Jamaica

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Laying the Foundations for Growth and Debt Sustainability

WORLD BANK GROUP

Macroeconomics
& Fiscal Management
Global Practice

Jamaica:

Laying the Foundations for Growth and Debt Sustainability

Jamaica Economic Update, No. 2

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Macroeconomics & Fiscal Management

Government Fiscal Year:	April 1 – March 31
Currency Unit:	Jamaican Dollar (JMD)
Currency Equivalent:	Exchange Rate as of November 6, 2015 US$1.00=JMD119.400
Weights and Measures:	UK System

Abbreviation and acronyms

EFF	Extended Fund Facility
CARICOM	Caribbean Community and Common Market
BSA	Banking Services Act
BOJ	Bank of Jamaica
GDP	Gross Domestic Product
IMF	International Monetary Fund
J$	Jamaican Dollar
VAT	Value-Added Tax

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Foreword

This second edition of the Jamaica Economic Update is part of a biannual set of reports designed to monitor economic conditions in Jamaica and examine priority issues impacting its development. It presents a broad overview of the country's macroeconomic, policy and structural context, and assesses its macro-fiscal profile and growth outlook over the short and medium term. The report was prepared by the World Bank's Macroeconomics and Fiscal Management Global Practice. Its authors are Sona Varma (Senior Country Economist), and Luiz Edgard Oliveira, Matias Antonio and Paul Beckerman (Consultants). The team is grateful to Sophie Sirtaine (Country Director), Francisco Carneiro (Lead Economist and Program Leader), Jorge Araujo (Economic Advisor), and Naoko Kojo (Senior Economist) for their guidance and support, as well as Miriam Beatriz Villarroel and Sarah Nankya Babirye (Program Assistants) for their assistance in the preparation of the final draft.

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Overview

An extended drought in 2014 and 2015 slowed Jamaica's economic growth and diminished its prospects for poverty reduction. GDP grew by just 0.2 percent in FY2014/15 (April-March). The service sector drove growth, expanding by 0.8 percent, while the drought caused agricultural output to contract by 4.6 percent. Tourism continued its recovery, and arrivals increased by over 5 percent during the fiscal year. However, manufacturing and industrial production stagnated, and fixed capital investment growth remained modest despite the launch of new investment initiatives. The country continues to maintain its strong track record of structural reforms, which have led to an increase in both consumer and business confidence. The impact of the global financial crisis and weak subsequent recovery erased the 10 percent reduction in poverty achieved between 1997 and 2009, and poverty and unemployment remain high at 19.9 percent and 13.2 percent, respectively.

The government continues to make impressive progress in macroeconomic stabilization and fiscal consolidation. The authorities have succeeded in maintaining a large primary fiscal surplus for a second year in a row at 7.5 percent of GDP. This has supported a substantial improvement in the fiscal balance (almost 6 percent of GDP) since FY2011/12. The central bank maintained exchange-rate flexibility, and the Jamaican dollar depreciated by 5 percent (in nominal terms) against the US dollar during FY2014/15. While fiscal consolidation efforts have focused on controlling expenditures, concurrent reforms in tax policy and administration are gradually increasing revenues. Low oil prices have supported the authorities' efforts to rein in inflation and reduce the current account deficit, previously a key source of macro-fiscal vulnerability. In September2015 Jamaica successfully completed the 9th of 15 scheduled reviews under its IMF Extended Fund Facility (EFF). This was an unprecedented achievement, as the country had not been able to advance this far under any of the many IMF programs it had undertaken in the past.

The GDP growth rate is expected to recover to 1.5 percent in FY2015/16, while progress continues towards achieving debt sustainability. Business and consumer confidence have increased steadily, and growth is expected to accelerate over the medium term. A number of investment projects are currently being prepared, including some designed to support the government's Logistics Hub Initiative, and capital spending is expected to rise. While the recent PetroCaribe debt buyback has reduced the debt overhang, Jamaica's progress on debt sustainability and its ability to address solvency issues will hinge on a resurgence in growth. Jamaica still faces large debt repayments over the medium term and will need to maintain access to commercial markets in order to finance them. A US$2 billion bond issue in July in support of the PetroCaribe buyback will also help pre-finance a large domestic debt repayment scheduled for February 2016, the first significant domestic debt amortization since the National Debt Exchange of 2013. A modest recovery in per capita GDP growth is expected to slightly reduce the poverty rate from 19.9 percent in 2012 to 18.7 percent in 2016.[1]

A. Recent Economic Developments

Growth, Poverty and Employment Dynamics

Economic growth remains anemic, and recent progress has been concentrated in the service sector. Real GDP grew by 0.2 percent in FY2014/15, as an extended drought caused agricultural production to contract by 4.6 percent (Figure 1). However, the agricultural sector has begun to show signs of a potential recovery, posting a quarterly growth rate of 0.4 percent, year-on-year, for the

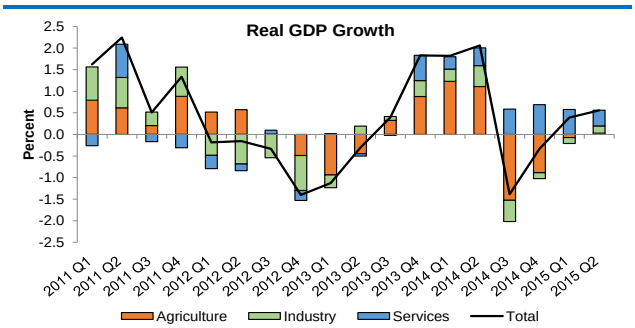
[1] Post-2012 poverty figures used in this Economic Update are World Bank staff estimates based on latest official statistics.

second quarter of 2015. Services grew at an average rate of 0.8 percent over FY2014/15, due largely to an increase in tourist arrivals. Manufacturing, industry and fixed capital investment remained stagnant over the fiscal year but have since begun to show signs of improvement, growing by 1.4 percent in the second quarter of 2015. Despite weak overall growth in FY2014/15, business confidence shot up by 25 percent, while consumer confidence improved by 16 percent as of December 2014. Stronger confidence indicators likely reflect the government's substantial progress in implementing vital macroeconomic and structural reforms, as well as its timely completion of reviews under the IMF's EFF program.

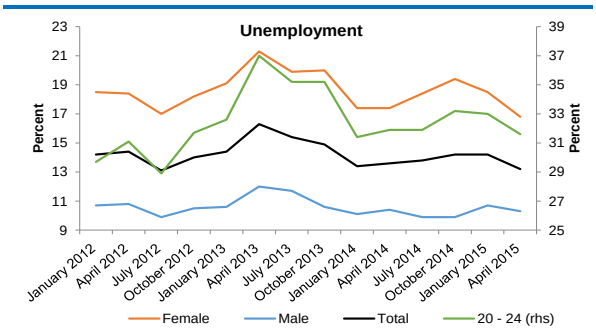
Poverty rates remain high, and the country has yet to reclaim the ground lost during the global financial crisis. The government's most recent household survey shows that the national poverty rate climbed from 17.6 in 2010 to 19.9 percent in 2012. The poverty rate rose rapidly in the wake of the crisis, and rural households were hit the hardest. While rural households registered important gains in a number of indicators between 2010 and 2012, more up-to-date data will be required to determine whether this progress has been sustained. Mean per capita consumption decreased marginally in real terms despite increasing in nominal terms.

