2 | 81.5 |
| Implied interest rate (%) | | 6.4 | 6.7 | 6.8 | 6.8 | 6.8 |
| Refinancing risk | ATM External Portfolio (years) | 8.2 | 8.8 | 8.8 | 8.7 | 8.5 |
| | ATM Domestic Portfolio (years) | 11.0 | 9.3 | 9.4 | 9.3 | 9.5 |
| | ATM Total Portfolio (years) | 9.6 | 9.0 | 9.1 | 9.0 | 9.0 |
| Interest rate risk | ATR (years) | 6.4 | 6.1 | 6.8 | 6.8 | 6.5 |
| | Debt refixing in 1yr (% of total) | 40.6 | 49.1 | 43.8 | 43.7 | 47.4 |
| | Fixed rate debt (% of total) | 65.6 | 61.9 | 67.3 | 67.5 | 63.9 |
| FX risk | FX debt as % of total | 49.9 | 57.9 | 57.8 | 57.8 | 51.1 |
| | ST FX debt as % of reserves | 75.6 | 53.3 | 53.3 | 53.3 | 53.3 |

Source: Ministry of Finance and Planning/MTDS Toolkit

**Figure 17: Debt Refixing in 1 Year as a Proportion of the Portfolio**




Source: Ministry of Finance and Planning/MTDS Toolkit

**Table7: Medium-term Debt Indicators Expected Outcomes FY 2016/17**

| Indicators | Mar 2017 |
|---|---|
| ***Profile (%)*** | |
| **Domestic Debt:** | |
| Fixed-rate | 70.0 |
| Floating rate* | 30.0 |
| Inflation-linked | 2.0 |
| *Total Foreign currency debt* | *61.0* |
| Proportion of foreign currency debt in domestic portfolio | 17.0 |
| **External Debt:** | |
| Fixed-rate | 70.0 |
| Floating rate | 30.0 |
| **Maturity structure** | |
| Average Maturity (years) | ≥9.0 |
| % Maturing in 1 year | ≤10.0 |

Source: Ministry of Finance and Planning

*Inflation-linked Bonds included in the floating rate

## 5. Development of the Domestic Debt Market

A strategic objective of Debt Management is the development of the domestic market. Government securities market development is a dynamic process in which continued macroeconomic and financial sector stability are essential to building an efficient market and maintaining the standing of the government as an issuer of debt securities.

The domestic market by Caribbean standards is relatively well developed. Jamaica has the fundamental elements necessary for an effective securities market including legal, tax, and regulatory infrastructure; smooth and secure depository and settlement arrangements; and a liberalized financial system with competing intermediaries. The BOJ in collaboration with the Jamaica Stock Exchange (JSE) is in the process of creating a trading platform to facilitate efficiency in the trading of securities.

Over the years, the operations of the domestic capital market were effective and functional and the Government played its role in the development of the market. To this end, there was a proliferation of small illiquid issues.

At the end of FY 2009/10, the Government, through a voluntary liability management exercise, JDX, exchanged three hundred and fifty (350) small-sized illiquid securities into twenty five (25) large liquid benchmark issues. This not only effectively realigned the portfolio, reducing refinancing risk but also laid the foundation for secondary trading of the GOJ securities and further development of the secondary market.

Three years later at end FY 2012/13, the Government of Jamaica executed a second market-friendly domestic debt exchange, to further realign the portfolio through the extension of maturities and reduction of interest rates to further address refinancing risk in the domestic portfolio.

In developing the FY 2013/14 Budget, the Government took a strategic decision to access concessional financing from multilateral institutions and the PCDF. Consequently, there were no debt issuances in the domestic securities market and limited activity in secondary market trading.

Recent reforms undertaken by the Government are geared towards improving key macroeconomic indicators, while supporting the enhancement of sound fiscal and monetary policies and prudent debt management. The Government has to date, met all the quantitative targets under the current EFF arrangement with the IMF. Additionally, the international rating agencies have recognised the improvements in the economy by issuing positive revisions to the sovereign credit ratings and/or outlook. These positive developments should help bolster

confidence in the economy and in the domestic securities market. In anticipation of an improved demand for government securities, the Government will issue on-the-run securities at various segments of the yield curve.

