DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

JAMAICA

LIQUIDITY PROGRAM FOR GROWTH SUSTAINABILITY

(JA-L1023)

LOAN PROPOSAL

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ANNEXES	
ANNEX I:	Results Framework

ELECTRONIC LINKS

REQUIRED

1. POA
   Does not apply (see ¶3.8).

2. Execution, Monitoring & Evaluation Arrangements
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1793206

3. Safeguard Policy Filter Report
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1785769

4. ESMR
   Does not apply (see ¶2.3 to 2.5)

5. Procurement Plan
   Does not apply (see ¶3.8)

OPTIONAL

6. Updated Debt Sustainability Analysis
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1793637

7. Analysis of the Jamaican Financial System and the impacts of the international financial crisis
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1793215

8. Credit Rules and Regulations
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1786142

9. Resources and Timeline for Project Preparation
   http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=1783848

ABBREVIATIONS

AFI	Approved Financial Institution
BOJ	Bank of Jamaica
CRR	Credit Rules and Regulations
DSA	Debt Sustainability Analysis
DBJ	Development Bank of Jamaica
ESMR	Environmental and Social Management Report
GOJ	Government of Jamaica
IDB	Inter-American Development Bank
POD	Proposal for Operation Development
RCL	Revolving Lines of Credit

PROJECT SUMMARY

JAMAICA

LIQUIDITY PROGRAM FOR GROWTH SUSTAINABILITY (JA-L1023)

Financial Terms and Conditions			
Borrower: Government of Jamaica		**Amortization Period**:	5 years
		Grace Period:	3 years
Executing Agency: Development Bank of Jamaica (DBJ)		**Disbursement Period**:	12 months
Source	**Amount**		
IDB (OC)	300 million	**Front End Fee**:	1%
Other/Cofinancing	n/a		
Local	n/a	**Interest Rate**:	6mo LIBOR + 4%
Total	300 million	**Credit Fee**:	0.75%
		Currency:	USD

Project at a Glance

Project Objective/Description:

Objectives. The general objective of the Program is to contribute to the sustainable growth of the country. The specific objective of the operation is to provide liquidity to maintain credit flows to the real economy, partially compensating, on a temporary basis, shortfalls in the normal credit flows to the country caused by the worldwide financial crisis. Program funds should assist in retaining national levels of production in the country, thereby protecting employment from a temporary external shock and at the same time reinforcing macro-economic soundness of the country (¶1.26).

Special contractual clauses:

1. A contract between the Government of Jamaica and the Development Bank of Jamaica will have to be in force on terms approved by the Bank as a pre-condition for first disbursement (¶3.5).
2. Credit Rules and Regulations (CRR) will have to be in force in the terms approved by the Bank as pre-condition for first disbursement (¶3.6).

Special aspects:

1. The disbursement period will be 12 months from the date of the signature of the loan. This period will be automatically extended to 18 months if 50% of the proceeds of the financing have been disbursed during the first 12 months of execution (¶3.7)
2. The Program will have a revolving fund (RF) of 10% (¶3.9).

Retroactive financing will be granted from November 26, 2008 up to 25% of the Loan amount (¶3.10).

3. Other special aspects: (i) Environmental management mechanism (¶2.4, 2.5); (ii) Eligible financial intermediaries (¶3.6a); (iii) Structure of the credits to the financial intermediaries (¶3.6b); (iv) Fund's allocation mechanism (¶3.6c); (v) Risk management of the program (¶3.6d); (vi) Eligible credit for sub-borrowers (¶3.6e); (vii) Eligible sub- borrowers (¶3.6f); (viii) Reports and monitoring (¶3.11).

Exceptions to Bank policies: None.

Project qualifies for: SEQ[ ] PTI [ ] Sector [ ] Geographic[ ] Headcount [ ]

Procurement: N/A

Date of ESR Verification: December 5, 2008.

I. DESCRIPTION AND RESULTS MONITORING

A. Background, problem addressed, justification

1.1 In the context of the current international financial crisis, the IDB has launched the Liquidity Program for Growth Sustainability (LPGS) for the purpose of supporting the efforts of Latin American and Caribbean countries to meet the challenge posed by the economic crisis generated abroad and maintain their economic growth.

1.2 The Program approved by the Bank will provide up to a maximum of USD500 million per country, to be made available for on-lending through regulated financial institutions that are confronting reductions in their access to external credit lines and inter-bank credit. In turn, these funds will allow the intermediaries to replace lost or reduced working capital credit lines both to exporters and importers as well as to producers for the local market.

1. Recent macroeconomic performance[1]

1.3 Jamaica is a small open economy and, while it is one of the largest in the Caribbean region, nominal GDP is just over USD10 billion. In per capita terms, the island's GDP, at USD4,172,[2] ranks Jamaica at the lower end of the mid-income Caribbean countries.

