INVESTMENT AND SOVEREIGN RESEARCH

SOVEREIGN: Jamaica

Executive Summary

The growth outlook has been revised downwards due to Hurricane Beryl. While the medium- to long-term growth remains positive, it is relatively subdued. Despite this lower growth expectation, the Government of Jamaica does not anticipate any significant changes to the fiscal balance planned for FY 2024/25. With falling inflation, the central bank has the flexibility to ease monetary policy and lower interest rates. Additionally, with foreign currency reserves remaining high, the central bank will continue to intervene in the foreign exchange market to protect the Jamaican dollar from significant fluctuations.

Growth

Table 1: Selected Macroeconomic Indicators

	2019	2020	2021	2022	2023	2024 (e)	2025 (f)	2026 (f)	2027 (f)
GDP per capita, USD	5,782	5,073	5,355	6,198	7,032	7,487	7,841	8,102	8,369
Real GDP, %	1.0	-9.9	4.6	5.2	2.6	0.2	0.8	1.8	1.9
Inflation, end of period, %	6.2	5.2	7.3	9.4	6.9	3.9	5.0	5.0	5.0
Unemployment, %	7.7	10.2	8.375	6.267	4.4	4.2	4.0	4.0	4.0
Revenue, % of GDP	30.6	29.5	31.0	30.1	30.5	31.1	30.6	30.5	30.6
Expenditure, % of GDP	29.7	32.6	30.1	29.8	30.5	30.8	30.5	30.2	29.9
Fiscal balance, % of GDP	0.9	-3.1	0.9	0.3	0.0	0.3	0.1	0.3	0.7
Debt to GDP, %	94.3	109.7	94.2	77.0	73.3	68.9	65.9	63.0	59.9
Current account balance, % of GDP	-1.9	-1.1	1.0	-0.8	2.9	-0.6	0.5	-0.3	-1.2

Sources: IMF and JMMBIR

Jamaica's near-term growth outlook is subdued as the lag effect of Hurricane Beryl and high interest rates weigh on growth. We now believe the economy will expand by 0.2% in 2024 and 0.6% in 2025. In early July, Hurricane Beryl had a devastating effect on agriculture, manufacturing and transportation, especially in the southeastern section of the island. Consequently, we are projecting a sharp decline in output in Q3:24 compared to the same period in 2023. The heavy rains in Q4 will weigh on agriculture output during the period and Q1:25. Additionally, the lag effect of high interest rates and inflation on the balance sheet of businesses and households' budget will continue to weigh on construction, manufacturing, and other business services.

However, conditions are expected to improve in Q3, driven by a turnaround in agriculture, manufacturing and transportation. Assuming weather conditions are stable in the first half of the year, agriculture output is likely to strongly rebound in the second half. Improvements in households purchasing power and increased availability of local input from the agriculture sector will help stimulate growth in manufacturing, especially food processing. The combination of increased activities in mining and elevated government capital spending will help to boost growth in the transportation sector.

Fiscal Outlook

Table 2: Abridged First Supplementary Budget vs. Approved Budget: FY 2024/25, J$ Million

	First Supplementary April-March	Approved Budget April-March	Diff	Diff %
Revenues & Grants	**1,073,771.4**	**1,033,594.4**	**40,177.0**	**3.9**
Tax revenue	905,059.3	899,232.6	5,826.7	0.6
Non-Tax revenue	162,091.8	128,844.6	33,247.2	25.8
Expenditure	**1,064,083.0**	**1,023,725.1**	**40,357.9**	**3.9**
Recurrent Expenditure	996,183.0	943,725.1	52,457.9	5.6
Compensation of Employees	453,672.2	442,047.7	11,624.5	2.6
Interest Payments	183,394.0	173,828.7	9,565.3	5.5
Capital	**67,900.0**	**80,000.0**	**(12,100.0)**	**-15.1**
Fiscal Balance	**9,688.4**	**9,869.3**	**(180.9)**	**-1.8**
Primary Balance	**193,082.4**	**183,698.0**	**9,384.4**	**5.1**
Overall balance	**(102,155.2)**	**(97,720.6)**	**(4,434.6)**	**4.5**
Total Spending	**1,381,774.3**	**1,341,064.7**	**40,709.6**	**3.0**

Sources: JMMBIR and MOF&P

The Government of Jamaica (GOJ) expects improvements in the fiscal accounts for FY 2024/25 despite the less favourable economic outlook over the period. In the First Supplementary Budget tabled in October, the GOJ is programming to spend $1,382.0 billion versus the initial budget of $1,341.1 billion, which is $40.9 billion (3.1%) more. Above the line and on the revenue side, the government is now looking to collect $1,073.7 billion, or $40.1 billion (3.9%) more than the initial budget. Programmed tax inflows of $905.1 billion exceed the initial budget by $5.8 billion (0.6%) while non-tax revenue of $162.1 billion is $33.2 billion more than the initial budget. The majority of the higher expected intake from Non-tax revenues reflects a one-off payment from the Airport Authority via securitization of its revenue streams from the Normal Manley International Airport.

