# Sovereign Bond Analysis: Government of Jamaica

VMWM Research | August 15, 2023

876-960-5000 vmwmclientservices@myvmgroup.com vmwealth.myvmgroup.com 53 Knutsford Boulevard, Kingston 5

- **Bond Recommendations:**
  Conservative Risk Appetite: **MARKETWEIGHT**
  Moderate Risk Appetite: **OVERWEIGHT**
  Aggressive Risk Appetite: **MARKETWEIGHT**

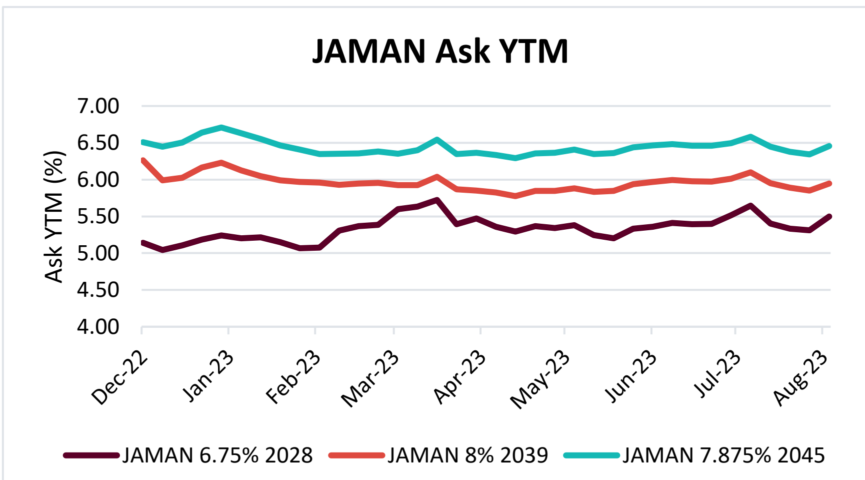
## ABOUT JAMAICA

The Jamaican economy has displayed remarkable resilience in its post-pandemic recovery. Being heavily reliant on tourism, the nation has experienced significant benefits from the resurgence of international travel, contributing to a growth rate of 4.70% during the fiscal year (FY) 2022/23, compared to the previous year. The expansion is accompanied by a shrinking debt-to-GDP ratio, despite higher interest and inflation rates globally and intermittent exchange rate volatility.

The Government of Jamaica (GOJ) received international financing from multinational agencies to cushion the blows of the COVID-19 pandemic, which resulted in the debt ratio soaring to 109.70% during FY 2020/21. However, through prudent fiscal measures, Jamaica has resumed its path towards reducing debt and aims to achieve its medium-term debt-to-GDP ratio of 60% by FY 2027/28. This commitment has contributed to the estimated decline in the debt ratio to approximately 79.70% at the end of FY 2022/23.

To address the challenge of elevated inflation, the Bank of Jamaica (BOJ) implemented 10 policy rate increases between 2021 and 2022, amounting to a total increase of 650 basis points (bps). As a result of these measures, Treasury Bill yields have risen, along with higher interest rates in the market for deposit-taking institutions (DTIs), and a gradual decline in the point-to-point inflation rate. Nonetheless, the GOJ continues to make interest payments, while lowering the debt metrics.

| Government of Jamaica: Bond Term Summary | | | |
|---|---|---|---|
| **Issuer** | Government of Jamaica | | |
| **Currency** | USD | | |
| **Credit Rating/Outlook** | Standard & Poor's (S&P): B+/Stable<br>Moody's: B2/Stable<br>Fitch Ratings: B+/Positive | | |
| **Day Count Basis** | 30/365 | | |
| **Issue Date** | 07/28/2015 | 03/15/2007 | 04/28/2016 |
| **Maturity** | **07/28/2045** | **03/15/2039** | **04/28/2028** |
| **Tenor** | 30 Years | 32 Years | 12 Years |
| **Maturity Type** | Bullet | Sinkable | Sinkable |
| **Coupon Rate** | 7.875% | 8.000% | 6.750% |
| **Amount Outstanding** | 1,815,000 (M) | 1,243,238 (M) | 1,421,447 (M) |
| **Ask Yield to Maturity[1]** | 6.457% | 5.946% | 5.500% |
| **Ask Price[2]** | $116.522 | $120.691 | $105.124 |




