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DEBT MANAGEMENT STRATEGY

FY 2006/07

Ministry of Finance & Planning

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INTRODUCTION

1. The annual *Debt Management Strategy* published by the Ministry of Finance and Planning, on behalf of the Government of Jamaica, has been critical to the Government's medium-term macroeconomic policy framework and fiscal strategy. The formulation and implementation of a *Debt Management Strategy* began in FY1998/99 and has been published since FY1999/2000.

2. This annual document provides information on the Government's objectives, policies, plans and strategies for managing the public debt in the ensuing fiscal year and over the medium term. It also reports on the achievements and challenges in implementation during the previous year. The *Debt Management Strategy* is complemented by details on Jamaica's public debt and debt developments contained in the annual *Memorandum on the Budget*, also published by the Ministry of Finance and Planning.

3. The policies and strategies implemented over the years have been designed to return the public debt to sustainable levels and to implement prudent debt practices. The primary objective of the Strategy has evolved from an initial focus on reducing the debt servicing costs to include risk management, consistent with international best practice.

4. The revised debt management objective is:

> ***To raise adequate levels of financing on behalf of the Government of Jamaica at minimum costs; develop and implement strategies to ensure the long term sustainability of the public debt and to reduce the Government's exposure to risk.***

5. In pursuit of this objective and in keeping with the medium-term strategy, the Government has sought to:

- Maintain a prudent debt structure by:
  - Maintaining an appropriate mix of fixed-rate and floating-rate debt to further diversify and minimize interest-rate risk;
  - Extending and smoothing the maturity profile of the debt to better manage refinancing risk; and
  - Minimizing foreign currency risk.
- Further diversify the debt portfolio;
- Use market mechanisms for domestic debt issuances;
- Increase the transparency and predictability of primary market debt issuance; and
- Promote and build a liquid and efficient market for government securities.

6. Given the dynamic nature of the macro-economic environment, the Strategy is kept under constant review. The annual update of the *Debt Management Strategy* takes into account the composition of the debt portfolio, the fiscal operations, developments in the macro-economy and in the domestic and international capital markets.

7. Significant progress has been made over the eight (8) years since the implementation of the Strategy. The debt portfolio has been progressively realigned by:

i. extending the maturity profile;
ii. effectively managing interest rate risk, thereby reducing the vulnerability to unexpected interest rate shocks;
iii. diversifying the investor base (both domestic and external), instrument type and market sources;
iv. promoting and facilitating the development of the domestic capital market; and
v. increasing transparency and predictability in debt management practices and operations.

8. The formulation and implementation of the Strategy have also had a positive impact on Jamaica's image and strengthened its credibility in debt management. This has contributed to increased investors' confidence as well as that of the rating agencies and international financial community in general. All of these factors have had a positive influence on the pricing of the country's debt securities.

Market Developments FY2005/06

9. Debt management in FY2005/06 was challenged mainly by:-

i. the requirements for additional financing to meet the revenue shortfall arising mainly from the impact of an unusually active hurricane season; and
ii the reluctance among investors to invest in long-term securities in light of the higher than projected inflation which contributed to expectations for higher interest rates. The demand was therefore for high fixed-rate securities and/or some investors opted for variable-rate instruments.

10. Domestic interest rates, while on a general downward trend, like the foreign exchange market, was relatively stable during the year.

11. In addition to the monthly issuance of the benchmark 6-month Treasury Bill, since August 2005, the Government has been issuing 3-Month Treasury Bills on a monthly basis to appropriately re-price all new securities with quarterly coupons.

12. In the international capital markets, investors again demonstrated their confidence in Jamaica, resulting in the Government's successful placement of a 20-Year 9.25% bond in October 2005 and a 30-Year 8.50% bond in February 2006.

13. Jamaica's sovereign credit ratings were re-affirmed by Moody's Investors Service and Standard & Poor's. In May 2005, Moody's maintained Jamaica's "B1" long-term foreign currency credit rating and the "Stable" outlook. In January 2006, Standard & Poor's re-affirmed its "B" long-and short-term rating and "Stable" outlook on Jamaica. The ratings were supported *inter alia*, by Government's ongoing commitment to fiscal discipline and debt reduction, even in the face of exogenous shocks.