On the expenditure side, the GOJ is seeking to spend $1,1064.1 billion versus the initial targeted spending of $1,023.7 billion, which is $40.4 billion (3.9%) higher. All line items show growth above the initial budget except for capital spending. Recurrent spending of $996.2 billion is $52.5 billion higher while capital spending contracts by $12.1 billion (15%) to $67.9 billion. The revised fiscal surplus of $9.7 billion is 1.8% lower than the initial budget.

Beyond FY 2023/24

The medium-term fiscal framework provides a glimpse of what the budget will look like over that timeline. With the general election constitutionally due in 2025, we believe that a change in the political administration will not have a material effect on the fiscal stance, as ideologically it is hard to separate both political parties and both have prefaced a commitment to maintaining fiscal prudence. With this in mind, we envisage the GOJ running fiscal surpluses and relatively high primary balance surpluses. In the context of stable growth and foreign exchange rate, debt to GDP will continue to decline, and the government will marginally increase its debt issuances in the domestic market to reduce the elevated foreign currency risk in the portfolio. **However, given the improved fiscal profile, the quantum of debt issued in the local market will be restricted to under $120 billion per fiscal year**.

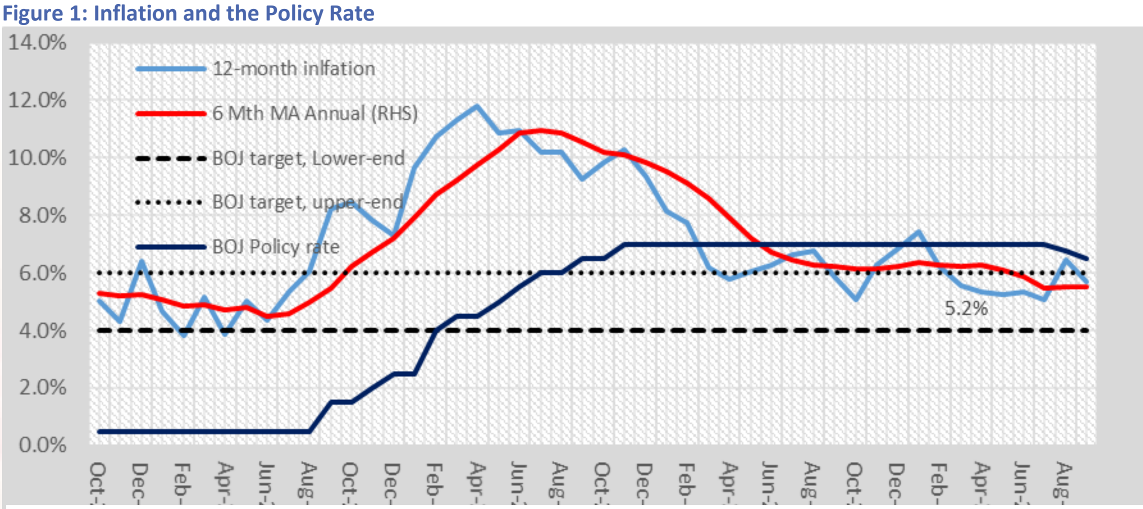
The crowding-in effect is welcome as investors with high-valued real investment projects may not find it as challenging to access funds from the domestic capital market relative to a decade ago. However, with the economy on a low growth path, the quantum of private fixed-income (debt) issuances could be lower than what the market requires, forcing portfolio managers to overweight other asset classes.

Inflation

We envisage inflation remaining low and stable over the short to medium term with low to moderate risk to the outlook. Inflation has receded within the BOJ's target range amid moderation in international prices and domestic wage adjustments. The sharp rise in commodity and international prices generally had a significant impact on the spike in domestic inflation in 2021 and 2022. With international prices falling or leveling off, the net impact on domestic prices is evident through the passthrough effect on energy prices, wheat and meats resulting in inflation falling in 2023 and 2024 to reach within the BOJ's target range. Our internal forecast shows inflation possibly falling above the band for one or two months but remain well within it over a 24-month period.

Risks to the inflation outlook is tilted towards the upside as geopolitical and weather-related shocks outweigh any further reduction in prices. An escalation in the Russia-Ukraine conflict could or weather-related events could cause commodity prices to rise and local inflation to rise. On the downside, a marked sustained increase in local agriculture output could cause inflation to trend lower in the coming quarters.

