Quarterly Press Briefing

Brian Wynter

Governor

Bank of Jamaica

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Good Morning Ladies and Gentlemen:

Since we met in February, the Executive Board of the International Monetary Fund (IMF) approved Jamaica's application for a four-year Extended Fund Facility (EFF). The final approval on 01 May 2013 followed the completion of all the prior actions which were agreed with the IMF as set out in the country's medium-term economic programme (see Box 1: *Jamaica's Medium-Term Economic and Financial Programme - FY2013/14 – FY2016/17*). The performance of the economy during the review quarter occurred in the context of strong fiscal actions aimed at reducing Jamaica's extremely high debt burden on a credible path to fiscal sustainability and accelerated economic growth over the medium term. These actions included the National Debt Exchange (NDX), initial reforms to the tax system (such as the significant curtailment of discretionary tax waivers) and a package of revenue and expenditure measures which have created the foundation for achieving a 7.5 per cent central government primary balance for FY2013/14.

Immediately following the IMF Board's approval, Jamaica received the first drawdown of US$207.2 million (SDR136.8 million) under the EFF. Of that amount, US$87.9 million represented budgetary support to the Government. This budgetary support will assist the Government by minimising the need for borrowing from the domestic market thus making more resources available to the private sector to facilitate investment and growth.

Against this background, I will now share some highlights of the performance of the main economic indicators in the March 2013 quarter and the Bank's outlook for these indicators in the near term.

Performance and Forecast of Selected Macroeconomic Indicators

Monetary Policy and Interest Rates

You will recall that in February Bank of Jamaica reduced the interest rate on its 30-day certificate of deposit by 50 basis points to 5.75 per cent. This policy action was in the context of the persistence of generally weak economic conditions and a favourable outlook for inflation. Also providing support for this policy action was the successful NDX in February which resulted in declines in interest rates in the range of 1.0 to 5.0 percentage points on selected domestic GOJ instruments. There were also consequential reductions in rates in the private money market. In particular, for the review quarter, average yields on Government of Jamaica 30-day, 90-day and 180-day Treasury bills fell by 94, 185 and 96 basis points, respectively, to 5.37 per cent, 5.82 per cent and 6.22 per cent at end-March. While there was some uptick in these rates in April in the context of a reduction of Jamaican Dollar liquidity, rates are nevertheless expected to remain relatively low in the context of the environment created by the NDX and very strong fiscal consolidation. The reduced level of liquidity reflected lower levels of net maturities of open market operations instruments as well as the introduction of new instruments by the Bank. In particular, the Bank offered a one-year US dollar-indexed note during the month which was followed by the introduction of three variable rate instruments which together absorbed approximately $12.0 billion.

For the near term, there should be little change to the Bank's current accommodative policy stance. This outlook is in the context of the forecast for continued weakness in the domestic economy and the constraints of fiscal consolidation. The Bank is also committed to containing inflation expectations consistent with delivering the inflation target for the fiscal year.

Inflation

For the March 2013 quarter, headline inflation was 2.7 per cent which was within the Bank's forecast range of 2.0 per cent to 3.0 per cent. Inflation in the review quarter primarily reflected the impact of drought conditions on domestic agriculture commodities and the pass-through to prices of the depreciation in the exchange rate. In addition, upward adjustment in the prices of some domestic goods and services, particularly energy, reflected the direct impact of the higher cost of crude oil. Further, the prices of processed foods reflected the lagged impact of increases in international grains prices. However, continued weak domestic demand, partly reflecting the impact of declining real wages, tempered the inflationary effect of these factors. For FY2012/13, headline inflation was 9.1 per cent, within the target range of 7.5 per cent to 9.5 per cent.

The Bank is forecasting that headline inflation will be in the range of 2.0 per cent to 3.0 per cent for the June 2013 quarter. As with the March quarter, inflation is expected to largely reflect the impact of drought conditions on the prices of agriculture commodities and the lagged pass-through of recent exchange rate depreciation. This is expected to be tempered by declines in the prices of international commodities due to favourable weather in major producing countries and weak global demand. In addition, weak domestic demand conditions will continue to constrain price increases. For FY2013/14, inflation is projected to be in the range of 8.5 per cent to 10.5 per cent. Our current assessment suggests that the risks to the inflation forecast are balanced.

