MINISTRY OF FINANCE AND THE PUBLIC SERVICE

Government of Jamaica (GOJ) Guaranteed Loans

Report – October – December 2017

March 28, 2018

Debt Management Branch
Economic Management Division

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Section 1: Introduction

Contingent liabilities can significantly weaken the fiscal outlook of the Government and this justifies the need for close monitoring. This report examines the performance of explicit contingent liabilities associated with Government of Jamaica (GOJ) guaranteed loans (GGLs) to public bodies for the quarter ending December 2017.

Government Guaranteed Loans (GGLs) continued along a downward trajectory, decreasing by 5.2 percent over the quarter. This was also reflected in the continued decline of the GGL-to-GDP ratio, estimated at 6.4 percent for the quarter ended December 2017, comfortably below the legislated limit of 8.0 percent for end- FY2017/18. These positive results reflect the GOJ's commitment to reduce the fiscal risks posed by contingent liabilities and augurs well for the overall management of the country's public finances.

The report is arranged as follows: **Section 2** examines total Public Bodies Debt while **Section 3** focuses on explicit Government Guaranteed Loans (GGLs). **Section 4** analyses the market risks associated with GGLs while **Section 5** examines the relative sensitivity of the GGL portfolio to changes in exchange rate and the Consumer Price Index (CPI). Refinancing risk is outlined in **Section 6** and **Section 7** details GGLs by economic sector. **Section 8** discusses the estimated fiscal impact associated with the probable default of GGLs and **Section 9** concludes the report.

Section 2: Total Public Bodies' (PB) Debt

Effective April 1, 2017, the Government of Jamaica (GoJ) adopted a new definition of public debt based on the consolidated reporting of government debt statistics. Under the new definition, public debt is defined as the consolidated debt of the Specified Public Sector, except that of BOJ, net of any cross holdings.[1] The introduction of the new definition effectively broadened the scope of coverage for public debt, to include all debt owed by the public bodies.[2]

Central Government's exposure to credit default risks from public bodies can be categorized as direct and indirect. Direct credit risks are related to circumstances where default by a public body has an immediate and direct financial cost to the Government. Loans from Central Government and explicit loan guarantees by Central Government are sources of direct risk. Indirect risks

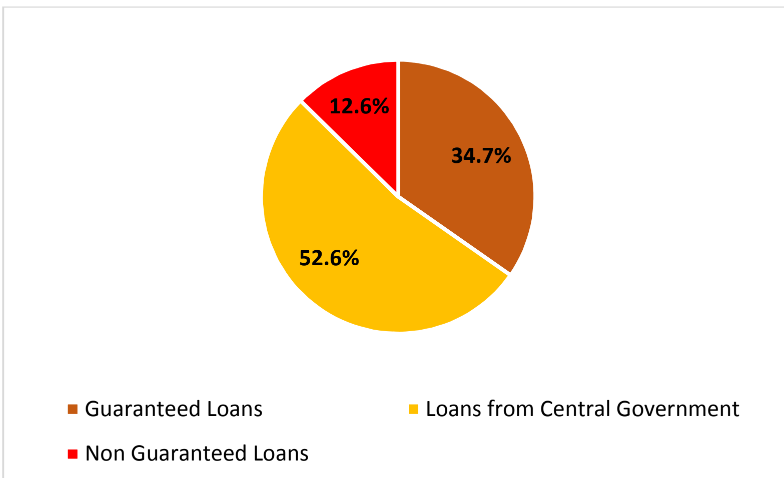
[1] The Specified Public Sector includes Central Government and all public bodies certified by the Auditor General as primarily carrying out functions that are of a non-commercial nature.

[2] The old GOJ definition of public debt included only external guarantees to public bodies.

relate to circumstances where, upon default by a public body, though there are no direct obligatory financial consequences, the Government may intervene on justifiable social, political or economic grounds. Other non-guaranteed loans to public bodies are examples of indirect risks or implicit contingent liabilities.

Proper management of the financial risks associated with GOJ's support to public bodies' necessitates close monitoring of all loan categories. Figure 1 highlights the distribution of public bodies' debt by loan category, at end-December 2017. Loans from Central Government and Government guaranteed loans continue to be the major financing sources for these entities, accounting for 52.6 percent and 34.7 percent of total public bodies' debt respectively. Non-guaranteed debt accounts for a smaller proportion (12.6 percent) of the overall debt portfolio. This highlights the entities dependence on Central Government for financial support.

