ANNUAL REPORT

2004

Report and Statement of Accounts for the
Year Ended 31 December 2004

Mission Statement

The mission of the Bank of Jamaica
is to formulate and implement
monetary and regulatory policies
to safeguard the value of the domestic
currency and to ensure the soundness
and development of the financial system
by being a strong and efficient
organisation with highly motivated
and professional employees
working for the benefit of
the people of Jamaica.

BANK OF JAMAICA
NETHERSOLE PLACE
KINGSTON

31 March 2005

Dr. The Hon. Omar Davies
Minister of Finance & Planning
National Heroes Circle
Kingston 4

Dear Minister:

In accordance with Section 44 (1) of the Bank of Jamaica Act, 1960, I have the honour of transmitting herewith the Bank's Report for the year 2004 and a copy of the Statement of the Bank's Accounts as at 31 December 2004 duly certified by the Auditors.

Yours sincerely,

Derick Latibeaudiere
Governor

PRINCIPAL OFFICERS

GOVERNOR

Mr. Derick Latibeaudiere

DEPUTY GOVERNORS

1.	Mrs. Audrey Anderson	-	Financial Institutions Supervisory Division
2.	Mr. Colin Bullock	-	Research & Economic Programming Division Banking & Market Operations Division
3.	Mr. Rudolph Muir	-	General Counsel & Bank Secretary, Corporate Secretary's Division

GENERAL MANAGER

Mr. Kenloy Peart

DIVISION CHIEFS

1.	Mrs. Myrtle Halsall	-	Research & Economic Programming Division
2.	Mrs. Gayon Hosin	-	Financial Institutions Supervisory Division
3.	Mr. Herbert Hylton	-	Finance & Technology
4.	Mrs. Faith Stewart	-	Financial Services Sub-Division Banking & Market Operations Division

SENIOR DIRECTORS

1.	Mr. Randolph Dandy	-	Senior Legal Counsel Legal Department
2.	Mrs. Natalie Haynes	-	Senior Director Financial Markets Sub-Division Banking & Market Operations Division
3.	Mrs. Evadnie Sterling	-	Chief Internal Auditor Internal Audit Department

BOARD OF DIRECTORS

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1. Overview

The generally stable macroeconomic environment that prevailed during 2004 allowed the Bank of Jamaica to relax its monetary policy stance while maintaining its focus on preserving low inflation. The easing of policy was effected through a series of reductions in the Bank's interest rate structure. The more stable environment in 2004 followed a period of economic challenges faced by the Bank during 2003 that had required a resolute tightening of monetary policy. By contrast, market conditions throughout 2004 reflected the restoration of strong foreign and local investor confidence, with optimism fuelled by foreign exchange market stability, the accumulation of foreign reserves and the expansion of economic output. These trends were reinforced by the Government's stated commitment to attaining the fiscal targets.

Early in the year, the Government and the International Monetary Fund agreed to enter into a non-borrowing relationship to be termed an Intensified Surveillance Programme (ISP). Annual and semi-annual performance targets in the real, external, monetary and fiscal sectors were set as the macroeconomic indicators that would be monitored closely by the Fund. These targets were consistent with the Government's economic objectives of a reduction in the debt burden, inflation moderation and growth. In this ISP, the Bank developed a monetary programme incorporating quarterly benchmarks for monetary expansion and the quantum of credit that would be consistent with the main target of monetary policy, the inflation rate.

Core or underlying inflation continued to trend downwards in line with the policy objective despite a shock to headline inflation in the latter half of the year. In this regard, core inflation slowed to 5.5 per cent in 2004, compared to 8.1 per cent in 2003. The upturn in headline inflation was a direct result of the effect of an increase in world oil prices as well as a tropical storm in August and hurricane in September, which severely reduced agricultural supply and increased related prices. For the January to September period, the consumer price index increased by 6.9 per cent, averaging 2.3 per cent per quarter. However, in the October to December quarter, the spike in food prices contributed to inflation of 6.4 per cent, which was much higher than the 1.8 per cent average increase experienced in the December quarter over the past five years. Nonetheless, inflation for 2004 was 13.7 per cent, exhibiting a modest downturn when compared to the rate of 14.1 per cent in 2003.

An adequate supply of foreign exchange from tourist expenditure, private remittances and official inflows facilitated stability in the foreign exchange market and a build up in the NIR. This stability was reflected in a mere 1.63 per cent depreciation in the foreign exchange rate, the lowest since 1998 when the Jamaica Dollar recorded depreciation of 1.53 per cent. These factors, coupled with improved fiscal performance throughout the year, helped to buoy investor confidence.

Supported by the restoration of market confidence and a downward trend in inflation, the Bank was able to lower the interest rates on its open-market instruments on nine occasions in the January to June period, while managing base money (the main operating target of policy) within programmed levels. Rates on the 180-day and 365-day

instruments were reduced by 5.95 percentage points and 6.60 percentage points, respectively. The improvement in market confidence was evident in a preference for the Jamaica Dollar, which was reflected in the conversion of US dollars for investment in local currency instruments. Interest in Jamaica Dollar bank deposits and equities was further heightened by the Government's net redemption of domestic debt instruments. After declining by 1.5 per cent in 2003, domestic currency deposits increased by 13.7 per cent in 2004, while foreign currency deposit growth slowed to 14.1 per cent compared to 40.1 per cent in 2003.

Monetary policy management in the latter half of the year faced challenges occasioned by the inflationary effects of rising oil prices and reduced supplies of agricultural commodities. In addition, post-hurricane expenditure compounded the seasonal increase in liquidity in the December quarter. Accordingly, the Bank reduced the magnitude and frequency of interest rate reductions to protect the stability gained in the foreign exchange market earlier in the year and to limit inflationary impulses. Despite the challenges, the Bank was able to manage liquidity through open market operations at progressively lower interest rates.

The pace of economic activity accelerated in the first half of the year. In the main, *export agriculture* grew by 8.1 per cent, *manufacturing* by 5.7 per cent and *electricity and water* 3.3 per cent. However, hurricane damage in September had an adverse impact on production later in the year. *Export agriculture* and *electricity and water* are estimated to have declined by 13.8 per cent and 3.1 per cent, respectively, while growth in *manufacturing* slowed to 2.1 per cent in the latter half of 2004. Notwithstanding these reversals, the Jamaican economy is estimated to have grown by 1.2 per cent in 2004, representing the sixth consecutive year of positive growth. The growth impetus emanated from services, which accounted for 58.4 per cent of the increase in real Gross Domestic Product (GDP). *Distributive trade* and *miscellaneous services* were the main areas of growth in services. There was much activity in the distribution of food and relief supplies in the aftermath of the September Hurricane, which influenced a 1.1 per cent growth in *distributive trade.* Given its weight in Jamaica's GDP, the sector was the fourth largest contributor to economic expansion in 2004. The performance in the tourist industry was a strong influence on the estimated 4.0 per cent expansion in the value added in *miscellaneous services.* Tourism expanded despite the damage of the Hurricane to tourist infrastructure and visitor expenditure is estimated to have increased by 4.1 per cent in 2004.

The improved performance of Jamaica's economy in 2004 was set against the background of significant advances in global economic activity. The strong growth recorded for the industrialized and developing countries influenced the strengthening of Jamaica's balance of payments position, despite the effect of extreme weather conditions on the major foreign exchange earning sectors. Growth in the world economy had a positive impact on alumina exports, tourism and private transfers. In this context, the current account deficit improved by US$64.3 million to US$699.5 million, 7.8 per cent of GDP. Net investment inflows from private and official sources, added to a capital account surplus, were more than sufficient to finance the deficit on the current account.

The official net international reserves stood at US$1 862.4 million as at 31 December 2004, an increase of US$693.7 million for the year. As custodian of Jamaica's

foreign reserves, the Bank continued to invest foreign assets consistent with its strict policy guidelines of investing exclusively in high quality investment-grade instruments. These included United States Agency Bonds and Eurodollar deposits, which earned more than half of the US$42.83 million in foreign investment income for 2004.

Macroeconomic stability in the year shaped investor expectations of favourable earnings from companies. As such, the Jamaica stock market, in 2004, recorded one of its strongest calendar year performances reflecting growth of 66.7 per cent in its main index. The falling rates on money market instruments as well as the extended period of exchange rate stability would have augured well for the growth of the equities market.

With regard to the Bank's supervision of deposit-taking financial institutions, supervisory methodology continued to be upgraded and reshaped to adapt to the increased complexities in banking operations and developments in international supervisory standards. In 2004, supervisory policy continued to focus on achieving full compliance with the Basel Core Principles for Effective Banking Supervision, as well as other related international standards. Off-site surveillance and on-site examination revealed a general improvement in the performance of the supervised system. The asset profile continued to be dominated by investments accounting for 41.3 per cent of total assets, while the stock of loans represented 30.9 per cent. The commercial banking sector continued to be a predominant influence on system trends, accounting for 60.0 per cent of the growth in assets and controlling 72.0 per cent of the system's assets as at 31 December 2004. The asset quality of the deposit-taking system, as measured by the proportion of non-performing loans to total loans, continued to steadily improve well within the prudential tolerance limit of 10.0 per cent. Profitability of the system declined marginally in 2004, in the context of declining interest rates and stability in the foreign exchange rate. This was reflected in a reduced pre-tax profit margin and return on assets in 2004 of 21.3 per cent and 3.0 per cent respectively, compared to 25.3 per cent and 4.3 per cent in 2003. The capital base of the system grew at a faster rate against total asset base. Capital adequacy therefore edged up to 8.5 per cent at 31 December 2004, from 8.4 per cent in 2003. This coverage was 2.5 percentage points above the prudential benchmark of 6.0 per cent.

The Bank continued to play a vital role in the development and execution of the national Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) framework. Through its leadership, a comprehensive revision of the financial legislative framework and related regulations continued in 2004. The Bank became involved in a newly formed national Financial Crimes Legislative Task Force whose work has resulted in legislative amendments being passed by Parliament in 2004. The amended legislation included the Bank of Jamaica Act, the Banking Act, the Financial Institutions Act, the Building Societies Regulations and the Financial Services Commission Act. In addition to the deposit-taking financial institutions, the legislative amendments had an impact on cambios, in their role as regulated foreign exchange traders, and on companies offering remittance services. In 2004, these institutions were sensitized to the money laundering legislation and CFT techniques through the issuance of revised Bank of Jamaica operating guidelines.

In order to effectively fulfill its stated mission, the Bank continued to invest in specialized training and development programmes for staff. These programmes

provided training in areas such as international best practices in financial supervision, new approaches in financial assessment and analysis, economic policy formulation and management, as well as plant management and maintenance. The Bank employed 34 permanent officers during the year, bringing the staff complement to 484 as at 31 December 2004.

In 2005, the Bank of Jamaica will continue to formulate appropriate monetary and regulatory polices to facilitate continued market stability and financial system soundness. The macroeconomic indicators now point to the attainment of single digit inflation in 2005 while the NIR level is expected to remain adequate to underwrite near term stability. The Jamaican economy is projected to expand by 2.5 per cent to 3.5 per cent in 2005 in the context of stability at home and a favourable environment in the world economy.

2.1. Monetary Policy Management

2.1.1. Introduction

Monetary policy during 2004 was conducted in the context of a favourable macroeconomic environment and improved investor confidence, which enabled the Bank of Jamaica (BOJ) to steadily reduce interest rates. Despite the shock to some commodity prices towards the end of the year, core inflation declined to 5.2 per cent, down from 8.1 per cent in 2003.

2.1.2. Developments and Challenges

The conduct of monetary policy in 2004 supported the restoration of confidence in the Jamaican economy. Optimism was fuelled by growth in key foreign exchange earning sectors such as mining and tourism, as well as the Government's commitment to meeting its fiscal targets. The return of investor confidence facilitated the Government sourcing a total of US$813.5 million from international financial markets in 2004. A build up in the stock of Net International Reserves (NIR), largely attributable to direct purchases of foreign exchange from private capital inflows, strengthened the ability of the BOJ to defend the value of the Jamaica Dollar. Moreover, the relatively stable conditions in the foreign exchange and domestic money markets permitted the BOJ to significantly reduce interest rates on its open-market instruments, particularly in the first half of the year.

The latter half of 2004 presented greater challenges for the conduct of monetary policy due to several shocks external to the Jamaican financial system. Instability in the foreign exchange market in June and July, which coincided with the Government not re-issuing a maturing US dollar-indexed bond, prompted the sale of foreign exchange by the Bank to stabilize market conditions. Inflationary pressures from a sustained rise in global oil prices threatened the attainment of the inflation objective. Moreover, given the temporary disruption in economic activity due to hurricanes in August and September, and the resultant inflationary impact primarily from the shortfall in agricultural supplies, the BOJ adopted a more cautious approach to monetary policy. Hence, interest rate reductions were effected only twice in the latter half of the year, relative to the nine occasions between January and June.

Despite the challenges to monetary policy in the second half of the year, the outturn for base money fell within the indicative programme target for 2004 (**see Table 1a**). The NIR stock surpassed the programmed target by US$113.7 million to close the year at US$1 858.5 million. The Jamaica Dollar liquidity impact of the higher NIR was primarily offset by an expansion in open-market operations, which brought the Net Domestic Assets (NDA) well below the programmed ceiling.

For 2004, the monetary base increased by 11.2 per cent relative to 13.3 per cent in 2003 (**see Table 1b**). The expansion reflected an increase in the stock of currency, which grew by 10.1 per cent, relative to 20.8 per cent in

the previous year. In addition, the 12.7 per cent increase in commercial bank statutory reserves was reflective of higher private sector deposits in the banking sector.

2.1.3. January to June

During the first half of the year the monetary base declined by 9.7 per cent primarily reflecting a 10.7 per cent decline in the March quarter. This decline in the first quarter reflected the impact of the seasonal redemption of currency from the banking system. The major counterpart to the decrease in base money for the first six months of the year was an increase of $41 252.7 million in open market operations (OMO). The increased level of OMO activity offset the liquidity impact of the build up in the NIR. The Bank's purchase of Eurobond receipts of €200.0 (US$248.8) million and US$125.0 million from the Government in February and April, respectively, contributed to the increase of US$439.1 million in the NIR between January and June.

The adequate supply of foreign currency inflows and improving macroeconomic conditions facilitated stability in the domestic money and foreign exchange markets. These favourable conditions allowed the Bank to aggressively ease monetary policy in the first half of the year. Between January and June there were nine interest rate reductions across the entire spectrum of BOJ open-market instruments. As at end June the interest rate offered on the 30-day instrument was 80 basis points below that at end December 2003 (**see Table 2**). Even more significant was the sharp decline on the 180-day, 270-day and 365-day securities of 595, 635 and 660 basis points, reflecting removal of the relatively high premium offered on longer tenors (**see Chart 1**).

2.1.4 July to December

The monetary base expanded by 23.1 per cent during the second half of the year. This expansion was reflected mainly in net currency issues attributable to post-hurricane related expenditure, in addition to the usual seasonal increase during December. The major source of the growth in the monetary base was the increase in the NIR of US$ 254.4 million. Foreign currency inflows emanated largely from Eurobond receipts of €200.0 (US$240.6) million in July and an earlier than anticipated €150.0 (US$199.0) million in October. Some of these foreign receipts were used to amortize GOJ external debt, including a Eurobond that matured in August. Remaining excess liquidity was offset through a 6.1 per cent increase in open market operations in the last two quarters of the year.

With the passage of Tropical Storm Charley and Hurricane Ivan in August and September respectively, as well as inflationary pressures from rising oil prices, the Bank acted more cautiously in loosening monetary policy in the second half of the year. In this context only one interest rate reduction was carried out in the September quarter. Modest reductions of 20 to 40 basis points were made on BOJ's 30-day to 365-day instruments on 3 September (**see Table 2**). Rates were held at that level for most of the remainder of the year. However, sustained optimism in the Jamaican economy due to timely recovery of key sectors in the aftermath of the hurricanes, in addition to evidence of the Government's adherence to fiscal prudence, created conditions for a further reduction in interest rates. On 28 December, the Bank cut OMO rates across all tenors, resulting in cumulative decline of 750 basis points on the 365-day instrument for 2004.

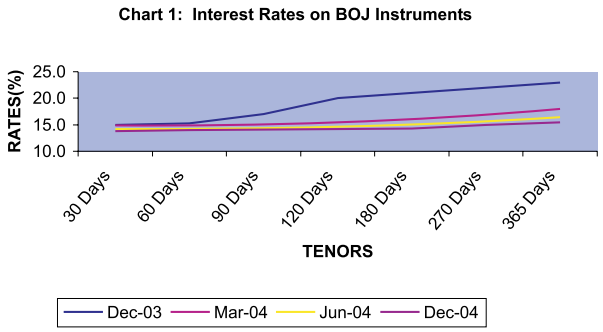

Table 1a

BANK OF JAMAICA-ECONOMIC PROGRAMME TARGETS STOCKS J$M December 2004			
	TARGET	OUT-TURN	DEVIATION FROM TARGET
Net International Reserves (US$)	1744.8	1858.5	113.7
NET INT'L RESERVES (J$)	107945.2	115228.2	7283.0
NET DOMESTIC ASSETS	-62324.5	-70172.6	-7848.1
MONETARY BASE	45620.7	45055.6	-565.1

Table 1b

BANK OF JAMAICA- SUMMARY FLOWS J$M	2003	2004				2004
	Total	Jan- Mar	Apr- Jun	Jul- Sept	Oct-Dec	Total
Net International Reserves (US$)	**-432.0**	**403.7**	**35.4**	**12.4**	**242.0**	**693.5**
NET INT'L RESERVES (J$)	**-22810.7**	**24584.1**	**2158.3**	**770.0**	**15004.0**	**42516.4**
-Assets	-23637.2	24393.5	2035.9	646.0	14954.4	42029.8
-Liabilities	826.5	190.6	122.4	124.0	49.6	486.6
NET DOMESTIC ASSETS	**27579.2**	**-28924.0**	**-1731.7**	**1007.9**	**-8339.3**	**-37987.1**
Net Claims on Public Sector	**27783.5**	**-2364.2**	**12999.0**	**7999.4**	**-5815.1**	**12819.1**
- Central Govt. Deposits	6799.8	-7176.2	4835.5	3134.2	-5284.6	-4491.1
- Govt. Securities	18501.6	-172.1	-843.8	8128.7	-1.0	7111.8
- Other	6354.4	4984.1	9007.3	-3263.5	-529.5	10198.4
Net Credit to Banks	**-8145.5**	**-308.7**	**526.7**	**-1585.1**	**-365.8**	**-1732.9**
Open Market Operations*	**8012.0**	**-26312.3**	**-14940.4**	**-4407.2**	**-3062.8**	**-48722.7**
Other	**-70.8**	**61.2**	**-316.9**	**-999.3**	**904.4**	**-350.6**
MONETARY BASE	**4768.5**	**-4339.9**	**426.5**	**1777.9**	**6664.7**	**4529.2**
- Currency Issue	5072.0	-4495.9	-333.2	1618.4	6182.2	2971.5
- Cash Reserve	89.0	168.5	839.5	105.8	274.3	1388.1
- Current Account	-392.4	-12.5	-79.8	53.7	208.2	169.6
Memo:						
NIR Stock (US$MN) e.o.p.	1165.0	1568.7	1604.1	1616.5	1858.5	
Growth in Monetary Base (qrtly)	13.3	-10.7	1.2	4.9	17.4	11.2
Inflation (qrtly)	14.1	1.9	1.9	2.8	6.4	13.7

** Includes only principal payments.*

Table 2

BOJ REVERSE REPURCHASE RATES (%) DECEMBER 2003 – DECEMBER 2004	31	9	21	26	16	27	10	2	19	5	3	28
	Dec. 03	Jan.	Jan.	Jan.	Feb.	Feb.	Mar.	Apr.	Apr.	May	Sept.	Dec.
30 Days	15.00	15.00	15.00	14.85	14.85	14.85	14.85	14.60	14.40	14.20	14.00	13.80
60 Days	15.30	15.30	15.20	15.00	15.00	15.00	15.00	14.70	14.50	14.30	14.10	13.95
90 Days	17.00	16.00	15.50	15.10	15.10	15.10	15.10	14.80	14.60	14.40	14.20	14.05
120 Days	20.00	18.00	17.00	16.00	15.50	15.50	15.50	15.10	14.85	14.55	14.35	14.15
180 Days	21.00	19.50	18.25	17.25	16.25	16.00	16.00	15.60	15.30	15.05	14.80	14.30
270 Days	22.00	21.00	20.00	18.75	17.75	17.25	16.95	16.50	16.00	15.65	15.35	15.00
365 Days	23.00	22.00	21.00	20.00	19.00	18.50	17.95	17.40	16.90	16.40	16.00	15.50

2.2. Monetary Survey

During 2004, broad money, M2*[1] increased by 15.4 per cent, a faster rate of growth than the 11.0 per cent recorded in 2003 (**see Table 3**). This outturn was underpinned by faster rates of growth in local currency deposits and currency in circulation and a slower rate of increase in foreign currency deposits. The increased demand for Jamaica Dollar deposits occurred at relatively lower rates of return consistent with an easing of monetary policy and reflected a restoration of investor confidence in the economy during 2004.

Narrow money, M1*[2], increased by 22.8 per cent, a faster rate of growth than the 7.3 per cent recorded in 2003. Growth in M1* during 2004, largely reflected a 28.3 per cent increase in demand deposits, a faster rate of expansion relative to 3.1 per cent in 2003. Demand deposits denominated in local currency grew by 29.7 per cent, relative to a reduction of 9.3 per cent in 2003. Improved output levels from most sectors in the economy would have contributed to the outturn for 2004. Demand deposits denominated in foreign currency increased at a notably slower rate during 2004, reflecting growth of 25.3 per cent, relative to 47.7 per cent in 2003. This is consistent with the strong demand for Jamaica Dollars observed during the year.

Currency with the public recorded growth of 15.1 per cent, a slightly faster rate than the 13.6 per cent increase in 2003. However, in real terms, currency with the public grew at a slower rate of 1.3 per cent in 2004 compared to 3.0 per cent in 2003. An increase in the number of debit cards issued by commercial banks would have contributed to the slowdown in real growth in currency with the public.

Quasi money (Savings and Time deposits) grew at a slightly slower rate of 12.3 per cent in 2004 relative to 12.6 per cent in 2003 (**see Table 3**). This outturn reflected a much slower growth in savings deposits and more specifically the foreign currency component of these deposits, which was partially offset by a strong growth in time deposits. The foreign currency component of savings deposits grew at a slower rate of 13.9 per cent during 2004 relative to 35.2 per cent in 2003, in a context of stable foreign exchange market conditions. Simultaneously, despite a lowering of interest rates, the local currency component of savings deposits grew at a faster rate of 11.1 per cent during 2004 relative to 9.6 per cent in 2003 reflecting increased confidence in the domestic currency during the review year. Time deposits increased by 12.7 per cent during 2004 relative to a reduction of 0.8 per cent in 2003. The outturn for 2004 reflected increases in both local and foreign currency deposits with foreign currency deposits growing at a relatively faster rate in the context of higher foreign exchange earnings in the economy.

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[1]. *Money supply M2* represents banking system domestic and foreign currency liabilities to the private sector in the form of notes and coin as well as demand, time and saving deposits.*

[2]. *M1* is comprised of notes and coin and demand deposits.*

Table 3

MONEY SUPPLY , M2*
(DOMESTIC AND FOREIGN CURRENCY)
(J$M)

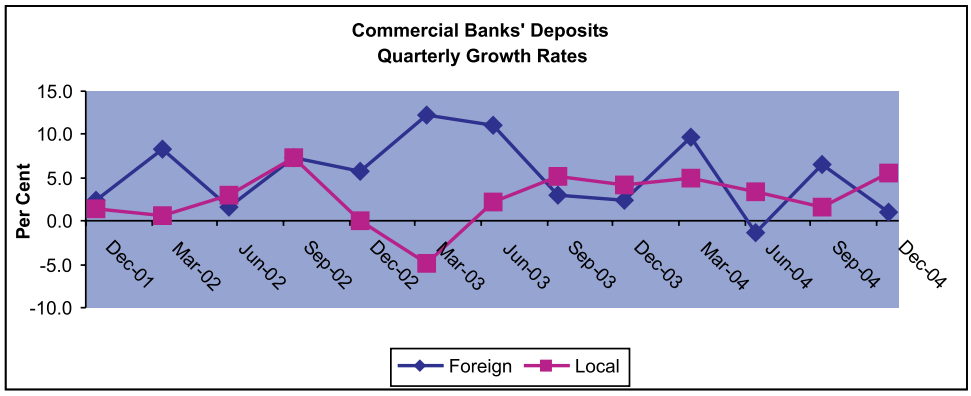
	2003 (J$M)	2004 (J$M)	2003 %	2004 %
COMPONENTS OF MONEY SUPPLY				
Money Supply (M2)*	18 091.4	28 277.9	11.0	15.4
Money Supply (M1)*	3 750.8	12 582.0	7.3	22.8
Currency with the public	2 779.4	3 497.5	13.6	15.1
Demand Deposits	971.4	9 084.5	3.1	28.3
Quasi Money	14 340.6	15 695.9	12.6	12.3
Savings Deposits	14 608.2	11 636.3	18.0	12.1
Time Deposits	-267.6	4 059.6	-0.8	12.7
SOURCES OF MONEY SUPPLY				
Net Foreign Assets	-25 796.6	41 684.1	-18.0	59.4
Bank of Jamaica	-22 810.8	42 618.2	-15.7	63.5
Commercial Bank	-2 985.8	-934.1	-48.1	-29.0
Loans and Advanced to Private Sector	22 874.5	14 101.4	44.8	19.1
Local Currency	14 493.3	8 535.0	43.1	17.7
Foreign Currency	8 381.2	5 566.3	48.1	21.6
Net Claims on Public Sector	44 616.5	-5 451.4	31.8	-2.9
Net Claims on Financial Institutions	-4 533.3	2 659.3	40.4	-16.9
BOJ Open Market Operations	8 011.9	-48 812.7	-8.9	59.5
Other Items (Net)	-27 081.6	24 097.2	287.0	-41.6
TOTAL	18 091.4	28 277.9	11.0	15.4

During the review year, a build up in the net foreign assets (NFA) of the BOJ, an unwinding of commercial banks repurchase agreements with the private sector largely reflected in one commercial bank and an expansion in banking system credit to the private sector were the main sources of monetary expansion. The increase in the NFA of the BOJ resulted from the purchase of foreign loan proceeds from the Government coupled with direct purchases of foreign exchange from the market (see **Base Money Management**).

Private sector credit, the other major source of expansion in M2*, increased by 19.1 per cent in 2004, a notably slower rate than the 44.8 per cent recorded in 2003. The slowdown was reflected in both local currency and foreign currency credit and was attributable to an increased use of foreign funding and retained earnings for financing as well as significant net repayments following the surge in lending during the previous two years.

The liquidity impact from these sources was partially countered by an increase in the stock of BOJ open market instruments and a reduction in the NFA of the commercial banks. The Central Bank's open market

Chart 2



operations absorbed liquidity at progressively lower rates of return during the year.

While local currency deposits grew at a faster rate than foreign currency deposits during 2004, the quarterly growth pattern reflected changes in the macro-economic environment. During the first quarter of the review year, both local and foreign currency deposits increased at a faster rate relative to that which obtained during the December 2003 quarter. However, growth in foreign currency deposits exceeded that of local currency deposits. Foreign currency deposits grew by 9.8 per cent and coincided with increased foreign exchange earnings by the Tourism and Mining sectors.

Growth in broad money M2* during the June quarter reflected an increase of 3.5 per cent in local currency deposits as foreign currency deposits declined by 1.4 per cent, given the continued lowering of inflation and stable foreign exchange market conditions (**see Chart 2**). The further growth in local currency deposits, albeit at a slower rate relative to the first quarter, reflected an increased confidence in Jamaica Dollars. For the July to September quarter, foreign currency deposits grew by 6.6 per cent as investors attempted to maintain a US dollar hedge in their asset portfolios subsequent to the maturity of a GOJ US$ instrument in July 2004. Beyond this, uncertainty emerged given the rising prices of imported commodities, particularly oil, and domestic price increases associated with the impact of Hurricane Ivan. The growth in foreign currency deposits occurred in tandem with relatively slower growth in local currency deposits as investors shifted their resources into alternate domestic assets that offered relatively higher rates of return.

In response to the jitters that emerged in the third quarter, the Bank maintained a conservative monetary policy stance that curtailed core inflation. Given this and a growing sentiment that the fiscal target would be met, there was a strengthening of investor confidence that was evident in a notable slowdown in the accumulation of foreign currency deposits and a build up in local

currency deposits during the December quarter. The growth in local currency deposits exceeded that of foreign currency deposits, as well as, the outturn for the September quarter.

Although money supply increased at a faster rate than in 2003, the Central Bank was successful in maintaining relative stability in the financial markets during 2004. This outturn augurs well for the achievement of the inflation target for 2005. The maintenance of a low inflation environment will facilitate an increase in local currency deposits and, by extension, growth in M2* that is line with nominal GDP. It is envisaged that an expansion in banking system credit to the private sector will be the major source of this increase in money supply.

2.3. Commercial Banks

The assets of the commercial banking sector continued to record strong growth during 2004, albeit at a slower rate than for 2003. This deceleration reflected slower growth in loans & advances, which was attributed to significant net repayments from the private sector following the surge in lending activity during the previous two years. Concurrently, there was a notable expansion in local currency deposits, in a context of improved confidence in the Jamaica Dollar. This constituted a major source of financing in 2004. Given the stable foreign exchange market conditions, there was a substitution by one bank of costly repurchase agreements contracted in 2003 with funds borrowed from overseas institutions. This provided another major source of financing for the institution's operations during the year. Due to a continued decline in past due loans, there was an improvement in the banks' asset quality in 2004. The number of commercial banks in operation remained at six with Bank of Nova Scotia (BNS), National Commercial Bank (NCB) and RBTT Jamaica, accounting for 86.2 per cent of total assets as at 31 December 2004.

1.1.1 Assets and Liabilities

The commercial banking sector's asset base increased by 10.1 per cent in 2004, relative to growth of 19.7 per cent in 2003. The slower rate of growth was largely reflected in *Loans & Advances*, which was the main source of growth in commercial bank assets (**see Table 4**). In a context of foreign exchange market stability, the expansion in *Loans & Advances* was largely reflected in foreign currency loans, which accounted for 57.8 per cent of the increase in 2004. The increased use of private capital inflows was a contributing factor to the slower rate of growth in *loans and advances* during the year.

Despite a reduction in 2004, commercial banks' holdings of *Investments*[3] continued to dominate the institutions' asset portfolio, accounting for 34.2 per cent of total assets as at 31 December 2004 (**see Chart 3**). This decrease was largely reflected in GOJ domestic securities, explicated by a reduction in the Government's demand for domestic financing in 2004. Against this background, there was a significant increase in the banks' holdings of BOJ certificates of deposits at lower rates of return reflecting a continued improvement in investor confidence (**see Table 4**). This increase was a major contributor to the growth in the sector's asset base in 2004. The decline in GOJ domestic currency securities resulted in a continued decrease in the ratio of domestic currency investments to total investments to 73.8 per cent from 76.2 per cent in 2003 and 79.5 per cent in 2002.