A mandate of debt management is to promote advances in instruments and issuance techniques as well as support structural changes that will foster deeper and more liquid markets. In executing its core functions, the Debt Management Branch (DMB) of the Ministry of Finance and Planning will ensure that it conducts its operations openly and transparently, and will continue to report on the debt and on the DMB's operations publicly through wide dissemination of information. Consistent with this, the following measures will be taken during FY 2014/15:

- Development of an Investor Relations programme and communication strategy;
- Market consultations with key stakeholders to enable tapping the long end of the yield curve;
- Increased co-ordination with the BOJ;
- Enhancements to the central securities depository system; and
- Continued collaboration with the BOJ and the JSE for the development of a trading platform for GOJ securities.

## 6. Annual Borrowing Plan

### 6.1. Financing Assumptions

The budget in FY 2014/15 is expected to be financed in part by loans of $110.9 billion of which $56.3 billion will be sourced from the domestic capital market and the PCDF and $54.6 billion from external sources.

**Box 3: Financing Sources**

***External Sources***

The programme anticipates that loans will be contracted from:

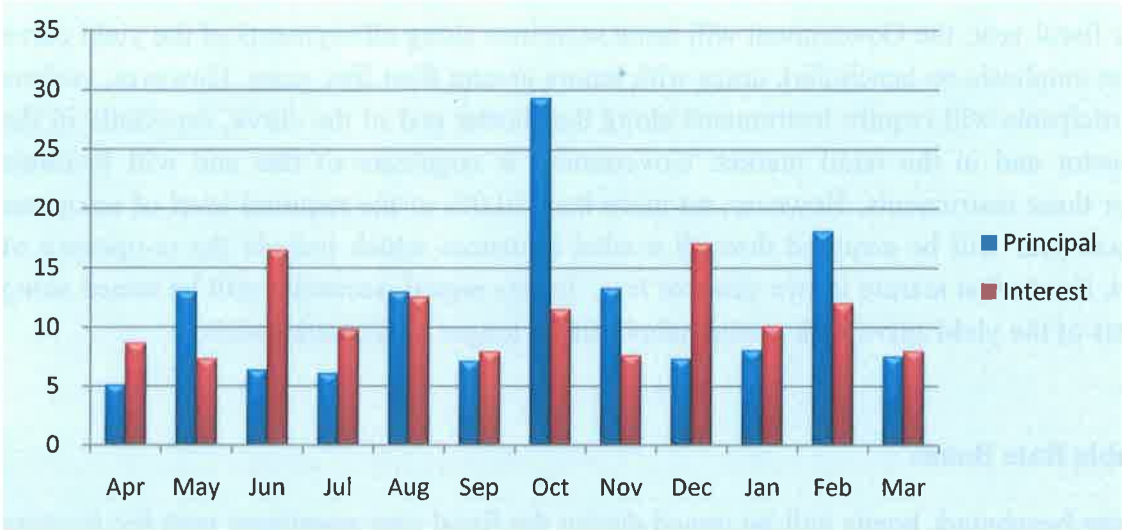
- Multilateral and bilateral sources; and
- The international capital markets.

***Domestic Sources***

The Government will issue/reopen a range of instruments along different segments of the domestic yield curve to satisfy budgetary requirements in addition to meeting investors' needs. Market-based securities that will be issued are geared towards financing the budget at minimum cost while mitigating risk in the portfolio. These securities will also serve to assist the Government with further development of the domestic capital market by increasing liquidity levels in various instruments to facilitate secondary market trading. Funding will be sourced from the:

- Domestic capital markets; and
- PCDF.

Figure 18: Monthly Interest and Principal Payments, FY 2014/15 ($billion)




Source: Ministry of Finance and Planning

**Issuance Strategy: S3 - *80.0% fixed-rate securities and 20.0% variable-rate securities in the domestic market and loans in the external market to meet amortisation and cost/risk objectives.***

The rationale for the selection of **S3** is that it is consistent with the baseline assumptions relating to the economic conditions in the domestic and external capital markets. It is also consistent with the medium-term debt targets that the government aims to achieve, which entail maintaining relatively long ATM, increasing the share of fixed-rate debt and maintaining the share of foreign currency debt in the portfolio.