Figure 1: Distribution of Public Bodies Debt by Loan Category



Source: Ministry of Finance and the Public Service

As shown in **Table 1** total public bodies debt at end-December 2017 was $351.3 billion, a reduction of $16.3 billion or 4.4 percent compared to the $367.6 billion recorded at end-September 2017. Whilst all creditor categories decreased over the review period, the overall decline in gross public bodies' debt was mainly due to a reduction in stock of outstanding loans from Central Government by $9.4 billion or 4.8 percent. Government guarantees contributed an additional $6.7 billion to the overall reduction and other non-guaranteed debt decreased by $300.0 million. The relative change in the respective loan categories highlights the gradual realignment of the balance sheet of the public bodies, away from a reliance on Government financial support, including loan guarantees.

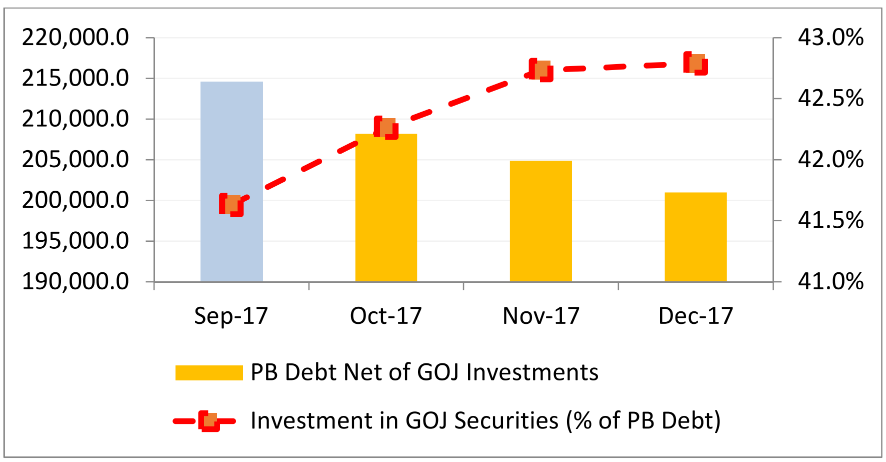
Table 1: Public Bodies Debt by Creditor/Loan Category

Creditor / Loan Category	end-Sep 2017	end-Dec 2017	Change J$Mn	Change (%)
Direct Risk	**323.0**	**306.9**	**(16.1)**	**(5.0)**
Guaranteed Loans	128.7	122.0	(6.7)	(5.2)
Loans from Central Government	194.3	184.9	(9.4)	(4.8)
Indirect Risk	**44.6**	**44.3**	**(0.3)**	**(0.6)**
Non-Guaranteed Loans	44.6	44.3	(0.3)	(0.6)
Gross Public Bodies Debt	**367.6**	**351.3**	**(16.3)**	**(4.4)**

Source: Ministry of Finance and the Public Service

The Government's net exposure to credit default risk from public bodies can be measured as gross public body debt net of investments in GOJ securities. As highlighted in **Figure 2,** Central Government's net exposure to credit default risks decreased over the review period, from $214.5 billion at end-September 2017 to $201.0 billion at end-December 2017. The reduction is mainly due to a decrease in total public body debt, rather than an increase in investment in GOJ securities.

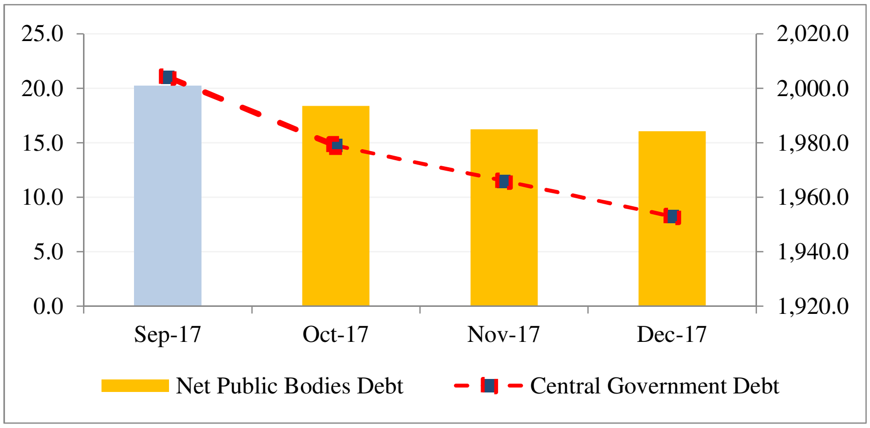
Figure 2: Net Financial Exposure to Credit Default Risk



Source: Ministry of Finance and the Public Service
Note: Total public body debt net of investment in GOJ securities can be read from the left-hand axis and investments in GOJ securities as a share of total PBs debt can be read from the right-hand axis

The consolidated or net public bodies' debt trended downwards over the quarter, from $20.3 billion at end-September 2017 to $16.0 billion at end-December 2017. This is a reduction of $4.2 billion and accounted for approximately 8.2 percent of the overall reduction in total public debt over the period of review (see **Figure 3**).