**Recommendation:** The Jamaican economy maintains its upward trajectory in the aftermath of the pandemic, driven by careful fiscal and monetary strategies. These measures have played a role in decreasing debt and alleviating inflationary pressures. The sinkable features on the JAMAN 6.75% 2028 and JAMAN 8% 2039 reduce some of the risks associated to investors, but the bonds remain below investment grade. However, the higher price premiums currently associated with all three bonds and the extended time until they reach maturity have had a greater influence on our recommendations. The JAMAN's are trading above par in an already high interest rate environment. We therefore recommend investors with conservative and aggressive risk appetites **MARKETWEIGHT,** while moderate risk appetites **OVERWEIGHT** Jamaica bonds.

## SELECTED MACROECONOMIC INDICATORS

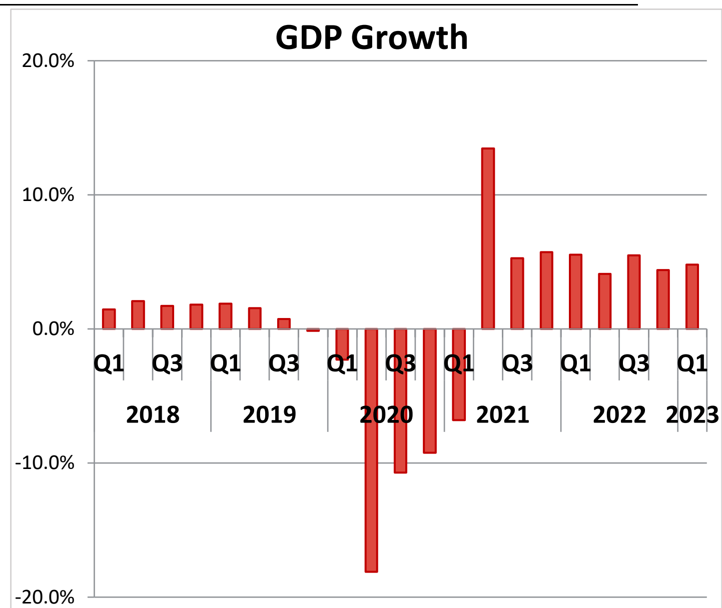
| | 2021 | 2022 (E) | 2023 (P) | 2024 (P) | 2025 (P) |
|---|---|---|---|---|---|
| **Real GDP (annual % change)** | 4.60 | 4.00 | 2.20 | 2.00 | 1.70 |
| **Average Unemployment rate (%)** | 8.35 | 6.28 | - | - | - |
| **Inflation Rate (end of period %)** | 7.30 | 9.35 | 5.16 | 5.32 | 5.77 |
| **BOJ Policy Rate (%)** | 2.50 | 7.00 | 7.00 | 6.50 | 5.50 |
| **Debt-to-GDP (FYE %)** | 109.70 | 94.20 | 79.70 | 74.20 | 68.20 |
| **Net International Reserves (USD Billions)** | 4.00 | 3.98 | 4.10 | 4.20 | 4.30 |