Despite strong job growth in the tourism sector the unemployment rate remained high at 13.2 percent in April 2015. Between April 2014 and April 2015, the tourism and real-estate sectors created approximately 18000 jobs, with construction adding another 6000 jobs to the economy. However, nearly 19000 jobs were lost in the public, agriculture, and manufacturing sectors combined during the same period. On aggregate, employment rose only marginally as illustrated by persistently high unemployment rates (Figure 1). Youth unemployment declined marginally from 33 percent in January 2015 to 31.6 percent in April, while female unemployment decreased from 19.4 percent in October 2014 to 16.8 percent in April 2015. The gap between male and female unemployment remains large at almost 6.5 percentage points. Chronically high unemployment levels among women and young men increase their vulnerability to negative social outcomes and economic exclusion.

Figure 1. A contracting agricultural sector has slowed growth, and unemployment remains high



Source: Bank of Jamaica.



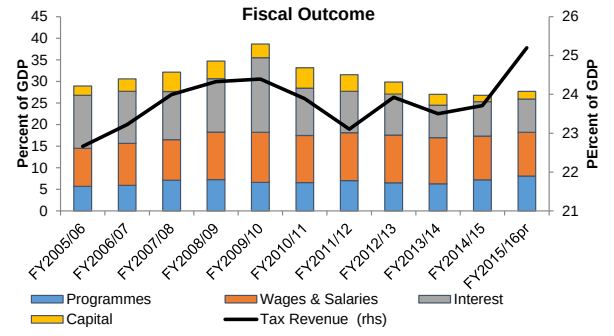
Source: Statin.

Fiscal Policy

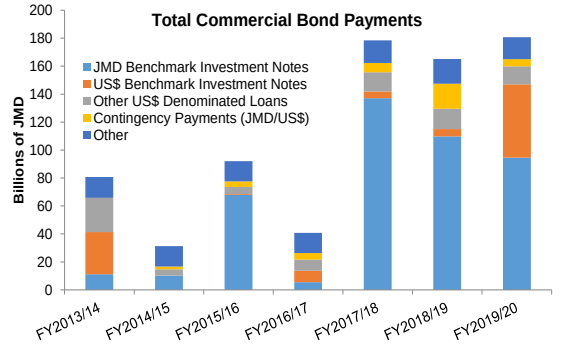
Fiscal policy remains the centerpiece of the government's reform program. Key measures include: (i) the introduction of a fiscal rule into the annual budget process; (ii) a freeze on the public sector wage bill; (iii) the publication of the Tax Administration of Jamaica's National Compliance Plan for FY2015/16; (iv) the preparation of amendments to the Customs Act, the General Consumption Tax, and the tax regime governing Special Economic Zones; and (v) the modernization of tax-collection systems. Spending cuts have driven the fiscal adjustment thus far, and due to a shrinking

wage bill coupled with slowing capital investment total expenditures are expected to fall to 26.8 percent of GDP in FY2014/15 (Figure 2).

Figure 2. Revenues are expected to increase rapidly, but large debt payments are fast approaching.



Source: Bank of Jamaica and IMF



Source: Debt Management Unit.

Budget execution has remained broadly in line with projections as of end-March 2015. Revenues underperformed slightly compared with the EFF target, largely due to lower consumption tax revenue. However, deeper expenditure cuts offset the shortfall, and the deficit is expected to remain below its target of 0.5 percent of GDP. Moreover, the consolidation of expenditures will not impact pro-poor social spending.

In an effort to achieve its primary surplus target of 7.5 percent of GDP the government is implementing a set of tax reforms. An increase in the tax on petroleum products is the cornerstone of these reforms, which are designed to boost revenue by 0.6 percent of GDP. Additional measures include an expansion of the environmental levy on domestic goods, an increase in the CARICOM import tax, the application of VAT to residential electricity consumption above a threshold, an increase in the excise tax on cigarettes, and a modest increase in the threshold for personal income tax. To support these efforts the Tax Administration of Jamaica has expanded the Large Taxpayers Office to increase collection efficiency.

In July 2015 Jamaica bought back its PetroCaribe debt at a discount, reducing the public debt-to-GDP ratio by almost 10 percent. The government reached an agreement with the Venezuelan state-owned oil company (*Petróleos de Venezuela*, S.A.) to retire most of Jamaica's stock of PetroCaribe debt, which had reached approximately US$2.97 billion at end-2014. In order to raise the US$1.5 billion necessary funds to complete the deal the government issued two international bonds on July 23rd, 2015: a 13-year US$1.35 billion bond with an interest rate of 6.75 percent, with equal payments scheduled for 2026, 2027 and 2028, and a 30-year US$650 million bullet bond with an interest rate of 7.875 percent. These bonds not only indicated that the government continues to have access to international financing markets (at competitive rates), but also immediately reduced the debt-to-GDP ratio. According to the IMF, overall fiscal savings from this operation are estimated at approximately US$287 million in net present value terms. At its current trajectory the public debt stock could fall to 90.7 percent of GDP by FY2020/21 (IMF, 2015a).

Monetary, Financial and External Sector Outcomes and Assessment

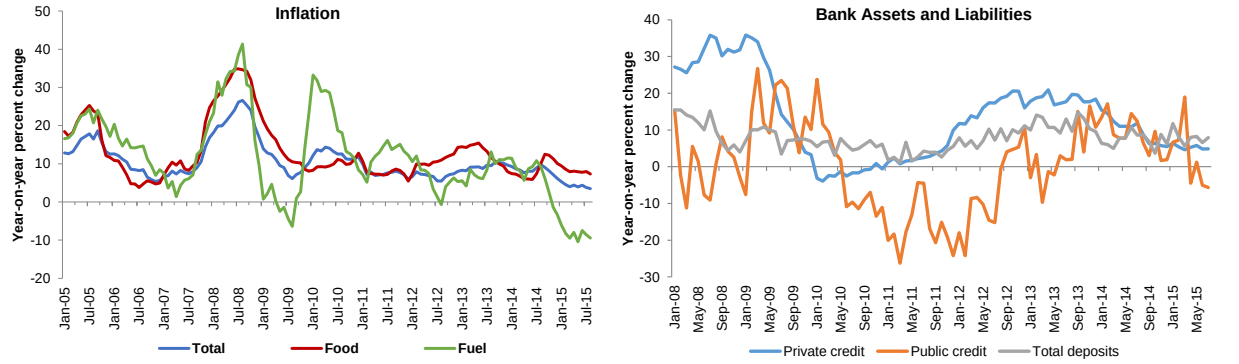
Inflation decreased faster than expected due to falling global oil prices. The overall inflation rate fell to 3.5 percent as of August 2015 (Figure 3) as international oil prices reached US$46 per barrel, their lowest monthly average since January. However, a 5.9 percent increase in food prices

over the last four months has slowed the decline of inflation. Meanwhile, prices for clothing and other basic consumer goods rose by 1.4 percent, also partially offsetting the decrease in fuel prices.