1.4 The economy has recorded an average growth of 1.5% in recent years, outperforming only Guyana (1.4%) and Haiti (0.5%) in the Caribbean region. In 2006, the highest growth rate in over a decade was recorded at a peak of 2.6%. This hike ignited optimism for a breakthrough from persistent underperformance but after the devastating impact of hurricane Dean, the economy suffered from major losses and the growth rate fell back to just 1.2% in 2007. Forecasts for 2008 after the effects of Tropical Storm Gustav and a potential slow-down in tourism in the last months of the year due to the economic problems in the US are just positive – October WEO forecasts 0.7% growth for 2008.

1.5 The deceleration of growth of GDP in 2007 is mainly the consequence of the damages caused by hurricane Dean. This does not dismiss the fact that structural imbalances and inefficiencies underpin the country's low growth over a longer period. Clearly, the primary fiscal surpluses of the past years, reaching an average of 10% of GDP, pose a heavy burden on the economy and dampen growth. In the first half of 2008, the economy noted a flat growth rate as compared to the same period in 2007.

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1 This section draws on the text of the Bank document "Jamaica: Independent Macroeconomic Assessment, October 2008." Nov. 4, 2008 (CS-3778)

2 IMF World Economic Outlook.

1.6 Under the Bank of Jamaica [Central Bank] Act (1960), the aim of monetary policy is to regulate the growth of the money supply and credit in line with the resources required to finance economic activity, without undermining the conditions of price stability.[3] To pursue its price stability objective, the BOJ uses the monetary base and interest rates as operating targets. Open market operations are the most commonly used instruments. The BOJ influences these operations through determination of and changes in the reverse repurchase (repo) rate[4]. At the same time, the BOJ guides the level of the exchange rate through direct interventions in the foreign exchange market. During 2007/08 the Bank of Jamaica performed frequent interventions in the foreign currency market.

1.7 Annually the Bank of Jamaica sets targets for inflation, money supply and net international reserves. The money supply target is based on estimated nominal GDP growth for the year. The BOJ's objectives for 2007 were to reduce inflation to a range of 6-7%, with an expected GDP growth of 2-4% and base money growth of 11%. By the end of FY2007/08, the monetary base stood at J$58.8 billion, which is 13% higher than the previous period and inflation reached 19.9%; hence the Bank missed both of these targets. However, BOJ reported that, apart from inflation, its main target is the real exchange rate.

1.8 Monetary policy is very challenging; nonetheless the Jamaican authorities did succeed in bringing inflation down to single-digit proportions. This was sustained for six consecutive years up to 2003 when inflation suddenly rose to 14% and again the authorities brought inflation down to 6% in 2006. By the end of 2007 inflation rose again to 17% and per end of June 2008 deteriorated further to 22%. Given falls in commodity prices, inflation has recently subsided. However, supply constraints after hurricane Dean, especially in agriculture, may limit further declines.

2. Effects of the financial crisis and the slowing world economy

1.9 The external environment implies opportunities and risks for Jamaica going forward. Higher inflation has hurt consumers in Jamaica but actually assists the Government in terms of its fiscal accounts and debt situation. Now, while falling commodity prices hurts most of Latin America, Jamaica will benefit from a lower oil and food import bill. Moreover, this will help to lower inflation, which is already showing signs of abating. However, the prospect of recession in the US and Europe is likely to depress receipts from tourism, remittances and FDI especially in the tourism sector. On the one hand, some of the factors causing the very high current account deficit are subsiding, on the other hand financing for that high deficit may also become more difficult. The net effect on the economy is therefore less likely to be as negative as it might first appear to be.

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3 BOJ online information. Available at: http://www.boj.org.jm/objective_monetary.asp.

4 In this respect, the IMF has recommended that the Bank of Jamaica reorient monetary policy toward a greater focus on inflation, operating through shorter-term interest rates, rather than longer-term rates.

1.10 The very high levels of public sector debt imply that the Government must aim for a high primary surplus which crowds out much needed capital spending in social areas. The Government has thus embarked on a strategy of reengagement with multilaterals and has formulated a quite ambitious reform program that appears to have attracted considerable multilateral support. This should give the Government breathing space in that it will not have to issue external debt for two years and interest payments on debt will be somewhat reduced. While the USD300 million increase in debt will add to Jamaica's sovereign debt, an updated debt sustainability analysis indicates that with a set of baseline assumptions the debt to GDP ratio would then start to decline. In fact, the new facility should be repaid using the proceeds of the loans granted to firms. In addition, depending on the final interest rate charged, administrative costs and loans defaults, the facility could produce dividends for the DBJ. Link 6: Updated Debt Sustainability Analysis.

