

Speaking Notes
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Implications of the Jamaica Debt Exchange on Financial Institutions and Opportunities and Threats for the Private Sector

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INTRODUCTION

- It is a real pleasure to have the opportunity to address you this morning.
- It is a very important time for Jamaican Manufacturers, Jamaica's Private Sector in general, and in deed for all Jamaicans. In fact, one could say that we are all standing at a cross roads for our country. We all know the challenges and the hardships we have faced for many years, and we all know the impact it has had on our businesses and our personal lives.
- For much of the past 20 years, Jamaica's manufacturing sector has been in decline. To make matters worse, over the past 18 months the worlds' economies have suffered the worst recession in almost 100 years. Locally, unemployment has risen and consumer confidence has fallen while demand in all of our major export markets has contracted.

- However, I truly believe that Jamaica is today facing a unique opportunity to change the course of the economy and, in doing so, the fortunes of you, Jamaica's manufacturers. The combined financial support from the IMF, IDB and World Bank of more than US\$2 billion, almost 20% of GDP, is virtually unprecedented internationally. Add to that, the voluntary exchange of J\$700 billion of GOJ bonds to save the Government over J\$42 billion in interest, and it is clear that Jamaica has today an opportunity to change the direction of its economy that has not been seen for a very long time.
- All of this support, from the Multilateral financial institutions and from domestic investors and financial institutions, was contingent upon the Government's commitment to do what is necessary to return Jamaica to a path of growth. It is contingent upon the Government's Medium Term Economic Programme, which was agreed with the IMF

JAMAICA'S MEDIUM TERM ECONOMIC PLAN

- It is important to recognize the JDX and the US\$2.4 Bn of Multi-lateral financing support are not a solution to our problems; they are only an Opportunity for the Government to make the fiscal changes necessary to put Jamaica on a path to economic growth.
- Tax Reform : Too many Jamaicans do not pay their fair share of the tax burden. We've all heard the 'horror stories' and know of many examples;
 - Failure to file tax returns
 - Failure to properly declare goods at the port, thus avoiding import duties
 - Insistence on payments in cash to avoid the need to report

- We need to broaden the tax base through Consumption Tax (GCT) while improving the tax assessment and collection infrastructure to reduce 'leakage' through income and other taxes.
- Fiscal Discipline : We need to reduce the size of government and reduce expenses hitting the fiscal accounts while directing more funding to long-term capacity building investments; infrastructure, education, healthcare, security.
 - Dispose of non-essential Gov't assets and businesses to provide increased funding for essential services
 - Look at efficiencies across the Gov't and 'right size' the civil service to efficiently provide good customer service in essential services
 - Eliminate duplication across ministries, state agencies and publicly owned companies
 - Increase user fees as needed to eliminate subsidies to more public companies
- Fiscal Transparency : We need to avoid surprises and unexpected expenses by increasing transparency.
 - Bring all public sector agencies, companies, joint ventures to Parliament so that all can see the finances
 - Regular review by Parliament of all Gov't and public sector accounts
 - Fiscal Responsibility Legislation
- The challenge over the next 3 – 5 years will be for the Gov't and the people of Jamaica to stick to the Medium Term Economic Programme ... the path to economic growth, and to avoid the temptation to spend now and pay later. This will be especially challenging in a weak economy that is still susceptible to external shocks such as oil prices and severe weather.

IMPACT OF THE JDX ON FINANCIAL INSTITUTIONS

- It is important to note that the exact impact of the JDX and the other elements of the Medium Term Economic Programme on any particular financial institution will depend upon the exact nature of the institution's business and their balance sheet.
- The obvious impact of the JDX will be to reduce significantly interest earned on GOJ securities. Local bond holders will see a reduction in interest received of \$42 billion per annum, or approximately 3.9% of GDP. These bond holders include;
 - Banks, broker dealers, building societies will see a reduction in interest income
 - Life insurance and General insurance companies (lower investment yields means pressure for higher insurance premiums)
 - Pension funds (lower yields means increase actuarial liabilities and pressure to increase pension contributions to meet defined benefit obligations)
 - Individual investors (lower yields means less income in an economy that is already weak)
- With increased tenor of bonds and lower coupon rates, all investors will face reduced liquidity. The extent to which this will be a problem will depend upon the nature of the investor/institution's liabilities and the percentage of the investor/institution's funds that are invested in GOJ assets captured under the JDX.
 - Banks typically maintain greater liquidity (BOJ mandated) and have a lower percentage of their balance sheet invested in securities, so the impact on their liquidity is less.
 - Broker/dealers typically have a higher percentage of their balance sheet in GOJ assets and maintain lower liquidity levels, so their impact is greater.

