Quarterly Press Briefing
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Bank of Jamaica
12 May 2010

Good morning, Ladies and Gentlemen:

Welcome to the second quarterly press briefing for 2010. I am pleased to present to you the Bank's Quarterly Monetary Policy Report for the March 2010 quarter. As usual, the report reviews economic developments in the quarter just ended and presents the Bank's perspective on the prospects for the near-term.

The release of this report comes against the background of the successful implementation of one of the most significant financial market transactions in Jamaica's history – *the Jamaica Debt Exchange (JDX)*. Consequently, we have included a special article on the JDX, highlighting the impact of the transaction on the Government's debt portfolio and financial markets.

Of course, the JDX was only one component of a comprehensive policy package aimed at reversing the cycle of unsustainable fiscal deficits, high real interest rates, high debt and low growth that has characterised the economy and placing it firmly on a path towards sustainable growth and development. In this regard, Jamaica's economic programme received strong endorsement from the International Monetary Fund and other multilateral development partners. We have begun to see some encouraging signs in the financial markets as investor anxiety about the JDX morphed into a more positive perception of Jamaica's medium-term economic prospects. There was a notable absence of capital flight during and after the transaction and financial institutions remained liquid and adequately capitalised. The improved outlook was manifested in stability in the exchange rate and declines in market interest rates, particularly in the post-JDX period.

Against this background I will now review the main highlights of the March 2010 quarter and comment on how the Bank expects the economy to perform over the short-term.

Financial Markets
Turning first to the financial markets, although there were some pressures prior to the JDX in January and the approval of the agreement with the IMF in February, the exchange rate appreciated by **0.1 per cent** for the review period. This followed a marginal depreciation in the preceding quarter. Most of the appreciation occurred in March, influenced by net private and official capital inflows and, to a lesser extent, tourism receipts. Earnings from tourism were buoyed by an estimated **11.6 per cent** increase in stopover visitor arrivals in the month of March, which translated into an **8.2**

per cent rate of growth for the March quarter. The reduction in the foreign currency cash reserve requirements by 2.0 percentage points on 01 March 2010 further served to augment the supply of foreign exchange in a context where the demand for foreign exchange to pay for imports declined. Of note, while remittance inflows for the quarter were seasonally lower than in the December 2009 quarter, they were **9.7 per cent** higher than the flows in the March 2009 quarter.

Concurrent with the relatively stable conditions in the foreign exchange market was the continued downward trend in market interest rates. This was indicated by a **631 basis point** fall in the benchmark 180-day Treasury Bill yield during the review quarter. This trend continued into April with both the 90-day and 180-day yields falling just below the 10.0 per cent mark and the newly issued Government of Jamaica domestic bonds trading above par. Yields on GOJ global bonds also declined resulting in lower spreads against the Emerging Market Bond Index and US Treasuries in the post-JDX period. Private money market rates also reflected this declining trend. While the fall in domestic market rates was influenced by increased demand for liquid assets by financial institutions, the Central Bank sees the declining trend in interest rates as an indicator of significantly improved market perceptions about the Government's fiscal and debt profile as well as a measure of the prospects for stable economic conditions over the medium term. This has occurred despite the increase in inflation and the continued weakness in the real sector in the March 2010 quarter.

Inflation

With respect to inflation, the Consumer Price Index rose by **4.1 per cent** during the March 2010 quarter, close to the midpoint of the **3.5 per cent** to **4.5 per cent** forecast range that I mentioned at the last press conference in February. Consequent on this outturn, inflation for the fiscal year was **13.3 per cent**, slightly higher than the **12.4 per cent** for fiscal year 2008/09 but within the Bank's forecast range of **11.5 per cent** to **13.5 per cent**.

The acceleration in inflation in the review quarter was largely influenced by the tax measures which took effect in January and the increase in public transportation costs (that is, taxi and rural bus fares) that were effected in February. The Bank estimates that the combined "first round" or direct impact of these measures accounted for two-thirds of the inflation during the quarter. If the impact of these measures were removed, inflation would have been slightly below the seasonal norm of 1.5 per cent for a March quarter. Additional inflationary impulses emanated from housing expenses and food prices.

These impulses occurred in a context where the purchasing power of consumers has been constrained by the fall in real incomes given the downturn in the economy.

