BANK OF JAMAICA

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BY
GOVERNOR DERICK LATIBEAUDIERE

Good Morning Ladies and Gentlemen,

Welcome to the release of another of the Bank's Quarterly Monetary Policy Reports (QMPR), which reviews economic developments for the period April to June 2006 and outlines the Bank's view of the near-term outlook.

As is customary, I will briefly highlight some of the developments in the review quarter and share our view as to how we see the September quarter unfolding.

Review of the June Quarter

Overall, the positive financial and economic trends that have been in evidence since the December 2005 quarter continued into the June 2006 quarter.

- Annual inflation continued to decelerate,
- the money and foreign exchange markets remained relatively stable,
- international reserves remained at a comfortable level, and
- real-sector activity is judged to have accelerated in spite of difficulties in the construction sector.

In the context of these favourable trends, the Bank undertook three policy adjustments early in the quarter. I mentioned these when we last met, but I will remind you of them. The Bank

- removed the 270-day and 365-day tenors from the spectrum of open market instruments;
- eliminated the Special Deposit Requirement for commercial banks and Licensed Financial Institutions; and
- lowered interest rates on our open market instruments by 15 to 20 basis points.

As we moved into the quarter the Bank thought it best to maintain a cautious policy stance given the uncertainties regarding further increases in US interest rates and in oil prices. Consequently, the expansion in base money was contained to 3.1 per cent, within the targeted expansion of 3.9 per cent.

Inflation

Of note during the quarter was the continued decline in the 12-month point-to-point inflation which returned to single digit for the first time since May 2003. The 12-month point-to-point inflation was 8.4 per cent at the end of June, significantly below the 17.5 per cent that was reported at the end of June 2005.

Headline inflation for the quarter was 2.8 per cent, higher than the out-turn for the previous quarter, but consistent with the Bank's forecast and with seasonal patterns. In fact, the out-turn for the review quarter compares favourably with the 5.7 per cent of the June 2005 quarter.
Inflation for the review quarter largely reflected increases in the prices of some agricultural commodities and the higher prices for some international commodities, such as grain and oil.

Core inflation was 0.9 per cent for the June quarter. This was consistent with the tight base money management over the previous quarters and with the Bank's medium-term trajectory.

For the September quarter, the Bank is forecasting a seasonal increase in inflation relative to the June quarter. This forecast is based partly on seasonally higher prices for agricultural commodities stemming from reduced supplies of these items and increased export demand for some tubers.

In addition, we expect inflationary impulses to come from higher prices for crude oil, given the usual summer demand and the increased geo-political uncertainties. The price of grains has also been increasing on the international market and this is likely to impact our inflation.

Further, we are anticipating the usual price increases associated with the start of the new school year in September, as well as the demand for goods and services for the holidays.

In this context, the Bank is expecting inflation in the range of 3.0 per cent to 4.0 per cent for the September quarter. However, for the second half of the year the Bank anticipates the usual reversal in the prices of agricultural commodities. Accordingly, we expect that inflation for the fiscal year will remain as previously forecasted at less than 10 per cent.

The threats to the near-term and fiscal year forecast are further increases in oil prices and the possibility of severe weather conditions which could affect agricultural commodity prices.

Foreign Exchange Market

The foreign exchange market exhibited a greater level of stability in the June quarter than was evidenced over the previous three quarters. This was reflected in the depreciation of 0.8 per cent in the weighted average selling rate of the Jamaica Dollar *vis-á-vis* the US dollar, relative to the average depreciation of 1.9 per cent over the three previous quarters.

The improved conditions in the foreign exchange market in the quarter were influenced by increases in private capital flows as well as inflows from tourism and remittances. The continued buoyancy in private capital flows was largely attributed to heightened investor confidence in the context of the moderation of inflation expectations and the continued improvements in other macroeconomic indicators.

Against the background of these improvements, the net international reserves increased by US$31.9 million in the quarter to US$2 110.1 million at end June. Gross reserves of US$2 293.2 million, were comfortably above the international benchmark of 12 weeks of estimated goods and services imports.

Growth

The Bank's estimates indicate that real GDP growth accelerated in the June 2006 quarter. All sectors are estimated to have expanded, with the exception of the construction sector, which was affected by problems in the cement industry. Growth for the period was led by ***Agriculture, Miscellaneous Services*** **and** ***Transport, Storage & Communications*****.**

<u>I now turn to our outlook for the Near-term</u>

We expect that the favourable economic and financial trends will continue in the September 2006 quarter.

Strong growth in real GDP is being projected, supported by stability in the domestic financial markets and continuing expansion in banking system credit to the private sector. In addition, the economy should continue to benefit from continued buoyancy in the international economy.

Continued expansion in ***Agriculture, Mining, Construction, Basic Services*** and ***Miscellaneous Services*** which includes ***tourism,*** are expected to be the drivers for overall growth**.**

The financial markets are also expected to remain stable during the quarter. In particular, we expect buoyancy in the foreign exchange market supported by continued strong inflows associated with tourism and remittances.

Despite these positive developments the Bank continues to be concerned about the impact of further increases in international oil prices and in interest rates. We are also in the hurricane season with the possibility of severe weather conditions posing a serious threat to the current projections. The industrial climate is also unpredictable.

Nevertheless, we believe that the upside and downside risks to the Bank's forecast are more or less evenly balanced. Therefore we will continue to monitor the domestic and global developments and to maintain a cautious monetary policy stance, undertaking adjustments as the opportunity arises.

In closing let me point you to the following special articles in this issue of the QMPR:

"A review of private sector credit over the past five years";

"An assessment of labour market trends in the economy" and,

"The factors influencing the narrowing of the Jamaican/US interest rate spreads".

I trust that you will find these articles useful reading.

Thank you.