Investment Planning: Managing through the implications of the IMF agreement.

Adrian A. Stokes
Challenging Economic Background

- Agriculture, Hotels & Restaurants: sectors on the positive side
- Mining & Quarrying, Construction and Manufacturing sectors major contributors to weakness
- Consumer & Business confidence remain weak

Source: SDBG, STATIN
Tax Revenues

- Weak revenue base implies fiscal prudence is extremely important

12-Moving Average of Tax Revenues

- The fall from the cliff, which began Aug-08
- Hit rock bottom in Sep-09

Source: SDBG, MOF
## 2010/11 Expenditure Budget

### CENTRAL GOVERNMENT SUMMARY ACCOUNTS

(in millions of Jamaica dollars)

<table>
<thead>
<tr>
<th></th>
<th>Budget FY 09/10</th>
<th>Budget FY 10/11</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Expenditure</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recurrent Expenditure</td>
<td>387,044.2</td>
<td>343,929.9</td>
<td>-43,114.3</td>
</tr>
<tr>
<td>Programmes</td>
<td>72,042.2</td>
<td>74,121.0</td>
<td>2,078.8</td>
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<tr>
<td>Wages &amp; Salaries</td>
<td>126,619.6</td>
<td>127,659.6</td>
<td>1,039.9</td>
</tr>
<tr>
<td>Interest</td>
<td>188,715.6</td>
<td>142,149.4</td>
<td>-46,566.2</td>
</tr>
<tr>
<td>Domestic</td>
<td>144,869.1</td>
<td>95,092.6</td>
<td>-49,776.6</td>
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<tr>
<td>Capital Expenditure</td>
<td>34,414.3</td>
<td>63,206.4</td>
<td>28,792.1</td>
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<tr>
<td><strong>Amortization</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>External</td>
<td>26,491.1</td>
<td>27,132.9</td>
<td>641.8</td>
</tr>
<tr>
<td>Domestic</td>
<td>144,458.9</td>
<td>69,701.4</td>
<td>-74,757.5</td>
</tr>
</tbody>
</table>

- **J$88.4B** reduction in budgeted expenditure due mainly to JDX effect
- **JDX impact**: domestic interest costs down **J$49.8B**; domestic amortization down **J$74.8B**
- Overall JDX impact: J$124.6B in budgeted expenditure cuts
- **Wages & Salaries** kept at minimum 0.8% (J$1.04B) growth
- Recurrent Exp. down **J$43.1B** offset by CapEx increase of J$28.8B
# Medium Term Economic Program

<table>
<thead>
<tr>
<th></th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (Real)</td>
<td>-2.5</td>
<td>0.5</td>
<td>2.0</td>
<td>2.0</td>
<td>2.0</td>
</tr>
<tr>
<td>GDP (Nominal)</td>
<td>7.0</td>
<td>12.7</td>
<td>8.4</td>
<td>10.2</td>
<td>9.1</td>
</tr>
<tr>
<td>Inflation</td>
<td>13.5</td>
<td>8.0</td>
<td>6.9</td>
<td>7.6</td>
<td>7.0</td>
</tr>
<tr>
<td>Current Account (% GDP)</td>
<td>-9.4</td>
<td>-8.8</td>
<td>-6.6</td>
<td>-5.9</td>
<td>-5.0</td>
</tr>
<tr>
<td>NIR</td>
<td>1751.9</td>
<td>1536</td>
<td>1649.2</td>
<td>1763.9</td>
<td>1836.3</td>
</tr>
<tr>
<td>Fiscal Balance (% GDP)</td>
<td>-10.9</td>
<td>-6.5</td>
<td>-4.3</td>
<td>-2.9</td>
<td>-0.7</td>
</tr>
<tr>
<td>Primary Balance (% GDP)</td>
<td>6.2</td>
<td>7</td>
<td>7.7</td>
<td>8.3</td>
<td>9.1</td>
</tr>
</tbody>
</table>
## SDBG Projections

**FORECAST 2010/11**

<table>
<thead>
<tr>
<th></th>
<th>FY 09/10</th>
<th>FY 10/11</th>
<th>Target 10/11</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Revenue Growth</td>
<td>8.0%</td>
<td>7.0%</td>
<td>8.5%</td>
</tr>
<tr>
<td>Tax Revenues</td>
<td>265,882.6</td>
<td>284,224.9</td>
<td>287,211.4</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>300,817.2</td>
<td>323,295.7</td>
<td>326,282.1</td>
</tr>
<tr>
<td>Non-Interest Expenditure</td>
<td>232,742.8</td>
<td>265,011.2</td>
<td></td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>421,458.5</td>
<td>407,160.6</td>
<td></td>
</tr>
<tr>
<td>Expected Primary Balance</td>
<td>68,074.3</td>
<td>58,284.5</td>
<td>83,300.0</td>
</tr>
<tr>
<td>Expected Fiscal Balance</td>
<td>-120,641.3</td>
<td>-83,864.9</td>
<td>-80,854.2</td>
</tr>
<tr>
<td>GDP</td>
<td>1,109,800.0</td>
<td>1,250,500.0</td>
<td>1,250,500.0</td>
</tr>
</tbody>
</table>

