BANK OF JAMAICA

# Quarterly Press Briefing


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Bank of Jamaica


14 November 2012

Good Morning Ladies and Gentlemen:

This morning I will be presenting the main highlights of the Quarterly Monetary Policy Report for the September 2012 quarter which is being released today. Similar to previous reports, economic developments in the external and domestic economies over the review quarter are assessed as well as the Bank's response. The report also includes the Bank's perspective on the outlook for economic developments in this quarter and the rest of the fiscal year. Of note, the impact of Hurricane Sandy is still being assessed. However, the projections that I will outline incorporate our preliminary assessment thus far and we have included a box on it in the report.

**Monetary and Exchange Rate Policy**

**Similar to the posture since the September 2011 quarter, the Bank's monetary policy stance was unchanged throughout the September 2012 quarter, largely because of continued uncertainties in the external and domestic economic environment**. As you may be aware, the Bank held its policy rate (the rate on its 30-day certificate of deposits) at 6.25 per cent. The negative expectations in Jamaica over the quarter stemmed from anxieties about the period of negotiations with the International Monetary Fund (IMF) around a new agreement covering the medium-term. The decline in net international reserves (the NIR) fueled these anxieties. Further, continued concerns about global growth and debt and fiscal sustainability in the Euro area permeated international financial markets. In the absence of these uncertainties, the Bank would have been obliged to consider further reductions in its policy rate.

**The uncertainties in the domestic economy continued to be reflected in demand pressures in the foreign exchange market and increased investor preference for short term domestic instruments.** In this regard, there was a depreciation of 1.4 per cent in the weighted average selling rate of the Jamaica Dollar vis-à-vis the US dollar, following a decline of 1.6 per cent in the June quarter. The rate of depreciation was tempered by the Bank's net sales of US$214.8 million to the market which contributed to the reduction in the NIR to US$1.3 billion at the end of the quarter. The intervention sales were used to satisfy pent-up demand for foreign currency to finance international trade.

Ladies and Gentlemen, while keen attention is usually paid to the level of the NIR it is important to note that at end-September, the stock of **gross international reserves was US$2.1 billion, representing 14.1 weeks of projected goods and services imports**. This level of reserves remains above the international benchmark of 12.0 weeks. Gross reserves represent the resources at our disposal and, at these levels, are more than adequate to meet the requirements of the central bank. The Bank remains optimistic that an agreement on the medium-term economic programme with the IMF in the near term will have a positive impact on market confidence and foreign exchange inflows to the economy.

**Inflation**

**For the September 2012 quarter, headline inflation was 2.1 per cent, slightly above the forecast range of 1.0 per cent to 2.0 per cent which we announced at the briefing in August 2012 when we revised our estimate downwards from 2.5 to 3.5 per cent.** Inflation in the quarter mainly reflected the impact of seasonally lower supplies of domestic agricultural commodities, higher demand associated with back-to-school preparations and the holidays in August, the lagged effect of the Government's tax measures as well as increases in international grain prices. In addition, there was an increase in the national minimum wage in the quarter. The impact of these impulses on inflation was partly offset by a sharper than expected decline in communication cost, in particular, the significant reduction in mobile-to-mobile rates. In addition, competitive pressures, in the context of weak domestic demand conditions, continued to limit the ability of businesses to increase the prices of their goods and services.

**The Bank is projecting domestic inflation in the range of 3.0 per cent to 4.0 per cent for the December 2012 quarter.** This forecast reflects the expected impact of higher international and domestic commodity prices. The projection for an increase in international commodity prices reflects the impact of the seasonally higher demand for crude oil prices. The impact of this increase is expected to be partly offset by lower prices for international grains due to better than anticipated harvests in major producing countries. It should be said also, however, that our projection for oil prices for the full year is currently running some 4 percentage points below our initial projections. At the same time, we have seen little evidence to date of a pass through of the movement in the exchange rate to prices. With respect to the forecast for increases in the prices of domestic agricultural commodities, this outlook also reflects the expected impact of the passage of Hurricane Sandy which, based on our survey, is expected to have a net impact on inflation for the fiscal year of approximately 0.7 percentage points.

