Exponential Growth

If profits grow at a steady 7% each year then profits will double in approximately 10 years. If inflation is a steady 10% each year prices double in approximately 7 years unless some absorption takes place..

When Jamaica's domestic debt grew from 10 billion dollars in 1990 to 50 billion in 1995 the average compound rate of growth calculates to 38% … Doubling of our debt took place on average every 22 months. The resulting inflation and the necessary increase in corporate and individual debt is directly related to the collapse of the financial sector in the 1990's.

Between 1995 and 2009 our domestic debt grew at a compounded rate that averaged 20% per year … moving the domestic debt to J$627 billion. That was unsustainable and led to the JDX in early 2010.

Since 2009 the rate of Jamaica's total debt … internal and external has grown at a compounded annual rate of 16%. This too is unsustainable.

If this rate of growth is maintained … which is just about impossible … but if it were the doubling of our debt would happen in just over 52 months.

An orderly default is preferable but a disorderly default is possible, and Jamaica would not be the first country to default.

Greece has defaulted 5 times since gaining independence in 1829

Spain has defaulted 13 times since 1476

France has defaulted 8 times

Germany had defaulted 8 times

England has not defaulted since the time of William the Conquer in 1066.

Jamaica has had one negotiated default …the JDX.

Another default has serious implications for banks, insurance companies, pension schemes, and living standards.

The table below shows the average compounded growth of Jamaica's domestic debt between 1990 and 2009

Year	J$ Domestic Debt	Compounded growth …………………	%
1990	10,000,000,000		
1991		13,800,000,000	38.00%
1992		19,044,000,000	38.00%
1993		26,280,720,000	38.00%
1994		36,267,393,600	38.00%
1995	50,000,000,000	50,049,003,168	38.00%
1996		60,058,803,802	20.00%
1997		72,070,564,562	20.00%
1998		86,484,677,474	20.00%
1999		103,781,612,969	20.00%
2000		124,537,935,563	20.00%
2001		149,445,522,676	20.00%
2002		179,334,627,211	20.00%
2003		215,201,552,653	20.00%
2004		258,241,863,183	20.00%
2005		309,890,235,820	20.00%
2006		371,868,282,984	20.00%
2007		446,241,939,581	20.00%
2008		535,490,327,497	20.00%
2009	627,000,000,000	642,588,392,997	20.00%

The growth in domestic debt between 1990 and 1995 averaged 38% compounded annually. A 38% compounded rate of growth means a doubling of debt every 1.842 years … that's every 22.1 months.

The annual average compounded growth rate of Jamaica's domestic debt between 1995 and 2009 was 20%

This means our debt doubled on average every 3.5 years … that's every 42 months.

Between 2009 and 2011 Jamaica's total debt has grown at a compounded rate of 16%.

It was one trillion one hundred and twenty seven billion in 2009 and today its one trillion six hundred billion.

Some Questions

What happens if government lays off thousands of public sector workers?

What happens to economic growth when taxes rise faster than the rate of GDP growth?

What rate of GDP growth is necessary to support 16% compounded growth in Jamaica's debt?

What are the implications for the holders of Jamaica's debt?

How much government debt is held by banks, insurance companies, pension schemes, and individuals?

How big a hair-cut are they able, or willing to take, and what will be the positive and negative results?

What will happen to interest rates? These questions should be addressed to Audley Shaw & Peter Phillips in a public debate.

