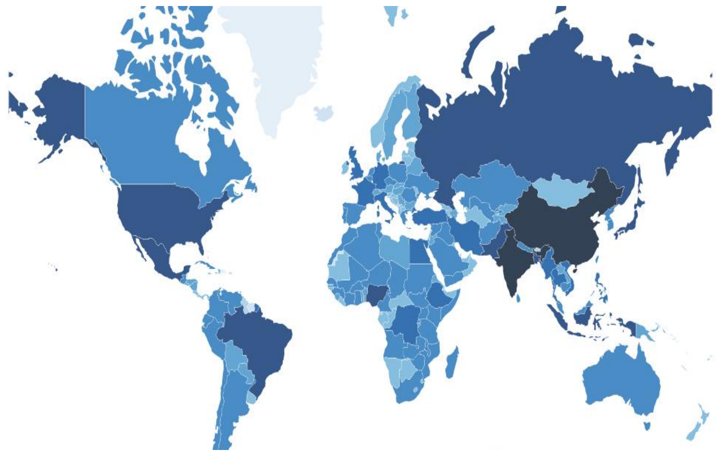
# Economic Outlook: Jamaica 2019

## *"Turning the corner… Rating Upgrade on the Horizon?"*

### Global Economy

2018 proved to be an eventful year with "risk-off[1]" sentiment the general theme within the global economy. Major stock indices, S&P 500 and the DOW both entered corrective territories[2], offering returns of -5.18% and -3.89%, respectively, while US Treasury yields fell to all-time lows. The Fed maintained its hawkish posture - delivering four (4) rate hikes which took the benchmark policy rate to 2.5%; and the Trump administration's "tit-for-tat" trade war with major trading partners created uncertainty and threatened global growth.

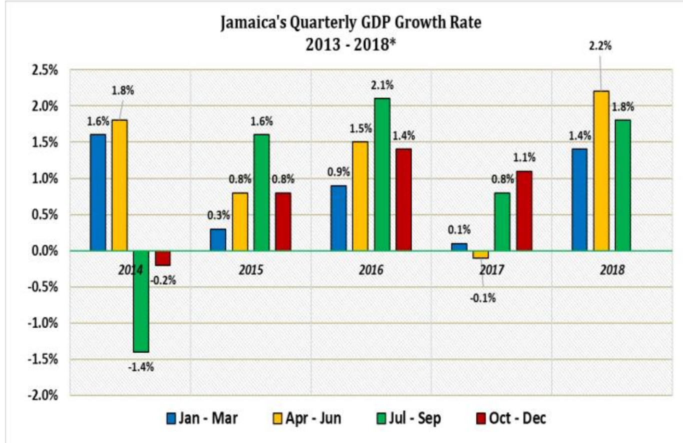


In the Eurozone, "BREXIT" negotiations remained at an impasse. As for Emerging Markets (EM), Latin America also had its woes as once again Argentina required an IMF[3] bailout. Closer to home, the Caribbean was not left unscathed as Barbados' debt burden materialized into a default on its domestic and international bonds. It was not all doom and gloom however as the finalization of the US, Mexico, Canada Agreement (formerly NAFTA) in November- on the brink of a deadline, was a beacon of hope for the future of North American regional trade. Additionally, although oil prices inched higher, they remained well below historical highs averaging around $65.06 per barrel[4], curtailing the import bill for oil dependent countries such as Jamaica.

In line with the October 2018 World Economic Outlook (WEO) forecast, global expansion for 2018 is estimated at as 3.7% and is believed to have peaked. January's (2019) WEO projects Global GDP growth to ease gradually at around 3.5% in 2019. The pullback in world growth reflects expectation of a spill-over of the negative effects of tariff increases by US and China during 2018; declining growth in advance economies together with a temporary decline in the growth rate for EM economies. Coupled with headwinds from trade tensions, monetary policies among major Central Banks are projected to become less accommodative over time- with the US Fed already charting the way. These conditions are expected to tighten financial conditions and could also take steam out of the global economy if exacerbated. Against this background, growth in advanced economies is projected at 2.0% in 2019 (2.3% in 2018) led by the US and Eurozone with 2.5% and 1.8%, respectively. Markets will look to EM economies for more aggressive expansion of about 4.5% (4.6% in 2018), with Latin America and Caribbean (LATAC) expected to register growth of 2.0%.

