

## Chapter 5

### DEBT AND CAPITAL MARKET DEVELOPMENTS

#### INTRODUCTION

The Government's medium term *Debt Management Strategy* is designed to attain and maintain public debt sustainability, and, ensure that the overall borrowing requirements are not only met at minimum cost but are also achieved with a prudent degree of risk.

Although there was some degree of success in attaining certain of the targets set in its *Debt Management Strategy* for FY 2008/09, the Government closed the fiscal year with limited achievements in its execution. One of the achievements of the Government's *Debt Management Strategy* was meeting its principal objective of financing its budgetary requirements.

On the domestic side, the Government was able to issue a higher proportion of longer term debt than in the previous year. On the external side, within the first quarter of the fiscal year the Government was able to raise US\$350mn of its targeted US\$600mn financing. Against the background of a virtual shut down of the financial markets caused by the global financial meltdown the Government was able to achieve its total external borrowing requirements at relatively low interest rates and long maturities by having engaged the multilateral institutions as part of its funding strategy.

These achievements were, however, overshadowed by the impact of the global economic crisis which resulted in a volatile foreign exchange market and unfavourable domestic and external capital market environments.

In the domestic market, relative interest rate stability early in the fiscal year subsequently gave way to significant interest rate increases resulting in higher than projected interest costs. In the face of the uncertainty underlying the macroeconomic fundamentals, investors in general demonstrated a reluctance to invest in long-term fixed rate instruments. There was an increase in the foreign currency component of the domestic debt portfolio, which exceeded the target established in the debt strategy.

The management of the external debt was also challenged, primarily by the effects of the global recession and in particular the financial melt down in the United States of America. During the fiscal year, there was heightened focus by the three major credit rating agencies, which all revised Jamaica's credit rating downwards, following the actual and perceived unfavourable effects on Jamaica's fiscal and external accounts by the deteriorating economic situation.

The nominal value of the public debt grew by 20.0% in FY 2008/09, compared to 8.4% in FY 2007/08. The stock of public debt at the end of FY 2008/09 was \$1,200,325.9mn compared to the \$1,000,676.5mn recorded at the end of FY 2007/08.

The main factors contributing to the nominal increase in the stock were:

- Financing of the fiscal deficit;

- Adverse movements in the foreign currency rates vis-à-vis the J\$; and
- The assumption by the Government of liabilities of the Sugar Company of Jamaica.

During the fiscal year the Government, through the Statistical Institute of Jamaica (STATIN) revised the System of National Accounts and the Gross Domestic Product (GDP) was rebased. The rebasing of the GDP revealed that the size of the economy was actually larger than previously recorded. This meant that as a percentage of GDP, total public debt at the end of FY 2007/08 was revised to 108.2% from 126.1%. At the end of FY 2008/09 this ratio had slipped slightly to 108.9%.

## DOMESTIC DEBT

### Performance Summary

FY 2008/09 was characterized by a deepening global economic crisis, which manifested itself in local investors holding short positions and choosing to remain liquid. Relative interest rate stability in the first half of the fiscal year gave way to significant increases in interest rates, resulting in a higher than programmed cost of debt financing and a subsequent rise in interest costs.

In the face of persistent high interest rates and the uncertainty underlying the macroeconomic fundamentals, the market continued to exhibit a preference for short-term variable rate instruments. These developments, coupled with a lowering of Jamaica's credit ratings, had a negative impact on the cost and structure of domestic financing and consequently the achievement of many of the objectives of the *Debt Management Strategy*.

Despite the constraints and challenging market conditions, the Government was able to satisfy its budgetary financing requirements and issue a higher proportion of longer term debt than in the previous year.

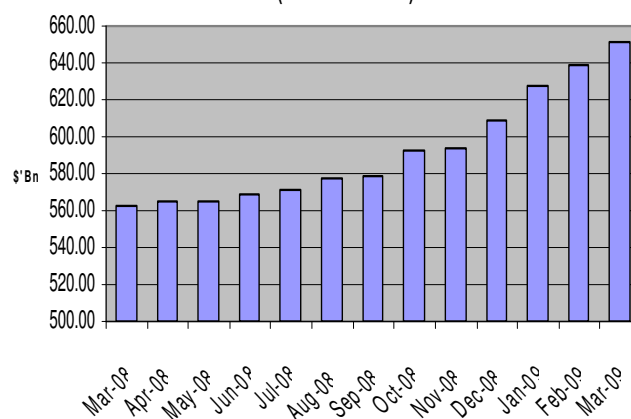
### Stock Composition

The stock of domestic debt moved from \$562,108.1mn at the end FY 2007/08 to \$651,657.4mn at the end of the review period, representing a net increase of \$89,549.3mn or 15.9%. The average monthly movement in the stock for the period was approximately 1.3%.

