

INTERNATIONAL MONETARY FUND

JAMAICA

Interim Staff Report Under Intensified Surveillance

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by Caroline Atkinson and Matthew Fisher

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- **Discussions.** Discussions were held in Kingston during April 20–May 3, 2005. The mission team—comprising Antônio Furtado (head), Goohoon Kwon, and Rafael Romeu (all WHD); and Piyabha Kongsamut (PDR)—met with finance minister Omar Davies; the outgoing and the incoming financial secretaries, Shirley Tyndall and Colin Bullock; Bank of Jamaica governor Derick Latibcaudière; other senior officials; opposition leader Bruce Golding; representatives of local financial institutions; and representatives of the official external creditors and donors. Mr. Richard Campbell (OED) attended the concluding policy discussions.
- **Intensified surveillance.** Intensified surveillance of the authorities' medium-term macroeconomic and structural policies was requested by the authorities and supported by the Executive Board at the time of the conclusion of 2004 Article IV consultation. The underlying economic strategy was formulated by the authorities without reaching prior understandings with Fund staff. Interim staff reports are to be prepared for information of the Executive Board in between Article IV consultations, the first of which was issued on January 31, 2005 (SM/05/37). As with past staff reports, the authorities expect to authorize publication of this interim report following its issuance to the Executive Board.
- **Last Article IV consultation.** The 2004 Article IV consultation was concluded by the Executive Board on August 3, 2004. Directors supported the priority placed by the authorities on bringing down the public debt-to-GDP ratio while noting that the magnitude and duration of the fiscal adjustment envisaged by the authorities are subject to considerable risks. They emphasized that reform measures will be critical for the success of the authorities' economic strategy.
- **Political setting.** Despite the adjustment measures over the last two years, including major wage restraint in the public sector, the political situation has remained stable. The governing People's National Party (PNP) retains a comfortable majority in parliament and elections are due by 2007. However, Prime Minister Patterson has indicated his intention to resign from office, which would trigger the choice of a successor from within the PNP for the balance of the current term.
- **Fund relations.** Jamaica has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. A multiple currency practice remains, which is subject to Fund jurisdiction. Relations with the Fund are detailed in Appendix I.

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EXECUTIVE SUMMARY

- **Following the adverse economic impact of Hurricane Ivan, the outlook for FY 2005/06 is for a rebound in growth in the context of broad macroeconomic stability.** Real GDP growth slowed and damage to agriculture contributed to double-digit inflation in FY 2004/05. While the hurricane also contributed to deviations in relation to FY 2004/05 fiscal targets, the public debt-GDP ratio continued to decline. The external current account deficit widened but strong capital inflows helped lower domestic interest rates, strengthen international reserves, and maintain exchange rate stability. In FY 2005/06, real GDP growth is expected to rise to 3½ to 4 percent, the public debt to decline to 125–130 percent of GDP, and inflation to return to single digits.
- **While global liquidity conditions have been very favorable, the generally positive results of the last two years owe much to renewed fiscal consolidation, reflected in very high primary budget surpluses.** A key factor for this consolidation has been the high degree of national ownership, evidenced notably by continued adherence to the Memorandum of Understanding agreed in February 2004 between the government and the trade unions; and by the recent passage of a balanced budget for FY 2005/06 incorporating the first stage of a comprehensive tax reform.
- **The government's balanced budget target for this fiscal year, which is of landmark importance for Jamaica's strategy to reduce the debt burden, appears within reach.** The mission encourages the authorities to keep expenditure strictly within the budgeted levels and to pursue vigorously their efforts at improving tax administration and raising taxpayer compliance.
- **Achieving the envisaged further reduction in the public debt-GDP ratio to 100 percent over the next four years will be challenging and demand high fiscal discipline.** In the budget area, exceptional restraint will be needed to sustain the required primary surpluses in excess of 13 percent of GDP. In particular, the government will have to devise policies during the current fiscal year to keep the wage bill under control following the expiration of the MOU in early 2006. Strict control must also be maintained over off-budget expenditure and debt guarantees. The authorities are encouraged to implement fully the planned restructuring of Air Jamaica. The recent adjustment of water tariffs and the establishment of an annual tariff review mechanism have also been important positive steps.
- **The reductions in policy interest rates in FY 2004/05 were appropriate.** However, with inflation still above international levels and prospects of global interest rate hikes, the staff advises caution with respect to the pace of further reductions in policy interest rates.
- **The staff welcomes the continuing progress towards strengthening the regulatory and supervisory framework of the financial system.** The banking sector appears to remain generally sound and profitable. Recent positive steps to reduce vulnerabilities in the securities industry and to strengthen the AML/CFT framework should be followed by further enhancements that may be identified in the context of the upcoming FSAP.

I. BACKGROUND

1. **In early 2004, the Government articulated a medium-term economic strategy to address high indebtedness and low growth, in the context of a broader socio-economic policy initiative.** The government's "Medium-Term Socio-Economic Policy Framework," which resulted from wide public consultations and enjoys strong donor support, comprises a broad range of policies aimed at placing Jamaica as close as possible to compliance with the Millennium Development Goals (MDGs). The government's economic strategy seeks to reduce the extraordinarily high public debt-GDP ratio (143½ percent in FY 2003/04) to around 100 percent by FY 2008/09. This objective is being pursued through intensified fiscal adjustment—including balancing the budget in FY 2005/06 (April–March fiscal year)—and higher growth.¹

2. **At the conclusion of the 2004 Article IV consultation, the Executive Board endorsed the authorities' request for intensified surveillance of their medium-term macroeconomic strategy.** In the first interim report under intensified surveillance (SM/05/37), staff found that the authorities' strategy remained broadly on track although deviations from the FY 2004/05 targets, due mainly to the impact of Hurricane Ivan, would make it more challenging to achieve the objective of balancing the budget in FY 2005/06.

II. DEVELOPMENTS UNDER THE AUTHORITIES' PROGRAM IN FY 2004/05

3. **As expected in the aftermath of Hurricane Ivan, the targets under the authorities' macroeconomic program for FY 2004/05 were not fully met.** Real GDP grew at about 2½ percent in the first three quarters of 2004, but slowed sharply in the fourth quarter due primarily to the adverse effects of the hurricane on agriculture, mining and tourism. As a result, the economy is estimated to have grown by only 0.7 percent during FY 2004/05 (Table 1 and Figure 1). Inflation picked up in the fourth quarter of 2004 largely reflecting the price impact of crop damage, and remained in the double digits for the whole of FY 2004/05. Unemployment rose slightly, from 11.4 percent in 2003 to 11.7 percent on average in 2004.

4. **The hurricane contributed to deviations in relation to FY 2004/05 fiscal targets.** Hurricane-related expenditure amounting to about 1 percent of GDP, and weaker tax revenues, led to a shortfall of 2 percentage points of GDP in the primary surplus relative to the target (Table 2). Still, the overall budget deficit narrowed by about 1.5 percentage points of GDP, to 5 percent of GDP, reflecting a decline in domestic interest rates from the elevated levels of the preceding fiscal year. The overall deficit of the central government, which includes off-budget expenditure,² narrowed from 9.7 percent of GDP in FY 2003/04 to

¹ A detailed discussion of the authorities' strategy is contained in the 2004 Article IV consultation report (SM/04/254).

² Off-budget expenditure is defined in the staff documents as the issuance of government debt related to central bank losses and to projects undertaken with deferred financing.

7.1 percent of GDP in FY 2004/05.³ Gross government and government-guaranteed debt continued to decline in relation to GDP, from 144 percent in March 2004 to 139 percent in March 2005 (Table 3).

5. **The fiscal position has also been affected by financial weaknesses in some public entities, which the authorities have now started to address.** The weak operating position of the National Water Commission (NWC) led the government to assume some of its domestic debt early in the fiscal year, amounting to J\$1.4 billion (0.2 percent of GDP). Air Jamaica returned to state control in late 2004 after accumulating liabilities to the government totaling about US\$400 million (4.4 percent of GDP) and a similar amount of debt to private creditors over the ten-year period of private management. Regarding NWC, the government raised water tariffs by 15–18 percent in January 2005 and has also put in place a mechanism to review these tariffs annually to ensure that the NWC will be able to service remaining debt obligations. Regarding Air Jamaica, new management is finalizing a restructuring plan to downsize operations and improve efficiency. The aim is to reduce annual losses from US\$60–70 million to a maximum of US\$30 million in FY 2005/06—to be financed by a budgetary subsidy—and to eliminate losses within three to four years. The authorities reserve the option of closing down the airline in the event of setbacks to the restructuring strategy.

6. **The external current account deficit widened but strong capital inflows helped lower domestic interest rates, strengthen international reserves, and maintain exchange rate stability.** The current account deficit widened from 6.8 percent of GDP in FY 2003/04 to 8½ percent of GDP in FY 2004/05 (Table 4). Imports rose rapidly, boosted by increased fuel payments, as well as FDI- and hurricane-related imports.⁴ Higher fuel imports reflected not only increased international prices, but also a five-month interruption in the operation of the local refinery (due to a major accident) which necessitated the importation of more expensive finished petroleum products in lieu of crude oil. Meanwhile, export and tourism receipts grew at a slower than expected rate because of the adverse effect of the hurricane on agriculture, mining, and tourism. The larger trade deficit was partly offset by an increase in official and private transfers. A strengthening of private capital inflows, attributable to ample global liquidity and positive market sentiment about Jamaica's fiscal adjustment effort,⁵ allowed for an accumulation of international reserves in the context of exchange rate stability. While the real effective exchange rate appreciated by 5.8 percent in the 12 months through March 2005, it remains 11 percent below the 1998–2002 average.