[1] shorthand for global market sentiment. When investors are optimistic about the outlook for the economy, or feel that markets are mispricing the outlook
[2] *A correction is generally defined as a 10 percent or greater decline in the price of a security from its most recent peak. Corrections can occur in individual stocks, indexes, commodities, currencies or any asset that is traded on an exchange.*
[3] *International Monetary Fund*
[4] *Source US Energy Information Administration*

## Gross Domestic Product (Real GDP)




Meaningful economic expansion continues to elude Jamaica. For the quarter ending September 30, 2018, real GDP grew by an estimated 1.8% relative to the corresponding third quarter in 2017 of 1.1%. Led by the construction and agricultural sectors, Jamaica's economy is estimated to have grown by 1.7% at the end of 2018. Increased output in Mining & Quarrying (+51.0%) and Construction (+3.7%) offset a 0.3% decline in the manufacturing industries, spurring growth in the Goods Producing Industries. Contributing factors were the reopening of Jiuquan Iron and Steel Company (JISCO) Alpart refinery and ongoing major road infrastructure projects in the Kingston Metropolitan Area.

The Goods Producing, and Services Industries grew by an estimated 5.1% and 0.7%, respectively. All components within the Services Industries recorded higher levels of output except for Electricity & Water Supply which declined by 0.1%, and the Producers of Government Services which remained unchanged. Increases in value added were recorded for: Wholesale & Retail Trade; Repairs; Installation of Machinery & Equipment (+0.8%), Hotels & Restaurants (+2.1%), Transport, Storage & Communication (+1.4%), Finance & Insurance Services (+0.7%), Real Estate, Renting & Business Activities (+0.5%) and Other Services (+1.2%).

Noticeably, growth in the Hotels & Restaurants industry was the highest among its peers and influenced by improved performances in hotels & other short-stay accommodation, restaurants, bars and canteens. The performance of hotels & other short-stay accommodation was impacted by the 3.8% increase in foreign national arrivals, reflected by increased Airbnb accommodations over the year. Concurrently, the tourism sector performed well, buoyed by a marginal 0.4% increase in total visit arrivals as at November 2018 to 3,830,909[5] with an annual estimated revenue of US$3.3Bn.

## Outlook

The BOJ has pointed to domestic demand, although improving, being less than robust to spark meaningful growth. Furthermore, there is additional downside risk to domestic growth from potentially weaker external demand from the US, signs of a weakening pace of expansion in private sector credit extended by deposit-taking institutions and oil prices remaining at current subdued levels. Notwithstanding the foregoing, tourism will continue to play a pivotal role to GDP growth.

The Tourism Ministry's '5x5x5' growth agenda, which aims to attract 5.0Mn tourists by 2021; generate US$5Bn in earnings; increase total direct jobs to 125,000 and add 15,000 hotel rooms bodes well for the sector. Furthermore, the privatization of the Norman Manley International Airport bodes well for increased business and leisure travels. Additionally, the small but growing Business Process Outsourcing (BPO) sector is expected to create an additional 11,000 jobs in 2019 and support

[5] *http://www.jtbonline.org/report-and-statistics/monthly-summary/*

economic activity. Over the near term, the economy is likely to continue to reflect some slack. In the medium term, growth prospects are heavily contingent on the continued expansion of construction and agriculture[6]. ***That said, GDP growth is projected at 1.9% in 2019, supported by the BOJ's accommodative monetary policy to stir domestic demand.***