Figure 1: Inflation and the Policy Rate



Sources: IMF and JMMBIR

Interest Rate

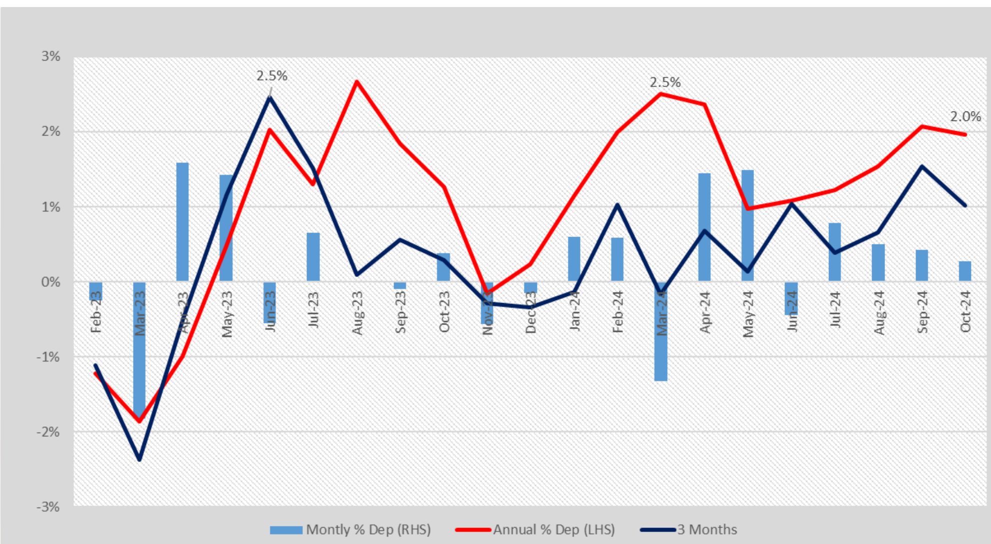
We envisage the BOJ cutting the policy rate over the coming quarters as inflation remains stable and the US Federal Reserve (Fed) lower its policy rate. With inflation falling and inflation expectations well within the 4% - 6% range, the central bank reduced its policy rate by 75 basis points to 6.25% since August, with the latest cut taking place in November where it was slashed by 25 basis points. Over the same timeline, the Fed lowered its policy rate by 75 basis points to 4.5% -5.0%. Further rate cuts by the BOJ is imminent, however, the speed and magnitude of those cuts will likely mirror rate movements by the Fed. As we have argued prior, the BOJ is mindful of how reduction in domestic interest rates relative to US interest rates can influence funds moving outside the country in search of higher returns as well as economic agents converting the Jamaica dollar holdings into US dollar holdings in anticipation of steep depreciation of the Jamaica dollar. Taking these things into consideration and the inflation path, the BOJ will cautiously lower the policy rate to mitigate these risks while anchoring inflation expectations within its target range.

Exchange Rate

We expect the pace of depreciation of the Jamaica dollar relative to the US dollar to remain subdued over the short term. At the end of October, the J-dollar traded at an exchange rate of $159.0 to US$1.0. The J-dollar depreciated 2.7% year-to-date and 2.0% year-over-year, which is well within the corridors observed over the last 24 months. Although US dollar inflows have been robust, there are periods where end-user demand has been elevated causing wide disparities between demand and supply. This results in sharp currency depreciation forcing the BOJ to intervene to realign market expectations to the depreciation path. Whenever the BOJ intervenes in the market, it tempers depreciation or causes the value of the Jamaica dollar to appreciate resulting in a relatively low depreciation rate on a 12-month basis since April 2022.

The currency account is likely to generate a small deficit which will be financed by foreign direct investments and official flows, resulting in a rise in foreign reserves. At the end of October, net international reserves stood at US$5.5 billion (7.1 months of imports of goods and services), nearly US$1.0 billion or 21.3% higher than the comparable period in 2023. The buildup in foreign reserves is a harbinger of the change in the value of the Jamaica dollar relative to the US dollar in the coming quarters. In a nutshell, it indicates greater levels of US dollar inflows relative to outflows. If conditions remain unchanged, the Jamaica dollar is likely to depreciate at a low to moderate rate relative to the US dollar.

Figure 2: Jamaica Dollar change vs. US Dollar



Sources: BOJ and JMMIR

Outlook

Structural handicaps in the economy - exposure to weather-related shocks, elevated levels of crime and violence, and corruption - limit the upside growth potential of the economy on a sustained basis. Consequently, we observe a boom-bust growth pattern that will likely continue over the medium to long term without diversification of capital flows into different sectors; better policy choices, especially regarding human capital; and a greater level of investment and effort to remedy the social deficits that weigh heavily on economic growth and development. Overall, we have a positive outlook on near-term growth, as the economy recovers from Hurricane Beryl and the central bank normalises its monetary policy.

However, over a longer period, the risk to the growth outlook is elevated due to economic shocks, especially weather-related shocks, and population dynamics: Over the next 10 years, Jamaica's population is expected to decline, and the dependency ratio rises as more people reach retirement age than are entering the labour force.

Despite the noise in the international economy, over the next 12 months, favourable external prices will help steer domestic inflation within the targeted range. The BOJ will continue to lower the policy rate and maintain a less restrictive monetary stance while intervening periodically in the foreign currency market. Within this context, we anticipate a reduction in interest rates in the money and capital markets with low volatility in the foreign currency market

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Overview of the Construction Rea/Estate in Jamaica for Lending Purposes.

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