³ A broader concept, the nonfinancial public sector (which includes a set of 12 key public entities monitored under past Fund programs and staff-monitored programs) recorded an overall deficit of 6.5 percent of GDP in FY 2004/05, down from 8 percent of GDP in FY 2003/04.

⁴ FDI-related imports were mainly for the tourism sector.

⁵ Spreads on outstanding Jamaican Eurobonds tightened by about 150 basis points during FY 2004/05. In comparison, the B-rated component of the EMBIG spread tightened by only 70 basis points during the same period.

7. **The authorities continued to anchor monetary policy on a target for base money, in the context of a managed floating exchange rate regime.** The accumulation of reserves, along with central bank losses associated with sterilization, far exceeded the targeted base money growth for the year.⁶ To sterilize the impact, the Bank of Jamaica (BOJ) continued to offer open market instruments (certificates of deposit) on tap. As a result, base money expanded by about 15 percent in FY 2004/05, in line with the target (Table 5). Broad money growth was somewhat slower, reflecting a modest reversal of dollarization (Table 6). The authorities noted that—reflecting confidence in Jamaica’s policy framework and favorable external conditions—NIR had increased in the context of broad stability in the exchange rate, and demand for BOJ certificates of deposit had remained strong despite continued reductions in policy interest rates. They also noted that a smaller build-up of NIR and/or somewhat higher interest rates would probably have caused a larger real appreciation of the Jamaican dollar and hurt competitiveness.

8. **The banking sector appears to remain generally sound and profitable although with significant exposure to the government (Table 7).** At end-2004, the ratio of nonperforming loans to total loans stood at 3 percent—well within the prudential limit of 10 percent. Bank profitability declined marginally in 2004, due to a falling interest margin, but continued to compare favorably with the profitability of other banking systems in the region. Capital adequacy improved slightly to 8.5 percent at end-December 2004, 2½ percentage points above the prudential benchmark. The weighted capital adequacy ratio, at over 13 percent, comfortably exceeds the Basel I threshold. In the nonbank sector, a moderate-size insurance company collapsed in March 2005, brought down by large claims from Cayman Island clients in the wake of Hurricane Ivan. The collapse was an isolated event and the authorities did not intervene financially to save the company.

III. THE AUTHORITIES’ MACROECONOMIC FRAMEWORK FOR FY 2005/06

9. **Real GDP growth is expected to rebound and the public debt ratio to decline to 125–130 percent of GDP in FY 2005/06, in the context of decelerating inflation and broadly stable international reserves.** The authorities project a pick up in economic growth to 3.5–4.0 percent, underpinned by accelerated expansion in tourism, mining, and construction together with a full recovery in agriculture. On the inflation front, the authorities expect to contain 12-month inflation below 10 percent, including the impact of higher consumption taxes (see below). Towards these objectives, and to achieve a further decline in the public debt ratio, the authorities intend to balance the budget and maintain base money growth broadly unchanged from last year, while continuing to manage the exchange rate to avoid wide swings and protect competitiveness.

⁶ As noted above, central bank losses are captured in the fiscal accounts as part of the overall government deficit.

Fiscal policy

10. **Despite the exogenous shocks experienced by the economy last year, the authorities have adopted a balanced budget for FY 2005/06 in line with their medium-term strategy.** In view of the FY 2004/05 outturn, this target implies a budgetary adjustment of 5 percentage points of GDP. While this would represent a sharp improvement in the fiscal position, there was concurrence during the discussions that the authorities' targets are achievable provided that the government maintains tight discipline on the expenditure side and fully implements the approved tax reform measures and ongoing efforts at raising taxpayer compliance.

- A substantial portion of the adjustment is expected to arise from a marked decline in the interest bill (by 3 percentage points of GDP), which had surged in FY 2003/04 and remained elevated in FY 2004/05 owing to the spike in interest rates in the wake of the near-crisis of two years ago.
- Wage and salary payments will fall considerably (2 percentage points of GDP) reflecting the full impact of the two-year Memorandum of Understanding (MOU) agreed with the trade unions in early 2004.⁷
- On the revenue side, measures taken in the context of the ongoing tax reform are expected to yield over 1½ percent of GDP, which would more than offset the loss of one-time receipts recorded in FY 2004/05. Most of the revenue increase will come from the General Consumption Tax (GCT) with increases in the standard GCT rate (from 15 percent to 16½ percent), and the preferential rate for the tourism sector (from 5 percent to 8¼ percent) and a reduction in the coverage of zero-rated goods.
- On the financing side, full implementation of the fiscal program is expected to facilitate rolling over the substantial amount of maturing government debt (scheduled budgetary principal payments amount to about 21½ percent of GDP).⁸

11. **Off-budget spending is expected to rise, somewhat offsetting the improvement in the on-budget balance.** Debt issued to the central bank in compensation for high sterilization costs incurred in FY 2004/05 is projected to drive off-budget spending up by 1 percentage point of GDP, to 2.5 percent of GDP. The resulting overall deficit of the central government, as defined by the staff, together with a continuing surplus of the 12 major public entities

⁷ While the MOU was already in effect last year, wages and salaries still increased somewhat in FY 2004/05 due to the clearance of statutory salary arrears. The FY 2005/06 budget does not contain such payments (see Table 2).

⁸ The government issued in late May 2005 10-year Eurobonds amounting to US\$300 million, equivalent to about three-fifths of the external debt amortization due in FY 2005/06. The spread over U.S. Treasuries was 503 basis points, and—as was the case in previous issues—the bonds did not incorporate collective action clauses.

(0.7 percent of GDP), implies an overall public sector deficit of 1.8 percent of GDP (compared with 6.5 percent of GDP in FY 2004/05). Assuming no debt related to the deferred financing scheme is taken on this year as indicated by the authorities,⁹ the broad outlook is consistent with a decline in government and government-guaranteed debt to 126 percent of GDP.

Monetary/exchange rate policy

12. **The central bank will target base money growth of 15 percent with a view to reducing inflation to single digits.** The authorities believe that this pace of money growth is consistent with the anticipated pick-up in economic activity and the disinflation objective, while allowing a further modest increase in NIR. Credit to the private sector would grow faster than broad money, as fiscal consolidation frees up resources for the private sector. The exchange rate will continue to be determined under a managed float, with intervention geared mainly to smoothing out transitory fluctuations. In the event of downward pressures in the foreign exchange market, the authorities would continue to keep intervention to a minimum and implement a balanced and cautious monetary/exchange rate policy response, taking into account its impact on inflation, reserves, and the debt dynamics.

External sector

13. **The external current account deficit is expected to widen somewhat further in FY 2005/06, as the trade and income balances deteriorate.** A recovery in exports and tourism is expected to be offset by strong import growth largely due to high fuel costs and FDI-related imports, as well as higher external interest payments. Nevertheless, continued strong private capital inflows, largely through FDI, would allow for a modest build-up in NIR.

Structural reforms

14. **In the fiscal area, the authorities have begun the first phase of tax reform drawing on the recommendations of the Tax Policy Review Committee.** The reforms are intended to improve revenue elasticity; reduce tax complexity, so as to facilitate administration and improve compliance and equity; and enhance the competitiveness of the Jamaican economy (through lower taxation of labor income). The reforms implemented this year include raising the income tax threshold while simplifying and reducing the transfer tax and the property tax. In addition, as noted, the reforms have increased the GCT rates and reduced the coverage of zero-rated goods. These tax reforms are supported by ongoing efforts to strengthen tax administration and increase compliance, which produced a yield (including collection of tax arrears) amounting to about 1 percent of GDP in FY 2004/05, with a similar amount expected by the authorities in FY 2005/06.

⁹ The authorities indicated that the use of deferred financing is being discontinued. The last assumption of debt under this heading is expected to take place in FY 2006/07, in an amount of J\$1.7 billion (0.2 percent of GDP).

Box 1. Authorities' Semi-Annual Macroeconomic Targets for FY 2005/06

Consistent with their economic program for FY 2005/06, the authorities have established semi-annual quantitative targets for the balance sheet of the BOJ and key budgetary indicators. The following targets have been adopted for September 2005 and March 2006:

Jamaica: Semi-Annual Quantitative Targets, FY 2005/06

	Apr. 05–Sep. 05	Apr. 05–Mar. 06
Change in net international reserves 1/	US\$0 million	US\$98 million
Change in the net domestic assets 2/	-J\$0.2 billion	J\$0.3 billion
Primary budget surplus	J\$28.2 billion	J\$87.6 billion
Overall budget deficit	J\$14.8 billion	J\$0 billion

1/ The changes in NIR reflect the seasonal pattern of foreign exchange flows.

2/ Defined as the difference between the change in base money and the change in NIR. The latter will be converted into Jamaica dollars at the accounting exchange rate of J\$63.89=US\$1.

15. **In the financial sector, the authorities are taking steps to enhance the prudential framework for nonbank institutions.** In this context, the Financial Services Commission (FSC) has recently introduced regulations to curtail the growth of the repo market, aiming to reduce the vulnerability of the securities industry to market risks. These include, inter alia, the imposition of minimum margin requirements for repurchase agreements and the strengthening of capital adequacy requirements (both effective end-2004).¹⁰ A National Pensions Act, passed in 2004, provides the basis for the FSC to license and regulate pension funds. The authorities are currently in the final stage of enacting regulations that are expected to encourage development of the sector by, inter alia, providing a transparent framework.

