Quarterly Press Statement

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Bank of Jamaica

18 November 2015

From Crowding Out to Crowding In

Good morning, ladies and gentlemen.

Today the Bank releases the Quarterly Monetary Policy Report for the July to September 2015 quarter.

We take note of the news that Jamaica has successfully concluded the staff-level stage of the tenth quarterly review under the Extended Fund Facility agreement with the International Monetary Fund. If and when the IMF Board concurs, this will be the tenth consecutive successful review, a record of performance that is, to say the least, remarkable. It is the result of the national consensus and discipline in implementing the difficult economic reforms that are, without doubt, essential for Jamaica to succeed in the turbulent and competitive global environment. An initial dividend is the economic stability that is reflected in the improved balance of payments, lower inflation and lower interest rates.

I would like to draw your attention this morning to a specific indicator for future growth that my staff has labelled the "crowding in" effect.

There was a welcome increase in the rate of credit expansion during the September quarter. Private sector credit increased by 7.8 per cent over the 12 months to the end of September 2015, compared to 4.5 per cent over the 12 months to the end of June 2015. Simultaneously, ongoing fiscal consolidation by the Government has sharply reduced its demand for domestic financing. Domestic financing for the government for the September 2015 quarter declined by almost 70 per cent relative to the same period in 2014 and, cumulatively, has hardly changed since the beginning of the agreement with the IMF. **In previous years, we have all seen that Government's appetite for domestic borrowing was crowding out private sector investment and shifting too much of those investment sources towards government paper and away from productive activity. In contrast, the recent combination of increasing private sector credit and sharply falling government**

borrowing represents a long overdue correction and demonstrates the positive crowding in effect of the economic reform programme.

A major boost to the crowding in effect will occur with the payout of $62 billion of maturing NDX bonds to bondholders in February next year. This will provide the banking system with additional liquidity to prompt further expansion in loans to the productive sector at what we anticipate will be even more affordable rates.

Lending rates, in particular mortgage rates and rates on instalment credit, have already declined, but they have done so at a slower than desired pace. You will recall that, during the quarter, the Bank reduced the rate on its 30-day certificate of deposit to 5.25 per cent from 5.50 per cent followed by a reduction of the spread on its lending facilities by 75 basis points relative to the rate on the 30-day CDs. This meant an overall cut of one percentage point in central bank lending rates.

We would certainly prefer to see most of the upcoming liquidity injection flow into productive activity and into the stock market. Indeed, we expect more and more stakeholders in both the private sector and the public sector to take advantage of the opportunity to issue debt and equity to finance projects or acquisitions. But it will also fuel greater consumption as some consumers seek to realise their dreams with a new car or a new home even as some may go into building up foreign exchange positions as they fall prey to alarmism or anxiety about devaluation of the Jamaican dollar. Rest assured that Bank of Jamaica has been carefully preparing for this event for some time. The Jamaican dollar is no longer overvalued and is therefore less susceptible to unpredictable slippage. As additional insurance, Bank of Jamaica has built up a very considerable surplus in the NIR (some US$1.0 billion in excess of agreed targets with the International Monetary Fund). Bank of Jamaica is also coordinating with the Ministry of Finance to ensure that orderly conditions are maintained in debt markets and money markets in addition to the foreign exchange market during the period. We are therefore confident that we will continue to reap the benefits of stability in the months and quarter ahead.

On the fiscal side, we take note of and welcome the proposed reductions in the primary surplus targets for FY2015/16 and FY2016/17 that will allow the government to enhance the potential for growth and job creation with a timely boost to capital and growth-inducing expenditures. These expenditures will further enable private sector investors to exploit the benefits to them of the crowding in effect. **With the move from an environment of crowding out by the public sector to one of crowding in of the private sector, there is a virtual red carpet for private sector investment and it is hoped that the banks and broader private sector will quickly, enthusiastically and effectively embrace the emerging opportunities.**

Moving on to inflation, **which is the target of monetary policy**, we once again recorded record lows in the September 2015 quarter. **At 1.8 per cent, annual inflation as at September 2015 is the lowest on record in over 40 years.** Looking ahead, as we previously indicated, our forecast is for inflation to be slightly higher for the rest of the fiscal year (FY2015/16) bringing overall inflation to end the year towards the lower end of the Bank's target of 5.5 per cent to 7.5 per cent. We continue to be encouraged by the results from the Bank's latest inflation expectations survey that indicate that inflation expectations continue to be firmly anchored in single digits. In the September survey, expected inflation 12 months ahead fell to 4.6 per cent from 5.3 per cent in the August survey.

Ladies and gentlemen, we are entering a new era. No longer is the economy characterised by high fiscal deficits, high inflation and high interest rates but by a more stable and sustainable macroeconomic environment with much improved fiscal accounts, a more competitive exchange rate, more sustainable current account deficits, lower inflation and lower interest rates.

We still have more work to do, but we have already achieved enough to build on and, as I have said before, the stage is set, the foundation is being laid and the time to build is now.

Thank you.