Jamaica's total debt 2009 to 2011 … and projected 16% yearly growth to 2016

2009 Total Debt 1,165,000,000,000

2010 Total Debt 1,351,400,000,000 … 16% growth over 2009

2011 Total Debt 1,567,624,000,000 … 16% growth over 2010

2012 Total Debt 1,818,443,840,000 … 16% growth over 2011

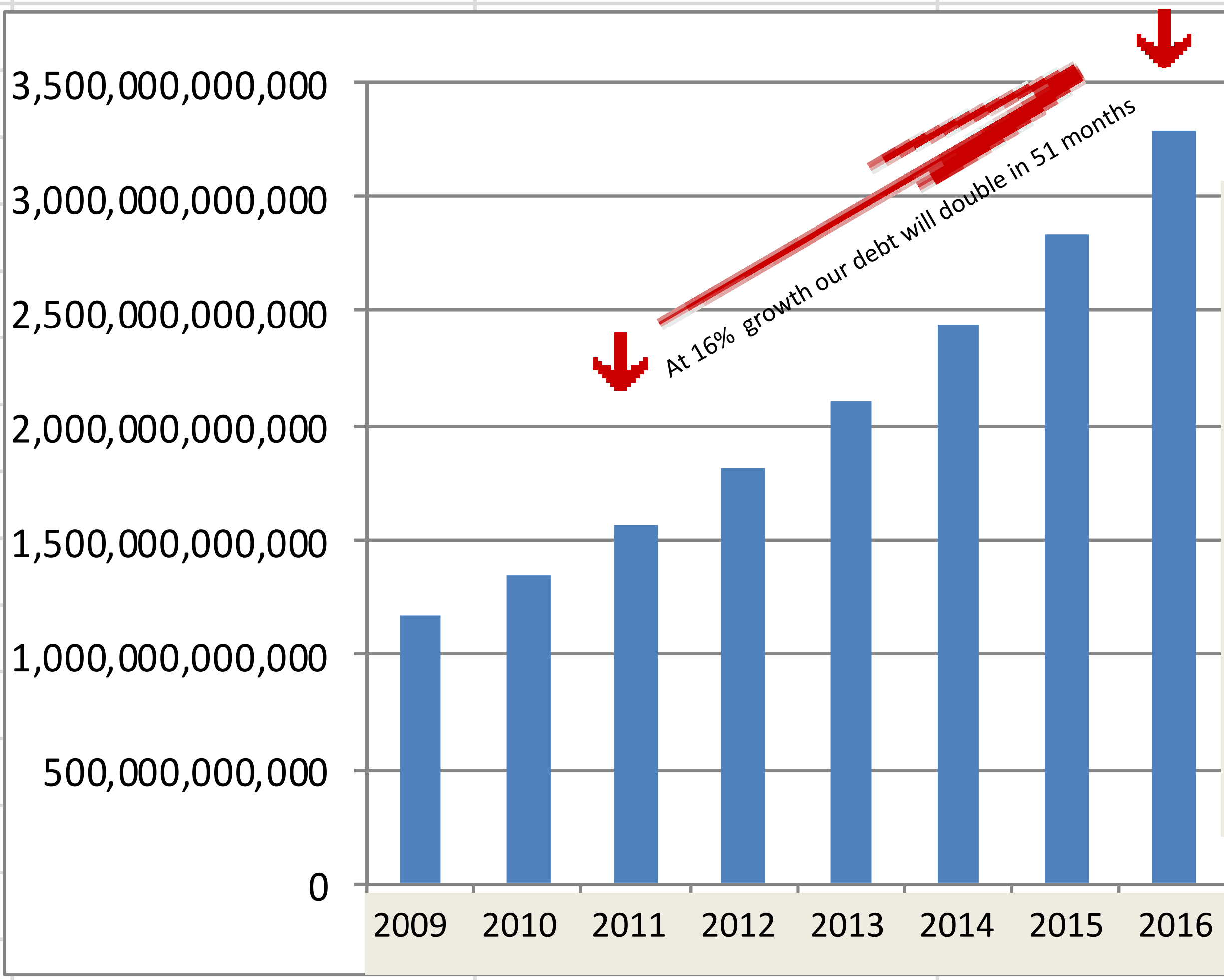
2013 Total Debt 2,109,394,854,400 … 16% growth over 2012

2014 Total Debt 2,446,898,031,104 … 16% growth over 2013

2015 Total Debt 2,838,401,716,081 … 16% growth over 2014

2016 Total Debt 3,292,545,990,654 … 16% growth over 2014 and this would be double our current debt load.

Note:- interest rates have fallen but defaults are rising and bank lending is shrinking … opposite to what was intended.



Jamaica's debt growing at the current 16% per annum doubles in 4.3 years.

If this is allowed to happen in the absence of strong growth in the real economy the burden on taxpayers will itself cripple growth prospects.

Some More Questions

I am thinking about our exchange rate, and asking the question … is it over or undervalued?

The fact that J$400,000,000,000 has been borrowed and introduced into the economy in 24 months and we had 13 quarters of negative growth followed by 2 quarter of growth must have an impact on the exchange rate.

The exchange rate at the beginning of 2009 was 80.47 and today its 86.50 which is a 7.5% devaluation in the same time that our total debt has increased by 37%. What are the implications here?

I suspect because of economic contraction debt has become harder to repay, and the demand for, and availability of financing has diminished. This has taken pressure off the exchange rate.

Once credit shrinks … whether by loans defaulting or people deciding to reduce exposure to debt prices will tend to stabilize and in some cases fall . This effect is however offset by government borrowing and spending.

For over 20 years economic activity has been driven mainly by government spending. And that spending has taken place compliments of borrowed money that we cannot repay.

Once the market shuns government debt interest rates will go up and that will curtail the ability to borrow … and could lead to default.

Question:- How do we change the culture to one where the private sector drives growth while government contracts to a balanced budget?

Clearly the government has a duty to create the environment in which the private sector becomes energized. The government must find ways to hand the economic stimulus baton to the private sector.

I remember a board meeting where the newly appointed minister informed us that he was the only one present looking for votes. Therefor if we had good news for the public we should tell him so he could tell the people. On the other hand when the news is bad we would have to tell the public. It was an honest revelation of what politics is all about. It's kind of obvious that politicians do not want to be the bearer of bad news.

This leads to the next question:- Can politicians solve Jamaica's debt problem?

Can anyone who depends on re-election solve Jamaica's debt problems?

Does our government need to be restricted by laws relating to how much debt they can assume in the name of the taxpayer?

It is the government's ability to raise taxes on its citizens that secures and underwrites the country's debt.

The relative stability of the J$ recently has had a positive impact on inflation and a negative effect on government revenues. Government is conflicted about the value of the Jamaican dollar.

They take credit for its stability but suffer the shortfall in revenues … A devaluing dollar is a revenue raiser for government. The cycle of borrowing and then devaluing the currency to raise revenue has to be broken. The only way to do that is to live within our means.

Devaluation steals the purchasing power of savers and those living on a fixed income like pensioners. It is an unfair tax imposed by governments addicted to spending borrowed money. That game appears to be changing worldwide … Jamaica must not be left out of this revolt against inappropriate debt.