16. **The legislative and regulatory framework for combating money laundering and the financing of terrorism is being strengthened.**¹¹ In this regard, amendments passed in

¹⁰ The margin requirement for government securities was set at 1 percent in December 2004, and will increase to 3 percent in September 2005, and to 5 percent in December 2006. The capital adequacy ratio was set at 10 percent. The capital base and risk weights applied by the FSC are broadly consistent with the Basel I capital standards.

¹¹ An assessment of the AML/CFT framework was conducted by the Caribbean Financial Action Task Force (CFATF, the FATF-style regional body for the Caribbean region), during an on-site visit in April 2005. The final report will be discussed in October 2005, at the next CFATF Plenary meeting, following which it will be submitted to the Fund for a pro-forma review.

late 2004 established comprehensive provisions for the BOJ and the FSC to share information with overseas regulators and strengthened their power to take regulatory action, including the revocation of licenses. In addition, a Terrorism Prevention Bill recently approved by parliament criminalizes the financing of terrorism. Moreover, amendments to the Money Laundering Act, and a new Financial Investigation Bill, were submitted to parliament in December 2004. According to the authorities, these amendments are intended to bring Jamaica's legislative framework in line with FATF requirements.

IV. MEDIUM-TERM OUTLOOK

17. **The baseline medium-term scenario is characterized by real annual growth of 3–4 percent, single-digit inflation, a modest rise in international reserves, and a further gradual decline in the public debt ratio.**¹² Growth would be driven primarily by tourism, mining and construction, and financed to an important degree by foreign direct investment. Monetary policy will target a further decline in inflation to 5–6 percent by FY 2008/09, underpinned by the maintenance of a balanced budget in FY 2006/07 and small surpluses in the next two years. The primary budget surplus would remain in the range of 13–14 percent of GDP even though the government's interest bill is projected to continue to decline as a percentage of GDP. These trends would provide for a slow but steady debt reduction to around 100 percent by FY 2008/09.

18. **The medium-term outlook for the balance of payments is strongly influenced by expected foreign direct investments.** Large investments in tourism and mining are expected to generate a strong demand for imports over the next two years, widening the current account deficit, particularly in FY 2006/07. As the projects come on stream, import growth will slow, contributing to a reduction in the current account deficit to around 4½ percent of GDP by FY 2008/09. The export-to-GDP ratio will likely decline over the next two years due mainly to expected price movements (associated with an erosion in the EU preferential treatment for sugar and bananas; and a projected decline in alumina prices) but would subsequently recover toward the end of the projection period. In the financial account, continued FDI-related private capital inflows should allow for a modest accumulation of reserves over the medium term, to about US\$2.3 billion.¹³

19. **In view of the implementation risks associated with the fiscal stance, and the economy's vulnerability to exogenous shocks, the staff has prepared an illustrative scenario incorporating less favorable assumptions than those in the baseline scenario.**

¹² The baseline scenario assumes full implementation of the authorities' economic strategy. It is virtually unchanged from the corresponding macroeconomic scenarios in the 2004 Article IV consultation report and in the first interim staff report under intensified surveillance of January 2005.

¹³ Equivalent to 19 weeks of imports of goods and services, about 400 percent of short-term external debt and nearly 180 percent of short-term external debt and foreign currency deposits.

The alternative scenario assumes no improvement in the primary budget compared with FY 2004/05, the assumption of an additional 0.7 percent of GDP in debt annually through the deferred financing scheme, and growth of government guaranteed debt in line with GDP. In addition, the scenario assumes no reduction in spreads between interest rates on domestic and foreign currency debt; and caps real GDP growth at 2.5 percent per year during the projection period. Under these assumptions, the public debt ratio would still decline over the medium term, albeit more slowly than in the baseline scenario, to approximately 122 percent of GDP by FY 2008/09.

Jamaica: Medium-Term Scenarios
(In percent of GDP, unless otherwise indicated)

	2004/05	2005/06	2006/07	2007/08	2008/09
I. Baseline 1/					
Real GDP (in percent)	0.7	3.7	3.0	3.5	3.5
Budget balance	-5.0	0.0	0.0	1.4	2.9
<i>Of which: primary balance</i>	11.8	13.6	13.3	13.5	14.0
Off-budget expenditure	2.2	2.5	2.5	1.7	1.6
Public debt	138.6	126.1	118.2	109.7	100.5
<i>Of which: government guaranteed debt</i>	7.3	6.8	6.4	6.1	5.8
Six-month treasury bill rate (in percent per annum, end of period)	13.5	13.0	11.5	10.8	10.0
II. Alternative					
Real GDP (in percent)	0.7	2.5	2.5	2.5	2.5
Budget balance	-5.0	-2.1	-3.2	-3.0	-3.0
<i>Of which: primary balance</i>	11.8	11.7	11.2	11.2	11.2
Off-budget expenditure	2.2	3.2	3.0	2.4	2.5
Public debt	138.6	130.7	127.0	124.4	122.3
<i>Of which: government guaranteed debt</i>	7.3	7.3	7.3	7.3	7.3
Six-month treasury bill rate (in percent per annum, end of period)	13.5	13.0	13.0	13.0	13.0
Memorandum item:					
Twelve-month inflation (in percent, end of period)	13.2	9.5	7.0	6.0	6.0

Sources: Jamaican authorities; and Fund staff estimates and projections.

1/ The baseline scenario assumes full implementation of the authorities' fiscal adjustment plans, whereas the alternative scenario reflects an unchanged primary balance from FY 2004/05 before grants and less favorable growth and interest rate assumptions.

20. However, stress-testing these scenarios for major macroeconomic shocks highlights the vulnerability of the Jamaican economy even under the relatively benign baseline assumptions. As highlighted by standard debt sustainability analysis (Table 8), the debt dynamics would considerably worsen in relation to the baseline under a variety of scenarios in which key economic variables are subject to adverse shocks. The dynamics is particularly sensitive to exchange rate and interest rate shocks, in reflection of the large

share—about three-fourths—of foreign currency and floating rate debts in total public debt.¹⁴ For example, stress tests indicate that the public debt ratio could rise to over 160 percent of GDP over the next two years if either the real interest rate climbs two standard deviations above its historical average in FY 2005/06 and FY 2006/07, or a one time 30 percent real depreciation occurs in FY 2005/06.

V. STAFF ASSESSMENT

21. **The authorities have succeeded for the second consecutive fiscal year in maintaining stability following the near crisis in the first half of 2003.** Domestic interest rates have declined sharply from their March 2003 peak, the exchange rate has stabilized, and inflation has decelerated markedly. In FY 2004/05, the economy showed resilience in the face of severe adverse external shocks, including Hurricane Ivan and high oil prices. While favorable global liquidity conditions have been an important factor, these results also owe much to commitment to the renewed fiscal consolidation since mid-2003, reflected in very high primary budget surpluses. A key factor for success thus far has been the high degree of national ownership, which has permitted, notably, continued adherence to an MOU on public wage restraint agreed in February 2004 between the government and the trade unions, and the initiation of a comprehensive tax reform. The staff also attaches importance to the government's establishment, in early 2004, of a medium-term social and economic policy framework, designed in close consultation with its International Development Partners (IDPs)—including intensified Fund surveillance of the economic strategy.

22. **Meeting the government's balanced budget target for FY 2005/06, which is of landmark importance for Jamaica's strategy to reduce the debt burden, will require determined control over expenditures and full implementation of tax reforms.** The government's target, which is supported by the staff, appears within reach. The reduction in the interest burden, as well as wage restraint through the MOU, will help contain the expenditure side of the budget. On the revenue side, the authorities have taken an important step by implementing the first stage of the tax reform in a manner that produces a significant net resource gain for the budget. To ensure achievement of the fiscal targets, the authorities are encouraged to keep expenditure strictly within the budgeted levels and to pursue vigorously their efforts at improving tax administration and raising compliance with current tax liabilities.

23. **The authorities' medium-term economic strategy will remain subject to important risks, both internal and external.** Jamaica's exceptionally high public debt and its vulnerable structure—with three-fourths of total public debt in foreign currency or at floating interest rates—mean that even modest deviations from policy objectives could undermine confidence. Moreover, the Jamaican economy remains susceptible to changes in

¹⁴ The scenarios underlying the debt sustainability analysis assume that the external debt is rolled over while fiscal surpluses are used to pay down domestic debt. As a result, the share of foreign currency and floating rate debt declines to about 60 percent of total public debt by FY 2008/09.

the external environment, which has thus far been very favorable, and natural disasters will continue to be a major source of vulnerability. Against this background, successful implementation of the authorities' program for FY 2005/06 is key for consolidating macroeconomic stability, enhancing policy credibility, and bolstering the economy's resilience to shocks. Following the significant gains made over the past two years, the current year's program needs to reinforce and further consolidate those gains, and to place the Jamaican economy on a path of sustained and credible debt reduction over the medium term.

24. The envisaged reduction in the public debt-GDP ratio to 100 percent over the next four years will be challenging and demand sustained fiscal discipline, and the authorities' commitment to take the steps to meet their objectives is welcome. In the budget area, exceptional restraint will be needed to sustain the required primary surpluses in excess of 13 percent of GDP. The government will have to devise policies during the current fiscal year to keep the wage bill under control following the expiration of the MOU in FY 2006/07. Realizing significant expenditure savings in this area will be challenging as it may require a carefully planned restructuring of the civil service. Other current expenditure will have to be reduced further in relation to GDP in coming years, and the room for expansion in capital outlays will remain modest. Efforts for improving tax administration will have to be sustained to reduce evasion and support revenue growth broadly in line with that of GDP. Off-budget expenditure under the deferred financing scheme should be eliminated as planned in FY 2006/07.

