Quarterly Press Briefing
Hon. Derick Latibeaudiere, Governor, Bank of Jamaica
28th November 2007

Good Morning Ladies and Gentlemen:

It is a pleasure to welcome you to our quarterly press briefing. Today we are releasing the Quarterly Monetary Policy Report for the September quarter. As usual, I will give you a synopsis of how the September quarter evolved as well as the Bank's outlook for the December quarter.

I look first at the Foreign Exchange Market:
The Central Bank was severely challenged during the September quarter and with the extended period of volatility in the foreign exchange market the challenges have continued into the present quarter.

The foreign exchange market experienced major demand-supply imbalances during the quarter. Contributing to this was a decline in net private capital inflows which resulted largely from the narrow interest rate differential between foreign currency-denominated instruments and domestic currency investments. The interest rate differential has continued to be low despite progressively higher monthly rates on GOJ Treasury Bills and a 50 basis point reduction in US Federal Funds rate in September.

The foreign exchange market also suffered from the disruption caused by the hurricane in August and the uncertainty surrounding the general election. In addition, there were continuing increases in global commodity prices, particularly crude oil and grains. The crisis in the US sub-prime mortgage market which spilled over into the global financial markets also eroded investor confidence. We have included an article in ***Box 1*** on this issue.

Delays in the implementation of a number of projects and the uncertainty regarding the availability of Jamaica Dollar instruments with the desired hedging features were other factors that had a negative impact on the foreign exchange market. Together these factors contributed to increasing the demand for foreign exchange, which fuelled the instability in the market and created an incipient upward pressure on interest rates.

The instability in the foreign exchange market was aggravated by the high level of liquidity in the system. As a consequence, the Bank was very active in the

financial markets during the quarter, selling significant sums of foreign currency to alleviate the demand pressures. The Bank also offered attractively priced Jamaica Dollar instruments during the quarter to absorb excess Jamaica Dollar liquidity.

The Bank of Jamaica sold a total of US$191.2 million (net) to the market during the quarter. This was significantly above the amount sold in the June quarter. In addition, the Bank offered two special variable rate certificates of deposit as well as a special fixed rate instrument to the market. Although these actions slowed the rate of depreciation to 2.6 per cent the depreciating trend was still faster than in the June quarter when the rate of depreciation was 1.1 per cent. As you may be experiencing, the cumulative impact of this is being passed through to domestic prices.

I now turn to Inflation:

You would have noticed that STATIN released the revised CPI basket in September. The revised basket captures the changes in the taste and expenditure pattern of households that has taken place over time as a result of changes in income and technology and the corresponding changes in the weights of some items in the consumer basket. We have provided a brief overview of the revised CPI in ***Box 2.***

Some of the factors that contributed to instability in the foreign exchange market also had a negative impact on the inflation out-turn for the September quarter. We expect that some of these same factors will impact the performance for the rest of the fiscal year.

For the September quarter, headline inflation as measured by the revised CPI basket was 3.6 per cent, relative to 2.5 per cent for the June quarter. This puts inflation for the **calendar year to September at 8.9 per cent** and for **the fiscal year to September 6.2 per cent**.

Higher prices for agricultural commodities caused by the disruption in supplies following the passage of Hurricane Dean, was the main contributor to inflation in the quarter. The continuing increases in international commodity prices, particularly oil and grains, also fed through to domestic prices. The impact of these factors was exacerbated by the depreciation in the value of the domestic currency. Inflation in the quarter was therefore reflected in the higher cost of food items, increased utility rates and higher transportation costs. Also **contributing** to the inflation out-turn for the September quarter was the usual increase in tuition fees at the start of the new school year.

For the December quarter the Bank expects headline inflation to be in the range of 3.3 per cent to 4.3 per cent. At this time our projections for the fiscal year are indicating that we will not achieve single-digit inflation as we had

anticipated. This is based largely on the expectation that in the December quarter inflation will continue to be driven by the same cost push factors that influenced the outturn in the September quarter that is, higher international commodity prices and increased costs for domestic agricultural commodities. We also expect some pass-through of the accelerated movement in the exchange rate.

With regard to international commodity prices, we are forecasting that oil prices, which increased by 16.2 per cent in the September quarter, will increase by about another 22.0 percent in the December quarter. This forecast reflects the impact of a lower US dollar, concerns about inventories as well as the geo-political tensions in the Middle East. The prices of wheat and corn are also expected to continue to increase in the context of the growing world demand and the shortfall in supplies.

Supplies of domestic agricultural commodities are not expected to recover sufficiently to meet the seasonal growth in demand and therefore we expect prices of these commodities to continue to increase in the December quarter. In particular, we expect that the shortfall in supplies of fruits and vegetables occasioned by the passage of Hurricane Dean will lead to higher costs for these commodities in the quarter. The hurricane and the recent flood rains also had an adverse effect on the supply of tubers for which we have seen a declining trend in supplies since the beginning of the fiscal year. The prices of these items in the consumer basket are also expected to be higher in the December quarter.

The main risks to the inflation forecast for the December quarter and indeed the fiscal year, are adverse weather conditions, greater than projected increases in the prices of international commodities, mainly oil, as well as continued instability in the domestic foreign exchange market.

Real Sector Performance

The Bank's estimates suggest that economic growth moderated during the September quarter. Growth for the quarter is estimated in the range of 0.5 to 1.5 per cent compared with the average growth of 2.5 per cent since the September 2005 quarter. The slower rate of expansion in the September quarter is attributed to the fall out in ***Tourism***, ***Mining*** and ***Agriculture*** as a result of the passage of Hurricane Dean. The fall-out from these sectors was partly off-set by expansion in ***Transport, Storage & Communication, Financing & Insurance, Manufacturing*** and ***Construction***.

The Bank is projecting stronger growth for the December quarter, than in the September quarter. This is predicated on recovery in ***Tourism*** and stronger growth in ***Construction & Installation***. Overall, we expect that growth in the economy will be supported by continued expansion in private sector credit, continued investment spending and increased productivity in some sectors.

Conclusion

Ladies and Gentlemen: as I indicated earlier, the developments in the international markets have continued to have an adverse impact on the domestic economy. The increases in the prices of some domestic commodities arising from our own domestic conditions have also created challenges for us. But as usual, the Central Bank will continue to meet these challenges with our customary resolve to ensure macroeconomic stability.