## 6.2. Domestic Market

In FY 2014/15, the issuance strategy will mirror the guidelines of gradually increasing the proportion of fixed-rate debt to floating-rate debt. This is consistent with the objectives of keeping short-term maturities at acceptable levels, improving the maturity profile of the debt while maintaining prudent levels of risk. The Government will also engage financial market participants with respect to further development of the domestic market, maintain transparency in debt operations including the issuance of securities during the fiscal year. This will be complemented by the maintenance of adequate levels of liquidity in each benchmark bond to facilitate secondary trading. Secondary market trading of Government bonds is vital to the medium-term objectives of the Government as it will enable more efficient price discovery and maintain investors' interest in domestic securities.

### 6.3. Fixed Rate Bonds

During the fiscal year, the Government will issue securities along all segments of the yield curve with greater emphasis on benchmark notes with tenors greater than five years. However, various market participants will require instruments along the shorter end of the curve, especially in the banking sector and in the retail market. Government is cognizant of this and will facilitate demand for these instruments. However, no more than 10.0% of the required level of resources for the fiscal year will be acquired through market issuances which include the re-opening of Benchmark Bonds that mature in two years or less. In this regard, securities will be issued along all segments of the yield curve with greater emphasis on longer benchmark bonds.

### 6.4. Variable Rate Bonds

Variable rate benchmark bonds will be issued during the fiscal year consistent with the strategy of moving gradually towards the 30.0% target. As in the case of the fixed rate series, bonds will be issued along all segments of the yield curve with emphasis on maturities five years or greater. The Government does not anticipate reopening or issuing variable rate bonds with tenors of two years or less. Issuances in the designated series will, among other things, be geared towards improving liquidity and helping to generate interest in secondary trading of these bonds.

### 6.5. PetroCaribe Development Fund Debt

Borrowing from the PCDF fits well within **S3** as it relates to streamlining overall cost-risk objectives and will be pursued to complement domestic market issuance. This fiscal year, the Government intends to secure US$250.0 million from the PCDF. The embedded exchange rate risk associated with loans from PCDF is given due consideration in the overall strategy to curtail foreign currency debt to no more than 61.0% of the debt portfolio over the medium-term.

### 6.6. External Debt

The Government will continue its strategy of refinancing external maturities with new issuances in the international capital markets and/or loans from official sources. Consequently, in FY 2014/15, the Government will seek to refinance the maturing Euro 150 million Bond. This will be complemented with loans from the World Bank and IDB to assist with meeting budgetary obligations.

Over the medium-term, the Government will implement policies to increase the efficiency of the external yield curve. To achieve this, market conditions permitting, the Government will pursue

a market-friendly external liability management programme through switches and buy-back of high yield off-the-run securities.

It is important to note that **S3** and its operational guidelines are supported by the Public Debt Management Act 2012, which gives the Minister of Finance or his designate the authority to borrow resources to meet budgetary obligations. Section 6 of the Act states that the Minister may, taking account of debt management objectives and the Debt Management Strategy, undertake portfolio management operations including roll-overs, swaps and other derivative transactions, buybacks, switches and redemption of Government's debt instruments.

### 6.7. Expected Outcome

The MTDS is designed with specific quantitative outcomes targeted for the debt portfolio. The expected outcomes have lower and upper limits or are within specified bands. The current macroeconomic conditions form the baseline on which the debt strategy is formulated. Notwithstanding, due consideration is given to changes in the domestic economic environment that may have implications on fiscal and debt operations. There is no certainty of the outcome of the underlying assumptions informing the strategy implementation. Consequently, limits and bands are established for strategic benchmarks for FY 2014/15 and are intended to provide the Government with some degree of flexibility to operate in the event of economic shocks. Below are the quantitative targets for FY 2014/15 in **Table 8**.

Table 8: Debt Indicators: Strategic Benchmarks end-March 2015

| Indicators | Limits end-March 2015 | |
|---|---|---|
| | Minimum | Maximum |
| ***Profile (%)*** | | |
| **Domestic Debt:** | | |
| Fixed-rate | 65.0 | 68.0 |
| *Floating rate | 31.0 | 35.0 |
| Inflation-linked | - | 2.0 |
| *Total foreign currency debt* | *61.0* | *63.0* |
| Proportion of foreign currency in domestic currency | 22.0 | 24.0 |
| **External Debt:** | | |
| Fixed-rate | 61.0 | 64.0 |
| Floating rate | 35.0 | 39.0 |
| **Maturity structure** | | |
| Average Maturity (years) | 9.0 | - |
| % Maturing in 1 year | - | 8.0 |

Source: Ministry of Finance and Planning
*Inflation-linked Bonds included in the floating rate

## 6.8. Schedule of Issuances

The borrowing requirement for the fiscal year is predicated on the Debt Management Strategy and the fiscal deficit. The projected financing requirement is $110,894.5 million and is to be funded from both domestic and external sources.