[3] *Investment represents securities (domestic and foreign) held by the commercial banks and exclude securities bought for resale.*

Table 4

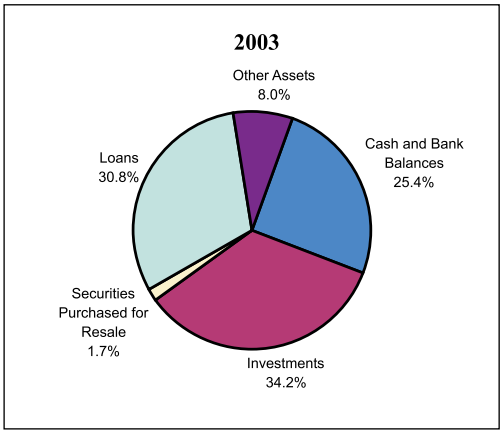
COMMERCIAL BANK
SUMMARY OF ASSETS AND LIABILITIES
(J$M)

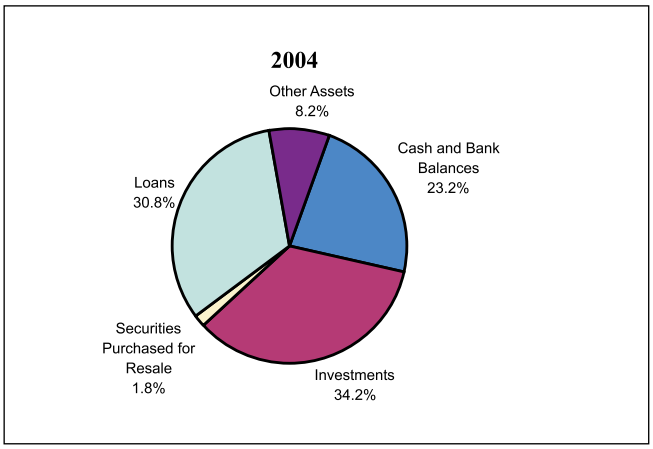
	Stock 2004	Flows 2002	Flows 2003	Flows 2004	% 2002	% 2003	% 2004
ASSETS	340 910.0	24 078.9	50 933.2	31 269.7	10.3	19.7	10.1
Cash and Bank Balances	80 616.8	10 035.0	10 501.2	14 741.3	22.1	19.0	22.4
Placements with Overseas Banks	32 719.67	3 973.7	3 350.1	10 365.2	26.4	17.6	46.4
Investments	115 956.2	-8 020.5	8 866.3	-2 615.8	-6.8	8.1	-2.2
-Domestic Currency	85 550.4	-12 667.9	3 053.3	-4 754.0	-12.7	3.5	-5.3
BOJ securities	23 984.1	-2 497.0	-3 332.9	11 341.0	-13.5	-20.9	0.0
Jamaica Government Securities	54 770.1	-12 039.0	6 199.0	-17 730.4	-15.4	9.3	-24.5
Other Public Sector	1 814.6	1 264.6	-176.2	-537.1	100.1	-7.0	-22.8
Other Local	4 981.7	0 603.5	363.4	2 172.5	32.8	14.9	77.3
-Foreign Currency	30 405.7	4 647.4	5 813.0	2 138.3	26.1	25.9	7.6
Ja. Gov. Foreign Securities	29 423.9	4 250.0	6 229.6	1 992.2	25.1	29.4	7.3
Securities Purchased for resale	5 960.3	-4 401.5	-1 476.9	797.3	-39.9	-22.2	15.4
Loans (Net of provisioning)	110 590.3	25 496.9	25 201.3	15 316.6	57.2	36.0	16.1
Domestic	68 104.2	16 496.9	12 411.0	6 136.4	49.9	25.0	9.9
Foreign	45 591.3	8 411.3	12 795.7	8 409.1	52.7	52.5	22.6
Accounts Receivable	5 588.4	-2 094.8	2 179.3	-841.0	-33.0	51.3	-13.1
Fixed Assets	7 627.4	2 075.7	223.6	549.2	43.4	3.3	7.8
Other Assets	14 570.6	0 988.1	5 438.4	3 322.1	20.5	93.6	29.5
Foreign Assets	41 861.0	2 724.3	4 906.8	12 361.2	12.5	20.0	41.9
LIABILITIES & CAPITAL	340 910.0	24 078.9	50 933.2	31 269.7	10.3	19.7	10.1
Deposits	228 579.1	20 061.4	19 795.3	29 804.3	12.6	11.1	15.0
Domestic	139 801.0	10 631.1	-1899.8	16 824.8	9.3	-1.5	13.7
Foreign	88 778.1	9 430.3	21 695.1	12 979.5	21.1	40.1	17.1
Due to Bank of Jamaica	229.9	51.8	32.9	62.2	62.4	24.4	37.1
Due to Commercial banks	20 028.0	-42.4	2 322.6	8 384.6	-0.5	24.9	72.0
Due to Overseas banks	19 922.9	-42.4	2 729.6	8 412.8	-0.5	31.1	73.1
Due to Specialised Institutions	6 885.0	-1 855.4	1 593.7	-1 984.2	-20.3	21.9	-22.4
Securities sold under Repurchase Agreements	22 417.4	628.6	16 149.4	-15 238.7	3.0	75.1	-40.5
Other Liabilities	21 726.4	347.5	5 154.9	3 680.3	2.8	40.0	20.4
Capital Account	41 044.1	4 887.4	5 884.4	6 561.2	20.6	20.6	19.0
Foreign Liabilities	38 645.7	3 797.9	7 102.5	7 245.1	18.5	29.2	23.1

Data account for provisioning
Investments and Cash and Bank Balances adjusted to reflect reclassification of Certificates of Deposits from "other accounts designated as liquid" to BOJ securities

Chart 3: The Composition of Commercial Banks' Assets at 31 December 2003 and 31 December 2004

Another significant element of growth in the sector's asset base was an increase in foreign currency placements with





overseas banks. This was primarily reflected in one large institution which recorded growth of J$5 684.3 million in September 2004. In addition, there was an increase of J$1 230.9 million in foreign currency placements by one small bank with its head office overseas in November 2004. These placements could have been attributed to an increase in interest rates in the US economy during 2004.

The increase in the sector's asset base was financed mainly through a faster rate of growth in total bank deposits, in particular local currency deposits (**see Table 4**). The expansion in local currency deposits in 2004 was in contrast to the decline recorded in 2003 and reflected the continued improvement in confidence. This improvement in confidence coupled with the relatively stable foreign exchange market conditions resulted in a slower rate of growth in foreign currency deposits in 2004, relative to 2003.

A disaggregation of total bank deposits revealed that the faster rate of expansion recorded in 2004 relative to the previous year was largely reflected in a build up in deposits held by the Government and the private sector. Of the increase in private sector deposits, time deposits increased by 12.7 per cent, compared to the 0.8 per cent reduction observed in 2003, whereas demand deposits grew at a faster rate of 28.3 per cent relative to an increase of 3.1 per cent in 2003.

With regard to the currency composition of private deposits, the ratio of foreign currency deposits to total private sector deposit liabilities remained basically flat at 31.1 per cent relative to end December 2003, having peaked at 32.6 per cent in February 2004 and recording a low of 30.8 per cent in July 2004 (**see Chart 4**). The peak in the ratio would have been attributed to increased foreign exchange earnings by the Tourism and Bauxite sectors during the first quarter of 2004.

Table 5

COMMERCIAL BANKS TOTAL DEPOSITS (J$M)								
	Stocks 2003	Stocks 2004	Flows 2002	Flows 2003	Flows 2002	% 2002	% 2003	% 2004
Deposits	198 999.2	229 623.4	19 562.0	20 825.7	30 624.2	12.3	11.6	15.4
Private Sector	159 971.9	184 752.2	17 343.2	15 312.0	24 780.3	13.6	10.6	015.5
Demand /1	32 092.0	41 176.4	4 555.4	971.4	9 084.4	17.1	3.1	28.3
Savings	95 898.7	107 535.0	9 197.3	14 608.2	11 636.3	12.8	18.0	12.1
Time	31 981.2	36 040.8	3 590.5	-267.6	4 059.6	12.5	-0.8	12.7
Government	18 822.2	22 834.9	1 577.5	-431.8	4 012.7	8.9	-2.2	21.3
Other	20 205.1	22 036.2	641.3	5 945.6	1 831.1	4.7	41.7	9.1

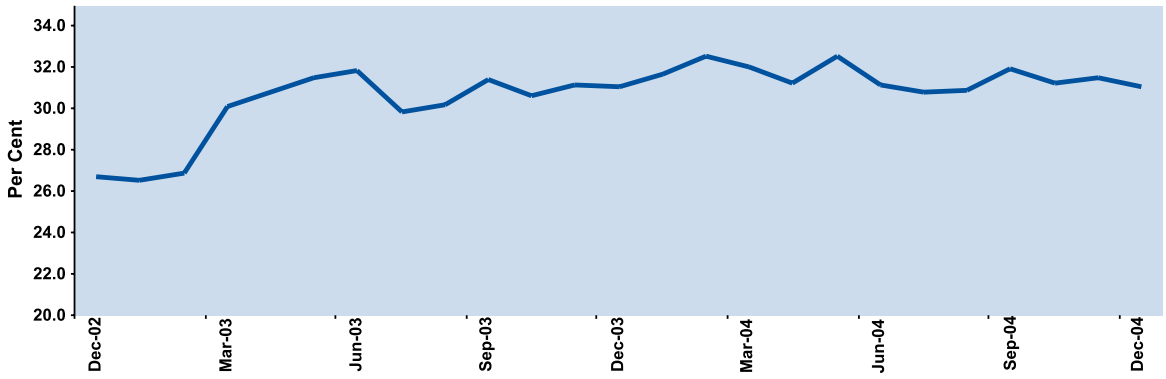
/1 Deposits adjusted for Net Items in the Process of Collection

Table 6

COMMERCIAL BANKS LOCAL AND FOREIGN CURRENCY DEPOSITS /1 (PRIVATE SECTOR) (J$M)								
	Stocks 2003	Stocks 2004	Flows 2002	Flows 2003	Flows 2004	% 2002	% 2003	% 2004
Private Sector Deposits	159 971.9	184 752.2	17 343.2	15 312.0	24 780.3	13.6	10.6	15.5
Local Currency	99 944.6	114770.5	8 290.1	980.2	14825.9	9.1	1.1	14.8
Foreign Currency	60 027.3	69981.7	9 053.1	14 331.8	9954.4	24.7	32.0	16.6

/1 Deposits adjusted for Net Items in the Process of Collection

Chart 4: Foreign Currency Deposits to Total Deposits
December 2002 to 2004



The operations of the commercial banking sector were also financed through borrowings from overseas banks, which increased by 73.1 per cent during 2004. This was relative to the growth of 31.1 per cent observed in 2003. The faster rate of expansion in borrowings from overseas banks 2004 was concentrated in one major bank and provided that institution with an alternate source of financing to the high-cost repurchase agreements contracted in 2003.

2.3.2. Liquidity

The statutory cash reserve and liquid asset requirements for commercial banks were maintained at 9.0 per cent and 23.0 per cent, respectively, during 2004. Against this background, the sector's holdings of liquid assets at end December 2004 was 38.4 per cent compared to 33.2 per cent at end December 2003. The growth in 2004 was largely reflected in increases in the institutions' holdings of BOJ reverse repurchase instruments and domestic currency cash reserves (**see Table 7**). The increase in holdings of BOJ reverse repurchase instruments at relatively lower rates of return, comes against the background of the reduced demand for credit during 2004 and was evidence of the improvement in confidence. The growth in the banks' domestic currency cash reserves was as a result of strong growth in the banks' deposit liabilities in 2004. Consequent on the expansion in liquid asset holdings, the banks' excess reserves rose to $21 400.0 million, reflecting a $6 900.0 million increase relative to its level at end December 2003.

2.3.3. Interest Rates and Spreads

During 2004, there were several reductions in rates offered on the Bank of Jamaica's open market securities. This translated into decreases in the overall average weighted rates offered on commercial bank deposits and loans (**see Table 8**). The institutions were able to attract deposits at a lower cost due to Government's reduced demand for domestic financing in 2004 relative to 2003. However, despite the decline in the overall average weighted rate, the cost of foreign currency deposits to the institutions remained virtually unchanged throughout 2004. As regards the cost of

Table 7

COMMERCIAL BANKS LIQUID ASSETS

	2002	2003	2004			
	Dec	Dec	Mar	Jun	Sep	Dec
Statutory Liquidity (%)						
Cash Reserve Ratio	9.0	9.0	9.0	9.0	9.0	9.0
Liquid Assets Ratio	23.0	23.0	23.0	23.0	23.0	23.0
Average Liquid Assets Holdings (%)	37.9	33.2	37.8	39.4	38.6	38.4
Liquid Assets (J$BN)						
Notes and Coins	4.0	6.3	4.3	3.5	4.1	5.8
Current Account	1.0	0.4	0.3	0.1	0.1	0.4
Cash Reserve	10.9	11.1	11.9	12.0	12.3	
Other Government Securities	0.0	0.0	4.4	1.4	2.0	1.1
Treasury Bills	1.5	1.4	1.4	1.1	1.0	
Local Registered Stocks*	4.3	6.3	4.9	8.3	5.1	3.3
Rev. Repurchase Agreements	26.6	17.0	27.4	27.5	27.3	29.0
Total	47.6	42.4	53.8	54.1	51.7	52.9
Prescribed Liabilities (J$BN)	120.4	121.4	122.6	132.6	133.8	136.8
Excess Reserves	19.9	14.5	25.6	23.6	20.9	21.4

** Net of securities pledged as collateral*

loans, a general reduction in the demand for bank credit in a context of increased private capital inflows to finance real sector projects, contributed to the decrease in loan rates in 2004. Notwithstanding the decline in the overall weighted average loan rate, however, there was an increase in the cost of foreign currency loans during the second half of 2004. This increase was mainly due to a heightened demand for foreign currency loans, particularly in the December 2004 quarter, which could have been attributed to the stability maintained in the foreign exchange market. The impact of two natural disasters in the September 2004 quarter was also a contributing factor to the increased demand for loans during the second half of 2004. Consequently, the foreign currency average weighted loan rate increased by 56 basis points during the second half of 2004, compared to a decrement of 22 basis points for the first six months of 2004 (**see Table 8**).

Following a significant increase in 2003, commercial banks' interest rate spread narrowed by 94 basis points to 11.68 percentage points at end December 2004 (**see Table 9**). This was consistent with an easing of monetary policy by the Central Bank during 2004, which led to a larger reduction in the overall average weighted loan rate vis-à-vis the overall average weighted deposit rate of commercial banks. The reduction in the overall spread largely reflected significant decreases in the spread on loans extended to other public sector entities and Central Government. These contractions were attributed to the reduction in the demand for bank loans in 2004, due to a continued improvement in the Government's fiscal operations.

2.3.4. Loans and Advances

The stock of commercial bank loans and advances outstanding reflected a slower rate of increase of 14.7

Table 8

INTEREST RATES IN DOMESTIC MARKETS

	2002 Dec	2003 Dec	2004 Mar	Jun	Sep	Dec
COMMERCIAL BANKS						
Overall Average Weighted Loan Rate	18.26	19.32	19.10	17.75	17.76	17.72
Foreign Currency Average Weighted Loan Rate	12.08	8.79	8.67	8.57	8.71	9.13
Overall Average Weighted Deposit Rate	6.88	6.70	6.48	6.27	6.03	6.04
Demand	3.45	3.52	3.36	3.44	3.34	3.31
Savings	6.38	6.33	6.11	5.84	5.61	5.71
Time	8.92	8.68	8.47	8.15	7.99	7.78
Certificates of Deposit						
1-month	9.98	10.06	8.57	8.04	8.06	7.71
3-month	10.77	10.85	9.39	8.94	8.71	8.45
12-month	10.08	10.65	7.91	7.48	7.62	7.17
Foreign Currency Average Weighted Deposit Rate	3.31	3.33	3.24	3.33	3.30	3.32
Demand	2.94	3.05	2.95	3.15	3.39	3.27
Savings	2.40	2.28	2.32	2.30	2.29	2.27
Time	5.28	5.45	5.16	5.27	5.29	5.27
GOJ 6-MONTH TREASURY BILL RATE	17.01	22.05	15.57	14.98	14.80	14.94
BOJ 180-DAY REPURCHASE AGREEMENT RATE	13.45	21.00	16.00	15.05	14.80	14.30
PRIVATE MONEY MARKET RATE	18.13	20.63	15.00	14.55	14.05	13.88

per cent for 2004, relative to an expansion of 34.1 per cent in 2003 (**see Table 10**). In real terms, the growth in loans and advances slowed considerably to 0.9 per cent in 2004, compared to increases of 21.6 per cent in 2003 and 40.8 per cent in 2002. The deceleration in the growth in loans and advances was in a context of an increase in the use of private capital inflows as a major source of financing real sector projects during the year. As a result, the slower rate of growth in loans extended to the private sector in 2004 reflected a normalization of the rate of increase, following the surge in lending activity over the previous two years. Despite this slowdown, however, the stock of loans outstanding to the private sector continued to dominate the commercial banks' loan portfolio, accounting for 72.9 per cent at end December 2004, compared to 71.8 per cent at end December 2003 and 65.9 per cent at end December 2002.

During 2004, there was a 16.4 per cent expansion in the commercial banks' private sector loan portfolio. This was significantly slower than the increases of 46.1 per cent and 27.3 per cent in 2003 and 2002, respectively. The slower rate of increase in 2004 was

Table 9

COMMERCIAL BANK INTEREST RATE SPREADS (BY SECTOR)

	2002	2003	2004			
	Dec	Dec	Mar	Jun	Sep	Dec
OVERALL AVERAGE WEIGHTED LOAN RATE	18.26	19.32	19.10	17.75	17.76	17.72
OVERALL AVERAGE WEIGHTED DEPOSIT RATE	6.88	6.70	6.48	6.27	6.03	6.04
OVERALL SPREAD	11.38	12.62	12.62	11.48	11.73	11.68
Installment Credit	18.73	17.31	17.74	17.85	17.90	17.82
Mortgage	12.14	14.49	14.40	14.47	14.45	14.12
Personal	20.45	23.04	23.41	24.08	24.31	24.15
Commercial	9.05	8.79	8.68	8.16	8.08	8.09
Central Government	10.92	17.05	15.59	12.43	12.41	12.23
Other Public Sector	8.83	10.08	10.17	5.68	6.26	5.59

primarily reflected in the categories of *Personal Loans* and *Tourism*. These increases were partly countered by significant net repayments from the *Transport, Storage & Communication*, *Distribution* and *Mining & Quarrying* sectors (**see Table 10**). The sectors of *Transport Storage & Communication*, *Tourism* and *Personal loans* continued to dominate the share of private sector loans outstanding, accounting for 72.0 per cent as at 31 December 2004, relative to 69.2 per cent at end December 2003 (**see Chart 5**). Despite a decline in the cost of funds during 2004 and given the general decrease in demand for bank credit, there was the slower rate of expansion in *Personal Loans* relative to 2003. As regards the *Tourism* sector, the slower rate of growth in loans extended in 2004 largely reflected the completion of financing arrangements related to refurbishing activities between the banks and several hotels islandwide.

Consequent on the deceleration in the growth in loans to the private sector, the ratio of non-performing to total loans outstanding declined to 2.7 per cent at end December 2004, from 3.1 per cent at end December 2003 and 3.8 per cent at end December 2002. These ratios compare very favourably with the international benchmark of 10.0 per cent.

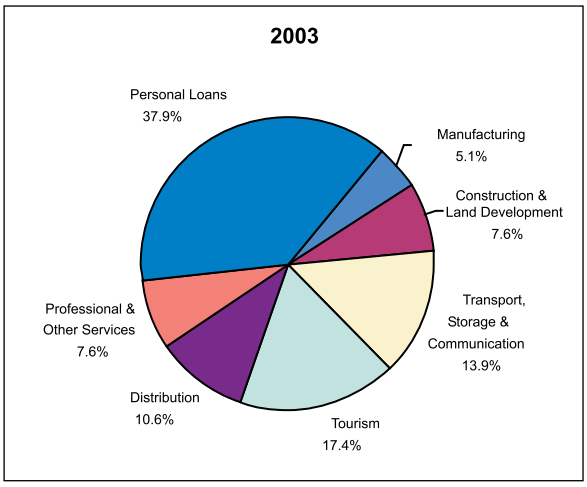
During 2004, the rate of increase in loans and advances denominated in United States dollars decelerated to 20.0

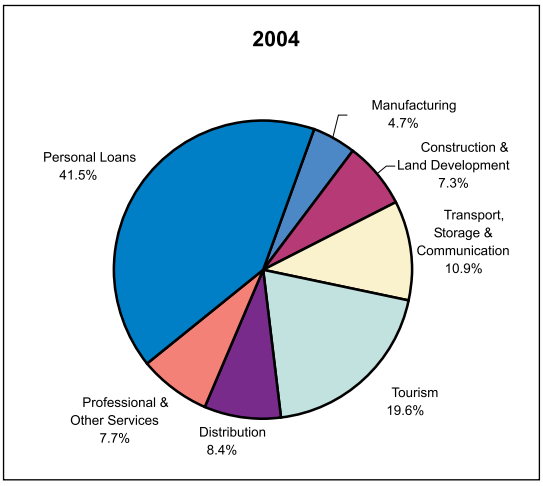
Table 10

COMMERCIAL BANKS
TOTAL LOANS AND ADVANCES
(J$M)

	Stocks 2003	Stocks 2004	Flows 2002	Flows 2003	Flows 2004	% 2002	% 2003	% 2004
Public Sector	27 511.6	30 136.5	12 484.9	4 450.3	2 625.0	118.0	19.3	9.5
Other Financial Instituions	431.0	644.5	1 980.5	-1 727.6	213.5	1 111.4	-80.0	49.5
Private Sector	71 207.4	82 914.4	10 442.8	22 484.0	11 707.0	27.3	46.1	16.4
Agriculture and Fishing	1 421.6	1 227.5	258.2	-316.3	-194.1	17.5	-18.2	-13.7
Mining and Quarrying	408.4	223.4	4.2	306.0	-185.0	4.3	298.8	-45.3
Manufacturing	3 462.8	3 746.4	58.9	284.7	283.6	1.9	9.0	8.2
Construction & Land Development	5 180.7	5 875.7	987.0	1 854.3	695.0	42.2	55.7	13.4
Transport, Storage & Communication	9 536.9	8 727.5	1 321.3	4 093.8	-809.4	32.1	75.2	-8.5
Tourism	11 908.5	15 741.8	1 874.7	4 867.6	3 833.3	36.3	69.1	32.2
Distribution	7 250.4	6 753.8	1 287.6	2 738.1	-496.6	39.9	60.7	-6.8
Professional & Other Services	5 182.0	6 194.9	683.5	945.8	1 012.8	19.2	22.3	19.5
Personal Loans	25 915.1	33 379.4	3 296.0	8 867.9	7 464.2	24.0	52.0	28.8
Electricity, Gas & Water	785.5	769.6	569.4	-1 040.8	-15.9	45.3	-57.0	-2.0
Entertainment	103.7	241.1	102.4	-88.0	137.4	114.5	-45.9	132.5
Overseas Residents	51.8	33.3	-0.4	-28.9	-18.4	-0.5	-35.8	-35.6
TOTAL	99 150.0	113 695.4	24 908.2	25 206.7	14 545.4	50.8	34.1	14.7

Chart 5: Distribution of Private Sector Loans and Advances at 31 December 2003 and 31 December 2004





per cent, relative to growth of 27.5 per cent in 2003. The slower rate of growth in foreign currency loans for 2004 was reflected in the public sector and the private sector, as foreign currency loans extended to other financial institutions accelerated to an increase of 73.2 per cent (**see Table 11**). The deceleration in the growth in loans extended to the public sector and the private sector was consistent with the reduced demand for bank credit, as a result of the increase in foreign exchange flows to these sectors in 2004.

Notwithstanding the deceleration in the growth in loans denominated in United States dollars, however, there was an increase in the demand for these loans in the December 2004 quarter. This increased demand was in a context of stable foreign exchange market conditions, which enhanced the attractiveness of these loans. Further, the need to finance infrastructure repairs that had to be undertaken by the public sector and the private sector in the aftermath of Hurricane Ivan, also contributed to the increased demand for foreign currency loans. For the December 2004 quarter, foreign currency loans increased by 10.5 per cent, relative to a growth of 8.7 per cent during the first nine months of 2004 and an increase of 4.9 per cent in the December 2003 quarter. Consequent on this, the proportion of foreign currency loans to total loans and advances at end December 2004 increased to 40.1 per cent relative to 37.5 per cent at end December 2003 and 32.9 per cent as at 31 December 2002.

The expansion in foreign currency loans to the private sector was mainly reflected in the sectors of *Tourism*, *Professional & Other Services*, *Distribution, Manufacturing* and *Transport, Storage & Communication*. Most of the expansion in loans to the *Tourism, Manufacturing* and *Distribution* sectors occurred in November 2004 and was concentrated in two institutions. These increases were mainly to facilitate repairs to infrastructure in the aftermath of

Table 11

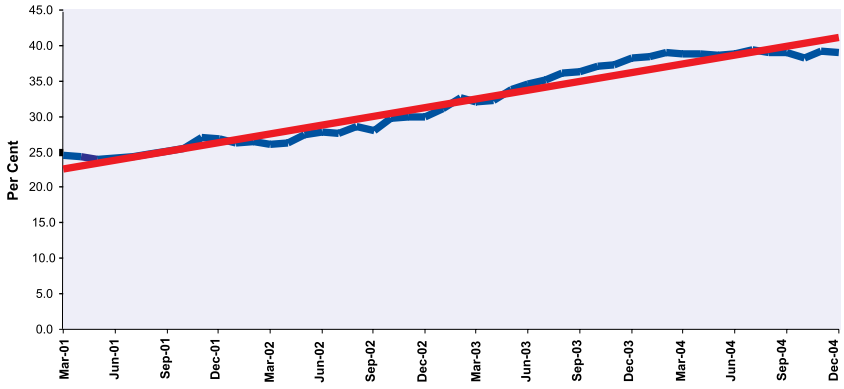
COMMERCIAL BANKS
FOREIGN CURRENCY LOANS AND ADVANCES
(US$'000)

	Stocks 2003	Stocks 2004	Flows 2002	Flows 2003	Flows 2004	% 2002	% 2003	% 2004
Public Sector	150 928	191 906	17 389	63 374	40 978	24.8	72.4	27.2
Other Financial Instituions	4 778	8 274	28 556	-23 837	3 496	48400.0	-83.3	73.2
Private Sector	460 730	539 776	98 929	93 279	79 046	36.8	25.4	17.2
Agriculture	1 459	870	-1 993	-283	-589	-53.4	-16.2	-40.4
Mining & Quarrying	4 689	0	-13	4 617	-4 689	-15.3	6412.5	-100.0
Manufacturing	18 342	28 537	4 236	-1 341	10 195	27.4	-6.8	55.6
Const., & Land Development	39 992	35 609	35 012	-954	-4 383	590.0	-2.3	-11.0
Transport, Storage & Comm.	113 248	122 050	20 592	20 448	8 802	28.5	22.0	7.8
Electricity, Gas & Water	10 345	10 299	4 828	-15 105	-46	23.4	-59.4	-0.4
Distribution	19 542	31 101	1 087	6 005	11 559	8.7	44.4	59.1
Tourism	197 327	232 635	24 640	72 259	35 308	24.5	57.8	17.9
Entertainment	199	1 801	815	-780	1 602	497.0	-79.7	805.0
Professional & Other Services	16 196	31 952	5 390	1 149	15 756	55.8	7.6	97.3
Personal Loans	39 391	44 922	4 348	7 268	5 531	15.7	22.6	14.0
Loans to Overseas Residents	0	0	-13	-4	0	-76.5	-100.0	0.0
TOTAL	616 436	739 956	144 874	132 816	123 520	42.8	27.5	20.0

Hurricane Ivan. The expansion in loans to *Professional & Other Services* largely reflected an increase of US$5.9 million in loans extended by one of the major institutions in May 2004. Further, there was a slower rate of growth in foreign currency loans to *Tourism* and *Transport, Storage & Communication* in 2004. The deceleration in the growth in loans to the *Transport, Storage & Communication* sector was tempered by a US$10.1 million loan extended by one major bank to air transportation in November 2004. At end December 2004, the proportion of private sector foreign currency loans to total foreign currency loans outstanding decreased to 72.9 per cent, from 74.7 per cent at end December 2003.

The ratio of commercial banks' advances to deposits remained virtually flat during 2004 (**see Chart 6**). At end December 2004, the advance to deposits ratio was 39.1 per cent, relative to 38.3 per cent at end December 2003. It is envisaged that there will be an upturn in the ratio during 2005 in the context of expectations of further reductions in interest rates.

Chart 6: Commercial Bank Advance to Deposits Ratio March 2001 to December 2004



2.4. Other Financial Intermediaries

2.4.1. Financial Institutions Act Licensees (FIAs)

There was notable growth in the asset base of the FIAs during the review period as well as further consolidation among the entities. During 2004, the number of institutions in operation declined to five from seven at end 2003, consequent on the closure of one and a merger of two licensees. The growth in the asset base, though lower than that observed during 2003, was largely reflected in increases in the entities' holdings of *Investments*. The expansion in assets was financed mainly by *Borrowings from Other Financial Institutions*. There were also significant increases in the deposit base of these entities, in the context of the realignment of the institutions' operations with their core business. The institutions were heavily dollarized with 73.4 per cent of their assets denominated in foreign currency compared to 62.2 per cent in 2003.