But someone with a large platform has to take responsibility for educating the population on these matters. We can not depend on politicians to tell the truth about Jamaica's debt predicament … because it's bad news.

It's not about punishing those who got us here … it has to be about how we correct the problem and what sacrifices have to be made in the process.

We must honour and encourage our savers because they create funds for investment. But how is this possible in an environment where those in authority undermine and devalue their savings? The government should not be allowed to steal the purchasing power of pensioners with devaluation.

If appropriate action is not taken right away the financial sector could suffer the consequences and the pain inflicted will be greater than that caused by FINSAC. One reason will be a lack of resources to bail out the sector.

For years the financial sector avoided taking private sector risk in favour of lending to the government. The government was accused of crowding out the private sector.

Eventually the private sector learned to avoid business risk by lending to the government as well. Now that game is over and suddenly the risk in government bonds is real and dangerous.

Fiscal Deficit

Analysts like to express the fiscal deficit as a percentage of GDP, but it's more revealing to express it as a percentage of revenue.

In Jamaica's case total revenue inclusive of grants is projected to be 350 billion dollars this fiscal year. With the deficit projected to be 11% of GDP and that calculates to 38.68% of revenue.

When deficits reach 20% of revenue there is a danger of hyperinflation. But even at 40% I do not expect hyperinflation if serious efforts are made to cut costs and increase revenues.

The danger comes when government attempts to inflate away domestic debt with printed money. However the IMF program along with the global financial meltdown suggests an implosion in credit .

The government may print money but when there is no velocity behind the money the result is disinflation … much like what is happening in the USA and Europe.

Over the next few days I intend to answer the questions I have asked, but I'd like to hear your answers … that's why I asked them!

For the current situation to be corrected there has to be a period of pain … the pain of change is quickly forgotten once the benefits are realized..

What happens if government lays off thousands of public sector workers?

I have heard figures ranging from 16,000 to 27,000. The government will save revenue;- This fiscal year government will spend 134 billion on wages which currently represents 38.29% of revenue. However when you add pension payments of 20 billion the total represents 44% of revenue.

Remember the fiscal deficit is 38.68% of revenue so we have now accounted for 82.68% of revenue. That leaves 17.32% to service debt.

Debt servicing accounts for about 76% of revenue so we now see that revenue is short by almost 60%.

Even if we save 50,000,000,000 on the wage bill we still need to raise revenue or loans to fill a fiscal gap of 45% of current revenue. That's 158 billion.

Analyst will express this figure as 13% of GDP. Remember without the pension payments the figure will be expressed as 11% of GDP. This puts the deficit back to where it was before the government settled its wage dispute leading to the impasse with the IMF.

The issue is how do we raise revenue after putting so many people out of work?

This is where government is conflicted. If they devalue the dollar revenue will increase but it may not be the result of a rise in productivity. It will be a continuation of the game government has become an expert at playing.

This time it must be different. Let us accept that an increase in government revenue must come from more people paying taxes so the rates can be lowered.

It's not fair that a small group must pay high taxes because a large group refuses to pay what they consider penal rates of taxation. Let's lower the rates and ensure that everyone pays … and they will pay if its FAIR … Do not charge "A" more because "B" refuses to pay.

If you have a TRN number, or a drivers license you are obliged to make a tax return … even if you fall below the tax threshold. We don't trust government enough to believe them when they say they'll lower rates when more people pay taxes. Do both at the same time. The objective must be to lower tax rates and full compliance.

Government must commit to:-

- Balance the budget, and use taxpayers money prudently with transparency and accountability. A balanced budget means a stable currency.
- Create the environment attractive to local and foreign investors. Why should foreign investors put their money at risk in any country where the locals are not enthusiastic investors in productive enterprises.
- Overhaul the justice system to ensure corporate disputes are resolved quickly and fairly. Why would anyone invest in any country where it takes up to 15 years to settle disputes. England had this problem and solved it … so we have an example to follow.
- Better living standards tied to increasing production and productivity.
- Stamping out corruption starting within their own ranks.
- Justifying all borrowed money based on its return … especially our investments in education.
- Promoting small business … by encouraging capital formation and expansion of the junior stock market. Banks ALONE have not worked.
- Set national goals and bench marks for achievement. Increase creativity, production, business startups, capital markets, entrepreneurship.

What happens to economic growth when taxes rise faster than the rate of GDP growth?

When taxes rise the economic effect is negative. Money is diverted from production to the most inefficient user of capital … government,

Growth, if it were taking place is stalled. In our case we have had 13 consecutive quarters of negative growth followed by two quarters of growth. Negative growth pushes up the debt to GDP ratio and that is likely to continue happening.

Our risk is greater in this period of global recession and the potential for a collapse in European bond markets.

A look at the 6 month LIBOR rates is instructive. They highlight the all out assault on the forces of deflation. In any other period these rates would stimulate inflation and GDP growth. It's not happening … and it will not happen.

In January 2007 six month LIBOR was 5.401% and in January 2008 it was 4.596%. Notice how the rates fall as the USA goes into recession and keep falling to the low of .398% in July 2011.

What these rates are saying is that the USA is in a life and death struggle they are losing. Imploding credit dwarfs all the stimulus funds injected into the economy so far. And there is little velocity behind the stimulus funds … banks not lending and reluctant borrowers.