The Plan is to re-enter the domestic market for an amount of $32,116.9 million and to access concessionary funds from the PCDF in the amount of $24,163.7 million to satisfy the domestic financing requirements of $56,280.6 million.

Financing from external sources will include international capital markets issuance, multilateral loans in the form of Development Policy Loans (DPLs), Policy Based Loans (PBLs) and disbursement from project loans. Cumulatively, external financing is projected to be $54,613.9 million.

Table 9: Financing Requirement for FY 2014/15

| Annual Borrowing Plan FY 2014/15 (Budgeted, in $million) | |
|---|---|
| **Domestic** | **$56,280.6** |
| PetroCaribe Development Fund | $24,163.7 |
| Market Issues | $32,116.9 |
| | |
| **External** | **$ 54,613.9** |
| Investment Loans | $12,814.1 |
| PBL/DPL Loans | $13,169.8 |
| ICM | $28,630.0 |
| **Total** | **$110,894.5** |

Source: Ministry of Finance and Planning

The Government is aware that a developed securities market is a critical source of domestic financing of the Budget and for national development. Accordingly, the issuance strategy is to create on-the run benchmark notes, at various segments along the yield curve.

During FY 2014/15 the Government plans to maintain a presence in the market in the interest of facilitating the resumption of active secondary market trading in government securities.

In keeping with debt management best practice of transparency in debt raising activities a calendar of issuances programmed for the first half of the fiscal year is presented in **Table 10.** The Schedule of Treasury Bill tenders for FY 2014/15 is presented in **Table 11**.

Table 10: Issue of Government of Jamaica Securities for the Period April 2014-September 2014

| Proposed Tender Date | Proposed Instrument Type |
|---|---|
| April 15, 2014 | 1-month Treasury Bill Tender |
| April 23, 2014 | 3-month and 6-month Treasury Bill Tenders |
| May 14, 2014 | 1-month Treasury Bill Tender |
| May 20, 2014 | 3-month and 6-month Treasury Bill Tenders |
| May 28 – 30, 2014 | New Issue FR Benchmark Note – Due 2016<br>New Issue VR Benchmark Note – Due 2017 |
| June 18, 2014 | 1-month, 3-month and 6-month Treasury Bill Tenders |
| June 25 – 27, 2014 | Reopen FR Benchmark Note – Due 2016 |
| July 16, 2014 | 1-month Treasury Bill Tender |
| July 23, 2014 | 3-month and 6-month Treasury Bill Tenders |
| July 29 – 31, 2014 | New Issue FR Benchmark Note – Due 2021<br>Reopen VR Benchmark Note – Due 2017 |
| August 13, 2014 | 1-month Treasury Bill Tender |
| August 20, 2014 | 3-month and 6-month Treasury Bill Tenders |
| August 25 – 27, 2014 | Reopen FR Benchmark Note – Due 2016<br>Reopen FR Benchmark Note – Due 2021 |
| September 17, 2014 | 1-month, 3-month and 6-month Treasury Bill Tenders |
| September 24 – 26, 2014 | New Issue VR Benchmark Note – Due 2022<br>Reopen FR Benchmark Note – Due 2016 |