## Fiscal Accounts

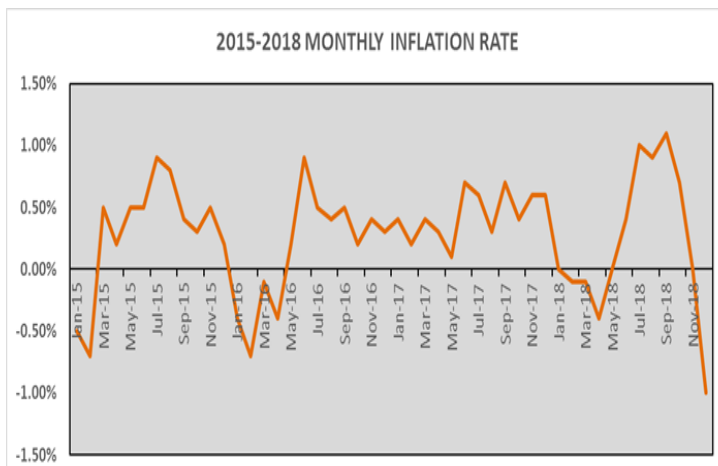
Despite no new taxes being implemented for the 2018/2019 fiscal year, Jamaica's fiscal accounts remained robust. Total revenues and grants for the fiscal period April to November 2018 stood at J$381.4Bn, 2.2% over the budgeted J$373.4Bn. This was driven by higher tax revenues (+3.3% above budget). Total expenditure was 1.5% below budget at J$380.1Bn. This translated to a fiscal surplus of J$1.27Bn compared to the budgeted deficit of J$12.5Bn. Additionally, primary surplus of J$83.1Bn, 16.9% more than the budgeted J$71.15Bn was recorded for the period. The performance places the government in good stead of achieving its estimated budget surplus of J$4.8Bn and primary balance of J$142.9Bn for the fiscal year ending March 31, 2019.

## Outlook

With the precautionary Stand by Agreement (SBA) with the IMF estimated to be completed at the end of this fiscal year, the GOJ is expected to continue practicing fiscal discipline and keep debt on its downward trajectory. With net redemptions[7] expected in 2019 (over J$50Bn) and the GOJ not indicating any intention to approach the international capital market; interest expenses will decrease throughout the year. It is anticipated that the GOJ will achieve its IMF primary surplus target of 7.0% resulting in debt-to-GDP falling below 100% in 2019.

## Inflation

Inflation softened to 2.4% in 2018, relative to 5.3% outturn in 2017. At 2.4%, this level of inflation falls below the Bank of Jamaica's (BOJ) 4.0-6.0% inflation target. BOJ credited this outturn to lower than anticipated oil prices on the international market along with increased supplies of agriculture produce, depressing prices further.




BOJ anticipates annual inflation to fall below the target at points during the March 2019 quarter and the latter half of the 2019/20FY. This outlook reflects current trends in international commodity prices, potential weakening in global demand and seasonal improvements in domestic agricultural food production. Given the BOJ's accommodative monetary policy which attempts to put upward pressure on inflation and GDP; w***e project that inflation will eventually range between 4.0% and 6.0% for 2019. Risks to the outlook reside in higher than expected oil prices along with a faster than expected depreciation in the local currency and adverse weather conditions.***

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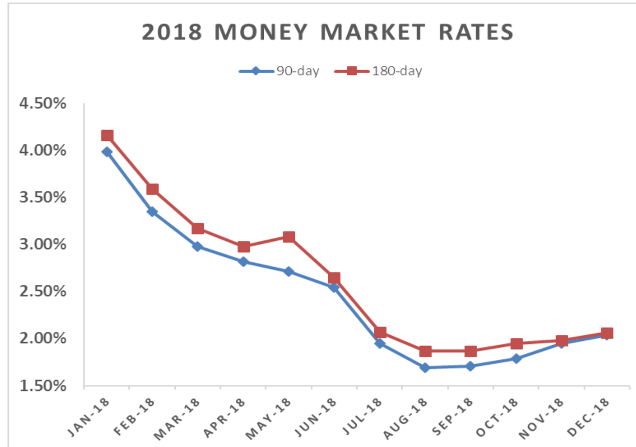
[6] *http://jamaica-gleaner.com/article/news/20190122/growth-jobs-get-involved-agriculture-holness-says-sector-can-grow-economy*
[7] *Debt payments exceeds debt issuances*