Low inflation and an improved external position have increased the scope for looser monetary policies, prompting the central bank to cut the policy rate by 25 basis points in April, and again in August, to 5.25 percent. These were the first adjustments to the policy rate since February 2013. During 2014 real credit grew by just 0.4 percent, and the policy rate was reduced in an effort to revitalize credit growth though the high lending-deposit interest rate spreads persist. Bank credit to the private sector is currently around 30 percent of GDP, well below the average of 51.9 percent among countries in Latin American and the Caribbean. Nevertheless, loans and advances to the private sector have continued to expand their share in commercial banks' asset portfolios, growing from 42.2 in January 2015 to 43 percent in July. Most consumer credit is in the form of car loans, but as lenders expand into other credit types over the medium term retail credit growth is expected to accelerate. Bank deposits growth has consistently exceeded private credit growth, reaching an average rate of 7.9 percent, year-on-year, over the last 12 months (Figure 3).

Financial sector reform has received a big boost with the completion of the process to transition retail repo contracts into a Trust-based framework. A key objective of financial sector reform was to reform the so-called retail repo market. A retail 'repo' is essentially a deposit-like product, typically secured by government debt. Unlike a traditional repo, however, the securities were not transferred to the client; they were instead maintained within the security dealer's accounts. The Trust-based framework creates a more transparent model with enhanced safeguards for clients. Two other key financial reforms include the enactment of the Banking Services Act (BSA, September 2015) and amendments to the Bank of Jamaica Act (November 2015). The BSA aims to harmonize prudential standards across deposit-taking institutions, strengthen the corrective action and sanctioning regime, and promote the operational independence of the BOJ's supervision function. Key elements of the BSA, such as the regime for financial holding companies and consolidated supervision are expected to be completed mid-2016. The amendments to the Bank of Jamaica Act will vest the central bank with additional responsibility for financial stability. These reforms are aimed at increased maneuverability and scope of action to the supervisory agencies in the run-up to and during a financial crisis. The authorities are also considering measures to improve access to credit as part of their Financial Inclusion Strategy, which is expected to be finalized by end-2015. The largely dormant domestic bond market appears to be reviving, as a few secondary trading transactions occur.

Figure 3. The inflation rate is declining, and foreign-exchange reserves are increasing.

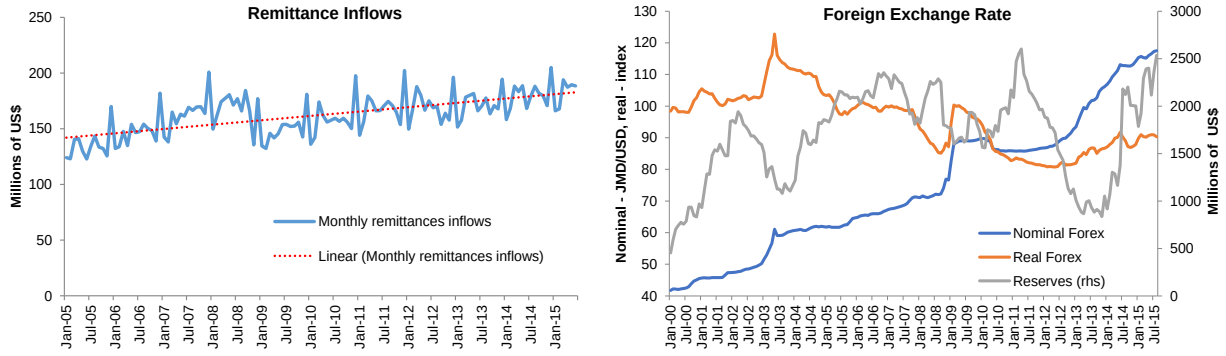


Source: Central Bank of Jamaica and World Bank Staff estimates.

Jamaica's current account deficit continues to narrow, reaching levels not seen for several years. The current account deficit shrank by over US$200 million in FY2014/15 to 7 percent of GDP. The dramatic decrease in global oil prices led to a nominal decline in fuel imports, which fell from US$2.2 billion in FY2013/14 to US$1.7 billion in FY2014/15. Meanwhile, the services balance improved by US$130 million, due primarily to a surge in tourism receipts. The number of long-stay visitors increased by 4.3 percent, year-on-year, between January and August 2015, and the number of short-stay visitors (including cruise ship passengers) rose by 22 percent over the same period. Remittance inflows grew by 4.1 percent, year-on-year, to a total of US$2,173 million in FY2014/15 (Figure 4).

The exchange rate stabilized at J$115 to US$1 between March and May 2015 before beginning to depreciate again. Overall, the exchange rate has depreciated by 20 percent since the government began its fiscal adjustment program in 2013. This has helped to bridge the current-account deficit and rebuild the government's foreign-exchange reserves. Net international reserves reached US$2.4 billion at end-September 2015, up from less than US$1 billion at the start of the government's program. This increase was also facilitated by external bond issues in 2014 and 2015 (Figure 4).

Figure 4. Remittances have steadily increased, while the exchange rate has depreciated.



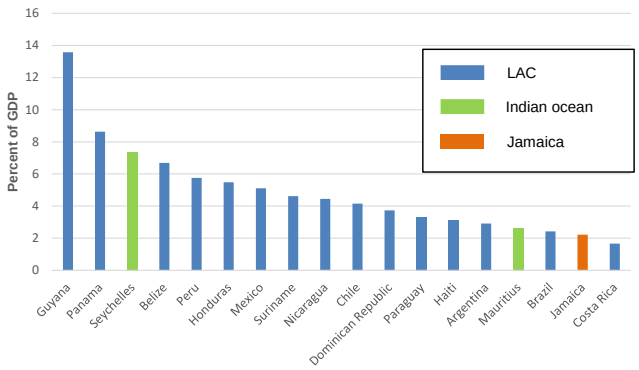
Source: Central Bank of Jamaica and World Bank Staff estimates.

B. Outlook

While the government has made important progress on the structural reform agenda, Jamaica will need to accelerate its growth in order to achieve lasting debt sustainability. Growth is expected to recover to 1.5 percent in FY2015/16 as the effects of the drought subside (Table 1). The service sector, especially tourism, will remain the principal driver of growth, though other services, such as business-process outsourcing, are showing signs of increased dynamism. The current account is expected to improve further as competitiveness gains boost exports while low oil prices contain the growth of imports. As falling debt-service payments expand the available fiscal space, a small programmed increase in capital investment should help facilitate growth. Jamaica's current level of capital investment is well below the average for high-growth comparator countries worldwide (Figure 5). To date, fiscal consolidation efforts have relied primarily on expenditure cuts, but as these reach their limit revenue-generating reforms will become critical to future fiscal sustainability. An increase in high return public investments could also support growth and enhance debt sustainability (see Section C).