Figure 3: Net Public Bodies Debt



Source: Ministry of Finance and the Public Service.
Notes: Consolidated net public bodies debt (J$ billions) can be read from the right axis and total public debt (J$ billion) from the right axis.

Section 3: GOJ Guaranteed Loans (GGLs)

GGLs are categorized as either external or domestic. External GGLs are commitments made by GOJ with respect to loans owed by a beneficiary entity to non-national creditors, whereas domestic GGLs are commitments made with respect to loans owed to domestic creditors. The financial costs associated with GGLs, if called, can have potentially significant fiscal implications. An important policy objective of the GOJ is therefore to mitigate the fiscal risks associated with GGLs.

Table 2 highlights the stock of GGLs and its external and domestic components for the period end-September 2017 to end-December 2017. Compared to end-September 2017, GGLs at end-December 2017 were $6.7 billion or 5.2 percent lower. Total GGLs at end-December 2017 were $122.0 billion, of which $86.2 billion or 70.7 percent were external and $35.8 billion or 29.3 percent were domestic. External GGLs decreased by 6.1 percent compared to a reduction of 3.0 percent for domestic GGLs, resulting in a slight rebalancing of the portfolio towards the latter.

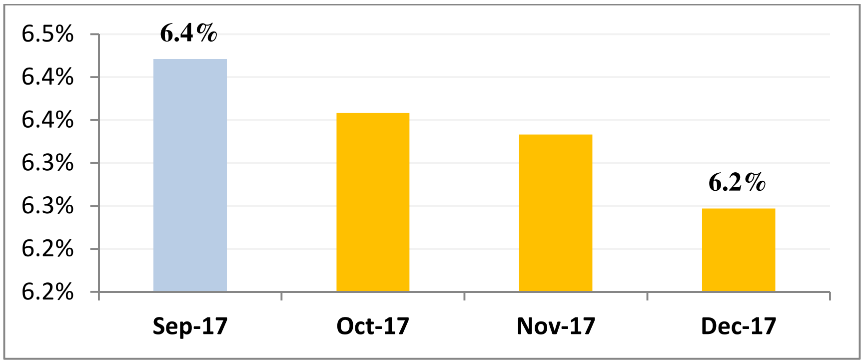
Table 2: External and Domestic GGLs at end-December 2017

	end-Sep 2016		end-Dec 2016		Change	
	J$Bn	(%) Total	J$Bn	(%) Total	J$Bn	(%)
External GGLs	91.8	71.3	86.2	70.7	(5.63)	(6.1)
Domestic GGLs	36.9	28.7	35.8	29.3	(1.11)	(3.0)
Total	**128.7**		**122.0**		**(6.7)**	**(5.2)**

Source: Ministry of Finance and the Public Service

Figure 4 highlights the share of GGLs in total public debt over the period end-September 2017 to end-December 2017. The share of GGL decreased marginally at end-December 2017 when compared to end-September, reducing by 0.2 percentage point.

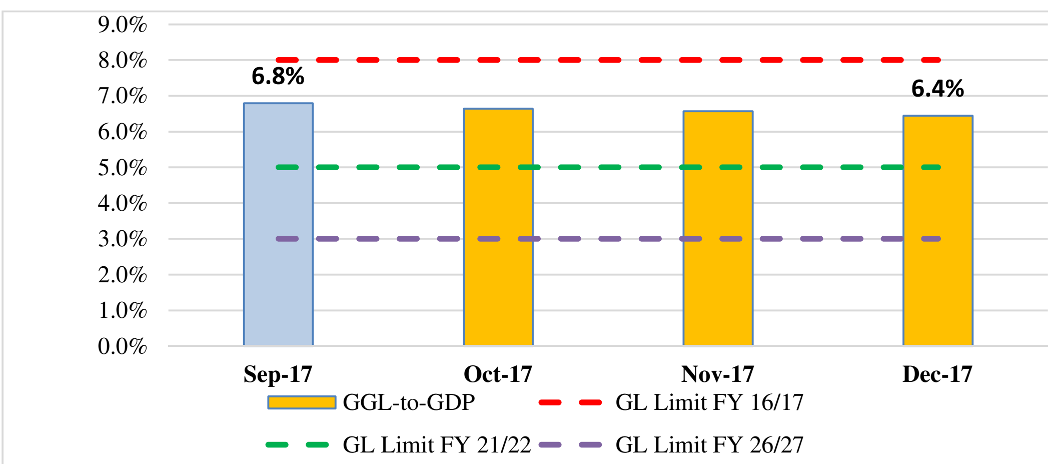
Figure 4: Share of GGLs in Total Public Debt



Source: Ministry of Finance and the Public Service.
Notes: Figure shows the share of GGL in total public debt as per the new definition.