2.4.1.1. Assets & Liabilities

The asset base of the FIAs expanded by 15.3 per cent during the review period, relative to an expansion of 58.3 per cent in 2003. The increase in assets during the period was largely underpinned by an expansion of 41.8 per cent and 18.3 per cent in *Investment* and *Loans & Advances*, respectively. The growth in *Investments* during 2004 largely reflected expansions in foreign currency investments, which represented 87.6 per cent of the total increase in the category. The increase in *Loans and Advances* over the review period was concentrated in local currency loans, which expanded by 36.8 per cent relative to 61.5 per cent in the previous year. The annual growth of foreign currency loans fell to

Table 12

ASSETS AND LIABILITIES OF FIAS 2003 AND 2004 (J$M)

	December 2004*	Flows 2003	% Change	Flow 2004	% Change
Assets					
Cash and Bank Balances with Commercial Banks	2 625.2	128.1	5.3	88.2	3.5
Balances with Other Financial Institutions	5.2	-177.9	-97.4	0.4	8.3
Balances with Bank of Jamaica	746.0	-224.8	-32.3	275.1	58.4
Investments	36 233.7	7 832.6	44.2	10 687.5	41.8
Securities Purchased with View of Resale	2 403.4	5 421.8	272.1	-5 011.1	-67.6
Loans & Advances (net of provision)	6 789.2	2 327.4	68.2	1 049.0	18.3
Accounts Receivable	1 238.5	704.3	73.9	-418.9	-25.3
Other Assets	504.0	138.0	40.5	25.3	5.3
TOTAL	50 545.0	16 149.6	58.3	6 695.5	15.3
Foreign Assets	37 091.3	7 461.2	37.7	9 825.7	36.0
Liabilities					
Deposits	11 436.4	-92.7	-1.1	3 157.4	38.1
Balances due to Commercial Banks	949.2	91.0	14.2	219.0	30.0
Balances due to Specialised Institutions	296.1	-70.4	-15.1	-101.0	-25.4
Borrowings from Other Financial Institutions	22 684.8	6 035.7	58.2	6 270.5	38.2
Securities sold under Repurchase Agreements	7 965.0	9 369.9	400.4	-3 744.8	-32.0
Other Liabilities	1 072.6	646.9	86.4	-323.1	-23.2
Capital & Reserve	6 140.8	169.1	3.6	1 217.7	24.7
TOTAL	50 545.0	16 149.6	58.3	6 695.5	15.3
Foreign Liabilities	33 841.5	7 790.7	46.6	9 336.6	38.1

* *Provisional Data*

6.1 per cent for 2004. This compares with the increase of 129.7 per cent in 2003, which occurred in a context of an increase in foreign currency liabilities resulting from the relative instability within the foreign exchange market during that period.

There was a 67.6 per cent contraction in the entities' holdings of *Securities Purchased with a View for Resale* during the review year. This was in sharp contrast to growth of 272.1 per cent during 2003. This fall off in *Securities Purchased with a View for Resale* during the review period was in accordance with BOJ's requirement for the institutions to effect a separation of managed funds from their core deposit-taking operations.

Growth in the asset base was concentrated in the FIAs' holdings of foreign assets, which expanded by 36.0 per cent. This contrasts with the previous year in which domestic currency assets dominated the increase in assets. The significant expansion in foreign

currency assets was dominated by holdings of Jamaica Government and other financial currency securities which expanded by 82.9 per cent and 29.5 per cent, respectively. The increase in foreign assets during the review period occurred in the context of relative stability in the foreign exchange market.

There was notable growth in *Borrowings from Other Financial Institutions* of 38.2 per cent during 2004, relative to 58.2 per cent observed in 2003. The deposit base grew by 38.1 per cent in the review period relative to the reduction of 1.1 per cent observed in the previous year. Growth in foreign currency liabilities outpaced that of domestic currency liabilities during the review period, which is in sharp contrast to the previous year. The increase in foreign currency liabilities was largely reflected in a 38.3 per cent increase in borrowings from overseas institutions.

During 2004, the FIAs' capital base expanded by 24.7 per cent relative to the 3.6 per cent increase recorded during the previous year. This expansion largely reflected increases in the entities' *Other Reserves* of $840.8 million and also their retained earnings of $395.7 million.

2.4.1.2. Sectoral Distribution of Loans

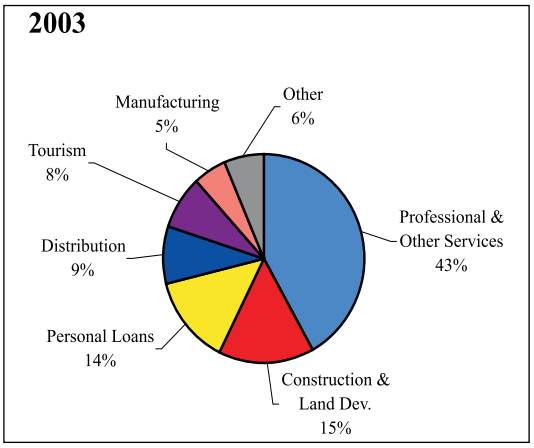
The stock of loans and advances continued to expand in 2004, increasing by 15.7 per cent, albeit lower than the 66.2 per cent expansion observed during 2003. The expansion was primarily concentrated in growth of loans to the private sector of $1 161.6 million as loans to the public sector and to financial institutions declined. Private sector loans accounted for 90.0 per cent of the total loan portfolio as at end December 2004 vis-à-vis the 84.5 per cent proportion observed at end 2003.

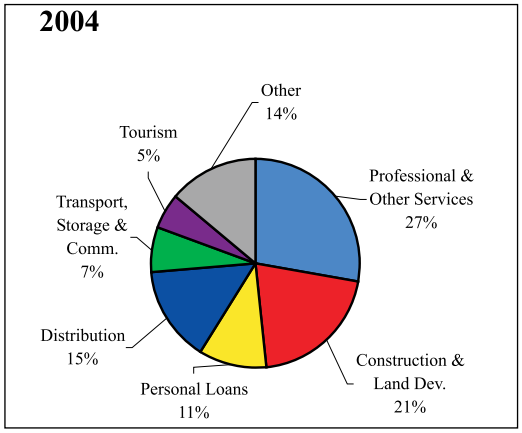
Table 13

SECTORAL DISTRIBUTION OF LOANS AND ADVANCES OF INSTITUTIONS LICENCED UNDER THE FINANCIAL INSTITUTIONS ACT AT DECEMBER 2003 AND 2004 (J$M)

	2003 Stock	Share of Total (%)	Annual Change in Stock	2004 Stock	Share of Total (%)	Annual Change in Stock
Public Sector	914.3	15.4	746.5	684.0	10.0	-230.3
Financial Institutions	0.8	0.0	-30.1	0.0	0.0	-0.8
Private Sector	5 007.0	84.5	1 642.1	6 168.6	90.0	1 161.6
Agriculture & Fishing	93.9	1.6	22.7	315.5	4.6	221.6
Mining & Quarrying	26.9	0.5	-27.3	20.4	0.3	-6.6
Manufacturing	254.7	4.3	-390.0	269.3	3.9	14.6
Construction & Land Development	766.9	12.9	486.8	1 266.0	18.5	499.1
Transport, Storage & Communication	17.2	0.3	-5.1	427.9	6.2	410.8
Tourism	425.4	7.2	122.9	335.6	4.9	-89.8
Distribution	444.6	7.5	117.2	921.0	13.4	476.4
Professional & Other Services	2 104.9	35.5	1 022.0	1 711.6	25.0	-393.3
Personal Non-Business Loans to Individuals	687.2	11.6	163.1	650.3	9.5	-36.9
Electricity	163.1	2.8	125.4	176.3	2.6	13.2
Entertainment	7.8	0.1	-5.6	68.9	1.0	61.0
Overseas Residents	14.4	0.2	10.2	6.0	0.1	-8.4
Total	5 922.1	100.0	2 358.5	6 852.6	100.0	930.5

Chart 7: Distribution of Private Sector Loans and Advances





Construction & Land Development was the main beneficiary of private sector credit during 2004 accounting for 43.0 per cent of the increase in credit. This was closely followed by expansion in *Distribution and Transport, Storage & Communication*. Concurrently, *Professional & Other Services* recorded significant net repayments during 2004, relative to the robust growth observed in 2003.

Despite net repayments of loans to *Professional & Other Services* and a decline in sectoral share during the review period, this category continued to account for the largest proportion (27 per cent) of outstanding private sector credit. *Construction & Land Development* increased its share of outstanding credit to 21 per cent at end 2004 from 15 per cent at the end of the previous year. **Distribution** also increased its share of outstanding private sector loans to 15 per cent at end 2004 from 9 per cent at the end of 2003, while all other sectors recorded a decline in their share of private sector credit (**see Chart 7**).

2.4.2. Building Societies

During 2004, the assets of the building societies grew by 21.8 per cent, relative to growth of 22.1 per cent in 2003. This outturn was largely reflected in increases in *Loans & Advances* extended by the institutions and their holdings of *Investments.* Concurrently, there was a notable increase in the entities' savings funds, which was the primary source of funding for their operations. During the review period the number of institutions operating under the Building Societies Act remained at four (4).

Loans & Advances expanded by 23.7 per cent during the review period, relative to 21.3 per cent in 2003. Mortgage loans expanded by 22.8 per cent, relative to 20.3 per cent observed in 2003 and occurred in the context of lower mortgage rates. Concurrently, there was a 34.5 per cent increase in *Investments,* which was largely reflected in increases in holdings of GOJ *securities. Other Local Securities* also recorded significant growth during the

Table 14

ASSETS AND LIABILITIES OF BUILDING SOCIETIES (J$M)

	STOCK December 2003	STOCK December 2004	FLOW Annual Change 2003	FLOW Annual Change 2004	Per Cent Change 2003	Per Cent Change 2004
ASSETS						
Cash and Balances with Commercial Banks	8 562.1	10 978.1	3 277.5	2 416.0	62.0	28.2
Balances with Other Financial Institutions	922.6	0.0	902.1	-922.6	4 403.7	-100.0
Balances with Bank of Jamaica	1 080.9	1266.6	235.9	185.6	27.9	17.2
Investments (net of provision)	13 909.3	18 702.4	2 019.4	4 793.0	17.0	34.5
Securities Purchaced with View to Resale	13 428.8	14894.6	226.0	1 465.8	1.7	10.9
Loans and Advances (net of provision)	23 161.6	28 639.5	4 068.5	5 477.9	21.3	23.7
- of which Mortgages	22 853.4	28 060.2	3 853.7	5 206.8	20.3	22.8
Accounts Receivable	2 591.6	3244.8	775.8	653.3	42.7	25.2
Fixed Assets	1 584.9	1816.7	162.0	231.8	11.4	14.6
Other Assets	395.2	405.6	222.5		128.9	0.0
TOTAL	65 637.0	79 948.1	11 889.8	14 311.2	22.1	21.8
LIABILITIES						
Savings Fund	49 437.0	58 792.3	6 204.2	9 355.3	14.4	18.9
Due to Bank of Jamaica	0.0	0.0	0.0	0.0	-	-
Due to Commercial Banks	372.8	837.9	126.5	465.2	51.3	124.8
Due to Specialized Institutions	1 298.3	1863.7	-78.9	565.5	-5.7	43.6
Due to Other Financial Institutions	585.5	644.8	342.0	59.3	140.5	10.1
Securities Sold Under Repurchase Agreement	131.7	0.0	0.0	-131.7	0.0	-100.0
Other Liabilities	2 683.0	2647.1	936.4	-35.9	53.6	-1.3
Capital and Reserves	11 128.7	15 162.3	4 359.7	4 033.6	64.4	36.2
TOTAL	65 637.0	79 948.1	11 889.8	14 311.2	22.1	21.8
INDICATIVE RATIOS (Per Cent)						
Liquid Assets : Total Assets	16.1	15.3				
Liquid Assets : Savings Fund	21.4	20.8				
Advance : Savings Fund	46.9	48.7				
Mortgage Loans : Savings Fund	46.2	47.7				

review period, reflecting the revaluations of the entities' equity portfolio.

Financing for the growth in the building societies' assets emanated mainly from an 18.9 per cent increase in the entities' Savings Funds compared with an expansion of 14.4 per cent in 2003. The expansion in Savings Funds during the review period was largely reflected in an increase in shareholder's savings, which accounted for 98.6 per cent of the total increase. The capital base recorded an expansion of 36.2 per cent during 2004 which included an expansion in Other Reserves, in

Table 15

BUILDING SOCIETIES' NEW MORTGAGE LOANS 2003 AND 2004

	2003	2004	Flow	% Change
Value of New Accounts (J$M)				
Residential	5 694.0	7 009.7	1 315.8	23.1
Commercial	42.4	114.3	71.9	169.3
Agricultural & Other	307.1	189.3	-117.8	-38.4
TOTAL	**6 043.5**	**7 313.4**	**1 269.9**	**21.0**
Number of New Accounts				
Residential	2 917	3 065	148	5.1
Commercial	20	30	10	50.0
Agricultural & Other	184	78	-106	-57.6
TOTAL	**3 121**	**3 173**	**52**	**1.7**
Overall Weighted Average Mortgage Loans Rate (%)	16.06	15.62	0.44	

particular, revaluation reserves which increased by $3 730.7 million.

The advance to savings funds ratio increased to 48.7 per cent from 46.9 per cent, with the mortgage loans to savings funds also increasing by 150 basis points to 47.7 per cent at end 2004. The ratio of liquid assets to total assets fell by 788 basis points while liquid assets to savings fund declined by 54 basis points during the review period.

2.4.2.1. New Mortgage Loans

During 2004, building societies extended 3 173 new mortgage loans, marginally higher than the 3 121 extended in 2003. This increase was particularly reflected in a 5.1 per cent increase in *Residential* loans as there was a 57.6 per cent fall-off in *Agricultural & Other* loans. There were 10 new commercial mortgages extended during 2004.

The value of new mortgages loans increased by 21.0 per cent during 2004 following the 68.2 per cent increase in 2003. The average size of new mortgages increased to $2.3 million at end 2004 relative to $1.9 million at the end of 2003. New *Residential* mortgages continued to account for the greatest share (95.8 per cent) of the increase in the value of new mortgage loans during the review period. *Commercial* mortgages increased significantly by 169.3 per cent, while *Agricultural*

& Other mortgages recorded net repayments during 2004.

The weighted average mortgage loan rate of building societies declined by 44 basis points in 2004. A continued decline in the mortgage rates coupled with an increase with joint lending with the National Housing Trust (NHT) should serve to sustain the demand for residential housing.

Building Societies continued to maintain very aggressive marketing campaigns utilizing various promotional and market segmentation strategies to increase mortgage lending. First time homeowners were specially targeted with offers of preferential rates.

2.5. Development Banks

2.5.1. Development Bank of Jamaica

The Development Bank of Jamaica (DBJ) continued to provide financing especially for projects aimed at generating foreign exchange or promoting import substitution. Access to funding from the DBJ was generally facilitated by Approved Financial Institutions (AFIs), which include commercial and merchant banks and People's Co-operative (PC) banks. The DBJ also continued to organize financing for several Government of Jamaica (GOJ) programmes. This participation remained a major influence on the institution's asset base as amounts on-lent for GOJ infrastructural programmes comprised 37.2 per cent of total assets. The

Table 16

DEVELOPMENT BANK OF JAMAICA
ASSETS AND LIABILITIES (J$M)

ASSETS	2003	2004	Change	%Change
Cash and Bank Balances	296.0	26.6	-269.4	-91.0
Receivables and Prepayments	7079.4	6737.1	-342.4	-4.8
Investments	56.2	75.9	19.6	34.9
Securities - Resale Agreements	127.0	60.8	-66.2	-52.1
Loans to Financial Institutions	6342.4	7311.0	968.6	15.3
- Loans to People's Co-operative Banks	781.3	751.7	-29.6	-3.8
- Loans to AFIs	4901.7	5623.4	721.7	14.7
- Other Loans	659.4	935.8	276.5	41.9
GOJ Infrastructural Loan Programmes	10699.7	9051.5	-1648.2	-15.4
Fixed Assets	147.9	758.7	610.8	413.0
Other Assets	616.8	341.2	-275.7	-44.7
TOTAL	**25365.6**	**24362.7**	**-1002.9**	**-4.0**
LIABILITIES AND SHAREHOLDERS' EQUITY				
Shareholder's Equity	4884.9	5294.3	409.4	8.4
Current Liabilities	1066.6	1403.2	336.7	31.6
Long-term Liabilities	16017.3	13155.0	-2862.3	-17.9
Short-term Liabilities	1078.5	1668.8	590.3	54.7
Other Liabilities	2318.4	2841.5	523.1	22.6
TOTAL	**25365.6**	**24362.7**	**-1002.9**	**-4.0**

DBJ recorded profits of $144.8 million for the calendar year, which was 49.1 per cent below the performance for 2003.

The assets of the DBJ declined by $1.0 billion or 4.0 per cent during 2004 (**see Table 16**). This was reflected in a decline in loans outstanding for GOJ Loan Infrastructure programmes, a fall-off in 'Receivables and Prepayments' and lower 'Cash and Bank balances' of $1.6 billion, $342.4 million and $269.4 million, respectively. The decline in the GOJ Loan Infrastructure category largely reflected repayment of portions of loans issued under the national roadwork programmes. There was however a 15.3 per cent increase in 'Loans to Financial Institutions' during the year which largely reflected a $721.7 million or 14.7 per cent increase in loans made to AFIs.

With respect to liabilities and shareholder's equity, growth was reflected in all categories except for 'Long-term Liabilities', which declined by 17.9 per cent for the year. This decline reflected the reclassification of some of the DBJ's long-term obligations to 'Current'.

Loan approvals and disbursements for 2004 are presented in **Table 17** and **Table 18**. Of the $1.5 billion local currency loans approved, 33.5 per cent fell under the 'Agro-Industry' category while services, inclusive of 'Tourism', accounted for a further 25.5 per cent. No foreign currency loans were approved during the review period. However, disbursements from prior year approvals amounted to $13.4 million. With respect to local currency disbursements, the 'Manufacturing' category accounted for a significant 31.6 per cent of the amounts provided. The 'Tourism' and 'Agro-Industry' categories also accounted for significant shares of the totals loans disbursed.

Table 17

LOAN APPROVALS TO AFIS AND PC BANKS BY SECTOR JANUARY -DECEMBER 2004

	Local Currency		Foreign Currency	
	J$MN	%	US$MN	%
Sector				
Agriculture	242.6	16.4	0	0
Agro-Industry	494.9	33.5	0	0
Manufacturing	310.0	21.0	0	0
Mining & Quarrying	54.1	3.7	0	0
Other Services	158.7	10.7	0	0
Tourism	218.9	14.8	0	0
Total	1479.3	100.0	0.0	0.0

Table 18

LOAN DISBURSEMENTS TO AFIS AND PC BANKS BY SECTOR JANUARY -DECEMBER 2004

	Local Currency		Foreign Currency	
	J$MN	%	US$MN	%
Sector				
Agriculture	148.3	11.7	0.0	0.3
Agro-Industry	262.1	20.7	0.0	0.0
Manufacturing	400.2	31.6	0.0	0.0
Mining & Quarrying	36.9	2.9	0.0	0.0
Other Services	124.3	9.8	0.0	0.0
Tourism	294.3	23.3	13.4	99.7
Total	1266.1	100.0	13.4	100.0

2.5.2. National Export-Import Bank of Jamaica Limited

2.5.2.1. Introduction

The National Export-Import Bank of Jamaica (Ex-Im Bank) recorded un-audited net profits of $135.3 million in 2004. This outturn was achieved notwithstanding challenges arising from competition brought on by globalization and the imminent removal of special and differential trade protection measures.

The institution's operations were guided by the objectives set out in its medium term Strategic Plan that requires greater collaboration and deeper involvement with the sectors identified for growth. To this end, the Ex-Im Bank launched an $80 million loan programme for the Information, Communication and Technology (ICT) sector in March 2004. Of this amount, $20 million was allocated for short-term financing to young start-up entrepreneurs in the ICT sector and the remaining $60 million earmarked as a medium term loan facility for the more mature and established ICT businesses. By the end of the year, the Ex-Im Bank had approved $20 million to this sector.

There was increased demand for Ex-Im's major medium-term loan programmes, in particular the Modernization Fund for Exporters (MFE), which provides financing for capital acquisition for factory upgrading and retooling. To augment its support for this area, the Ex-Im Bank secured US$2 million from the Government of Jamaica/Jamaica Exporters' Association Export Growth Initiative Loan Programme. The utilization of the Cuban Line of Credit also increased during the first quarter of 2004. However, utilization of the facility did not meet the target at year-end because of a trade impasse that developed between one of the major exporters and the Cuban authorities. The Ex-Im Bank sought to resolve the impasse by liaising with its Cuban counterparts and relevant Government Ministries in order to facilitate the resumption of high levels of exports to Cuba.

2.5.2.2. Loan Disbursements

Total foreign and local currency loan disbursement was $2.4 billion, 14.3 per cent lower than the amount disbursed in 2003. This was attributed primarily to a fall in demand for loan financing, particularly by the public sector and the dislocation of productive activities after the passage of Hurricane Ivan. The Ex-Im Bank also continued to experience increased customer demand for medium-term facilities which exceeded budgeted expectations. As a result early in the year there was a curtailment until additional funds to facilitate lending were sourced.

2.5.2.3. Local Currency Disbursements

As outlined in **Table 19,** total local currency disbursement of approximately $1.8 billion represented a decline of approximately 9 per cent below 2003. The reduction was due in part to lower demand for the Ex-Im Bank's short-term loan facilities such as the Bankers Export Credit Facility (BECF) and the Export Credit Facility (ECF), as there were fewer repeat business deals than in the previous year. The period of hiatus, which the medium term loan portfolio experienced in the earlier part of the year, also had an impact on the overall disbursement of local currency loans.

Table 19

LOCAL CURRENCY DISBURSEMENTS (J$MN)				
Facilities	**2003**	**2004**	**Change**	**% Change**
Bankers Export Credit Facility	714.4	521.0	-193.4	-27.1
Export Credit Facility	758.2	664.0	-94.2	-12.4
Insurance Policy Discounting Facility	58.1	46.6	-11.5	-19.8
Pre-Shipment/CoPack Facilities	193.8	358.4	164.6	85.0
Apparel Sector Financing	21.0	28.1	7.0	33.5
Modernization Fund for Exporters	135.5	137.4	1.9	1.4
Small Business Facility	79.1	49.1	-30.0	-37.9
Ornamental Fish	3.4	2.9	-0.5	-14.0
Export Growth and Incentive Fund	3.5	0.0	-3.5	100.0
JMA/Ex-Bed	2.0	3.2	1.2	59.0
JEA/Ex-Bed	49.1	16.9	-32.2	-65.6
Information Communication Technology - ICT)	-	4.2	4.2	-
Total	**2,018.1**	**1,831.7**	**-186.3**	**-9.2**

2.5.2.4. Approved Local Currency Loans by Industry

As indicated in **Table 20** below, the Food and Beverage sector was the major user of the short-term facilities, accessing approximately 61 per cent of total loan disbursement. However, this was below the level and share of disbursement achieved in 2003. The reductions represent loss of market share in the very competitive environment of the food and beverages market overseas.

Table 20

APPROVED LOANS BY INDUSTRY				
	2003		2004	
Industries	**J$M**	**Share (%)**	**J$M**	**Share (%)**
Agro Processing	419.8	20.80	396.7	21.7
Food & Beverage	1,271.2	62.99	1113.7	60.8
Textile & Apparel	25.0	1.24	29.1	1.6
Other Manufacturing	135.6	6.72	227.8	12.4
Mining	4.8	0.24	-	-
Distribution/Services	161.7	8.01	64.5	3.5
Total	**2,018.0**	**100.00**	**1831.7**	**100.0**

Table 21

FOREIGN CURRENCY DISBURSEMENTS				
	2003	2004		
Facilities	**US$M**	**US$M**	**Change US$M**	**% Change**
Lines of Credit	12.5	9.0	-3.5	28.0
Bankers Export Credit Facility	0.5	0.5	-0.03	5.9
Total	**13.0**	**9.5**	**-3.5**	**-26.9**

2.5.2.5. Foreign Currency Disbursements

Foreign currency loan disbursement in 2004 was US$9.5 million compared with US$13.0 million in 2003 (**see Table 21**). This reduction was due to the combined effect of reduced utilization under the Cuban Line of Credit and lower usage by the public sector.

The Ex-Im Bank intends to broaden the scope of possible new areas of financing in 2005. To this end the feasibility of providing financing to the Tourism Sector as well as to companies with linkages to the Bauxite and Alumina Sector is being explored. These sectors have been highlighted as having the potential for significant growth.

3. Financial Market Operations

3.1. Money Market Operations

3.1.1. Bank of Jamaica Operations

During 2004, monetary policy focussed on creating the macroeconomic environment which would facilitate the lowering of inflation. In this context, the Bank continued to manage Jamaica Dollar liquidity through open-market operations (OMOs), which was conducted mainly through Primary Dealers (PDs). These institutions accounted for approximately 69.0 per cent of the new open-market operations agreements in 2004. The number of PDs was reduced to 12 at end-2004 from 14 at the end of 2003.[4]

The Bank's liquidity management resulted in a net absorption of $30 194.1 million in 2004, and was largely reflective of the absorption of $30 146.8 million in the first half of the year (**see Table 22**). During this period, the persistence of relative stability in the foreign exchange market influenced a demonstrated preference for Jamaica Dollar instruments. In this regard, there was a shift in the composition of investors' portfolio as was reflected in the conversion of US dollars for investment in Jamaica Dollar assets. Further, in an environment where the Government of Jamaica (GOJ) net redeemed domestic instruments, investors became increasingly attracted to BOJ's open market instruments. As such, the BOJ net purchased foreign currency of Jamaica Dollar equivalent $18,617.5 million. This contributed to an increase of US$439.1 million in the NIR between end-December 2003 and end-June 2004.

While stability persisted during the second half of the year, the shock in September arising from Hurricane Ivan, resulted in extraordinary liquidity requirements, which was followed by the seasonal currency demand in December. However, there was a deliberate

Table 22

BANK OF JAMAICA OPEN MARKET OPERATIONS 2004 (J$MN)

	Q1	Q2	Q3	Q4	Total
Net Outright Sales (+)/Purchases (-)	172.49	1,177.37	-	-	1,349.86
Net Reverse Repurchase	21,457.07	7,339.88	(51.07)	98.33	28,844.21
Net Absorption (+)/ Injection (-)	21,629.56	8,517.25	(51.07)	98.33	30,194.07

Data include principal and interest payments

[4] *The reduction arose from the merger of two institutions and the temporary disruption in trading with the other institution given the delayed completion of administrative arrangements as stipulated by the regulatory authority.*

programming of OMO maturities by institutions to coincide with currency needs, leading to a virtual rollover of OMO maturities during the period. Of note, the Government's domestic financial requirements were not significant enough to affect the pattern of open market trading.

3.1.2. Government Activities

The Bank continued to act as fiscal agent for the Government's publicly issued primary offers. In that regard, the BOJ executed forty-four (44) debt issues in 2004 relative to forty (40) in 2003. The GOJ issues comprised nineteen (19) Treasury Bills, ten (10) Investment Debentures, six (6) Investment Bonds, four (4) Local Registered Stocks, three (3) Registered Bonds, and two (2) US dollar denominated bonds (**see Table 23**).

Domestic Public Issues

While the debt management strategy for FY 2004/05 spoke to extending the maturity profile of domestic debt, there was continued strong demand for short to medium-term instruments. Consequently, the stock of short-term to medium-term instruments (tenors up to 5 years) increased by approximately 9.7 per cent in

Table 23

COMPARATIVE PROFILE OF GOJ PUBLIC OFFERS - 2003/2004

Quarter		2003				2004			
		Number of Offers							
		Tenor							
		<=1 year	1-5 years	>5 years	Total	<=1 year	1-5 years	>5 years	Total
March	Investment Debenture	-	1	-	1	-	1	-	1
	Variable Rate Investment Bond	-	-	-	0	-	3	-	3
	US$ Indexed Bond	-	1	2	3	-	-	-	0
	Treasury Bill	2	-	-	2	4	-	-	4
	Eurobond	-	-	-	0	-	2	-	2
June	Investment Debenture	-	2	-	2	-	3	-	3
	Variable Rate Investment Bond	-	-	-	0	-	1	-	1
	US$ Indexed Bond	-	2	-	2	-	-	-	0
	Treasury Bill	3	-	-	3	5	-	-	5
	Local Registered Stock	-	3	-	3	-	3	-	3
	Fixed Rate Registered Bond	-	-	-	0	-	-	2	2
	Eurobond				0	-	-	1	1
September	Investment Debenture	-	1	-	1	-	3	-	3
	Variable Rate Investment Bond	-	2	-	2	-	-	1	1
	US$ Indexed Bond	-	1	-	1	-	-	-	0
	Treasury Bill	4	-	-	4	5	-	-	5
	Local Registered Stock	-	2	-	2	-	-	-	0
	FRUS$ Bond	-	1	-	1	-	1	1	2
	Fixed Rate Registered Bond	-	-	-	0	-	1	-	1
	Eurobond	-	-	-	0	-	-	1	1
December	Investment Debenture	-	2	-	2	-	3	-	3
	Variable Rate Investment Bond	-	1	-	1	-	1	-	1
	US$ Indexed Bond	-	1	-	1	-	-	-	0
	Treasury Bill	7	-	-	7	5	-	-	5
	Local Registered Stock	-	2	-	2	-	1	-	1
	Eurobond	-	1	-	1	-	-	1	1
	Total	**16**	**23**	**2**	**41**	**19**	**23**	**7**	**49**

2004, relative to 2003 while the stock of instruments with tenors in excess of 5 years remained fairly flat. The issuance of two instruments with a tenor above six years saw fairly low subscriptions and reflected the preference for shorter tenor instruments. Subsequent to these issues, the GOJ increased its offers of short-term instruments, as 12 of the 14 registered instruments offered in the domestic market for the remainder of the year had tenors ranging from 1-year to 5-years.

The Government reduced the exposure of the domestic debt portfolio to exchange rate risk through the non-issuance of three (3) US dollar Indexed Bonds, which matured during the year. As such, the stock of domestic currency debt indexed to or denominated in US dollars was reduced to $89.2 billion from $97.1 billion.

The stock of Treasury Bills declined to $3.75 billion at end 2004 from $4.40 billion at end 2003. As in previous years, the 6-month instrument was the most frequently issued tenor and was offered at the end of each month to replace maturing bills. The average yield on this tenor represents the benchmark for re-pricing GOJ instruments. In addition, there were four 3-month issues, two 1-year issues and one 9-month issue.

Foreign Debt Issues

In January 2004, the Government returned to international financial markets for the first time since June 2002[5]. For the year, the Government raised €550.0 million from the issue of three (3) Eurobonds, US$125.0 million from the re-opening of GOJ Global Bond 2017 and US$50.0 million from a regional bond. The Euro denominated bonds were issued at successively longer tenors of five (5) years, eight (8) years and ten (10) years. These instruments had yields ranging from 10.63 per cent on the five-year instrument to 11.10 per cent on the eight-year bond (**see Table 24**).

In February, Standard and Poor's downgraded Jamaica's long-term local currency sovereign debt from 'B+' to 'B' and revised the country's long-term sovereign outlook from stable to negative. However, subsequent to that, with improvements in the country's macroeconomic outlook, the GOJ was able to raise US$125.0 million and €350.0 million on the international capital market. With increased investor confidence and the Government's stated commitment to achieve its fiscal targets, Standard and Poor's revised its outlook on

Table 24

GOJ EUROBONDS

Quarter	Tenor (years)	Amount (MN)	Coupon (%)	Yield to Maturity at Time of Issue(%)
March	5	€ 200	10.5	10.63
"	4.5	US$50	9.5	9.5
June*	11	US$125	10.625	10.55
September	8	€ 200	11.0	11.10
December	10	€ 150	10.5	10.58

**GOJ 2017 was re-opened on 17 April 2004. Consequently, the nominal value of bonds outstanding on this instrument is US$425MN*

[5] *US$50 million was raised on the regional capital market in 2003*

the long-term sovereign credit rating on Jamaica from negative to stable but affirmed its 'B' rating on GOJ short-term and long-term bonds in December.