Source: Ministry of Finance and Planning

**Please note that the above schedule is subject to change.**

Table 11: Proposed Schedule for Treasury Bill Tenders for FY 2014/15

| Proposed Treasury Bill Tranche | Proposed Tender Date | Proposed Issue Date |
|---|---|---|
| **Quarter 1** | | |
| 1-month T/Bill | April 15, 2014 | April 17, 2014 |
| 3 & 6-month T/Bills | April 23, 2014 | April 25, 2014 |
| 1-month T/Bill | May 14, 2014 | May 16, 2014 |
| 3 & 6-month T/Bills | May 20, 2014 | May 22, 2014 |
| 1, 3 & 6-month T/Bills | June 18, 2014 | June 20, 2014 |
| **Quarter 2** | | |
| 1-month T/Bill | July 16, 2014 | July 18, 2014 |
| 3 & 6-month T/Bills | July 23, 2014 | July 25, 2014 |
| 1-month T/Bill | August 13, 2014 | August 15, 2014 |
| 3 & 6-month T/Bills | August 20, 2014 | August 22, 2014 |
| 1, 3 & 6-month T/Bills | September 17, 2014 | September 19 2014 |
| **Quarter 3** | | |
| 1-month T/Bill | October 15, 2014 | October 17, 2014 |
| 3 & 6-month T/Bills | October 22, 2014 | October 24, 2014 |
| 1, 3 & 6-month T/Bills | November 19, 2014 | November 21, 2014 |
| 1, 3 & 6-month T/Bills | December 17, 2014 | December 19, 2014 |
| **Quarter 4** | | |
| 1-month T/Bill | January 14, 2015 | January 16, 2015 |
| 3 & 6-month T/Bills | January 21, 2015 | January 23, 2015 |
| 1, 3 & 6-month T/Bills | February 18, 2015 | February 20, 2015 |
| 1, 3 & 6-month T/Bills | March 18, 2015 | March 20, 2015 |

Source: Ministry of Finance and Planning

## 7. Special Topics

### 7.1. The Public Debt Management Act (PDMA)

The Public Debt Management Act (PDMA) was enacted to consolidate the governing framework for debt into one Act which clearly outlines the objectives of debt management. Prior to the enactment of the PDMA, legislation relating to public debt management was captured under more than twenty (20) discrete pieces of legislation that included, *inter alia*, the Constitution of Jamaica, the Financial Administration and Audit Act (FAA Act), the Loan Act of 1964 (both as amended from time to time), a large number of subsidiary Loan Acts, and the Bank of Jamaica Act. While containing basic principles for management of the public debt, they did not comprehensively address some salient features of public debt management that promote sound debt management practice. The PDMA is a coherent and comprehensive legislative framework which takes a strategic approach to public debt management in conformity with international best practice.

The PDMA has, by Sections 7 and 8 respectively, constituted a Public Debt Management Committee (PDMC) and a Public Debt Financing Committee (PDFC).

By Section 7 of the Act the PDMC shall:

a) Monitor the implementation of the Act in general and the Medium-Term Debt management Strategy in particular;
b) Assess the policies, strategies and operations of debt management and the management of contingent liabilities with a view to ensuring consistency with this Act and the macroeconomic, monetary and fiscal policies of the Government; and
c) Perform such other functions as may be assigned to it by the Minister.

Similarly, Section 8 of the Act defines the list of functions of the PDFC in relation to the management of the Public Debt.

### Regulations

During FY 2014/15 the Government proposes to effect regulations to guide the efficient operation of debt management functions consistent with the Act. Section 25 (1) of the Act stipulates areas which might be considered when the Minister makes regulations pursuant to the Act. In keeping with this provision, the regulations will be structured to define the overall functions of the Debt Management Branch (DMB), and the main roles, functions, and responsibilities of the operational units. Additionally, the functions of the debt committees, the PDMC and PDFC, as created in the Act will be described.

Concurrently with the promulgation of the Regulations, amendments will be proposed for Sections 2, 25(2) and the third schedule of the PDMA with respect to four crucial areas to ensure that the Act is effective, easily understood and more consistent with both international and local standards.

### 7.2. Ratings Developments

#### Sovereign Risk

A sovereign's credit risk, which is linked to its credit ratings, gives investors insight with respect to the risks associated with investment in a particular country as well as the political risk. Jamaica's sovereign credit risk has been consistently reviewed and rated by Moody's Investors Service, Standard & Poor's Ratings Services (S&P) and Fitch Ratings Inc. This provides transparency in regards to the country's economic and political environment and demonstrates its credit standing to the public. A good credit rating is associated with lower risk premium on sovereign bonds issued in the ICM and serves to attract foreign direct investments. It gives investors confidence in the country's socio-economic and political affairs.

During FY 2013/14, Fitch and S&P upgraded Jamaica's long-term foreign and local currency sovereign credit ratings from CCC and CCC+, respectively, to B-. Both rating agencies assigned stable outlook to the sovereign's credit. Moody's Investors Services maintained the sovereign's Caa3 ratings, but revised the outlook from "stable" to "positive". The arguments advanced for the rating upgrades include the progress that the Government has made in stabilizing the economy, improvement in fiscal operations, and reforms undertaken to consolidate fiscal and debt operations. Other positive developments include the agreement between the Government and the IMF, which has helped to improve foreign currency reserves occasioned by the financing unlocked from multilateral sources and a reduction in the current account deficit. In addition to this, the country's stable and democratic government and willingness to meet debt obligations also contributed to the sovereign credit rating upgrades.