The composition of congress guarantees they will not be allowed to match imploding credit. Three trillion dollars of stimulus compared with defaulting credit and deleveraging over the next few years that could be between 20 and 30 trillion dollars. [Google Kondratieff Winter]

Six Month Libor History (6 Month Libor)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2011	0.456	0.454	464	0.460	0.431	0.403	0.398	0.430	0.486	0.558		
2010	0.430	0.384	0.387	0.444	0.531	0.752	0.753	0.668	0.497	0.463	0.448	0.461
2009	1.750	1.660	1.803	1.736	1.565	1.240	1.111	0.925	0.755	0.629	0.564	0.488
2008	4.596	3.041	2.931	2.614	2.965	2.911	3.109	3.084	3.118	3.981	3.121	2.591
2007	5.401	5.372	5.321	5.358	5.384	5.381	5.386	5.327	5.535	5.133	4.806	4.910
2006	4.813	4.991	5.120	5.288	5.322	5.639	5.547	5.450	5.370	5.390	5.350	5.365
2005	2.958	3.1495	3.388	3.415	3.531	3.691	3.924	4.082	4.215	4.447	4.580	4.690

www.erate.com/six_month_libor_index.6-months-libor.htm

The fact that LIBOR is rising could fool a lot of people, and it has. This matches up with the tepid recovery taking place in the USA.

However between April 2010 and July 2010 there was greater bullishness on US economic recovery. Economic recoveries are the result of a positive change in social mood. The social mood worldwide is now negative and that is what determines economic direction … http://www.socionomics.net/

People are fed up with politicians lying to them. Too many are out of jobs, lost their houses, lost their business … graduated with a huge student loan and cannot get a job. They know easy money was a trap that destroyed their parents. They recognize this period of low interest rates as another trap.

Corporations are paying down debt and accumulating cash … not investing. The same thing is happening at the household level. The herd mentality has changed to negative and it feeds on itself. This is the area of real growth for the next few years.

If one person decides to deleverage and then save for retirement if makes little difference. When a critical mass does it the result is economic contraction. That's why the global social mood index is what decides economic direction.

Europe's austerity and its bond market troubles will push the US into another recession. Actually the real peak in the US stock market was in 2000 if measured against a basket of commodities including gold. By this measurement the US market is 80% off its peak in 2000. So its been a stealth bear market and we have had a few counter trend rallies that continue to be sucker traps.

By 2015 the social mood will have hit bottom … its what happens between now and then that will affect us all. Look out for intolerance between nations and intolerance between governments and those they govern.

Of course there are survival strategy's but first there must be expanded awareness and a willingness to do more than just talk.

It's actions that count and that means real commitment to the goals we set. Not New Years' resolutions that are forgotten by February. Next question:-

What are the implications for holders of Jamaican debt?

Here is a quote from Mark Weisbrot … co-director of the Center for Economic and Policy Research, in Washington, DC that should concern the holders of Jamaica's debt. http://www.guardian.co.uk/commentisfree/cifamerica/2011/jul/22/jamaica-debt-crisis

"Jamaica – a middle-income developing country of 2.8 million people – has one of the worst debt burdens in the world, with a gross public debt of 123% of GDP.

At first glance this looks better than Greece (166% of GDP) but the more important number is the interest burden of the debt: for Jamaica it has averaged 13% of GDP over the last five years. This is twice the burden of Greece (6.7% of GDP), which is in turn the highest in the Eurozone. (It is worth keeping in mind that the burden of the debt can vary widely depending on interest rates, and on how much is borrowed from the country's central bank – Japan has a gross public debt of 220% of GDP but pays only about 2% of GDP in annual net interest, so it doesn't have a public debt problem.)

Not surprisingly, a country that is paying so much interest on its debt does not have much room in its budget for other things. For the 2009/2010 fiscal year, Jamaica's interest payments on the public debt were 45% of its government spending. This crowding out of public investment and social spending has hurt Jamaica's progress towards the Millennium development goals."

"Jamaica's debt burden is outrageous, and needs to be drastically reduced. It is difficult to imagine the country making much progress in economic development while so much of its resources go to interest payments."

He says interest is 45% of spending and I calculated it at 60% of revenue … and we know spending is more than revenue.

According to the CIA World Fact Book for 2010 Jamaica's revenues were $3.607 billion and expenditures were $4.458 billion. https://www.cia.gov/library/publications/the-world-factbook/geos/jm.html

This is why all those bankers and pension fund managers responsible for gobbling up Jamaica's bonds should wear pampers to work from now on … just in case!

Worse are the near banks that recommend them to naïve investors, Last week one of them refused to show the company's audited financial statements even though their website says its available on request.

Last week the treasury department of my bank told me the dollar was losing ground because everyone is buying dollars to get into a US$ government bond. I hope they know the level of risk they are taking … but I doubt they do.

I have heard that as much as 80% of Jamaica's debt is held by Jamaicans and Jamaican institutions.

Politicians must acknowledge their responsibility to all bondholders. This is serious business and they are taking on huge responsibility. I would like to know that those who have a platform use it to keep reminding politicians that this time its different

Here is another quote from Mark Weisbrot:-

"unfortunately the European authorities, the IMF, the Paris Club and allied institutions – look at this issue from the point of view of the creditors."