The main factors contributing to the increase were:

- Financing of the fiscal deficit;
- Loans of the Sugar Company of Jamaica assumed by the Government;
- The adverse foreign exchange rate movements during the review period; and
- The consolidation of loan financing made by PetroCaribe Development Fund to Central Government.

**Domestic Debt Stock**  
(Mar-08 to Mar-09)



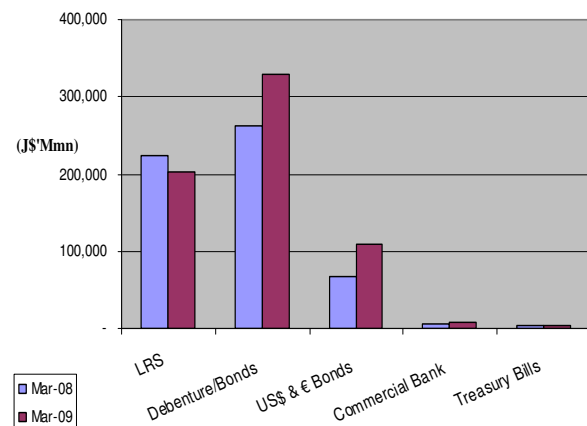
There was a continuation, from the previous year, of the shift in the structure of the domestic debt portfolio from medium term instruments to short term instruments. Of significance was the increase in the category of Debenture/Bonds, which moved from 46.5% at the start of the fiscal year, to 50.4% at the end of the review period. The corollary of this change was the decrease in the holdings of Local Registered Stocks, which moved from 39.8% at the start of the fiscal year to 31.0% at the end of the review period.

Similarly, there was an increase in the stock of US\$ local denominated and US\$ indexed bonds by 61.4%. The combined stock of US\$ denominated local bonds and US\$ indexed bonds increased from 12.1% at the start of the fiscal year to 16.8% of the portfolio at the end of FY 2008/09. These changes will potentially increase both roll over and foreign exchange risks of the portfolio.

### Structure of the Domestic Debt Portfolio March 2008 – March 2009

	Mar-08	%	Mar-09	%
LRS	223,581.6	39.8	201,936.1	31.0
Debentures/ Bonds	261,459.9	46.5	328,268.2	50.4
Treasury Bills	4,200.0	0.8	4,094.5	0.70
US\$ Indexed Bonds	17,843.2	3.2	29,743.4	4.6
US\$ Denominated Bonds	49,894.3	8.9	79,567.4	12.2
Commercial Bank & Other Loans	5,129.1	0.8	8,047.6	1.2
<b>Total Domestic Debt</b>	<b>562,108.1</b>	<b>100.0</b>	<b>651,657.4</b>	<b>100.0</b>

### Structure of the Domestic Debt Portfolio



### Holdings

Merchant banks, trust companies and brokers remained the main holders of Government securities. Their holdings however, decreased from 37.8% at the end of FY 2007/08 to 35.2% at the end of FY 2008/2009. The Bank of Jamaica was the second largest holder accounting for 13.5%. Commercial banks accounted for 13.2% of the portfolio. Holdings by insurance companies and pension funds, including the National Insurance Fund, decreased from 25.2% at the end of FY 2007/08 to 20.4% at the end of FY 2008/09 while holdings by individuals increased from 1.8% at the end of FY 2007/08 to 3.7% at the end of FY 2008/09.

### Maturity Profile

In spite of the market environment and investor preference for short and liquid investment, the Government was able to increase the issue of new debt with maturities greater than 10 years. At the end of FY 2008/09 the issue of new debt securities with maturities greater than 10

years had increased to 14.4% compared with 8.0% at the end of FY 2007/08.

The Government was also successful in meeting its target of 3-4% of new issues with maturities of 20 years and over. The issuance of these securities provided investors with long term investment solutions to support their asset/liability needs.

