Jamaica Securities Dealers Association

10th Anniversary Members Luncheon 2012

Securing Jamaica's Financial Future

by

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Governor

The Pegasus Hotel

11 September 2012

Good Afternoon

Let me first thank the JSDA for inviting me to participate in this your 10th anniversary luncheon.

Your theme for today, '*Securing Jamaica's Financial Future*', is very timely given the unusually uncertain external economic environment, largely related to the debt and fiscal sustainability challenges in the Euro area and in the USA. Added to these factors are concerns about food security brought on by a shortage in grains supplies due to adverse weather in the major producing countries, particularly the USA, the world's largest supplier of grains. Closer to home, there have been uncertainties since mid-2011 about the medium-term economic programme, particularly with regard to the status then of our agreement and now of our negotiations with the IMF. Directly related to this, there has been apprehension in the market about the continued adequacy of the net international reserves (NIR) in the context of the global uncertainties about prices, external demand and capital flows.

At the same time, the Bank is more sanguine about the path of macroeconomic policy. This stems from the FY2012/13 budget in which a number of strong fiscal measures to be pursued by the Government were outlined by the Minister of Finance. The implementation of these measures demonstrates decisively the Government's commitment to fiscal and debt sustainability over the medium term. With respect to a new borrowing programme with the IMF, the Government is moving assiduously to have an agreement before the end of the year. Agreement with the IMF will lead to an unlocking of official flows as well as provide a fillip to business confidence. Accordingly, the Bank is forecasting a gradual recovery in the NIR in the second half of the fiscal year.

However, the tax measures in the Budget and recent increases in international grains prices may have engendered some anxiety about the likely outturn for inflation. Perhaps this is why you invited me today, given the Bank's mandate for price stability. So, I would like to share with you this afternoon the Bank's current outlook for inflation in the rest of the fiscal year.

As you are aware, the Bank revised its forecast range for inflation to10.0 per cent to 12.0 per cent from the earlier announcement of 6.0 per cent to 8.0 per cent. This revision followed the presentation of the budget for FY2012/13 by the Minister of Finance which contained a number of tax measures. The Bank's assessment, which was shared with the public on 14 June, suggested that the tax measures would have an impact of approximately 3.4 percentage points for the fiscal year. In the context of these expected impulses, the Bank indicated that there would have been a temporary spike in inflation in the June and September quarters. In fact, at that time we projected that inflation in the June quarter would have been in the range of 3.0 per cent to 5.0 per cent as we expected a sharp increase in the month of June with the widening of the range of basic items that were subject to GCT. For the September quarter, we projected a slower rate of increase in the range of 2.5 per cent to 3.5 per cent. The Bank had also indicated that inflation was expected to continue to subside in the December 2012 and March 2013 quarters as the inflationary impact of the tax measures normalized.

Well, the inflation outturn to date has been more favourable than the Bank anticipated. In particular, for the June quarter, headline inflation was 1.5 per cent, much lower than our forecast range. This more favourable outturn reflected markedly lower inflation for the month of June than was projected by the Bank. In fact, the inflationary impact from the tax measures in the month was not as significant as we anticipated. In addition, there was a decline in crude oil prices during the June quarter which led to a reduction in the cost of electricity and fuel.

Similar to the outturn in June, headline inflation in July was significantly lower than the Bank's forecast. In fact, there was a general fall in prices, by 0.3 per cent, in the month in contrast to the Bank's forecast for an increase. While there were some increases in prices related to the tax package they were restrained by competitive pressures and, of course, there was the impressively agile competition by the providers of mobile telephone services which led to a significant reduction in the cost of communications. In addition, there was a further decline in utility rates. These factors more than offset the inflationary impact of the tax measures in July.

As a result, for the first four months of this fiscal year headline inflation was just 1.1 per cent significantly lower than the 2.8 per cent for the corresponding period of 2011. Core inflation has also been contained. These developments point to a domestic economic environment of moderate inflation, consistent with the Bank's monetary policy objective. Further, the Bank's survey of business expectations confirms a perception of a moderate inflationary environment.

Against this background, for the rest of the fiscal year, the Bank expects the main inflationary impulses to emanate from increased prices for international grains. Since July, there have been significant increases in grains prices on the international market. These increases have been occurring in the context of concerns about a shortage in food supplies given adverse weather conditions in major grain producing countries, particularly the USA where the Midwest has been experiencing its worst drought in approximately 50 years. There is also projected to be moderate upward movement in crude oil prices, largely stemming from the European ban on oil from Iran, but low global demand should constrain increases in price. Further, the Bank expects some pass through of the recent movements in the exchange rate. However, the inflationary impact of these factors will be constrained by the impact of the relatively weak domestic demand conditions.

The recent developments and near-term outlook signal that the rate of price increases may fall well below the Bank's forecast range of 10.0 per cent to 12.0 per cent for FY2012/13. In fact inflation in this quarter could be similar to the previous quarter in the range of 1.0 per cent to 2.0 per cent. Of course, there are risks to this forecast. The upside risks include higher than projected international grains prices as well as the probability of adverse weather given the forecast for an above average hurricane season. These upside risks are counterbalanced by risks to the downside caused by possibly weaker than forecasted external and domestic economic activity. It is also anticipated that the tight fiscal stance will constrain domestic demand, further limiting the scope and extent of possible price increases.

The successful implementation of the strong fiscal consolidation programme sets the stage for a very stable macroeconomic environment over the medium-term which the Bank believes will foster continued reduction in interest rates, particularly lending rates. While there is currently some measure of uncertainty among businesses and households, the continued implementation of strong fiscal budgets and fundamental reforms, including those that will enhance competitiveness, should in time reassure economic agents and lead to a recovery in domestic demand and economic enterprise.

Thank you.