1.11 The debt to GDP ratio is likely to be stable this year and in a baseline scenario will fall in subsequent years. However, there are substantial risks. If Jamaica is subject to several external shocks at the same time, analysis carried out as part of the Independent Macroeconomic Assessment shows that the debt to GDP ratio may rise rather than fall. Moreover, a key risk going forward is that the international financial crisis adversely affects the local financial system and confidence wanes. The Government is also dependent on rolling-over debt in the domestic market. While it has been able to do that quite successfully to date at ostensibly negative real interest rates, a concern is that higher real interest rates are demanded or roll over risks increase.

1.12 In October the Bank of Jamaica (BOJ) established a "Temporary Lending Facility to Preserve Financial Stability" designed to assist local financial institutions holding GOJ bonds used as collateral for various transactions. These institutions were facing margin calls in international markets on their holdings due to the decrease in Jamaican bond prices. This highly specialized BOJ facility complements the proposed LPGS as the former helps to assure the solvency of the banks that might participate in the latter.

1.13 The IMF "Jamaica: 2008 Article IV Consultation – Staff Report" was released in June 2008 and noted that, "The new authorities have ambitious plans to address the policy imperatives they inherited along with a much more difficult environment" as well as several other points regarding the debt and fiscal agenda and monetary policy. The report concluded recommending the next Article IV consultation take place on the standard 12-month cycle. Furthermore, on November 10, 2008 the Director of the IMF Western Hemisphere Department sent the Bank's Manager of the Caribbean Country Department an updated assessment ("comfort") letter regarding Jamaica's macroeconomic situation in which the impact of recent external events and the authorities' actions to address them are noted. Currently, Jamaica is under intensified surveillance by the IMF.

3. The financial system: The institutional context and current situation

a) Structure

1.14 The financial system in Jamaica consists of ten major groups of intermediaries as indicated in Table 1. (A more detailed in-depth analysis is included in Link 7: Analysis of the Jamaican Financial System and the impacts of the international financial crisis).

Table 1
Financial System structure as of September 2008

Institution Type	Number of institutions	Total Assets Millions J dollars	share system assets (%)
Commercial banks	7	529,653	38.2
Merchant banks	3	30,398	2.2
Building societies	4	133,827	9.7
Credit unions	50	49,059	3.5
Financial houses & trust companies	n/a	1,259	0.1
Life insurance companies	7	114,781	8.3
Non-life insurance companies	13	43,251	3.1
Unit trust funds	10	582	.00
Securities firms	30	481,679	34.7
Pension funds*	n/a	173,642	12.1
Total assets		1,384,489	
Percent GDP*		192	

*Data for 2007
Source: Bank of Jamaica. September, 2008

1.15 Commercial and merchant banks account for approximately one third of the total system assets, while the other large group is the securities firms. As only commercial and merchant banks will be eligible to participate in the proposed Program, the following comments are concentrated on their role in the overall system. As of June 2008, total assets for commercial and merchant banks amounted to 560 billion JMD (USD7.7 billion), with a total capital of 63.3 billon JMD (USD881 million). These assets represented 66% of estimated GDP in 2007.[5]

1.16 The commercial banks are one of three types of deposit taking institutions (DTI) that fall under the supervision of the Bank of Jamaica (BOJ). All commercial banks are members of broader financial institutions, and foreign financial groups own five of them, representing 97% of the commercial bank assets. The remaining DTI are merchant banks and building societies, the latter specializing in mortgage lending. Supervision and regulation of these institutions has been substantially improved over the last decade. (Link 2: Monitoring and Evaluation Arrangements).

[5] Based on PIOJ estimated GDP in 2007 of USD11.21 billion.

b) Profitability

1.17 Commercial bank interest rate spreads have been quite high compared to other highly indebted developing countries, with Jamaican banks enjoying a spread of an average of 12 percentage points, while spreads in comparable countries are all in single digits, except for Uruguay with an average spread of 10 percentage points. This reflects low deposit rates due to some extent to limited competition for deposits on the liability side; while lending rates are high due in part to fiscal crowding out and poor supply conditions for lending. Additionally, the banks themselves are a major holder of GOJ securities (representing 32% of their total assets). The annual income from these securities amounts to about 35 to 40% of their regulatory capital. Overall, the commercial banks had a pre-tax profit margin of 28.6% for the quarter ending in June 2008 compared to 26.6% for the comparable period the previous year. This translated into a return on average assets of 1.0 % and 0.9% respectively.[6]

c) Solvency

1.18 Commercial banks are financially sound, with regulatory capital to risk weighted asset ratios (CAR) ranging from 14.42% to 15.57% between December 07 and June 08, decreasing slightly to 14.79% in September 08. These ratios are well above the minimum of ten percent required by the Bank of Jamaica[7] (see Link 7 table 2). The un-weighted capital-to-assets ratios are also above the minimum, ranging from 11.7% at the end of 2007 to 12.1% in September 2008. The difference is largely attributable to the significant holdings of zero weighted government securities in the banks' portfolios. Capital of the commercial banks has also been growing during 2008 despite the adverse international financial situation. As noted below, capital has grown in each of the last four quarters, with an abnormal growth in second quarter due to the conversion of a merchant bank (Pan Caribbean) into a commercial bank.

