BANK OF JAMAICA

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Quarterly Press Briefing
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Governor

Good morning, Ladies and Gentlemen:

Welcome to the Bank of Jamaica. Today we are releasing the Quarterly Monetary Policy Report for the June 2010 quarter. The report covers the economic issues that occupied our attention in the review quarter as well as the Bank's perspective on the short-term trends and economic outlook for Jamaica. Two special features are also included. **Box 1** looks at the recent movement in the domestic exchange rate in the context of Jamaica's external competitiveness. **Box 2** examines the adequacy of gross international reserves.

When we last met, I indicated that Jamaica had embarked on a comprehensive programme of policy reforms. These reforms aim at transforming the economy from the vicious cycle of high interest rates, excessive debt, recurrent instability and low growth to a benign cycle of lower financing costs for the public and private sectors, more stable financial markets, less volatility in domestic prices and sustained growth. During the June 2010 quarter, we continued to see signs of that transformation. In particular, the perception of a positive outlook for the Jamaican economy has been strengthening. This is manifested in the continued appreciation of the exchange rate, lower market-determined interest rates, a decline in inflation expectations and strong net international reserves. It is against this background that I will now speak to the issues outlined in the report. I will also share some thoughts with you on Bank of Jamaica losses, an issue that has recently sparked some interest.

Monetary Policy

The Bank continued to ease monetary policy in the context of the positive economic developments in the review quarter. The Bank's actions were also supported by the strengthening of investor confidence, which was boosted by the announcement that Jamaica had successfully met the first set of targets under the Stand-by Arrangement with the International Monetary Fund. These circumstances allowed Bank of

Jamaica to reduce the interest rate on its 30-day open market securities by 100 basis points to 9.00 per cent during the quarter.

In the context of buoyant Jamaica Dollar liquidity, the Bank continued sales of Government of Jamaica securities from its portfolio on the secondary market during the review period. All sales were above par, that is, the Bank received a premium on each sale, and absorbed $14.8 billion. This absorption completed the permanent sterilisation of the funds advanced to the government in the December 2009 and March 2010 quarters.

Financial Markets

The pace of appreciation of the exchange rate accelerated in the June quarter relative to the previous quarter. For the review period, the weighted average selling rate appreciated by **4.1 per cent**, continuing the appreciating trend that was observed in the second half of the March quarter. This was the sharpest quarterly appreciation since the June quarter of 1996. The strongest appreciation occurred in June when the exchange rate strengthened by 2.9 per cent, or J$2.46, influenced largely by increased investor preference for Jamaica Dollar assets. The preference for Jamaica Dollar assets was reflected in increased net private capital inflows the impact of which more than offset the demand for resources to meet current transactions.

In an effort to smooth the pace of movement in the exchange rate, the Bank purchased approximately US$54.0 million net from the market during the quarter. This contributed to an NIR stock at end-June of US$1 795.8 million, which was not only higher than the stock at end-March but was also above the end-June target. At end-June 2010 the Bank's gross reserves amounted to US$2 526.7 million, representing 19.7 weeks of projected goods and services imports, relative to the international benchmark of 12 weeks.

Market-determined interest rates declined over the period in parallel with the appreciation of the value of the domestic currency during the quarter. The average yield on the benchmark 180-day Treasury bill fell by **123 basis points** to **9.26 per cent** while the yield on the 90-day instrument fell by **166 basis points** to **8.52 per cent**. It went further at the July auction when the 180-day Treasury bill yield also fell below 9.00 per cent. Average yields on Government of Jamaica global bonds also continued to decline during the review quarter. Concurrent with the lower yields, there was continued narrowing in the spreads between Government of Jamaica global bonds and emerging market bonds and US Treasuries, respectively. Private money market rates also reflected this declining trend.

Inflation

Headline inflation fell to **2.6 per cent** for the June 2010 quarter, close to the lower bound of the forecast range of **2.5 per cent** to **3.5 per cent** that I announced at the last press briefing. The decline in inflation occurred in spite of the significant impact of the increase in bus fares in April. Because of the increase in bus fares, *Transportation* accounted for 81.2 per cent of the 1.3 per cent inflation in April.

The moderation in inflation over the quarter was influenced by lower imported commodity prices, the appreciation in the exchange rate and weak consumer demand. In particular, the price of crude oil fell by 7.4 per cent during the quarter, influenced by growing concerns about the impact of a sovereign debt crisis in Europe on prices. Concurrently, the prices of soybean, corn and wheat fell in the context of high inventories and increased production.

