BANK OF JAMAICA

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Quarterly Press Briefing

Hon. Derick Latibeaudiere,
Governor, Bank of Jamaica

Good Morning Ladies and Gentlemen:

It is a pleasure to welcome you to the release of the Bank's Quarterly Monetary Policy Report for the quarter ended June 2009. The current Report analyses financial and economic developments in the review quarter and sets out the Bank's near-term outlook for the economy.

Ladies and Gentlemen,

I must say that we are mindful of the extraordinary challenges that we have been facing and aware of the uncertainties that many persons feel especially with regard to the government's intention to return to the IMF. Indeed, Jamaica's intended return to a borrowing relationship with the International Monetary Fund (IMF) is a positive effort to assist in stabilizing external pressures and in addressing structural reforms in a sustainable way. To facilitate a clearer understanding of the IMF and Jamaica's experience with the Fund we have included a special article on the IMF in this quarter's Report.

Adding to the prevailing uncertainties is the recent **pre-mature** downgrade of Jamaica's credit rating by Standard and Poors. S&P's lowering of the country's long term foreign and domestic currency ratings to 'CCC+' from 'B-', was based on their interpretation of a set of options that were presented to the government for consideration. However, the Government had not taken a decision on those proposals.

The options were presented to the government by a private institution and a specialist legal advisor was engaged to help in assessing the merit of these options. It was important to ensure that in coming to a decision there would be no breach of contract that would lead to the unhinging of public trust. It was also important to be mindful of the binding nature of contractual obligations and the implications of establishing a precedent. The Government continues to maintain its resolve to honour all obligations, as contracted, and therefore the rating action was unwarranted.

Having said all of that, before I get to the matter of the Quarterly Report I also want to assure the public that the Bank of Jamaica continues to keep monetary policy focused on maintaining macro-economic stability. I believe that it is important for the public and the market players alike to know that the fundamentals of our economy have not been deteriorating despite the many near-term challenges.

Indeed, most of the economic indicators are pointing in the right direction, that is, to improvement over the medium term. Inflation and inflationary expectations have been trending down and we expect them to remain subdued. The exchange rate has remained relatively stable and we expect this stability to continue. The current account of the Balance of Payments is projected to improve dramatically, from a deficit of 21 percent in FY2008/9 to a deficit of 12 percent in FY2009/10. These are all positive signs for our economy.

We are all aware that prompt attention to questions of fiscal sustainability is particularly critical to the achievement of financial stability and lasting economic growth. The government is committed to addressing the country's fiscal problems. However, this will require difficult choices. Postponing those choices will only make them more difficult. Therefore, if we can agree on a sustainable long-run fiscal path now, this could yield considerable economic benefits in the form of lower interest rates, debt reduction and increased consumer and business confidence over the medium term.

Ladies and Gentlemen,

Making policy decisions in an extraordinary difficult environment involves making tough choices. Perfect solutions are not always achievable or even feasible. But I can assure you that our decisions will always be made carefully, and with an eye towards finding the right balance between the risks and rewards of alternative choices. Most critical is our commitment never to take actions that might compromise our ability to maintain sound monetary policy or actions that might undermine our ability to achieve the Bank's mandate of price stability and financial stability as the bases for fostering sustainable economic growth.

I trust that with this digression, I have clarified some of the issues that are of concern and I will turn now to the subject of our Quarterly Report, some aspects of which I have already mentioned.

Monetary and Foreign Exchange Policy

Interest rates

Against the background of a relatively stable foreign exchange market since mid-February and the Bank's preference to operate in the shorter end of the market, the Central Bank reduced the interest rate on its 365-day certificate of deposit (CD) by 133 basis points at the beginning of the June 2009 quarter. This action brought the rate on the 365-day instrument to 22.67 per cent, removed the premium on the instrument and aligned the yield with that paid on the 180-day CD. Later in the quarter the 365-day CD was removed from the spectrum of open market operations instruments.

On July 24th and 30th the Bank again reduced interest rates by 100 basis points and 150 basis points, respectively, across the entire spectrum of its open market operations instruments. These actions were based on the continued stability in the foreign exchange market, the reduction in annual inflation and in inflationary expectations. The Bank will continue to monitor the developments in the market and adjust policy to ensure continued stability in the financial markets. We believe that these actions together with the Government's announced intention to enter into a borrowing arrangement with the International Monetary Fund has boosted investor confidence.