- Individual investors; it will depend upon their cash flow needs.
- Under the Medium Term Economic Programme the Government has committed to further development of the unit trust and mutual fund markets. This will reduce the interest earnings of broker dealers, but will pass along greater returns to the Investor and reduce the liquidity risk of the sector. So, Investors will start seeing more unit trusts and other securities available.
- For commercial banks in particular, the reduction in interest earned will force a greater emphasis on;
 - Managing Interest Margins; ie. reduction in Liability & deposit rates
 - More focus on business lines that generate Non-Interest Revenue; ie. Cash Management, Merchant Services, Investment Sales, Foreign Exchange, Investment Management, etc.
 - Aggressive push for Operating Efficiencies; ie. centralization, investment in technology, outsourcing, etc.
 - Aggressive push to grow Private Sector business

IMPACT OF THE MEDIUM TERM ECONOMIC PROGRAMME ON THE PRIVATE SECTOR

- The most obvious impact of the JDX in particular will be the reduction of interest rates to both borrowers and investors over the short term. This process has already started and so long as market rates remain stable will continue over the coming months.

- While reduced borrowing costs will increase net income, all things equal, the most important impact of reduced rates will be the positive impact it will have on capital investment and expansion decisions. The project which didn't make economic sense yesterday is more likely to make sense today. Hopefully (for the economy) this will result in more projects started that will expand Jamaica's exports, reduce imports and create employment. In theory, this will help grow the economy, increase consumer confidence and increase consumer demand for your products and services.
- As the Government stops 'crowding out' Private Sector borrowing, and as Banks compete more aggressively for Private Sector business, it should become easier for you to access financing. This will not happen overnight, but Banks will be motivated to invest more in training of Business Bankers and improve the efficiency of the credit granting systems.
- If the Medium Term Economic Programme is successful and interest rates continue reducing, alternate financing opportunities will develop. Longer term investors will look for ways to diversify their portfolios and maximize yields, and will be prepared to look at longer term corporate bonds. Investors will return to the stock markets, and the economics of accessing capital via public equity will increase.
- However, it is important to remember that there is still risk that the Medium Term Economic Plan will not be successful. It is too early to determine if we will, in fact, see all of the benefits expected. The risks to a successful Programme are;
 - Government's sustained commitment to pursue the Programme and achieve the reduction to Jamaica's fiscal deficit over the coming 3 years.
 - External shocks such as a significant increase in Oil Prices, or a major Hurricane, or something to significantly impact our Tourism Industry.

- A rapid or excessive devaluation of the J\$ will put upward pressure on interest rates. As an Investor, if I find that the J\$ has declined by 15% and I can earn 3 or 4% in US\$, why would I accept only 12% return on my J\$s?
- A decline in confidence of the average Jamaican Investor. If I have no confidence that the Medium Term Economic Programme will succeed and expect the economy to continue to decline I will want to move my money outside of Jamaica. This in turn puts pressure on the J\$ and results in higher interest rates.

WHAT CAN WE ALL DO TO ENSURE SUCCESS?

- In order to maximize the likelihood of success, we all need to work together;
 - We, the Banks, must continue to reduce borrowing rates as market rates stabilize over the coming months.
 - We must continue to invest in our SME and Commercial Banking platforms in terms of people and technology.
 - We all must work to improve financial transparency through support for the proposed Credit Bureau legislation and investment in financial accounting systems across the Private Sector.
 - We must support confidence and stability in the forex and financial markets
 - We must support the Government and encourage them to maintain their focus on the Medium Term Economic Programme.

THE IMPORTANCE OF LEADERSHIP

- I truly believe that we, collectively, have the ability to be successful. However, if we are to have any success seizing the Opportunities coming out of the Economic Crisis, if we are to succeed in achieving the Medium Term Economic Programme; if we are to see a rebound in Jamaica's Productive Sector, we must first look inward and ask whether we have what it takes to lead Jamaica where we know we have to go.

- I remember once, early in my career when I was facing a serious challenge in meeting the targets the organization had set. When a senior executive of the company was visiting I took the opportunity to point out the challenges and 'lay the groundwork' in case I did not meet my targets. After listening to me for some time, he asked; "If I were to search across North America for the very best people in this industry, do you think I could find someone that could meet these targets in spite of the challenges? Well, if you honestly believe that you are as good as you tell me you are, then you will find a way to achieve your targets. If, on the other hand you do not believe that you are amongst the best people in the industry you should let me know now, and I will find someone who is."

- Those of us in this room; you and I, we are the leaders of Jamaica. I honestly believe that there is a path for Jamaica to achieve its potential, to be a truly competitive nation in the global market. If there truly is a path, then I refuse to believe that we; you and I in this room, are not good enough leaders to get us there.

- However, leadership is not standing up and pointing fingers at others about what they are not doing. Leadership is about;
 - recognizing Jamaica's potential in the world,
 - recognizing what we can do to impact that vision and believing in our ability to do so,
 - inspiring others to see their own strengths and do what they can to achieve the vision,

- and most importantly, to hold ourselves accountable for doing what is in within our control to achieve the vision.

- There is no question that Jamaica is today facing a serious economic crisis. There is also no question that there are a lot of things beyond our control that will impact our success. However, you and I, as leaders in Jamaica, have it within us to seize the Opportunities now facing us and lead Jamaica to a better place. It will not be easy; nothing truly worthwhile is, but if we believe in ourselves and are prepared to hold ourselves accountable as leaders, I know that we can together see Jamaica truly realize its Potential.

- Thank you and God Bless you All.