25. Adjustment and restructuring efforts will be needed in the public entities, whose financial weaknesses prevented a sharper decline in the public debt in the last two years. The staff therefore welcomes the recent review of water tariffs and the new mechanism in place to review these tariffs annually to help strengthen the financial position of the National Water Commission. The authorities are encouraged to fully implement the planned down-sizing of Air Jamaica and related cost-cutting measures while capping the subsidy the airline will continue to receive. As is appropriate, this is now being recognized explicitly in the budget. The staff stresses the need to strengthen fiscal procedures in the public sector with a view to fully incorporating in the budget, ex ante, any decisions to provide government support to public entities. Moreover, the granting of debt guarantees to such entities must be avoided to the extent possible. The authorities are encouraged to consider participating in a fiscal ROSC with a view to identifying procedural and institutional enhancements in support of their fiscal policy objectives.

26. The authorities are encouraged to continue to review, in consultation with the IDPs, the scope for a more proactive role of fiscal policy in support of the Millennium Development Goals. In particular, there may be scope for efficiency gains on the expenditure side to make more room for social spending. Such a reallocation would have to be supported by gains in addressing the crime problem, which the mission understands hinders not only private investment, but also the delivery of basic government services at the community level.

27. In the monetary policy area, the staff believes that the reductions in interest rates implemented in FY 2004/05 were appropriate, but caution is advised with respect to further easing. Lower interest rates turned out to be consistent with the targeted growth in base money. They also contributed to containing the budget deficit and central bank losses.

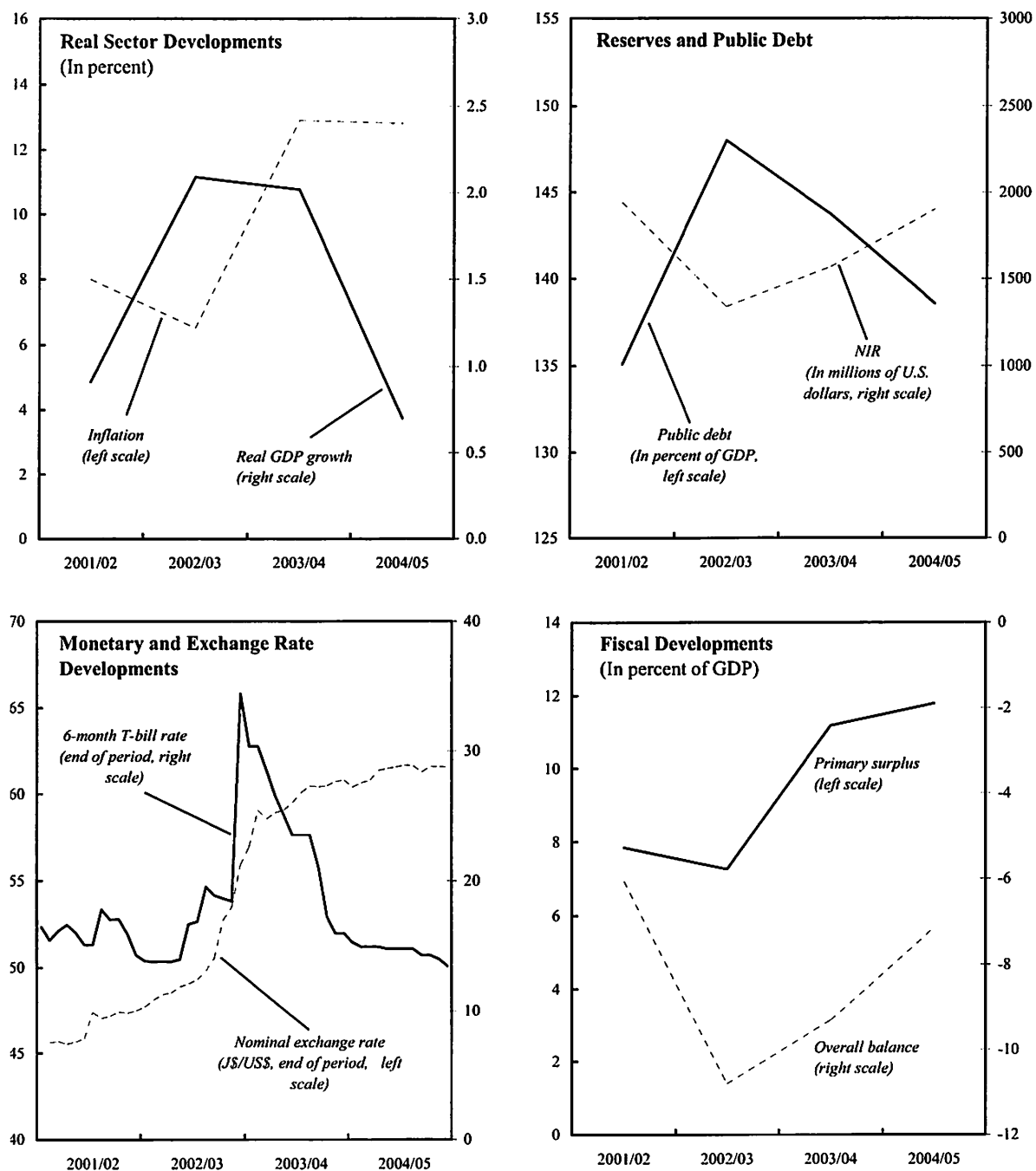
However, with inflation still above international levels and prospects of global interest rate hikes, the mission advises caution with respect to the pace of further reductions in policy interest rates.¹⁵

28. **The staff believes that the current level of the exchange rate is broadly appropriate.** The reduction in policy interest rates and the build-up of official reserves have maintained exchange rate stability, thereby limiting the real appreciation of the currency, which has been warranted on competitiveness grounds. Looking ahead, the staff welcomes the authorities' indication that, were there to be pressures in the foreign exchange market, for example due to tighter global liquidity conditions, they would keep intervention to a minimum and implement a balanced response comprising interest rate action and exchange rate flexibility. Over the medium term, the modest build-up in international reserves envisaged by the authorities appears to be justified, notwithstanding the high sterilization cost. The uneven and heavy external debt payment profile and the need for safeguarding against exogenous shocks, to which Jamaica is highly vulnerable, suggest a reserve cushion is warranted.

29. **The staff welcomes the continuing progress towards strengthening the regulatory and supervisory framework of the financial system.** In this context, the steps taken recently to reduce vulnerabilities in the securities industry and to strengthen the AML/CFT framework are particularly noteworthy. However, the securities industry remains highly exposed to interest rate and liquidity risks, and the authorities are therefore encouraged to take maximum advantage of the upcoming FSAP exercise to identify ways to address this vulnerability.

¹⁵ The mission's projections indicate that maintenance of real interest rates somewhat higher than those assumed in the authorities' macroeconomic framework would not in itself prevent achievement of the envisaged debt reduction to 100 percent of GDP by FY 2008/09.

Figure 1. Jamaica: Selected Macroeconomic Indicators, FY 2001/02–FY2004/05



Sources: Jamaican authorities; and Fund staff estimates.

Table 1. Jamaica: Selected Economic Indicators 1/

	2001/02	2002/03	2003/04	Prog. 2004/05	Prel. 2004/05	Projections			
						2005/06	2006/07	2007/08	2008/09
(Annual percentage changes)									
GDP, prices, and employment									
Real GDP	0.9	2.1	2.0	2.5	0.7	3.7	3.0	3.5	3.5
Nominal GDP	9.5	10.0	18.6	14.2	11.8	16.1	11.6	10.0	9.7
Consumer price index (end of period)	7.6	6.2	16.8	9.9	13.2	9.5	7.0	6.0	6.0
Consumer price index (average)	8.0	6.5	12.9	11.5	12.8	12.5	8.1	6.5	6.0
Exchange rate (end of period, in J\$/US\$)	4.0	18.2	8.1	...	1.1	...	...	...	...
End-of-period REER (percent change, depreciation +)	-3.9	14.3	-4.2	...	...	...	...	...	...
Unemployment rate (in percent)	14.8	15.4	12.8	...	...	...	...	...	...
(In percent of GDP, unless otherwise indicated)									
Government operations									
Budgetary revenue	27.0	28.1	29.4	31.8	30.9	31.2	30.4	30.1	29.9
Budgetary expenditure	32.6	35.7	36.0	35.2	35.9	31.2	30.4	28.7	27.0
Primary expenditure	19.2	20.8	18.2	17.9	19.1	17.6	17.1	16.6	15.9
Interest payments	13.4	14.9	17.8	17.3	16.7	13.6	13.3	12.1	11.1
Budget balance	-5.6	-7.6	-6.6	-3.5	-5.0	0.0	0.0	1.4	2.9
Of which: primary balance	7.8	7.3	11.2	13.8	11.8	13.6	13.3	13.5	14.0
Off-budget expenditure 2/	0.5	3.2	3.1	3.0	2.2	2.5	2.5	1.7	1.7
Overall fiscal balance	-6.1	-10.8	-9.7	-6.5	-7.1	-2.5	-2.5	-0.3	1.3
Public debt	135.1	148.0	143.7	136.4	138.6	126.1	118.2	109.8	100.6
External sector									
Current account balance	-9.6	-15.2	-6.8	-13.2	-8.5	-8.9	-11.0	-7.8	-4.4
Of which: exports of goods, f.o.b.	17.8	17.2	17.7	17.4	17.6	17.2	16.2	16.8	17.5
Of which: imports of goods, f.o.b.	37.6	43.8	39.7	41.0	40.3	39.9	40.9	38.6	36.0
Of which: tourism services, net	11.7	12.9	13.8	13.6	13.2	13.0	13.3	13.7	14.1
Net international reserves (in millions of US\$)	1,942	1,340	1,569	1,400	1,902	2,000	2,046	2,228	2,311
(Changes in percent of beginning-of-period broad money)									
Money and credit									
Net foreign assets 3/	24.3	-8.1	9.0	-2.9	7.5	9.4	6.6	8.0	5.3
Net domestic assets	-14.3	15.6	11.3	17.0	2.7	6.0	4.7	2.0	4.4
Of which: credit to the central government	71.2	8.2	9.7	10.0	0.5	7.1	5.6	3.0	1.0
Broad money	10.0	7.5	20.2	14.1	10.3	15.4	11.3	9.9	9.7
Interest rate (180-day BoJ CD rate, end of period, in percent per annum) 4/	13.8	33.5	16.0	15.0	13.5	13.0	11.5	10.8	10.0
Velocity (ratio of GDP to broad money)	2.6	2.7	2.6	2.6	2.6	2.6	2.7	2.7	2.7
Memorandum items:									
Nominal GDP (in billions of Jamaica dollars)	379.8	417.7	495.5	556.2	554.0	642.9	717.8	789.9	866.6
Exchange rate (end of period, J\$/US\$)	47.6	56.2	60.8	...	61.5	...	...	...	...