A total of \$41,568.4mn or 25.5% of the new debt issues had maturities in excess of five (5) years, compared with 36.9% at end FY 2007/08. New domestic debt issued in FY 2008/09, had 74.5% maturing within 5 years, compared with 63.4% in FY 2007/08. Within this five-year period, 70.0% will mature within 3 years, while 4.5% will mature in 3-5 years. Debt issues with maturities between 5 and 10 years decreased to 11.1% from 28.6% in FY 2007/08.

**Maturity Structure of New Debt  
By Original Maturities  
(%)**

<b>Years to Maturity</b>	<b>F/Y 2006/07</b>	<b>F/Y 2007/08</b>	<b>F/Y 2008/09</b>
Up to 5 yrs	22.9	63.4	74.5
<i>Of which up to 3 yrs</i>	8.4	28.0	70.0
<i>Of which 3-5 yrs</i>	14.5	35.4	4.5
5-10 yrs	36.1	28.6	11.1
10 – 20 yrs	37.6	4.9	11.1
20 – 30 yrs	3.4	3.1	3.3
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Of the total domestic debt outstanding at the end of FY 2008/09, 67.4% had maturities of up to 5 years, compared with 62.4% in FY 2007/08, while 14.5% had maturities of 10 years and over, a decrease when compared with 16.1% at the end of FY 2007/08.

The weighted average maturity of the domestic debt at the end of the review period was 5.2 years. This compared with the 5.5 years reported at the end of FY 2007/08.

**Debt Raising**

Gross new debt issued during FY 2008/09 amounted to \$162,714.84mn, compared with budgeted financing of \$130,751.7mn. The total recorded during this period represented an increase of \$31,963.1mn or 24.4% over the budgeted financing when compared with the 14.9% increase at the end of FY 2007/08.

Guided by the objective of greater transparency, \$131,789.5mn or 81.0% was issued directly to the market, while \$30,925.3mn or 19.0% represented non-market issues (Non-market issues related to loans from the PetroCaribe Development Fund, and financial institutions for budgetary financing and the assumption of the Sugar Company of Jamaica loans). Debt raised for budgetary financing totaled \$145,564.0 or 89.5%, while non-budgetary financing represented the remaining 10.5%.

The issuance of US\$ denominated and US\$ indexed bonds totaled \$38,824.1mn or 23.9% of the new debt issued during the period.

The total stock of foreign currency denominated debt represented 16.8% of the domestic debt portfolio. This resulted in an increase in the risk inherent in the foreign currency exposure of the domestic debt portfolio and was a reversal of the proposed reduction in the foreign currency component of the debt. The specific factors contributing to the increase were:

- The requirement to partially finance the repayment of the maturing €200 million bond from the domestic market in the context of the closure of the international capital markets;
- Consolidation of loan financing made by PetroCaribe Development Fund to Central Government ;
- Loans from PetroCaribe Development Fund for budgetary financing; and
- The assumption of liabilities of the Sugar Company of Jamaica.

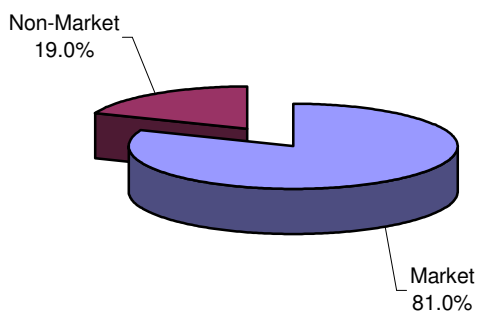
A total of \$88,605.7mn or 54.5% was issued as fixed rate debt, while \$74,109.1mn or 45.5% was issued as variable rate. Despite strong demand for variable rate debt, the share of fixed rate debt issued during the year increased to 54.5%, from 34.1% in FY 2007/08.

## Interest Rate Structure

During FY 2008/09 debt management was faced with challenging market sentiments and preferences that affected the debt strategy objective of increasing the ratio of fixed rate to variable rate debt of the portfolio. Of the total outstanding domestic debt at the end of FY 2008/09, 40.8% had been contracted on a fixed interest rate basis up from 37.6% at the end of FY 2007/08 and 40.0% at the end of March 2007.

The weighted average interest rate of J\$ debt in the portfolio at the end of the review period was 15.32% p.a., up from 14.76% p.a. at the end of FY 2007/08. However, for the US\$ denominated local bonds and the US\$ indexed bonds, the weighted average interest rate fell to 8.49% p.a. at the end of FY 2008/09 from 9.42% p.a. at the end of FY 2007/08.

