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**JAMAICA**

**May 31, 2016**

## **POLICY LETTER**

Mr. Luis Alberto Moreno  
President  
Inter-American Development Bank  
1300 New York Avenue, N. W.  
Washington, D.C. 205771  
United States of America

Dear President Moreno,

### **Re: Financial System Reform Support Programme (JA-L1058)**

The Government of Jamaica (GOJ) is presently undertaking a broad set of structural reforms aimed at enhancing economic growth by improving the legislative and regulatory framework governing the effectiveness of the financial sector on the economy. In this regard, the GOJ is in the process of implementing specific policy actions to ensure the proper and efficient functioning of the financial system and consequently, the promotion of real economic activity and growth. Notably, Jamaica has identified four (4) main areas of priority which are being pursued in order to further the contribution of the financial sector in Jamaica. These priorities include (i) a sound predictable macroeconomic framework that encourages low inflation, a stable exchange rate and competitive interest rates; (ii) a strong and stable financial system; (iii) a framework inducing financial inclusion and financing for Micro, Small and Medium Enterprises (MSME); and (iv) an adequate legal, institutional and regulatory framework for the business and financial climate.

In order to ensure that this package of reforms will be sustainable over the long run, the Inter-American Development Bank (IDB) is being requested to provide financing through a programmatic loan for the "Financial System Reform Support Programme", together with technical assistance during execution. Once the agreed indicative targets under the Policy Matrix for the aforementioned Programme have been achieved, the GOJ intends to apply for a

second programmatic loan from the Bank to support additional activities under the second phase of the programme. This Policy Letter therefore outlines the Government's commitment to the reformation of the framework for the strengthening of the financial sector and demonstrates the consistency of the programme with the national priorities. This Letter will also indicate the overall measures that will be taken during the programme.

## I. Background

Jamaica is committed to the promotion of a strong and sustained economic growth trajectory facilitating an enabling environment for financial stability and strengthening the pillars of the financial sector to promote economic growth. In spite of favourable conditions for high levels of growth including the country's natural resources, the strategic geographic position, a well-educated labour force, as well as high levels of investment over the last decade, the country has experienced persistently low levels of growth for approximately thirty (30) years. Since acceleration of growth is largely dependent on private sector development supported by a sound and stable financial framework with an appropriate financial and business environment, the GOJ is currently implementing a series of measures aimed at strengthening the financial sector in Jamaica.

### Macroeconomic Framework

Jamaica's real Gross Domestic Product (GDP) has increased at an average of 1 percent per annum over the last 30 years. Natural disasters and financial shocks coupled with insufficient fiscal restraint, resulted in persistent public deficits financed through significant public sector borrowings. Since entering an IMF Extended Fund Facility (EFF)<sup>1</sup> in 2013, Jamaica's economic indicators have been recovering, with an estimated increase in Gross Domestic Product (GDP) of 0.9 percent for FY 2015/16. The stabilization has been reinforced by a series of policy reform programmes,<sup>2</sup> in the areas of competitiveness enhancement; fiscal modernization, public finance and the financial sector. The rate of inflation has been trending down and declined to a historic low of 3.0% for FY 2015/16 in the context of falling world oil prices, which tempered the impact of higher prices for agricultural commodities as a result of the negative effects of

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<sup>1</sup> On May 1, 2013 a four-year Extended Fund Facility (EFF) arrangement for Jamaica was approved to support a comprehensive economic reform agenda. The EFF arrangement amounted to SDR 615.38 million (about US\$932.3 million at the time of approval), the equivalent of 225 percent of Jamaica's quota in the IMF. The financing arrangement formed a critical part of a total funding package of US\$2 billion from Jamaica's multilateral partners including the World Bank and the Inter-American Development Bank, with each having preliminarily agreed to allocate US\$510 million over the following four years. The main objective of the program was to decrease public debt and thereby create a virtuous cycle of debt sustainability and higher economic growth. The authorities' multi-layered reform agenda comprised fiscal consolidation, improvement in competitiveness, debt reduction, and improved social protection programs. According to the "Tenth Review under the Arrangement under the EFF" carried out by the IMF in December 2015, program performance was on track and structural reforms had progressed broadly on schedule.

<sup>2</sup> The Inter-American Development Bank supported a variety of these reforms through different programs, including the "Competitiveness Enhancement Program" II and III (JA-L1010 and JA-L1014, respectively), the "Fiscal Consolidation Program" I and II (JA-L1032 and JA-L1034), and the "Fiscal Structural Program for Economic Growth" (JA-L1038).