Jamaica's medium-term outlook depends in large part on the continued implementation of its debt-deleveraging strategy, as well as further progress on structural reforms and greater infrastructure investment. The PetroCaribe debt buyback helped Jamaica reduce its total public debt by approximately 10 percent of GDP. However, large bond payments are due in FY2018/19, FY2019/20 and FY2020/21, with payments averaging US$1.5 billion equivalent each year (Figure 2). This debt, which is partly domestic and the product of past debt restructuring, will need to be rolled over, as insufficient fiscal space will be available to pay it off in full. Maintaining long-term debt sustainability will require a forward-looking debt strategy that spreads maturities evenly and avoids large concurrent debt repayments. The 2015 bond issues were well designed in that sense, as they will come due after 2025/26, during a relative lull in the repayment schedule. The revitalization of the domestic bond market will be important to the success of this strategy.

Figure 5. Average Capital Expenditures, 2012-2015 (residual estimates)



Source: World Bank staff calculations
Note: Capital expenditure estimates are calculated as residuals between General government total expenditure and General government expense, as defined by the Imf GFS Manual 2001.

While GDP growth is expected to recover over the near term, a number of factors, both domestic and global, could threaten Jamaica's macroeconomic outlook. The external environment presents upside as well as downside risks to the Jamaican economy. In the short term low international oil prices will continue to shrink Jamaica's current account deficit, though the bilateral PetroCaribe agreement will play a more limited role in budget financing, as its terms are directly tied to oil prices.[2]

In the medium term the continuing economic recovery in the United States will boost demand for Jamaican exports. The potential opening of the US-Cuba tourism market could have mixed effects on Jamaica's tourism industry. While it may divert some US tourists from Jamaica to Cuba, it is also likely to divert European tourists from Cuba to Jamaica and other Caribbean markets. A rising US Federal Reserve policy rate could divert capital from emerging-market paper, increasing Jamaica's premium on international debt markets. However, higher international interest rates would primarily increase financing costs in the short-run, with little impact on Jamaica's long-term financing costs. On the downside, the ongoing appreciation of the dollar would increase both the real cost of servicing outstanding Jamaican debt and the debt-to-GDP ratio.

Domestic risks include both policy challenges and exogenous factors. Though crucial to debt sustainability, the fiscal adjustment may have a more negative impact on growth than is currently anticipated. Steadily expanding capital spending, while focusing on projects with high economic returns and clear opportunities for complementary private investment, would help mitigate this risk. The potential continuation of the drought presents an important exogenous threat to short-term

[2] The volume and financing terms offered by the PetroCaribe agreement vary according to international oil prices. With prices between US$40 and US$50 per barrel, Jamaica can finance 30 percent of the volume of debt purchased. This share would rise to 50 percent if prices were between US$80 and US$100 per barrel. Moreover, if international oil prices were to fall below US$40 per barrel, interest rates would double to 2 percent and maturities would decrease from 25 years to 17.

growth. Finally, political pressures related to the upcoming Parliamentary elections could slow reform momentum.

Table 1. Key Macroeconomic Indicators [1]

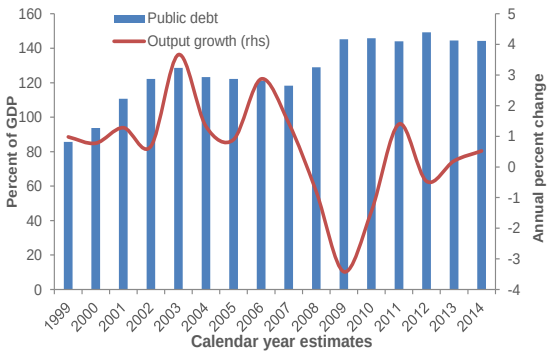
	FY2012/13	FY2013/14	FY2014/15	FY2015/16	FY2016/17	FY2017/18	FY2018/19	FY2019/20	FY2020/21
Real Economy				*Annual percentage changes, unless otherwise indicated*					
GDP (J$ billions)	1,337	1,463	1,563	1,656	1,803	1,977	2,168	2,366	2,576
Real GDP	-0.7	0.9	0.2	1.5	2.2	2.5	2.7	2.7	2.7
Imports of goods	-3.1	-7.2	-4.6	-5.5	1.6	5.5	4.4	3.6	3.0
Exports of goods	7.8	-12.3	-8.6	-4.0	3.0	5.7	5.7	5.6	5.0
Unemployment rate (eop)	14.4	13.4	14.2	...	...	...	...	...	...
CPI (average)	7.2	9.4	7.2	4.5	6.5	7.0	6.8	6.3	6.0
Fiscal Accounts				*Percentage of GDP*					
Budgetary revenue	25.8	27.1	26.3	27.7	27.4	26.9	26.2	26.1	26.1
Budgetary expenditure	29.9	27.0	26.8	27.8	27.3	26.8	25.6	25.2	24.8
Overall fiscal balance	-4.1	0.1	-0.5	-0.1	0.1	0.1	0.6	1.0	1.2
Public debt[2]	145.3	139.7	135.7	124.8	120.5	112.7	105.1	97.8	90.7
Selected Monetary Accounts				*in J$ billions, unless otherwise indicated*					
Base money (eop)	7.6	3.1	6.7	14.0	-0.7	11.0	12.1	12.5	17.6
Interest (key policy interest rate, eop)	5.75	5.75	5.75	...	...	...	...	...	...
Balance of Payments				*Percentage of GDP, unless otherwise indicated*					
Current account balance	-10.0	-8.3	-7.0	-3.7	-2.6	-2.7	-2.5	-2.1	-1.8
Imports of goods, f.o.b.	38.8	37.5	36.4	34.3	34.0	34.3	34.2	33.7	33.0
Exports of goods, f.o.b.	11.9	10.9	10.1	9.7	9.7	9.8	9.9	9.9	9.9
Direct investment (US$ million, net)	325	635	494	530	547	563	579	595	591
Gross reserves (weeks of imports of GNFS)	11.4	14.5	19.5	23.3	25.8	24.8	23.4	22.2	21.1
Net international reserves (US$ million)[3]	884	1,304	2,294	2,590	2,837	2,894	2,902	2,964	2,999
Exchange rate (average, J$/US$)	91.2	103.9	113.1	...	...	...	...	...	...
Other memo items:									
GDP nominal (US$ million)	14,661	14,081	13,820	...	...	...	...	...	...

