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DEBT MANAGEMENT STRATEGY FY2007/08

Ministry of Finance and Planning
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DEBT MANAGEMENT STRATEGY 2007/08

INTRODUCTION

1. The *Debt Management Strategy*, an annual publication of the Ministry of Finance and Planning, provides information on the Government's objectives and strategies for managing the outstanding stock of debt while meeting the Government's financing needs at minimum cost and risk.

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

3. The objective of the Debt Management Strategy continues to be:

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

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

- Maintain a prudent debt structure by:
  - having 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.

5. Since the implementation of the Strategy in 1998/99 significant progress has been made in:

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.

6. In FY2007/08 the Debt Management Strategy will continue to ensure that the debt management policies and operational framework are consistent with international best practices.

Market Developments FY2006/07

7. Some measure of success was achieved in FY2006/07 in the Government's Debt Management Strategy as evidenced by:

i. containment of the growth rate of the domestic debt which has shown marginal decreases over the past three fiscal years;
ii. lower cost funding and reduced borrowing costs;
iii. reduction of the level of foreign exchange risk in the domestic debt stock; and
iv. the extension and smoothing of the maturity profile of the domestic portfolio by the issuance of debt securities with twenty to thirty years tenure.

8. The overwhelming demand by investors in the international capital markets for Jamaica's benchmark 32-Year Amortizing 8.0% Bond issued in March 2007 reflected the confidence of the external market in the solid performance of the Jamaican economy.

9. During the fiscal year Jamaica's credit ratings were reviewed by the rating agencies Moody's Investors Service (Moody's), Standard and Poor's (S&P) and Fitch Ratings (Fitch). Moody's re-affirmed Jamaica's long-term foreign currency credit rating of "B1", its long-term local currency rating of "Ba2"and maintained its "Stable" outlook for Jamaica. S&P also re-affirmed Jamaica's long-term foreign currency rating of "B" and maintained its "Stable" outlook. Fitch conducted its inaugural sovereign rating of Jamaica and assigned a foreign and local currency issuer default rating of "B+" and a "Stable" outlook. The ratings were supported by the country's political stability, the Government's willingness to pay its debts and its on-going impressive commitment to fiscal discipline despite exogenous shocks.

Review of FY2006/07

10. At the end of March 2007, total public debt stood at $923.1 billion. This represented an increase of 9.0% over the stock of $847.3 billion recorded at the end of March 2006. The Debt-to-GDP ratio stood at 130.4% at the end of FY2006/07, compared with the 131.5% recorded at the end of FY2005/06 and the 138.2 % at the end of FY2004/05.

11. The stock of public and publicly guaranteed external debt stood at $409.2 billion (US$6,035.3 million) at the end of March 2007. This represented an increase of 12.2% compared with the stock of $364.6 billion at the end of March 2006. In US$ terms, the external debt rose by 8.4% from US$5,567.4 million at the end of March 2006. This was due to increases in both Central Government and Government Guaranteed debt. As a percentage of GDP, the external debt reflected a marginal increase to 57.8% at the end of FY2006/07, compared with 56.6% at the end of FY2005/06.

12. Central Government external debt increased from $316.1 billion (US$4,826.3 million) at the end of March 2006 by 11.8% to $353.3 billion (US$5,210.3 million) at the end of March 2007. In March 2007, the Government took advantage of favourable market conditions and low long-term interest rates to partially pre-fund its FY2007/08 external borrowing programme, raising US$350 million. The increase in Government Guaranteed external debt mainly reflected borrowings in support of the financial restructuring of the debt portfolio of Clarendon Alumina Production Ltd. (CAP) and for the Fifth Phase Expansion Programme of the Port Authority of Jamaica.

13. Central Government stock of domestic debt at the end of March 2007 stood at $513.9 billion. The debt stock increased by $31.2 billion or 6.5% over that at the end of March 2006. The main factors contributing to the increase were the issue of government securities to cover Bank of Jamaica (BOJ) losses, the capitalization of interest on LRS issued to replace FINSAC Bonds and the assumption of contingent obligations in respect of the Sugar Company of Jamaica Ltd.

14. The rate of growth of the domestic debt declined from 39.6% in FY2001/02 to 6.5% in FY2006/07 and the domestic debt-to-GDP ratio declined from 79.0% in FY2001/02 to 72.6% in FY2006/07.