I wonder how many bondholders know that Jamaica has, relatively speaking, TWICE THE DEBT BURDEN OF GREECE?

I bet not even one of them knows.

Does our government need to be restricted by laws relating to how much debt they can assume in the name of the taxpayer?

Lets look at our revenue as a percentage of our debt and compare that to some other countries in the news … because they are having financial difficulties. For a benchmark lets use Germany's debt to revenue ratio since they are the strongest economy in Europe.

Germany's debt is 1.65 times its revenue. Let us call this acceptable.

Ireland is having serious difficulties. Their debt is 2.48 times their revenue.

Greece is the weakest economy in Europe as far as we know. If they default on their debt a lot of big European banks will be in trouble. I suspect the desire to bail them out has a lot to do with protecting those banks and less about helping Greece.

Greece's debt is 3.05 times their revenue. I am not an economist but common sense tells me this is far too high. Any country with a debt to revenue ratio this high is being ridiculed for abusing their creditors and their tax payers.

This is what the Greek government is being accused of by their European partners and their own citizens … who express themselves by rioting in the streets.

Jamaica's debt is 4.58 times its revenue, and hardly anyone is aware of it in this context.

This is because of politicians not being able to level with tax payers when the news is so bad, and they are responsible.

The economic crisis of the 1990's added about 40 percentage points to our debt to GDP ratio. That crisis was caused by high interest rates being kept in place far too long. Our net international reserves grew because interest rates were much higher than our inflation rates. Those reserves came at an extremely high price.

The result was devastating to those taking business risk, and helpful to those holding cash. The truth is Jamaica liberalized its currency without having any international reserves to maintain stability.

High interest rates attracted foreign currency and destroyed a major section of our business community.

We're still paying the price of those mistakes, and we'll be paying for a long time. In fact our great grand children will be paying off the FINSAC debt.

Politicians talk about the medicine they will have to administer, but they are afraid to explain the sickness and how long it will take to recover. This is true of both major political parties. Bad news is not going to attract any votes.

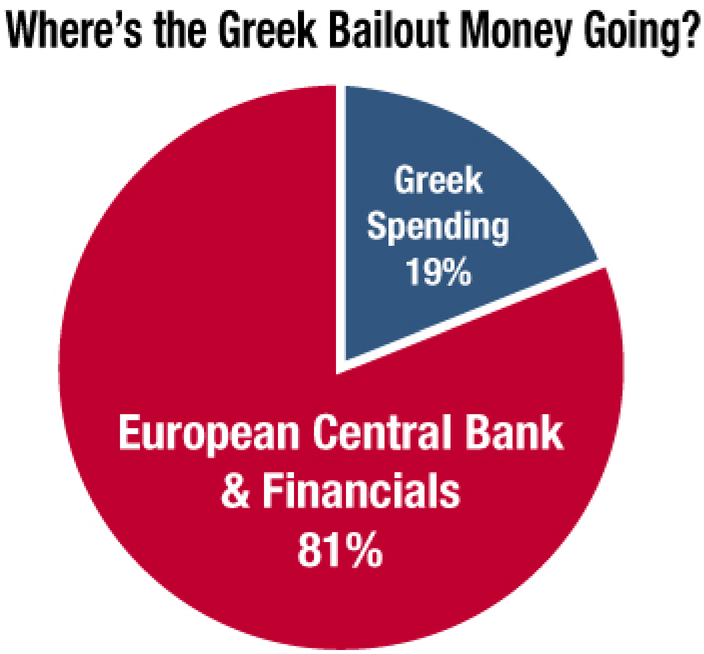
So the answer to the question is YES!

We must use legislation to restrict politicians from burdening us and future generations with inappropriate debt.

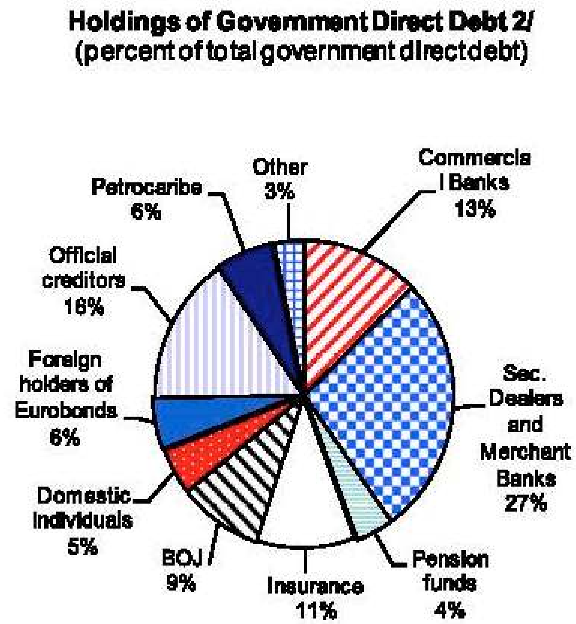
If we cannot tolerate the medicine I suspect there will be social unrest. And social unrest could lead to us throwing up the medicine.

We are in no position to deal with any external shocks, or any natural disasters. As a country we are in a perilous situation.

In the next few weeks we must pressure the political parties for full disclosure, and credible plans to deal with our debt burden. If we do not we will get the government we deserve.