1.19 The ratio of non-performing loans as a proportion of total loans and total assets has also remained well below international averages and the BOJ's own benchmark of ten percent. The former has ranged from 2.0 to 2.4% over the same last four-quarter period (see Link 7, table 3), while the latter has ranged from 0.8 to 1.1%. These are not only below international averages but also below the levels for the banking system as a whole in Jamaica.

1.20 Stress tests routinely performed by the BOJ also show that the commercial banks would be resilient to major reductions in the exchange rate. For example had a 50% depreciation in the exchange rate occurred in September 2008, the commercial bank average CAR would have only fallen from 14.79% to 12.19%, still well above the statutory minimum of 10%.

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[6] Bank of Jamaica News Release Sept. 8, 2008.

[7] It should be noted that the Basle recommended risk-weighted capital adequacy ratios are only 8 percent, thus the BOJ standard is relatively conservative.

d) Impact of foreign developments on the Jamaican financial system

1.21 The current worldwide financial sector crisis has had several important effects on the domestic Jamaican financial system: (i) after a growth in foreign liabilities, there has recently been a withdrawal of international credit lines for companies and some fall off in foreign exchange supplies from earners;[8] (ii) remittance growth is expected to decrease, as the rate dropped to 7.4% for the period January-October 2008 and is expected to fall into the 5-6% range for the entire fiscal year; (iii) there has been a decline in the value of the asset portfolio of financial institutions, especially those with heavy exposure to emerging market sovereign bonds, including Jamaican sovereign debt; (iv) while turbulence in the financial markets and economic downturns among its major trading partners have hurt Jamaica, the recent reductions in international commodity prices of imports, particularly petroleum, have benefited the country. Profit remittances by FDI companies are projected to decline due to the shocks in the terms of trade. Although the effects of these developments are expected to be offset by projected slowdowns in FX inflows form tourism, mining and remittances, the BOJ nonetheless projects a net positive impact on the current account deficit of 1.0 to 2.0% as a proportion of GDP; and (v) the financial account of the balance of payments has already seen significant private capital outflows responding to the call on foreign liabilities and suspension of credit lines. (Link 7).

1.22 The BOJ Quarterly Monetary Policy Report (July-September 2008) concludes that despite the repercussions of these international financial market developments, the local financial institutions remain adequately capitalized even with the impact of the crisis on the domestic financial industry.

e) The problem addressed

1.23 The worldwide financial crisis has caused important shortfalls in the normal credit flows to the country: almost 40% of the correspondent lines have already been cut, are in danger to be cut or have experienced a heavy re-pricing cost[9].

1.24 Although the situation is thought of as being temporary, the macro-economic soundness of the country and its employment level[10] need to be protected from an external shock, even if such a shock is only transitory. In this context, the GOJ has asked the Bank for help to set up a stop-gap program using the LPGS.

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[8] It should be noted, however, that banks headquartered in Canada, due to their conservative lending practices in the past, have been relatively unaffected and are therefore still relatively willing to provide credit lines to their subsidiaries in Jamaica, which, as noted in Link 7, account for an important share of the entire market.

[9] Based on mission survey of stakeholders and financial institutions.

[10] Unemployment rates have been in the 9 to 12 percent range between January 2005 and April 2008. Most recently unemployment has increased from 9.5% to 11.9% between April ’07 and April ’08, thus highlighting the sensitivity of employment to external factors. (Source: Statistical Institute of Jamaica)

f) Suitability of the Jamaican banking system for the LPGS

1.25 In conclusion**,** both from the perspective of the soundness of the domestic banking system and from the perspective of recent global financial market developments, Jamaica is a capable and timely candidate for short-term, external liquidity-replacing loan resources such as those available from the LPGS. In virtually all cases, the intermediaries meet the prudential soundness criteria and, in most cases, the banks face decreasing alternative supplies of ready liquidity to meet their clients' demand for working capital and trade credits.

B. Objective, components and cost

1.26 Objectives. The general objective of the Program is to contribute to the sustainable growth of the country. The specific objective of the operation is to provide liquidity to maintain credit flows to the real economy, partially compensating on a temporary basis the shortfalls in the normal credit flows caused by the worldwide financial crisis. This should assist in maintaining national production levels, thereby protecting employment from a temporary external shock and at the same time reinforcing macro-economic soundness of the country.

1.27 Components. The Program will have one single component: revolving credit lines (RCLs) to make funding available to eligible intermediaries operating in the Jamaican financial system. The loan will also fund the audit and the front end fees.