Figure 5 highlights the trajectory of GGL-to-GDP from end-September 2017 through end-December 2017, relative to the legislated ceilings[3]. GGL-to-GDP at end-December 2017 was 6.4 percent, 0.4 percentage point lower than the 6.8 percent recorded at end-September 2017 and 1.6 percentage points below the legislated ceiling for end FY2017/18.

Figure 5: GGLs as a Share of GDP



Source: Ministry of Finance and the Public Service

[3] The PDMA limits the GGL-to-GDP to 8.0 percent, 5.0 percent and 3.0 percent for end-FY 2016/17, end-FY 2021/22 and end-FY 2026/27, respectively.

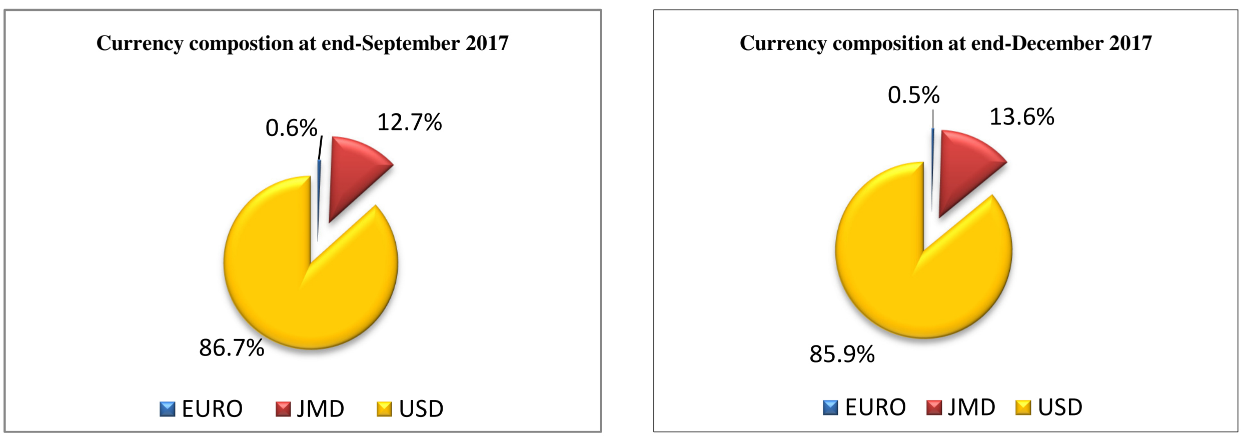
Section 4: Market Risks

The stock of GGLs represents explicit contingent liabilities for the Government. Adverse movements in market and broader macro-economic variables that affect the value of outstanding GGLs and the associated debt service costs of the beneficiary entities will increase the risks to Central Government. A distinctive feature of the GGL portfolio is its exposure to foreign currency risk. Though not as large, the portfolio's exposure to inflation and interest rate risks is also of important concern.

4.1 Foreign Currency Risk

The currency composition of the GGL portfolio is an indication of the portfolio's exposure to foreign currency risk. Compared to end-September 2017, there were only minor adjustments in the currency distribution of the GGL portfolio at end-December 2017. US dollar-denominated GGLS continued as the main currency denomination but reduced slightly at end-December 2017 (see **Figure 6**).

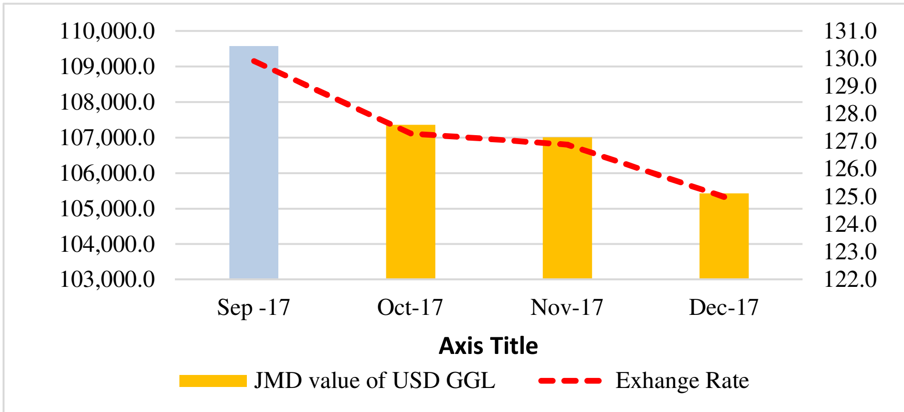
Figure 6: **Currency Composition of GGL Portfolio**