Jamaica



Here you can see plainly the reason the Europeans are determined to bail out Greece. They see their banks … not Greece.

The difference in our case is that at least 80% of our total debt is owed to local financial institutions and individuals

A Jamaican debt default would wipe out a major slice of Jamaica's wealth.

During the 1990's real growth was taking place in paper assets even as "real asset" destruction was taking place directly related to governments high interest rate policy. Security dealers and merchant banks now hold 27%. Ouch!

At what point will our debt service be equal to current revenue in the absence of devaluation? GDP growth that comes from devaluation is only an illusion of growth … and is in fact a tax levied for the purpose of debt service.

If there is no devaluation and debt increases by slightly more than 400 billion, debt service will be equal to or greater than current revenue … depending on the level of interest rates.

That leaves two options:-

1) Print enough money to devalue the debt and the currency … but that is what we have been doing for years and it has not worked. Today we are drunk with debt.

2) Come up with credible strategies to grow GDP through production increases. The real deal for the first time in a long time.

Involve everyone in what must be the Nations number one priority. To save Jamaica through innovation, creativity, production, entrepreneurship, and a passion to achieve budget surpluses within 7 years.

Its not a JLP goal or a PNP goal … it has to be everyone's goal to play a part and celebrate our success when it comes. Like when Kennedy made it a National goal to put a man on the moon within a decade.

With so much of our debt owed to Jamaicans any default, whether negotiated or disorderly, will devastate and pauperize hundreds of thousands of Jamaicans and those dependent on them. This is why it must be our Nation's goal to have budget surpluses in 7 years.

In a default government revenue would fall along with debt servicing. Financial institutions would bear the biggest blow and would have to be propped up by the US$ 950 million offered by the Multi Laterals specifically for that purpose.

If we are forced into that position our National pride will be mutilated and solutions will come at a heavier price than FINSAC.

Right now the most important task is to make sure those hoping to represent us in Parliament understand at a cellular level what has happened and what must be done to make us whole again.

If they don't get it … they are dealing with social unrest.

What can you do to help them get this message and understand it in their DNA?

Biggest Risk to the Financial System

Security Dealers and Merchant Banks hold 27% of Jamaicas total debt … that exceeds 400 billion Jamaican dollars. But the frightening aspect is their business model … which is Repo based.

These dealers raise money for government from the domestic market. They buy huge amounts of government bonds by leveraging their equity up to 12 times. … and that level of leverage is very dangerous.

So there is probably about 40 billion of equity controlling 400 billion of government bonds. The bonds are bought for their own account and tenures range from short term to long term.

These dealers then sell small slices for short periods to individual investors using what is called a Repurchase Agreement … or Repo. The dealer sells you an interest in their security for say 30 or 60 days. They make a spread on the transaction and they H O P E you roll it over *every time* it matures. But they are obliged at your request to return your money at the 30 or 60 day repo date.

That word 'hope' is important … because there's a miss-match between the security they hold and the one they issued to you. So if investors become skittish and decide not to roll over their Repo's all hell could break loose.

The underlying security will lose value at the same time they need cash to honour the Repos. This then leads to margin calls from the foreign institutions that took the underlying bond as security … for the loan they gave the Dealer to load up with government bonds.

A 10% fall in the value of government bonds on the secondary market would force the dealers to "mark the securities to market" on their balance sheet. At that point all their equity is gone and they could not meet the margin calls.

That's why the Multi Lateral lending agencies loaned Jamaica US$950 million … 81.7 billion Jamaican dollars to bail out the dealers when this happens. However those funds were tied to 90% participation in the JDX and may not still be available.

In the United States MF Global declared bankruptcy a few weeks ago. They leveraged up on Italian bonds that lost value and they could not meet the margin calls. It seems they then raided client accounts.

The Chicago Mercantile Exchange did not do what they have always done … protect client funds. So everyone got hurt.

Both the government and the IMF projections for Jamaica are based on a recovery in the Global economy. In other words our economic recovery is tied to a recovery in the Global economy. This recovery looks less certain today than when the projections were made. In fact the IMF now forecasts global economic contraction for 2012 and 2013.

The performance of our economy reflects weakness in the Global economy … so we have to find the creativity and energy to buck this trend.

So much energy goes into servicing debt there is not much left to deal with the pressing social issues facing us.

Government must get out of the business of directing economic activity, and picking winners. They must create the environment and let the energy of market forces work in our favour.

On the next page is an extract from the IMF report on Jamaica expressing concern about the vulnerability of the Securities Dealers. Government has allowed a high level of risk presumably because they are raising money on the local market for government. And government debt is supposed to be risk free.

Extract from an IMF report on Jamaica.

The securities sector in Jamaica has emerged as an outgrowth of high levels of domestic debt and has benefited from the high yields on government paper. The securities industry is built almost entirely around one product, a 'repo' contract wherein a customer makes a short term investment with a dealer and receives a guaranteed return, backed by government of Jamaica (GOJ) bonds, held on the dealer's books. Dealer purchases of long-term GOJ bonds are financed with short-term repo contracts (generally in 30-, 60- and 90-day terms) that traditionally enjoy high rollover rates-upwards of 80 percent in normal times. Investors are both retail and institutional investors that widely regard repos as a risk-free deposit, despite the fact that investors enjoy returns that reflect sovereign and currency risk premiums. The existence of the repo model has allowed the placement of GOJ bonds with the domestic public because it transforms long-term, large denomination bonds into short term investments in small denominations that provide relatively higher returns than comparable time deposits in commercial banks. This business model has been replicated elsewhere in the Caribbean.