Sources: IMF, Statistical Institute of Jamaica and Bank of Jamaica, and World Bank staff estimates.
1/ Fiscal years run from April 1 to March 31. Authorities' budgets presented according to IMF definitions.
2/ Central government direct and guaranteed only, including PetroCaribe debt (net of its financing to the central government) and projected IFIs disbursements.
3/ Excludes the part of gross reserves to address potential FSSF - related demand

C. In focus: Accelerating Growth to Achieve Debt Sustainability

Jamaica has grown slowly over the past two decades. Real GDP growth averaged just 1 percent per year between 1997 and 2007, and fell to an annual average of -0.6 percent since the global financial crisis. Between 1997 and 2007 Jamaica's poverty rate fell from 19.7 to 9.9 percent, but by 2012 the poverty rate had rebounded to 19.9 percent. Slow growth has also contributed to the country's high debt-to-GDP ratio, which peaked in 2012 (Figure 6). Moreover, a heavy debt burden has deterred private investment and perpetuated slow growth. In an effort to attract greater private investment the government has launched efforts to promote the growth of the tourism, logistics and energy sectors, which are identified as priorities in the Growth Agenda Policy Paper that was presented to Parliament in March 2015.

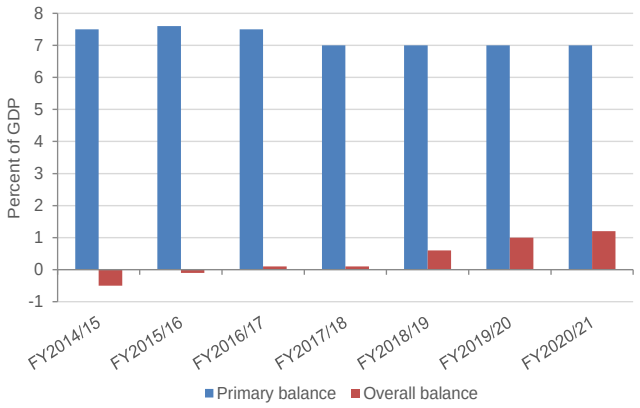
Figure 6. GDP has grown slowly, and debt has accumulated rapidly.



Sources: IMF WEO and World Bank staff estimates.

While the fiscal adjustment process and associated economic reforms have strengthened investor confidence recently, growth has not picked up. Thus far the adjustment program has been anchored by a large primary fiscal surplus, which since 2013 has averaged 7.5 percent of GDP, among the highest rates in the world. The primary surplus is projected to stay at or above 7 percent for at least the next 5 years (Figure 7). The international literature indicates that a well-managed fiscal consolidation can promote faster growth by bolstering private sector confidence and thereby spurring private investment (Gupta et al., 2002; Alesina, 1997). However, recent studies have shown that while expenditure-based fiscal adjustments are most likely to permanently reduce a country's debt-to-GDP ratio—a core objective of Jamaica's fiscal adjustment—they are also associated with lower short-term growth or even brief recessions (Alesina and Ardagna, 2012; Spilimbergo et al., 2009; Gechert and Will, 2012), as lower government spending has a negative impact on economic activity.

Figure 7. The overall balance is projected to improve as the reform process



Sources: IMF and World Bank estimates.

The Jamaican government is now faced with the difficult challenge of accelerating growth in the context of an expenditure-based fiscal adjustment. The government's current strategy prioritizes macro-fiscal stability and structural reforms, while also incentivizing private investment and pursuing public-private partnerships. This approach appears to have been successful in bolstering private sector confidence, though the strategy remains in its early stages. Due to its tight fiscal constraints the government is implementing a number of pro-growth initiatives that are financed almost exclusively through private investment, such as the privatization of the Kingston Container Terminal, the creation of a global logistics hub and the development of Special Economic Zones. While public expenditure is programmed to increase slightly from 1.8 to 2.8 percent of GDP between FY2015/16 and FY2020/21, it will remain well below the level where it could meaningfully impact growth. The need to maintain an extremely high primary fiscal surplus precludes investment above a certain threshold, limiting the authorities' ability to implement vital infrastructure projects that could increase the country's competitiveness and attract further private investment.

The critical importance of accelerating growth despite tight fiscal constraints underscores the need to maximize the efficiency of public investment. The impact of capital spending largely depends on the composition of the project portfolio. Recent studies indicate that portfolio composition, implementation capacity and the amount of economic slack all condition the efficacy of public investment (Brückner and Tuladhar, 2010; Ilzetzki et al., 2011; IMF, 2014). The composition of the investment portfolio is a key determinant; a recent IMF paper argues that "shifting the composition of spending toward infrastructure investment could add 0.25 percentage points" to the GDP growth rates, while increased "education and health spending are followed by higher growth in 20 to 40 percent of all identified cases" (IMF, 2015b). Public investment in infrastructure has had a direct effect on private sector productivity and technological progress in Chile (1970s and 1980s), Malaysia (late 1980s and 1990s), and Poland (early 2000s). Investments in health and education facilitated the adoption of new productivity technologies in Ireland (beginning in the late 1960s), and in Tanzania and Uganda (1990s and early 2000s). However, research highlights the crucial

importance of expenditure efficiency, as higher rate of public investment are likely to result in higher debt-to-GDP ratios in developing countries (IMF, 2014).

In this context, a programming exercise examining medium-term macroeconomic scenarios in Jamaica can offer insights into alternative strategies for public investment and their implications for debt sustainability. This exercise, which encompasses the national, external, fiscal, and monetary accounts, takes FY2015/16 as a base year and projects the evolution of key macroeconomic variables through FY2020/21. It applies programming assumptions to base-year data, which include the annual real GDP growth rate, the growth rate of public expenditures (excluding interest on public debt), the repayment rate for the current external debt stock, and other variables. Following a standard methodology, the exercise calculates the residual debt flows required to fill the financing gaps in each year's projected fiscal balance and balance of payments, and then tracks the resulting debt stocks. The objective is to determine whether it is possible to accelerate real GDP growth by increasing capital investment above what is currently envisioned in the government's strategy, while achieving a similar or even deeper reduction in the debt-GDP ratio.[3]

The baseline scenario reflects the government's current fiscal adjustment program, which targets a steady decline in the debt-to-GDP ratio to about 90 percent by FY2020/21. The programming assumptions are aligned with the policies set out in the government's "Fiscal Policy Paper 2015/16" and the IMF-supported program.[4] Under this scenario the annual real GDP growth rate would rise gradually from 1.4 percent in FY2015/16 to 2.7 percent in FY2020/21. Over the same period, tax revenue would remain constant at around 26.5 percent of GDP, budgetary expenditures would decline from 27.9 to 25 percent of GDP, and the central government's primary balance would remain above 7 percent of GDP. This would constitute an austere approach to budget management primarily focused on reducing the debt stock. The key indicator for such a strategy would be the debt-to-GDP ratio, which would fall from just under 122 percent of GDP at the end of FY2015/16 to 91.4 percent of GDP at the end of FY2020/21. The debt-to-GDP ratio would be reduced primarily through its numerator (debt) rather than its denominator (GDP), because the austerity required to maintain a large primary surplus would limit real GDP growth.