Source: Ministry of Finance & the Public Service

Figure 7 highlights the trajectory of the Jamaica dollar/US dollar exchange rate for the period September 2017 to December 2017, and estimates of the concomitant valuation effects, in Jamaica dollar terms, on the existing stock of US dollar-denominated GGLs at end-December 2017. The Jamaica dollar appreciated by approximately 3.8 percent resulting in a reduction in the value of US dollar denominated GGLs, in Jamaica dollar terms by approximately $4.1 billion.

Figure 7: USD FX Rate Fluctuations on the Stock of GGLs at end-December 2017



Notes: Figure shows the effect of changes in the JMD-USD exchange rate on the stock of USD denominated GGL at end-December 2017 on the left axis. The end of period selling rate of the US dollar is presented on the right axis.
Source: Ministry of Finance and the Public Service and the Bank of Jamaica (BOJ).

4.2 Interest Rate Risk

Interest rate risk relates to the exposure of the GGL portfolio to changes in market interest rates. Increases in benchmark interest rates will increase the debt service costs for variable rate GGLs and may imply higher roll over costs for public bodies in respect of near-to-maturity fixed rate debt. **Table 3** compares key interest rate risk indicators at end-September 2017 and end-December 2017. An increase in the share of variable rate GGLs in the domestic portfolio by 1.1 percentage point was offset by an equal proportioned decreased in the share of variable rate GGLs in the external portfolio. Overall, the share of variable rate GGLs decreased marginally from 35.2 percent at end-September 2017 to 34.6 percent at end-December 2017. The increased exposure to interest rate risks is also reflected in a reduction in the average time to re-fixing (ATR) by 0.7 years. This was driven by the external portfolio which saw a reduction in the ATR by 0.7 years while the ATR in the domestic portfolio increase by 0.2 years.

Table 3: Interest Rate Risk Indicators

	end-Sep 2017	end-Dec 2017	Change
Domestic Portfolio			
Variable Rate (%)	38.3	39.4	1.1
Average Time to Re-fixing (years	5.2	5.4	0.2
External Portfolio			
Variable Rate (%)	33.9	32.8	(1.1)
Average Time to Re-fixing (years	4.4	3.7	(0.7)
Total			
Variable Rate (%)	35.2	34.6	(0.6)
Average Time to Re-fixing (years	4.8	4.1	(0.7)

Source: Ministry of Finance and the Public Service.

4.3 Inflation Risk

Inflation-linked GGLs are susceptible to changes in the consumer price index (CPI). Adverse movements in the CPI will increase the nominal value of inflation-linked GGLs, exposing the Government to additional risks. Table 4 shows the share of inflation linked GGL in the total and domestic GGL portfolios. The share of inflation linked GGLs in the total portfolio increased by 0.8 percentage point from 11.0 percent at end-September 2017 to 11.8 percent at end-December 2017. However, inflation risks are concentrated in the domestic GGL portfolio, where the share of inflation linked GGLs increased by 1.3 percentage points from 39.0 percent at end-September to 40.3 percent at end-December 2017.

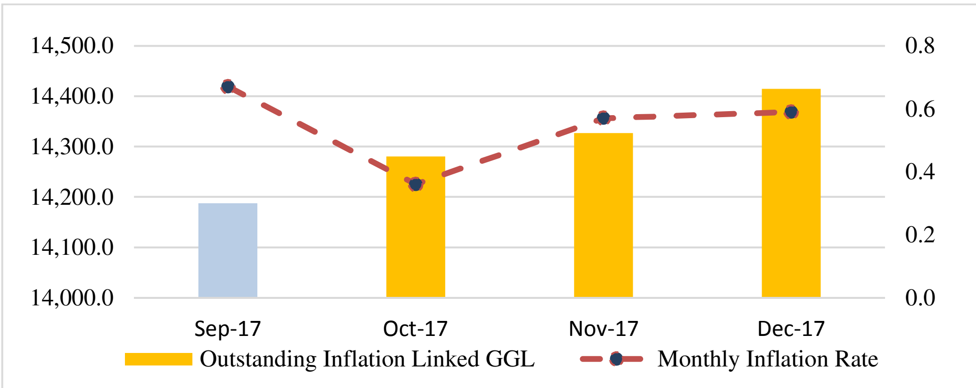
Table 4: Share of CPI-Linked GGL at end-September 2017 and end-December 2017

	end-Sep 2017	end-Dec 2017	Change
Share in Total GGL (%)	11.0	11.8	0.8
Share in Domestic GGL (%)	39.0	40.3	1.3

Source: Ministry of Finance and the Public Service.