14. In May 2005, Jamaica made its final debt payment to the International Monetary Fund (IMF), thereby ending almost three decades of borrowing relationship with that institution.

Review of FY2005/06

15. At the end of March 2006, total public debt stood at $847.3 billion. This represented an increase of 11.5% over the stock of $759.7 billion recorded at the end of March 2005. The Debt-to-GDP ratio stood at 131.5% at the end of FY2005/06, an improvement over the 138.2% recorded at the end of FY2004/05 and the 140.0% at the end of FY2003/04.

16. The stock of public and publicly guaranteed external debt stood at $364.6 billion (US$5,567.4 million) at the end of March 2006. This represented an increase of 17.5% compared with the stock of $310.4 billion at the end of March 2005. In US$ terms, the external debt rose by 10.4% from US$5,044.4 million at the end of March 2005. This was due to increases in both Central Government and Government-guaranteed debt. As a percentage of GDP, the external debt remained relatively flat at 56.6% at the end of FY2005/06 compared with 56.5% at the end of FY2004/05.

17. Central Government external debt increased from $278.0 billion (US$4,517.5 million) at the end of March 2005, to $316.1 billion (US$4,826.3 million) at the end of March 2006, as new borrowings exceeded amortization. During the year, there were disbursements on new and existing project loans. In addition, in February 2006, the Government took advantage of strong market conditions and low long-term interest rates to pre-fund its FY2006/07 external borrowing programme, tapping the markets for US$250 million. The increase in Government-guaranteed external debt mainly reflected borrowings in support of the financial restructuring by the national airline, Air Jamaica Ltd., and for infrastructural development by public sector entities such as the National Water Commission.

18. Central Government domestic debt stood at $482.7 billion at the end of March 2006. This represented an increase of 7.4%, compared with the stock of $449.2 billion recorded at the end of March 2005. The main factors accounting for the increase were the issuance of securities to the Bank of Jamaica (BOJ) representing capitalization of accrued interest on BOJ losses and BOJ/FINSAC Local Registered Stocks (LRS), the additional requirements for the fiscal operations and the assumption of debts on behalf of certain public sector entities.

19. The rate of growth of the domestic debt has recorded a significant decline over the last five (5) years, moving from 39.6% in FY2001/02, 14.0% in FY2003/04, 7.6% in FY2004/05 to 7.4% in FY2005/06. The Domestic Debt-to-GDP ratio declined from 81.7% at the end of FY2004/05 to 74.9% at the end of FY2005/06.

20. During FY2005/06, the *Debt Management Strategy* sought to:

- Maintain a prudent debt structure by:
  - Maintaining an appropriate mix of fixed-rate and floating-rate debt to further diversify and minimize interest-rate risk; and
  - Extending and smoothing the maturity profile of the debt to better manage refinancing risk.
- Continue to increase the transparency and predictability of debt issuance.

21. The Government made some progress in executing its *Debt Management Strategy* in FY2005/06.

Maintain a Prudent Debt Structure

Maintaining an appropriate mix of fixed-rate and floating-rate debt to further diversify and minimize interest-rate risk.

22. Of the new domestic debt issued in FY2005/06, 35.9% was contracted on a fixed-rate basis and 64.1% on a variable-rate basis. This compared with a 73.6% fixed-rate and 26.4% variable-rate mix of the new debt issued in FY2004/05. The increased issuance of variable-rate securities reflected the Government's response to market conditions in the context of higher than projected inflation and expectations for increases in interest rates. The demand was for variable-rate and/or high fixed-rate securities. In this context, prudent debt management dictated increased issuance of variable-rate securities.

23. At the end of FY2005/06, the fixed-rate component of the domestic debt portfolio stood at 47.0%, down from the 58.6% recorded at the end of FY2004/05. For the external debt portfolio, the share of fixed-rate debt continued to increase, reaching 77.4% at the end of FY2005/06, compared with 76.2% in FY2004/05.

Extending and smoothing the maturity profile of the debt to better manage refinancing risk

24. The Government was successful in extending the maturity profile of the domestic debt in FY2005/06, despite the challenges of the market. However, the market environment was not conducive to implementing plans to "smooth" the domestic amortization profile through the exchange of securities nearing maturity for new instruments with longer maturities, as domestic investors displayed a preference for short- and medium-term securities over longer-term securities.