## Interest Rates

The BOJ maintained an accommodative policy throughout 2018 with the benchmark interest rate falling from 3.0% in January to 1.75% at the end of December. With inflation at 2.4% and GDP growth still sluggish, the low interest rate environment is expected to support economic activity and in turn, place inflation within BOJ's inflation 4%-6% target range.

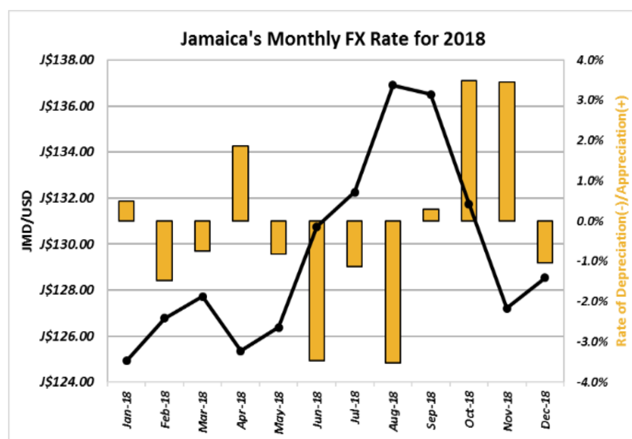



Lack of investment securities and increased J$ liquidity contributed to a downward trend in short term instruments. The yield on the Government of Jamaica Treasury Bill (T-Bill) also fell throughout the year on all tenors with December 90-day T-Bills being 2.04% (2017: 4.18%) and 180-day being 2.06% (2017: 4.63%).

Going forward, we anticipate that interest rates will remain low in the near term with limited potential upside given inflation hovering below the target range. ***We anticipate that the policy rate will remain low throughout the year. This would likely influence general market rates such as Treasury Bills to slightly remain at current levels over the next twelve months. At the same time, there is the possibility that if inflation continues to trend lower over the next three months, the BOJ could use the opportunity to reduce rates by another 25 basis points.***

## Foreign Exchange

As at the end of December 2018, Net International Reserves (NIR) stood at US$3.00Bn which was marginally lower than the US$3.21Bn recorded last year and below the projected US$3.22Bn for the fiscal year 2018/19. Notwithstanding, the figure remains healthy, representing 31.81 weeks in imports of goods and services and remains above the 12 weeks international benchmark.




The JMD/USD foreign exchange (FX) rate as at the end of 2018 stood at J$127.72, representing a 2.37% depreciation over 2017. The introduction of the BOJ's Foreign Exchange Intervention & Trading Tool (B-FXITT) helped to smooth excessive currency market volatility in the wake of increased market liquidity from the JAMAN 2018 maturities in July.

With Bank of Jamaica openly sharing and promoting its policy of being inflation focused, the expectation is that there will be more volatility. This driven by the Central Bank's focus on inflation and use of its B-FXITT system. The general expectation will be that the exchange rate movements will track the differential between local and US inflation rate.

Using the mid-point of 5% relative to the 2% target inflation in the US would suggest that the local currency will depreciate by 3% on average over the medium term. However, it could fall below that range if inflation continues to trend lower than projections as it has done for the last two months of 2018.