15. During FY2006/07 the *Debt Management Strategy* sought to:

- Maintain an appropriate mix of fixed-rate and floating-rate debt to further diversify and 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 debt securities; and
- Increase the transparency and predictability of debt issuance.

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

16. Of the new domestic debt issued in FY2006/07, 28.3% was contracted on a fixed-rate basis and 71.4 % on a variable-rate basis. This compared with a 35.9% fixed-rate and 64.1% variable-rate mix of the new debt issued in FY2005/06. The Government was able to reduce its re-pricing risk over the short-term as a result of the declining interest rate path, although market demand for variable-rate instruments did not allow it to achieve its objective of increasing the fixed-rate share of the domestic debt.

17. At the end of FY2006/07, the fixed-rate component of the domestic debt portfolio stood at 40.0% down from the 47.0% recorded at the end of FY2005/06. For the external debt portfolio, the share of fixed-rate debt continued to increase, reaching 78.9% at the end of FY2006/07, compared with 77.4% in FY2005/06.

Extend and Smooth the Maturity Profile of the Debt to Better Manage Refinancing Risk

18. During FY2006/07, consistent with the debt strategy objective of reducing refinancing risk over the medium-term, the Government was extremely successful in extending the maturity structure of the domestic debt and was able to issue 41.0% of its new debt securities with maturities over 10 years.

19. Of the domestic debt issued in FY2006/07, a significant 37.6% was issued with maturities between 10 and up to 20 years, compared with 17.4% in FY2005/06. The GOJ also successfully issued 3.4% of new debt securities with 20 to 30 years maturity.

20. Debt issues with maturities between 5 and 10 years saw a marginal increase from 35.2% in FY2005/06 to 36.1% in FY2006/07. In addition, of total debt issued, 22.9% will mature within 5 years, a big improvement when compared with 43.4% in FY2005/06 and 71.5% in FY2004/05. Within this period, 8.4% will mature in 1-3 years and 14.5% in 3-5 years.

21. Of the total domestic debt outstanding at the end of FY2006/07, 44.3% had maturities of 10 years and over, an improvement over the 12.2% at the end of FY2005/06 and 55.7% had maturities of up to 5 years, compared with 71.9% in FY2005/06. Within the 1-5 year category, 13.1% is due to mature within a year, 25.4% in 1-3 years while 17.2% will mature in 3-5 years.

22. 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 32-year amortizing 8.0% global bond in March 2007.

Increased Transparency and Predictability of Debt Issuance to Better Manage Refinancing Risk

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

24. Comprehensive domestic and external debt data are published on the Ministry of Finance and Planning's website (*www.mof.gov.jm/dmu*) on a monthly basis. During FY2006/07, the Government published on a monthly basis schedules of upcoming market issues and all results of all market issues. Information on its debt strategy, operations and relevant investor information are also available on the Ministry's website (*www.mof.gov.jm/dmu*).

25. During FY2006/07, the Government continued its market-oriented approach to debt management, 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.

Minimizing Foreign Currency Exposure of the Domestic Debt Portfolio

26. 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 FY2006/07, the overall foreign currency component of the domestic debt had declined to 14.5% from 15.9% at the end of FY2005/06 and 18.9% at the end of FY2004/05. US$-indexed bonds totaled $24.6 billion (US$362.2 million equivalent) or 4.8% of the domestic debt portfolio at the end of FY2006/07, compared with $25.6 billion (US$389.9 million equivalent) or 5.3% at the end of FY2005/06. The stock of US$-denominated bonds stood at $50.0 billion (US$736.8 million) or 9.7% of the domestic debt portfolio at the end of FY2006/07. This compared with $51.2 billion (US$781.2 million) or 10.6% of the domestic debt stock at the end of FY2005/06.

Increase Use of Auction Mechanism for issuance of Domestic Debt Securities

27. The Government continued to use the auction system to issue fixed rate securities across a range of maturities. A total of 10 auctions were conducted over a 7-month period. During the last quarter of FY2006/07, the Government was able to stay out of the domestic market as a result of the pre-funding conducted in the international capital market at the end of FY2005/06. The Government was unable to re-open existing issues by auction as the required systems were not in place.