A strong demand for GOJ Eurobonds was evident in the re-opening of GOJ Global Bond 2017 in April, which raised an additional US$125.0 million, bringing the total outstanding on this bond to US$425.0 million[6]. Additionally, in July, the size of the offer on the 8-year tenor was increased to €200.0 million from the initial €100.0 million offer due to strong investor demand. Borrowing on international financial markets in the review period culminated with the issue of a 10-year Eurobond on 12 October 2004. This instrument raised €150.0 million at a coupon of 10.5 per cent, representing a decline of 50 basis points relative to the coupon offered on the 8-year tenor in July (**see Table 24**).

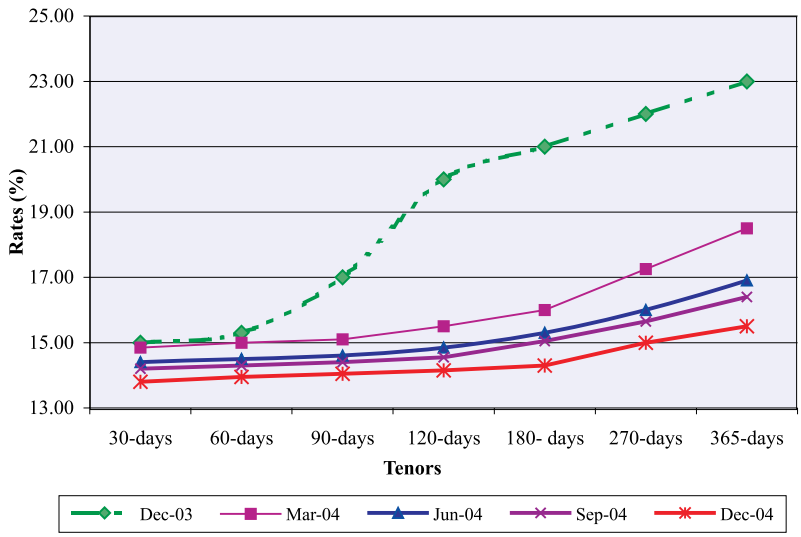
3.1.3. Interest Rates

Throughout the year, favourable macroeconomic conditions facilitated a steady decline in domestic interest rates. In particular, the adjustments were effected at an accelerated pace during the first half of the year but slowed during the second half. The adjustments in the latter half reflected concerns regarding the inflationary impact of increases in world oil prices and the passage of Hurricanes Charley and Ivan in the September quarter.

During the first half of 2004, the financial markets remained relatively stable, providing several opportunities for the Bank to reduce interest rates on its OMO instruments as well as to normalize the yield curve (**see Chart 8**). In that regard, significant reductions were effected on the rates applicable to the 180-day to 365-day instruments. By the end of the March quarter, the rates on the 180-day and 365-day instruments were reduced by **5.00** and **5.05** percentage points, respectively, from **21.0** per cent and **23.0** per cent on the respective instruments at end-December 2003. Following these reductions, marginal adjustments of **0.95** of a percentage point and **1.55** percentage points on the respective instruments were effected, to reflect rates of **15.05** per cent and **16.40** per cent, respectively (**see Table 25**). These adjustments, done on 5 May

Chart 8

BOJ's Yield Curve (End-Period)



[6] *These bonds were initially issued in June 2002*

2004, were the sole reductions for the June quarter as instability that emerged in the foreign exchange market in mid-May prevented further reductions.

During the second half of 2004, the Bank reduced the magnitude and the frequency of interest rate adjustments as concerns regarding higher inflation emerged. These concerns were based on the continued increase in world oil prices in the September quarter coupled with the surge in prices of agricultural products in the aftermath of Hurricane Ivan. The more cautious stance adopted by the Bank during September and December quarters was evidenced by the reduction of **0.75** of a percentage point and **0.90 of a** percentage point in rates on the 180-day and 365-day instruments, respectively, which ended the year at **14.30** per cent and **15.30** per cent, respectively. The rate on the 30-day was **13.80** per cent at year-end or **0.40** of a percentage point below the rate at end-June.

In a similar vein, market determined rates exhibited a declining trend as the weighted average yield on the GOJ's 6-month Treasury Bill declined to **15.57** per cent by March 2004, relative to **22.05** per cent in December 2003 (**see Table 26**). The rate of decline in the June, September and December quarters was significantly lower with interest rates remaining within a narrow band around the Bank of Jamaica's 180-day rate (**see Chart 9**).

The coupons offered on medium-term GOJ instruments issued during the year also reflected declines. At the beginning of the March quarter, a 24-month GOJ Investment Debenture was offered at a coupon of **22.125** per cent relative to **25.0** per cent on a 19-month offer of a similar instrument in December 2003. Throughout the year, lower coupons were offered on these instruments

Table 25

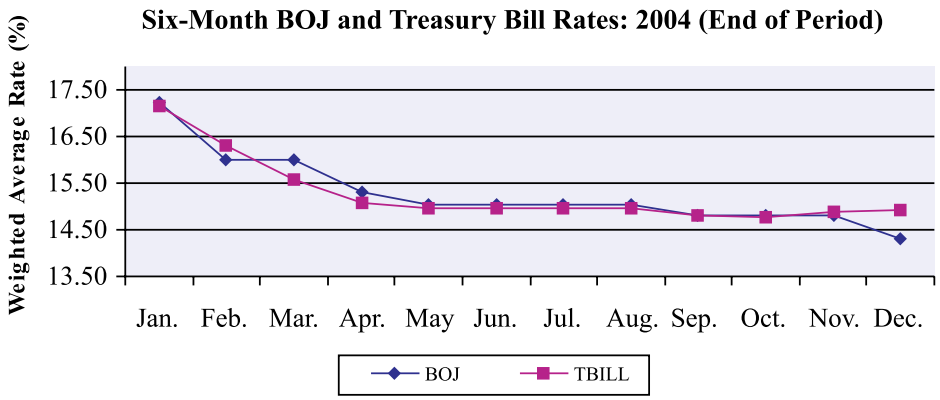
RATES ON OMO INSTRUMENTS (%)
(End December 2003 - December 2004)

End Month	30-day	180-day	365-day
December '03	15.00	21.00	23.00
January	14.85	17.25	20.00
February	14.85	16.00	18.50
March	14.85	16.00	17.95
April	14.40	15.30	16.90
May	14.20	15.05	16.40
June	14.20	15.05	16.40
July	14.20	15.05	16.40
August	14.20	15.05	16.40
September	14.00	14.80	16.00
October	14.00	14.80	16.00
November	14.00	14.80	16.00
December '04	13.80	14.30	15.50

Table 26

Six-Month Treasury Bill Average Yield (%) 2004 (End of Period)			
Jan	17.15	Jul	14.96
Feb	16.31	Aug	14.95
Mar	15.57	Sep	14.80
Apr	15.09	Oct	14.78
May	14.96	Nov	14.90
Jun	14.98	Dec	14.94

Chart 9



and by end-December 2004, the coupon on a 27-month debenture was **16.50** per cent. Similarly, the average yield on an auctioned 5-year GOJ instrument declined marginally to **17.22** per cent at year-end relative to **17.26** per cent in the June quarter.

4. Supervision Of Deposit -Taking Financial Institutions

4.1. Introduction

Bank of Jamaica, by virtue of provisions contained in Section 34A of the Bank of Jamaica Act, is charged with the supervision and periodic examination of deposit-taking financial institutions. The deposit-taking sector of the financial system can be grouped into three sub-sectors.

- Commercial banks licensed under the Banking Act
- Merchant Banks licensed under the Financial Institutions Act
  (FIA licensees)
- Building Societies governed by the Building Societies Act and Bank of Jamaica (Building Societies) Regulations.

Additionally, credit unions have been designated by the Minister of Finance as 'specified financial institutions' under the Bank of Jamaica Act, enabling the Bank to obtain information on their operations. Regulations to establish a formal supervisory framework for these entities have been drafted after extensive discussions with sector representatives and await approval.

Regulatory responsibility for non-deposit taking financial institutions resides with the Financial Services Commission which has oversight of insurance companies, securities dealers, unit trusts, pension management companies and mutual funds (**see Section 4.10. Supervisory Cooperation and Interaction**).

4.2. Supervisory Methodology

The supervisory methodology that has been traditionally applied combines annual on-site examinations with ongoing off-site monitoring, which allows for continuous and timely review of developments in the system, and the condition of the supervised institutions.

On-site examination involves a review and assessment of key areas of a licensee's operations, in particular, capital adequacy, asset quality, liquidity, earnings performance, management oversight and the overall risk management framework within which the institution operates as it relates to operational areas, as well as, its anti-money laundering and anti-terrorism financing arrangements. One such examination is conducted annually for each licensee as required by statute or more frequently if deemed necessary by the Supervisor. Generally, the examination focus is on evaluating the quality and estimated real value of assets as well as the robustness of the licensee's corporate governance framework. This is effected through physical inspection of the entities' records and documents and interviews with senior management and relevant operations personnel, to inform the final assessment of the overall financial condition.

Ongoing off-site assessments are facilitated by prudential returns which licensees are required to submit to the Bank at stated intervals (monthly, quarterly, annually), as well as review of audit and other external reports. The off-site review involves analysis of the prudential

returns for trends in operations and financial condition. This also includes an 'Early Warning System' whereby various financial and prudential indicators are monitored and subjected to scenario and stress tests to allow for forward looking assessments and facilitate proactive supervisory responses. Further, in collaboration with the Financial Stability Department of the Bank of Jamaica, a forecasting model has been developed to enhance predictive analyses.

The off-site surveillance and on-site examination processes are complemented by other supervisory techniques, such as reviewing compliance with legal requirements and prudential regulations. The Bank of Jamaica also provides formal guidance through the dissemination of Best Practice Standards and Guidelines, and promoting the highest degree of disclosure through the Bank's publication of quarterly un-audited balance sheet data for each licensee as well as sector and overall system trends in prudential indicators.

The Bank's supervisory methodologies are constantly being upgraded and reshaped to adapt to changes in international best practices, supervisory techniques and initiatives, as well as to respond to changes in the risk appetite of supervised entities as they seek to compete in the domestic and international markets. In this regard, the Bank has in recent years expanded the scope of its on-site review of licensees' framework for Anti-money Laundering and Anti-terrorism Financing (AML/TF) in order to ensure that such measures remain in keeping with heightened international obligations under United Nations (UN) Security Council Resolutions and other international standards promulgated by the Financial Action Task Force (FATF), and the Caribbean Financial Action Task Force (CFATF) of which Jamaica is a member.

Feedback from all the Central Bank's reviews and assessments is communicated to licensees' management by means of a mix of meetings, correspondence and written reports on examination findings, highlighting any issues of concern and requiring remedial actions as deemed necessary within specified time frames. In instances of 'unsafe and unsound' practices, the Bank utilizes sanction powers/measures as provided under the respective financial legislation and in accordance with its supervisory "Ladder of Enforcement".

4.3. Legislative Framework

The major pieces of legislation and supporting regulations governing the operations of the licensed deposit taking institutions are shown in **Table 27.**

Licensees also have statutory responsibilities that may or may not be peculiar to their nature of business, which devolve from other pieces of legislation. These include, but are not limited to, the Companies Act, and the Deposit Insurance Act, the Drug Offences (Forfeiture of Proceeds) Act, the Money Laundering Act and related Regulations and Guidance Notes issued by the Supervisory Authority (**see Financial Legislation**).

Table 27 – Overview Of Legislative Framework

Type of Legislation	Title of Statute
Principal Legislation	• The Bank of Jamaica Act • The Banking Act • The Financial Institutions Act • The Building Societies Act • The Bank of Jamaica (Building Societies) Regulations
Subsidiary Legislation	• The Building Societies (Licenses) Regulations • The Banking (Establishment of Branches) Regulations • The Banking (Amalgamation and Transfers) Regulations • The Banking (Capital Adequacy) Regulations, 2004 • The Banking (Licence Fees) Regulations, 2003 • The Financial Institutions (Establishment of Branches) Regulations • The Financial Institutions (Amalgamation and Transfers) Regulations • The Financial Institutions (Capital Adequacy) Regulations 2004 • The Financial Institutions (Licence Fees) Regulations, 2003

4.4. Profile Of The Supervised Deposit Taking System

During the first half of 2004, two mergers which were in progress at the end of 2003 were finalized as follows:

- Grace Kennedy Limited, parent company of **George and Branday Limited** (a FIA Licensee) and **First Global Bank** (a commercial bank) consolidated the operations of both deposit-taking subsidiaries effective 1 April 2004 into First Global Bank.

- **Pan Caribbean Merchant Bank Limited** and **Manufacturers Sigma Merchant Bank Limited,** both FIA licensees, merged operations into Pan Caribbean Merchant Bank Limited as at 1 June 2004 as part of a wider merger involving their respective parent companies and subsidiaries.

As a result of the mergers, the number of supervised deposit-taking institutions (excluding credit unions) contracted to 15 as at end December 2004 from 17 as at December 2003. **(see Table 28).**

Table 28 - Market Composition – Number of Deposit-taking Entities

Supervised Entities	2000	2001	2002	2003	2004
Commercial Banks	6	6	6	6	6
FIA Licensees	11	11	10	7	5
Building Societies	5	4	4	4	4
Total	**22**	**21**	**20**	**17**	**15**

Table 29 – Licensed Deposit Taking Entities as at 31 December 2004

Sub-sector	Institution Name	*Related Deposit-taking Institution*
Commercial Banks	The Bank of Nova Scotia Jamaica Limited	*Scotia Jamaica Building Society*
	Citibank N. A.	*Citimerchant Bank Limited*
	FirstCaribbean International Bank (Jamaica) Limited	*FirstCaribbean International Building Society*
	First Global Bank Limited	
	National Commercial Bank Jamaica Limited	
	RBTT Jamaica Limited	
FIA Licensees	Capital & Credit Merchant Bank Limited	
	Citimerchant Bank Limited	*Citibank N. A.*
	DB&G Merchant Bank Limited	
	MF&G Trust and Finance Limited	
	Pan Caribbean Merchant Bank Limited	
Building Societies	FirstCaribbean International Building Society	*FirstCaribbean International Bank (Jamaica) Limited*
	Jamaica National Building Society	
	Scotia Jamaica Building Society	*The Bank of Nova Scotia Jamaica Limited*
	Victoria Mutual Building Society	

4.5. System Performance Review

4.5.1. Overview

Growth in the deposit-taking sector moderated to 12.6 per cent during 2004 relative to 23.2 per cent in 2003. This reflected the implementation of International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) as well as a slower rate of change in the exchange rate. Accordingly, in 2004 assets increased by J$52.7 billion to J$471.8 billion. Asset growth continued to be influenced by the foreign currency asset portfolio, which grew by US$0.5 billion or 18.6 per cent to US$3.1 billion at end December 2004.

Expansion in assets was financed primarily by deposit inflows of J$42.3 billion (domestic and foreign currency) and was reflected in an increase in investments of $23.6 billion (which included revaluations under IFRS), loans & advances of $21.5 billion and cash & bank placements of $5.5 billion. IFRS principles for the recognition and measurement of financial instruments (IAS 39) require fair value differentials on investments to be reflected in profits. However, the Bank of Jamaica has directed adoption of the option under IFRS for its licensees to carry such valuation differences as a reserve pending the realization and booking to profits of these differentials upon disposal of the assets. As at December 2004, such fair value unrealized reserves stood at $5.9 billion.

Profits were affected by reduced interest income and lower foreign exchange gains. These earnings generated increased equity with permanent capital growing faster than overall asset base, resulting in stronger capital indicators relative to end 2003.

4.5.2. Asset Review

The system's asset profile continued to be dominated by investments, representing 41.3 per cent of total asset base, marginally higher than the 40.9 per cent at end December 2003. Of total investments, assets acquired under repurchase agreements accounted for 11.9 per cent down from 15.2 per cent at end 2003. The stock of loans represented 30.9 per cent, of total assets, up progressively from 29.6 per cent and 27.2 per cent at end 2003 and 2002 respectively) while cash and bank placements accounted for 19.9 percent of total assets relative to 21.1 per cent at end 2003.

Deposits remained the principal source of funding, representing 63.3 per cent of assets at end 2004 compared with 61.2 per cent end December 2003. Borrowings, including securities sold under repurchase agreements and borrowings under margin contracts, funded 18.8 per cent of assets, down from 21.7 per cent at end December 2003.

Although yielding some market share to other deposit-takers, the commercial banks continued to be the predominant influence on system trends, accounting for over 60 per cent of the growth in assets and controlling 72.3 per cent of the total deposit-taking sector at the end of 2004 (**see Table 30**). Bank of Nova Scotia and National Commercial Bank remained the market leaders and combined accounted for over 50 per cent of total market assets. Growth in the commercial banking sector was mainly financed from increased deposits, which facilitated expansion of the loan portfolio and overseas placements.

Notwithstanding a reduction in the number of market players (**see Table 28**), FIA licensees increased their share of the deposit-taking market to 10.7 per cent from 10.5 per cent at end 2003. Their asset base grew by 15.3 per cent ($6.7 billion) to total $50.5 billion, compared to growth of 58.3 per cent ($16.1 billion) experienced in the previous year.

Building societies also strengthened their market presence accounting for 17.0 per cent of the deposit-taking system's assets as against 16.0 per cent at end 2003. Growth in assets of $14.3 billion for the sector continued to be financed primarily from new savings of $9.3 billion, which funded, in the main, a $5.7 billion expansion of the mortgage portfolio. An increase in the assets of building societies was also significantly influenced by fair value measurement of listed equity holdings, primarily at one society.

4.5.3. Liquidity

The statutory minimum Cash Reserve and Liquid Assets requirements for the system's three sectors remained unchanged during 2004. There was however some widening of eligible liquid assets as a result of rationalization of the liquid assets treatment for all Government of Jamaica debt instruments. Previously, apart from Treasury Bills and other instruments carrying a specific 'liquid asset' designation in their prospectus, only Local Registered Stock (LRS) with residual maturities of nine months or less were eligible for inclusion in the statutory liquid assets measure. Accordingly bonds, debentures or others debt instruments issued by the Government of Jamaica would not qualify irrespective of residual maturity. During March 2004, the Minister of Finance, on the recommendation of the Bank of Jamaica, designated all debt securities or instruments issued by the Government of Jamaica (denominated in both domestic and foreign currency) with nine months or less to maturity, eligible as liquid assets. All Treasury Bills irrespective of maturity continue to qualify as liquid assets.

The institutions continued to maintain comfortable margins of liquidity over and above the statutory requirements during 2004. The ratio of domestic currency liquid assets held by licensees to domestic prescribed liabilities increased to 36.3 per cent in December 2004 from 33.0 per cent for December 2003. The US dollar liquid assets ratio increased to 54.5 per cent in December 2004 from 42.6 per cent for December 2003.

Table 30 - Market Share of Deposit-Taking Financial Sub-sectors (Assets*)

	December 2002		December 2003		December 2004	
	J$BN	**Per cent**	**J$BN**	**Per cent**	**J$BN**	**Per cent**
Commercial Banks	258.7	76.1	309.6	73.8	341.3	72.3
Building Societies	53.8	15.8	65.7	15.7	80.0	17.0
FIA Licensees	27.7	8.1	43.8	10.5	50.5	10.7
Total	**340.2**	**100.0**	**419.1**	**100.0**	**471.8**	**100.0**

**Assets net of contingent liabilities and provisions for losses*

During the year, the statutory requirements for liquid assets were satisfied throughout by all but one licensee. The breach resulted from misinterpretation of the liquid assets measure and is in the process of correction. There were however a few instances of infractions of the Cash Reserve ratio, which resulted from either untimely adjustments to monthly Cash Reserve balances on the part of licensees or inaccurate computations of reservable liabilities. Penalty charges pursuant to the relevant statutes were imposed at the Bank's established rates of 45 per cent per annum on domestic currency shortfalls and 20 per cent per annum on foreign currency shortfalls.

4.5.4. Asset quality

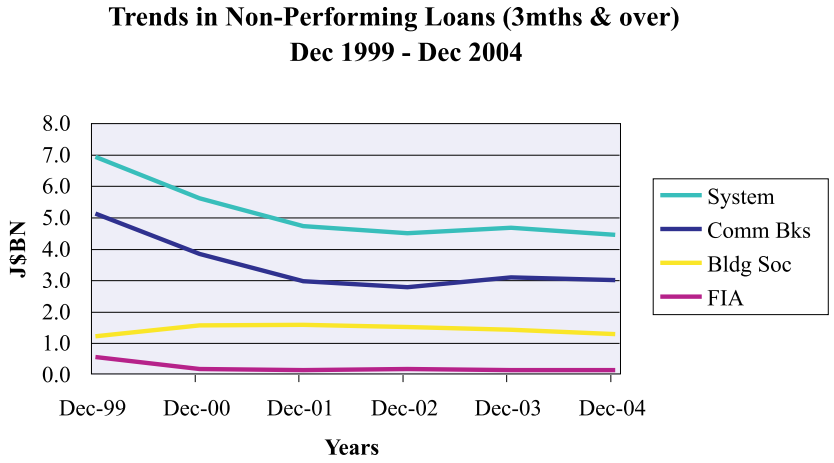
The deposit taking system continued to register steady improvement in asset quality as reflected in further reduction in reported non-performing loans by $0.2 billion or 3.2 per cent to total $4.5 billion at the end of 2004. With non-performing loans representing 3.0 per cent of total loans at end 2004 from 3.6 per cent at year-end. All three sectors reported reduced delinquencies in their loan portfolios, with individual institutions all being well within the prudential tolerance limit of 10.0 per cent.

Provisions for losses (aggregate of prudential and IFRS determined provisioning) continued to offer over 100 per cent coverage of the delinquent portfolios, being 113.1 per cent at the end of 2004 up from 104.2 per cent at end 2003.

4.5.5. Profitability

The system's unaudited pre-tax profit for 2004 was $13.1 billion, a contraction of J$3.3 billion relative to 2003. These results partly reflect reduced interest income arising from lower interest rates as well as smaller gains attributable to exchange rate changes. As a consequence pre-tax profit margin and return on average assets fell to 21.3 per cent and 3.0 per cent respectively, as compared to 25.3 per cent and 4.3 per cent for the year 2003.

Chart 10 – Trends in Non-Performing Loans



Gross revenue for the system totaled $61.3 billion, of which 82.7 per cent was generated from interest income. Of this, $23.3 billion was generated from loans, $21.4 billion from investments while non-interest income of $10.6 billion accounted for the remaining 17.3 per cent. Service charges and commissions totaling $5.2 billion were the major source of non-interest income earned. On the other hand, interest costs on deposits and borrowings totalled $22.4 billion and was the major expense item, representing 46.6 per cent of $48.0 billion in total operating expenses. Staff expenses of $12.2 billion accounting for 25.4 per cent of total expenses was the second largest charge against earnings.

Of the $13.1 billion in profits generated across the system, the commercial banking group accounted for $10.2 billion or 77.8 per cent, the building societies $2.0 billion or 15.3 per cent and FIA licensees $0.9 billion or 6.9 percent.

4.5.6. Capital Adequacy

Profits, along with fair value and other equity based reserves accounted for growth in shareholders' equity of 23.7 per cent during the year to $62.6 billion. Of this value, capital base elements (i.e. regulatory capital) which represent permanent realized capital sources grew by $4.7 billion or 13.6 per cent to $39.9 billion at year end. The increase in capital base reflected mandatory and discretionary transfers of $4.1 billion from realized profits to statutory capital reserve funds as provided for under financial legislation, as well as, a $0.6 billion reduction in capital impairments which were in evidence in two licensees at the end of December 2003.

Given a faster rate of increase in capital relative to asset, the ratio of primary capital to total assets increased marginally to 8.5 per cent at end December 2004 from 8.4 per cent at end December 2003, or 2.5% above the prudential benchmark of 6.0 per cent. At end December 2004, only one licensee, as a result of fairly rapid asset growth, fell marginally below the prudential minimum and took remedial action at the request of the regulatory authorities.

Licensees operated within the statutory deposit and borrowings to capital base leverage limits of 25:1 and 20:1 for commercial banks and FIA licensees, respectively. The overall system recorded a ratio of 9.8:1 at end December 2004.

4.6. Credit Unions

During 2004, the Bank continued efforts aimed at achieving finalization of the draft Bank of Jamaica (Credit Unions) Regulations that will establish a new supervisory regime for credit unions. In this regard, the BOJ, at the request of the Minister of Finance and Planning, convened several meetings during the year with the representative organization, the Jamaica Cooperative Credit Union League (hereafter the League). These meetings were held to address new concerns raised by the League subsequent to its earlier discussions with the Bank. The deliberations to a large extent centered on the League's appropriate role as well as issues relative to proposed minimum capital requirements and unsecured credit limits under the forthcoming regulations. Pending the Minister's final determination on the applicable supervisory structures and other policy matters, it is anticipated that the regulations should shortly be finalized and submitted to Parliament for approval during 2005.

4.6.1. Supervisory Developments

The BOJ has continued its preparatory work in anticipation of the adoption of full supervisory

responsibility for credit unions and the licensing process that will be implemented and flow from the new Regulations.

During the year, the Bank in collaboration with the Caribbean Regional Technical Assistance Centre (CARTAC) convened two seminars on corporate governance (which also included segments on Anti-Money Laundering requirements) for credit unions, which saw a high level of participation by industry representatives.

The programme of prudential reporting introduced in 2003 continued with credit unions submitting the preliminary monthly balance sheet and quarterly earnings and expenditure returns directly to the Bank to facilitate off-site assessment. Training seminars have been conducted on the filing of returns with the Central Bank and in instances where specific needs were identified, further training sessions were convened for relevant credit union representatives. The full suite of prudential returns for credit unions will be introduced on a phased basis, to bring this sector on par with the rest of the deposit-taking system in terms of regulatory reporting.

On-site examinations of credit unions, which commenced in mid-2003 continued during 2004. By year end, the Bank had examined 77 per cent of the sector in terms of market size in assets.

During the year there was a merger of two small credit unions (Mount Friendship Cooperative Credit Union Limited and Cassava River Cooperative Credit Union Limited) with one of the larger entities (Churches Co-operative Credit Union Limited), while another credit union (Government Workers Cooperative Credit Union Limited) opted for voluntary liquidation. At the end of 2004, the number of credit unions in operation totalled 50 as against 53 at the end of 2003.

4.6.2. Credit Union Performance Highlights

Despite the contraction in the number of entities as at 31 December 2004, total assets of the credit union sector increased by 19.8 per cent to $28.5 billion, from $23.8 billion recorded in the previous year. Growth in this sub-sector was further underscored by an increase in membership to 760,245 from 728,447 as at December 2003 (**see Table 31**).

During 2004, total loans increased by 30.8 per cent to $17.3 billion relative to $13.3 billion at end 2003. Loans continued to represent the major component of overall assets with its relative share increasing to 60.8 per cent up from 55.6 per cent as at end 2003. This increase in loans was funded primarily by an expansion in savings of 18.2 per cent to $22.5 billion. The loans to saving ratio increased to 77.2 per cent from 69.7 per cent at end 2003.

Table 31 Selected Credit Union Data 2000-2004

Year End	No. of Credit Unions	Membership	Total Savings J$m	Total Loans J$m	Loans: Savings %age	Total Assets J$m
2000*	60	597,041	12,004.5	7,870.4	65.6	14,642.9
2001*	58	637,257	14,174.1	9,133.0	64.4	17,278.6
2002*	56	680,338	16,363.7	11,130.2	68.0	20,002.7
2003*	52	728,447	19,008.8	13,255.0	69.7	23,828.4
2004	50	760,245	22,475.8	17,342.0	77.2	28,538.1

**Source of data: Jamaica Co-operative Credit Union League (JCCUL).*

Figures do not include data for one credit union that is not a member of JCCUL with assets of $28 MN at end 2004.

4.7. Current Issues In Bank Supervision

4.7.1. Basle Core Principles

In 2004, the Bank's supervisory policy and development functions continued to focus on achieving the following:

1. Full compliance with the Basel Core Principles for Effective Banking Supervision- the global standard on which the effectiveness of bank supervisory systems are assessed, as well as other international standards governing banking and related issues; and

2. Ensuring that Jamaica's legislative and regulatory framework, as well as, Bank of Jamaica's supervisory approaches, methodologies and tools remain dynamic and relevant to the local banking environment.

In this regard, the Bank reassessed its compliance with the Basel Core Principles and completed an action plan that will ensure that the necessary recommendations for legislative amendments and enhancements to the regulatory/supervisory framework are effected on a timely basis.

4.7.2. Basel II

In June 2004, the Basel Committee of Banking Supervisors issued the New Capital Accord commonly referred to as Basel II, which is a revised framework for the computation of capital adequacy for internationally active banks, and promoted for adoption by all G-10 member countries by 2007, and at a later date for developing countries. The primary objective of this new Accord is to introduce a more risk sensitive capital requirement and by so doing, promote stronger risk management practices within the banking industry.

The New Accord is based on three pillars:

- Pillar 1: Minimum Capital Requirements (which require explicit capital charges for credit risk, market risks and operational risk exposures);
- Pillar II: Supervisory Review; and
- Pillar III: Market Discipline.

During the year, the Bank participated in several regional discussions, regarding the implications of the implementation of Basel II on financial institutions in the Latin American and Caribbean regions and is also spearheading a Caribbean Technical Working Group on Basel II implementation (see Section: Supervisory Cooperation and Interaction). The Bank also analysed the implications for local financial institutions and commenced the development of a plan for eventual implementation in Jamaica. The plan will establish the areas of national discretion and the methodologies for the calculation of risk exposures. This document will be finalized during 2005 at which point, the Bank will invite further discussions with the industry. The Central Bank is targeting 2009/2010 for full adoption of Basel II, with immediate focus being given to implementing pillar II and Pillar III in the medium term in advance of a later adoption of Pillar I.

4.7.3. Capital Adequacy Framework

The Capital Adequacy Regulations for commercial banks and FIA licensees which set out the minimum risk-based capital standards and a minimum asset based leverage ratio (the primary ratio) for the licensees were passed in March 2004. The minimum risk-based capital ratio is based on the Basel I methodology and requires minimum capital of 10.0 per cent in relation to on- and off-balance sheet assets, adjusted for exposures to credit and foreign exchange risks. This is 2.0 per cent above the minimum of 8.0 per cent stipulated under Basel I. The minimum primary ratio (capital to total assets) is set at 6 per cent.

The Bank has assessed the prudential risk-based capital adequacy ratio since the late 1990s, and indicators show that all institutions are currently compliant with the minimum. A new quarterly Capital Adequacy prudential return to the Bank of Jamaica was introduced in December 2004 to facilitate a more refined computation and reporting of the risk-based capital ratio.

4.7.4. Consolidated Supervision

In recent years, there has been a growing trend towards the establishment of financial and mixed conglomerate structures across the region, particularly through mergers and acquisitions. A number of supervisory issues have arisen as a result of banks operating within large complex structures, primary of which are the resultant vulnerabilities to contagion risks arising from the operations of other group companies and the creation of complex structures that may obfuscate supervisory scrutiny.