## Bonds

2018 was a dire time for global fixed income securities and the GOJ Global Bonds (JAMANS) were not immune. This given the market sentiments surrounding EM bonds and investors seeking less credit risk in higher rated sovereign bonds. Similar to other EM credits, JAMANs were impacted by US Federal Reserve (FED) hikes along with market volatility stemming from trade wars between the US and China. The US Fed Rate moved from 1.25%-1.75% in January to 2.25-2.5% in December. As such, despite outlook upgrades by credit ratings agencies and continued fiscal prudence by the GOJ, JAMANs generally offered lower returns to investors in 2018 in comparison to 2017. Investors earned an average risk-adjusted return of 3.695% in 2018 compared to 13.642% in 2017.

Shorter tenured bonds gave investors the highest returns given their lower sensitivity to interest rate increases. This same rationale justifies the lower return on the longer dated bonds on the curve as the US Federal Reserve maintained a hawkish stance for the majority of 2018.

| GOJ Bond Yield and Price Summary | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| GOJ GLOBAL BONDS | Coupon | Maturity | Offer Yield 29-Dec-17 | Offer Yield 31-Dec-18 | Offer Price 29-Dec-17 | Offer Price 31-Dec-18 | YOY Price Change ($) | YOY Price Change % | Total Return |
| JAMAN2019 | 8.000% | 24-Jun-19 | 2.470% | 2.870% | $ 103.63 | $ 102.50 | -$ 1.13 | -1.09% | 6.910% |
| JAMAN 2021 | 8.500% | 11-Nov-21 | 4.581% | 5.020% | $ 108.29 | $ 109.25 | $ 0.96 | 0.89% | 9.387% |
| JAMAN2022 | 11.625% | 15-Jan-22 | 3.570% | 3.820% | $ 128.68 | $ 122.27 | -$ 6.41 | -4.98% | 6.647% |
| JAMAN2025 | 7.625% | 09-Jul-25 | 4.250% | 5.210% | $ 119.68 | $ 113.21 | -$ 6.47 | -5.41% | 2.218% |
| JAMAN2025 | 9.250% | 17-Oct-25 | 4.390% | 5.350% | $ 131.76 | $ 122.00 | -$ 9.76 | -7.41% | 1.843% |
| JAMAN2028 | 6.750% | 28-Apr-28 | 4.920% | 5.670% | $ 114.40 | $ 107.70 | -$ 6.69 | -5.85% | 0.897% |
| JAMAN2036 | 8.500% | 28-Feb-36 | 6.030% | 6.630% | $ 127.16 | $ 119.00 | -$ 8.16 | -6.42% | 2.082% |
| JAMAN2039 | 8.000% | 15-Mar-39 | 6.000% | 6.580% | $ 123.47 | $ 115.75 | -$ 7.72 | -6.25% | 1.751% |
| JAMAN2045 | 7.875% | 29-Jul-45 | 5.150% | 6.650% | $ 122.97 | $ 115.15 | -$ 7.82 | -6.36% | 1.518% |

## Outlook

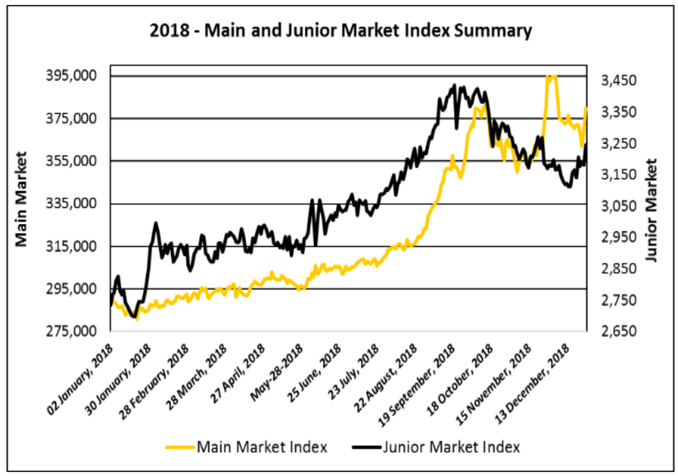
With the expected, but gradual, 1-2 rate hikes by the US Federal Reserve, we don't anticipate that there will be any significant bond price appreciation over the next twelve months. However, we expect less downside for JAMANs in 2019 compared to 2018 given Jamaica's improving fundamentals and the likelihood of a credit rating upgrade over the short to medium term. Furthermore, if the GOJ does not tap the international capital market, there will be no significant additions to Jamaica's debt profile, allowing for the debt-to-GDP metric to continue its downward trend. These conditions will further enhance JAMAN attractiveness, and investors should still be able to eke out positive returns from JAMAN bonds in 2019 from a total return perspective. Our base case scenario is for GOJ bond prices to continue being volatile but could be limited given that the bonds are tightly held by local investors.

