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Quarterly Press Briefing
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Ladies and gentlemen,

This is our first press briefing for 2009. I am very pleased to welcome you and I want to wish you all everything that is good this year. Today, we will discuss the Bank's Monetary Policy Report for the quarter ended December 2008 which we published this morning. But before I get to that, allow me to say something about the very difficult global environment in which we are operating.

Let me start by saying that 2008 was a difficult year, to say the least. Economies across the world encountered challenges, the magnitude and scope of which have not been seen since the 1930s. Since we last met, the outlook for the global economy has deteriorated, as the financial crisis intensified and spilled over into the real economies of the advanced and developing countries alike. The major developed countries have now moved into recession, and this has brought a cycle of job losses fuelled by low consumer demand. The repercussions of the crisis are increasingly being felt in the emerging-market and smaller developing economies, and there is a significant erosion of confidence everywhere. The hope is that the continuous all-round effort to stem the tide of the crisis and return the economies to good health, will bear fruit sooner than we think.

It is against this background that the Jamaican economy operated during the December quarter, and it is in this context that we are striving to continue to "make ends meet" in 2009, knowing full well that this is not going to be an easy year for us. The only thing we know for sure, is that Jamaica is not alone and the challenges are more or less the same everywhere, with the only possible difference being the scale and intensity of the problems. Like several other countries, Jamaica has been experiencing its share of exchange rate depreciation, largely as a consequence of the crisis. Further afield in the Caribbean, we were told only recently of some of the effects of the global crisis in the region.

Country Experiences

In view of all that has been happening, I think we should take the time to look at the effects of the crisis on some economies that were deemed to be relatively strong prior to the crisis. These economies - **Iceland, Russia, South Africa, Brazil and Mexico** - have experienced significant capital outflows, exchange rate depreciation, loss of reserves, deterioration in the external accounts and stock market declines as a direct result of the uncertainties surrounding the crisis. In addition, interest rates were increased in all of these countries with the exception of Mexico.

Between 2004 and 2007, all these countries recorded *average real GDP growth* in the range of 3.4 per cent to 7.3 per cent. With the exception of South Africa and Russia, the *unemployment rate* was fairly benign. The *fiscal accounts* were either in surplus, or within the internationally accepted deficit of 3 per cent of GDP, while the *total debt to GDP ratios* were all below 50 per cent. Additionally, with the exception of Iceland, the *external current account* was either in surplus or marginally negative. Given the relatively strong economic fundamentals in most of these economies, and their well developed export sectors, the *nominal effective exchange rate* was either fairly stable or appreciating. In addition, all of these countries had *investment grade ratings* from the major rating agencies.

So what went wrong? Because of the *tightened credit conditions* in the global market, many banks were unable to access international financing to satisfy obligations that became due, and some went bankrupt. The *fall in international commodity prices* led to *terms of trade shocks* and a *decline in production* in some countries. Additionally, the countries that were highly dependent on *inflows from tourism and remittances, experienced a sharp fall-off* in these flows. Finally, with *heightened risk aversion*, these countries experienced *significant capital outflows and a sharp depreciation* in the value of their currencies.

The crisis was transmitted to **Iceland** through the banking system. Iceland was strongly dependent on banking services, particularly off-shore banking. Private foreign denominated debt amounted to 462 per cent of GDP, which made the country particularly vulnerable. When the debt obligations became due, the Icelandic banks were unable to honour these obligations as the international credit market was literally frozen. The financial system in Iceland was also reported to have been poorly supervised.

The government responded to this crisis by taking control of the three largest banks, and formalizing capital account restrictions to prevent further capital outflows. An emergency loan of US$2.1 billion was received from the International Monetary Fund. At the same time, *the monetary authorities increased the key interest rate to 18 per cent from 13.7 per cent in December 2007*. In light of the problems, Iceland's real GDP growth slowed to 1.6 per cent in 2008, from an average of 6.1 percent over the previous 3 years and is projected to decline by 10 percent in 2009. The fiscal balance became negative; Public sector debt to GDP climbed to 108.9 per cent; *the exchange rate depreciated by 43 per cent* and inflation jumped to 18.6 per cent. Iceland's investment rating was downgraded by the rating agencies. The rapid expansion of a poorly supervised financial system was, apparently, Iceland's Achilles heel.

In the case of **Russia**, the crisis was transmitted largely through the downturn of most of its major industries. The *exchange rate depreciated by 20 per cent,* associated with the significant fall in earnings from exports. Real GDP growth decelerated and unemployment increased. Nine (9) banks were closed. The stock market declined sharply amidst declining investor confidence and earning prospects. In response to these developments, the central bank intervened heavily in the foreign exchange market, resulting in a sharp reduction in the level of international reserves. This caused the central bank to cease its intervention and allow the exchange rate to adjust. The central bank also increased its interest rate, established a six-month lending facility for banks, and expanded the range of securities that financial institutions can use as security for repurchase agreements. Russia's investment rating was downgraded, due largely to the loss in reserves.