In recognition of these developments and related supervisory implications, banking statutes were amended in 2002 to enable the Bank of Jamaica to more effectively undertake consolidated supervision. These amendments were designed to allow the Supervisory Authority to quantitatively, as well as qualitatively assess the financial condition of business groups which includes licensed deposit-taking institutions. This is to identify and evaluate all the risks to which those entities may be exposed and to require corrective actions when and where necessary.

During 2004, the BOJ continued work towards the full implementation of the provisions of the 2002 amendments with the aim of having consolidated supervision fully effected in 2005/06. To this end, in examining the supervisory issues of both domestic and cross-border consolidated supervision, the Bank has determined that the governing laws will require further amendment to reflect the broad principles and objectives of consolidated supervision (including full access to and control over the holding companies of banks), and allow for supervisory flexibility to respond to changing circumstances. This legal framework will also need to be supported by enforceable technical guidelines, standards and directions that may be issued and altered by the Supervisor under the authority presently provided by the BOJ Act. In this regard, the BOJ has been reviewing the current legal framework for consolidated supervision with a view to presenting recommendations for the promulgation of specific Holding Company legislation, as the first step towards effective implementation.

Given the significant increase in cross-border expansion into regional markets, and the imminence of the Caribbean Single Market and Economy (CSME), the Caribbean Group of Bank Supervisors (CGBS) has undertaken a regional approach to consolidated supervision to ensure that there is harmonization of legal frameworks and supervisory methodologies (see section 10.2 Regional Interaction). To this end, a Technical Work Group was formed during 2003 to examine the issues and to make the necessary recommendations as to the way forward. The first report of the Work Group was presented at the XXII Annual Conference of the Caribbean Group of Banking Supervisors in May 2004 wherein a critical need was identified by the Group for harmonized legislative requirements across the region to facilitate consistency in supervisory approaches and eliminate opportunities for regulatory arbitrage. Basic principles to be incorporated in such legislation were also identified including the need for specific holding company laws.

4.7.5. Corporate Governance

There has been increasing local and international attention to the issue of corporate governance with international agencies such as the Organisation for Economic Co-operation and Development (OECD) and the Basel Committee of Banking Supervisors, issuing standards and guidelines to enhance the framework for corporate governance in organizations. At the Bank, full recognition is given to the fact that supervisory objectives can only be achieved if accompanied by a sound corporate governance framework in deposit-taking entities, promoted and adhered to not only by the board and management, but shareholders and other stakeholders as well. Since the mid-1990s, the Bank has issued Standards of Best Practice, which detail its expectations of the Board and Management in various aspects of licensees' operations (e.g. credit, foreign exchange, capital management and other areas).

During 2004 the BOJ undertook the further development of a specific Standard of Best Practice on Corporate Governance, which will be issued to the industry for comment in early 2005. The draft Standard primarily emphasizes the necessity of the four important oversight functions within a financial institution as outlined below, and the minimum expectations of the Supervisory Authority with regard to the execution of these functions:

- Board and senior management oversight;
- Independent oversight;
- Direct line supervision of business areas; and
- Independent risk management and audit.

Of equivalent importance, the relevant financial statutes give the Bank of Jamaica responsibility for assessing the fitness and propriety of individuals responsible for carrying out the corporate governance function in licensees (i.e. shareholders, directors and senior officers) in accordance with stated criteria. In this regard, the Bank makes recommendations to the Minister of Finance who has the ultimate responsibility for determining the "fit and proper" status of such individuals to undertake the fiduciary responsibilities inherent in deposit-taking activities. In order to provide greater clarity to the approach of the Central Bank in fulfilling this statutory obligation, the BOJ issued 'Guidelines for Fit and Proper Assessments' in December 2004. The purpose of the Guidelines is not only to disclose the criteria applied by the BOJ in its own review, but also to set the standard for entities' own assessment of individuals in determining their suitability to undertake board, management and senior staff responsibilities in financial intermediaries.

4.8. Anti-Money Laundering/Combating the Financing of Terrorism (Aml/Cft)

The BOJ continued to play a vital role in the development and execution of a national AML/CFT framework to promote the safety, soundness and integrity of Jamaica's financial system. This has involved the promotion of compliance with international obligations under the various United Nations Security Council Resolutions and other international standards, particularly the accepted benchmark, the Forty Plus Eight Recommendations issued by the Financial Action Task Force (FATF) on anti-money laundering and the combating of the financing of terrorism. As of January 2005 these Recommendations have formally been revised to the FATF Forty + Nine Recommendations.

This was carried out primarily through the Bank's active involvement in the Financial Crimes Legislative Task Force, a national committee established by the Hon. Minister of Finance and Planning, with a mandate

to review the existing legislative framework and make recommendations to strengthen the country's AML and CFT Frameworks. The Task Force, chaired by the Deputy Supervisor of Banks produced two reports which made recommendations for key reforms to increase the effectiveness of Jamaica's anti-money laundering framework. This has resulted in amendments to financial legislation being passed by Parliament in 2004 (**see Section 4.9: Legislative Amendments**).

The Task Force also proposed several critical amendments to the existing Money Laundering Act and the promulgation of a new statute, the Financial Investigations Division (FID) Act, to give necessary legal identity to the Financial Investigations Division of the Ministry of Finance. Both the Money Laundering Amendment Bill and the FID Bill were at the end of 2004, before a Joint Select Committee of Parliament. The Bank also participated in the development of the Terrorism Prevention Bill which is currently before Parliament for final passage (**see Section 4.9: Legislative Amendments**).

Further, the BOJ also issued during the year the '*2004 Guidance Notes for the Prevention and Detection of Money Laundering and Terrorist Financing Activities'* to all specified financial institutions (deposit-taking licensees including credit unions). These revised Guidance Notes were upgraded to incorporate the Forty Plus Eight Recommendations of the FATF, as well, as the Best Practice Standards for Customer Due Diligence issued by the Basel Committee on Banking Supervision. Additionally, the scope of the Guidance Notes was expanded to incorporate special requirements for cambios and remittance agents, which fall within the oversight of the Bank.

The BOJ's examination methodology was also comprehensively reviewed to enhance the scope of the on-site assessment of the AML/CFT frameworks within BOJ's supervised entities. Seminars were also held for managers and compliance officers of deposit-taking institutions to review and discuss the upgraded AML/CFT requirements and fully apprise them of the Bank's expectations with regard to an operationally effective AML/CFT framework.

4.9. Legislative Amendments

A comprehensive revision of the legislative framework is a necessary and fundamental step in achieving the supervisory policy and developmental objectives noted elsewhere in this section. Hence in keeping both with its role as Chair of the National Financial Crimes Legislative Task Force as well as Regulatory Authority for the deposit taking sector, the Bank of Jamaica during the year spearheaded and/or undertook a number of initiatives for reform of legislation and related regulations. This included the start of a major review of legislation with a view to making recommendations to ensure that:

- Jamaica's financial laws are in full compliance with the Basel Core Principles for Effective Banking Supervision;
- The amalgamation of the various pieces of legislation governing banking and other deposit-taking institutions, into an Omnibus statute after eliminating the existing gaps/differences in the various Acts to create a level playing field across all deposit-taking entities; and
- Explicit promulgation of Financial Holding Company legislation under the proposed omnibus statute (**see Section 4.7.5: Consolidated Supervision**).

The status of specific work and developments on both direct supervisory and AML/CFT legislation are noted below.

Amendments to the **Money Laundering Act and Regulations**, designed to further strengthen the country's AML/CFT framework and give legal recognition to new international standards in this area were before Parliament at year end. The amendments seek to expand the range of predicate offences, lower the threshold reporting requirements to US$15,000, improve on existing investigatory powers of the authorities and further create an avenue for the future designation and AML/CFT regulation of "gatekeeper" professions (i.e. lawyers, accountants) and "designated non-financial institutions".

The **Terrorism Prevention Bill** was before Parliament for passage at year end, having already been reviewed by a Joint Select committee**.** This Bill will serve to criminalize the act of and financing of terrorism and impose obligations on financial institutions for customer identification, record keeping, internal controls and reportage of suspicious transactions relating to possible terrorist activities or terrorist entities to the Designated authority.

The **Financial Investigations Division Bill** which was also before Parliament at year end, deals with the statutory establishment of the Financial Investigations Division, which acts inter alia, as Jamaica's Financial Investigations Unit (FIU). The Division, which is currently a unit of the Ministry of Finance, will be statutorily responsible for the investigation of serious financial crimes, including money laundering. The Bill also addresses information sharing, powers of investigation and establishes a regime for asset seizure, confiscation, and forfeiture of proceeds of financial crimes.

Amendments to the **Bank of Jamaica Act** approved by the House of Representatives during the last quarter of 2004, expanded on the regime for the Bank of Jamaica to share information with overseas regulators. These amendments also legislate the necessary safeguards governing how such information may be used, to assure the continuing confidentiality of shared information.

The House of Representatives also approved amendments to the **Banking and Financial Institutions Acts** during the last quarter. These amendments now give the Bank of Jamaica express and unequivocal authority to take regulatory action against financial institutions where they are found to be in breach of the Money Laundering statute and any other statute governing the operations of these institutions (which would include the Terrorism Prevention Bill, when passed). Up to that point the Bank has taken action in any and all circumstances where breaches of the Money Laundering Act was deemed to be "unsafe and unsound conduct" on the part of the licensee. The amendments also rationalize and increase penalties across the banking industry.

The **Bank Of Jamaica (Building Societies) (Amendment) Regulations** were affirmed by resolution in Parliament shortly after year end and serve to rationalize the supervisory regime applicable to building societies with those applicable to banks and FIA licensees in terms of offences, penalties and supervisory sanctions. These Regulations will come into effect when they have been gazetted.

Credit Classification and Provisioning Regulations are presently in process of redrafting and will provide

specific legal guidelines for credit classification, required levels of provisioning for bad and doubtful debts and other related matters (e.g., credit renegotiations). Among other things, these regulations will detail the Bank of Jamaica's approach to classifying credits into defined loan categories and also stipulate specific minimum provisioning levels. The Bank of Jamaica has already required that all licensees comply with the proposed regulations.

The **Qualifications of Auditors Regulations**, which are expected to take effect during 2005 following on extensive dialogue that has already taken place with the Institute of Chartered Accountants of Jamaica (ICAJ) and the industry, will specify the standards for auditors in undertaking an external audit of a supervised financial institution. Among other things, such criteria relate to the independence, experience, expertise and academic qualifications of the external auditors, and will also require prior notification to the Bank of Jamaica of proposed appointments.

4.10. Supervisory Cooperation And Interaction

4.10.1. Financial Regulatory Council

The Financial Regulatory Council[7] (FRC) met on five occasions during 2004 to examine issues affecting the financial industry as well as issues specific to dually licenced entities.

4.10.2. Regional Interaction – The Caribbean Group of Banking Supervisors

The Caribbean Group of Banking Supervisors (CGBS)[8] was established in 1983 under the aegis of the Central Bank Governors of member countries of the Caribbean Community (CARICOM), with the specific mandate to co-ordinate the enhancement of bank supervisory practices in the English speaking Caribbean, consistent with internationally accepted standards.

A significant development and achievement by the CGBS during 2004 was the crafting and execution of a formal **Information Sharing Agreement (MOU)** to facilitate the consolidated supervision of cross-border institutions operating in member jurisdictions. This was originally conceptualized to apply to jurisdictions impacted by the merger of the Caribbean operations of two internationally active banks which span eight member jurisdictions. However, given the generic applicability of the MOU, almost all of the CGBS membership have since become signatories to the agreement to facilitate consolidated supervision in the region, wherever it is necessary. Acting under the provision of the MOU, the Bank of Jamaica participated in the examination of a holding company located in Barbados during 2004.

The Bank continued to provide Secretariat services to the CGBS. Activities undertaken by the Secretariat include liaising with CGBS members on research matters; organizing technical work-groups to discuss, research and strategise on regional approaches to supervisory developments; coordinating regional training programmes with international providers; maintaining interfaces with international and other regional supervisory bodies; and maintaining a comprehensive database and record of the group's activities. During the year the Secretariat launched an extranet site (developed with the assistance of the Bank's

[7] *The FRC comprises The Governor, Bank of Jamaica; The CEO, Financial Services Commission; The Financial Secretary; The CEO, Jamaica Deposit Insurance Corporation and The Solicitor General.*

[8] *CGBS Membership now comprises fourteen regional jurisdictions, nine of which are presently core members of CARICOM. The Bank of Jamaica assumed the Chair of the Group for a two-year term in January 2003.*

Information Systems Department) to house supervisory information pertaining to member jurisdictions (e.g. profile of members' supervisory frameworks, papers from conferences, CGBS events listings, legislation etc.). The website also allows for on-line application for bank supervisory programmes of study and facilitate discussion forums on bank supervisory issues.

The Bank also chaired a Technical Group of the CGBS with a mandate to

- assess the implications of Basel II implementation for Caribbean jurisdictions and strategize on practical approaches for the region; and
- determine operational protocols for the conduct of effective Consolidated Supervision within the region. This was against the background of complex financial and mixed group structures within several jurisdictions, as well as increasing cross-border expansion of certain banking groups across the region (**see section 4.7.5: Consolidated Supervision**).

The Working Group is also far advanced in the development of a 'Quantitative Impact Study' (QIS), which is to be deployed in each member jurisdiction to assess the potential impact of Basel II on supervised institutions. The Group also examined the types of calculations necessary for determination of **market risk capital charges**, given that this area of the original Capital Accord has not been comprehensively implemented by any of the Caribbean or Central American member jurisdictions.

The mandate of the Group was also expanded during the year to incorporate an assessment of the implications of the Caribbean Single Market and Economy (CSME) to ensure that the corollary legislation is adequately reconciled to international supervision standards and requirements, and to ensure that proper measures are in place to manage the transition.

4.10.3. International Interaction

The Bank of Jamaica remains committed to applying the highest international standards in its supervisory processes. In addition to policy enhancement and implementation work being undertaken, the Bank participated in international conferences and accessed specialist training opportunities for its supervisory staff from overseas regulatory authorities such as the Federal Reserve, the Office of Supervision of Financial Institutions, the Financial Stability Institute of the Bank of International Settlements (BIS). The Bank was also represented by two senior officials at the biennial **International Conference of Banking Supervisors** which is organized by the Basel Committee/ Financial Stability Institute (FSI)/ Bank for International Settlements (BIS) and hosted by the Bank of Spain during September 2004.

Other critical participatory roles in international organizations included the Deputy Supervisor of Banks' Deputy Chairmanship (for a two year term commenced in June 2003) of The **Association of Supervisors of Banks of the Americas** (ASBA) whose membership spans thirty-five (35) supervisory jurisdictions across North, Central and South America and the Caribbean.

The Bank of Jamaica also continued to serve as principal contact for Jamaica to the **Caribbean Financial Action Task Force** (CFATF), and maintains interaction with the Basel Committee on Banking Supervision both in its own capacity and that of Chair and Secretariat or the CGBS.

In addition to its own AML/CFT review exercises at domestic banking entities, the Bank also participated in an AML examination conducted in Jamaica by an overseas regulator, in its capacity as 'home' supervisory authority for that local banking group.

4.11. Outlook

In addition to the work in train as indicated under 'Current Bank Supervision Issues', focus will also be given during 2005 to a critical re-look of supervisory approaches in the face of increased complexities in banking operations and developments in international supervisory standards. Work will also be on-going on various aspects of legislation to further codify principles of sound supervisory practice.

4.11.1. Administrative Outlook

The Bank seeks to maintain a dynamic and proactive posture in its supervisory approach. Recognising the need for better and timelier information on licensees to inform assessments and supervisory response, a review of the Information Systems under-pinning the business processes of the Division continues. Although a few ancillary Information Technology (IT) related solutions were initiated during 2003, development work on a core new IT system to underpin the major business processes of FISD is scheduled to commence 2005.

4.11.2. Developments in Supervisory Management and Approaches

A critical review of the examination process was commenced in 2004, starting from the licensing stage to on-site examination, reporting and ongoing monitoring. This work is expected to continue in 2005 and will lead to a complete revamping of present approaches with a move towards a more risk-focused process.

4.11.3. Risk Management Framework in Deposit-Taking Entities

Inextricably intertwined within an effective governance framework in financial entities should be a dynamic, enterprise-wide risk management program, which constantly assesses, measures, monitors and seeks to mitigate or control the risks to which financial institutions are exposed. Some of the major risks faced by banking entities include market (interest rate and foreign exchange risk), credit, operational, legal and reputational. Further to the suite of Standards of Best Practices already issued which provide guidance to banks for the risk management of specific areas of operations, the BOJ will continue during 2005, the drafting and dissemination of Standards for areas such as: -

- Electronic Banking Risks;
- Market Risk Management which will incorporate and replace standards issued in 1999 with respect to interest rate and foreign exchange);
- Credit Risk Management – originally issued in 1999 but is being updated given enhanced risk management approaches, and the evolution of international best practices;
- Country and Transfer Risk Management; and
- Conglomerate Risk Management

The Standard for the Management of Country and Transfer Risk was finalized shortly after year-end following comments from the industry and issued to the industry for adoption. The remaining Standards are expected to be issued to the industry for comments by the second quarter of 2005.

4.11.4. Electronic Banking

In recent years, the local financial market has seen significant growth in institutions' development of electronic banking (e-banking) capabilities and the offering of related services. Such developments have been influenced by a combination of: increasing competition within the financial sector and the resultant thrust to broaden product base and service delivery channels, the demand for more efficient and convenient capabilities; and the widening cost and delivery differentials between electronic capabilities and traditional delivery channels.

E-banking opportunities however expose entities to significant risks and it is therefore necessary that financial institutions engaging in e-banking activities adopt comprehensive risk management programmes that begin with a sound strategic plan, which should, inter alia, include efforts to mitigate these risks. In this regard, the Bank of Jamaica has drafted new guidelines that prescribe the minimum policies and procedures that each financial institution should have in place, as a complement to its existing framework, in ensuring the safety and soundness of e-banking activities. These guidelines will be circulated to the industry for comment during first quarter 2005.

Table 32

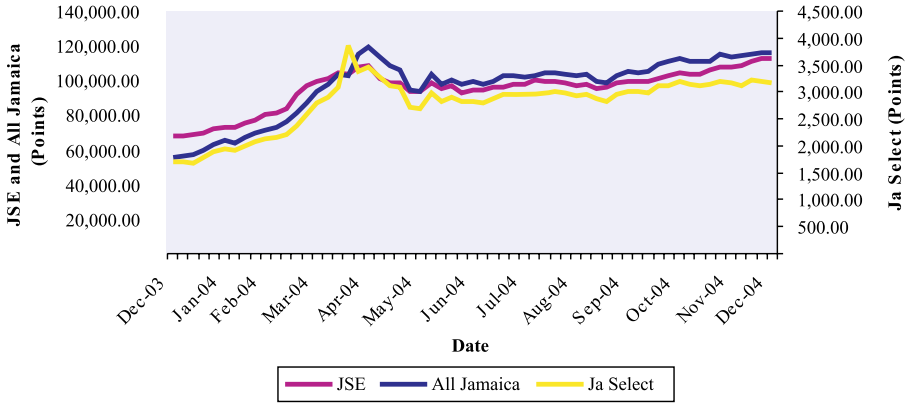
5. The Stock Market

Within a context of increased macroeconomic stability and expectations of favourable earnings from companies, the Jamaican stock market recorded one of its strongest calendar year performances in 2004. This was reflected in robust gains in the indices, particularly in the first and last quarters of the year. The Main JSE Index closed at 112 655.51 points, reflecting growth of 66.7 per cent for 2004 (**see Chart 11**). The Jamaica Select Index and the All Jamaica Composite Index ended the period 87.1 per cent and 108.9 per cent higher, respectively.

The significant growth in the market was reflected in the increase in the total market capitalization of 71.0 per cent to $866.1 billion for 2004. The total volume of shares traded[9] increased by 9.1 per cent to 3.0 billion units (**see Chart 12**), while the value of these trades increased by 103.0 per cent to $29.0 billion. The lower returns from fixed income and the foreign exchange markets relative to 2003 would have engendered investor confidence in the growth prospects of the equity market (**see Financial Market Operations** and **The Foreign Exchange Market**). Additionally, the higher than anticipated inflation rate of 14.1 per cent for 2003, may have influenced higher inflationary expectations by investors for the 2004 period. This would have had a positive effect on the stock market as investors sought an appropriate hedge for inflation.

The profit expectations for many of the listed companies helped to kindle the market as did the mergers and acquisitions[10] that took place during the year. Many of the companies had benefited from the high returns on local fixed income instruments as well as from their holdings of foreign currency in the early part of 2003. The strong earnings from fixed income instruments in 2003 had also rendered many of the share prices on the market undervalued relative to the earnings of companies during that period. As such, the market's performance in 2004 also represented a process by which the prices began to reflect appropriate share values of these companies.

Chart 11



[9] *The number of units traded excludes block transactions (i.e., large units of individual trades in a particular stock) and includes the additional shares issued to the market by some companies.*

[10] *In 2004, Pan Caribbean Financial Services merged with Manufacturers' Investment Ltd, Hardware and Lumber merged with Rapid Sheffield and Life of Jamaica acquired Pan Caribbean Financial Services and First Life's insurance and pension business.*

Chart 12

The stock market started the year strongly with gains of 7.8 per cent and 9.9 per cent for the months of January and February, respectively. The returns then increased sharply to 24.5 per cent for March and, by the end of the first quarter, the Main JSE Index had grown by a robust 47.4 per cent.

The extraordinary gain in the index for the first quarter was followed by a lull in activity over the second quarter (**see Chart 13**). After attaining a high of 62.6 per cent in April, the index recorded its largest monthly decline for the year of 13.2 per cent in May. This decline contributed to a second quarter loss of 4.9 per cent. The third quarter outturn was much stronger as the Main JSE Index gained 5.4 per cent. At the end of the December quarter, the returns on the local equity market increased, compensating for the negative and low returns of the previous two quarters. For this last quarter, the index gained 12.9 per cent with three consecutive months of growth.

On average, share prices increased by 112.7 per cent with 17 stocks recording share price appreciation of over 100.0 per cent in 2004. Overall, 34 stocks posted gains for the period, while only 4 declined. Institutions within

Chart 13

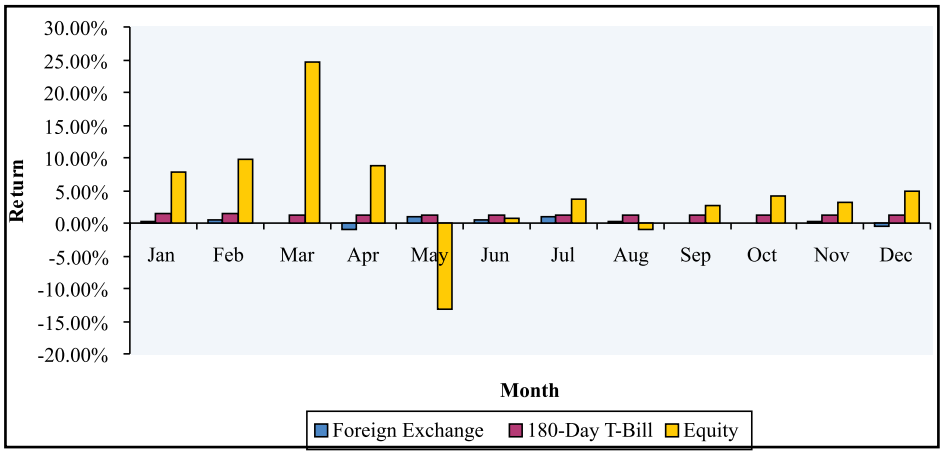


Table 33

Top Ten Share Price Performers in 2004			
	Price at end 2004 ($)	Change 2003 (%)	**Change 2004 (%)**
Financial Services			
Capital & Credit Merchant Bank	32.0	19.8[12]	434.2
Pan Caribbean Financial Services	34.1	15.8	416.7
Dehring Bunting & Golding	21.5	-34.8	186.7
Manufacturing			
Caribbean Cement Company	12.9	34.6	268.6
Distribution			
Hardware & Lumber	29.9	54.5	214.2
Other services			
Kingston Wharves	4.9	-50.0	276.9
Pegasus Hotels	10.0	70.0	194.1
Insurance			
First Life	45.5	25.7	229.5
Life of Jamaica	11.3	44.4	189.7
Conglomerates			
Lascelles de Mercado	202.1	13.3	197.1

Financial Services headed the list of the top 10 share price performers for the year. The market leaders within this sector were Capital and Credit Merchant Bank (434.2 per cent), Pan Caribbean Financial Services (416.7 per cent) and Dehring, Bunting & Golding (186.7 per cent) (**see Table 33**).

Financial Services accounted for most of the market's capitalization for 2004. This sector represented 77.4 per cent of the total value of shares in issue on the market, ahead of **Manufacturing**[11] and **Conglomerates**, which were 9.4 per cent and 8.6 per cent of market capitalization, respectively.

The returns from the stock market in 2004 overshadowed the equivalent investment gains in the foreign currency market as well as the returns on fixed income investments[13] (**see Chart 13**). The changes in the value of the weighted average selling rate of the US dollar were noticeably lower relative to 2003 when the rates were mainly influenced by the speculative impulses of the first four months of that year, while the growing

[11] West Indies Pulp and Paper was de-listed from the Jamaica Stock Exchange for failure to submit their financial statements in accordance with the rules of the Exchange.
[12] Capital & Credit Merchant Bank was listed on the JSE in May of 2003.
[13] The 6-month GOJ Treasury Bill Rate is used to represent the returns from fixed income investments in 2003 and 2004.

confidence by investors about the prospects for the economy in 2004 were reflected in lower GOJ Treasury Bill yields.

Investors with holdings in United States currency began the year with a first quarter return of 0.6 per cent. This reflected the monthly gains of 0.2 per cent and 0.4 cent in January and February, respectively, against the Jamaican Dollar. This was followed by a lower second quarter return of 0.3 per cent, which partially reflected the 0.5 per cent loss against the Jamaica Dollar in April.

Over the course of the third quarter, the return from holding the US dollar increased to 1.1 per cent. This included gains of 1.0 per cent in June and 0.2 per cent in July. By the final quarter of the year, the returns from holding US dollars became less attractive to investors as the US dollar lost 0.01 per cent in October and 0.6 per cent in December vis-à-vis the Jamaica Dollar, on its way to a loss of 0.4 per cent for the quarter. By the end of the year, the return from holding US currency was 1.7 per cent compared to 18.9 per cent in 2003.

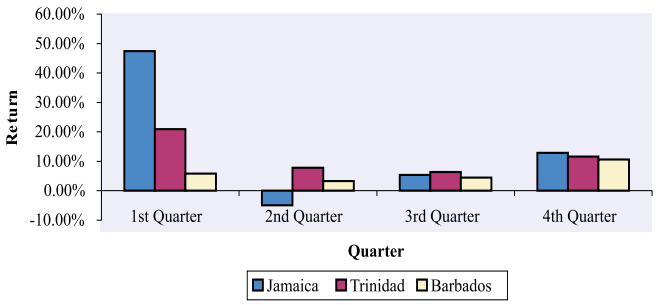
The yields on the 6-month Treasury Bills were markedly lower in 2004 in comparison to the yields that obtained in 2003. The yields, measured on a monthly basis, ranged from 1.2 per cent to 1.4 per cent, whereas in 2003, the rates ranged from 1.5 per cent to 2.8 per cent. On average, the returns from the 6-month Treasury Bills were 15.3 per cent in 2004 compared to 25.3 per cent in 2003.

The equity returns on the other major regional exchanges were not as high as in Jamaica. During the year, the Composite Index in Trinidad & Tobago appreciated by 54.8 per cent compared to 27.2 per cent in 2003, while in Barbados, the Local Index grew by 26.3 per cent compared to 29.0 per cent in 2003. The markets in Trinidad & Tobago and Barbados were supported by strong share price gains by the Jamaican cross-listed companies[14].

The market in Trinidad & Tobago started the year strongly with a gain of 20.9 per cent in the first quarter, which included a 10.3 per cent growth in the index in February while in Barbados, the Local Index began the year with a quarterly gain of 5.8 per cent (**see Chart 14)**. During the second quarter, the rate of growth in the indices in Trinidad & Tobago and Barbados had slowed, but by less than the decline in the growth rate experienced in the JSE in that quarter. The Composite Index in Trinidad & Tobago grew at a slower but reasonable rate of 7.8 per cent, while in Barbados, the Local Index increased by 3.3 per cent for the quarter.

Chart 14

Quarterly Equity Returns in Jamaica, Trinidad and Barbados -2004



[14] *Capital & Credit Merchant Bank, Jamaica Money Market Brokers, Dehring, Bunting & Golding and Grace, Kennedy & Company are the only Jamaican stocks cross-listed in Trinidad & Tobago. Grace, Kennedy & Company was the only Jamaican stock listed on the Barbados Stock Exchange.*

The third quarter returns on the equity markets in Trinidad & Tobago and Barbados were comparable to that of Jamaica. The main indices in Trinidad & Tobago and Barbados grew by 6.4 per cent and 4.5 per cent, respectively. These markets ended the year on a strong note as the indices posted gains of 11.6 per cent and 10.6 per cent for the December quarter, respectively.

Capital and Credit Merchant Bank was the top performing stock in Trinidad & Tobago's market with a capital gain of 275.0 per cent. Grace, Kennedy & Company's share price did well with an appreciation of 108.6 per cent and was also the fourth best performing stock in Barbados with a capital gain of 96.9 per cent. The share prices of Jamaica Money Market Brokers and National Commercial Bank recorded sizeable gains of 70.0 per cent and 50.6 per cent, respectively.

In 2004, Dehring, Bunting & Golding became the fifth Jamaican company to be cross-listed on the Trinidad & Tobago Stock Exchange. This took place on 15 October 2004 and by the end of the year, the company's share price had recorded a decline of 1.7 per cent.

The prospects for another creditable performance in the stock market for 2005 are favourable. A stable macroeconomic environment could allow for a continued reduction in interest rates, which in turn would enhance the attractiveness of the stock market. In addition, the Initial Public Offerings[15] that are anticipated during 2005 could foster greater market activity while adding depth to the stock market.

[15] *Mayberry Investments Ltd and First Global Financial Services have announced their intentions to list on the Jamaica Stock Exchange in 2005.*

6. 1. Overview

Global economic growth accelerated by 1.1 percentage points to 5.0 per cent in 2004, driven in large part by strong growth in the major industrialised economies and rapid expansion in emerging markets, in particular, China. World inflation also accelerated during the year, partly the consequence of shocks to oil prices and partly related to the robust growth among the more developed economies.

The performance of the Jamaican economy in 2004 was set against the background of the advances in global economic activity during the year. Increased external demand, particularly from the major developed economies, had a positive impact on Jamaica's balance of payments (BOP). More specifically, tourist arrivals, current transfers and bauxite and alumina export earnings grew appreciably in 2004. The current account was, however, negatively affected by the high prices on imported grains and crude oil. In the context of these influences, the current account deficit is estimated to have contracted by US$30.7 million to US$732.6 million in 2004.