## Local Bonds (JMD)

Lower interest rates and improved fiscal numbers were the main catalysts behind the improved trading activity in local JMD bonds. With the GOJ not very active in the market there has been a shortage of J$ securities to mop up excess J$ liquidity. With interest rates expected to remain around current levels, we anticipate that trading will continue to be moderate in these securities. The GOJ is expected to tap the market in the current year, at least to maintain some presence to gauge market sentiment and possibly contribute to maintaining the current rates. With new issuances projected during the calendar year up until April 2019 to finance medium-term needs, and the maturity of the JAMAN 2019, we expect an additional US$90Mn liquidity to enter the market but less than in 2017 (J$58Bn) when the JAMAN 2018 matured. The new issuances are expected to add variety to the investment pool for investors in terms of duration who will have additional J$ to invest.

## Equity Market

Following a tortoise start to 2018, the Main market picked up steam in the final quarter of the year, posting an annual return of 31.70% and closing the year at 379,790.86 points. The late run-up was mainly driven by heavyweights such as NFCBG[8] and KW[9] whose price surged 33.66% and 46.86%, respectively[10]. Merger and acquisition (M&A) activity helped to boost index during the in the latter part of the year with Barita shares jumping more than 500%. The Junior market also delivered an attractive 18.84% return closing at 3,246.81 points. Overall positive performance of the equities market was influenced by strong domestic liquidity conditions as well as continued positive earnings, macroeconomic developments, including low and stable inflation and a low interest rate environment.




Other companies that played their part in upward trajectory of the main market and the stability of the Junior Market include Salada Foods (SALF) and Barita Investments Limited (BIL), which saw price increases of 211.11% and 611.78%, respectively while CAC 2000 recorded a 160.31% price appreciation over the year.

## Outlook

The low interest rate environment remains attractive for firms to pursue debt restructuring which will strengthen their bottom-line by lowering interest cost. Furthermore, given the GOJ's reduced borrowing from the market and low market interest rates, investors continue to find equities as a source of attractive returns. Amid strong core earnings growth, Market price-earnings multiples continued to inch higher averaging 17.2x (compared to 15.2x a year earlier) suggesting that stock prices are approaching their fair values. That said, we believe we are moving towards the tail-end of the cycle and expect market returns to fall in the region of 10%-20% for 2019 driven by solid earnings in heavily weighted companies.

[8] *National Commercial Bank Financial Group*
[9] *Kingston Wharves*
[10]*Sept-Dec 2018*

However, expansion of listed securities should fuel the momentum of the stock market while from a total return perspective, strong earnings will support attractive dividends from dividend paying firms, which will add to capital price appreciation.

## Conclusion

The country is currently on a solid footing, and barring any catastrophe, is expected to continue along the same path. Business confidence is high, and the macroeconomic variables are the best in the country's history which bodes well for higher GDP growth. Furthermore, Debt-to-GDP is expected to fall below 100%, the first time in over a decade. This increases the likelihood of a credit upgrade in the near future. On the other hand, there are headwinds that will hinder GDP growth. The country faces the impact that US political policy could have on tourism and spending which is critical driver of GDP growth and geopolitical risk remains a cause for concern. OPEC's efforts to curb oil supply could push oil prices higher putting pressure on the country's external balance. Additionally, adverse weather conditions could derail economic stability.