*Sources: STATIN, IMF, Ministry of Finance & Public Service, Bank of Jamaica*

## ECONOMIC OVERVIEW & OUTLOOK

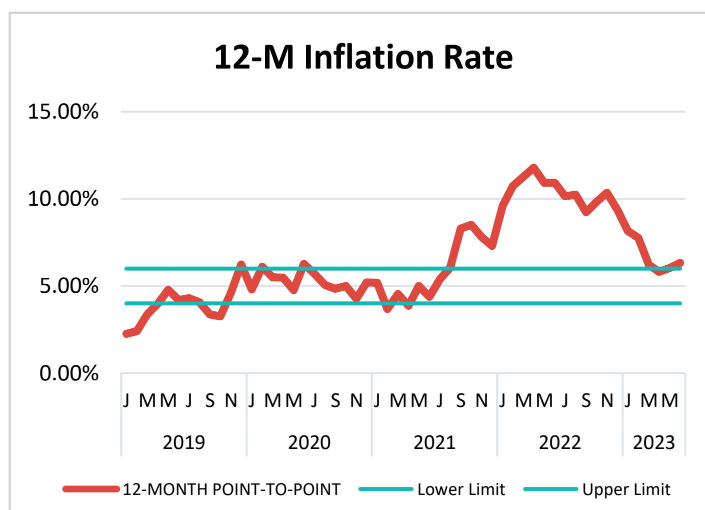
**Economy is Robust and Tourism Edges Closer to Pre-Pandemic Numbers**

In the face of high prices and stricter monetary policies, the Jamaican economy is demonstrating robust growth, surpassing the pre-COVID-19 threshold[3] for the third consecutive quarter in Q1 2023. During this period, the economy expanded by 4.20% compared to Q1 2022, with the Services and Goods Producing Industries recording growth of 5.40% and 1.00%, respectively. This expansion was facilitated by the resumption of production at the JAMALCO plant, favourable weather conditions benefiting the agriculture sector, and a continued rebound in the tourism industry. In 2022, stopover arrivals increased 117.05% year-over-year, as arrivals reached 79% of the historic 2019 levels. The Ministry of Tourism is strategically working to bolster the number of arrivals by closing deals to increase the number of flights into the island, retrofitting tourist attractions and increasing the number of available rooms. Looking ahead, the economy is projected to grow by 2.20% in 2023, and then slightly decelerate to 2.00% in 2024. Despite this marginal slowdown of the growth rate, government revenue is expected to remain strong over the medium term, due to buoyant economic activity.




**Receding Inflation but Monetary Policy Remains Tight**

The domestic inflation rate has decelerated from its peak of 11.79% recorded in April 2023, even landing within the Bank of Jamaica's (BOJ) 4% to 6% target range in April 2023. The last point-to-point inflation rate came in at 6.30% in June 2023, mainly driven by sizeable increases in the heavily weighted 'Food and Non-Alcoholic Beverages', 'Restaurant and Accommodation Services' and 'Furnishings, Household Equipment and Routine Household Maintenance' divisions. The inflation rate is expected to maintain its downward trajectory beyond 2023, if there are no additional exogenous shocks to the global and domestic economies. Despite cooling inflation, the BOJ has kept its policy rate constant at 7% from Q4 2022, the highest rate since March 2011. The policy rate is projected to remain elevated at 7% until Q4 2024 due to the lagged pass-through effect of rate hikes, rising interest rates in the US and a small threat of contracting the local economy.

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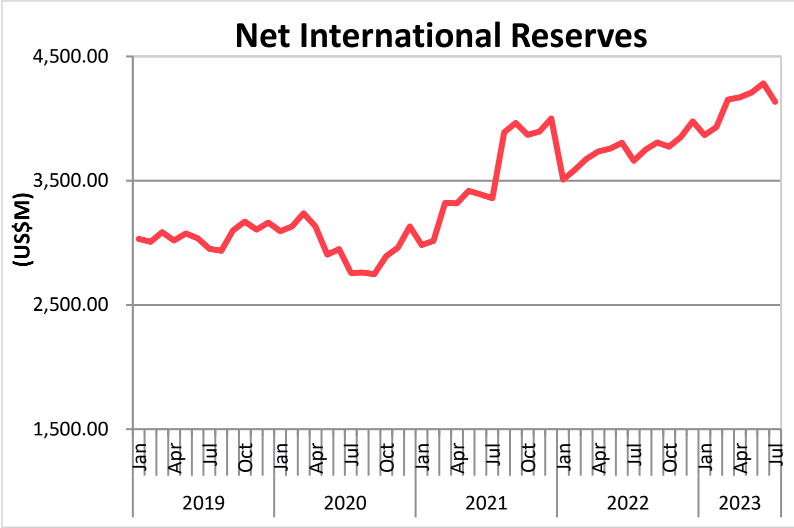
[3] This threshold represents the value of real GDP in the quarter immediately before the COVID-19 pandemic began, that is Q4 2019.