Real Sector

While there are signs of recovery, economic activity remained weak during the June quarter. Real GDP is estimated to have declined in the range of **0.0 per cent** to **1.0 per cent;** a marginally slower pace of contraction than the reduction of **1.0 per cent** recorded in the March 2010 quarter. Both tradable and non-tradable industries were estimated to have recorded slower rates of contraction. The resumption of growth in ***Mining & Quarrying*** and ***Transport, Storage & Communication*** were the major influences on this improvement. However, domestic demand remained weak as a result of increased unemployment and lower real income and continued to restrain growth.

Outlook

Although the outlook for growth in the global economy remains positive, there are concerns about the pace of recovery. These concerns are related largely to the sustainability of the pace of recovery in the United States as well as the health of the European economy, particularly in light of the fiscal austerity measures implemented by Greece, Portugal and Spain.

Against this background, the Bank estimates that there will be weak growth in the domestic economy in the range of **0.0 per cent to 1.0 per cent** for fiscal year 2010/11. This growth is expected in the latter part of the fiscal year with the first expansion since the September 2007 quarter projected to occur in the September 2010 quarter. Already, there has been resumption of production in the alumina industry which will contribute to growth in the mining sector. This will be complemented by growth in ***Agriculture, Forestry & Fishing, Transport, Storage & Communication*** and ***Electricity & Water Supply***. However, weak demand will continue to have a moderating impact on domestic economic conditions.

For the September 2010 quarter, the Bank is forecasting further deceleration in headline inflation relative to the March and June 2010 quarters, to a range of **1.5 per cent** to **2.5 per cent**. The inflation forecast for the September quarter is also lower than the average rate of 3.8 per cent for the previous five September quarters. Contributing to the lower projected inflation out-turn are the expectations of stable capacity conditions, declining inflation expectations and stability in the foreign exchange market.

The Bank expects that domestic inflation for the fiscal year 2010/11 will be in the lower bound of the targeted range of **7.5 per cent to 9.5 per cent**. The projection is underpinned by continued low consumer demand and a stable exchange rate. The risks to the inflation projection are balanced, as can be seen in the inflation forecast fan chart contained in the report. The upside risks include adverse weather conditions which could affect domestic production. The downside risks include a greater than anticipated contraction in demand due to sharper than expected reductions in real incomes.

On 01 July 2010, the Bank reduced the cash reserve requirement against Jamaica Dollar liabilities by 2.0 percentage points to 12.0 per cent. This was followed on 04 August 2010 by a reduction of 50 basis points to 8.50 per cent in the rate of interest payable on the Bank's 30-day certificates of deposit. The continued loosening of monetary policy was in the context of slower than expected expansion in money supply and private sector credit in the June quarter, which has kept underlying inflation stable. In addition, the impulses from imported inflation are expected to be negligible leading to a benign inflation environment. Going forward, the Central Bank's policy strategy will continue to be guided by its objective of achieving low and stable prices.

BOJ Losses

I will now speak briefly on Bank of Jamaica losses. The Bank is projected to sustain losses on its operations for FY 2010/11. It has increased its gross foreign assets through purchase of the proceeds of multilateral loan inflows, repayment by financial institutions of loans granted by the Bank in the context of significant margin calls in late 2008 and through net private capital inflows associated with positive investor sentiment about the Jamaican economy. Interest income on foreign assets will continue to be very low, reflecting the monetary stance of central banks in the major developed countries. In addition, the Bank's local currency income from Government of Jamaica securities has been reduced with the successful implementation of the JDX.

Concurrently, the stock of open market liabilities will remain relatively high and, even in a declining interest rate environment, will continue to attract higher interest rates than is being earned on our assets. This is in a context where the liquidity emanating from the increased foreign currency inflows has to be sterilised. We will also be experiencing some exchange losses due to movements in the SDR/US exchange rate and the appreciation of the Jamaica Dollar relative to the US Dollar. However, the overall loss is not expected to have an impact on money supply or inflation as the Bank will manage its balance sheet to offset any such impulse.

Conclusion

Since the completion of the Jamaica Debt Exchange and the signing of a Stand-by Arrangement with the International Monetary Fund, there has been a gradual improvement in Jamaica's macroeconomic fundamentals. All targets were met under the first review of the IMF Stand-by Arrangement and, from all indications, the targets under the second review will also have been met. In addition, no financial institution requested assistance under the Financial System Support Fund. These developments have boosted investor and consumer confidence as demonstrated in the JCC Conference Board survey of consumer and business confidence and our own survey of business expectations. The sacrifices being borne by businesses and individuals in terms of lower returns on investment and the cut in real wages are already producing positive results by setting the stage for private sector-led economic dynamism. The Bank of Jamaica remains committed to its mandate of maintaining a stable macroeconomic environment characterised by orderly financial markets and stable consumer prices. These are the necessary macroeconomic conditions for sustainable growth and development.

Thank you.