The high price of crude oil and imported grains also influenced the inflation outturn for Jamaica during the year. The *Fuels & Other Household Supplies,* as well as the *Housing & Other Housing Expenses* of the consumer price index (CPI) were the main sub-categories affected.

Growth in the Jamaican economy was positively affected by developments in the international arena. The most significant impetus to economic expansion in 2004 emanated from the services sector. Value added in miscellaneous services, in particular, expanded by 4.0 per cent in 2004, driven by the performance of the tourism sector. The major factor contributing to the performance of the tourism industry was an increase of 4.8 per cent in total stop over arrivals, led by growth in arrivals from Europe, UK and Canada.

In respect of international trade agreements, after almost a year of deadlock, the members of the World Trade Organization (WTO) adopted a framework agreement that sought to advance the goals of the Doha Development Agenda (DDA). For Jamaica and other African, Caribbean and Pacific (ACP) economies, the dispute over the preferential access guaranteed by the European Community (EC) to its market was challenged at the level of the WTO and by the EC's proposal for the reform of its common market organization for sugar.

6.1.1 International Economic Developments

6.1.2. Industrial Countries

The International Monetary Fund (IMF) indicated that the significant acceleration in global economic growth was underpinned by a strengthening in demand among the major industrialised economies. These economies, led by the United States of America (USA), recorded growth in real output of 3.6 per cent in 2004, which compares favourably with the growth of 2.1 per cent recorded in 2003.

Growth in real GDP in the USA[16] accelerated by 1.3 percentage points to 4.3 per cent in 2004, relative to the growth recorded in 2003. The increase in real output in the USA was led by a robust expansion of 3.8 per

[16] *The USA is Jamaica's main trading partner, accounting for approximately 40.5 per cent of Jamaica's merchandise trade and 71.8 per cent of its stopover visitor arrivals in 2003.*

Table 34

ADVANCED ECONOMIES: EXCHANGE RATES				
	National Currency per unit of US$ /1		Annual percent Change	
	2003	2004	2003	2004
Canadian Dollar	0.72	0.77	12.0	7.9
Japanese Yen	115.91	108.16	-8.2	-7.2
Pound Sterling /2	1.63	1.83	8.9	12.1
Euro /2	1.14	1.24	19.8	10.0

Source: US Federal Reserve

1 US Dollar Nominal Exchange Rates
2 Expressed in US Dollars per unit of national currency

cent in consumer spending, relative to 3.3 per cent in 2003, due in part to enhanced incentives for purchasing automobiles. Business investment, particularly in equipment and software, also increased during the year, supported by historically low interest rates. In addition, US exports, accelerated during the year in the context of the depreciation of the US dollar against the currencies of its main trading partners. This growth also reflected an improvement in external demand, particularly from Asia.

Notwithstanding the expansion in real output in the USA, growth in economic activity slowed during the second and fourth quarters of 2004. This slowdown was associated with a decline in growth in consumer spending, reflecting higher energy prices and the waning effects of tax cuts.

During the year, the value of the US dollar fell by an average of 9.0 per cent vis-à-vis the currencies of its main trading partners[17], following a fall of approximately 12.0 per cent the previous year. The continued depreciation

Table 35

INDUSTRIAL ECONOMIES Real GDP, Consumer Prices and Unemployment Rates								
Country	GDP Annual % Change		Unemployment Rate % of Labour Force		Inflation Rate Annual % Change		Current Account (% of GDP)	
	2003	2004*	2003	2004	2003	2004	2003	2004*
US	3.0	4.3	6.0	5.5	2.3	3.0	-4.8	-5.4
UK	2.2	3.4	5.0	4.8	1.4	1.6	-1.9	-2.0
Euro area	0.5	2.2	8.9	9.0	2.1	2.1	0.3	0.8
Canada	2.0	2.9	7.6	7.2	2.7	1.9	2.0	2.9
Japan	2.5	4.4	5.3	4.7	-0.2	-0.2	3.2	3.4

Source: The World Economic Outlook, September 2004, Statistics Offices of individual countries
** Estimates*

[17] *The Great Britain Pound, the Euro, the Yen and the Canadian Dollar.*

in the US dollar against the major currencies was driven mainly by concerns about the sustainability of the US current account and fiscal deficits. The fiscal deficit widened to an estimated 4.5 per cent of GDP for the year, compared with approximately 4.0 per cent in 2003, due in part to tax cuts and higher spending by the US administration. The US fiscal expansion, reflected in increased domestic demand, fuelled the widening of the current account deficit to approximately 5.4 per cent of GDP, compared with 4.8 per cent in 2003. The decline in the value of the US dollar was also associated with the uncertainty related to the outcome of US elections in November 2004 and the continued security concerns in Iraq during the year.

The annual average inflation rate in the USA for 2004 was 3.0 per cent, compared with 2.3 per cent for 2003. This acceleration was attributed to increases in the price of crude oil as well as the cumulative impact of the depreciation of the US dollar. To counter the negative effects of rising inflation, the US Federal Reserve tightened monetary policy five times during the year. The US Federal funds rate was increased by 125 basis points over the year to 2.25 per cent by December 2004.

The economies of the Euro area, which accounted for approximately 9.0 per cent of Jamaica's merchandise trade in 2003, expanded by 2.2 per cent in the review year, compared with a growth of 0.5 per cent in 2003. The accelerated growth in the Euro area was primarily attributed to increases in external demand, particularly from the Middle East. Notwithstanding the general expansion in economic activity in the Euro area, growth in real output varied markedly among the four major economies of the region. Domestic output in France and Spain grew strongly but rose at slower rates in Italy and Germany. The expansion in the economies of France and Spain was partly underpinned by robust growth in consumer spending. For Italy and Germany, a falloff in the employment rate negatively affected domestic demand during the year.

Inflation among the economies of the Euro area remained at 2.1 per cent for 2004, despite higher oil prices and increases in indirect taxes and government-regulated prices. The containment of inflation pressures in the region was in part attributed to the appreciation in the Euro vis-à-vis the US dollar.

In the United Kingdom (UK), real output expanded by 3.4 per cent in 2004, relative to 2.2 per cent in 2003. Growth in that economy was primarily underpinned by expansions of 3.2 per cent and 5.8 per cent in private consumption and investment spending, respectively.

Despite the significant increases in oil prices during the year, the annual average rate of inflation in the UK remained relatively low at 1.6 per cent, compared with 1.4 per cent in 2003. This was in part the result of a tightening in monetary policy by the Bank of England, which increased the repurchase rate by approximately 100.0 basis points to 4.75 per cent in 2004.

In the case of Canada, which accounted for approximately 6.0 per cent of Jamaica's merchandise trade in 2003, economic activity expanded by 2.9 per cent in 2004. Growth in real output was partly attributed to approximate increases of 5.0 per cent and 3.3 per cent in investment and consumer spending, respectively. In addition, Canada's exports of goods and services, particularly to the USA, increased by approximately

5.5 per cent in 2004, after registering a decline of 2.4 per cent in 2003. Increases in commodity prices largely accounted for the widening of Canada's current account surplus to 2.9 per cent in 2004, compared with a surplus of 2.0 per cent in 2003. Inflation in Canada fell to 1.9 per cent over the course of the year, relative to 2.7 per cent in 2003.

Real GDP in Japan expanded by 4.4 per cent in 2004, relative to growth of 2.5 per cent in 2003. The expansion in real output was associated with increased exports to Asia and an expansion in business investment spending. The strong growth in exports also contributed to the widening of that country's current account surplus by 0.2 percentage points to 3.4 per cent of GDP in 2004, relative to 2003. Japan continued to experience negative inflation of 0.2 per cent in 2004, similar to the rate in 2003, in part the result of a 7.2 per cent appreciation in the yen vis-à-vis the US dollar.

6.1.3. Developing Economies

The developing countries also experienced robust increases in economic activity. Growth in real gross domestic product (GDP) for this group was 6.6 per cent in 2004, relative to 6.1 per cent in 2003. The developing economies of the Asian region experienced the highest growth rate, fuelled primarily by strong growth in investment spending and net external demand, particularly from China. However, the most significant acceleration in real output was experienced among the developing economies of the Western Hemisphere. These economies expanded by approximately 4.6 per cent in 2004, relative to a 1.8 per cent expansion in 2003, supported by strong growth in exports in the context of increases in commodity prices during the year.

Within the Latin American region, strong growth of 12.1 per cent and 4.0 per cent was experienced in Venezuela and Mexico, respectively, the major oil exporters within the region. The expansion in economic activity reflected higher oil production, underpinned by increases in external demand for the commodity, as well as a pickup in domestic demand. The economies of Uruguay and Brazil also expanded by 10.0 per cent and 4.0 per cent, respectively, during the year, reflecting robust export growth and increases in domestic demand. The Dominican Republic was the sole country within the Latin American region that experienced a decline in real output during the year, the result of high oil prices and the continued adverse effects of the financial sector crisis of 2003.

The annual average change in the price index for Latin American countries was 12.0 per cent in 2004, compared with 14.0 per cent in 2003. This lower rate of inflation was in part attributed to the tightening of monetary policy in several of the region's economies, in particular Brazil. However, inflation pressures remained relatively high in the region, due in part to higher oil prices and exchange rate depreciations during the year.

Table 36

SELECTED DEVELOPING COUNTRIES REAL GDP & CONSUMER PRICES (ANNUAL PERCENT CHANGE)				
Country	**GDP**		**Inflation Rate****	
	2003	2004*	2003	2004
Developing Countries	6.1	6.6	6.1	6.0
Western Hemisphere	1.8	4.6	10.6	6.5
Latin America				
Argentina	8.8	7.0	13.4	4.8
Brazil	-0.2	4.0	14.8	6.6
Chile	3.3	4.9	2.8	1.1
Colombia	3.7	4.0	7.1	6.0
Costa Rica	5.6	3.8	9.4	10.2
Dominican Republic	-0.4	-1.0	27.4	55.5
Ecuador	2.6	5.4	7.9	3.2
Mexico	1.3	4.0	4.5	4.4
Paraguay	2.6	2.1	14.2	5.2
Uruguay	2.5	10.0	19.4	9.8
Venezuela	-7.6	12.1	31.1	23.7
Caribbean				
Antigua & Barbuda	2.5	1.0	2.5	2.5
Barbados	2.2	3.0	1.5	1.5
Dominica	0.0	1.0	1.6	2.3
Guyana	-0.8	2.4	6.0	4.5
Jamaica	2.3	1.3	10.3	13.6
St. Kitts/Nevis	2.1	2.4	1.4	1.5
St. Lucia	2.3	2.0	1.0	1.0
Trinidad & Tobago	13.1	6.2	3.0	4.0
Developing Asia				
China	9.1	9.0	1.2	4.0
India	7.2	6.4	3.8	4.7
Indonesia	4.1	4.8	6.8	6.5
Malaysia	5.3	6.5	1.1	2.2
Philippines	4.7	5.2	3.0	5.4
Thailand	6.8	6.2	1.8	2.7

Sources: The World Economic Outlook, September 2004, Statistics Offices of individual countries,
** Estimates, **Annual average*

For the Caribbean sub-region, there was growth in economic activity in 2004, despite the adverse effects of the hurricanes that affected the region over the last half of the year[18]. Trinidad and Tobago continued to record strong growth in 2004, despite experiencing a deceleration relative to 2003. The main engine for growth was the energy sector, with oil production increasing by approximately 46.0 per cent during the year, compared with an increase of 12.6 per cent in 2003. Growth in real output in Guyana was estimated at 2.4 per cent in 2004, which compares favourably with the decline of 0.8 per cent the previous year. This growth

[18] *Official statistics on Grenada are unavailable due to the impact of Hurricane Ivan. It is estimated however that the Grenadian economy will experience a significant decline in real output in 2004. Prior to the hurricane, Grenada was expected to record growth of approximately 4.5 per cent in 2004, relative to 2.5 per cent in 2003.*

was related to increases in bauxite and other agricultural commodity exports during the year. Economic activity in Barbados and the economies of the Organisation of Eastern Caribbean States expanded steadily during the year, underpinned by an improvement in tourism and agriculture. With the exception of Jamaica, inflation in the Caribbean remained low and stable during 2004, compared with 2003.

6.1.4. Commodity Markets

The IMF's index of primary commodity prices recorded an increase of 26.0 per cent in 2004, compared with 13.1 per cent in 2003. The increase was primarily attributed to significant increases in energy and metals prices. The main development in energy markets during 2004 was the significant rise in crude oil prices and the increased price volatility that obtained during the year. The average price of crude oil, as measured by the West Texas Intermediate index, increased by 34.6 per cent in 2004. Given this increase, the average price per barrel of oil surpassed the record highs reached during the 1990 invasion of Kuwait by Iraq.

Several factors underpinned the significant increase in oil prices for 2004. The International Energy Agency (IEA) reported an increase in oil demand of 3.2 per cent for 2004, representing the fastest annual increase since 1980. This expansion in demand primarily reflected the growth in China, North America and other non-OECD countries (including Brazil and India). In addition, supply concerns were raised with regard to Iraq and Nigeria, where, for the former country, the sabotage of oil wells and, for the latter, a general strike by oil workers reduced the export of the commodity during the year. The take-over by the Russian government of Yukos Oil Company, the second largest Russian oil company, also served to increase supply concerns. Unexpected declines in US inventories, particularly in October 2004, adversely affected the market towards the end of the year. There was also a marked increase in speculative activity in the futures market for crude oil (in particular, on the New York Mercantile Exchange (NYMEX)), which exacerbated price pressures. This increased activity in the market was reflected in a 27.0 per cent increase in crude oil futures and option contracts, as well as an increase of 17.5 per cent in the ratio of non-commercial contracts[19] to total open contracts[20], relative to 2003. In response to the surge in prices, OPEC sought to augment supplies by increasing the official export quotas of member states by 2.0 million barrels per day (mbpd) in July 2004 and a further 0.5 mbpd in August 2004.

Following an increase of 11.8 per cent in 2003, metals prices grew significantly by 36.4 per cent in 2004. The price of copper, tin and lead recorded the strongest increases during the year, reflecting robust world demand. The price of aluminium also recorded an increase of approximately 20.0 per cent in 2004, compared with an increase of 6.1 per cent in 2003. The surge in the price of aluminium was attributed to growing demand, primarily from China.

Non-fuel commodity prices also experienced gains during the year with the food and beverages sub-indices increasing by 13.7 per cent and 3.0 per cent, respectively, relative to 2003. The increase in the food

[19] *A trader's reported futures positions in a commodity are classified as non-commercial if the trader uses futures contracts in that particular commodity for other purposes than hedging, for example, speculating.*
[20] *Open interest is the total number of futures contracts that have not expired or been fulfilled by delivery.*

Table 37

SUMMARY OF WORLD COMMODITY PRICES		
(Annual per cent change)		
	2003	2004
All Primary Commodities	13.1	26.3
1. Non-fuel Commodities	7.0	18.0
1.1 Edibles	5.8	12.5
(a) Food	5.9	13.7
(b) Beverages	4.9	3.0
1.2 Industrial Inputs	8.5	22.9
(a) Agricultural Raw Materials	3.8	3.8
(b) Metals	11.8	36.4
2. Energy	16.7	30.9
Petroleum /1	9.6	34.8

Source: IMF Primary Commodity Prices
/1 *West Texas Intermediate measure*

sub-index largely reflected a 23.2 per cent increase in the price of rice, after a disappointing harvest in China resulted in above-average imports to that country. Low global rice inventories also supported the increase in the price of the commodity. The beverages sub-index grew by 3.0 per cent in 2004, reflecting an increase of 18.2 per cent in the average price of coffee (arabica), relative to 2003. The increase in coffee prices reflected increased concerns during the year about Brazilian weather conditions.

6.1.5. Trade Negotiations

During the review period, Jamaica, along with other CARICOM countries, continued its engagement in external trade negotiations, which were geared towards the realisation of the WTO's Doha Development Agenda (DDA), the Economic Partnership Agreement (EPA) between CARIFORUM countries and the European Union (EU) and the establishment of the CARICOM Single Market and Economy (CSME). Jamaica also played an integral role at the level of the WTO Disputes Settlement Understanding (DSU) system as a third party to Brazil's challenge of the European Community's (EC) common market organisation for sugar.

On 31 July 2004, the General Council of the WTO reached a consensus on framework agreements for pursuing the multilateral trade talks[21]. With regard to agriculture, the framework agreement stipulated the elimination of export subsidies, the reduction of trade distorting domestic support policies and substantial tariff reductions. Developing countries would, however, continue to benefit from special and differential treatment. The agreement also launched negotiations on trade facilitation, one of the four Singapore issues, with the remaining three issues being removed from the formal agenda. The "July package" opened the way for more detailed negotiations, which are scheduled to begin in 2005.

[21] *The negotiations towards the realisation of the WTO's DDA had stalled in 2003, as member states were unable to arrive at a consensus on substantive concerns related to the 'Singapore issues' and agriculture. The Singapore issues first emerged in 1996 at the WTO Ministerial Conference in Singapore.*

The Caribbean was the first within the ACP grouping to hold detailed discussions in 2004 with the EU on the scope and priorities of the EPA negotiations. It was agreed that special and differential treatment should form the core element of the EPA and should not necessarily be limited to the existing provisions under the WTO. The reorienting of assistance to address the development of new industries, as well as older ones, such as sugar and bananas, was also discussed. These discussions formed a precursor to the launch of the second phase of the CARIFORUM/EU EPA negotiations in September 2004. This phase of the negotiations is expected to continue until September 2005, with the aims being the establishment of a common understanding on the priorities for EU's support of Caribbean regional integration efforts, the identification of the sources of assistance which are required for CARIFORUM capacity building, and the targets to be attained at the time of the agreement's implementation on 1 January 2008.

Jamaica, Trinidad & Tobago and Barbados "fast-tracked" their efforts toward the establishment of the CSME by early 2005. Member states sought to remove the legal and administrative restrictions on the Right of Establishment, the Provision of Services and the Movement of Capital during the year. For Jamaica, this was realized with the passing of CARICOM 2004 Act, which established the legality of the CARICOM Court of Justice (CCJ)[22] and the supremacy of the requirements of the Treaty of Chaguaramas over Jamaica's laws (excepting the Constitution of Jamaica) and the Caribbean Community (Movement of Factors) Bill, which allows the free movement of people, services and capital within the region across Jamaican borders. It is anticipated that all members of CARICOM will participate in the CSME by 2006.

During the year, Jamaica, along with other members of the ACP states, played an active lobbying role in the sugar dispute, which was initiated against the EC by Brazil. In the dispute before the WTO's dispute settlement panel, Brazil alleged that the EC's export subsidies on sugar exceeded its WTO agreed limit and claimed that EC's common market organisation for sugar stifled competition and distorted prices on the international market. The WTO's dispute resolution panel issued a preliminary ruling in September 2004 in favour of Brazil. The concerns about the potential impact of the erosion of preferences for sugar was heightened during the year by the EC's announcement on 14 July 2004 of its proposal to reform its common market organization for sugar. The reform proposal sought to maintain preferential access for ACP sugar producing countries, while reducing the price ACP exporters receive by more than a third. The proposal would take effect from July 2006, on a phased basis, in two steps over three years of implementation.

6.1.6. Prospects for 2005

The IMF's World Economic Outlook suggests that world output will grow by 4.3 per cent in 2005. It is anticipated that the advanced economies will expand by 2.9 per cent, while the developing economies will grow by 5.9 per cent in 2005. This expected deceleration in growth for the world economy, relative to the growth in 2004, is attributed to an anticipated moderation in growth in the USA and China. Growth in these respective economies in 2005 is expected to decelerate

[22] *The CARICOM 2004 Act was subsequently rendered null and void by a ruling of the British Privy Council in February 2005 as to the constitutionality of the CCJ as a final court of appeal.*

by 0.8 and 1.5 percentage points, to 3.5 per cent and 7.5 per cent. The moderation in growth in the USA is set against the background of weaker than expected growth in real output during the December 2004 quarter. For China, the authorities have sought to tighten monetary policy in an effort to prevent the incipient "overheating" of the economy. Further tightening in monetary policy is expected in 2005.

Inflation pressures within the world economy could strengthen in 2005, in a context of low spare capacity for oil production. In this regard, the international oil market is expected to remain volatile during the year. This could necessitate a further tightening of monetary policy among the advanced economies during the year. In most cases, however, the risk of a marked pick-up in inflation appear moderate given the excess capacity in the economies and relatively moderate labour market pressures. The other main concerns for the global economy include the growing US current account deficit, which may require further adjustment in the exchange rate for the US dollar against its major trading partners and fiscal tightening during the year.

In the area of international trade negotiations, there appears to be a renewed effort to resume formal negotiations at the level of the WTO on the specific commitments that would lead to a successful conclusion of the DDA. There also appears to be a deeper recognition by both developed and developing countries of the need to protect sensitive and special products. However, for Jamaica and the other ACP countries, the outlook for specific negotiations related to the protected ACP markets in the EU, remains uncertain.

6.2. Balance of Payments

Jamaica's balance of payments (BOP) continued to strengthen in 2004, despite the negative effects of Hurricane Ivan on some of the major foreign exchange earning sectors. The improvement in Jamaica's external position, which started in 2003, was influenced by strong growth in the major developed economies **(see International Economic Developments**), which had a positive impact on alumina exports, tourism and private transfers. In this context, the current account deficit is estimated to have contracted by US$63.9 million to US$699.5 million (7.8 per cent of GDP) in 2004. An expansion of US$141.8 million in the surplus on the *current transfers* account, complemented by a US$2.3 million contraction in the merchandise trade deficit, were the main factors influencing the improvement in the current account during the review period. The impact of these changes was partly offset by an increase of US$79.8 million in net payments on the *income* account and a fall of US$0.5 million in the surplus on the *services* account.

A surplus of US$696.5 million on the *financial* account reflected net official and private investment inflows of US$479.2 million and US$910.8 million, respectively. When combined with the *capital account* surplus of US$3.0 million, these flows were more than sufficient to finance the deficit on the *current account*. Consequently, the net international reserves of Jamaica increased by US$693.5 million in 2004 (**see Table 38**).

Table 38

SUMMARY OF BALANCE OF PAYMENTS (US$M)

	1/ 2002	1/ 2003	2/ 2004	Change
CURRENT ACCOUNT	**-1073.9**	**-763.4**	**-699.5**	**63.9**
A. GOODS BALANCE	**-1870.3**	**-1942.2**	**-1939.9**	**2.3**
Exports (f.o.b.)	1309.2	1385.7	1586.1	200.4
Imports (f.o.b.)	3179.5	3327.9	3525.9	198.0
B. SERVICES BALANCE	**315.0**	**561.1**	**560.6**	**-0.5**
Transportation	-245.6	-143.6	-163.5	-19.9
Travel	950.6	1102.7	1150.2	47.6
Other Services	-390.0	-397.9	-426.1	-28.2
GOODS & SERVICES BALANCE	**-1555.3**	**-1381.1**	**-1379.2**	**1.8**
C. INCOME	**-605.5**	**-571.4**	**-651.2**	**-79.8**
Compensation of employee	82.1	70.7	96.5	25.8
Investment income	-687.6	-642.1	-747.7	-105.6
D. CURRENT TRANSFERS	**1086.9**	**1189.1**	**1330.9**	**141.8**
General Government	107.6	105.2	104.7	-0.5
Other Sectors	979.3	1083.9	1226.2	142.3
2. CAPITAL & FINANCIAL A/C	**1073.9**	**763.4**	**699.5**	**-63.9**
A. CAPITAL ACCOUNT	**-16.9**	**-0.3**	**3.0**	**3.3**
General government	0.2	0.1	0.1	0.0
Other Sectors	-17.1	-0.4	2.9	3.3
B. FINANCIAL ACCOUNT	**1090.8**	**763.7**	**696.5**	**-67.2**
Other Official Investment	77.1	-363.8	479.2	843.0
Other Private Investments 3/	770.0	695.3	910.8	215.5
Reserves 4/	243.7	432.1	-693.5	

1/ Revised

2/ Estimates

3/ Includes Errors & Omissions

4/ Minus denotes increase

6.2.1. Merchandise Trade

Exports

Total earnings from merchandise exports were estimated at US$1 586.1 million (17.8 per cent of GDP) in 2004. *General merchandise* exports, valued at US$1 411.2 million, continued to account for the largest portion of total exports, while *freezone exports* and *goods procured in ports* by foreign carriers totalled US$126.8 million and US$48.0 million, respectively (**see Table 39**).

Table 39

TRADITIONAL & NON-TRADITIONAL EXPORTS (US$M)

	1/ 2003	2/ 2004	Change	% Change
GENERAL MERCHANDISE EXPORTS	**1196.0**	**1411.2**	**215.2**	**18.0**
DOMESTIC EXPORTS	1166.9	1372.0	205.1	17.6
Major Traditional Exports	863.7	1012.7	149.0	17.3
Bauxite	90.1	79.2	-10.9	-12.1
Alumina	688.4	822.5	134.1	19.5
Sugar	66.3	98.1	31.8	48.0
Bananas	18.8	12.8	-6.0	-32.0
Other Traditional Exports	67.5	76.0	8.5	12.7
Citrus	3.3	2.2	-1.1	-33.5
Cocoa	3.5	1.9	-1.5	-44.5
Coffee	29.5	39.5	9.9	33.6
Pimento	2.8	2.2	-0.6	-21.7
Rum	27.4	28.5	1.1	4.1
Gypsum	1.0	1.8	0.8	77.4
Non Traditional Exports	235.8	283.3	47.5	20.2
RE-EXPORTS	29.1	39.2	10.2	34.9
FREEZONE EXPORTS	**141.7**	**126.8**	**-14.9**	**-10.5**
GOODS PROC. IN PORTS	**48.0**	**48.0**	**0.0**	**0.0**
GRAND TOTAL	**1385.7**	**1586.1**	**200.4**	**14.5**

1/ Revised

2/ Estimates

Earnings from merchandise exports grew by 14.5 per cent in 2004 following growth of 5.8 per cent in 2003 (**see Chart 16**). The growth in exports was influenced by a 18.0 per cent (US$215.2 million) expansion in the value of *general merchandise exports*, partly offset by a 10.5 per cent (US$14.9 million) decline in earnings from *freezone exports*. Within *general merchandise exports*, respective expansions of US$149.0 million, US$47.5 million and US$10.2 million were recorded for *major traditional exports*, *non-traditional exports* and *re-exports*.

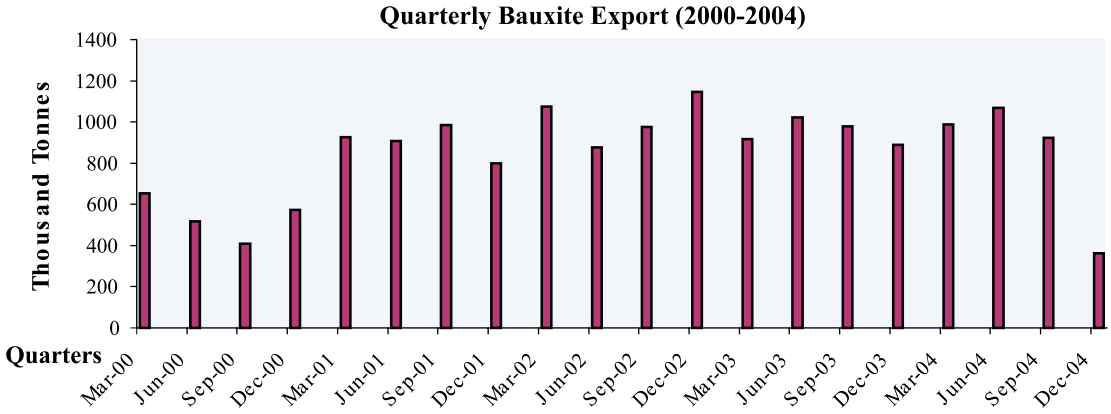
Chart 15

The growth in earnings from *major traditional exports* reflected respective expansions of US$134.1 million and US$31.8 million in receipts from alumina and sugar. Earnings from bauxite and banana exports, however, fell by US$10.9 million and US$6.0 million, respectively. The performance of alumina exports during 2004 was attributed to respective increases of 13.9 per cent and 4.9 per cent in the average price of the ore and volumes exported. Higher alumina prices in 2004 were largely influenced by robust demand for aluminium, associated with world economic growth, especially in China. The growth in the volume of alumina exports was facilitated by a 400 000 tonne expansion in the capacity of the sector during the review year. However, in the context of delays in production associated with Hurricane Ivan, capacity utilization declined to 95.7 per cent in 2004 from 99.8 per cent in 2003.

Lower earnings from bauxite exports in 2004, relative to 2003, largely reflected a 12.3 per cent decline in export volumes, most of which was attributed to a fall of 59.3 per cent in exports in the December 2004 quarter. This decline represented an 11.4 percentage points decline in capacity utilization to 74.1 per cent for the year. Exports during the quarter was affected by technical problems as well as hurricane damage to the loading facility at the St. Ann Bauxite Company (**see Production**), which reduced exports in the quarter to the lowest level in a decade (**see Chart 16**).

The value of sugar exports amounted to US$98.1 million in 2004, representing a 48.0 per cent increase, relative to the level of earnings in 2003. Export volumes and the average realised price (ARP) per tonne of sugar were estimated to have expanded by 43.4 per cent and 3.2 per cent, respectively. The growth in export volumes was associated with improvements in both the quality and quantity of sugar cane milled. The improvement in the quality of the crop was evidenced by a decline in the tonnes cane to tonnes sugar (TC/TS) ratio to 11.2 in 2004 from 11.6 in 2003. Production and export for the year were not affected by the passage of Hurricane

Chart 16



Ivan in September, given that the 2004 crop-year ended in July. The increase in the ARP partly reflected the appreciation in the Euro vis-à-vis the US dollar during 2004 (**see International Economic Developments**).

Earnings from banana exports were estimated to have contracted by US$6.0 million (32.0 per cent) in 2004, relative to 2003. The fall-off in earnings from banana in 2004 largely reflected a 30.7 per cent decline in export volumes, principally associated with the destruction of the crop by Hurricane Ivan. As a result, there was no export of the fruit in the December 2004 quarter.

Total earnings from *non-traditional exports* rose by 20.2 per cent in 2004, mainly reflecting increased earnings from chemicals, mineral fuels as well as manufactured goods exports. The estimated 34.9 per cent increase in *re-exports* was partly associated with the export of petroleum derivatives by Petrojam to the USA.

Imports

There was an increase of US$221.3 million (or 5.7 per cent) in total spending on merchandise imports (c.i.f.) in 2004. This increase was influenced primarily by a US$248.3 million expansion in *general merchandise imports*, which was partly offset by a decline of US$27.6 million in *freezone imports* (**see Table 40**). The expansion in general merchandise imports principally reflected increased imports of manufactured goods, food, mineral fuels and miscellaneous manufactured goods. These increases were partially offset by a decline in the value of chemical imports.