Legal and Regulatory Framework

28. The Government reviewed the amount of loans raised under the Loan Act vis-à-vis the loan ceiling and, consistent with its medium-term borrowing programme, amended the Loan Act to increase the ceiling. Approval was also granted for a review of legislation governing debt management to modernize the relevant statutes and to facilitate the electronic registration of securities.

Development of the Domestic Debt Capital Markets

29. The Bank of Jamaica, as part of its mandate to reform the payments and securities settlement system has assumed responsibility for the immobilization of fixed-income securities. They are currently in discussions with the Government for the development and implementation of a Central Securities Depository.

DEBT STRATEGY FY2007/08

30. Debt management in FY2007/08 will continue to focus on the strategic objective of the Government's medium-term *Debt Management Strategy* of containment of the Government's exposure to risk within acceptable levels. Emphasis will be placed on liability management aimed at reducing long-term financing costs and maintaining a sustainable level of risk.

31. In addition, the *Debt Management Strategy* will continue to seek to:

- Maintain an appropriate mix of fixed-rate and floating-rate debt to further diversify and 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

32. During FY2007/08, in keeping with the declining trend in interest rates, the Government will seek to maintain an appropriate mix of fixed and variable rate domestic debt consistent with the objective of insulating the portfolio from unexpected interest rate shocks.

Extend and Smooth the Maturity Profile to Better Manage Refinancing Risks

33. The strategy in FY2007/08 will continue to offer government securities with maturities of 10 years and over in the domestic market. This will facilitate the

development of the long end of the yield curve with the objective of reducing refinancing risk over the medium-term.

Minimize Foreign Currency Exposure of the Domestic Debt Portfolio

34. 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.

Increase the Use of the Auction System

35. The Government will continue to use the auction mechanism to ensure that borrowing requirements are met at minimum cost and to promote intense competition through the bidding process.

36. Auctions will be conducted on a regular basis with issues across a wide range of maturities. The size of auctions will be gradually increased to create benchmarks. The required systems will be put in place to facilitate the re-opening of existing issues.

Increase Transparency and Predictability

37. Increased transparency and predictability have played and will continue to play a key role in guiding the Government's issuance strategy. Its approach to risk, relative costs, market conditions and opportunities, the size of maturing securities and 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.

38. The Government will offer securities in the domestic market on a regular and pre-announced basis. While the Government remains committed to the use of market mechanisms for the issuance of securities, it will be flexible in terms of the options used to meet the budgetary requirements.

39. 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;
- Advance 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.

40. These, along with the Government's *Debt Management Strategy* and relevant investor information, will continue to be made available in the print media and electronically on the Ministry's website (*www.mof.gov.jm/dmu*).

Calendar of Announcements

41. The Ministry of Finance and Planning will make available to the market, the schedule of market issues 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 and type of instruments to be placed in the market. 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.

Market Consultation

42. 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. This consultative approach to the markets has proven to be mutually beneficial, fostering greater understanding of Government's debt operations and debt management objectives by the domestic and external market. 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

43. The Government will continue to facilitate the development of a modern and efficient domestic capital market infrastructure. Work already begun on the immobilization of debt securities will be heightened. The immobilization of government securities will remove the need for issuance of certificates and 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

44. 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 legislation governing debt management to modernize the relevant statutes and to facilitate the electronic registration of securities will be finalized.

Liability Management

45. The Strategy will seek to reduce the interest cost of the debt portfolio by either or a combination of:

i. Replacing short-term debt with long-term maturities;
ii. Prepayment of high-cost debt; and
iii. Replacing high-interest-rate debt with lower-interest-rate debt.

Government Borrowing Requirements FY2007/08

46. Gross issuance in FY2007/08 is programmed to be moderately lower than in FY2006/07. The budgetary financing requirement is forecasted at $113.9 billion. With the pre-funding of the FY2007/08 external borrowing programme in March 2007, it is proposed to raise the greater portion of the funding requirements in the domestic market through various instruments across the yield curve. It is anticipated that the combination of the strategic approach to meeting the financing requirements and the expected adequacy of liquidity in the market will support this borrowing without creating pressures. Disbursements on project-related loans are estimated at US$97.7 million in FY2007/08.

47. Based on the improving macroeconomic environment and the prudent and effective borrowing programme, the Debt-to-GDP Ratio is projected to further decline in FY2007/08.

Omar Davies M.P.
Minister of Finance and Planning
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