Figure 8 highlights the impact of changes in the monthly CPI on the nominal value of inflation-linked GGLs over the review period. The inflation rate for the October to December quarter was 1.5 percent, an increase of 0.03 percentage point relative to the previous quarter. The value of inflation-linked GGLs increased by $227.3 million or 1.6%, from $14.2 billion at end-September 2017 to $14.4 billion at end-December 2017.

Figure 8: Value of CPI-Linked GGLs and Monthly Change in CPI



Notes: Figure shows nominal changes in the value of inflation linked GGLs (left axis) in millions of Jamaica dollars and monthly percentage change in the CPI (right axis)
Source: Ministry of Finance and the Public Service.

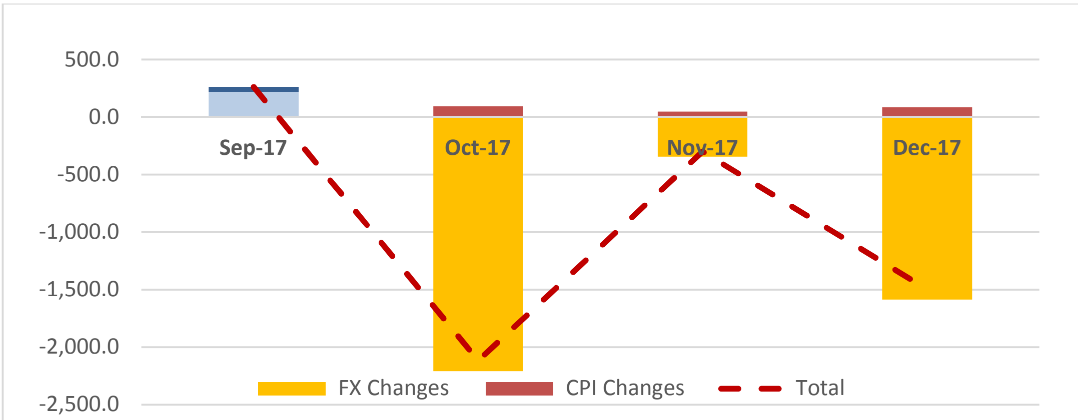
Section 5: Relative Sensitivity of GGL Portfolio to Changes in the USD Exchange Rate and CPI

Managing risks associated with GGLs requires an assessment of the relative sensitivity of the portfolio to key risk factors. Given the currency composition of the GGL portfolio, foreign currency risk is the dominant risk factor. However, during the review period, the appreciation of the Jamaica dollar relative to the US dollar contributed to an overall reduction in the stock of GGL in Jamaica dollar terms. On the other hand, increases in the CPI contributed to an increase in the stock of GGL. **Figure 9** compares the month-on-month valuation effects from changes in the Jamaica dollar / US dollar exchange and inflation rates, on the stock of GGL over the review period.[4] Relative to inflation, the valuation effects from changes in the exchange rate are more volatile. The overall effect on the GGL portfolio was a reduction of approximately

[4] Month-on-month changes are reflected **ONLY** for GGLs on record at end-December 2017 and **DO NOT** included GGLs that were previously called or absorbed. Changes in the FX portfolio reflect the pure valuation effects of changes in the Jamaica dollar / US dollar exchange rate on the stock of FX denominated GGL at end December 2017. Changes in CPI linked GGLs reflect changes in the nominal value of the outstanding balance and therefore does not distinguish between changes related to amortization or movements in the CPI.

$3,913.8 million. The appreciation of the Jamaica dollar contributed to a $4.1 billion reduction in the value of US dollar-denominated GGLs, while increases in the CPI resulted in a $227.3 million increase in the value of CPI-linked GGLs.

Figure 9: Changes in the USD-Denominated and CPI-Linked GGLs



Source: Ministry of Finance and the Public Service

Section 6: Refinancing Risk

The maturity profile of the GGL portfolio highlights the refinancing risks to the beneficiary entities, specific to select maturity categories. GGLs with longer maturities carry extended risk exposure for the GOJ, relative to those with shorter maturities, since they extend the period of payment guarantee with respect to the associated contingent liabilities. On the other hand, near-term maturity GGLs can pose significant refinancing risks where beneficiary entities face solvency and liquidity challenges, which increases their probability of default. Further, large amortization obligations (bunching) due in a single period can imply significant risk to the GOJ, to the extent that the guaranteed entities are unable to make these payments.