Table 40

VALUE OF IMPORTS BY SITC (C.I.F.) (US$M)	1/ 2003	2/ 2004	Change	% Change
GENERAL MERCHANDISE IMPORTS	**3678.9**	**3927.2**	**248.3**	**6.7**
1. BEVERAGE & TOBACCO	487.4	527.3	39.9	8.2
2. CRUDE MATERIALS	33.5	46.2	12.8	38.1
3. MINERAL FUELS	52.0	68.0	16.0	30.7
4. ANIMAL & VEGETABLE OIL	830.1	910.5	80.4	9.7
5. CHEMICALS	24.1	32.4	8.3	34.7
6. MANUFACTURED GOODS	444.1	403.2	-40.9	-9.2
7. MACHINERY & TRANSPORT EQUPT	486.4	563.1	76.7	15.8
8. MISCELLANEOUS MANUFACTURED GOODS	878.9	880.7	1.8	0.2
9. MISCELLANEOUS COMMODITIES	384.0	426.4	42.4	11.0
10.BEVERAGE & TOBACCO	58.5	69.4	10.8	18.5
FREEZONE	**94.3**	**66.7**	**-27.6**	**-29.3**
GOODS PROC. IN PORTS	**76.2**	**76.8**	**0.6**	**0.8**
GRAND TOTAL	**3849.4**	**4070.6**	**221.3**	**5.7**

1/ Revised

2/ Provisional

Higher international grain prices, in conjunction with increased importation of agricultural products following the hurricane, were partly responsible for the expansion of US$39.9 million in food imports. Increased spending on mineral fuel imports was associated with a 34.8 per cent increase in international crude oil prices during 2004 (**see International Economic Developments**). The expansion in the value of manufactured goods imports primarily reflected growth in durable, semi-durable, non-durable, as well as other miscellaneous manufactured goods imports.

6.2.2. Services

Net earnings from *services* is estimated to have declined by US$0.5 million to US$560.6 million in 2004. This fall principally reflected higher deficits on the *transportation* and *other services* sub-accounts. An increase of US$47.6 million in the surplus on the *travel* sub-account served as a partial countervailing influence.

Transportation

Net payments for *transportation* services, estimated at US$163.5 million in 2004, represented an expansion of US$19.9 million, relative to 2003. The deterioration primarily reflected increased outflows of US$25.8 million, mainly related to freight charges on higher volumes of imports. Higher inflows, which stemmed from the increased conveyance of visitors to the Island by the national carrier, served to partially mitigate the increase in outflows.

Travel

The *travel* sub-account continued to grow in 2004, despite the effects of Hurricane Ivan on the tourism

Table 41

VISITOR ARRIVAL STATISTICS

	1/ 2003	2/ 2004	% Change
Total Stop-overs	**1350284.0**	**1414786.0**	**4.8**
Foreign National Stopovers	1262108.0	1326918.0	5.1
Long-stay	1186780.0	1253917.0	5.7
Short-stay	75328.0	73001.0	-3.1
Non-resident Jamaican stopovers	88176.0	87868.0	-0.3
Cruise Passengers & Armed Forces	**1133411.0**	**1099773.0**	**-3.0**
Total Visitors	**2483695.0**	**2514559.0**	**1.2**
Gross Estimated Expenditure (US$M)	**1355.1**	**1436.4**	**6.0**

1/ Revised

2/ Provisional

sector. Gross earnings from visitor expenditure was estimated to have increased by 6.0 per cent to US$1 436.4 million (16.1 per cent of GDP) in 2004. However, the growth in earnings was partly offset by an increase of US$33.8 million in the expenditure of Jamaicans traveling oversees, including temporary workers abroad.

The overall growth in visitor expenditure resulted from an increase of 1.2 per cent in total visitor arrivals, influenced primarily by an increase of 4.8 per cent in stop-over visitor arrivals. The expansion in stop-over arrivals reflected growth of 5.1 per cent in foreign nationals and a marginal decline of 0.3 per cent in non-resident Jamaicans (**see Table 41**). For the year, cruise passenger arrivals declined by 3.0 per cent. Average daily expenditure per stop- over visitor was estimated at US$97.5, representing an increase of 2.3 per cent, compared with the previous year, while cruise visitors spent an estimated US$84.30 per day, representing an improvement of 4.3 per cent. The average stay of stopover visitors to the Island remained relatively constant at 10.0 days.

Growth in stop-over visitor arrivals was associated with increased marketing efforts of the Jamaica Tourist Board (JTB) and the addition of new airlift capacity to the Island, partially through new air routes by Continental and United Airways. In addition, a real depreciation of the Jamaica Dollar vis-à-vis the currencies of Jamaica's main trading partners, fostered in part by the depreciation of the US dollar vis-à-vis the Euro and the Pound Sterling, engendered growth in the sector. In this context, there were strong expansions of 16.8 per cent, 7.9 per cent and 10.9 per cent in arrivals from the European, UK and Canadian markets, respectively. Visitors from Europe accounted for 17.1 per cent of total stop-over arrivals in 2004, up from 16.2 per cent in 2003. This positively affected the average length of stay, as well as the average expenditure per person for the year. There was also an increase in activities by Spanish hotel chains in the Island as the sector benefited from the opening of a 420 room all-inclusive hotel in Negril.

The performance of visitor arrivals in 2004 represented a deceleration in growth rate, when compared with the increase of 16.4 per cent in 2003. The slower rate of growth in stop-over visitor arrivals and the decline in cruise passenger arrivals occurred in the context of the passage of Hurricane Ivan which damaged hotel infrastructure as well as caused delays and cancellations of several scheduled cruise vessels during the second half of the year **(see Production**).

The performance of Jamaica's stop-over arrivals in 2004 compared favourably with the average growth of selected Caribbean countries. Cuba and St. Lucia experienced strong growth in 2004, while Barbados, Dominican Republic and Martinique recorded expansions of similar magnitudes to Jamaica (**see Table 42**). The decline in cruise arrivals to Jamaica was, for the most part, in contrast to the growth experienced by other islands.

Other Services

The deficit on the *other services* sub-account continued to widen in 2004. Net payments for other services was estimated at US$426.1 million in 2004, a US$28.2 million increase, relative to 2003. This was influenced by an expansion of US$25.7 million in outflows, the effect of which was reinforced by a contraction of US$2.5 million in inflows.

Increased outflows for *other services* in 2004 mainly reflected higher payments for financial and other business services of US$9.7 million and US$13.8 million, respectively. The increase in charges for financial services was associated with Government's external debt raising activities, while the increase in other business services reflected an expansion in the payment of commissions by the travel sector. With regard to inflows, a contraction of US$2.3 million in financial services was responsible for the decline experienced in 2004.

6.2.3. Income

The deficit on the *income* account of US$651.2 million in 2004 surpassed the deficit in 2003 by US$79.8 million. This deficit reflected *net investment income* outflows of US$747.7 million, the effect of which was partly offset by net inflows of US$96.5 million for *compensation of employees* (**see Table 38**). Expansion of US$105.6 million in net *investment income* outflows was partially offset by an increase of US$25.8 million in compensation of employees during the review year. The deterioration in the investment income account was primarily associated with profit remittances by foreign direct investment companies. The increased inflows via compensation of employees[23] occurred despite the effect of Hurricane Ivan on the various job centres.

Table 42

Stopover Visitor Arrivals (Selected Caribbean Countries)

	2003	2004	% Change
Bahamas	1,428,599	1,450,043	1.5
Barbados	531,211	554,914	4.5
Cuba*	1,843,701	2,017,009	9.4
Dominican Republic	3,268,182	3,443,205	5.4
Martinique*	427,482	444,154	3.9
St. Lucia	276,948	298,431	7.8
Total	**7,776,123**	**8,207,756**	**5.6**

[23] *To Jamaicans working abroad for less than one year.*

6.2.4. Current Transfers

The *current transfers* account improved by US$141.8 million to US$1 330.9 million in 2004, relative to 2003, resulting primarily from a 13.1 per cent expansion in net inflows to the private sector. Gross transfer inflows to the private sector rose by US$199.5 million to US$1 613.0 million in 2004, which was partly offset by a 17.3 per cent increase (or US$57.1 million) in gross outflows (**see Table 43**). Notwithstanding the overall growth in inflows for the year, there was a slowdown in remittances to the Island in the final quarter. This was due primarily to the impact of Hurricane Ivan on Florida and Cayman Islands, two of the main sources of remittances.

Increased competition in the remittance market during 2004, as evidenced by the entry of five new players to the industry, served to enhance the service provided by the sector. The remittance companies, however, continued to account for the major share of inflows, despite the increased competition. The remittance companies acted as conduit for 47.3 per cent of total remittances in 2004, representing a marginal decline of 0.6 per cent relative to 2003. In contrast, the share of inflows through the financial institutions increased to 43.5 per in 2004, from 41.8 per cent in 2003. The postal and *other* agencies registered declines in their respective shares of total inflows.

Net current transfer inflows to the Government declined by US$0.5 million to US$104.7 million in 2004. This performance mainly reflected an expansion of US$2.4 million in outflows, which was partially offset by a rise of US$1.9 million in grant receipts, relative to 2003.

6.2.5. Capital and Financial Account

The *capital* account recorded a surplus of US$3.0 million in 2004. The *financial account* also recorded a surplus of US$696.5 million, representing an 8.8 per cent decline relative to the previous year (**see Table 38**). Within the *financial* account, the *other*

TABLE 43

CURRENT TRANSFERS (US$M.)

	1/ 2003	2/ 2004	Change
TOTAL RECEIPTS	**1523.5**	**1724.9**	**201.4**
General Government	110.0	111.9	1.9
Private Sector	1413.5	1613.0	199.5
Postal System	1.2	1.2	0.0
Financial System	591.3	701.2	109.9
Remittance Companies	677.0	763.4	86.4
Other	144.0	147.2	3.2
TOTAL PAYMENTS	**334.4**	**393.9**	**59.5**
General Government	4.8	7.2	2.4
Private Sector	329.6	386.7	57.1
Financial System	283.0	351.9	68.9
Other	46.6	34.8	-11.8
NET CURRENT TRANSFERS	**1189.1**	**1330.9**	**141.8**

1/ Revised

2/ Estimates

official investments sub-account recorded a net inflow of US$479.2 million in 2004, relative to a net outflow of US$363.8 million in the previous year. Influenced by favourable international market conditions, gross investment inflows to this sector expanded by US$846.8 million to US$960.2 million in 2004. Three Eurobonds totalling US$726.8 million were issued during the year, while an existing Eurobond was reopened in April raising US$125.0 million. Gross official payments of US$481.0 million, including a maturing Eurobond of US$210.8 million, were marginally above the level recorded in 2003.

Net private investments inflows grew by 31.0 per cent to US$910.8 million in 2004, reflecting foreign direct and portfolio investments flows, as well as substantial borrowing by Government on the local market. This surplus, combined with overall positive balances on the official investment and the *capital* account, was more than sufficient to finance the deficit on the *current account*. As a consequence, the net international reserves of the country expanded by US$693.5 million to US$1 862.2 million at the end of 2004.

The growth in the stock of Jamaica's gross foreign assets during 2004, largely reflected a substantial build-up in Bank of Jamaica's NIR, partly associated with Government's US dollar borrowing activities on both the local and international capital markets. The level of gross reserves for Jamaica at the end of December 2004 stood at US$1 885.6 million, representing an estimated 27.4 weeks of goods imports, or 18.6 weeks of imported goods and services.

Table 44

OTHER OFFICIAL INVESTMENT FLOWS
(US$M)

	1/ 2003	2/ 2004	Change
GROSS OFFICIAL INFLOWS	**113.4**	**960.2**	**846.8**
Donor Countries	0.0	0.0	0.0
Multilateral Institutions	0.0	49.4	49.4
Other Assistance	50.0	856.5	806.5
Project Loan	63.4	54.3	-9.1
GROSS OFFICIAL OUTFLOWS	**477.1**	**481.0**	**3.9**
Government Direct	476.8	477.5	0.7
Bank of Jamaica	0.3	3.4	3.2
NET OFFICIAL INVESTMENTS	**-363.8**	**479.2**	**843.0**

1/ Revised
2/ Provisional

TABLE 45

FOREIGN EXCHANGE RESERVES
(US$M)
As at December 31

	1/ 2003	2/ 2004	Change
GROSS FOREIGN ASSETS	**1200.0**	**1885.6**	**685.6**
Bank of Jamaica	1196.3	1881.9	685.6
Central Government	0.6	0.7	0.1
Other official Institutions	3.1	3.0	-0.1
GROSS FOREIGN LIABILITIES	**31.3**	**23.4**	**-7.9**
OFFICIAL NET INTERNATIONAL RESERVES	**1168.7**	**1862.2**	**693.5**
Weeks of estimated imports of Goods and services	12.3	18.6	

1/ Revised

2/ Provisional

6.3. Foreign Exchange Management

6.3.1. Bank of Jamaica International Reserves

The net international reserves (NIR) of the BOJ grew by US$693.5 million to US$1 858.5 million during 2004. The NIR increased during every quarter of 2004, with the most significant increase of US$403.7 million occurring in the March quarter (**See Table 46**). Significant purchases from the market accounted for this increase in the stock.

Total foreign liabilities declined to US$23.4 million at the end of 2004, from US$31.4 million at the end of December 2003. The reduction reflected payments of US$7.95 million to the IMF during 2004.

Table 46

NET INTERNATIONAL RESERVES (NIR)
US$MN

	2003 Dec.	2004 Mar.	June	Sept.	Dec.	Annual Change ($)
NIR	1165.0	1568.7	1604.1	1616.5	1858.5	693.5
Gross Foreign Assets	1196.3	1596.9	1630.3	1640.7	1881.9	685.6
Foreign Liabilities	31.4	28.2	26.2	24.2	23.4	-7.9

6.3.1.1. Foreign Exchange Inflows and Outflows

Inflows

Foreign exchange inflows to the BOJ for 2004 totalled US$2 112 million, an increase of US$751.5 million relative to 2003. The main sources of inflows were the purchases of Government's foreign currency receipts, funds from the bauxite sector, as well as from the domestic market (**see Table 47**).

Purchases from GOJ grant and loan flows were US$1,173.9 million, accounting for 55.8 per cent of total inflows. Another contributor to foreign currency inflows was market purchases. These volumes remained significant during 2004, accounting for US$662.4 million or 31.4 per cent of total inflows. This includes US$343.6 million purchased under the surrender arrangement[24] and US$318.8 million purchased directly from the market.

Purchases from the bauxite sector during 2004 were US$158.5 million, 16.3 per cent lower than in 2003. The lower inflows were in a context where production was interrupted following the passage of Hurricanes Charlie and Ivan in the September quarter and damage to the loading facility at St. Ann Bauxite Limited (formerly Kaiser Bauxite) in the December quarter.

[24] *Under the surrender arrangement, Authorised Dealers and Cambios agree to sell to the BOJ 5% – 10% of their purchases from the Clients segment of the market.*

Table 47

SOURCES OF FOREIGN EXCHANGE
US$MN

	Inflows		Change	
	2003	2004	($)	(%)
Exports & Services	**837.2**	**820.9**	**-16.4**	**-2.0**
Bauxite Receipts	189.4	158.5	-30.9	-16.3
Direct Purchases	**647.8**	**662.4**	**14.5**	**2.2**
Surrender to BOJ				
- authorised dealers	169.0	203.1	34.1	20.1
- cambios	151.9	140.5	-11.3	-7.5
Other purchases	327.0	318.8	-8.2	-2.5
Purchase of GOJ Loan Proceeds	**410.1**	**1124.7**	**714.6**	**174.2**
- Eurobond	0.0	805.4	805.4	-
- Local/Regional US$ bond	376.2	270.6	-105.6	-28.1
- Other loans	33.9	48.7	14.7	43.4
Grants	0.0	49.2	49.2	-
Divestment	0.0	0.0	0.0	0.0
Other Receipts*	113.2	117.2	4.0	3.6
Total Cash Inflow	**1360.5**	**2112.0**	**751.5**	**55.2**

** - includes income earned on foreign assets and funds lodged to sundry GOJ accounts at the BOJ*

6.3.1.2. Outflows

Total foreign currency outflows of US$1 426.4 million during 2004 were US$380.8 million lower than 2003. Foreign currency debt payments on behalf of the Government amounted to US$1 076.9 million, accounting for 75.5 per cent of total outflows.

In a relatively stable foreign exchange market during 2004, the Bank sold US$279.6 million to the market compared to US$739.3 million during 2003 (**see Table 48**).

6.3.2. Reserve Management

6.3.2.1.Performance

The Bank of Jamaica's foreign assets totalled US$1 881.9 million at 31 December 2004, US$685.6 million above the level at the end of 2003. Foreign investment income in 2004 amounted to US$42.8 million, an increase of US$12.8 million relative to the amount earned in 2003. The 32 per cent increase in average holdings of foreign assets was mainly responsible for the increased earnings. Income earned over the period translated to a return on

Table 48

USES OF FOREIGN EXCHANGE
US$MN

	Outflows		Change	
	2003	2004	($)	(%)
Public Debt	**994.4**	**1076.9**	**82.5**	**8.3**
- Principal	636.2	705.0	68.8	
- Interest	358.2	371.9	13.7	
Direct Sales	739.3	279.6	-459.7	-62.2
Other Payments	73.5	69.9	-3.6	-5.0
Total Cash Outflow	**1807.2**	**1426.4**	**-380.8**	**-21.1**

Table 49

Foreign Investment Income
For Year Ended 31 December

ASSETS	2003 US$M	2003 %	2004 US$M	2004 %
Euro Dollar Deposits	8.05	21.47	15.09	35.23
Bond Holdings	26.51	70.69	23.99	56.01
External Fund	1.46	3.89	1.46	3.41
Other	1.48	3.95	2.29	5.35
TOTAL	37.50	100.00	42.83	100.00
Portfolio Return	**3.13**		**2.70**	
Average Income Earning Assets	**1 198**		**1 585**	

investment of 2.70 per cent per annum compared to a return of 3.13 per cent per annum in 2003. This was due mainly to a reduction in the proportion of holdings of the higher yielding bonds, which in 2004 averaged 25 per cent of the Bank's portfolio compared to nearly 40 per cent in 2003. **Table 49** below provides details of earnings by asset class for the years 2003 and 2004.

6.3.2.2. Asset Distribution

The Bank continued to maintain a significant proportion of its reserves in US dollar denominated investments, influenced largely by the currency structure of Jamaica's international commerce and capital flows. **Table 50** shows the distribution of foreign assets by currency at 31 December 2003 and 2004.

Table 50

Currency Composition of Foreign Assets
at 31 December 2003 and 2004

	Currency (MN)		S$ Equivalent (MN)		% Share	
	2003	**2004**	**2003**	**2004**	**2003**	**2004**
US Dollar	1 088.18	1 616.37	1 088.18	1 616.37	90.96	85.88
Euro	26.37	122.08	33.22	165.26	2.78	8.78
Pound Sterling	28.15	29.91	50.23	57.30	4.20	3.05
Canadian Dollar	28.69	47.84	22.20	39.76	1.86	2.11
Yen	258.71	264.39	2.41	2.57	0.20	0.14
Other	-	-	0.09	0.67	0.01	0.04
TOTAL FOREIGN ASSETS			**1 196.33**	**1 881.93**	**100.00**	**100.00**

6.3.2.3 Investment Strategy

As in previous years and consistent with the Bank's policy guidelines, investment instruments such as United States Agency Bonds and Eurodollar deposits dominated the portfolio throughout 2004. **Table 51** shows the comparative breakdown by asset class at 31 December 2003 and 2004.

The benchmark 10-year US Treasury yield declined sharply during the first quarter, moving from a high of 4.4 per cent to a low of 3.7 per cent. As expected, this resulted in heavy redemption of callable United States Agency bonds by the issuers. Given the low re-investment rates available in the 5 to 10 year sector of the curve during that period there was limited replacement of these bonds.

During the second quarter the ten-year Treasury yield reversed the first quarter decline, spiralling upwards by as much as 102 basis points to 4.86 per cent, thereby providing an opportunity for the repositioning of the portfolio.

As the short term Federal Funds rate began to increase in the third quarter, the yield on the ten-year US Treasury note maintained a steady decline to a low of 3.98 per cent. There was limited recovery of yields in the fourth quarter as range trading took place within a slightly elevated band of 3.96 to 4.35 per cent. This led again to a build-up in the short-term sector as the Federal Open Market Committee (FOMC) continued to increase short-term rates by 25 basis points at each of its six-weekly sittings.

Table 51

DISTRIBUTION OF INVESTMENTS BY ASSET CLASS
at 31 December

	2003		2004	
ASSET CLASS	**US$ M**	**%**	**US$ M**	**%**
Cash	75.72	6.33	170.65	9.07
BHA	56.79	4.75	85.40	4.54
Euro Dollar Deposits	563.67	47.11	969.11	51.50
Auction Rate Certificates	0.00	0.00	144.35	7.67
U.S. Agency Bonds	458.20	38.30	470.02	24.97
Reserve Fund	41.95	3.51	42.40	2.25
TOTAL FOREIGN ASSETS	**1 196.33**	**100.00**	**1 881.93**	**100.00**

6.3.3. The Foreign Exchange Market

The foreign exchange market was characterized by relatively stable conditions in 2004, despite continuing increases in world oil prices throughout the year and the impact of Hurricane Ivan in September. This was manifested in the distinctly lower rate of depreciation in the value of the Jamaica Dollar against its three major counterparts – the United States dollar, the Canadian dollar and the Great Britain Pound – relative to previous years. At 31 December 2004, the weighted average selling rate for the Jamaica Dollar vis-à-vis the United States dollar was US$1.00 = J$61.63, a depreciation of 1.6 per cent when compared to US$1.00 = J$60.62 at end-December 2003. This rate of depreciation was the lowest since 1998 when the Jamaica Dollar recorded depreciation of 1.5 per cent. For 2003, the weighted average selling rate depreciated by 15.9 per cent.

During the first half of 2004, the foreign exchange market generally remained stable, with the Jamaica Dollar reflecting a daily average depreciation of 0.01 per cent relative to 0.11 per cent over the same period in 2003. This overall stability was supported by improved confidence in macroeconomic management, with a critical element being the Government's attainment of a better-than-budgeted deficit performance for FY 2003/04. Market confidence was sustained throughout the year, as in each successive quarter the Government continued to meet its fiscal targets. Additionally, NIR levels remained strong over the review period, having been bolstered, during the first half of the year, by the purchase of proceeds from Government's international bond issues.

Notwithstanding the general market stability, by mid-May the market was unsettled by investors' positioning to replace maturing proceeds from a GOJ US Dollar Indexed Bond. This entailed heightened demand for foreign exchange as investors sought to maintain their hedge in US dollars. Nonetheless, this was short-lived due to timely intervention by the Central Bank. Hence, the exchange rate depreciated by 0.6 per cent and 0.3 per cent in the March and June quarters, respectively. These movements compare favourably with 9.4 per cent and 4.7 per cent for the corresponding quarters of the previous year.

At the beginning of the September quarter, there was a re-emergence of some demand pressure. This was primarily attributed to the non-reissuance of a US Dollar Indexed Bond in July, followed by two (2) US dollar denominated bonds reissued by the Government in the domestic market. There was also evidence of wider spreads[25] on foreign exchange transactions, averaging 0.5 per cent for the quarter relative to the average of 0.4 per cent for the first half of the year. The September quarter experienced the largest quarterly depreciation for 2004, with the exchange rate depreciating by 1.2 per cent to end the quarter at US$1.00 = J$61.88.

During the December quarter, supply remained fairly buoyant and in contrast to the quarterly outturn in previous years, the exchange rate appreciated by 0.4 per cent. This was the first quarterly appreciation since the June quarter in 1998 of 0.3 per cent.

Foreign exchange purchases and sales reported by authorised dealers and cambios in 2004 were lower

[25] *Given as a percentage of the buying rate ((sell rate - buy rate) + buy rate) % 100*

than in 2003, with purchases and sales reflecting decreases of 8.7 per cent and 7.1 per cent, respectively (**see Table 52**). Excluding intervention, daily purchase and sale volumes during 2004 averaged US$31.0 million and US$31.3 million, respectively, compared to US$32.1 million and US$31.8 million reported for 2003. These declines of 3.8 per cent and 2.0 per cent in reported purchases and sales, respectively, were largely due to reduced inter-dealer trading, which averaged US$11.2 million and US$10.7 million daily compared to US$13.7 million and US$12.4 million daily in 2003. Despite the marginal decline in trading volumes relative to 2003, there was a general increase in the supply to the market from net earners, which corresponded with strong flows from tourism and remittances. In that regard, supply from net earners averaged US$19.8 million daily, relative to US$18.5 million in 2003, with the highest daily supply occurring during the December quarter, when it averaged US$20.5 million (**see Table 53**). The demand for foreign currency, based on sales to end-users, remained strong during the year averaging US$20.6 million daily, relative to US$19.4 million in 2003.

Authorised dealers increased their market share by 2.0 percentage points during 2004, accounting for 66.0 per cent of the total foreign exchange market activity, with cambios accounting for the remainder.

The market traded at a daily average spread of 0.47 per cent during 2004, a marginal decline relative to 0.52 per cent in 2003. This narrowing of the trading spread was indicative of the favourable conditions that obtained in the foreign exchange market during the year. In a context where the imbalances were less evident than the previous year, the Bank sold US$279.6 million relative to US$739.3 million in 2003.

The stability noted during 2004 was also influenced by the opportunities that emerged for institutions to conduct arbitrage or cross currency transactions. In this regard, the quantum of net sales in USD was frequently matched with net purchases in GBP, which would suggest that funds sourced through cross-trades may have contributed to the buoyancy in US liquidity in the domestic market. The generally buoyant USD liquidity and market stability would have encouraged end-users

Table 52

Purchases and Sales of Foreign Exchange (US$MN)

	Purchases		Sales	
Quarter	**2003**	**2004**	**2003**	**2004**
March	2 646.3	2 009.4	2 631.9	2 059.7
June	2 204.1	2 061.1	2 183.8	2 074.6
September	1 911.8	1 905.8	1 884.6	1 891.1
December	2 040.1	2 056.5	2 012.6	2 070.9
Total	**8 802.3**	**8 032.8**	**8 713.0**	**8 096.3**

Includes BOJ intervention

Table 52

Daily Average Trading Volumes (US$MN)						
2004	Purchases			Sales		
Quarters	from net earners	Inter-dealer	Total	to end-users	Inter-dealer	Total
March	20.18	11.27	31.45	21.47	10.78	32.25
June	19.92	11.45	31.37	20.76	10.82	31.58
September	18.46	10.80	29.26	18.85	10.17	29.02
December	20.51	11.40	31.91	21.22	10.92	32.13
Total per diem	19.78	11.23	31.01	20.59	10.68	31.27
2003	Purchases			Sales		
Quarters	from net earners	Inter-dealer	Total	to end-users	Inter-dealer	Total
March	19.97	20.03	40.00	22.95	16.82	39.77
June	17.33	13.83	31.16	18.49	12.35	30.83
September	17.82	10.11	27.93	17.84	9.66	27.51
December	18.68	10.90	29.58	18.44	10.71	29.15
Total per diem	18.45	13.68	32.12	19.41	12.35	31.77

** Data excludes BOJ Intervention*

to adopt a demand strategy that reflected their opting to acquire US dollars at the time of need, making the allocation of available foreign currency more efficient.

6.3.4 Cambio Licensing & Monitoring

The cambios continued to provide an effective means through which foreign exchange was traded as evidenced by the maintenance of approximately one-third of the foreign exchange market. Throughout the year, the Central Bank continued to discharge its supervisory responsibility through semi-annual on-site inspections. In that regard, a total of 221 inspections were conducted. In addition, ongoing dialogue was facilitated through quarterly meetings with the Cambio Association of Jamaica, where macroeconomic updates were provided and developments affecting cambio operations were discussed. Significant developments in 2004 were:

- Proposed amendments to the money laundering legislation
- Enhancements to the Bank of Jamaica Operating Guidelines

Cambios were sensitized to the proposed amendments to the money laundering legislation and counter-financing of terrorism techniques through the issuance of revised Guidance Notes to all Bank of Jamaica licencees in August. In recognition of the fundamental difference between cambio operations and deposit-taking institutions, a section specifically designed for cambios and remittance companies was included in the revised Guidance Notes. This section addressed Know Your Customer (KYC) policies and procedures.

The Bank of Jamaica enhanced its operating guidelines for cambios in early 2004, with the introduction of additional requirements for initial licensing and renewals, which include the submission of Tax Compliance Certificate and audited Financial Statements of the entities. The submission of audited Financial Statements previously applied to new applicants, but was now also

required for existing cambios seeking renewal of their licences. The assessment of significant shareholders, directors and managers of cambios, under the BOJ's 'Fit and Proper' criteria continued in 2004. A total of 103 persons were assessed.

In 2004, 12 new cambio locations were approved. Twenty-two cambio locations were closed (**see Table 54**) of which 21 voluntarily surrendered their licences, while the other licence was revoked for non-compliance with the BOJ's Operating Guidelines and the money laundering legislation. Consequently, at the end of 2004 there were 138 cambios representing 64 entities. These cambios were distributed across the island with 25.5 per cent in the parishes of Kingston and St. Andrew, 16.3 per cent in St. James and 13.5 per cent in St. Ann, being the areas of greatest concentration. These percentages compare to 22.3, 17.6 and 13.5 respectively in 2003 (**see Table 55**).

6.3.5. Remittance Licensing & Monitoring

In keeping with the international thrust of regulating institutions providing financial services, a licensing and

Table 54

Status of Cambio Licences As at 31 December 2004		
	2003	**2004**
Applications Approved	11	12
Cambios Closed	6	22
Total Cambios Licensed	148	138

Table 54

Geographical Distribution of Cambios as at 31 December 2004		
PARISH	**2003**	**2004**
	%	%
KINGSTON & ST. ANDREW	22.3	25.5
ST. JAMES	17.6	16.3
ST. ANN	13.5	13.5
WESTMORELAND	9.5	6.4
OTHERS	37.1	38.3
TOTAL	**100**	**100**

regulatory regime for companies which offer remittance services in Jamaica was introduced in February 2004. The BOJ was authorized to discharge this regulatory function by way of an amendment to the Bank of Jamaica Act. By virtue of the fact that companies which offer remittance services were designated financial institutions effective 15 January 2002, they were previously subject to the requirements under the money laundering legislation.