25. Of total new domestic debt issued in FY2005/06, 43.4% had maturities of up to 5 years, a reduction from the 71.5% recorded at the end of FY2004/05. Of this category, 16.3% had maturities of between 1 and 3 years and 27.1% between 3 and 5 years. Issues with maturities in excess of 5 years accounted for 56.6%, compared with 28.5% at the end of FY2004/05. Issues with maturities between 5 and 10 years grew significantly from 21.2% in FY2004/05 to 35.7% at the end of FY2005/06. Despite the challenges, of the new domestic debt issued during the year, 3.5% had maturities in excess of 20 years, of which 1.1% had maturities of 30 years.

26. Of the total domestic debt outstanding at the end of FY2005/06, 71.9% had maturities of up to 5 years compared to 74.4% at the end of FY2004/05 and 73.1% at the end of FY2003/04. Issues with maturities between 5 and 10 years increased to 15.9% from 15.3% in FY2004/05. Maturities of 10 years and over accounted for 12.2% of outstanding domestic debt stock at the end of FY2005/06, up from the 10.3% recorded at the end of FY2004/05.

27. The Government took advantage of strong market conditions and low long-term interest rates in the international capital markets and accessed the long end of the US$ yield-curve. This was accomplished by the issuance of a 20-year and a 30-year global bond during the fiscal year.

Minimizing Foreign Currency Risk

28. The Government continued to make significant progress in reducing the foreign currency exposure of the domestic debt portfolio towards the internationally acceptable standard of 10%. At the end of FY2005/06, the overall foreign currency component of the domestic debt declined to 15.9% from 18.9% at the end of FY2004/05 and a high of 23.2% at the end of FY2003/04. US$-Indexed bonds totaled $25.6 billion (US$389.9 million equivalent) or 5.3% of the domestic debt portfolio at the end of FY2005/06, compared with $37.2 billion (US$599.9 million equivalent) or 8.3% at the end of FY2004/05. The stock of US$-denominated bonds stood at $51.2 billion (US$782.4 million) or 10.6% of the domestic debt portfolio at the end of FY2005/06. This compared with $47.5 billion (US$772.4 million) or 10.6% of the domestic debt stock at the end of FY2004/05.

Increased Transparency and Predictability

29. The Government remains firm in its commitment to transparency and predictability in the execution of its policies. During the year, the Government continued to disclose comprehensive, timely and reliable information on the performance and management of the public debt, thereby ensuring greater clarity and accountability to the general public.

30. Comprehensive domestic and external debt data are published on the Ministry of Finance and Planning's website on a monthly basis. Information on the Government's debt operations is publicly disclosed by means of monthly schedules of upcoming issues. Information on Government's debt, its strategy, operations and relevant investor information are available on the Ministry's website *(www.mof.gov.jm/dmu).*

Market Consultation

31. During FY2005/06, the Government continued its market-oriented approach to debt management by actively engaging the local and international financial communities in dialogue through various media, such as press conferences, meetings, investor fora and presentations, as well as quarterly conference calls. Formal consultations and discussions between the public and private sectors continued in an effort to explore options for reducing the debt and debt servicing costs.

Legal and Regulatory Framework

32. Since sufficient room existed under the loan ceiling to satisfy the Government's borrowing programme in FY2005/06, there was no need to amend the Act to increase the loan ceiling. The Loan Act 1964, and its subsequent amendments, is the Government's primary borrowing authority.

33. There are ongoing activities aimed at modernizing the legislation and regulations in relation to the management of the public debt. Steps are being taken to obtain the necessary approval to amend the legislation to facilitate the electronic registration of Government securities.

Development of the Domestic Capital Market

34. In FY2005/06, the Government continued to perform a catalytic role in the development of the domestic capital market. At the policy and technical levels, collaboration continued with the Jamaica Central Securities Depository, a subsidiary of the Jamaica Stock Exchange, for the immobilization of fixed income securities. Immobilization of securities will involve, *inter alia*, the development of a central securities depository, the electronic registration of debt securities and thereby reducing the issuance of paper certificates.

DEBT STRATEGY FY2006/07

35. Debt management in FY2006/07 will continue to be guided by the fundamental strategic objective of the Government's medium-term *Debt Management Strategy* of lowering the costs of borrowing, subject to the containment of risks within acceptable levels. Risk management will continue to be a critical tool in Government's *Debt Management Strategy* in FY2006/07 and beyond.