South Africa's problems stemmed from the significant decline in the price of its exports, which led to a sharp reduction in the external current account surplus. This, together with increased risk aversion and capital outflows, contributed to *depreciation of 24 per cent in the South African rand*. The central bank intervened heavily in the foreign exchange market, resulting in a loss of reserves. The *central bank also tightened its monetary stance by increasing the repurchase rate*. South Africa's investment rating was also downgraded by the rating agencies.

Brazil suffered a 50 per cent decline in the stock market index, due to increased investor uncertainty which led foreign investors to sell-off Brazilian shares and holdings of local currency, in order to cover losses elsewhere or simply to move to safer assets. The capital outflows led to a *depreciation of 30 per cent in the exchange rate*. In addition, the Industrial Production Index declined sharply, the external current account balance deteriorated, and there was postponement of some foreign direct investments. Following these developments, *the central bank increased the repurchase rate*; modified cash reserve requirements and sold foreign exchange to the market. Collateralized loans were also extended to the export sector, and taxes on fixed income capital inflows were removed. Brazil's investment rating was downgraded by the rating agencies.

In the case of **Mexico,** exports, investments, remittances and the level of employment fell significantly. In addition, the *exchange rate depreciated by 20 per cent*. The Mexican authorities responded with several measures. The central bank reduced interest rates in spite of an acceleration in inflation, and intervened in the foreign exchange market, which resulted in a fall in the international reserves. A new liquidity facility, together with changes in the auction schedule of government securities and a reduction in the tenor of these instruments, were also introduced along with interest rate swaps and government securities repurchase auctions. On the fiscal side, the government increased public spending on infrastructure, provided assistance to small and medium enterprises and instituted a modest stimulus package of US$150 million.

Against the background of the experience of these countries, we can now look at the impact of the crisis on Jamaica. As you know, the Jamaican economy has encountered periods of difficulty in the past. We have learned from those experiences, and have for many years been building a sound banking system and a responsive monetary policy framework. We have also been ensuring that we maintain a reasonable level of reserves for insurance. There was therefore some 'cushioning' as we entered this period of global financial and economic downturn.

The banking reforms of earlier years ensured that Jamaican banks were adequately capitalized above the BIS standard, and were subject to strict regulatory requirements and oversight. Consequently, our exposure to the troubled global financial institutions has so far been minimal. In addition, our monetary framework enabled the Bank of Jamaica to take decisive action to maintain stability in the financial markets. The reserves that we have worked so hard to build, continue to provide some cushion and insurance for the future.

In 2008, the value of the Jamaica Dollar depreciated by 12.2 per cent, but this was still below the level of depreciation in some of the countries that I just mentioned. Our reserves have remained relatively strong in spite of the bank's intervention in the foreign exchange market, and inflation is now on a downward trend. Indeed, the IMF in its last report on Jamaica commended the Bank for being proactive in its policy stance, as it is recognized that exceptional developments require exceptional policy action.

Recent Developments

However, as the crisis in the global financial markets intensified during the December 2008 quarter, some of our financial institutions were called upon, at short notice, to repay loans that had been extended by international banks. This followed the increased tightening in global credit conditions, and the decision by investors to further reduce their exposure to risks, particularly to emerging market debt. Global stock market indices also declined further. Central Banks in the major developed countries reduced their interest rates, but the heightened aversion to risk has kept credit conditions tight. Consequently, interest rates in the private retail market have not fallen in tandem with the central banks' signal rates. Heightened risk aversion has also caused international capital markets to remain closed to emerging market economies. These developments, along with unfavourable reports from rating agencies had a negative impact on Jamaica's sovereign bonds.

With these developments, demand pressures in the Jamaican foreign exchange market intensified, despite sales of foreign exchange to the market by the BOJ. This was reflected in a sharp depreciation of 9.7 per cent in the value of the Jamaica Dollar in the December quarter. The pressures in the foreign exchange market were largely influenced by the loss of credit facilities, the pay out of margin-call liabilities and a slowdown in tourism and remittance inflows. As I indicated before, a number of local financial institutions were called upon at short notice, to repay loans that had been extended by international banks. The loss of credit facilities was also experienced by commercial importers, which heightened the demand for cash to both repay outstanding lines and to pay for current imports during the period of seasonally high demand.

The Bank of Jamaica implemented a number of measures in the review quarter to alleviate the demand pressures in the market and to maintain stability in the financial system. These measures were:-

i. ***Establishment of a Special Loan Facility in foreign currency on October 15, 2008 for security dealers and deposit taking institutions with foreign currency needs to repay margin arrangements on GOJ global bonds.***
ii. ***Establishment of an Intermediation Facility in foreign currency on November 12, 2008 to facilitate the flow of credit in the system.***
iii. ***Extension of the foreign currency Intermediation Facility to include deposits and loans in local currency.***
iv. ***Increasing interest rates across the spectrum of open market instruments on October 17 and December 01.***
v. ***Offering of a special 15-day CD to primary dealers and commercial banks on November 18 - 19.***
vi. ***An increase in the statutory cash reserves requirement from 11 per cent to 13 per cent effective December 01***
vii. ***Intervention sales of US$432.1 million in the foreign exchange market for the quarter***.