**International Reserves are Healthy**

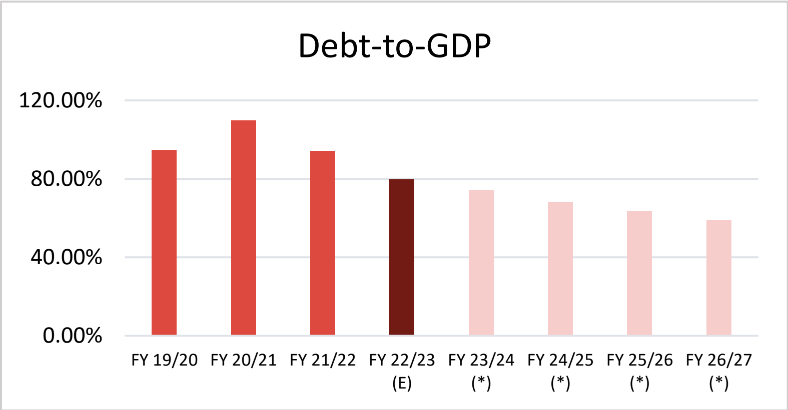
In Q1 2023, Jamaica obtained approval from the International Monetary Fund (IMF) to receive financial assistance amounting to US$968 Million under the Precautionary and Liquidity Line (PLL) and US$764 Million under the Resilience and Sustainability Facility (RSF). This aid has played a crucial role in bolstering the stock of net international reserves (NIR), which reached a record high of US$4.28 billion in June 2023. The abundant NIR holdings have been frequently utilized by the Bank of Jamaica (BOJ) to intervene in the foreign exchange market, thereby mitigating foreign exchange volatility. As a result, the Jamaican dollar has only experienced a marginal 2.30% year-to-date (YTD)[4] depreciation against the US Dollar as of the end of July. Moreover, even with the slowdown of remittance inflows, the NIR is anticipated to remain in a healthy state beyond 2023, aiding in the stabilization of the local currency, meeting international obligations, and financing the current account.




[5]

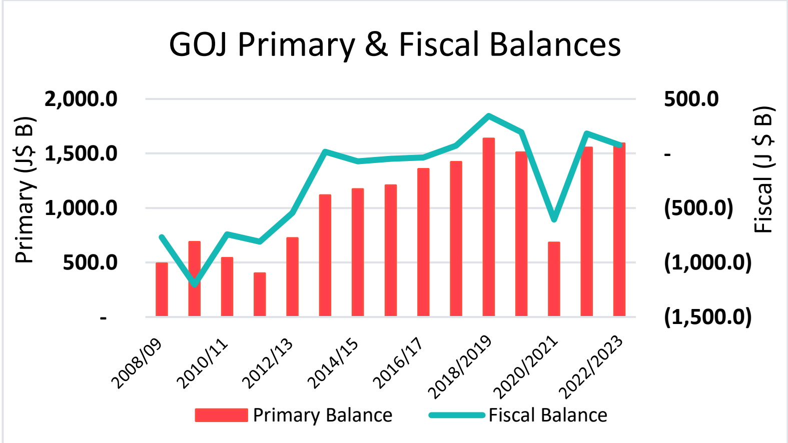
**High, but Declining Debt-to-GDP Ratio**

The country's debt-to-GDP experienced a transient spike in 2020, due to the COVID-19 pandemic, but the GOJ has since put structural reforms in place to rebuild fiscal buffers and return to the medium-term debt target. The debt ratio fell to an estimated 79.70% at the end of FY 2022/23, a significant decline from the 109.70% recorded at the end of FY 2020/21. Despite elevated interest rates, domestically and internationally and higher prices, the macroeconomic improvements are expected to support the downward debt trajectory towards the targeted 60% or less of GDP by FY 2027/28.