### New Domestic Debt March 2009



### Interest Rate Composition

March 2007 – March 2009

(%)

	FY 2006/07	FY 2007/08	FY 2008/09
Fixed Rate	40.0	37.6	40.8
Variable Rate	59.9	62.3	59.1
Non Interest-Bearing	0.1	0.1	0.1
<b>Total Debt</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

## **Interest Rates**

During the first half of FY 2008/09, the average yields on the 3 and 6-month Treasury Bills remained relatively stable showing a trend of very moderate increases.

The average yield moved from 13.97% p.a. and 14.22% p.a. on the 3 and 6-month Treasury Bills, respectively at the end of FY 2007/08, to 20.51% p.a. and 21.77% p.a. respectively at the end of FY 2008/09. The global economic crisis had an unfavourable impact on both the foreign exchange market and the domestic interest rate environment. In an effort to contain inflation and maintain macroeconomic stability the Bank of Jamaica adjusted interest rates on its Certificate of Deposit on December 1, 2008. The 3-month Treasury Bill peaked at 22.33% p.a. in January 2009 and the 6-month Treasury Bill peaked at 24.45% p.a. in December 2008.

## **EXTERNAL DEBT**

### **Performance Summary**

External debt management was challenged in its fundraising efforts in the International Capital Market (ICM) in FY 2008/09, due mainly to the global recession and in particular the financial melt down in the United States of America. Notwithstanding, due to a proactive approach and proper timing, the Government with a sovereign credit rating of “B”, was able to access US\$350mn of the planned amount of US\$600mn in June 2008 from the ICM. Consequently, before the end of the first quarter of the fiscal year, the Government successfully raised over 58.3% of its external financing requirement for the year. Given prevailing market conditions the bond issue was attractively priced and the Government was again able to achieve

the lowest coupon of 8% for its external bonds, having first done so in FY 2006/07.

The issuance of the bond also offered the Government the opportunity of maintaining a presence in the markets and widening its investor base, despite unfavourable market conditions.

Preparatory to approaching the markets and in order to expedite the fund raising process, the Government completed the annual updating of its base prospectus filed with the United States Securities and Exchange Commission.

In response to the challenge and in light of the outlook for future debt issuances, the Government effected its strategy for raising the additional amount to include that of engaging the multilateral institutions for financing under the policy based/development policy loan facilities. This proved beneficial to the Government, as these loans were contracted at tenors at the longer end of the yield curve and at interest rates lower than those obtainable by other “B” rated issuers on the ICM.

The Government achieved its policy objective of raising external funding for FY 2008/09 to the extent of external amortization from a mix of funds from both the ICM and multilateral institutions and was able to maintain a prudent debt structure by the realignment in the proportion of commercial and official creditor debt categories.

During FY 2008/09 the major economies, in the face of a deepening economic crisis, implemented measures aimed at stabilizing their economies and providing stimuli to foster growth and productivity. One of the principal tools used was interest rates, which resulted in several rounds of rate reductions. The external debt portfolio benefited from

this decline as evidenced by a marginal reduction in interest costs.

### Stock Composition

At the end of FY 2008/09 the stock of public and publicly guaranteed external debt stood at \$548,668.5mn (US\$6,177.6mn) compared with \$438,568.1mn (US\$6,169.3mn) at the end of FY 2007/08. In US\$ terms the stock remained relatively flat compared with an increase of 2.2% at the end of FY 2007/08 over FY 2006/07. The external debt to GDP ratio increased to 49.8% at the end of FY 2008/09 from 47.4% at the end of FY 2007/08. In February 2009 the Government retired its €200mn 10.625% Bond, the single largest amortization for the fiscal year. This was achieved by a combination of external and local commercial bank financing.

During FY 2008/09 the Government contracted new loans for social, economic and infrastructure projects. Among those contracted were loans for the:

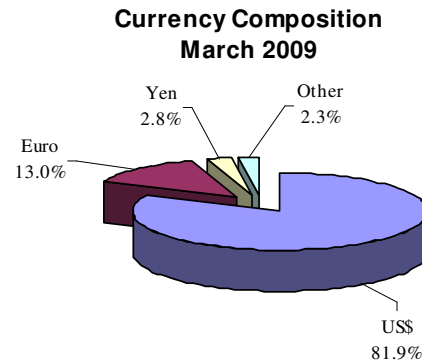
- Fiscal & Debt Sustainability Development Project;
- Early Childhood Development and Social Protection Project;
- Liquidity Programme for Growth Sustainability;
- Transportation Infrastructure Rehabilitation Programme;
- Education Reform Programme;
- Youth Development Programme;
- Jamaica Competitiveness Enhancement Programme; and
- Public Financial and Performance Management Programme.