In light of these developments, the Government will continue to maintain a strong fiscal stance and enhance the country's resolve to meet its debt obligations while providing an enabling environment to attract investments, which will help to accelerate economic growth and development. These measures complement the many reforms – economic, social and structural - being undertaken by the Government which will facilitate further rating upgrades in the future.

## GLOSSARY

### Amortisation

Amortisation refers to principal repayments on loans. These repayments reduce the borrowed money by portions, which are usually fixed amounts or expressed as a percentage of the whole.

### Auction

An auction is a system by which securities are bought and sold on a competitive bidding process. The auctions are conducted on a multiple-price-bidding basis, which means that the successful investor will receive stocks at the price he bids.

### Benchmark Bonds

These are bonds that are sufficiently large and actively traded, such that their prices serve as reference for other bonds of similar maturities. More specifically, the benchmark is the latest issue within a given maturity. For a comparison to be appropriate and useful, the benchmark and the bond being measured against it should have a comparable liquidity, issue size and coupon. Government bonds are almost always used as benchmark.

### Contingent Liabilities

Contingent liabilities are obligations that materialise if a particular event occurs. They can be explicit, if the sovereign contractually acknowledges its responsibility to cover the beneficiary under specific circumstances, or implicit, when the government is expected to do so because it has a "moral" obligation to act, in most cases related to a high opportunity cost of not intervening.

### Debt Service Payments

Debt service payments cover interest charges on a loan. Some sources also include amortisation under debt service payments. These payments liquidate the accrued interest (and loan obligations if amortisation is included).

**Eurobond**

A bond underwritten by international investors and sold in countries other than the country of the currency in which the issue is denominated. Usually, a eurobond is issued by a corporate or sovereign and categorised according to the currency in which it is denominated. In July 1997 Jamaica issued a five-year US$200mn Eurobond, which was its first ever.

**Inflation-Indexed Bonds**

Inflation-Indexed bonds are securities with the principal linked to the Consumer Price Index. The principal changes with inflation, guaranteeing the investor that the real purchasing power of the investment will keep pace with the rate of inflation. Although deflation can cause the principal to decline, at maturity the investor will receive the higher of the inflation-adjusted principal or the principal amount of the bonds on the date of the original issue.

**On-the-run security**

In finance, an on-the-run security or contract is the most recently issued, and hence most liquid, of a periodically issued security. On-the-run securities are generally more liquid and trade at a premium relative to other securities. Other, older issues are referred to as off-the-run securities, and trade at a discount to on-the-run securities.

**Project Loan**

The term refers to loans, which fund capital development activities. The term capital refers to lasting systems, institutions and physical structures. Project loans are typically funded from foreign sources by bilateral/multilateral institutions.

**Public Debt Charges / Public Debt**

Public debt refers to the loan obligations of Central Government. The obligations of Government entities are also included if such entities are unable to meet their obligations. The entities, however, are then indebted to the Central Government. Public debt charges are interest payments on the loan obligations and include related incidental expenses such as service fees, late payment penalties and commitment fees.

### Sovereign Rating

A sovereign rating is an assessment of the default risk for medium and/or long-term debt obligations issued by a national Government (denominated in foreign currency), either in its own name or with its guarantee. Ratings are produced by independent agencies (Moody's Investors Service, Standard & Poor's and others). The ratings provide a guide for investment risk to capital market investors.

### Treasury Bills

Treasury Bills are short-term debt obligations backed by the government with maturities less than one year. The Government of Jamaica issues Treasury Bills with 30-, 60- and 180-day tenors. Treasury Bills are issued through a competitive bidding process at a discount from par, which means that rather than paying fixed interest payments like conventional bonds, the appreciation of the instrument provides the return to the holder.

### Yield Curve

A line graph showing the interest rates at specific points in time by plotting the yields of all securities with the same risk but with maturities ranging from the shortest to the longest available. The yield curve for Government securities is often used as a benchmark for pricing other debt in the market. The curve is also used as an indicator of macroeconomic conditions.