36. Within the context of the medium-term strategy aimed at achieving a sustainable level of indebtedness, in FY2006/07 the *Debt Management Strategy* will continue to seek to:

- Maintain an appropriate mix of fixed-rate and floating-rate debt to further minimize interest-rate risk;
- Extend and smooth the maturity profile of the debt to better manage refinancing risk;
- Minimize foreign currency exposure of the domestic debt portfolio;
- Increase the use of the auction mechanism for issuance of domestic securities; and
- Increase the transparency and predictability of debt issuance and operations.

Maintain an Appropriate Mix of Fixed-rate and Floating-rate Debt to Further Minimize Interest-rate Risk

37. During FY2006/07, increased emphasis will be placed on reducing the sensitivity of the domestic debt portfolio to unexpected interest rate shocks, especially given the increased level of variable-rate domestic debt. The Government will seek to increase the fixed-rate share of the domestic debt.

Extend and Smooth the Maturity Profile to Better Manage Refinancing Risks

38. Significant progress has been made over the years in re-balancing the maturity structure of the public debt, particularly the domestic debt. Market conditions prevailing, the Strategy in FY2006/07 will seek to increase the number of offers of Government securities with maturities in excess of 10 years. This is consistent with the objective of reducing refinancing risk over the medium-term. In addition, the availability of these securities will provide investment options and opportunities for long-term investors such as individuals and institutions in the growing insurance and pension industries and other investment vehicles such as mutual funds and annuities.

Minimize Foreign Currency Exposure of the Domestic Debt Portfolio

39. The Government will continue to build on the progress made and take the necessary steps to further reduce the foreign currency exposure of the domestic debt portfolio. Except under extraordinary circumstances, the Government will continue to limit the use of U$-Denominated and U$-Indexed instruments in the domestic market in order to further reduce the foreign currency exposure of the domestic debt portfolio towards internationally acceptable levels over the medium-term.

Increase the Use of the Auction System

40. In October 1999, the Government introduced the use of the auction mechanism to issue Local Registered Stocks. The main objectives were to ensure that the Government's borrowing requirements are met as cost-effectively as possible and to contain interest cost through the promotion of intense competitiveness through the bidding process. These objectives were realized through regular use of the auction mechanism. There was a notable tightening of spreads that resulted in the average yields declining with positive implications for the Government's borrowing costs.

41. During FY2006/07, subject to market conditions, the Government will conduct auctions on a monthly basis, with issues across a wide range of maturities. The size of auctions will be gradually increased and where possible, issues will be re-opened to create benchmarks.

Increase Transparency and Predictability

42. Over the years, the Government has been cognizant of the views of the market players that transparency and predictability in debt issuance are important as they allow for better investment planning and portfolio management. Experience has shown that transparency and predictability have helped to lower the Government's borrowing costs and strengthen credibility. Therefore, increased transparency and predictability have been and will continue to be the guiding principle for the Government's issuance strategy.

43. The Government's approach to risk, relative costs, market conditions and opportunities, the size of maturing securities, the maturity profile of the existing stock of debt will determine funding sources and instrument types. These are all consistent with Government's efforts to maintain a prudent debt structure.

44. The Government will offer new securities in the domestic market on a regular pre-announced basis. While the Government remains committed to the use of market mechanisms for the issuance of securities, it will ensure flexibility in terms of the options to meet the budgetary requirements.

45. Transparency in the Government's debt operations and borrowing programme will continue to be enhanced by:

- Monthly publications of comprehensive external and domestic debt data;
- Advanced notices of upcoming debt issues;
- Quarterly announcements of Government's borrowing requirements;
- Monthly schedules of market issues;
- Timely publication of the results of market issues; and
- Quarterly reports on debt-related developments.

46. These, along with the Government's *Debt Management Strategy* and relevant investor information, will continue to be made available in the print media and/or electronically at the Ministry's website.

47. The Ministry of Finance and Planning will make available to the market, gross financing requirements for the ensuing quarter by the beginning of each quarter. Monthly schedules of market issues will be announced by the end of the preceding month. The schedule will initially indicate the timing, type of instruments to be placed in the market and, in the case of auctions, the number of tranches and the tenures. Details of the terms and conditions of the instruments will be provided to the market at least four (4) business days prior to the subscription dates.