Alternatively, the government could leverage the success of its reforms over the past two years to create additional fiscal space for growth-enhancing investments; this strategy could also support a decline in the debt ratio, but this would be contingent on achieving higher growth rates. In an alternate scenario with higher rates of public investment, real GDP would expand more rapidly than in the baseline. In this scenario increased investment would translate into higher rates of gross fixed capital formation in both the public and private sectors. The annual real GDP growth rate would rise gradually from 1.4 percent in FY2015/16 to 4.5 percent in FY2020/21, well above the baseline projection of 2.7 percent. As a result, real GDP growth would average 2.9 percent over the projection period, up from 2.4 percent in the baseline. The fiscal accounts would remain broadly similar as a share of GDP. Increased public spending would be partially offset by higher revenues, slightly reducing the primary surplus to an average of 6.8 percent of GDP over the medium-term. Nevertheless, more rapid GDP growth would yield a larger reduction in the debt-to-GDP ratio. The total external and domestic debt stock would fall to 89.8 percent of GDP in FY2020/21, compared

[3] Malcolm and Schmid (2015) run similar scenario analyses with similar results, as a debt-decomposition analysis reveals that economic growth is not the main driver of the projected medium-term debt reduction. In addition, they quantify the beneficial impact of a higher growth trajectory on employment outcomes, indicating that if growth were 1 percentage point above the baseline, unemployment would reach 7.8 percent by 2020, well below the rate of 13.2 percent recorded in April 2015.

[4] While its baseline scenario assumptions are informed by the IMF's 9th Review of the EFF (IMF Country Report No. 15/270), the exercise is not meant to reproduce the IMF's macroeconomic projections.

with 91.4 percent in the baseline scenario. Meanwhile, per capita private consumption would grow by 2.7 percent per year over the projection period, up from 2.2 percent in the baseline. The poverty rate would decline to 16.6 percent in FY2020/21, compared with a baseline projection of 17.1 percent. These are relatively small differences, but they are uniformly positive.

This programming exercise suggests some promising policy options. The findings indicate that policymakers may be able to effect a reduction in the debt-to GDP ratio by carefully balancing the focus on fiscal contraction with higher public investments that can catalyze private investment to achieve higher growth. Ceteris paribus, reducing the debt-to-GDP ratio through higher growth offers a number of important advantages, especially in terms of its impact on poverty reduction and shared prosperity. After two years of successful macroeconomic stabilization and structural reforms, the authorities may wish to consider easing austerity measures to some extent in order to generate the necessary fiscal space for increased public investment, while continuing to enhance expenditure efficiency. A key challenge will be to ensure that the public investment program is well prioritized and managed, so that an expanded investment portfolio produces the desired economic impact.

Jamaica's ability to grow its way out of debt will depend on a number of factors. The country's current strategy of expenditure-side fiscal adjustment has yielded important benefits, restoring its ability to access commercial markets and mitigating macro-fiscal volatility. Nevertheless, the potential benefits of accelerated growth through increased investment are considerable. According to the government's own estimates the successful implementation of projects already identified in its March 2015 Growth Agenda Policy Paper could boost the GDP growth rate to over 3 percent in FY2016/17. If these investments were complemented by further structural reforms to improve the business climate and continued macroeconomic stability, they could help to create a virtuous cycle of growth and debt reduction. However, ensuring that increased public investment translates into accelerated growth will require the efficient selection and prioritization of public investments, access to financing on reasonable terms, and substantial project implementation capacity, as well as a supportive external economic environment.

Table 2. Sensitivity analysis of alternative growth and public investment scenarios

	Baseline Scenario			Alternative Scenario		
	FY2015/16	FY2016/17 -FY2020/21 (Average)	FY2020/21	FY2015/16	FY2016/17 -FY2020/21 (Average)	FY2020/21
National Accounts and Prices						
Real GDP growth (annual percent change)	1.4	2.4	2.7	1.4	2.9	4.5
Real GDP per capita growth (annual percent change)	1.1	2.1	2.4	1.1	2.7	4.2
Gross fixed capital formation (percent of GDP)	22.6	22.6	22.6	22.6	23.3	24.0
of which, central government (percent of GDP)	2.3	2.3	2.3	2.7	2.8	2.9
National Saving (percent of GDP)	19.0	19.7	20.6	19.0	20.1	20.8
CPI inflation (end-of-period, yoy percent change)	6.1	6.4	6.0	6.1	6.4	6.0
REER (yoy percent change)	1.6	0.2	0.0	1.6	0.2	0.0
Per-capita real non-government consumption (annual percent change)	...	2.2	3.3	...	2.7	5.5
Poverty incidence (percent)	19.7	18.1	17.1	19.7	18.1	16.6
External Accounts (percent of GDP)						
Current account balance	-3.9	-3.1	-2.3	-3.9	-3.5	-3.5
Exports of goods and non-factor services	31.8	30.2	28.6	31.8	30.0	27.7
Imports of goods and non-factor services	-49.3	-49.2	-49.1	-49.3	-49.4	-49.6
Reserves and related items	26.5	32.8	39.3	26.5	32.5	38.2
Fiscal Accounts (percent of GDP)						
Primary fiscal balance	7.1	7.2	7.3	6.7	6.8	7.1
Overall fiscal balance	-0.7	0.6	1.5	-1.2	0.1	1.3
Total revenue and grants	27.1	26.7	26.5	27.1	26.8	26.6
Total expenditure	27.9	26.2	25.0	28.3	26.6	25.3
of which, capital expenditure	2.6	2.6	2.6	3.0	3.1	3.2
Public Debt	121.4	105.6	91.4	121.9	106.1	89.8

Source: Beckerman, Paul, 2015; "Jamaica: Medium-Term Growth and the Reduction of the Public Debt-GDP Ratio".

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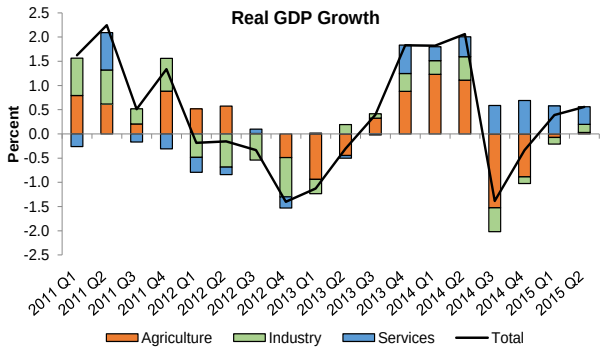
Annex I. Supporting Figures

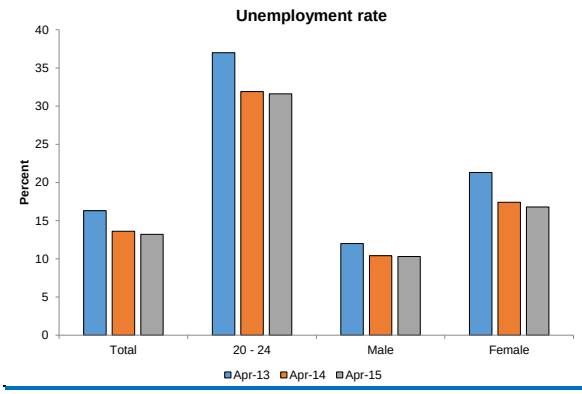
Economic Growth and Labor

Figure 8. GDP growth has recovered from the drought, but services remains the main growth driver…



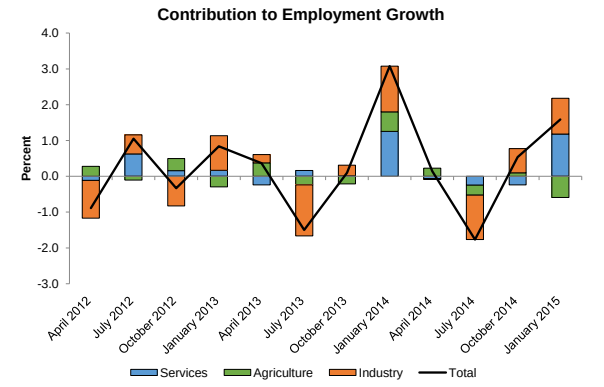
Source: Statin and PIOJ.

