Quarterly Press Briefing

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Ladies and Gentlemen:

Welcome to this the release of the first Quarterly Monetary Policy Report for 2011. My presentation will follow the usual format. There will be a brief review of macroeconomic developments in the December 2010 quarter, followed by the Bank's view of the near-term prospects for the economy. In this report we have also included an article on inflation targeting, an alternative monetary policy framework that has become increasingly popular in recent years because of the success achieved in reducing inflation. This article comes in light of the success the Government has had to date in its effort at fiscal consolidation and the commitment to a fiscal responsibility framework, which are important pillars of an inflation targeting framework. We encourage you to read the article and let us have your feedback.

Recent Developments

When we last met on 10 November 2010, I indicated that the process of transformation was continuing in line with the objective of lower volatility in domestic prices, lower interest rates and stable financial markets. The objectives set out in the financial programme continue to be met. To date, the Government and the BOJ have met all the quantitative targets under Stand-by Arrangement ("SBA") with the International Monetary Fund ("IMF") and are set to meet those for end-December 2010. The reviews that the country has received from the IMF have been encouraging and we continue to make progress on the structural benchmarks which are aimed at increasing efficiency in fiscal management and the financial system. In the context of these developments, the outlook for inflation remains favourable, interest rates continue to trend down, the foreign exchange market remain relatively stable and net international reserves continue to be robust . However, although there are signs of improvement in domestic output, the economy remains weak.

Money and Financial Markets

On 15 November 2010, the Bank reduced the interest rate on its 30-day open market instrument by half of one per cent to 7.5 per cent. On 01 February 2011 we reduced this rate by a further quarter of one per cent. These rate reductions were done in the context of continued weakness in the domestic economy and the favourable prospects for inflation. In addition, investors have continued to show a preference for Jamaica Dollar instruments, signifying their confidence in the positive near-term prospects for continuing stability in the economy.

Market-determined interest rates also continued to decline in the quarter. The weighted average yield on the 1-month, 3-month and 6-month Treasury bills declined by 78 basis points, 35 basis points and 51 basis points, respectively to 7.48 per cent, 7.40 per cent and 7.48 per cent at the auctions in the December 2010. Yields have continued to decline falling by an average of 2 basis points at the auctions in January, with all tenors significantly over-subscribed.

The external community has also continued to demonstrate its confidence in Jamaica's creditworthiness. Average yields on Jamaican sovereign bonds have fallen from about 10.50 per cent at the end of January last year – just before the implementation of the Jamaica Voluntary Debt Exchange (JDX) – to 7.57 per cent at the end of January this year. This occurred in the context of a fall of about 2 percentage points in the average spread between Jamaican sovereign bonds and US Treasury bonds – an indication that investors perceive a meaningful reduction in the risks associated with investing in Jamaican securities. When compared with other emerging markets, Jamaica's bonds have also performed well. The spread between Jamaican sovereign bonds and the benchmark emerging market bond index (known as the EMBI) fell by more than 3 percentage points over the course of 2010.

Also reflective of the increasing confidence about the near-term prospects for the economy, the foreign exchange market was relatively stable for the December quarter. In this context, there was a marginal appreciation of 0.45 per cent in the weighted average selling rate of the Jamaica Dollar for the review period. This was in comparison to average depreciation of 3.0 per cent for the last five December quarters. For the calendar year 2010, the value of the Jamaica Dollar appreciated by 4.4 per cent against the US dollar. This was in contrast to the depreciation of 10.2 per cent in 2009.

The appreciation in the value of the domestic currency in the quarter was associated with increased net private capital inflows which were more than sufficient to offset the impact of increased demand to satisfy payments for current account transactions. In the context of this excess supply of foreign currency in the market, the Bank made net purchases of US$51.9 million during the quarter. These purchases along with the purchase from Government of the proceeds of a US$200.0 million loan from the Inter-American Development Bank, contributed to an increase of US$197.7 million in the NIR during the quarter. At end-December 2010 the NIR amounted to US$2 171.4 million, which was US$351.4 million above target under the IMF-SBA programme. Gross reserves amounted to US$2 982.8 million, representing 23.0 weeks of projected goods and services imports, comparing favourably with the international benchmark of 12 weeks.

Inflation

The out-turn for inflation for the December quarter was somewhat higher than the forecast range I had shared with you at the last briefing. Headline inflation was **3.3 per cent** for the December quarter, compared to **1.3 per cent** in the September 2010 quarter and the projected range of **2.0 per cent – 3.0 per cent**. As a result of the out-turn for the quarter, there was an uptick in the annual point-to-point inflation to 11.7 per cent relative to the 10.2 per cent in 2009, the original forecast made in December 2009 for CY2010 was 11.4 per cent. However, all the annual measures of core inflation recorded declines, with the exception of the trimmed mean which remained flat.

The temporary acceleration in inflation in the review quarter was largely due to the passage of Tropical Storm Nicole at the end of September, the impact of which was more prolonged than we had anticipated. This led to temporary shortages in the supply of some agriculture produce and consequently higher prices for these items, particularly vegetables.

