Bank of Jamaica

Quarterly Press Briefing
14 February 2007

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Governor, Bank of Jamaica

Good Morning Ladies and Gentlemen:

It is a pleasure to welcome you to our first quarterly briefing for 2007.

Today we are releasing the Quarterly Monetary Policy Report for the quarter ended December 2006.

The Report comes against the background of sustained stability in the macroeconomic environment and strong indications of growing economic vitality: output expansion, falling unemployment, stable prices, reserve accumulation and declining interest rates. The Report also comes in the wake of the recent movement in the exchange rate that has seen a decline in the value of the Jamaica Dollar of about 0.8 per cent since December.

As usual we focus on the performance of the main indicators during the review quarter and highlight the actions taken by the Bank of Jamaica in the evolving scenario. We also include the Bank's outlook for the March 2007 quarter.

Let me turn first of all to the matter of **Inflation**

Ladies and Gentlemen, for the December quarter headline inflation was 0.3 per cent, well below the average increase of 2.9 per cent for the last 5 December quarters. With this out-turn **headline inflation for the calendar year 2006 was 5.8 per cent. This compares with 12.9 per cent for 2005. The inflation for 2006 was therefore the lowest for a calendar year since 1981.**

The inflation out-turn for the calendar year benefited from the sharp reversal in international oil prices and lower prices for agricultural commodities in the second half of the year, and more-so in the review quarter. Crude oil prices fell by 14.8 per cent to an average of US$60.00 per barrel in the December quarter - the sharpest decline in oil prices since the June 2003 quarter. Concurrently, the favourable weather conditions contributed to increased supplies and lower prices for agricultural commodities, particularly starchy foods. Monetary impulses were also well contained and the foreign exchange market remained fairly stable.

We estimated core inflation at 0.5 per cent for the quarter and 3.3 per cent for the calendar year. This is in line with the Bank's medium-term trajectory for maintaining annual core inflation below 4.0 per cent.

Going forward, **the Bank expects headline inflation to be in the range of 0.4 per cent – 1.4 per cent for the March 2007 quarter**. F**or the fiscal year therefore, we expect headline inflation to be between 6.0 and 7.0 per cent.** As we see it, the risks to this forecast are fairly balanced. Inflationary impulses could emanate from the seasonal increases in some service items, such as insurance premiums and increases in the cost of property rental during the quarter. However, the continued reduction in the price of agricultural commodities is likely to be a countervailing influence. The possibility that oil prices could increase as a result of reductions in international oil supply is, of course, an added threat.

I now turn to the … **Foreign Exchange Market**

The foreign exchange market was fairly stable in the review quarter, in spite of some bouts of instability in October and November. In the context of the these bouts of instability, the value of the Jamaica Dollar *vis-à-vis* the US dollar depreciated by 1.6 per cent, relative to an average depreciation of 0.75 per cent for the previous three quarters. Inflows to the foreign exchange market in the quarter were bolstered by the growth in receipts from private transfers and tourism. In addition, there was lower demand for foreign currency to facilitate payments for imports, relative to the September quarter.

The stock of net international reserves remained strong at over US$2.32 billion at the end of the quarter - this, notwithstanding a marginal decline of US$20.4 million relative to the September quarter. Gross reserves at end-December were in excess of US$2.4 billion, representing 18.1 weeks of projected imports of goods and services.

For the March quarter, the Bank is expecting that the money and foreign exchange markets will remain fairly stable. Consistent with seasonal patterns and with the sentiments expressed by business leaders in the sector, we are anticipating robust flows to the market from tourism. The Bank is also forecasting higher inflows from other export receipts and a decline in demand for foreign exchange to effect payments for imports. This should be complemented by lower demand for funds to meet outward remittances and to facilitate Jamaicans travelling abroad. We also anticipate strong private sector inflows towards the end of the quarter. In the context, we expect to continue to maintain a comfortable level of net international reserves.

Against the background of positive economic fundamentals, we have no reason to believe that the recent bout of instability in the foreign exchange market in January will result in any major disequilibrium in the market. Information suggests that the demand pressures could have been due to portfolio switching in view of limited domestic financial assets. Additionally, there was some exceptional demand from the energy sector as well as demand from some authorized dealers who might have been trying to cover temporary short positions. As you would have noticed, the Central Bank acted decisively to quell the demand pressures by selling foreign currency to the market as well as by offering Jamaica Dollar instruments to absorb the excess liquidity in the system.

The Bank, as you know seeks to avert sharp movements in the exchange rate by maintaining order in the foreign exchange market. Accordingly, we will continue to monitor the markets and act pre-emptively where necessary.

Interest Rates

In the context of the positive trends in the December quarter and the expectation of a favourable March quarter, **the Bank reduced interest rates on the spectrum of open market operations instruments on December 22, 2006, by 30 basis points**. As a consequence, rates presently range from 11.65 per cent on the 30-day tenor to 12.0 per cent on the 180-day tenor.

So much for our core-mandate areas. I now turn to

<u>Developments in the Real Sector</u>

The Bank's preliminary assessment of Gross Domestic Product (GDP) for the December 2006 quarter shows that there was continued growth in the economy in line with that of the three previous quarters. All sectors are estimated to have grown with the exception of *Manufacturing*. It is estimated that *Agriculture, Construction, Mining & Quarrying* and *Transport, Storage & Communication* were the main drivers of growth.

The main factors supporting growth were investment spending, recovery following the adverse shocks of 2005, enhanced productivity in some sectors as well as relatively favourable domestic and external conditions. In addition, the productive sector benefited from an increase in loans from the commercial banks.

For the March 2007 quarter, the Bank's forecast indicates that the economy will expand at a faster rate than for the previous three quarters. Growth will be largely driven by *Construction, Mining, Tourism* and *Agriculture* with the Construction and Mining sectors expected to normalize after the problems in those sectors in 2006.

<u>Conclusion</u>

Finally, Ladies and Gentlemen, let me again assure you of the Central Bank's commitment to low and stable inflation. This means containing demand in line with country's productive capacity. The process involves not only the Central Bank but the Government, the private sector and the workers. The Government must continue to improve the management of the fiscal accounts and the private sector and workers must be committed to a sustained increase in productivity. As partners in the effort to sustain growth and development, we must all ensure that we meet our end of the bargain.

Thank you.