Figure 9. Unemployment edged down slightly, but male-female gap remains high …



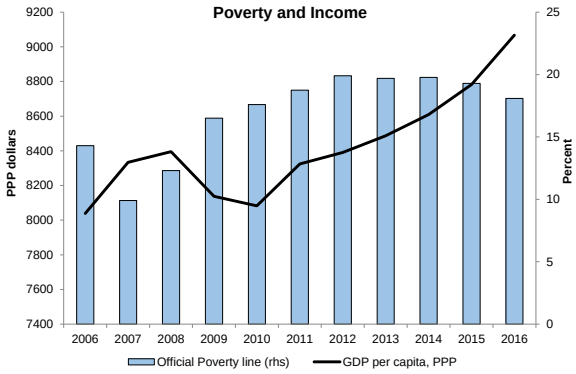
Source: Statin.

Figure 10. Services was the largest contributor to employment growth…



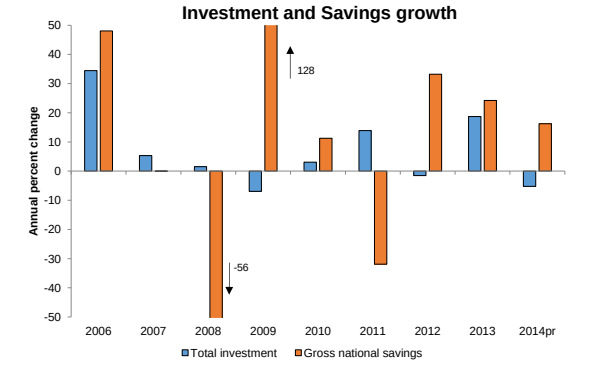
Source: Statin.

Figure 11. …and poverty is estimated to have begun to decrease as the program is implemented.



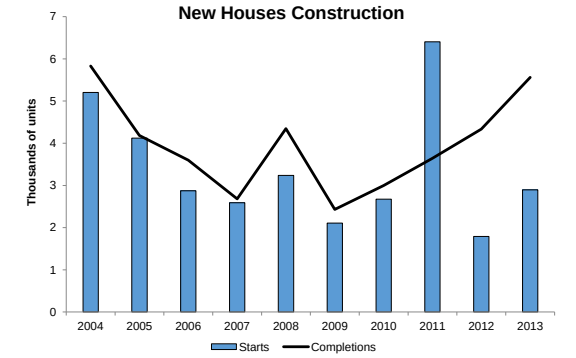
Source: Statin and World Bank estimates.

Figure 12. Savings have begun to recover yielding liquidity for new investments…



Source: IMF April 2015 WEO.

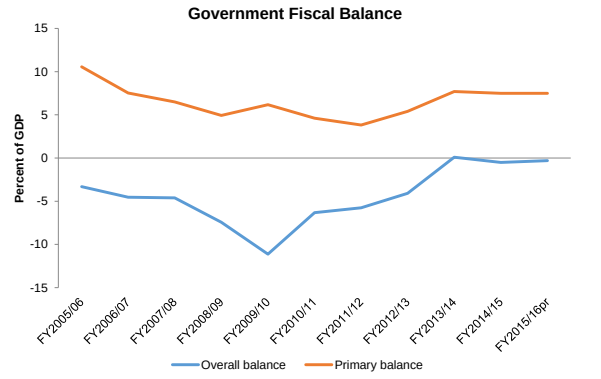
Figure 13. … while housing completion continues to increase.



Source: Statin.

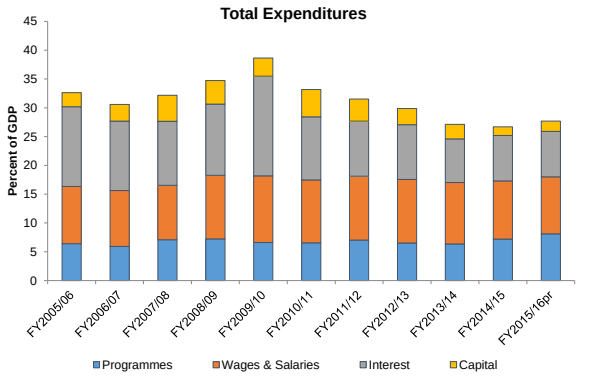
Fiscal Policy and Public Debt

Figure 14. The sustained 7.5% of GDP primary surplus is among the highest in the world…



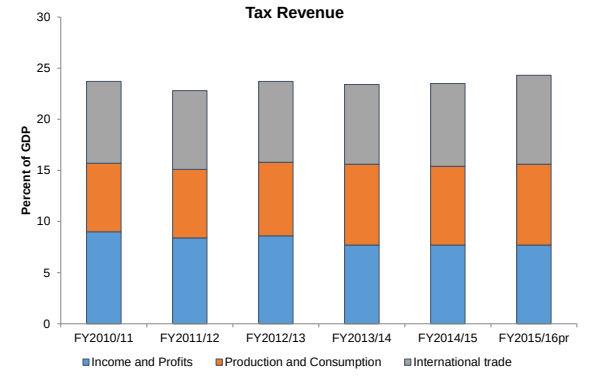
Source: Ministry of Finance and IMF.

Figure 15… with adjustments mainly coming from the expenditure side…



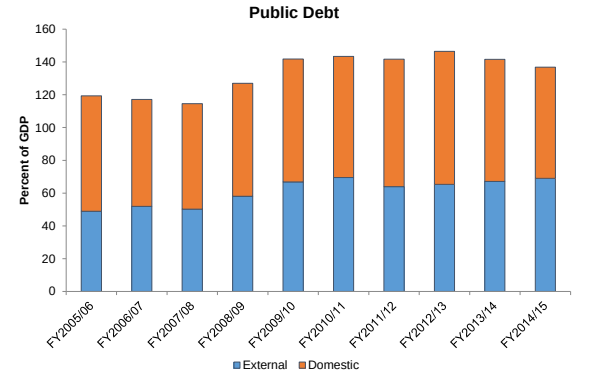
Source: Ministry of Finance and IMF.

Figure 16. … while the recent and upcoming reforms are expected to help increase revenues.