The maturity profile of the stock of GGLs at end-December 2017 is presented in **Figure 10**.[5] The maturity profile extends 22 years, with 11.6 percent of existing guarantees becoming due in one year or less. Approximately 61.4 percent of current GGLs will mature within the next 10 years, with most of these maturities occurring between 5 to 10 years.

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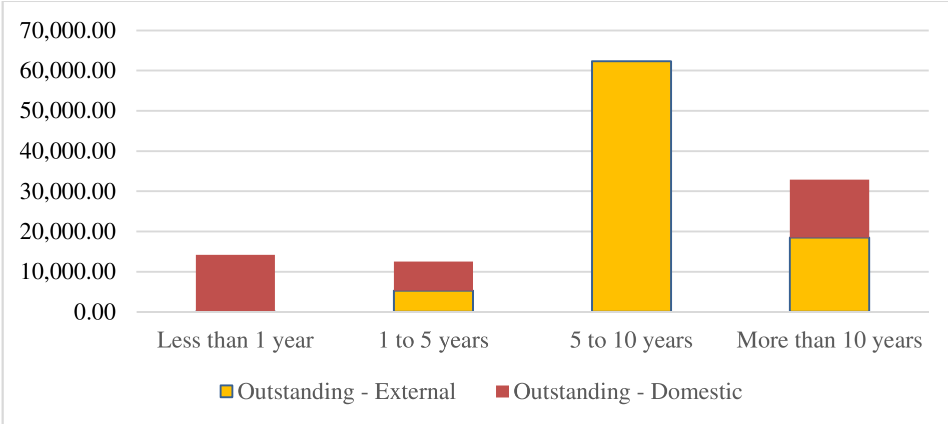
[5] Data for the amortization schedule are from CS-DRMS as at end-December 2017.

Figure 10: Maturity Profile of GGLs at end-December 2017



Source: The Ministry of Finance and the Public Service

Table 5 highlights the average time to maturity (ATM) for the GGL portfolio. The ATM of the GGL portfolio decreased by 0.2 years, from 6.0 years at end-September 2017 to 5.8 years at end-December 2017. The ATM for domestic and external guarantees at end-December 2017 is estimated at 5.7 years and 5.9 years, respectively. The slightly longer maturities on the external side imply prolonged exposure to the attendant risks for the GOJ, relative to domestic GGLs.

Table 5: Average Time to Maturity of GGLs

	end-Sep 2017	end-Dec 2017	Change
Domestic			
ATM (years)	5.1	5.7	0.6
External			
ATM (years)	6.4	5.9	-0.5
Total			
ATM (years)	6.0	5.8	-0.2

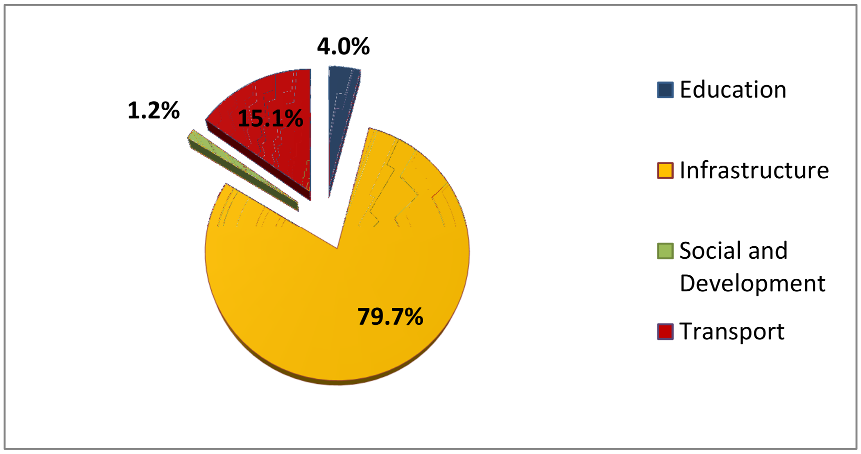
Source: Ministry of Finance & the Public Service

Section 7: GGLs by Areas of Main Economic Activity

As at end-December 2017, twelve (12) public bodies had Government guaranteed loans. This number is down from thirteen (13) at end-September 2017. The main areas of activity for beneficiary entities were generally unchanged relative to end-September are highlighted in

Figure 11. GGLs at end-December 2017 were categorized[6] into 4 sectors; infrastructure (79.7%), transport (15.1%), education (4.0%) and social development (1.2%).