Real Sector

Turning now to the real sector, economic activity remained weak although there was a slowdown in the rate of contraction during the March quarter. Real GDP is estimated to have declined in the range of **1.0 per cent** to **2.0 per cent** in the review quarter when compared with the **2.2 per cent** decline recorded in the December 2009 quarter. Against this background, the estimated decline for fiscal year 2009/10 is in the range **2.0 per cent** to **3.0 per cent**. Economic activity was buoyed by tourism and agriculture which partially offset contractions in the ***Mining & Quarrying, Transport, Storage & Communication, Manufacture*** and ***Construction*** sectors. The performance of the real sector continues to reflect the lagged impact of the global recession which has resulted in weak external and domestic demand.

Outlook

In our outlook, the recovery in the US and a number of major economies that commenced in the latter half of 2009 is expected to continue in 2010. However, the unwinding of various stimulus measures as well as concerns about public debt, particularly in Europe, could temper the pace of recovery.

The positive economic trends in Jamaica's main trading partners since the second half of 2009 will nevertheless continue to have positive spillover effects on the domestic economy. Against this background, the Bank remains cautiously optimistic that the buds of economic recovery will begin to be seen in the latter part of the fiscal year. The prospects for mining are encouraging while growth in tourism and agriculture is expected to continue. However, domestic economic conditions will continue to be constrained by weak demand. The Bank is therefore anticipating a marginal contraction in the June quarter, within the range of **0.0 per cent** and **1.0 per cent,** and very moderate growth in the range of **0.0 per cent** to **1.0 per cent** for fiscal year 2010/11.

Headline inflation in the June 2010 quarter is expected to decelerate to a range of **2.5 per cent** to **3.5 per cent**. The main drivers of overall inflation are expected to be transportation costs and food prices. The projected increase in transportation costs reflects the higher bus fares for the Kingston Metropolitan Area introduced in April 2010 while food prices are expected to be adversely affected by the drought conditions and the pass-through of higher transportation and energy costs. The projection for inflation for the fiscal year 2010/11 remains within the targeted range of **7.5 per cent to 9.5 percent**. This projected deceleration is underpinned by low consumer demand and a stable exchange rate which will temper the impact of an anticipated rise in oil prices over the year. The inflation forecast fan chart in the report shows that the risks to the inflation projection are balanced. The most significant upside risk is the second round effect of the taxes on electricity and fuel which is counter-balanced by the downside risk of a weaker than forecasted real sector which would depress consumer spending.

Monetary Policy

I will now discuss the recent developments and near-term prospects for monetary policy. During the March 2010 quarter, following the withdrawal of its usual offerings of open market instruments with tenors above 30 days, the Bank reduced its signal rate by **50 basis points**. This was in the context of the JDX and, more importantly, the Bank's expectation that the rise in inflation in the first part of 2010 would be temporary. Additionally, given the risk to the monetary targets and to inflation, the Bank commenced operations to permanently sterilise the liquidity impact of the financial support that was extended to the Government in the December 2009 quarter by selling GOJ securities from its portfolio on the secondary market.

Approximately $7.7 billion of GOJ securities were sold during the March quarter followed by a further $5.9 billion in April. It should be noted that the bridging loans extended to the Government during the March 2010 quarter were repaid and the short term GOJ securities purchased by the Bank were redeemed during the quarter. The absorption from the sale of securities in addition to a build-up in Government balances at the Bank of Jamaica limited the expansion in the Bank's net domestic assets (NDA). Consequently, the NDA was comfortably within the programme target at end March.

This was against the background of a higher than programmed net international reserves (NIR) which at end-March was US$1.7 billion, or US$695.2 million above the target. This overperformance reflected higher than anticipated net private capital flows - that is, the absence of capital flight to which I referred earlier.

The Bank expects that the programme benchmarks for the NIR and NDA for the June 2010 quarter will again be met. The continuation of progress towards the achievement of the fiscal and monetary targets for the June quarter and a favourable outlook for single digit inflation for fiscal year 2010/11 will provide the basis for further monetary policy adjustments.

The Bank remains committed to the objective of single digit inflation. In this regard we have included a special feature in **Box 1** of the Report which looks at the issue of the desirable rate of inflation for a country such as Jamaica. We hope that this will stimulate broad discussion on the merits of low inflation and help to forge a consensus around the kind of inflation target that the Bank of Jamaica should deliver.

Conclusion

Over the past few months, we have seen the introduction of a bold programme of fundamental reforms that has required sacrifices by all stakeholders. The resulting commitment by our multilateral development partners has been unprecedented. The end-game is the achievement of sustainable growth and improvement in living standards for all Jamaicans. For this to be achieved, a low and stable rate of inflation that will support sustained confidence, long-term planning and investment must be delivered. The Bank's monetary policy will remain focussed on its mandate to maintain a stable economic environment characterised by orderly financial markets and stable consumer prices.

Thank you.