Foreign Exchange Market

The foreign exchange market remained relatively stable in the June quarter. This was reflected in the marginal depreciation of 0.29 per cent in the value of the Jamaica Dollar vis-á-vis the United States dollar over the quarter.

Stability in the foreign exchange market during the quarter was also enhanced by an estimated contraction in net foreign currency demand to facilitate current account transactions. This contraction was associated with a decline in foreign exchange outflows resulting from lower expenditure on consumer goods and fuel imports. Stability was achieved in the market despite the fall out in tourism and remittances.

At end-June the net international reserves was US$1,619.4 million. Gross reserves amounted to US$1,660.6 million, representing 13.1 weeks of projected goods and service imports. Notably, the stock of NIR increased to US$1,654.9 mn. as at 10th August, 2009.

Inflation

Headline inflation was 2.7 per cent, relative to ther Bank's forecast of 4.0 – 5.5 percent and 1.3 per cent for the preceding quarter. The lower outturn relative to forecast was due largely to the stability in the foreign exchange market and the lower than expected im0pact of recent tax measures on retail prices. The outturn for the quarter brought the twelve-month point-to-point inflation to 8.9 per cent. Underlying or core inflation also continued to decline reflecting the Bank's tight monetary policy stance.

Inflation in the June 2009 quarter reflected an increase in non-food prices. This stemmed mainly from increases in international commodity prices and adjustments in some administered prices arising from the implementation of the Government's tax measures during the review period. Of note, was the increase of 38.4 per cent in the price of the benchmark West Texas Intermediate crude oil in the March quarter. This followed an increase of 16.0 per cent in the March quarter.

For the September quarter, headline inflation is projected in the range of 2.0 per cent to 3.5 per cent. Increased energy prices and seasonal demand and supply factors will be the major influences on inflation in this period. However, excess production capacity, depressed domestic aggregate demand and stable inflationary expectations are expected to provide some offsetting impulses.

The forecast for headline inflation for the fiscal year has been revised downwards to the range of 10-12 per cent from the previous forecast of 11-14 per cent. This revision is largely due to the lower than expected pass-through of some of the recent tax measures as well as the deceleration in the rate of depreciation in the value of the domestic currency.

The downside risks to the inflation forecasts include the impact of a greater than anticipated reduction in global and domestic demand. The upside risk is the possible impact of adverse weather.

Real Sector

The Bank estimates that the Jamaican economy contracted in the range of 3.5 per cent to 4.5 per cent for the June quarter. This was the sixth consecutive quarter of decline. The estimated decline also represented the sharpest quarterly contraction in the past ten years. The main influence on the performance of the real sector was a sharp decline in ***Mining & Quarrying,*** due to the closure of two of the three aluminium plants. However, robust growth is estimated for ***Agriculture, Forestry & Fishing*** and ***Hotels and Restaurants.***

The estimated contraction of the real sector occurred against the background of continued weak external and domestic demand as well as uncertainty regarding future economic prospects, indicated by the decline in the business and consumer confidence indices in the review period. The continued decline in remittances as well as growth in local unemployment contributed to the weak domestic demand.

The downturn in the global economy will continue to have an adverse impact on the Jamaican economy in the September quarter. The domestic economy is projected to contract in the range of 3-4 per cent for the September quarter with continued contraction in ***Mining & Quarrying, Construction, Transport, Storage & Communication*** and ***Manufacture***. The sectors projected to grow are ***Agriculture, Forestry & Fishing*** and ***Hotel & Restaurants***.

We are continuing to maintain our forecast for contraction in domestic output in the range of 3-4 per cent for the fiscal year. We expect that the major contraction will occur in the first half of the year, with the rate of decline slowing in the second half of the year as the world recession moderates.

Conclusion

As in the case of other small open economies, the speed of recovery of the Jamaican economy is contingent on the pace at which the global economy improves. Many analysts are of the view that the global recession is at its point of inflexion as there are increasing signs that a number of economies and financial markets have responded positively to the aggressive fiscal and monetary stimuli of the past few months. The projection is for moderate growth in the world economy in 2010.

The stability in the Jamaican economy in the last several months indicates the importance of co-operation in the face of severe resource constraints. A financial programme which enhances resource availability provides a basis for monetary relaxation which is an important component underpinning fiscal improvement and economic recovery.

Ladies and Gentlemen: These are indeed challenging times but with the commitment of all of us, Jamaica will emerge a stronger economy.

I will now take your questions.