drought conditions. The current account of the balance of payments deficit has more than halved from 13.5 percent of GDP in FY 2011/12 to 7.1 percent of GDP in FY 2014/15 and is estimated to have improved to the sustainable level of 2.2% of GDP for FY 2015/16. Since the beginning of 2015, the Bank of Jamaica (BOJ) has reduced interest rates on its benchmark 30-day Certificate of Deposits by 50 basis points. The BOJ has also narrowed the interest rate spread between its deposit and its lending facilities by 200 basis points over that period and transitioned to auctioning its 14-day repo facility. International Capital Markets (ICMs) and credit rating agencies have endorsed the economic programme being implemented in Jamaica. The upgrade of Jamaica's ratings by Standard & Poor's (S&P) and Moody's in June 2015 and the raising of US\$2 billion on the ICM in July 2015 at record low coupons are positive indicators of return of confidence in the Jamaican economy. These indicators are further supported by Jamaica's improved ranking in the World Bank Doing Business Report 2016 which moved from 71 to 64 out of 189 countries. Going forward, it is projected that a reduction in public sector wages and salaries will create fiscal space for more programmes and capital expenditure. Similarly, a decline in interest payments from close to 10 percent of GDP in FY 2011/12 will support debt reduction. Despite the implemented reforms, the level of economic growth in Jamaica remains low. Fostering an environment supportive of macroeconomic stability and sustained economic growth therefore remains a major priority for Jamaica in order to improve its developmental outcomes and to complement the aforementioned macroeconomic adjustments. In that regard, the Fiscal Policy Paper for FY 2016/17 tabled in the House of Representatives on April 14, 2016, has highlighted the GOJ's priority objectives through the medium term of growing the economy and creating meaningful jobs and in so doing facilitate a faster and sustainable reduction of the public debt. These objectives will be underpinned by efficient expenditure management, robust and progressive tax reform, comprehensive pension reform, public sector transformation and reduction in corruption and waste. The GOJ is confident that these efforts will ensure a more stable macroenvironment, a sustainable debt trajectory and an improved business climate that will attract new investments.

### **Relevance of the Strengthening of the Financial Regulatory System for Promoting Growth in Jamaica**

The financial system has a critical role in promoting economic growth in Jamaica. In recognition of this role, several efforts to improve the respective financial soundness indicators have been undertaken while increasing the depth of financial intermediation in Jamaica, as measured by: (i) total financial institution assets as a share of GDP (the ratio increased by 6.2 percentage points to 191.1 percent between 2014 and 2015); (ii) the performance of deposit taking institutions (DTIs); and (iii) improving solvency levels particularly in insurance companies. However, the ratio of credit to the private sector calculated as a percentage of GDP has

remained low (30 percent) and more than 40 percent of Jamaican firms identify access to financing as a major constraint compared to the average 31 percent in Latin American Countries (LACs). In order to enhance the contribution of the financial sector to long term growth, the GOJ has already embarked on an ambitious financial reform agenda to address weaknesses in the following three main areas: (a) strengthening financial stability; (b) enhancing financial inclusion; and (c) improving the financial and business legal framework.

## **II. Structural Policy Reform Components Associated with the Programme**

### **a. Strengthening Financial Stability**

The GOJ is taking steps toward an efficient and secure functioning of the financial system, by i) strengthening of the financial system's regulation and supervision including the enhancement of the regulatory and supervision capacities of the financial deposit taking institutions (FDTI) and strengthening the regulatory framework for Credit Unions; ii) strengthening of the regulatory and supervisory framework of the securities, pension and insurance sector by enhancing the regulatory framework for the retail repo market, improving investor security, improving the protection of the private pension plan members and improving supervision and protection of insurance policy holders; iii) strengthening financial transparency by improving financial transparency regulation and supervision and iv) strengthening the financial crisis management system.

### **b. Enhancing Financial Inclusion of Firms and Individuals**

In order to enhance financial inclusion and reach the individuals who are not a part of the formal banking sector, the GOJ is currently undertaking a comprehensive series of reforms aimed at: i) strengthening the institutional and policy framework for financial inclusion; ii) improving the consumer protection framework, and iii) improving the access to financing for MSMEs and for the rural and agricultural sector.

### **c. Financial and Business Climate Reforms**

In addition, the Government is taking steps towards improving business climate reforms conducive to the expansion of growth of the economy. In this regard, the GOJ is seeking to provide the mechanisms to: i) strengthen the long term financing regulation and instruments including a modernized and agile Public Private Partnership (PPP) framework and the establishment of alternative financing mechanisms (venture capital, angel financing and innovation grants); ii) improve the legal rights of creditors and contract enforcement, including improved usage of the Secured Interest in Personal Property (SIPPA), enhancement of creditor's legal rights by implementing the Insolvency Act and expediting conflict resolution for commercial disputes; and iii) reduce the time and cost of doing business by reducing the time

and cost of obtaining a construction permit and reducing the time and cost of registering a business.

The GOJ has targeted economic growth as its highest priority while holding firm to the path of fiscal prudence, debt reduction and macroeconomic stability and reiterates its commitment to the Programme as presented and welcomes the technical and financial support of the Bank through this operation and the anticipated subsequent operation as part of the programmatic loan series.

Yours sincerely,



Audley Shaw, CD, MP  
Minister of Finance and the Public Service  
Jamaica

