BANK OF JAMAICA

Quarterly Press Briefing

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Good Morning Ladies and Gentlemen:

This morning we are pleased to present the Quarterly Monetary Policy Report for the period April-June 2011. I will also share some of the Bank's perspectives on the possible impact on the Jamaican economy if there is a sharp deceleration in world growth and, in particular, growth in the USA consequent on the events leading to the recent rating downgrade of US treasury bonds and the on-going debt crisis in Europe.

Developments in the June 2011 quarter

Global Developments

The Bank's estimates indicate that there was continued moderation in world growth in the June 2011 quarter, relative to the previous quarter. These estimates primarily reflect slower growth in the advanced economies as emerging market economies, such as China and India, continued to expand at a robust pace. Growth in output in the advanced economies continued to be adversely affected by the disruption in supply chains following the crisis in Japan and the on-going political tensions in the Middle East and North Africa. In addition, there were upward pressures on the prices of international commodities in the review quarter in spite of some abatement towards the end of the period.

Developments in the Domestic Economy

In the context of continued growth in the external economy and marginal improvements in domestic demand conditions, the real sector is estimated to have recorded real growth in the range 1.0 per cent to 2.0 per cent for the June 2011 quarter. This follows growth of 1.4 per cent in the March 2011 quarter. The performance in the review quarter reflected moderately strong growth in the tradable industries as well as marginal expansion in the non-tradable industries. Within the tradable industries, robust growth was estimated for ***Mining & Quarrying*** and modest expansion for ***Hotels & Restaurants***. Estimated growth in ***Agriculture, Forestry & Fishing*** and ***Wholesale & Retail Trade, Repairs & Installation*** largely influenced the performance of the non-tradable industries.

Headline inflation was 2.0 per cent for the June 2011 quarter, at the lower end of the Bank's forecast range of 2.0 per cent to 3.0 per cent. This outturn also compared favourably with the 5-year average of 3.1 per cent for June quarters. Consequent on the outturn for the review quarter 12-month inflation continued to decline to 7.2 per cent at end-June 2011 relative to 13.2 per cent at end-June 2010. Similarly, all the Bank's 12-month measures of underlying inflation declined significantly, relative to the estimates at end-June 2010. The inflation outturn in the review quarter largely reflected the effect of the increases in crude oil prices on the cost of energy as well as the lagged impact of higher grains prices in the previous quarter on domestic processed food prices. In addition, there were increases in the prices of some domestic crops as supplies moderated towards the end of the quarter. Continued stability in the foreign exchange market and weak but improving demand continued to have a moderating impact on inflation.

The continued stability in the foreign exchange market was reflected in a marginal depreciation of 0.19 per cent in the June quarter, following appreciation of 0.13 per cent in the March 2011 quarter. This stability was largely influenced by continued strong net private capital inflows which partly reflected repayments at maturity by the Government of Jamaica of a Eurobond in May 2011. Repayment of the bond was facilitated by a drawdown from net international reserves

(NIR) of the funds that were raised for this purpose by the government in February 2011. As a result, the NIR was US$2 267.1 million at end-June, relative to US$2 553.1 at end-March 2011.

Recent Global Developments and Implications for the Jamaican Economy

On 05 August 2011, Standard and Poor's Rating Agency (S&P) downgraded the credit rating of US federal government debt to AA+ from its top rank of AAA. The agency's negative outlook on the US economy adversely impacted perceptions about the global economic standing of the USA which had maintained a AAA credit rating at S&P since 1941.

In the context of the downgrade and the on-going debt crisis in the Euro area, there has been increased uncertainty in global financial markets. There have been wild fluctuations in global stock indices, particularly those of the developed countries. The market's response was exacerbated by the worse-than-expected US GDP outturn for the June 2011 quarter and downward revisions to GDP estimates for the past two years. The negative economic releases have also resulted in a flight to safe-haven assets such as, perhaps paradoxically, US Treasuries. As a result, the yields on 5-yr, 10-year and 30-year US Treasuries have fallen to all-time lows. At the same time, US consumer confidence has fallen to the lowest in three decades. Prices in the commodities market have also been fluctuating. In particular, crude oil prices plunged initially but have since shown some marginal recovery, while the price of gold has hit all-time highs. The impact of developments in the USA and the Euro area on emerging markets, however, could be negative in the medium to long-term in the context of increased risk aversion.