In spite of the expected up-tick in inflation for the December quarter, the Bank has revised downwards its forecast for inflation for FY2012/13 to a range of 7.5 per cent to 9.5 per cent from the previously projected range of 10.0 per cent to 12.0 per cent. This revision largely reflects the impact of lower than expected pass through of the tax measures as well as lower than previously anticipated increases in international commodity prices. In addition, the Bank expects that the generally tight fiscal stance will continue to constrain domestic demand. The Bank's projection for a declining trend in inflation is also supported by recent surveys of business expectations conducted on behalf of the Bank.

**Real GDP Growth**

**The Bank's estimates suggest that real GDP growth in the September quarter was largely similar to the performance in the first half of the calendar year.** The performance of the economy has continued to reflect the impact of weak domestic demand as well as slower growth in the global economy. ***Hotels & Restaurants*** is the only industry estimated to have grown in the quarter as activities in the other industries are estimated to have either remained flat or contracted. In particular, ***Mining & Quarrying*** is estimated to have continued to decline due to mechanical problems in the industry while production in ***Agriculture, Forestry & Fishing*** was adversely affected by drought conditions earlier in the year.

**For the December quarter, the Bank is projecting a contraction in economic output in the range of minus 0.7 per cent to minus 1.7 per cent**. The negative outlook for real sector activities is influenced by preliminary estimates of the damage caused by the recent passage of Hurricane Sandy on the Jamaican economy as well as the East Coast of the United States. In particular, ***Agriculture, Forestry & Fishing*** is projected to decline sharply as reports from official and news sources indicate that crops in St. Mary, Portland and St. Thomas were severely damaged. ***Mining & Quarrying*** is forecast to register a sharper decline than previously expected due to the closure of the alumina and bauxite plants for a day and a half. The Bank is also projecting a decline in ***Electricity & Water Supply*** given the disruption to the supply of services. ***Hotels & Restaurants*** is also expected to contract in the context of anticipated cancellations in stop-over arrivals due to the impact of the hurricane on both Jamaica and the USA as well as the diversion of cruise lines from Jamaica during the period of the hurricane. Stop-over visitors from the US East Coast account for almost 19.0 per cent of visitors from the USA.

In addition to the impact on domestic real sector activity, there is also likely to be lower earnings from tourism as well as a fall in remittance flows from that area. The forecast for output in the December quarter also reflects the impact of continued weakness in the domestic economy, slower global growth and tight fiscal policy. The Bank is expecting a marginal rebound in economic activity in the March 2013 quarter which will contribute to real GDP growth for FY2012/13 being relatively flat in the range of 0.0 to minus 1.0 per cent.

Despite the slowdown in real sector activity for the calendar year to September, the 12-month growth in credit to the private sector from commercial banks was 19.4 per cent as at September 2012. The ratio of non-performing loans to total loans in commercial banks also continued to decline in the review quarter to 6.3 per cent at end-September from 7.8 per cent at end-September 2011.

**Risks to the Near-term Outlook**

There are risks to the outlook for inflation and growth. It is possible that increased geopolitical tensions, adverse weather and stronger than anticipated global growth could lead to higher prices for international commodities and consequently higher domestic inflation. A greater than expected impact from Hurricane Sandy could alter the current forecast for inflation. In addition, while the persistence of weak domestic conditions, partly due to the slow growth in real incomes, would contribute to a more favourable outturn for inflation, real sector activities could become more fragile.

**The Way Forward**

Given the risks mentioned above, the Government will need to maintain its commitment to strong fiscal performance over the medium term. The achievement of the fiscal targets to date signals the Government's commitment to the macroeconomic programme being discussed with the IMF and paves the way for an agreement on the medium-term economic programme. This development should lead to the release of multilateral inflows as well as give reassurance about Jamaica's creditworthiness to the international capital markets. Further, these developments will provide a boost to investor confidence and lead to an increase in net capital inflows which will contribute to rebuilding the NIR. The more stable economic environment created by increased foreign currency inflows would also form the basis for sustaining low interest rates.

Ladies and gentlemen: the challenges in the world and domestic economic environment can create new opportunities for growth and development. These challenges should cause us to be more innovative and creative in managing our resources. In this regard, I urge you to take full advantage of the window of opportunity that an extended period of relatively low and stable interest rates creates for investment in real activity. As I stated at the release of the previous monetary policy report, at the end of the day, any measure of economic success that we seek to attain will be driven by our efforts to capitalize on opportunities in whatever field that they present themselves, while remaining conscious of the need for us, as citizens, to make our rightful and responsible contribution to the conduct of public business.

Thank you.