Jamaica's securities dealer model is fraught with inherent risks and the sector is vulnerable to shocks with potential systemic implications. The securities dealer business model bears a concentration risk because dealers are heavily exposed to the GOJ, and liquidity risk because the secondary market for GOJ paper is illiquid. Given mismatch between the rollover period of the contracts and the terms of the bonds these contracts finance, balance sheets are also vulnerable to rollover and interest rate risks.

The dealers are not well capitalized-prudential regulation has not properly recognized these inherent risks-and lax controls on margin operations have allowed some dealers to become over leveraged. These are long-standing risks that were identified in the 2006 FSAP.

Recent stress tests undertaken by the BOJ confirm that the dealers do not have sufficient capital to withstand meaningful shocks to the GOJ market. In addition, given the extent of financial conglomeration in Jamaica, these vulnerabilities could have negative spillovers that could threaten financial system stability.

The debate … a disappointment!

The Minister of Finance, Mr. Audley Shaw says the bitter medicine is already being administered … he must mean we are getting a teaspoon now but next year the dose will be measured in gallons. He skillfully avoided losing any votes.

Dr. Phillips while regretting the financial meltdown of the 90's takes credit on behalf of his government for bailing out depositors. More accurate is depositors were bailed out by taxpayers. How about "we burdened taxpayers, their children, their grand, and great grand children to bail out depositors."

Each of them should submit to an hour on "All Angles" I believe we would get more probing questions and answers.

Banks and Security Dealers … on Repos

Two pieces of information published in the last 24 hours confirm the risk in Repos. The Bank of Nova Scotia is winding down their participation in government securities. It's a risk based decision. But they will not abandon government paper completely. They will pass the risk on to customers in their unit trust. They will lower their risk by passing it to their clients. This is a recommendation of the IMF to lower the level of risk Security Dealers are exposed to in GOJ paper.

And then Proven Investments Ltd admit to losing USD $5,000,000 or J$434,000,000 on disposing of Repos held by its subsidiary "Proven Wealth"

On the other hand First Caribbean International Bank has deleveraged their balance sheet … they now have very little GOJ paper assets. As a result profits have fallen dramatically … but they are better prepared. They seem to think the extra profits that come from leveraging equity to own GOJ debt is not worth the risk. This seems to be a new mindset for them

You can download the FCIB balance sheet from the Jamaica Stock Exchange website.

The two news items I referred to follow on the next 2 pages.

Scotia to focus more on loans

Bruce Bown, CEO of the Scotia Group.

Bruce Bowen, the CEO of the Scotia Group, says the bank will be looking to grow the amount of assets on its balance sheet that are tied up in securities.

Most of the bank's securities are actually tied up in government paper, but the bank says it does not intend for that to be the case going forward.

"We've been managing, trying to shift more of our balance sheet into loans as apposed to securities and that is a risk management decision that we taken (as) too much of our balance sheet was exposed to government securities, so we've been trying to manage that balance," Mr. Bowen said.

The strategy is a marked shift in the bank's thrust over recent years to hold most of its assets in what were once lucrative government securities.

Currently, about 47% of Scotia's balance sheet is tied up in government securities.

Mr. Bowen even indicated that while the bank has been seeing strong growth in deposits, it will not increase the amount of government securities on its balance sheet.

"I'm not comfortable investing it in building our securities book and so we'll be moving it into investment grade securities."

The bank says it wants to focus more on making loans best practice.

Loans currently account for 30% of Scotia's balance sheet.

The Scotia Group says it will not close its vaults to the government, but will do so through off balance sheet methods, such as its unit trust.

Proven Pref Share Offer Opens Tuesday

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Christopher Williams, president and CEO, Proven Investments Limited. - File

Proven Investment Limited (PIL) will next Tuesday open its planned $1-billion preference share offer in a bid to finance acquisition deals.

The offer opens December 20 and closes on December 23, according to the prospectus posted on the Jamaica Stock Exchange this week.

The company plans to issue two hundred million shares at J$5.00 (US$0.01) each, the minimum subscription amount of which is 20,000 shares for a total price of J$100,000. The five-year issue, arranged by NCB Capital Markets, will offer an annual tax-free dividend of eight per cent.

Chairman of PIL, Hugh Hart, said in an accompanying statement to the offer that "the purpose ... is to raise funds to pursue additional acquisition opportunities, to fund corporate debt deals with Jamaican blue-chip companies, as well as to expand our investment portfolio, with the purpose of continuing to provide an enhanced level of income, above-average returns, and preservation of capital."

PIL had earlier stated that it would use the funds to acquire a small loansfinancing company, a stake in a tourism attraction, and it would set up a real-estate subsidiary, a REIT, to purchase two properties.

On July 14, 2011, PIL became the first company to list ordinary shares on the Jamaica Stock Exchange denominated in United States dollars.