Sources: Jamaican authorities; and Fund staff estimates and projections.

1/ Based partly on assumptions provided by the authorities. Fiscal years run from April 1 to March 31.

2/ Includes issuance of debt to the BoJ to cover its cash losses and related capitalized interest, and assumption of debt related to off-budget projects financed initially by the private sector.

3/ Including valuation adjustments.

4/ This rate is tracked very closely by the six-month Treasury bill yield, which is the benchmark for indexing variable rate debt instruments that account for a major part of the government domestic debt.

Table 2. Jamaica: Summary of Central Government Operations

	2001/02	2002/03	2003/04	Prog. 2004/05	Prel. 2004/05	Projections 3/			
						2005/06	2006/07	2007/08	2008/09
(In billions of Jamaican dollars)									
Budgetary revenue and grants	102.6	117.2	145.5	176.6	171.3	200.6	218.1	237.6	259.5
Tax	92.8	104.7	133.2	160.5	153.0	180.8	202.7	223.1	243.5
Nontax	7.8	11.6	11.7	11.8	14.4	15.6	14.0	13.8	15.1
Grants	2.0	0.9	0.6	4.3	4.0	4.2	1.4	0.8	0.9
Budgetary expenditure	123.8	149.0	178.3	195.9	198.8	200.6	218.2	226.4	234.0
Primary expenditure	72.8	86.9	90.1	99.7	106.0	113.1	122.8	130.8	137.9
Wage and salaries	42.6	51.5	60.5	63.0	63.5	61.4	68.2	71.9	75.4
Of which: statutory arrears	...	...	...	3.6	3.6	...	...	...	...
Other expenditure	20.1	27.5	24.6	28.2	32.1	38.2	41.6	44.2	46.8
Capital expenditure	10.1	7.9	5.0	8.5	10.4	13.4	13.0	14.7	15.7
Interest	51.0	62.1	88.2	96.2	92.8	87.6	95.3	95.6	96.1
Domestic	40.4	46.9	71.5	75.2	72.6	64.4	70.6	69.8	67.7
External	10.7	15.2	16.7	21.0	20.1	23.2	24.8	25.8	28.5
Budget balance	-21.2	-31.8	-32.8	-19.3	-27.5	0.0	0.0	11.3	25.5
Of which: primary balance	29.8	30.3	55.4	76.9	65.3	87.6	95.3	106.8	121.6
Off-budget expenditure	1.8	13.4	15.3	16.9	12.0	16.1	17.9	13.7	14.3
Issuance of debt to the BoJ 1/	-	11.5	11.5	14.9	8.2	16.1	16.2	13.7	14.3
Operating losses	6.3	8.3	8.3	8.1	5.5	10.0	8.9	7.2	6.3
Accrued interest	-	3.3	3.3	6.8	2.6	6.1	7.3	6.5	8.1
Deferred financing 2/	1.4	1.4	3.8	2.0	3.9	0.0	1.7	0.0	0.0
Overall balance	-23.0	-45.1	-48.1	-36.2	-39.5	-16.1	-17.9	-2.5	11.2
Financing	23.0	45.1	48.1	36.2	39.5	16.1	17.9	2.5	-11.2
External financing	25.9	-12.9	11.5	1.7	7.8	3.2	2.0	1.4	1.4
Domestic financing	-2.9	58.1	36.6	34.6	31.7	12.9	15.9	1.1	-12.6
Banking system	28.9	12.1	19.1	19.0	13.4	14.8	16.1	8.5	3.3
Others	-31.8	45.9	17.5	15.6	18.3	-1.9	-0.2	-7.5	-15.9
(In percent of GDP)									
Budgetary revenue and grants	27.0	28.1	29.4	31.8	30.9	31.2	30.4	30.1	29.9
Tax	24.4	25.1	26.9	28.8	27.6	28.1	28.2	28.2	28.1
Nontax	2.1	2.8	2.4	2.1	2.6	2.4	2.0	1.7	1.7
Grants	0.5	0.2	0.1	0.8	0.7	0.7	0.2	0.1	0.1
Budgetary expenditure	32.6	35.7	36.0	35.2	35.9	31.2	30.4	28.7	27.0
Primary expenditure	19.2	20.8	18.2	17.9	19.1	17.6	17.1	16.6	15.9
Wage and salaries	11.2	12.3	12.2	11.3	11.5	9.5	9.5	9.1	8.7
Other expenditure	5.3	6.6	5.0	5.1	5.8	5.9	5.8	5.6	5.4
Capital expenditure	2.7	1.9	1.0	1.5	1.9	2.1	1.8	1.9	1.8
Interest	13.4	14.9	17.8	17.3	16.7	13.6	13.3	12.1	11.1
Domestic	10.6	11.2	14.4	13.5	13.1	10.0	9.8	8.8	7.8
External	2.8	3.6	3.4	3.8	3.6	3.6	3.4	3.3	3.3
Budget balance	-5.6	-7.6	-6.6	-3.5	-5.0	0.0	0.0	1.4	2.9
Of which: primary balance	7.8	7.3	11.2	13.8	11.8	13.6	13.3	13.5	14.0
Off-budget expenditure	0.5	3.2	3.1	3.0	2.2	2.5	2.5	1.7	1.7
Issuance of debt to the BoJ 1/	-	2.8	2.3	2.7	1.5	2.5	2.3	1.7	1.7
Deferred financing 2/	0.5	0.4	0.8	0.4	0.7	0.0	0.2	0.0	0.0
Overall balance	-6.1	-10.8	-9.7	-6.5	-7.1	-2.5	-2.5	-0.3	1.3
Budgetary principal payment	23.9	21.5	20.0	23.9	23.9	21.5	20.2	18.3	23.7
Domestic	20.4	12.9	16.5	18.6	18.6	16.6	18.1	14.3	18.9
External	3.6	8.6	3.5	5.3	5.3	4.9	2.2	4.0	4.7
Memorandum items:									
Primary balance excluding grants (percent of GDP)	7.8	7.3	11.2	13.8	11.8	13.6	13.3	13.5	14.0
Interest expenditure net of interest tax (percent of GDP)	11.2	12.7	14.8	14.6	14.0	11.2	10.9	9.8	8.9
Overall balance of public enterprises	0.5	1.1	1.3	0.9	0.7	0.7	1.0	1.0	1.0
Public sector overall balance	-5.5	-9.7	-8.4	-6.5	-6.5	-1.8	-1.5	0.7	2.3
Public debt	135.1	148.0	143.7	136.4	138.6	126.1	118.2	109.8	100.6
Gross financing (in percent of GDP)	...	...	27.7	52.2	31.2	24.0	22.7	18.6	22.4
GDP (in billions of J\$)	379.8	417.7	495.5	556.2	554.0	642.9	717.8	789.9	866.6

Sources: Jamaican authorities; Fund staff estimates and projections.

1/ Refers to debt issued in relation to central bank losses.

2/ Debt issued upon assuming public investment projects carried out by the private sector.

3/ The starting point for the projections is the staff projection for FY 2005/06.