Foreign Exchange Market

The weighted average selling rate of the US dollar vis-à-vis the Jamaica Dollar was J$98.89 = US$1.00 at end-March 2013, reflecting a depreciation of 6.0 per cent for the quarter. This was in comparison to depreciation of 3.3 per cent in the December 2012 quarter. The increased pace of depreciation in the review quarter reflected market perceptions of greater uncertainty regarding the timing and content of an agreement with the IMF. In addition, in the first half of the quarter there were anxieties about the Government's ability to finance very large debt payments that were due in February. These concerns were reflected in a sharp decline in net private capital flows to the economy for the quarter. However, the Bank's estimates show that there was a continued decline in the net demand for current account transactions, that is, external trade in goods and services. This decline was largely related to estimated reductions in payments for consumer goods and raw materials. In the context of these developments, the NIR declined by US$241.3 million for the quarter to US$884.3 million at the end of March. However, this was higher than the target set under the Staff-level agreement for a Fund-supported programme. Of note, with the receipt of the first disbursement under the EFF and substantial purchases from the market by the Bank, the NIR was US$997.3 million on 10 May. The NIR is expected to continue to increase gradually over the fiscal year due to growth in multilateral inflows as well as incremental improvements in net private capital flows.

The uncertainties which characterised the foreign exchange market during the March quarter have now waned. This, together with market expectations of increased foreign currency inflows and the liquidity effects of the longer-tenor instruments introduced by the Bank, has led to an appreciation in the exchange rate since mid-April. The Bank remains committed to providing an orderly market for foreign exchange and will take the necessary actions to maintain order. Orderly movements in the exchange rate which enhance price competitiveness will help to create an environment which facilitates strong and sustained growth in exports and import substitution, which is a key objective of the Government's medium-term macroeconomic programme.

Real Gross Domestic Product (GDP)

The Bank's estimates suggest that the economy contracted in the range of minus 1.2 per cent to minus 0.2 per cent for the review quarter. This outturn is a continuation of the trend decline in real output observed since the March 2012 quarter. The estimated outturn for the quarter reflected the impact of drought conditions as well as weak domestic and external demand. In particular, domestic demand continued to be adversely affected by declining real incomes, high unemployment and reduced remittance inflows. In addition, continued uncertainty about the prospects for the economy had a debilitating impact on investments and economic activity in general. The estimated decline in the quarter reflected contractions in both the tradable and non-tradable sectors. In particular, ***Agriculture, Forestry & Fishing, Mining & Quarrying, Hotels & Restaurants*** and ***Electricity & Water Supply*** are assessed to have contracted in the quarter. Given the estimate for the March quarter, the economy is judged to have contracted in the range of minus 1.0 per cent to 0.0 per cent for FY2012/13.

For the June 2013 quarter, growth in real GDP is forecast to be flat in the range of minus 0.5 per cent to plus 0.5 per cent. However, it is projected that there will be a gradual improvement in real output in subsequent quarters resulting in growth in the range of 0.5 per cent to 1.5 per cent for FY2013/14. The materialisation of this forecast is predicated on the expected boost to investor confidence provided by the approval of Jamaica's programme by the IMF and the programmed loan and grant flows which are to be received by the country over the medium term in the context of the EFF. In particular, the on-going fiscal consolidation should release additional resources for private sector investments. Further, the robust growth of 18.4 per cent in private sector credit for FY2012/13 is anticipated to provide some momentum for the projected growth for the current fiscal year. Note can be taken of the decline of 50 basis points in average lending rates to the private sector at commercial banks during the March quarter. Although these rates are still higher than desired, this trend bodes well for future credit expansion. In this regard, at 5.3 per cent the quarter saw the strongest rate of quarterly growth in loans and advances to businesses since 2011.

Conclusion

The approval of the EFF for Jamaica is providing a boost to confidence in the domestic economy. Continued improvement in confidence is anticipated with the strengthening in foreign currency flows to the economy, particularly the approximately US$2 billion in multilateral loan and grant inflows over the medium term. Already there have been more orderly adjustments in the exchange rate as economic agents are reassured of the Government's commitment to achieve sustainable debt and fiscal ratios. In addition, interest rates in the economy continue to be at historically low levels and are expected to remain relatively low under the influence of the successful NDX and strong fiscal consolidation currently under way. These developments are expected to lead to a gradual recovery in domestic economic activity and per capita income over the near to medium term. In this context, Bank of Jamaica's primary focus will remain the reduction of inflation over the medium term towards levels which prevail among our trading partners.

Thank you.