In spite of these measures, the exchange rate continued to depreciate as the demand in the system remains strong while supply is below seasonal levels. The Bank has therefore implemented a temporary facility to satisfy the demand of public sector entities. By providing foreign exchange on a timely basis for payments such as oil imports, this measure should help to reduce some of the pressure in the market. Monetary policy has continued to be tight with incremental increases totaling 3 percentage points, in the cash reserve requirement being effected on January 2 and February 6.

I will now go to the Economic Review for the December quarter.

Inflation

Headline inflation, as measured by the Consumer Price Index, was zero percent in the December 2008 quarter, relative to 4.7 percent in the September quarter. This out-turn was in comparison to the Bank's forecast of inflation in the range 1.3 per cent to 2.3 per cent for the quarter. The out-turn was also significantly below the 4.7 per cent recorded in the September 2008 quarter, and was well below the previous five December quarters. For the calendar year, inflation was 16.8 per cent, similar to the rate for 2007, while for the fiscal year to December, inflation was 11 per cent compared to 14 per cent for the corresponding period of Fiscal Year 2007/08.

The significant fall in inflation in the December quarter, occurred against the background of tightened monetary conditions, reversal in international commodity prices, deceleration in the prices of some domestic agriculture commodities and weak domestic demand. Specifically, the decline in inflation reflected deceleration in the prices of starchy foods and sharp declines in the cost of utilities and transportation. This latter was related to a 69.1 per cent reduction in the price of international crude oil over the September and December quarters.

For the March quarter, the Bank is forecasting inflation in the range of 1.5 per cent to 2.5 per cent. The inflation outturn for January 2009 was *minus* 0.3 percent, but for the quarter we are still expecting some lagged effect from the recent depreciation in the exchange rate. We also anticipate that there will be some impact from the renewal of annual contracts for various services. Hence our projections for an increase in the March quarter relative to the December quarter. The impact of these increases are expected to be partly mitigated by the continued moderation in domestic food prices, the lagged effects of declining international commodity prices and a general reduction in demand.

Given the lower than anticipated out-turn for the December quarter and the forecast for the March quarter, the projection for inflation for the fiscal year has been revised downwards in the range of 12.5 per cent to 13.5 per cent. This revision is relative to the Bank's earlier forecast of 14 per cent to 16 per cent.

Real Sector Performance

In the context of the deepening global recession, the Jamaican economy is estimated to have declined in the December quarter, continuing the trend since the June 2008 quarter.

In light of the decline in external and domestic demand, both the tradable and non-tradable sectors are estimated to have contracted in the review quarter. The main sectors that are estimated to have either declined or recorded weak growth were, *Hotel & Restaurants*, *Mining & Quarrying* and *Transportation Services*. However, *Agriculture, Electricity & Water* are estimated to have grown.

The Bank's forecast suggests that the economy will continue to experience negative growth in the March quarter. This forecast is underpinned by the continued recession of the global economy into at least the middle of 2009. Given the forecast for the March quarter, GDP growth for the fiscal year is projected to decline in the range of zero to 2 per cent.

You will understand of course, that the outlook for the economy remains surrounded by a high degree of uncertainty, and the risks to our economic performance remain clearly on the downside, due largely to the potential for the turmoil in the financial markets to have a stronger impact on the real economy.

Notwithstanding the many challenges, our experience has shown that things change. We also know that sound policies will eventually work. The speed with which Jamaica recovers, will depend as much on how soon the rest of the world returns to a state of normalcy, as on how well we prepare ourselves for the eventual upturn. So, even as we continue to be mindful of the challenges that are still upon us, we must continue to build the necessary safeguards for the future.

It is critical for all parties concerned, to make their contribution in helping us lay a sound foundation for a sustainable recovery. The Bank of Jamaica is doing its part to limit the impact of the crisis, and to implement sound policies in anticipation of the upturn. In this regard, we continue to maintain a medium-term perspective, and a stability-oriented and sustainable approach to monetary and macroeconomic policy. This, we believe, is the best way to preserve and enhance confidence. But we need the full support and cooperation of the private sector to maintain discipline in the financial and exchange markets.

As we move forward the Bank will continue to carefully assess the future outlook for economic activity and prices, as well as the risk factors, and will implement monetary policy appropriately. We will also carefully consider the opportunities for monetary policy to enhance the environment for sustainable long-term growth.

There is no doubt that, like the rest of the world, we are going through very challenging times, in some respects unprecedented times. For this reason, it cannot be business as usual. In our business, policy making is also about building confidence and enhancing economic and financial education. In this regard, I have deliberately tried to vary this presentation from what is usually the norm. I trust that in doing so, I have managed to convey the need for us to continue to remain cautiously optimistic, even amid the hovering clouds. This difficult period too will pass, if working together we all do our part to minimize the extent of the global fall-out on the Jamaican economy.

Thank you.