Table 3. Jamaica: Summary of the Public Debt

	2001/02	2002/03	2003/04	Prel. 2004/05	Projections			
					2005/06	2006/07	2007/08	2008/09
(In billions of Jamaican dollars)								
Debt stock								
Public debt	513	618	712	768	811	849	867	872
Government debt	491	588	677	727	767	803	819	822
Domestic	300	366	418	449	467	487	492	482
Of which : US\$ linked	60	73	97	85	90	94	98	101
External	191	222	259	278	300	315	327	340
Concessional	94	112	113	103	97	88	76	64
Commercial	86	110	146	175	203	227	251	276
Government guaranteed debt	22	30	35	41	44	46	48	50
External	15	21	27	32	34	36	37	38
Domestic	7	9	9	8	10	10	11	12
Domestic currency debt	248	302	329	373	387	403	405	393
Foreign currency debt	206	244	286	310	334	351	364	378
US\$ linked debt	60	73	97	85	90	94	98	101
(In percent of GDP)								
Public debt	135.1	148.0	143.7	138.6	126.1	118.2	109.8	100.6
Government debt	129.2	140.8	136.6	131.2	119.3	111.8	103.7	94.9
Domestic	79.0	87.6	84.3	81.0	72.7	67.9	62.2	55.7
Of which: US\$ linked	15.7	17.5	19.5	15.3	14.1	13.2	12.4	11.6
External	14.5	53.2	52.3	50.2	46.6	43.9	41.4	39.2
Concessional	44.8	26.9	22.8	18.6	15.1	12.2	9.6	7.4
Commercial	4.7	26.3	29.5	31.5	31.5	31.7	31.8	31.8
Government guaranteed debt	15.7	7.2	7.2	7.3	6.8	6.4	6.1	5.8
Domestic currency debt	65.2	72.2	66.5	67.3	60.1	56.2	51.3	45.3
Foreign currency debt	51.2	58.3	57.7	56.0	52.0	48.9	46.1	43.7
US\$ linked debt	15.7	17.5	19.5	15.3	14.1	13.2	12.4	11.6
Memorandum items:								
Net debt (in billions of J\$)	480	596	690	747	790	828	846	852
In percent of GDP	126.3	142.7	139.3	134.8	122.9	115.4	107.1	98.3
Gross debt held by the market (in percent of GDP)	84.3	94.9	100.0	99.3	92.3	88.6	84.0	78.6
Domestic currency	43.4	51.9	52.0	53.2	47.5	44.4	40.4	35.7
Foreign currency or US\$ linked	40.9	43.0	48.0	46.1	44.9	44.2	43.5	42.9
Total debt (in billions of US\$)	10.5	11.0	11.7	12.5	12.4	12.4	12.2	11.9
Of which: foreign currency debt	4.1	4.3	4.7	5.0	5.1	5.1	5.1	5.2
GDP (in billions of J\$)	380	418	495	554	643	718	790	867

Sources: Jamaican authorities; and Fund staff estimates and projections.

1/ Authorities' program, originally projected for FY 2004/05, as reported in SM/04/254.

2/ Revised projections for FY 2004/05, as reported in SM/05/37.

Table 4. Jamaica: Summary Balance of Payments
(In millions of U.S. dollars)

	2001/02	2002/03	2003/04	Prog. 2004/05	Prel. 2004/05	Projections			
	2001/02	2002/03	2003/04	2004/05	2004/05	2005/06	2006/07	2007/08	2008/09
Current account	-753	-1,160	-567	-1,178	-764	-901	-1,177	-883	-532
Trade balance	-1,577	-2,026	-1,821	-2,103	-2,055	-2,293	-2,635	-2,476	-2,225
Exports (f.o.b.)	1,424	1,314	1,473	1,550	1,584	1,739	1,738	1,902	2,105
Imports (f.o.b.)	3,001	3,340	3,294	3,653	3,640	4,032	4,373	4,377	4,330
Services (net)	323	371	603	542	579	657	690	833	986
Transportation	-254	-227	-132	-213	-180	-205	-250	-221	-183
Travel	956	986	1,145	1,214	1,188	1,315	1,419	1,557	1,697
<i>Of which : tourism receipts</i>	1,166	1,248	1,401	1,481	1,470	1,612	1,730	1,884	2,040
Other services	-379	-389	-410	-460	-429	-453	-478	-503	-527
Income (net)	-457	-613	-584	-832	-660	-720	-694	-751	-833
<i>Of which : investment income (net)</i>	-531	-696	-658	-912	-757	-824	-805	-870	-961
Current transfers (net)	958	1,109	1,234	1,215	1,373	1,455	1,462	1,510	1,539
Government (net)	117	108	105	66	114	114	76	80	83
Private (net)	842	1,000	1,129	1,150	1,259	1,340	1,386	1,431	1,456
Capital and financial account	1,409	558	796	1,014	1,096	1,000	1,223	1,065	615
Capital account (net)	-24	-12	1	-18	3	3	2	2	2
Financial account (net)	1,433	570	796	1,032	1,094	997	1,222	1,064	614
Direct investment (net)	454	405	593	337	515	708	1,276	1,145	733
Official capital flows (net)	590	-227	143	147	175	50	30	20	20
Private flows (net)	388	392	60	548	403	239	-85	-101	-140
Portfolio investment (net)	-26	-218	-286	-182	-286	-308	-323	-339	-356
Other private inflows (net)	415	610	346	730	689	547	239	238	217
<i>Of which : unidentified flows</i>	2	159	-49	0	541	0	0	0	0
Overall balance/change in NFA	656	-602	229	-163	333	98	46	182	83
Memorandum items:									
Net international reserves	1,942	1,340	1,569	1,400	1,902	2,000	2,046	2,228	2,311
Current account (in percent of GDP)	-9.6	-15.2	-6.8	-13.2	-8.5	-8.9	-11.0	-7.8	-4.4
Exports (in percent of GDP)	17.8	17.2	17.7	17.4	17.6	17.2	16.2	16.8	17.5
Imports (in percent of GDP)	37.6	43.8	39.7	41.0	40.3	39.9	40.9	38.6	36.0
GDP (in millions of U.S. dollars)	7,979	7,622	8,304	8,909	9,021	10,116	10,700	11,329	12,020

Sources: Jamaican authorities; and Fund staff estimates.

Table 5. Jamaica: Summary Accounts of the Bank of Jamaica 1/

	2001/02	2002/03	2003/04	Prog. 2004/05	Prel. 2004/05	Projections			
						2005/06	2006/07	2007/08	2008/09
(In billions of Jamaica dollars)									
End-of-period stocks 1/									
Net international reserves	95	75	96	89	118	131	140	158	169
Net domestic assets	-65	-43	-59	-48	-76	-83	-87	-99	-105
Net claims on public sector 2/	37	64	76	93	95	111	125	139	151
<i>Of which:</i> central government	41	57	68	84	78	94	110	124	138
Open market operations	-99	-86	-108	-112	-144	-163	-174	-195	-206
<i>Of which:</i> commercial banks	-29	-17	-25	25	-34	-54	-62	-74	-91
Credit to commercial banks	-4	-12	-14	-12	-13	-9	-9	-10	-11
Net credit to nonbank financial institutions	-1	-1	-1	-1	-1	-1	-1	-1	-1
Other 3/	3	-7	-12	-16	-14	-22	-28	-33	-38
Monetary base	30	32	36	42	42	48	53	59	65
Currency in circulation	17	17	21	23	24	27	30	33	36
Liabilities to commercial banks	13	15	16	19	18	21	23	26	28
Fiscal year flows 1/									
Net international reserves	36.9	-19.7	20.5	-6.2	22.1	13.6	9.0	17.7	11.5
Net domestic assets	-37.1	22.0	-16.8	11.8	-16.7	-7.2	-3.6	-12.4	-5.8
Net claims on public sector 2/	4.7	27.2	11.9	17.7	19.3	16.2	13.7	14.3	11.9
<i>Of which:</i> central government	26.2	15.9	11.5	16.4	9.3	16.1	16.2	13.7	14.3
Open market operations	-37.8	13.0	-22.1	-3.3	-35.6	-19.2	-10.6	-21.0	-11.5
<i>Of which:</i> commercial banks	-37.7	12.5	-8.4	-0.2	-59.3	-20.0	-7.9	-12.4	-17.0
Credit to commercial banks	2.2	-8.1	-1.2	1.3	1.1	3.9	-0.7	-0.6	-0.6
Net credit to nonbank financial institutions	-0.1	0.1	0.1	0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Other 3/	-6.1	-10.2	-5.5	-4.0	-1.4	-8.0	-6.0	-5.0	-5.5
Monetary base	-0.3	2.3	3.7	5.6	5.5	6.4	5.4	5.3	5.7
Currency in circulation	1.6	-0.2	3.3	2.6	2.9	3.6	3.1	3.0	3.2
Liabilities to commercial banks	-1.8	2.4	0.4	3.0	2.5	2.8	2.4	2.3	2.5
(Changes in percent of beginning-of-period monetary base)									
Net international reserves	121.0	-65.3	63.1	-17.2	61.1	32.6	18.8	33.0	19.6
Net domestic assets	-121.8	72.8	-51.8	32.7	-46.0	-17.2	-7.5	-23.1	-9.8
Net claims on public sector 2/	15.4	90.1	36.7	48.8	53.4	38.9	28.5	26.7	20.2
Open market operations	-123.9	43.0	-67.9	-9.2	-98.3	-46.1	-22.1	-39.3	-19.5
Net credit to commercial banks	7.2	-26.8	-3.7	3.7	3.0	9.3	-1.4	-1.1	-1.0
Net credit to nonbank financial institutions	-0.4	0.2	0.2	0.4	-0.3	-0.1	-0.2	-0.1	-0.1
Other 3/	-20.1	-33.7	-17.0	-11.1	-3.8	-19.1	-12.4	-9.3	-9.3
Monetary base	-0.8	7.5	11.3	15.5	15.1	15.4	11.3	9.9	9.7
Memorandum items:									
Change in net claims on the central government (percent of GDP)	6.9	3.8	2.3	2.9	1.7	2.5	2.3	1.7	1.7
Exchange rate (end of period)	47.6	56.1	60.9	...	...	...	...	...	...
NIR (in millions of U.S. dollars)	1,942	1,339	1,569	1400	1,902	2,000	2,046	2,228	2,311

Sources: Bank of Jamaica; and Fund staff estimates and projections.

1/ A fiscal year runs from April 1 to March 31.

2/ Includes Bank of Jamaica's losses.