The company's US$29.68 million in shareholder equity at September 2011 declined 17 per cent year on year due to the sale of Government of Jamaica repos held in its subsidiary Proven Wealth.

PIL made US$1.14 million in net profit for its September quarter, or 71 per cent less than the prior year's quarter.

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Too Big to Rescue … The Financial Sector

During the 1990's government strategy encouraged the formation and growth of "Security Dealers" so they could become the engine driving distribution and sale of government securities. And now that over 80% of Jamaica's debt is, owed to Jamaicans and local institutions, the IMF is encouraging a change in the risk profile of Security Dealers. They want to transfer risk from dealers to their clients. More on that later.

With interest rates on government paper higher than commercial bank savings rates … dealers expanded by leveraging their equity between 12 and 16 times buying government bonds and selling "repos" for 30, 60 or 90 days to the general public. The Security Dealers business model is almost entirely based on "Repos" This presents us with huge concentration of risk … too many eggs in one basket.

However in the 1990's there were 3 big winnersr!

- The government raised humungous amounts of money from Jamaicans, rather than having to take exchange risk by borrowing from foreigners.
- Jamaican's earned a better rate of interest than they could get from the formal banking sector.
- The dealers unleveraged equity made 3% … however by leveraging the equity the dealer could, and did, make up to 16% on average equity. That's the difference between making 200 million and making one billion dollars.

Greed, and governments huge uncontrolled appetite for borrowing money they cannot repay ... has led to a "CONCENTRATION OF RISK" dilemma.

For the last 15 years government paper was viewed as risk free … this perception along with a yield higher than inflation led to parabolic growth by Security Dealers and fed GOJ's appetite for debt.

In the process one set of people got wiped out and another set earned so much interest they became reluctant entrepreneurs … why take business risk to make 10% on the bottom line when you can earn 40% on government paper.

So we saw a huge slice of Jamaican wealth wiped out when the financial sector collapsed. At the same time another set of Jamaicans cut back on investments in productive enterprises to favour lending to the government.

The Security Dealers were purchasing government bonds by leveraging their equity up to 16 times, and selling short term REPOS's to Jamaican's and Jamaican institutions.

They guarantee to repurchase in 30, 60, or 90 days at a fixed price. The underlying bond is a longer term instrument … so there is a mismatch that could lead to system wide problems in the financial sector.

The IMF is encouraging the government to promote the establishment by Security Dealers of pooled investment vehicles like "Unit Trusts" and "Mutual Funds". Their clients will be encouraged to buy shares in these "FUNDS" and by doing so, risk that now resides with the Security Dealers, is transferred to FUND participants.

The tax payer is being set up to bail out the financial sector ... for a second time.

Politicians are ready to make the serious decisions needed to correct our troubled financial situation ...

However everyone is looking to the government for something … big corporations want waivers and everyone else wants to know what government is going to do for them.

What has happened to being self sufficient and independent?

We need self reliant and self sufficient citizens. Where this is not possible, through disability, civil society and government have responsibility.

We can be self reliant and caring at the same time. In fact self reliant citizens have the ability to respond in caring ways.

Becoming self reliant starts with quality early education …

Government must set the example by becoming self sufficient. They must teach self sufficiency by the example they set … and the manner in which they manage the country's affairs.

Global currency crisis

The signs of a global financial and currency crisis have been visible for years. The current world crisis did not happen by accident … it's been a deliberate act.

In 2003 I published on the internet an assessment of what the USA was doing to its currency . It was based on my noticing similarities between what was happening in the US and what had already happened in Jamaica. Though it would take much longer in the USA because the USD has the worlds reserve currency … and oil is priced in USD. Once the demand for oil increases the demand for US dollars increases. This simple fact gives the USA the opportunity to print more and more currency. Then they started taking advantage of the privilege.

Towards the end of 2006, or maybe it was early 2007, General Alexander Haig wanted to interviewing me for a program to be aired on CNBC. I was happy that General Haig showed interest in the ideas I expressed however I declined his invitation .

Today I am more convinced than I was in 2003 that the USA and the world are about to pay a huge price for failed attempts to smooth out economic cycles of expansion and consolidation. The result … many bad investments have been transferred from their original owners to the tax payer.

And a huge mountain of bad investments are still with us. They mushroomed in an environment of low interest rates and easy money … in an era of cultivated bubbles. Deliberately cultivated and inflated by politicians and Central Bankers around the world. Even though the bubbles have burst efforts are being made to push the consequences further into the future.

Next I intend to look at the role Face Book and Twitter are playing in global economic and political matters. The world is radically different because of them. They have facilitated a huge transfer of power from governments … to those they govern.

What governments and dictators believed could not happen to them is occurring now. … in Jamaica governments expect at least two terms … almost as an entitlement. This too has changed!

Arrogance and contempt to, and for, 'the people' is being collectively resisted in the social media. Brilliant young minds … exposed from birth to computers & the information age have developed software and programs to exploit linkages between people … loosely called friends. Within minutes one message that resonates with millions of people can reach those millions. And the message may contain a resonant call to action.

Most people over 50 do not fully comprehend the technology … and people of my generation are barley computer literate. Young people are changing the world fast … and that is how it should be. They understand the technology and how to exploit it. Time appears to be speeding up simply because knowledge doubles about every 12 months.

Compare that to when things remained unchanged for centuries, and then decades.