1.28 Cost. The estimated amount of the Program is the equivalent of USD300 million, as shown in Table 2. All of the cost will be financed with the Bank Loan.

Table 2 - (USD)

Investment Category	Bank
1. Revolving Credit Lines	296,900,000
2. Audit	100,000
3. Front-end-Fee	3,000,000
Total	**300,000,000**

1.29 Sizing. To determine the size of the Program at USD300 million, an initial analysis was conducted with the collaboration of the GOJ, the BOJ, and the Commercial Banks. The main factors that were taken into account were: i) the cost of the Program and ii) the estimated demand, current and future, for credit lines of the type provided by the Program.

1.30 Further analysis has led to a final assessment of the size of the Program based on three main considerations: (i) Estimated Financing Gap. The outstanding short-term liabilities in foreign currency of commercial banks are estimated at USD1 billion (August 2008). Based on team interviews conducted during the November

2008 Mission with participating financial institutions, the expected reduction in external sources of financing is conservatively estimated at 40%. (USD400 million). This figure was then adjusted to take into account the fact that existing lines are usually underutilized by a factor of 20% (80 million USD). There is also the probability of a decrease in economic activity resulting in an additional decrease in demand for foreign liabilities of approximately 5% (USD 20 million). Consequently, the financing gap is estimated at around USD300 million; (ii) Revealed Demand During the Mission. The team conducted a survey among potential participating banks which showed an overall potential demand around USD336 million; and (iii) DBJ Operational Capacity. The DBJ has an outstanding loan balance of USD450 million (March 2008) which means that any figure much above USD300 million could be difficult to manage by the DBJ.

C. Key results indicators

1.31 It is very important to mention that in this operation, just as in any operation of this type, the first-tier banks (Approved Financial Institutions – AFI's) will select for financing those viable firms and projects that meet their own creditworthiness criteria. This will allow for the greatest impact of the sub-loans given the structural and current conditions of the economy. Effectively, the AFIs will choose the best enterprises/projects and, the market mechanism will: i) guarantee selection of the best projects; and ii) set the level to be achieved by the results indicators. From this point of view, any indicator can only be considered an *apriori* estimation of the outcome that would result from market forces and, therefore, the success or failure of the operation can never be judged definitively. On this basis, the principal indicators are those included in the corresponding Results Matrix: (i) at the output level, the indicator is the establishment of a credit line at the wholesale (second-tier) level. This is the only factor directly within the control of the Program; (ii) the intermediate outcome level depends on the basic premises of this type of program, namely; the reciprocal willingness of the sub-borrowers and the AFIs respectively to take and provide this kind of credit. Strictly speaking, these decisions are exogenous to the operation; however the intermediate outcome is measured in terms of AFI allocation of credit to sub-borrowers in response to the latters' requests; and (iii) the final outcome of the Program will be measured in terms of disbursements to sub-borrowers.

1.32 Following the OVE guidelines regarding evaluation of Multisectoral Credit Programs, in order to increase the volume of information and to be able to quantify the Program's impact, in addition to the Results Matrix, additional data will be collected on the results of the Program (based on the goal indicators).

II. FINANCING STRUCTURE AND MAIN RISKS

A. Financing instruments

2.1 The objectives of the present Program are those of the Liquidity Program for Growth Sustainability (LPGS). Therefore, the operation will be prepared and financed under the rubric of the LPGS and its associated operational guidelines. The LPGS (GN-2492-3) was approved by the Board of Governors on November 5, 2008 (AG-9/08) and the Operating Regulations were submitted to the Board of Executive Directors for information on November 26, 2008 (GN-2492-5).

2.2 The most important guideline specifies that LPGS programs need to adapt to the form of a second tier on-lending mechanism, with eligible credits consisting of working capital and trade finance. The implementation section, below, explains that the Program presented in this document complies with the guidelines for LPGS operations.

B. Enviromental and social safeguard risks

2.3 *Environmental Risks* - According to the policy guidelines of the document GN-2492-3 and according to the B.13 directive of the Environmental and Safeguard Compliance Policy (OP-703), the present operation does not require an environmental classification. Under the Liquidity Program for Growth Sustainability, the operation will provide funding for a second-tier lending institution, the Development Bank of Jamaica (DBJ), to finance short term, working capital and trade finance for private sector operations through loans granted by first-tier financial intermediaries. The nature and impacts of the activities financed cannot be ascertained in advance but their environmental and social aspects will be required to comply with applicable local legislation.