**Continued Improvement to the Fiscal Balance**

The GOJ has achieved fiscal surpluses, which include the GOJ's interest payments, since FY 2017/18, except for FY 2020/21. These fiscal surpluses have been sustained by the increase in revenue and grants over and above the growth in spending. Despite facing greater expenses, including higher interest and overall costs due to elevated inflation, government spending has been well backed by tax revenue and grants provided by international organizations. Notably, the GOJ has maintained a positive primary surplus, which excludes interest payments, since as far back as FY 2008/09. The GOJ approved an historic J$1.02 trillion budget for FY 2023/24, which is anticipated to be financed by J$1.05 trillion in revenue, with the absence of any new or higher taxes.

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[4] YTD as at August 4, 2023

[5] (E): Expected (*): Projected

**Well-capitalized Banks:**
After the gradual withdrawal of pandemic support measures, the banking industry maintains a strong capital position, and the occurrence of non-performing loans remains minimal. This can be attributed to the post-pandemic economic rebound. As of September 2022, the capital adequacy ratio stood at 13.4%, surpassing the mandatory 10% regulatory threshold. Additionally, the non-performing loan ratio was 2.5%, which is lower than the average from the five years prior to the pandemic.

The local financial landscape has become highly interconnected, with banks evolving into financial conglomerates that operate both deposit-taking and non-deposit taking entities. In light of this, the finance minister has proposed the adoption of a Twin Peaks Regulatory Model. Presently, the regulation entails the BOJ overseeing deposit-taking institutions, while the Financial Services Commission (FSC) regulates non-deposit taking institutions. However, the Twin Peaks Regulatory Model will introduce two overseeing bodies: the BOJ, responsible for maintaining financial system stability, and the FSC, tasked with supervising market conduct and ensuring consumer protection. This proposition emerges in the aftermath of the investment fraud incident at Stocks and Securities Limited (SSL) and other instances of regulatory oversights in the banking sector. Nevertheless, the resilient state of the banking industry is in line with the government's goal of securing 70% of its funding needs from domestic sources.

## CREDIT RATINGS

**Fitch Ratings: (B+: Positive)**
On March 7, 2023, Fitch Ratings adjusted the Outlook for Jamaica's Long-Term Foreign and Local Currency Issuer Default Ratings (IDRs) from Stable to Positive, while maintaining the 'B+' IDRs. The 'B+' rating for Jamaica is underpinned by notably stronger World Bank Governance Indicators compared to the 'B' median. However, the ratings are constrained by fundamental structural weaknesses, encompassing challenges like a high crime rate, limited productivity, and unfavourable demographics, resulting in restrained underlying growth potential. The change in the outlook reflects Jamaica's substantial advancements in reducing debt, even in the face of the pandemic's impact. It also considers Jamaica's institutional framework focused on stability and favourable financing conditions, further supported by new IMF facilities. Although public debt has resumed its downward trajectory after a temporary rise in 2020, it remains higher than the current 'B' median of 57% of GDP.

**Standard & Poor's (S&P): (B+/B: Stable)**
On October 4, 2021, Standard and Poor (S&P) revised its assessment of Jamaica's economic outlook, upgrading it from Negative to Stable. The credit rating agency maintained its long-term rating at 'B+' and its short-term rating at 'B.' S&P acknowledged Jamaica's commitment to fiscal consolidation despite the challenges posed by the COVID-19 pandemic, which led to reduced economic and fiscal risks. The revisions to the BOJ Act have also bolstered the central bank's monetary credibility. In the medium term, the GOJ's dedication to maintaining a sustainable fiscal policy is expected to bolster macroeconomic stability. Therefore, the Stable outlook indicates the expectation that the fiscal position will improve, potentially returning to a surplus position due to economic growth. Moreover, Jamaica's high debt levels are anticipated to start declining, and the adverse impacts of the pandemic should gradually diminish.