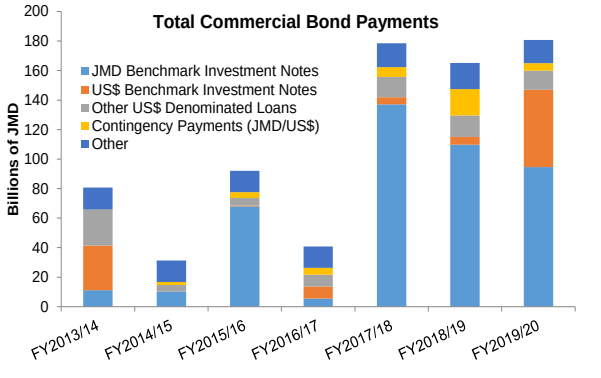
Source: Ministry of Finance and IMF.

Figure 17. Debt continues to be high, though it has begun to decrease as the program continues…



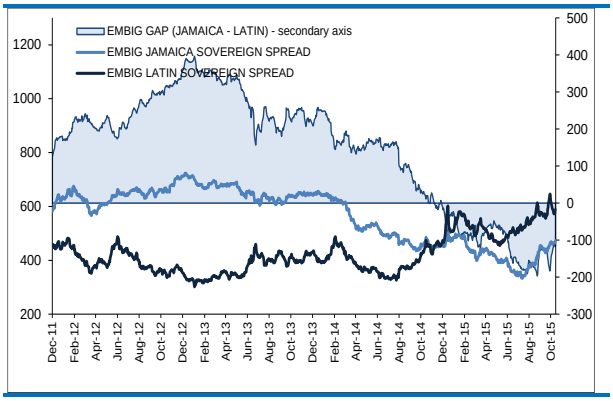
Source: Ministry of Finance and IMF.

Figure 18. The years after 2016 will be the most challenging, as large repayments are due…



Source: Bloomberg and World Bank staff calculations.

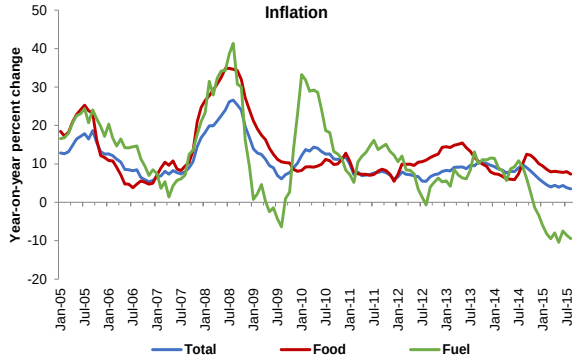
Figure 19. … however, risks have moved below regional averages since late-2014.



Source: Bloomberg.

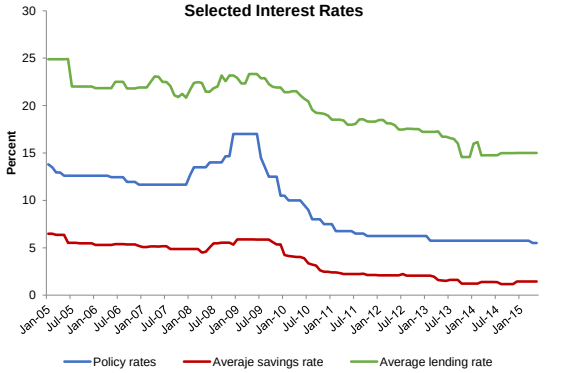
Monetary Policy and External Sector

Figure 20. Inflation has declined more than expected due to the fast decrease of fuel prices…



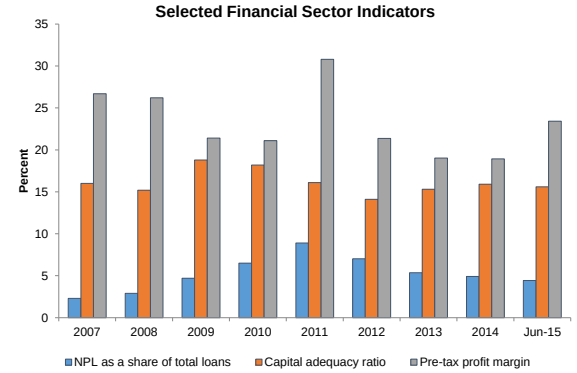
Source: Central Bank of Jamaica.

Figure 21. … allowing for looser monetary policy to recently take place.



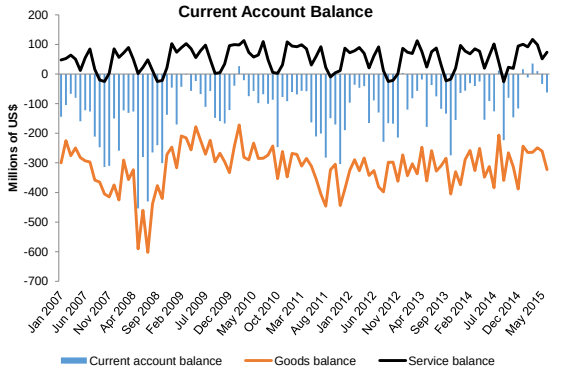
Source: Central Bank of Jamaica.

Figure 22. NPLs have reached their lowest ratio since 2011, suggesting an improving banking sector.



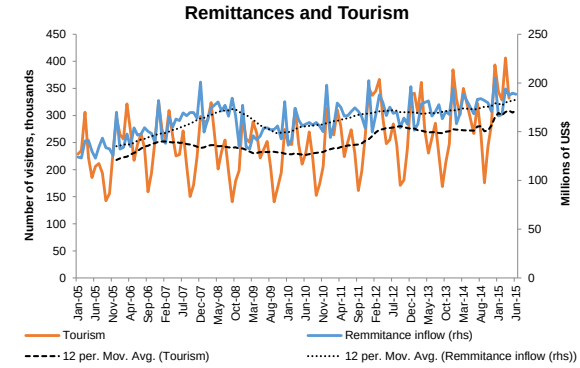
Source: Prudential indicators, Central Bank of Jamaica.

Figure 23. The current account deficit has shrunk, as the exchange rate devalues…



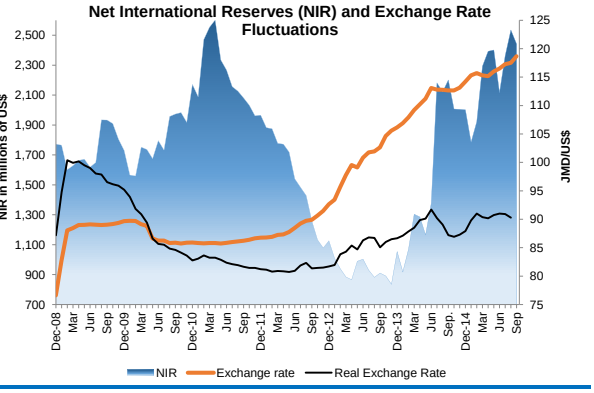
Source: Central Bank of Jamaica.

Figure 24. … and remittances and tourism remains stable.



Source: Central Bank of Jamaica.

Figure 25. In this context, International reserves have continued accumulating.



Source: Central Bank of Jamaica.

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