2.4 As a second tier bank, the DBJ will not carry out due diligence for each transaction. The AFIs will carry out the due diligence on environmental matters for each transaction and applying local environmental legislation. In addition, the Credit Regulations will establish: (i) a list of excluded activities that will not be eligible for inclusion in the Program; (ii) a list of sectors that will only be eligible if the final borrowers present the necessary environmental documentation including any licenses and permits required under local laws; (iii) the requirement that all transactions not included in (i) and (ii) be in compliance with applicable local laws; and (iv) a provision that indicates that violations of local environmental laws will result in the acceleration of the respective loans and non-eligibility of the final borrowers for future transactions under the Program.

2.5 The loan agreements between the final borrowers and the financial intermediaries will include a representation by the borrower that it is not engaged in the excluded activities and is in compliance with all applicable environmental laws. Thus they will not require a specific environmental treatment by the Program and will be overseen utilizing the country’s current environmental systems and legislation.

The Bank will periodically review the list of transactions under the Program in order to verify compliance with these requirements and, if necessary request additional information from the DBJ or the Program auditors.

C. Fiduciary risk

2.6 The operation faces the fiduciary risk of funding business through the financial system. The DBJ is exposed to the credit risk of the AFIs, and in the event of a systemic crisis there is the risk that these debtors could not honor their obligations. The possible adverse selection risk will be mitigated by requiring that the revolving credit line (RCL) drawn by a particular AFI will be fully collateralized with securities issued or guaranteed by the Government of Jamaica (GOJ), or the Bank of Jamaica, or other liquid assets of equivalent quality.[11] The DBJ's risk is further mitigated by the periodic evaluations that it carries out of the AFIs and by their supervision by the Bank of Jamaica. At the retail level, the first-tier lenders will require collateral from the real-sector sub-borrowers according to the respective AFI's risk assessment of each credit.

D. Other key issues and risks

2.7 <u>Macroeconomic Risks</u>. The success of the Program is based on a stable macroeconomic framework. The high level of debt (130% of GDP) complicates macroeconomic management, creates vulnerability to shocks, and poses risk to macroeconomic sustainability. In addition, a sizeable share of the financial sector portfolio (around 30%) is concentrated in public sector debt. However, the term structure of the debt is such that Jamaica does not face very large amortizations of external debt during 2008 and 2009, and until recently (October 2008), Jamaica continued to be able to place domestic debt at relatively low real interest rates. Given the planned PBL lending from the IDB and similar lending plans from the World Bank, the Caribbean Development Bank, and the European Union, Jamaica may not need to issue any external debt for 2009 or 2010[12].

2.8 The Jamaican authorities are planning to substitute more expensive private external debt with multilateral debt and to pursue a policy agenda that directly attacks the debt problem, through the rationalization of public sector entities and pro-growth reforms. On the other hand, the objective of the LPGS operation is to foster economic growth by improving the business conditions of the private sector, by allowing the access to credit to small and medium enterprises under the current external financial situation, thus ameliorating the effects of the current macroeconomic situation and reducing the vulnerability of the private sector to external shocks.

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[11] At present, the DBJ provides unsecured lending to each AFI up to the amount of its net worth.

[12] The IDB has agreed to provide loans for the GOJ for USD200 million for 2009, and of those, USD120 million correspond to policy reform operations that support reforms aimed at promoting private-sector led growth and reducing fiscal imbalances. Similarly, the World Banks is negotiating operations for USD100 million for 2009 in the form of policy reform operations as well.

2.9 Financial Risks. The Financial risks for the Bank as well as the risks for the DBJ, are low, due to the nature of a second-tier lending operation. The first-tier AFIs will absorb the credit risk from the private enterprises. The AFIs eligible for the lines of credit will provide specific guarantees to the DBJ when the requested amounts are above their allocated credit line. In addition, the operation is backed by a sovereign guarantee.

III. IMPLEMENTATION AND MANAGEMENT PLAN

A. Summary of implementation arrangements

3.1 The borrower will be the Government of Jamaica and the executing agency will be the Development Bank of Jamaica (DBJ).

3.2 Executing Agency. The Development Bank of Jamaica (DBJ) is a wholly government-owned institution that acts as second-tier vehicle for Government sponsored credit programs.[13] The DBJ has operated programs financed by the World Bank, the IDB, the CDB and the OPEC Fund. The DBJ's mission is to assist in the development and modernization of all viable enterprises in the agriculture, agro-industrial services, and manufacturing and tourism sectors of the economy. The on-lending activity of the Bank takes place principally through a network of AFIs which include commercial and merchant banks which in turn provide loans to local businesses. The Bank has sought to improve the productive sector placing priority on projects that generate employment and create linkages to other sectors, particularly manufacturing and agriculture.

3.3 The DBJ currently has an outstanding loan portfolio of approximately USD450 million. The Finance and Treasury Department and the Department of AFI Relations will be the main units within the DBJ responsible for the execution of the Program. However, the rest of the DBJ will also provide full support to the operations of the credit lines.

3.4 The DBJ will be in close collaboration with the Ministry of Finance and the Public Service, to monitor the operation's risks on a real time basis.