**Moody's: (B2: Stable)**
On November 23, 2021, Moody's confirmed Jamaica's B2 rating with a Stable Outlook. The rating acknowledged Jamaica's strong commitment to fiscal consolidation, which is expected to facilitate a reduction in government debt levels after a temporary increase caused by the COVID-19 pandemic. However, the rating also considered the challenges posed by Jamaica's low economic growth, limited diversification, and small economy, which constrained its overall economic and credit prospects. The Stable Outlook indicates a balanced assessment of potential risks to the rating, including anticipated economic recovery despite possible threats like weather-related events. The stability outlook also relies on the expectation that the government will adhere to medium-term debt targets, leading to a return to pre-pandemic fiscal trends characterized by significant primary surpluses and decreasing government debt ratios.

## S.W.O.T ANALYSIS

| Strengths: | Weaknesses: |
|---|---|
| • The economy continues to recover from the COVID-19 pandemic-induced recession in 2020.<br>• Strong fiscal and monetary frameworks implemented by the GOJ and BOJ support price stability, full employment, debt reduction and economic growth.<br>• Stable political and democratic institutions lower the probability of economic disruptions due to political upheavals. | • Crime and corruption remain a drag on business confidence and FDI's.<br>• The local economy is heavily dependent on tourism, which exposes it to the economic and environmental impacts of climate change on the sector.<br>• Although domestic inflation is trending downwards, prices remain elevated. This will see a dip in consumer spending, which can have a negative impact on fiscal revenue and GDP growth. |
| **Opportunities:** | **Threats:** |
| • Jamaica benefits from a strategic location, which provides the opportunity to become a logistics hub, boost investments and promote economic growth.<br>• The addition of new rooms and more direct flights to the island are expected to further enhance the tourism product, which should reflect in increased economic activity and government revenue.<br>• External financing from the IMF under the PLL and RSF are expected to safeguard from fallouts from external shocks and mitigate the impacts of climate change. | • Higher interest rates globally and locally threaten the size of the fiscal balance, as interest expenses rise.<br>• Possible recessions in our main source markets may see a significant reduction in tourist arrivals and remittance inflows, both of which are major contributors to economic activity.<br>• Natural disasters such as hurricanes and earthquakes pose threats to infrastructure and economic livelihoods.<br>• Global inflationary pressures are widening the current account deficit, which may require increased reserves to finance. |

VM Wealth Management Limited

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## Conclusion

Following the pandemic, the Jamaican economic activity continues to trend upwards, propelled by cautious fiscal and monetary tactics. These approaches have contributed to debt reduction and the easing of inflationary tensions. While international inflation concerns, crime rates, and economic homogeneity pose challenges to the nation's performance, prudent macroeconomic strategies have mitigated these potential setbacks. Factors such as the decreasing debt load, a recent upgrade in the country's outlook, and the premiums associated with the sovereign bonds have been the key elements considered while formulating our recommendations, while considering the credit profile.

The following recommendations were applied to investors with the following risk appetite:

Conservative Risk Appetite: **MARKETWEIGHT**
Moderate Risk Appetite: **OVERWEIGHT**
Aggressive Risk Appetite: **MARKETWEIGHT**

**SOURCES**

Bloomberg, SFCL's Company's Website, S&P, Fitch Ratings, IMF, World Bank, SFCL's Financial Statements, Ministry of Finance & Public Services, Central Bank of Barbados



**DEFINITIONS**

- **OVERWEIGHT** - Security is deemed to be undervalued and is expected to outperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **MARKETWEIGHT** – Security is expected to provide similar returns compared to the market in general or at the same pace as comparable companies; neither strongly positive nor negative.

- **UNDERWEIGHT** – Security is deemed to be overvalued and is expected to underperform compared to the average market return and/or return of comparable securities in the same sector or industry.

- **ZEROWEIGHT** – This security is substantially distressed or at risk of a shock which may significantly impair its value.