In J\$ terms the growth rate of the external debt was 25.1% in FY 2008/09 over FY 2007/08 compared with 7.2% in FY 2007/08 over FY 2006/07.

### Currency Composition

The US\$ remained the principal currency in which external loans were denominated. By maintaining a large component of the debt in US\$ currency, the portfolio is insulated against the risks associated with the cross

currency parity changes. At the end of FY 2008/09 the US\$ accounted for 81.9% of the debt compared with 73.3% at the end of FY 2007/08. The proportion of the debt denominated in Euro decreased to 13.0% from 20.8% at the end of FY 2007/08. The decrease resulted from the maturity of Euro 200mn bond in February 2009. Yen denominated loans represented 2.8%, while other currencies accounted for 2.3%, compared with 2.9% and 1.6% respectively in FY 2007/08.



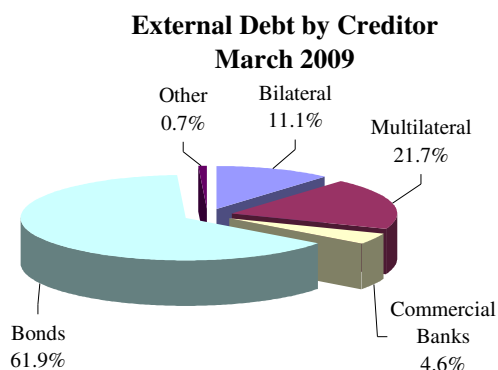
### Creditor Composition

At the end of FY 2008/09 the proportion of the debt held by Official Creditors, comprising multilateral and bilateral creditors represented 32.8% of the debt stock compared with 30.8% at the end of FY 2007/08. The increase in this component comes against the background of Jamaica's re-engagement of the multilateral financial institutions.

In previous years the Government placed heavy reliance on the ICM for budgetary support. During the year there was a shift to securing financing from the multilateral institutions, which coincided with the multilaterals' review of their lending policies. The rationale for this was to improve the maturity and interest rate

profiles of the external debt portfolio, which would result from the longer tenors and lower interest rates usually offered by these institutions.

At the end of FY 2008/09 Private Creditors consisting of bondholders, commercial banks and suppliers credits represented 67.1% of the external debt stock compared with 69.2% at the end of the previous year. The reduction in the share of this category reflects the Government's focus on securing more funding from official sources, in particular from the multilaterals. Eurobonds issued in the ICM continued to represent the major component of the external debt stock, even though it declined from 64.0% at the end of FY 2007/08 to 61.9% at the end of the review period. Commercial bank credits represented 4.6 % of the stock.



## Interest Rate Structure

At the end of FY 2008/09 the external debt continued to be heavily skewed towards fixed rate instruments, albeit with a slight reduction, with 76.9% fixed and 23.1% variable, compared with 81.2% and 18.8%

respectively at the end of FY 2007/08. The mix of fixed and variable rate debt reflects the *Debt Management Strategy* objective of maintaining an appropriate mix of fixed and variable rate debt and provides a level of protection to the portfolio against adverse interest rate movements. The variable rate component of the portfolio had a positive impact on interest payments, as the Government benefited from the downward movement of international interest rates with base rates such as US\$ 6-month LIBOR, trending downward reaching a low of 1.7% in February 2009. This resulted in lower than projected interest payments during the period.

The average interest rate on bilateral and multilateral loans at the end of the period was 3.81% p.a., compared with 3.99% p.a., while international bonds was 9.83% p.a., compared with 9.98% at the end of FY 2007/08.

## External Debt Interest Rate Structure March 2007 – March 2009 (%)

	FY 2006/07	FY 2007/08	FY 2008/09
Fixed-Rate Debt	78.9	81.2	76.9
Variable Rate	21.1	18.8	23.1
<b>Total</b>	100.0	100.0	100.0

## **Maturity Structure**

In keeping with the debt strategy of extending maturities, the external debt was contracted mainly on a long term basis during FY 2008/09. As a result, the external

debt portfolio remained predominantly long-term. This effectively lowers the cost of the stock in present value terms and also reduces potential rollover risk. Of the total external debt outstanding at the end of FY 2008/09 18.9% had maturities of up to 5 years compared with 21.9% at the end of FY 2007/08; 30.6% had maturities of 5-10 years down from 30.8% in FY 2007/08 and 50.5% had maturities in excess of 10 years up from 47.3% in FY 2007/08.