3.5 General Structure. The Government of Jamaica will make available the resources of the Program to the Development Bank of Jamaica (DBJ) according to the terms of a mutually agreed contract. Bank approval of this contract will be a condition prior to first disbursement. The DBJ will function as a second-tier operator and on-lend the resources to banks that have been approved to act as such by the DBJ. Following standard DBJ procedures, these banks will be called the Approved Financial Institutions (AFIs). The AFIs will act as first-tier banks. The AFIs will

[13] The Development Bank of Jamaica Limited was established in April 2000 when the Agricultural Credit Bank and the National Development Bank of Jamaica, two wholly owned Government of Jamaica Institutions, merged. The operations of a third entity, the National Investment Bank of Jamaica, were consolidated in September 2006

receive funding from the DBJ to finance (eligible) credits. The AFI will select the individual (eligible) sub-borrowers and define the terms and conditions of the sub-loans. The credit risk of the sub-loans will be entirely kept on books of the granting AFI.

3.6 Credit Rules and Regulations (CRR). The Credit Rules and Regulations are a fully detailed description of the on-lending structure of the Program, as well as of the contracts that regulate the interaction among all intervening parties (Link 8). CRR will have to be in place and approved by the Bank as pre-condition for first disbursement. A summary of the main features of the CRR follows:

a. Eligible AFIs. The eligible AFIs for the Program will have to be banks licensed, regulated and monitored by the (central) Bank of Jamaica (BOJ). Other regulated financial institutions could be included at a later date should the evolution of the Program warrant it. This figure will be monitored by the DBJ based on the information provided by the BOJ.

b. Structure of the credits to the AFIs. The credits from the DBJ to the participating AFI will take the form of revolving credit lines (RCL). Upon request of an AFI, the DBJ will transfer the requested amount of Program funds to the AFI. The latter will have a period of thirty days (or the period established in the CRR) to justify to the DBJ the corresponding sub-loans. The proceeds of the repayments of the sub-loans could be reinvested by the AFI in further loans or could be repaid to the DBJ. The RCL will be denominated in USD.

c. Fund's Allocation Mechanism. Program funds will be allocated among participating AFIs on a first come, first served basis. This is a transparent and competitive mechanism, as has been proved over time by the many credit operations financed by the Bank.

d. Risk Management of the Program. The RCLs granted to the AFIs will be fully collateralized with securities issued or guaranteed by the Government of Jamaica (GOJ), or the Bank of Jamaica (BOJ), or other liquid assets of equivalent quality The specific collateralization mechanism will be defined in CRR.

e. Eligible Credits to the Sub-borrowers. Eligible credits to sub-borrowers will be those applied to finance working capital or trade finance operations. The maximum term will be 36 months or a period established in the CRR. The credits to the sub-borrowers will have to comply with the general credit regulations enacted by the BOJ.

f. Eligible Sub-borrowers. All private sector firms, including small and medium size enterprises will be eligible sub-borrowers for the Program. Only those firms that conduct activities that fall within the negative list (specified in the CRR) or that could be deemed environmentally pernicious will be declared

non eligible. As a second-tier bank, the DBJ will not carry out the due diligence for each transaction leaving it to the first-tier banks to apply local legislation.

g. Interest Rates: (i) from the DBJ to the AFI. DBJ will lend the Program resources to the AFIs at the terms agreed with the Ministry of Finance and the Public Service; and (ii) from the AFI to the Sub-borrowers. The AFI will on-lend the Program funds at those rates and conditions that they see fit, taking into account the specific characteristics and risk profile of each individual sub-borrower.

3.7 Timeframe. The execution period will be three years from the date of the signature of the loan. The disbursement period will be 12 months from the date of the signature of the loan. This period will be automatically extended to 18 months if 50% of the proceeds of the financing have been disbursed during the first 12 months of execution.

3.8 Procurement. This Program will follow the standard procurement procedures for Multi-sectoral Credit Programs. Therefore, there will be no need to include a POA or a Procurement Plan.

3.9 Disbursements. Initially the Program will have a revolving fund (RF) of 10%. The revolving fund has been dimensioned taking into account the needs for the DBJ to have enough float to smoothly accommodate the AFI's demand for disbursements. That has been done by means of a survey among the participating AFI. In principle, the Bank will make the disbursements of the loan resources to the GOJ. But, in order to speed up the process, the GOJ may choose to use an account of the DBJ where the Bank's funds would be directly disbursed. The DBJ would keep such an account segregated from its other accounts.

3.10 Retroactive Financing. Retroactive financing will be granted for all sub-loans formalized on or after November 26, 2008[14] up to 25% of the Loan amount.