3/ Includes medium- and long-term liabilities, valuation adjustments, and allocation of SDRs.

Table 6. Jamaica: Summary Monetary Survey 1/

	2001/02	2002/03	2003/04	Prog. 2004/05	Prel. 2004/05	Projections			
						2005/06	2006/07	2007/08	2008/09
(In billions of Jamaican dollars)									
End-of-period stocks 1/									
Net foreign assets	100	88	102	97	116	136	152	174	190
Net domestic assets	48	71	89	121	94	106	118	123	136
Net claims on public sector 2/	119	151	165	183	179	193	207	216	216
<i>Of which:</i> central government	120	132	147	165	148	163	179	187	190
Open market operations	-70	-69	-83	-87	-110	-109	-112	-120	-115
Credit to private sector	40	55	80	106	93	109	124	142	163
<i>Of which:</i> foreign currency	11	20	27	33	33	39	45	52	59
Other 3/	-42	-66	-73	-82	-68	-86	-101	-114	-128
Liabilities to private sector (M3)	148	159	191	218	210	243	270	297	326
Money supply (M2)	108	107	125	142	139	164	185	207	231
Foreign currency deposits (FCD)	40	51	66	75	71	79	85	90	95
Fiscal year flows 1/									
Net foreign assets	32.6	-12.0	14.2	-5.6	14.4	19.9	16.0	21.6	15.6
Net domestic assets	-19.2	23.1	17.9	32.4	5.2	12.6	11.4	5.3	13.2
Net claims on public sector 2/	22.6	31.6	13.8	18.7	13.8	14.9	13.6	8.7	0.4
<i>Of which:</i> central government	95.5	12.1	15.4	19.0	1.0	14.8	16.1	8.1	2.9
Open market operations	-16.6	0.5	-13.7	-3.6	-26.9	0.8	-2.7	-8.6	5.5
Credit to private sector	5.8	14.9	25.2	26.2	13.0	15.7	15.3	18.1	21.1
<i>Of which:</i> foreign currency	3.9	8.4	7.5	5.8	5.9	6.1	6.5	6.3	7.0
Other 3/	-31.0	-24.0	-7.3	-8.9	5.3	-18.8	-14.7	-12.9	-13.8
Liabilities to private sector (M3)	13.5	11.0	32.1	26.8	22.6	29.4	27.5	28.4	28.2
Money supply (M2)	6.9	-0.5	17.4	17.4	15.4	19.4	18.1	18.7	18.5
Foreign currency deposits (FCD)	6.5	11.6	14.6	9.4	7.1	10.1	9.4	9.7	9.6
(Changes in percent of beginning-of-period M3)									
Net foreign assets	24.3	-8.1	9.0	-2.9	7.5	9.4	6.6	8.0	5.3
Net domestic assets	-14.3	15.6	11.3	17.0	2.7	6.0	4.7	2.0	4.4
Net claims on public sector 2/	16.8	21.4	8.7	9.8	7.2	7.1	5.6	3.2	0.1
<i>Of which:</i> central government	71.2	8.2	9.7	10.0	0.5	7.0	6.6	3.0	1.0
Open market operations	-12.3	0.4	-8.6	-1.9	-14.1	0.4	-1.1	-3.2	1.9
Credit to private sector	4.3	10.1	15.9	13.7	6.8	7.5	6.3	6.7	7.1
<i>Of which:</i> foreign currency	2.9	5.7	4.7	3.1	3.1	2.9	2.7	2.3	2.3
Other 3/	-23.1	-16.2	-4.6	-4.7	2.8	-8.9	-6.1	-4.8	-4.7
Liabilities to private sector (M3)	10.0	7.5	20.2	14.1	10.3	15.4	11.3	9.9	9.7
Memorandum items:									
Dollarization (share of FCD in total deposits)	30.5	36.2	37.6	38.7	31.2	30.0	29.0	28.0	27.0
M3 velocity	2.6	2.6	2.6	2.6	2.6	2.6	2.7	2.7	2.7

Sources: Bank of Jamaica; and Fund staff estimates and projections.

1/ A fiscal year runs from April 1 to March 31.

2/ Includes Bank of Jamaica's losses.

3/ Includes net credit to nonbank financial institutions, capital accounts, valuation adjustment, securities sold under repo and net unclassified assets

Table 7. Jamaica: Selected Vulnerability Indicators

	2000/01	2001/02	2002/03	2003/04	2004/05 1/
Key economic and market indicators					
Real GDP growth (in percent)	1.1	0.9	2.1	2.0	0.7
CPI inflation (period average, in percent)	7.7	8.0	6.5	12.9	12.8
Short-term (ST) interest rate (in percent)	16.9	14.3	33.5	16.0	13.5
EMBI secondary market spread (bps, end of period)	...	550	800	551	405
Exchange rate NC/US\$ (end of period)	45.7	47.6	56.2	60.8	61.5
External sector					
Exchange rate regime	Managed float				
Current account balance (percent of GDP)	-5.3	-9.6	-15.2	-6.8	-8.5
Net FDI inflows (percent of GDP)	6.7	5.7	5.3	7.1	5.7
Exports (percentage change of US\$ value, GNFS)	3.7	-8.4	1.7	10.8	4.9
Real effective exchange rate (1995/96=100; end of period)	141.4	142.8	142.5	122.3	129.4
Gross international reserves (GIR) in US\$ billion	1.4	2.0	1.4	1.6	1.9
GIR in percent of ST debt at remaining maturity (RM)	375.5	273.9	472.0	327.0	350.5
GIR in percent of ST debt at RM and banks' FX deposits.	124.6	127.9	114.5	99.6	113.0
Net international reserves (NIR) in US\$ billion	1.3	1.9	1.3	1.6	1.9
Total gross external debt (ED) in percent of GDP	46.0	50.7	54.8	54.5	55.9
Total gross external debt in percent of exports of GNFS	102.1	127.2	126.4	123.6	131.2
Gross external financing requirement (in US\$ billion) 2/	0.7	1.0	1.9	0.8	1.5
Public sector (PS) 3/					
Overall balance (percent of GDP)	-4.8	-6.1	-10.8	-9.7	-7.1
Primary balance (percent of GDP)	11.2	7.8	7.3	11.2	11.8
Debt-stabilizing primary balance (percent of GDP) 4/	7.3	7.3	17.3	10.0	3.5
Gross PS financing requirement (in percent of GDP) 5/	19	30	32	33	31
Public sector gross debt (PSGD, in percent of GDP)	132	132	146	143	138
Public sector net debt (in percent of GDP)	126	126	141	138	135
Financial sector (FS) 9/					
Capital adequacy ratio (in percent)	21.7	17.8	14.4	13.1	13.5
NPLs in percent of total loans	9.6	8.0	4.9	3.9	3.6
Provisions in percent of NPLs	116.8	126.5	117.9	117.1	118.2
Return on average assets (in percent)	0.4	2.1	2.8	4.3	2.2
Return on equity (in percent)	4.1	22.1	26.4	39.0	18.8
FX deposits held by residents (in percent of total deposits)	24.0	28.0	30.1	32.0	31.2
FX loans to residents (in percent of total loans)	21.5	28.1	35.7	33.8	35.5
Net open forex position (in percent of capital) 10/	...	...	20.9	-8.2	-8.2
Government debt held by FS (percent of total FS assets)	17.6	36.6	27.6	25.7	22.0
Credit to private sector (percent change)	7.3	17.1	37.6	46.0	16.3
Memorandum item:					
Nominal GDP in billions of U.S. dollars	7.6	8.2	7.6	8.3	9.1

1/ Staff estimates, projections, or latest available observations as indicated in the last column.

2/ Current account deficit plus amortization of external debt.

3/ Public sector covers central government only.

4/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates).

5/ Overall balance plus debt amortization.

6/ ST debt and maturing medium- and long-term debt, domestic and external, excluding external debt to official creditors.

7/ Debt in foreign currency or linked to the exchange rate, domestic and external, excluding external debt on concessional terms.

8/ ST debt and maturing medium- and long-term debt at variable interest rates, domestic and external.

9/ Financial sector includes commercial banks only.

10/ Sum of on- and off-balance sheet exposure.