## **Debt Forgiveness**

The Government of Jamaica has over the years benefited from debt forgiveness from a number of bilateral creditors. Jamaica and the United Kingdom have on an annual basis agreed on specific parameters for the granting of debt forgiveness as outlined in the Medium Term Socio-Economic Policy Framework document. Accordingly, with Jamaica having satisfied most of the mutually agreed targets and in recognition of its commitment to the internationally agreed Millennium Development Goals and policies debt forgiveness was granted. These policies seek to promote a transparent and accountable Government and sustainable development.

During FY 2008/09 the Government of the United Kingdom provided debt forgiveness to the value of £4.9mn under the renewed Commonwealth Debt Initiative (CDI). The programme covers all principal and interest payments due in the fiscal year to both the United Kingdom Government's Overseas Development Assistance (ODA) Programme

and the Commonwealth Development Corporation (CDC).

Of the amount forgiven, £2.6mn was in respect of ODA loans while £2.3mn represented payments due to CDC. This £4.9mn forgiven compared with an amount of £5.4mn which was eligible and forgiven in the previous year.

## **International Capital Markets and Developments**

During FY 2008/09 the ICM was characterized by uncertainty, volatility and instability precipitated by the collapse of key financial institutions and power brokers in the major economies of the world. The resulting financial crisis imposed constraints and challenges upon both issuers and investors. Despite the adverse international financial environment, in June 2008 the Government of Jamaica aggressively and successfully tapped the international capital markets for US\$350mn, representing 56% of its projected financing requirements. The bond carries a coupon of 8.0% p.a. and will be amortized over the last three years of the tenor, with final maturity in June 2019. By September 2008, the financial meltdown had caused a virtual shut down of the financial market especially for "B" rated issuers such as Jamaica.

As part of its funding strategy the Government of Jamaica had early in the fiscal year engaged the multilaterals for external financing. A combination of ICM and multilateral sources achieved the debt strategy objective of satisfying the external borrowing requirements. The process was timed to coincide with the single largest amortization for the fiscal year which occurred in February 2009. Jamaica's impeccable record of debt servicing was maintained and this supported investors' confidence in Jamaica's credit.

At the beginning of FY 2008/09 Jamaica's sovereign bonds enjoyed robust trading activity with prices above par. Consequent on the financial difficulties which affected the external investment brokers the credit lines to some local investment institutions were withdrawn leading to margin calls and depressed values on the Government's bonds.

The bonds closed the fiscal year at consistently lower and weak trading levels, but nevertheless performed better than a number of other emerging market issuers.

During the fiscal year under review Jamaica's credit rating was reviewed six times by the rating agencies: Standard and Poors (S&P) (three times), Moody's Investor Services (Moody's) (two times) and Fitch Ratings (once).

In May 2008 S&P reaffirmed Jamaica's long-term foreign currency rating of "B" and maintained its "Stable" outlook. However, in October the rating agency revised the rating outlook from "Stable" to "Negative" and in March 2009 lowered its long-term foreign and local currency sovereign credit ratings to "B-". The rating on the short term debt was also lowered to "C" from "B".

In November 2008, Moody's reviewed Jamaica's performance and placed the credit on a downgrade watch. The pending rating action was effected in March 2009, when the agency revised Jamaica's country ceiling rating for foreign currency bonds and notes from "B2" to "B3". The local currency denominated bond issuer rating was also revised to "B2" from "Ba2". A "Stable" outlook was maintained on all ratings.

In November 2008, Fitch also revised Jamaica's long-term foreign and local currency Issuer Default Ratings to "B" from "B+".

A "Negative" rating outlook was also assigned.

The rating agencies have all recognized that Jamaica has demonstrated a strong willingness to service its debt in a timely manner. However, the deteriorating economic situation and its increasing spillover into Jamaica's fiscal and external accounts have been the basis for the rating action taken by the agencies.

## **DEBT INDICATORS**

In October 2008 the Statistical Institute of Jamaica carried out a revision of the Jamaican System of National Accounts, which among other things provided a rebasing of the Gross Domestic Product (GDP) that showed the size of the Jamaican economy larger than previously reported. Prior to the revision, the total debt as a percentage of the GDP at the end of FY 2007/08 was 126.1%, down from 132.4% at end of FY 2006/07.