B. Summary of arrangements for monitoring results

3.11 Monitoring of the Program. The DBJ will be responsible for preparing periodic reports for the Bank regarding the evolution and performance of the RCL based on information provided by the AFIs. The reports will contain data on: i) evolution of the RCL based on information provided by the AFIs; ii) AFI compliance with the CRR; iii) characteristics of sub-borrowers and types of activity; and iv) environmental performance of the financed activities. The periodicity of the reports will be established in the CRR of the Program. The reports will be used by the Bank to update its Program Performance and Monitoring Report. The information gathered by the DBJ during the monitoring of the Program's evolution will be the basic input to guarantee that the resources of the Program are used for eligible financings. Whenever a financing is found to

[14] Date of inclusion of this operation in the pipeline.

be not eligible, the AFI will have to reimburse the DBJ for the corresponding funds.

3.12 Program Evaluation and Auditing: Two external evaluations will be conducted by the IDB: i) two years after the beginning of the Program; and ii) sixty days after the date of the payment of the last amortization. The purpose of the evaluations will be to determine the compliance with the objectives of the Program and its impact, taking as benchmarks the parameters established on the matrix of Results Matrix.. The cost of the evaluation will be absorbed by the Bank.. To elaborate the PCR, all the relevant information will be processed in the most exhaustive manner in accordance with the existing budgetary restrictions. The possibility of conducting additional activities of information collection, such as surveys, will be entertained. The Program will be audited by an external firm of auditors acceptable to the Bank.

C. Other

3.13 Coordination with IMF and World Bank**.** The Bank has ongoing contact with counterparts in the IMF and the World Bank regarding changes in Jamaica's overall debt situation, the extent to which their access to credit has been curtailed and regarding the parameters of this Program. In addition to the general support for the IDB's program with Jamaica expressed in the comfort letter, the IMF is aware of the scope and nature of this Program. The World Bank is preparing a program that will support Jamaica's reform agenda via a substantial PBL to be disbursed during the current fiscal year (ends March 2009). The project team for this operation has maintained constant contact with their counterparts in the World Bank to keep them appraised of the progress in our analysis and the design of the Program. Given the IMF's mandate to monitor financial stability and that Jamaica is under intensified IMF surveillance a close coordination will be maintained with the IMF during the execution of the operation.

ANNEX I
RESULTS MATRIX
Jamaica: Liquidity Program for Growth Sustainability (JA-L1023)

Objective	The general objective of the Program is to contribute to the sustainable growth of the country.
Purpose	The purpose of the operation is to provide liquidity to maintain credit flows to the real economy.

INDICATORS							**Description**
	Base line	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Goal**	
COMPONENT ONE: The Development Bank of Jamaica (DBJ) provides lines of credit to Approved Financial Institutions (AFI) to finance short term capital needs and trade financing to provide resources to AFIs for local businesses' needs.							
Output							
AFIs get assigned lines of credit from the DBJ	0%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	The proportion is indicative of the DBJ's capacity and that of the AFI to allocate funds through the Program.
PURPOSE: The productive sector obtains resources for short term capital and trade finance, thus mitigating the consequences of an international financial crisis.							
OUTCOME: AFIs have access to funding for providing credit to local businesses for short term working capital and trade. Local businesses have access to resources to finance their short term needs.							
Intermediate Outcome							
AFIs get credit from the DBJ.	0%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	The DBJ will determine the maximum amount of the line of credit to be assigned to each AFI, based on market conditions and risk considerations.
Final Outcome							
AFIs provide credit to local businesses for short term capital and trade financing.	0%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	Up to a 100%	The DBJ will provide quarterly reports on the use of the resources by local businesses.

ANNEX I
RESULTS MATRIX
Jamaica: Liquidity Program for Growth Sustainability (JA-L1023)

The DBJ, as part of the monitoring activities of the Program, will collect the following information:

PURPOSE: The financial system is able to provide resources for short term capital and trade finance						
INDICATORS	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Goal**	**Description**
Level of Activity of the Program: • Credit Lines awarded by AFIs.	Resources allocated to AFIs	Resources allocated to AFIs	Resources allocated to AFIs	Resources allocated to AFIs	Resources allocated to AFIs	This indicator shows the proportion of resources allocated to each AFI according to the credit line limits and the level of demand.
• Resources disbursed to local businesses by each AFI.	Resources lent by AFIs to small businesses. Number of businesses benefited by the Program.	Resources lent by AFIs to small businesses. Number of businesses benefited by the Program.	Resources lent by AFIs to small businesses. Number of businesses benefited by the Program.	Resources lent by AFIs to small businesses. Number of businesses benefited by the Program.	Resources lent by AFIs to small businesses. Number of businesses benefited by the Program.	This indicator shows the amount of resources that are channeled to local businesses by each AFI.
• Other characteristics of the AFIs, loans, and sub-borrowers (size, geographics, rates, spreads, sectors, etc.).						This information will be gathered for the benefit of further studies.