- Fiscal model reveals growth in tax revenues of only 7.0% for the FY 10/11, amounting to at best J$284 billion or 22.7% of GDP.
- The primary balance will emerge at 4.7% of GDP (or J$58.3 billion), below its target. The shortfall results mainly from Air J’s J$21.9 billion cost.
- Excluding Air J, the primary balance would surface within 0.3% of the target at 6.4% of GDP.
- Achieving the target set for the fiscal deficit of J$80.9 billion is possible under reasonable circumstances. The deficit will likely hit 6.7% of GDP by the end of March-2011, only 0.2 percentage points below target.
Post JDX Effect: T-Bill Yields

- 6.31 percentage points fall in average 6-month Treasury bill yield

![Interest Rates Graph](Image)

*Source: SDBG, BOJ*
Post JDX Effect: Negative Real Rates

- Negative real interest rates are positive for asset price growth: real estate, equities, credit activities

Real 6 Month T-Bill Returns

Real returns peaked at 8.2%

Source: SDBG, BOJ, STATIN
Post JDX Effect: J$ Yields

- J$ yields have declined 439BP on average
- Difference between longer term yields and shorter term yields has declined 217BP on average
Post JDX Effect: US$ Yields

- US$ yields have declined on average 194BP
- Difference between longer term and shorter term yields has declined 37BP on average
Post JDX Effect: GOJ Global Bond Yields

- Global bond yields have declined 357BP on average
Post JDX Effect: J$/US$ Exchange Rate

- J$0.99 appreciation of local currency versus USD as multilateral flows have buoyed Jamaica’s FX reserves

![Chart showing J$ to US$ Pre and Post JDX with JDX announcement and Closure of JDX highlighted.]
Post JDX Effect: International Reserves

- Improvement in Net International reserves from increased multilateral flows. Reserves now cover 7.6 more weeks of goods imports.
Post JDX Effect: JSE Index

- JSE main index has risen 16% from the lows as capital seeks higher risk adjusted returns.
- Increased trading volumes post JDX transaction
Inflation Trends

- Inflation will likely remain “sticky” downwards until second round effects from tax hikes have abated.
US Job Recovery

- Recovery in US job growth is especially positive for Tourism, Remittances and Mining sector

![Graph showing US Jobs Growth](image-url)

Source: SDBG, BLS

2010 Business Convention | May 6 - 9 | Sunset Jamaica Grande Resort - Ocho Rios
Remittance Flows Recovering

- Recovery in remittances key for the economy: approximately 16% of GDP. Enhances consumer spending.

12 Month Growth in Remittance Inflows


Recovery in remittances correlated with recovery in US jobs growth.

Remittance trends: Jan up 1.6%; Feb up 7.4% respectively over last year.

Source: SDBG, BOJ
Tourism Recovery

- Stopover arrivals up 8.2% and 4.5% Jan & Feb 2010
- Total arrivals down 3.3% and 1.8% Jan & Feb 2010
- Total expenditure up 0.7% and 6.8% Jan & Feb 2010
Main Themes: Financial Planning

• Interest rates are at all time low
• Borrow at fixed rate in this environment. Capital Market Transactions
• Stock market will do well in this environment given low risk free rate. Buy companies that have diversified revenue streams
• Real Estate exposure makes sense.
• Bonds have performed well. Would not look to add material exposure here. Wait for a pull back.
• The J$ should continue to depreciate against the USD at a measured pace. Always good to have currency diversification
• Diversifying country risk is also important. While home bias to Jamaica, some exposure to countries that are not heavily correlated with Jamaica makes sense.
Risks to Economy

- Consumer and business spending likely to remain weak during the near term, impacting GDP growth and tax revenues

- Inflation risks are skewed to the upside

- Fiscal deficit and debt to GDP are still quite large despite concerted effort to control expenditure

- Public sector wage negotiations remain a near term risk for economic stability if not resolved

- Improving global economy still has potential for periods of sudden sharp reversals, which could have negative impact on local economy

- Budget has zero degrees of freedom to facilitate unexpected shocks such as hurricanes or other forms of natural disaster
Summary

Overall, we see reduced risks in the local landscape emanating from contraction of the fiscal deficit target and increasingly favorable global backdrop.

- Our forecasts show that the government should come close to achieving the fiscal deficit target for 2010/11 absent shocks.

- Major macro variables remain well behaved, largely reflecting reduced risks associated with the JDX. Inflation and natural disasters remain key risks to the forecasts.

- Improving global economy will not be enough to stimulate near term growth to levels that are required (>3%). Growth likely to remain weak near term.

- Medium term growth dependent upon government’s ability to navigate economy through challenges to meet fiscal targets AND unleash private sector expansion.

- Jamaica faces long and challenging road ahead, but important necessary first steps have been taken to place economy on stable path.