Given these developments and the associated increased uncertainty about the prospects for the world economy, the Central Bank has considered an extreme scenario of the possible near-term impact on the Jamaican economy if the downgrade of the US federal government bond rating and the factors which led to it were to result in markedly slower growth for the US economy in the short-term, leading in turn to a slowdown in the global economy. The slowdown in activity would stem from a contraction in government spending and higher borrowing costs in the US economy. ***The Bank's assessment suggests that the Jamaican economy would still record growth in the range 1.0 per cent to 2.0 per cent for FY2011/12. However, growth would likely be at the lower bound of the forecast range, with the risks to the projection being biased to the***

downside. This would be in contrast to our previous forecast which indicated growth towards the upper bound of the range for the fiscal year. The moderation in output would stem from a general contraction in external and domestic demand. The impact of the slower global growth on Jamaica would be reflected predominantly in the **mining**, **travel** and **transportation** industries. In this extreme scenario, the **mining** industry, in particular, could seethe largest fallout from reduced international demand for aluminium. In addition, in light of reduced global income, particularly in the USA, Jamaica's largest source market for visitors, value-added in the **Hotel & Restaurant** sector could also expand at a significantly slower rate in FY2011/12, relative to the growth previously expected. A slower rate of expansion in these industries, in addition to increasing uncertainty, would also affect non-tradable sectors such as wholesale & retail trade.

However, in the context of a moderation in world demand and domestic economic growth, ***Jamaica's current account deficit would improve, relative to the previous forecast***. This is against the background that a contraction in spending on imports would fully offset the possible fall in earnings from exports of goods and services. Financing for the current account would be adversely affected by lower levels of both foreign direct and portfolio private investment inflows relative to the previous forecast. Nonetheless, in the context of these changes, the NIR at end-FY2011/12 would not change materially, relative to the previous forecast of approximately **US$2.0 billion**.

Headline inflation for FY2011/12 could also be at the lower bound of the forecast range of 6.0 per cent to 8.0 per cent. The most significant impact would emanate from the decline in international oil prices. This would result in a direct moderating impact on inflationary impulses in key divisions of the Consumer Price Index (CPI) such as ***Transportation*** and ***Housing, Water, Electricity, Gas & Other Fuels*** due to lower petrol and household energy and fuel prices. There would also be second-round effects on the cost of services and other consumer goods. In particular, the cost of producing processed foods, such as baked goods which utilise a significant amount of energy, would decline. The decline in other international commodity prices would also have a moderating impact on prices in the domestic economy.

The price of crude oil has already declined at a sharper rate than the Bank has forecasted. This will have a moderating impact on inflation in this quarter. Accordingly, the Bank is forecasting inflation in the range 1.5 per cent to 2.5 per cent for the September quarter, marginally lower than the outturn in the previous quarter. Reduced imported inflation should temper the impact of expected increases in the prices of domestic crops as well as inflation pressures from back-to-school expenses. This is expected to be supported by the continuation of excess domestic capacity conditions as well as relative stability in the foreign exchange market.
Given recent international developments, the risks to the inflation forecast are largely on the downside. On the upside, the major risk is extreme adverse weather conditions.

Given the continued positive outlook for inflation in FY2011/12 and the increased downside risks to economic growth, the Bank will maintain its accommodative policy stance. In fact, on 01 July 2011 the Bank reduced its 30-day rate by 0.25 basis points as the concerns about the impact of higher commodity prices waned. In the June quarter the Bank had maintained its signal rate at the end-March level of 6.75 per cent in the context of a possible risk to the achievement of the inflation target due to the then intensification of uncertainties about the direction of international commodity prices.

Ladies and Gentlemen, recent developments emphasise Jamaica's vulnerability to external shocks. The economic programme that we are pursuing with the support of the Stand-by Arrangement with the International Monetary Fund is designed to reduce these vulnerabilities over the medium-term. In particular, the primary objective of the economic programme is to create the fiscal space to allow the country to respond to such shocks when they occur. The recent award of wage increases to public sector workers represents a permanent increase in the obligations of the Government in a context where the means of affording these claims over the medium-term without resorting to borrowing are not assured. A close re-examination is now taking place of the prospects and the policies to enable the Government of Jamaica to achieve long-term debt sustainability and macroeconomic soundness for the country. The gains that have been achieved to date are real and cannot be denied. Holding on to the gains and building on them demands a disciplined approach to forward planning. The Government is deeply engaged in this process which also involves the Bank and Jamaica's international development partners.

At the Bank, we are committed to building a framework that embeds low inflation as a permanent feature of our environment because stable low inflation is a necessary companion in our quest for sustainable growth and development.