Figure 11: Value of GGLs by Areas of Economic Activity at end-December 2017



Source: Ministry of Finance & the Public Service

Section 8: Estimated Fiscal Impact from Default of GGLs

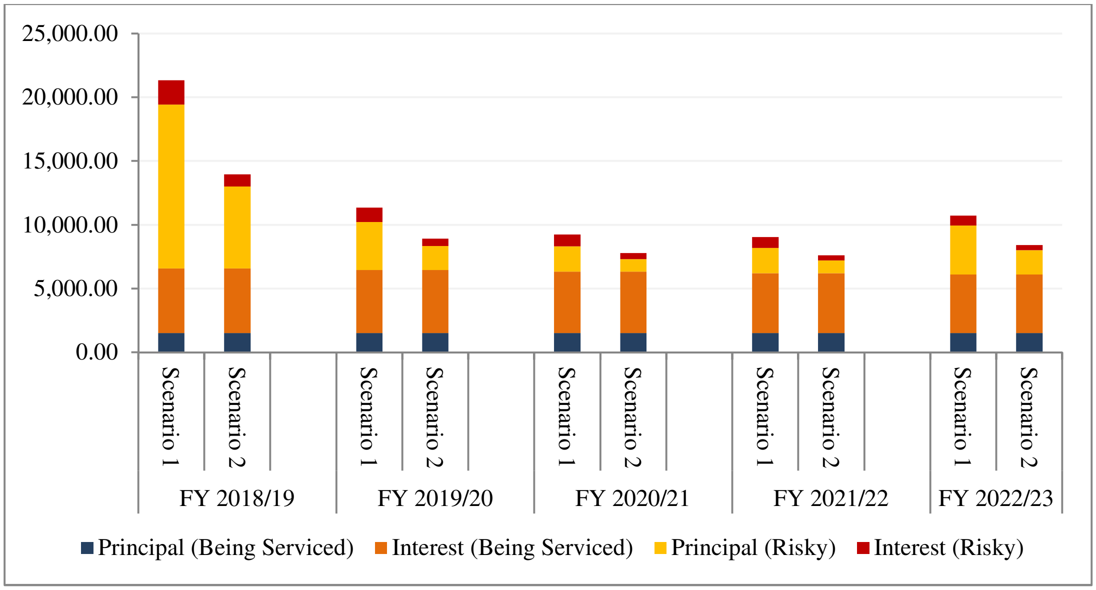
Realizations of contingent liabilities could have potentially large fiscal implications for the Government. The Government currently services four (4) of the GGLs on record and provides for the associated annual debt servicing costs through budgetary allocations. The remaining GGLs can be classified as either low risk or risky, based *inter-alia* on the financial position of the beneficiary entity. Low risk GGLs are excluded on the basis that these are not likely to be called. Risky GGLs are those for which there is a reasonable probability of default and consequent absorption of the debt by GOJ.

Figure 12 compares the potential estimated cash flow effects for Central Government from a potential default on GGLs for FY2018/19 through FY2022/23 for two scenarios. Both scenarios assume the full absorption of the debt service obligations in the event of default. Additionally both scenarios account for the full debt service costs for GGLs currently being serviced. Scenarios 1 and 2 assume a 100 percent and a 50 percent default probability for risky GGLs and scenario 2 assumes a 50 percent default probability for risky GGLs, respectively. Estimated debt service costs for GGLs currently serviced by the GOJ are roughly constant, averaging approximately J$6.3 billion over the next five years. Total estimated potential debt service costs

[6] Categorizations are crude and are based on authors' assessment of the primary areas of activity in which the beneficiary entity either directly engages or which it supports. For example, entities engaged in port and road development projects were categorized as being engaged in infrastructure development, but those engaged in education financing were categorized as education. Entities that provide financing for a range of activities are categorized as operating in the financial sector

over the five (5) years range between were J$61.6 billion and J$46.7 billion under scenarios 1 and 2, respectively.

Figure 12: Estimated Fiscal Cost from Realization of Guarantees



Source: Ministry of Finance and the Public Service

Section 9: Conclusion

The stock of GGLs continues on a downward trajectory and GGL-to-GDP is 1.6 percentage points below the legislated ceiling of 8.0 percent for FY 2017/18. Notwithstanding, the potential fiscal costs associated with the realization of contingencies related to GGLs remain a significant concern. Further, the GGL portfolio is exposed to revaluation effects from adverse movements in the exchange and inflation rates which imply significant upside risks to debt service costs.

Contingent liabilities have the potential to impose significant fiscal costs to the Government and hence the monitoring and management is critical. In this regard the GOJ will continue work towards developing a comprehensive framework for the monitoring and management of contingent liabilities. This will span the gamut from explicit loan guarantees to other contingencies including public-private partnerships, natural disasters and judicial awards. The framework will be centered on risk identification, risk mitigation, risk tolerance and making provisions for residual risks.