In addition to the impact of adverse weather conditions, domestic inflation was also negatively affected by the pass-through of increases in international commodity prices during the review period. The higher inflation in the December quarter also reflected increased costs for energy and transportation as a result of a rise in international oil prices. The upward movement in oil prices largely resulted from a weakening in the US dollar against all major currencies as well as the impact of improvements in the outlook for global growth. Accordingly, *Food & Non-alcoholic Beverages*; *Housing, Water, Electricity, Gas & Other Fuels;* and *Transportation* were the major contributors to inflation in the quarter. Of note, *Food and Non-alcoholic Beverages* contributed 59.8 per cent of the inflation out-turn in the review quarter. The impact of the above factors was moderated by the appreciation in the exchange rate and continued weakness in the domestic economy.

As was indicated previously, the up-tick in inflation in the December quarter was temporary. In this regard, the Bank is projecting that there will be a moderation in inflation in the March 2011 quarter, within the range of 1.0 per cent to 2.0 per cent. The projected deceleration in inflation in the March quarter is largely predicated on the expected price reversals for agriculture crops which occurred in the December quarter. In addition, we are expecting continued stable domestic capacity and declining inflation expectations to have a moderating impact on inflation. However, the Bank is projecting continued increases in international commodity prices, which should be the major influence on inflation in the quarter.

Real Sector

The Bank estimates indicate that real GDP contracted in the range of 0.0 per cent to 1.0 per cent for the December quarter, similar to the contraction in the September quarter. Similar to our forecast in November 2010, all industries are estimated to have contracted with the exception of ***Mining & Quarrying*** and ***Hotels & Restaurants.*** Underlying aggregate demand is estimated to have remained weak due mainly to continued declines in *Consumption* and *Investment*.

For the March 2011 quarter, the Bank is projecting that there will be marginal growth in economic activity. This will be largely driven by continued expansion in ***Mining & Quarrying*** and ***Hotels & Restaurants*** as well as growth in ***Electricity & Water Supply***. The strength of the expansion in these sectors is expected to offset the slower rate of decline in the other sectors.

Outlook

The consensus is that the global economy grew at a faster rate in 2010 than was previously expected, led by emerging economies such as China and India. Although the prospects for global growth in 2011 have also improved, this is expected to be at a slower rate than in 2010. This expectation of slower growth is in the context of monetary tightening being undertaken by some emerging economies. Nonetheless, the forecast for continued growth in the world economy, particularly the USA, bodes well for remittance inflows and tourist arrivals to Jamaica.

In spite of the improvements in the global economy and the expected marginal growth in the March quarter, the Jamaican economy is projected to contract in the range of **0.0 per cent to 1.0 per cent** for FY 2010/11. The projected contraction is a direct result of the declines that were experienced in the first three quarters. However, we are expecting that growth in the March quarter will continue into the next fiscal year with all sectors being projected to register expansion.

Given the forecast for the March quarter, the Bank is expecting inflation for FY 2010/11 to fall within our original target range of 7.5 per cent – 9.5 per cent. The forecast for single-digit inflation is predicated on the continued weak consumer demand, relative stability in the foreign exchange market and continued moderation in inflation expectations. The risks to the inflation projection are still balanced. Higher than anticipated increases in international commodity prices continues to be the main upside risk, while on the downside a greater than anticipated contraction in domestic demand could contain inflation pressures.

For the medium-term the Bank is forecasting that inflation will fall in the range of 5.5 per cent to 7.5 per cent. Most of the inflation in FY 2011/12 should occur in the first half of the fiscal year due to the forecast for increased prices for international commodities. Thereafter, we expect the prices of international commodities to normalise. The Central Bank's goal is to achieve low and stable inflation in line with that of our major trading partners in the long-term. While the achievements to date of high single-digit inflation may be satisfactory from a historical perspective, it is not too soon for us to consider how we will reach the lower single-digits of our trading partners which for 2010 was 5.1 per cent. Accordingly, the Bank's monetary policy stance will continue to be consistent with the objective of achieving low stable prices and maintaining stability in the financial markets.

Conclusion

Ladies and Gentlemen, the Jamaican economy has continued to benefit from the on-going transformation which commenced in 2010. Consolidation in the fiscal accounts and the demonstrated commitment to fiscal responsibility have reassured investors about the favourable prospects for stability in the economy. This has been reflected in the continued decline in interest rates in the money and bond markets as well as the stable to appreciating trend in the exchange rate. By now, you would have heard of the offer made to investors amounting to US$400 million by way of a re-opening of the 2019 Global Bond at a yield to maturity of 7.95 per cent. That offer which was floated in anticipation of the maturity in May of the 2011 Global Bond and was heavily over subscribed.

The quarterly observance of the targets under the IMF-SBA and the associated programme of reform have affirmed perceptions about the progressive improvements in Jamaica's macroeconomic management. These continuing improvements must now form the foundation for a more robust participation by the private sector in the creation of sustainable economic growth and development.

Thank you.