At the end of FY 2008/2009 the total debt as a percentage of GDP was estimated at 108.9%, slightly above the revised ratio of 108.2% reported at the end of last fiscal year. When disaggregated in debt component terms, the domestic debt as a percentage of GDP at the end of FY 2008/09 was approximately 59.1%, an improvement over the revised 60.8% at the end of FY 2007/08, while the external debt as a percentage of GDP at the end of FY 2008/09 was 49.8%, a marginal increase over the revised 47.4% at the end of FY 2007/08.

## **THE DEBT MANAGEMENT STRATEGY FY2009/10**

The objective of the Debt Management Strategy will continue to be:

*“To raise adequate levels of financing on behalf of the Government of Jamaica at minimum costs, to develop and implement strategies to ensure the long-term sustainability of the public debt while maintaining risk at an acceptable level”.*

The *Debt Management Strategy* will:

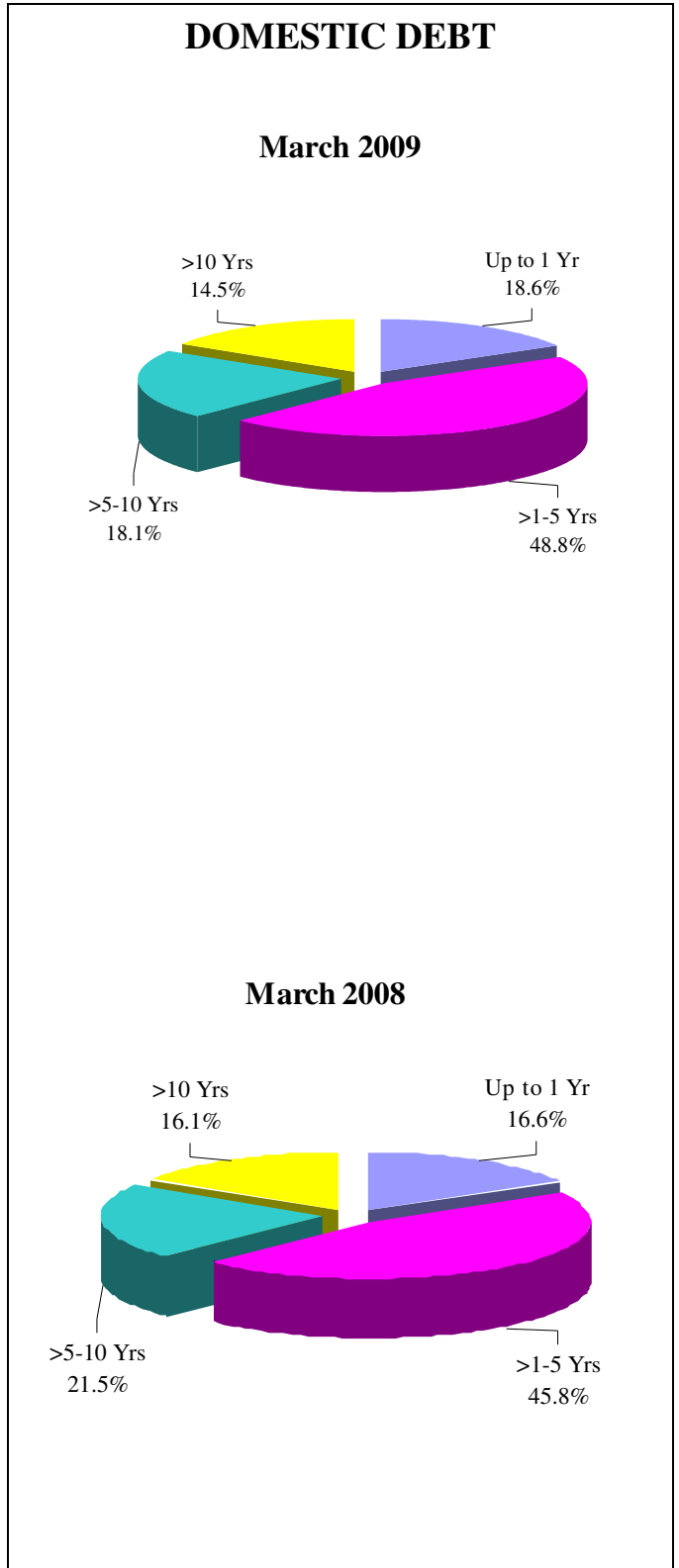
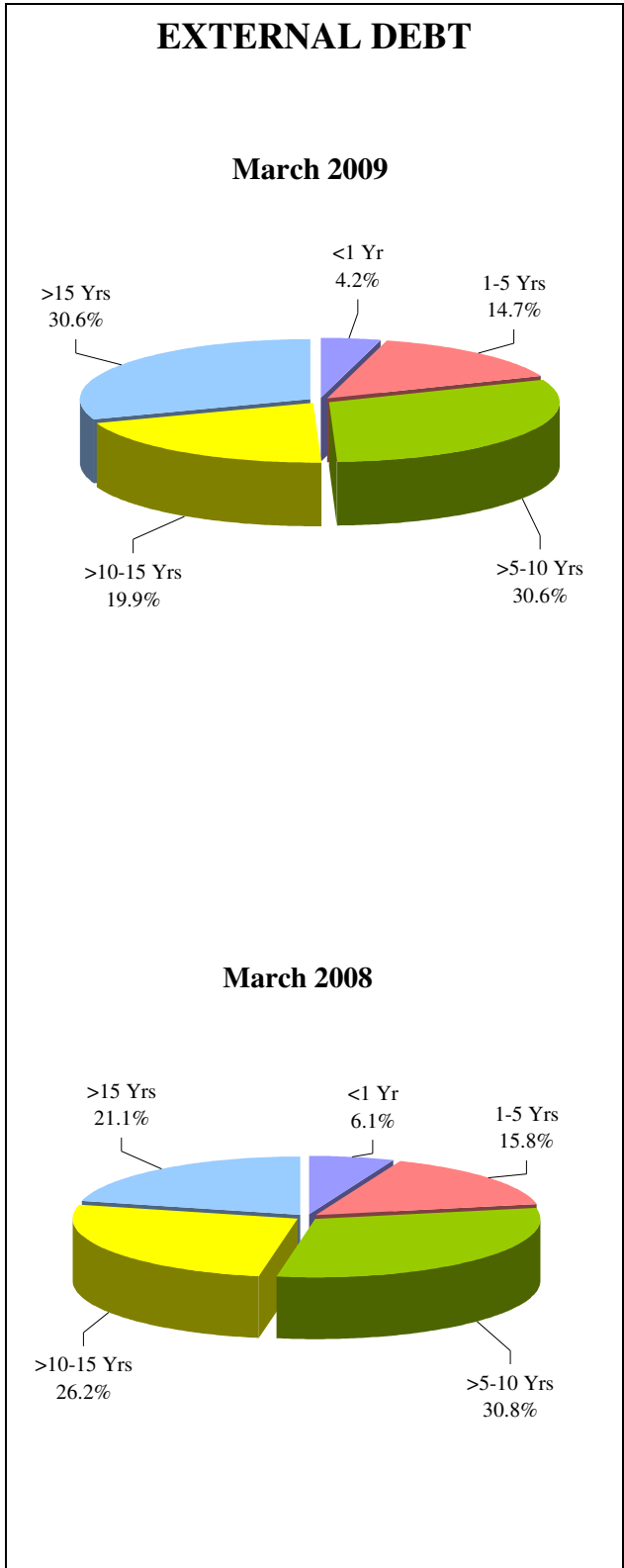
- Seek to aggressively reduce the interest rate impact on the debt portfolio;
- Address aspects of realignment of the portfolio;
- Maintain the fixed-rate proportion of the domestic debt portfolio;
- Extend and smooth the maturity profile of the debt;
- Minimise foreign currency exposure of the domestic debt portfolio;
- Increase the use of the bid auction mechanism for issuance of domestic securities;

- Increase the transparency and predictability of debt issuance and operations;
- Re-engage the bilateral creditors and continue to engage the multilateral institutions;
- Maintain the level of new issuance of external debt equivalent to the level of external amortization; and
- Implement the dematerialization of securities.

### **Medium-term Goals**

Strategies aimed at cost minimization and reduction of risk to the debt portfolio will be pursued. Liability management, in the form of replacing high cost debt with more concessionary type financing and extension of the maturity profile of the domestic debt, will be the main focus of cost containment thereby providing fiscal space for social development issues.

**MATURITY PROFILE OF THE DEBT  
(Remaining Maturity)**



## HOLDINGS OF GOJ REGISTERED SECURITIES