48. The Government will continue to hold regular meetings with the domestic and international market makers, host quarterly investors' conference calls and conduct investors presentations and road shows in North America and Europe.

49. This consultative approach to the markets has proven to be mutually beneficial, fostering greater understanding by the domestic and external market players of Government's debt operations and debt management objectives. It has also contributed to the achievement of the Government's objective of reducing borrowing costs, diversifying the investor base and facilitating the development of the domestic capital market.

Domestic Capital Market Development

50. The Government will continue to facilitate the development of a modern and efficient domestic capital market infrastructure. Work aimed at the immobilization of debt securities will be ongoing. The immobilization of Government securities will reduce the turnaround time for the issuance and delivery of certificates and will result in savings for the Government. In addition, it will allow for the further development of the domestic capital market by increasing efficiency and reducing the risks associated with the holding, trading and settlement of paper securities.

Legal and Regulatory Framework

51. Consistent with the Government's commitment to annually review the amount of loans raised under the Loan Act vis-à-vis the loan ceiling, steps will be taken to increase the loan ceiling consistent with the Government's medium-term borrowing programme. Activities relating to the updating of legislations governing debt management will continue.

Government Borrowing Requirements FY2006/07

52. Gross issuance in FY2006/07 is programmed to be moderately lower than in FY2005/06. The total budgetary financing requirement is projected at $119.7 billion, of which $7.8 billion represents disbursements on project loans. Having pre-funded the FY2006/07 external borrowing programme in the international capital markets, it is projected that the greater portion of the funding will be raised in the domestic market through various instruments across the yield curve. The combination of the strategic approach to meeting the financing requirements and the adequacy of liquidity in the market will support this borrowing without creating pressures in the market.

53. In addition to the budgetary financing requirements, non-budgetary debt issuance for the fiscal year is projected at $9.7 billion to cover BOJ losses, capitalization of accrued interest on BOJ/FINSAC LRS and the assumption of debt on behalf of certain public sector entities.

54. Based on the improving macroeconomic environment and the prudent and effective borrowing programme, the Debt-to-GDP is projected to further decline in FY2006/07.

Omar Davies, MP
Minister of Finance and Planning
April 27, 2006

ANNEX

SIGNIFICANT DEVELOPMENTS IN DEBT MANAGEMENT

- July 1997 – Jamaica's re-entry into the international capital markets
- March 1998 – Initial sovereign rating by Moody's Investors Service
- April 1, 1998 – Establishment of the Debt Management Unit
- April 1998 – Consolidation and centralization of debt management functions within the Ministry of Finance and Planning
- June 1999 – Long-Term Savings Accounts introduced
- June 1999 – Implementation of policy of 15% tax on interest withheld at source
- July 1999 – US$ indexed-linked bonds introduced in the domestic market
- October 1999 – Auction system for the sale of Local Registered Stocks (LRS) introduced.
- November 1999 – Initial sovereign rating by Standard & Poor's
- April 2000 – First publication of the *Debt Management Strategy*
- April 2000 – Implementation of policy of 25% tax on interest withheld at source
- March 2001 – Jamaica included as case study in IMF/World Bank publication of *Guideline for Public Debt Management,* as implementing prudent debt management practices consistent with the Guidelines
- April 2001 – First 12-year LRS sold by auction. A total of six 12-year LRS' issued by auction during FY2001/02
- May 2001 – First 10-year global eurobonds issued
- December 2001 – First 20-year eurobonds issued
- December 2001 – Schedule B Registration Statement filed with the United States' Securities and Exchange Commission (US SEC)
- February 2002 – "Shelf" Registration programme established with the US SEC
- June 2003 – First 15-year LRS sold by auction
- September 2003 – First 30-year LRS sold by auction
- April 2004 – Launch of quarterly investors' conference call
- November 2004 – Publication of quarterly financing requirements
- March 2005 – Jamaica selected as a member of the Steering Committee of the Latin America and Caribbean Debt Group
- May 2005 – Jamaica ended its borrowing relationship with the IMF by fully repaying all outstanding debt to that institution
- June 2005 – Air Jamaica Ltd., the national airline, successfully accessed the international and regional capital markets
- February 2006 – First 30-year eurobonds issued