Table 8. Jamaica: Public Debt Sustainability Framework, FY 1994/95–2008/09
(In percent of GDP, unless otherwise indicated)

	1994/95	1995/96	1996/97	1997/98	1998/99	1999/00	2000/01	2001/02	2002/03	2003/04	Prel. 2004/05	Projections 2005/06	2006/07	2007/08	2008/09	Debt-stabilizing primary balance 10/
I. Sensitivity Analysis Projections																
Public debt 1/	99.5	85.2	79.1	103.2	116.5	132.5	132.0	135.1	148.0	143.7	138.6	126.1	118.2	109.8	100.6	
Government debt 1/	99.5	78.4	73.8	98.9	113.5	129.5	127.5	129.2	140.8	136.6	131.2	119.3	111.8	103.7	94.9	3.5
Of which: foreign-currency denominated	83.7	55.4	48.0	49.7	43.4	43.6	44.7	49.9	76.1	73.5	74.2	64.8	61.8	57.5	53.5	
Government guaranteed debt 1/	0.0	6.8	5.3	4.3	3.0	3.0	4.4	5.9	7.2	7.2	7.3	6.8	6.4	6.1	5.8	
Change in government debt	-11.4	-21.1	-4.5	25.1	14.6	16.0	-1.9	1.7	11.6	-4.3	-5.2	-12.4	-7.9	-8.5	-9.1	
Identified debt-creating flows (4+7-12)	-14.7	-28.0	-0.8	25.5	14.2	12.2	-11.7	-5.0	11.4	-6.7	-6.5	-11.3	-7.1	-7.8	-8.5	
Primary deficit	-11.5	-10.2	-5.0	-1.7	-5.4	-9.4	-11.5	-7.4	-4.1	-8.1	-9.6	-11.1	-10.8	-11.8	-12.4	
Revenue and grants	26.0	27.5	25.6	24.8	25.8	29.1	29.1	27.0	28.1	29.4	30.9	31.2	30.4	30.1	29.9	
Primary (noninterest) expenditure	14.4	17.3	20.6	23.1	20.4	19.7	17.7	19.6	24.0	21.3	21.3	20.1	19.6	18.3	17.6	
Automatic debt dynamics 2/	-3.1	-18.1	2.4	6.2	14.2	12.1	5.2	2.3	15.4	1.4	3.1	-0.1	3.7	4.0	3.9	
Contribution from interest rate/growth differential 3/	-17.7	-10.8	0.5	4.4	10.4	8.9	3.4	2.3	3.1	-4.3	2.3	-4.5	0.8	1.9	1.9	
Of which: contribution from real interest rate	-16.2	-10.7	-0.3	4.0	9.9	10.1	4.3	2.3	5.6	-1.9	3.2	-0.4	4.0	5.4	5.2	
Of which: contribution from real GDP growth	-1.5	0.0	0.7	0.4	0.5	-1.2	-0.9	0.0	-2.5	-2.4	-0.9	-4.1	-3.2	-3.6	-3.3	
Contribution from exchange rate depreciation 4/	14.6	-7.3	1.9	1.8	3.8	3.2	1.8	0.0	12.3	5.7	0.8	4.4	2.9	2.1	2.0	
Other identified debt-creating flows	0.0	0.3	1.8	21.1	5.4	9.5	-5.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.2	2.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.3	1.8	21.1	5.4	9.2	-7.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3)	3.3	6.9	-3.8	-0.5	0.4	3.8	9.8	6.7	0.2	2.4	1.3	-1.2	-0.8	-0.7	-0.6	
Public debt-to-revenue ratio 1/	383.0	309.6	308.7	415.2	451.8	455.6	453.1	500.2	527.3	489.4	448.0	404.3	389.1	364.9	336.1	
Gross financing need 5/	7.7	5.3	15.9	20.3	24.0	25.7	23.2	30.1	32.3	29.7	31.2	24.0	22.7	18.6	22.4	
In billions of U.S. dollars	0.4	0.3	1.1	1.5	1.8	1.9	1.8	2.5	2.5	2.5	2.8	2.4	2.4	2.1	2.7	
Key macroeconomic and fiscal assumptions																
Real GDP growth (in percent)	1.8	0.0	-1.1	-0.6	-0.6	1.1	0.8	0.0	2.1	2.0	0.6	1.2	0.7	3.7	3.0	3.5
Average nominal interest rate on public debt (in percent) 6/	10.4	10.5	16.4	15.1	18.8	16.6	14.5	11.5	12.7	15.0	14.2	2.8	13.7	12.0	12.4	11.7
Average real interest rate (nominal rate minus change in GDP deflator)	-18.7	-13.4	-0.6	5.8	10.7	9.7	3.8	2.0	4.9	-1.3	0.3	9.5	2.7	0.1	4.0	5.6
Nominal appreciation (increase in U.S. dollar value of local currency)	-16.5	14.1	-3.9	-4.6	-9.2	-7.7	-4.0	0.0	-15.4	-7.6	-5.5	8.6	-1.0	-6.2	-4.3	-3.3
Inflation rate (GDP deflator, in percent)	29.1	23.9	17.0	9.3	8.1	7.0	10.7	9.5	7.7	16.3	13.9	7.6	11.0	12.0	8.4	6.3
Growth of real primary spending (deflated by GDP deflator, in percent)	-4.6	19.6	18.1	11.4	-12.2	-2.6	-9.5	11.1	24.8	-9.5	4.7	13.8	0.8	-2.3	0.5	-3.4
Revenue to GDP ratio	26.0	27.5	25.6	24.8	25.8	29.1	29.1	27.0	28.1	29.4	27.2	1.6	30.9	31.2	30.4	29.9
II. Stress Tests for Public Debt Ratio																
A. Alternative scenarios																
A1. Key variables are at their historical averages in 2005/06-08/09 7/											138.7	133.8	127.8	121.2	114.6	4.2
A2. Primary balance under no policy change in 2005/06-08/09											138.7	129.9	125.5	122.3	119.8	3.5
A3. Alternative scenario 8/											138.6	130.2	126.2	123.2	120.8	5.2
B. Bound tests																
B1. Real interest rate is at historical average plus two standard deviations in 2005/06 and 2006/07											138.7	148.4	160.7	153.3	145.5	5.3
B2. Real GDP growth is at historical average minus two standard deviations in 2005/06 and 2006/07											138.7	134.1	134.5	128.1	121.2	4.4
B3. Primary balance is at historical average minus two standard deviations in 2005/06 and 2006/07											138.7	136.1	138.2	130.1	121.4	4.4
B4. Combination of 1-3 using one standard deviation shocks											138.7	150.3	162.7	155.4	147.6	5.4
B5. One time 30 percent real depreciation in 2005/06 9/											138.7	169.5	162.6	155.4	147.6	5.6
B6. 10 percent of GDP increase in other debt-creating flows in 2005/06											138.7	135.8	127.8	119.3	110.2	3.9

1/ Central government and government guaranteed debt on gross basis. From FY 2002/03, includes debt issued to the BoJ to cover its cash losses and related capitalized interest. The primary balance includes budgetary primary balance and off-budget expenditure

2/ Derived as $(1 - \pi(1 + g) - g - \alpha(1 + r)) / (1 + g + \pi + g\pi)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation value of U.S. dollar.

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1 + g)$ and the real growth contribution as g .

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha(1 + r)$.

5/ Defined as overall fiscal deficit (including off-budget issuance of debt to BoJ), plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ The key variables include real GDP growth, real interest rate, and primary balance in percent of GDP.

8/ The implied change in key variables under this scenario is discussed in the text.

9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

10/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

JAMAICA—FUND RELATIONS

(As of May 31, 2005)

I. Membership Status: Joined February 21, 1963; Article VIII

II. General Resources Account:	SDR Million	Percent of Quota
Quota	273.50	100.00
Fund holdings of currency	273.55	100.02

III. SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	40.61	100.00
Holdings	0.27	0.66

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	12/11/92	03/16/96	109.13	77.75
Stand-by arrangement	06/28/91	09/30/92	43.65	43.65
Stand-by arrangement	03/23/90	05/31/91	82.00	82.00

VI. Projected Obligations to the Fund (SDR million); based on existing use of resources and present holdings of SDRs:

	Projections				
	2005	2006	2007	2008	2009
Principal					
Charges/interest	0.75	1.01	1.01	1.01	1.00
Total	0.75	1.01	1.01	1.01	1.00

VII. Exchange Rate Arrangements:

The external value of the Jamaican dollar has been determined in an interbank market operated by commercial banks beginning September 17, 1990. The Jamaican dollar has depreciated significantly since then, though not in a uniform trend. As of March 31, 2005, it was trading at around J\$61 to the U.S. dollar. A multiple currency practice (MCP) exists subject to Fund jurisdiction under Article VIII. The MCP arises from the implementation of the surrender requirement where authorized foreign exchange dealers and cambios are required to surrender at least 5 percent—but not more than 10 percent—of their purchases of U.S. dollars, Canadian dollars and pound sterling to the Bank of Jamaica (BOJ). This surrender requirement is effected based on the previous day's average selling rate for the U.S. dollar, the Canadian dollar, and the pound sterling, respectively, against the Jamaican dollar (referred below as "surrender rates").

The surrender rates have resulted in cross rates between the U.S. dollar and the Canadian dollar, and between the U.S. dollar and the pound sterling, that diverge periodically (for more than five days) by more than 1 percent from the midpoint spot exchange rates for those two currency pairs in their principal markets.

VIII. Last Article IV Consultation and Program Relations:

Jamaica is on the standard 12-month consultation cycle, and the last Article IV consultation was completed by the Executive Board on August 4, 2004 (SM/04/254). Intensified surveillance of the authorities' medium-term macroeconomic and structural policies was requested by the authorities and supported by the Executive Board at the time of the conclusion of 2004 Article IV consultation. The underlying economic strategy was formulated by the authorities without reaching prior understandings with Fund staff. Interim staff reports are prepared for information of the Executive Board in between Article IV consultations, the first of which was issued on January 31, 2005 (SM/05/37). Jamaica is participating in the Financial Sector Assessment Program in 2005. In this connection, the first of two Fund/World Bank missions visited Jamaica in May, 2005.

IX. Technical Assistance:

Department	Dates	Purpose
MAE	May 1995	Review of deposit insurance scheme
	October–December 1995	Banking supervision
	February–June 1996	Banking supervision
	September 1996	Banking crisis and restructuring
	October 1996	Banking supervision
	February 1997	Central bank accounting
	May 1997	Banking supervision
	August 1997	Banking supervision
	January 1998	Banking supervision
	April 1998	Public debt management
	May 1998	Financial sector restructuring
	April 2001	Banking supervision
	January 2002	Banking supervision
STA	September 1996	Multisector statistics assessment
	July 2002	Organization of Statistics Office

X. Resident Representative:

The post of the resident representative was closed in August 1997.