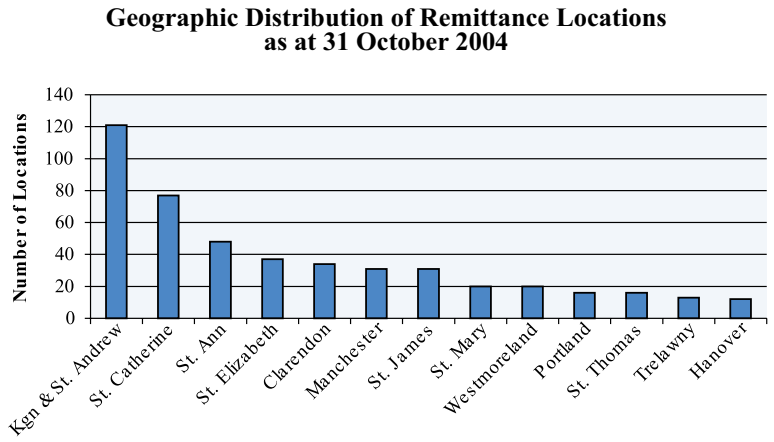
In order to fulfill this mandate, the BOJ drafted operating guidelines for companies offering remittances services in Jamaica and held discussions with the industry to obtain their input in finalizing these guidelines. The guidelines stipulate the standards against which the operations of remittance companies will be monitored. The regulatory regime will entail the issuing of licences to all companies approved to offer the service in Jamaica.

As at 31 October 2004, applications from 15 companies (primary agents)[26] that are currently offering the service in Jamaica as representatives of 25 overseas-based remittance service providers had been received and are being processed by the BOJ. Each primary agent offers the service through various branches and sub-agents from 476 locations island-wide, with 121 (25.4 per cent) located in Kingston & St. Andrew (**see Chart 17**). The primary agents were allowed to continue to operate at these locations, pending issue of the licences. However, prior approval will be required to operate from any location for which an application was not submitted prior to the deadline date of 31 October 2004. In addition, companies not currently being processed by the BOJ will require a licence before commencing operations to provide the service.

The licensing process entails, *inter alia*, the assessment of directors and significant shareholders of the company and the manager of each location under the BOJ's 'Fit & Proper' criteria. At end-2004, 531 persons were being assessed.

The regulatory function will be discharged through onsite inspections of primary agents and in-house monitoring through reports submitted electronically to the BOJ.

Chart 17



[26] *Primary Agents are local companies that conduct remittance transactions through branch offices and sub-agents.*

7. Production and Prices

7.1 Production

The Jamaican economy is estimated to have grown by 0.9 per cent in 2004, relative to a growth of 2.3 per cent in 2003 (**see Table 56**). The estimated expansion in real Gross Domestic Product (GDP) represented the sixth consecutive year of economic growth, not- withstanding the impact of a tropical storm and a hurricane on the economy in the second half of the year. The most significant impetus to growth emanated from services, which accounted for approximately 87.9 per cent of the growth in real GDP for the year.

Table 56

SECTORAL CONTRIBUTION TO GDP GROWTH (%)		
Sectors	Jan –Dec 2004	Contribution (2004)
1. GOODS	1.3	48.7
AGRICULTURE FORESTRY & FISHING	-8.9	-59.8
MINING & QUARRYING	2.6	15.4
MANUFACTURING	3.0	42.2
CONSTRUCTION & INSTALLATION	5.0	50.9
2. SERVICES	1.2	87.9
BASIC SERVICES	0.7	12.5
Electricity & Water	-0.1	-0.4
Transport Storage & Communication	0.9	12.8
OTHER SERVICES	1.3	75.5
Distributive Trade (Wholesale & Retail)	1.3	30.9
Financing & Insurance Services	-0.7	-6.4
Real Estates & Business Services	2.1	11.4
Producers of Government Services	0.2	2.4
Miscellaneous Services	4.3	37.1
Households & Private Non-Profit Instit.	0.3	0.2
3. IMPUTED SERVICE CHARGES	5.1	36.6
TOTAL GDP	0.9	100.0

Source: STATIN

Distributive trade, **miscellaneous services**, **transport, storage & communication** and **real estate & business services** were the main areas of growth in services. An expansion in the goods producing sectors during the year principally reflected growth in **manufacturing**, **construction** and **mining**.

The value added of the **agriculture** sector contracted by 8.9 per cent in 2004, compared with the growth of 4.8 per cent recorded the previous year. This contraction stemmed both from the *domestic agriculture* and *export agriculture* sub-sectors. The decline in output was due primarily to the impact of Hurricanes Charley and Ivan on agricultural production in the September and December 2004 quarters.

Estimates compiled by the Ministry of Agriculture indicate that, for 2004, domestic crop production declined by 15.6 per cent (**see Table 57**). Reports from the Ministry indicate that Hurricane Ivan resulted in damage to the domestic agriculture sector amounting to $2.3 billion (17.0 per cent of GDP). Approximately 31.0 per cent of the total hectares under cultivation, or 11,130 hectares, were affected by the hurricane. Agriculture was also affected by periodic dry spells in some parishes during the March 2004 quarter and island wide drought conditions in the June 2004 quarter. In addition to weather related factors, increases in the cost of inputs such as fertilizers, pesticides and some planting materials, adversely affected the sector. The scarcity and high cost of farm labour, as well as the continued high level of praedial larceny also hampered production.

The *export agriculture* sub-sector declined by 5.6 per cent in 2004. For the first half of the year, the sub-sector expanded by 15.0 per cent, but declined by 42.5 per cent in the second half. The performance in the second half was affected by severe weather conditions.

Table 57

DOMESTIC CROP PRODUCTION
Production ('000 tonnes)

Crop Group	2003	2004	% Change
Yams	152.2	136.2	-10.6
Vegetables	171.8	138.5	-19.4
Other tubers	35.6	32.4	-8.9
Fruits	46.6	35.2	-24.3
Condiments	26.2	22.7	-13.3
Plantains	20.2	17.8	-12.0
Potatoes	30.3	25.1	-17.0
Legumes	5.5	4.7	-14.9
Cereals	2.0	1.6	-21.6
Total	**491.5**	**414.8**	**-15.6**

Source: Ministry of Agriculture

For the review year the export of banana, citrus and cocoa declined by 28.9 per cent, 16.9 per cent and 12.4 per cent, respectively (**see Table 58**). Hurricane Ivan destroyed bananas under cultivation for the local and export markets as well as 35.0 per cent of the fruits in citrus. Output in the coffee industry did not fall in the current year although the hurricane affected the industry, as the crop year had already been completed, however, it is anticipated that output will be adversely affected in the 2005 crop year.

Sugar cane production grew by 10.4 per cent during 2004, attributable to the initiatives by the Sugar Corporation of Jamaica (SCJ) to rejuvenate the sector. These initiatives included better field management practices and additional hectares cultivated. In relation to sugar export, a growth of 43.3 per cent in volume was associated with an increase of 17.8 per cent in sugar production, the consequence of improvements

in both the quality and quantity of sugar cane milled. The improvement in the quality of the crop was evidenced by a decline in the tonnes cane to tonnes sugar (TC/TS) ratio to 10.9 in 2004 from 11.6 in 2003.

Table 58

EXPORT CROPS			
Crop	2003	2004	% Change
	Exports ('000tonnes)		
Banana	38.9	27.6	-28.9
Citrus	5.6	4.7	-16.9
Cocoa	1.1	1.0	-12.4
Coffee	1.5	1.6	7.2
Pimento	0.4	0.4	11.3
	Production (000'tonnes)		
Sugar cane	1779.6	1965.3	10.4

Sources: Bank of Jamaica Estimates & Sugar Corporation of Jamaica

The value added of the **mining** sector expanded by 2.6 per cent in 2004, a lower rate than the average growth of 3.6 per cent recorded between 2001 and 2003. For the year alumina production grew by 4.6 per cent. This growth was due to the addition of refining capacity at three alumina plants during the year. However, there was a decline in capacity utilisation to approximately 95.7 per cent from 99.8 per cent in 2003, attributed in part to Hurricane Ivan. Crude bauxite production declined by 13.4 per cent in 2004, this reflected a decline in capacity utilisation to 74.1 per cent from 85.5 per cent in 2003. Damage sustained to the loading gantry at the St. Ann Bauxite Company significantly affected output in the review year.

For **manufacturing**, the sector recorded growth of 3.0 per cent in 2004, the first notable increase since 2001. The sector grew by 5.9 per cent for the first half of the year, partly reflecting the normalisation of production in the sugar, molasses & rum and petroleum refining industries following reduced output levels over the same period in 2003. A decline of 0.2 per cent was recorded for the second half of 2004. This reduced growth was associated with the impact of Hurricane Ivan on production, given the temporary absence of electricity and potable water at various manufacturing companies. In addition, the closure of the Petrojam oil refinery in October reduced overall activity in that industry for the year.

The expansion in value added in the manufacturing sector stemmed from both the *food, beverages & tobacco* and the *other manufacturing* sub-sectors. With regard to *food, beverages & tobacco*, growth in food (excluding sugar), alcoholic beverages and tobacco production was partly offset by the decline in the production of non-alcoholic beverages. The improvement in food processing stemmed primarily from the poultry meat, edible fats, and condensed milk producing industries, which offset the declines in animal feeds, cornmeal production and flour production (**see Table 59**). Increased export demand, partly influenced by enhanced promotional activities, was mainly responsible for the growth in alcoholic beverages production.

Growth in *other manufacturing* was attributed to the performance of the non-metallic mineral and chemical producing sub-sectors. The performance of the non-metallic mineral industry reflected a 31.4 per cent increase in cement production in 2004, stemming from reduced competition from imports, as well as growth in the domestic construction sector. The production of chemical products grew by 1.9 per cent in 2004, driven primarily by an increase of 13.8 per cent in the manufacture of detergents.

Economic activity in **construction & installation** increased by 5.0 per cent in 2004, representing five consecutive years of expansion.

Table 59

Items	Production ('000tonnes)		
	2003	2004	% Change
Poultry Meat	94.2	96.3	2.2
Edible Oils	6.8	7.4	9.4
Cornmeal	12.3	11.6	-6.2
Condensed Milk	13.9	14.2	2.2
Flour	130.0	128.8	-0.9
Animal Feeds	363.7	345.9	-4.9
Sugar	158.4	181.0	14.3

Source: Planning Institute of Jamaica

The industry grew consistently throughout the year, registering the strongest growth of 9.5 per cent in the December quarter. Growth emanated primarily from on-going road works, hotel construction, as well as the post hurricane reconstruction activity. The expansion in road works reflected the completion of the Bushy Park to Mandela segment of Phase 1A of the Highway 2000 project, as well as work on the Portmore segment. In addition, there was continued work on the North Coast Highway project. These activities were complemented by public sector capital projects, such as the expansion of the port facilities in Kingston. Increased construction activity in residential housing also contributed to growth in the sector. For example, housing completions by the National Housing Trust (NHT), the major provider of residential houses in Jamaica, grew by an estimated 98.3 per cent in 2004. Cement sales, another indicator for construction activity, increased by 35.8 per cent during the year.

With respect to services, all the sub-sectors, with the exception of **electricity & water**, and **financing & insurance**, improved in 2004. The **distributive trade** sector grew by 1.3 per cent for the year and, given its weight in GDP, was the fourth largest contributor to the overall economic expansion. The reconstruction process in the aftermath of Hurricane Ivan fuelled much of the activity in distributive trade. Growth was also indicated by an estimated real increase of 4.8 per cent in merchandise imports in 2004.

For **electricity & water**, output declined marginally by 0.1 per cent in the review year. The sector recorded growth of 3.3 per cent in the first half of the year, in contrast to the decline of 3.4 per cent realised in the second half. The performance of the sector in the latter half was attributed to the disruption in electricity generation caused by Hurricane Ivan. For the review year, there was marginal growth of 0.4 per cent in total electricity generation while sales declined by 0.8 per cent. Electricity sales categorized as "industrial" and "other" declined by 0.3 per cent and 1.7 per cent, respectively. Water production in 2004 also fell by 2.5 per cent, relative to a growth of 3.9 per cent in the previous year.

The **transport, storage & communication** sector recorded a marginal growth of 0.9 per cent in the review year. This marginal growth is relative to the average growth of 5.6 per cent recorded over the previous five years. With regard to the *communication* sub-sector, the total number of telephone "lines" in service (mobile and 'plain old telephones' (POTS)) was estimated to have expanded by approximately 17.9 per cent for the review year. The marginal growth in the transport sub-sector was related, in part, to declines of 5.6 per cent, 0.5 per cent and 8.8 per cent in air cargo, domestic cargo movements and the number of ships calling at Jamaican ports, respectively. These contractions were attributed primarily to the passage of Hurricane Ivan.

A contraction of 0.7 per cent in the real value added of **financing & insurance** services during the year reflected the performance of the *banking institutions* sub-sector. Commercial banks' interest income declined in real terms by 9.5 per cent. This decline was influenced primarily by a reduction in investment earnings, which outweighed the growth on interest earned from loans and advances. During 2004, commercial banks' stock of investments declined in real terms by 4.3 per cent, while average Treasury bills

rates and commercial bank weighted average deposit rates fell by approximately 765 and 66 basis points, respectively. Non-interest income declined by 10.4 per cent due to the decline in foreign exchange gains during the year, which offset increases in income earned from service charges, fees and commissions.

Driven by the performance in tourism, value added in **miscellaneous** services expanded by 4.3 per cent in 2004. The major factor contributing to the performance of the tourism industry was an increase of 4.8 per cent in total stop over arrivals, led by an expansion of 5.1 per cent in foreign national arrivals. On the other hand, there was a reduction of 3.9 per cent in cruise ship arrivals. Against this background, visitor expenditure increased by 7.5 per cent in 2004 (**see Balance of Payments**). Of note, total stop over and cruise passenger arrivals expanded by 9.4 per cent and 1.2 per cent, respectively, for the first half of the year. For the latter half, total stop over arrivals grew by a marginal 0.1 per cent, while there was a decline of 9.6 per cent in cruise passenger arrivals.

The growth in stop over visitor arrivals for the year was associated with continued marketing efforts of the Jamaica Tourist Board (JTB) and the addition of new airlift capacity to the Island, including new air routes by Continental and US Airways. In this context, there were strong expansions of 16.8 per cent, 7.9 per cent and 10.9 per cent in arrivals from the European, UK and Canadian markets, respectively. The share of total arrivals attributed to visitors from Europe increased to 17.1 per cent in 2004, from 16.2 per cent in 2003, this positively affected the average length of stay and the average expenditure per person to the Island for the year. Further, unusually cold weather in the USA, and the real depreciation of the Jamaica Dollar vis-à-vis the currencies of Jamaica's main trading partners, attributed to the depreciation of the US dollar vis-à-vis the Euro and the Pound Sterling could have engendered growth in the sector.

The significant slow down in stop over arrivals was due to the passage of the hurricane. A few hotels were forced to close after the hurricane and were reopened after mid November. The cruise industry was also affected by the hurricanes, which forced operators to reorganize their itineraries and in some cases cancel cruises. Jamaica benefited from the diversion of ships from the Cayman Islands in particular, but the local ports also suffered loss of business as some of the cruise routes, that included Jamaica, had to be cancelled because of damage to other ports on the route. Some ten ship calls were lost because of the Hurricane and the Topical Storm, but five additional calls were gained because of damage to other destinations.

Outlook

The Jamaican economy is projected to grow within the range of 1.0 per cent to 1.5 per cent for 2005. This projection is predicated on positive expectations for the goods producing sectors, as well as services. The most notable growth is expected in **construction**, **mining**, **distributive trade** and **electricity** and **water**.

The maintenance of a stable macro environment should support the continued expansion in the economy. The external environment is also expected to remain favourable as world economic growth continues, albeit at a reduced pace, while low inflation is expected to be maintained among Jamaica's major trading partners. However, adverse developments in the international oil market could have an impact on growth in the Jamaican economy.

7.2. Prices

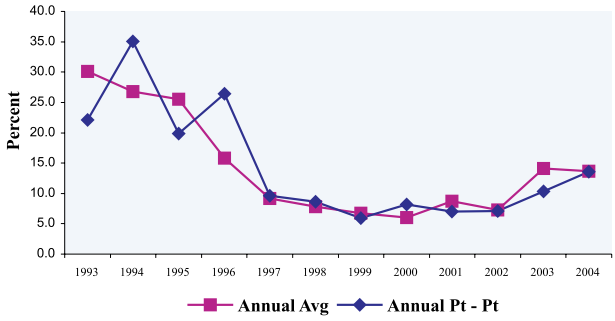
7.2.1. Overview

The macroeconomic variables performed fairly well in 2004 and provided a stable background for price movements. In particular, there was relative stability in the foreign exchange market, a favourable fiscal environment and the prudent demand management pursued by the Central Bank. The dampening impact of these factors on inflation however, was partially countered by increases in international oil prices and the impact of Hurricane Ivan, particularly on agricultural supplies.

The rate of inflation during 2004 was 13.7 per cent compared to the 14.1 per cent in 2003, (**see Chart 18**). The outturn for the year was mainly influenced by inflation in the December quarter, as prior to the passage of Hurricane Ivan, inflation for the year to September was 6.9 per cent. The quarterly inflation rates in 2004 were 1.9 per cent for each of the March and June quarters, 2.9 per cent and 6.4 per cent for the September and December quarters, respectively.

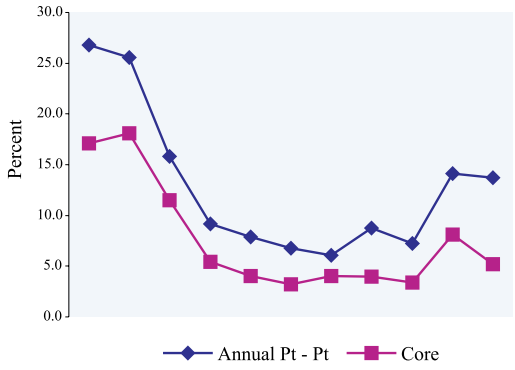
The prudent demand management pursued by the Central Bank helped to moderate inflation rate during 2004. Base money management for the first nine months of the year was within programmed target, which had a positive effect on core inflation. For the year, core inflation was 5.2 per cent, down from 8.1 per cent in 2003 (**see Chart 19**). Monthly movements in core inflation remained fairly stable in the first three quarters of the year. However, the adverse shock of the Hurricane led to a noticeable increase in core inflation in October. With the prudent management of base money and stability in the foreign exchange market, there was a moderation in this trend towards the end of the year. However, in the latter half of the year, the disruption in domestic production, particularly in agriculture, brought on by the passage of the Hurricane, led to a deterioration in the supply of consumer goods and services. Additionally, increases in international oil prices had an adverse effect on consumer prices.

Chart 18: Jamaica's Headline Inflation Rate



The stability in the Jamaica Dollar, however, helped to moderate these inflationary impulses.

Chart 19: CPI and Core Inflation (y-o-y)



7.2.2. Factors Affecting Inflation

The inflation outturn for 2004 was influenced by exceptional domestic and international factors. The primary domestic factors include administered price adjustments and agricultural supply shortages. The main international factor relates to the significant increase in crude oil prices. However impulses to inflation were moderated by the Bank's demand management policies.

Domestic Shocks

Administered price adjustments were related to increases in postage and utility rates. During the year, the cost of inland postage doubled, while postage to the United States and the United Kingdom rose by 50.0 per cent and 55.6 per cent, respectively. The adjustment was advanced as an attempt by the postal authorities to increase profitability and stem the use of Jamaica as a bulk distribution point by some US companies.

The increase in the utility rates during the year emanated from both administered adjustments as well as external factors. The major provider of fixed-line telephones increased rental rates by 25.0 per cent in March. This was in a context where the Office of Utilities Regulation (OUR), the utility supervisory body, lifted some restrictions on the fee structure of the telephone company thus enabling them to charge the economic cost of their landline service. The increase in the cost of electricity stemmed from an annual adjustment in customer charge and energy tariffs, as well as movements in fuel charges. The yearly adjustment in energy tariffs, approved by the OUR during the year, was intended to recover maintenance cost of the electricity plant.

Supply Shock

Agricultural production experienced the usual seasonal decline in the summer months and damages due to Tropical Storm Charlie in August, which had the expected adverse effect on prices for these commodities. However, the shortage in agricultural supply was further exacerbated in the December quarter as a result of the negative impact of Hurricane Ivan. A comparison of price increases, given similar shocks, revealed that the impact of Hurricane Ivan on prices in general was more severe than Hurricane Gilbert in 1988 (**see Table 60**). This occurred in a context where in 1988 there were price control policies in place.

Despite significant reduction in the import duty on vegetables, there were instances of significant price increases on some of these commodities. This occurred in a context where the pass through of the savings from the import reduction was not passed on to the consumer, in light of the shortage.

External Shocks

The impact of international price movements of petroleum products was significant on domestic prices in 2004. The price of the benchmark West Texas Intermediate (WTI) crude oil rose by 34.8 per cent in 2004, relative to increases of 9.6 per cent and 51.8

Table 60

The Impact of Weather Related Shocks on Inflation			
	Starchy Foods Mthly(Qrtly)	**Veg. & Fruits Mthly(Qrtly)**	**Inflation Mthly Chge* (Qrtly)**
Gilbert 1988	21.1* (34.9)	14.6* (18.8)	2.9* (4.9)
May 2002 Floods	4.9* (13.3)	3.0* (18.3)	2.4* (2.9)
November 2002 Rains	3.7 (-1.0)	7.5* (2.3)	1.7 (1.4)
Ivan 2004	12.2* (22.4)	20.2* (30.1)	3.3* (6.6)

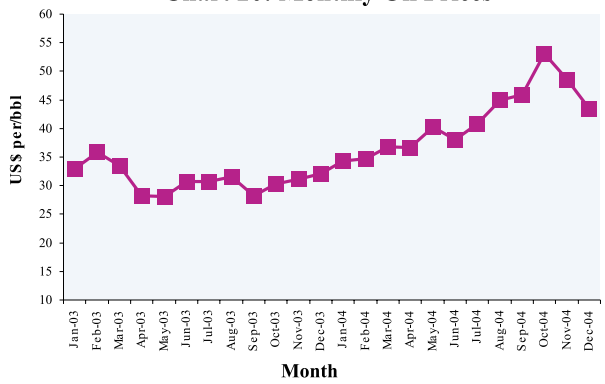
* *Month immediately after impact*

per cent in 2003 and 2002, respectively. The average price of crude oil in 2004 was approximately US$41.5 per barrel, relative to US$31.1 per barrel in 2003 (**see Chart 20**). However, crude oil price rose to as high as US$55.2 per barrel in 2004, relative to a high of US$37.8 in 2003. The increase in the price of crude oil had a noticeable effect on the prices of domestic household and automotive fuels, as well as utility rates.

The increase in fuel charges for electricity was primarily attributed to the strong movements in world oil prices. For the year, fuel charges increased by approximately 72.4 per cent, relative to 27.6 per cent in 2003. Additionally, other oil related products such as kerosene and cooking gas experienced average increases of 27.1 per cent and 21.2 per cent, respectively. Increases in the price of crude oil typically lead to second round adjustments in the prices of domestically produced goods and services. However, there is generally rigidity in downward adjustments with declines in international prices.

The rise in the prices of vegetable oils on the world market also had an unfavourable effect on domestic prices (**see Chart 21a**). These increases were influenced by heightened world demand, coupled with reduced output in the major producing areas. The annual average increase in the prices of coconut oil and soybean oil in 2004 was 41.3 per cent and 11.1 per cent, respectively (**see Table 61**). This compared to price increases of 11.0

Chart 20: Monthly Oil Prices



per cent and 21.9 per cent, respectively, in 2003.

Increases in international grain prices also had an adverse impact on domestic prices. In particular, rice prices in 2004 increased on average by 35.4 per cent, relative to 2003 (**see Table 61**). The movement in the price of rice primarily reflected the concurrence of higher demand for the Thai product, with the Thai

Chart 21a: Annual Coconut Oil Prices

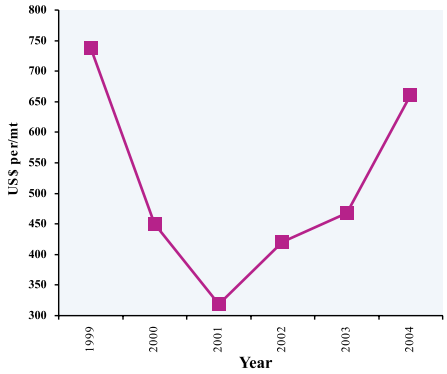


Chart 21b: Annual Rice Prices

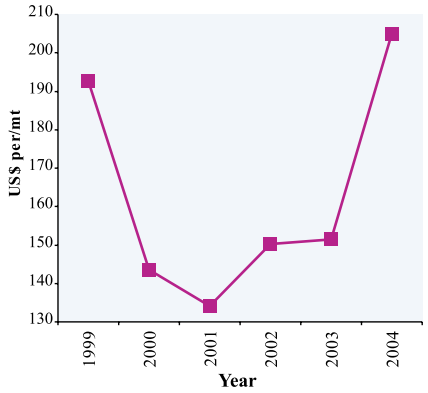


Table 61

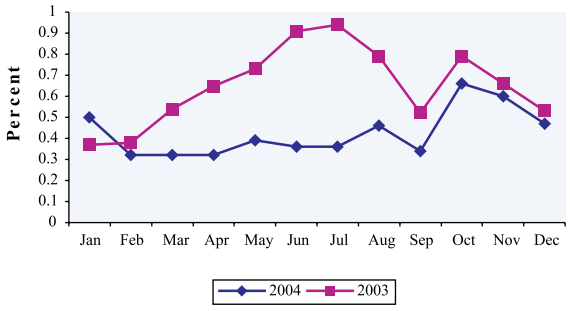
International Prices of Selected Commodities Annual Averages (US$)				
Commodity	Units	**2003**	**2004**	**Annual Average (%)**
Vegetable Oils				
Coconut Oil	$/mt	467.3	660.4	41.3
Groundnut oil	$/mt	1243.2	1159.5	-6.7
Soybean Oil	$/mt	553.9	615.6	11.1
Grains				
Soybean meal	$/mt	210.9	241.2	14.4
Soybean	$/mt	264.0	306.4	16.1
Maize	$/mt	105.4	111.8	6.1
Sorghum	$/mt	106.5	109.8	3.1
Wheat Canada	$/mt	177.4	186.5	5.1
Rice (A1)	$/mt	151.5	205.1	35.4
Raw Materials				
Cotton, 'A'	¢/kg	139.9	136.6	-2.4
Rubber, US	¢/kg	122.5	148.3	21.1
Fertilizer-TSP	$/mt	179.4	186.3	24.8
Zinc	¢/kg	82.8	104.8	26.6

government's decision to temporarily suspend sales of the commodity to the international market, during the year.

7.2.3. Core Inflation

Core inflation[27] slowed to 5.2 per cent in 2004, from 8.1 per cent in 2003. For the first nine months of the year, core inflation was relatively stable and consistently below the rate that obtained in the previous year (**see Chart 22**). This stability was consistent with the management of base money, within programmed target, by the Central Bank. However, core inflation was particularly high in October in the context of increased expenditure associated with the Hurricane. Given the pervasiveness of the shock to the CPI, some of these impulses could not be eliminated from the measurement of core inflation.

Chart 22: Monthly Core Inflation: 2003 & 2004



[27] *measured by the Trimmed mean*

Table 62

DECOMPOSITION OF INFLATION OUTTURN: CALENDAR YEAR 2004		
	INFLATION (%)	CONTRIBUTION (%)
NON- CORE	**8.5**	**62.1**
Food & Drink	*5.0*	*36.5*
Starchy Foods	2.1	15.2
Vegetables & Fruits	1.5	10.9
Meat, Poultry & Fish	1.4	10.4
Fuels/Other Housing Expenses	*1.2*	*8.4*
Housing /Other Housing Expenses	*1.1*	*8.1*
Other	*1.2*	*9.1*
CORE	**5.2**	**37.9**
TOTAL	**13.7**	**100.0**

7.2.4. Contribution to Inflation

The main sub-indices that contributed to inflation in 2004 were, *Food & Drink*, *Fuels & Other Household Supplies*, *Housing & Other Housing Expenses* as well as *Miscellaneous Expenses* (**see Table 63**). Within *Food & Drink*, the movement in *Starchy Foods* was mainly due to increases in the prices of tubers such as yams, potatoes, dasheen and green bananas. With respect to *Vegetables & Fruits* the main price increases related to tomatoes, cabbages, escallion, carrots, pumpkins and oranges. *Meat Poultry & Fish* prices were affected by the movement in international grain prices, as well as the Hurricane. Increases in international grain prices affected important elements of domestic animal feeds, which by extension led to increases in the cost of meat. Additionally, poultry and fish prices in particular, were significantly affected by the Hurricane, as there was extensive damage to fish ponds, fishing vessels and equipment, as well as to chicken farms.

Table 63

Jamaica - Component Contribution to Inflation 2003 vs 2004					
Groups and Sub-groups	Group Weights	Price Inflation (%)		Contribution to Inflation (%)	
		2003	2004	2003	2004
FOOD & DRINK	0.5563	**11.2**	**16.2**	**47.8**	**63.9**
- Meals Away From Home	0.0741	15.7	9.0	8.4	5.0
- Meat Poultry & Fish	0.1613	11.9	10.6	13.9	12.9
- Dairy Products Oils & Fats	0.0668	19.1	10.8	9.2	5.4
- Baked Products Cereals & Breakfast Drink	0.0864	19.0	8.7	11.9	5.7
- Starchy Foods	0.0525	0.7	47.7	0.3	18.8
- Vegetables & Fruits	0.0650	-6.5	27.6	-3.0	13.5
- Other Food & Beverages	0.0502	19.7	6.9	7.2	2.6
FUELS & OTHER HOUSEHOLD SUPPLIES	0.0735	**20.7**	**19.5**	**9.4**	**10.5**
- Household Supplies	0.0482	12.5	18.1	4.3	6.6
- Fuels	0.0253	27.6	20.4	5.0	3.9
HOUSING & OTHER HOUSING EXPENSES	0.0786	**16.7**	**17.2**	**9.4**	**10.1**
- Rental	0.0209	13.4	14.2	2.0	2.2
- Other Housing Expenses	0.0577	17.6	18.0	7.4	7.8
HOUSEHOLD FURNISHINGS & FURNITURE	0.0283	**8.5**	**10.0**	**1.7**	**2.1**
- Furniture	0.0068	11.4	10.8	0.6	0.6
- Furnishings	0.0215	7.3	9.4	1.1	1.5
HEALTHCARE & PERSONAL EXPENSES	0.0697	**11.5**	**8.2**	**5.8**	**4.3**
PERSONAL CLOTHING FOOTWEAR & ACC.	0.0507	**6.0**	**4.0**	**2.1**	**1.5**
- Clothing Materials	0.0055	1.6	1.1	0.1	0.0
- Readymade Clothing & Accessories	0.0242	4.6	2.8	0.8	0.5
- Footwear	0.0159	8.9	6.4	1.0	0.8
- Making & Repairs	0.0051	6.6	4.3	0.2	0.2
TRANSPORTATION	0.0644	**28.6**	**3.9**	**15.3**	**1.9**
MISCELLANEOUS EXPENSES	0.0785	**18.5**	**9.8**	**10.5**	**5.8**
ALL GROUPS	1.0000	**14.1**	**13.7**	**100.0**	**100.0**

Prices for *Fuels & Other Household Supplies* were primarily influenced by increases in international oil prices, as well as the impact of adverse weather conditions. This group contributed 10.5 per cent to inflation. *Fuels*, which increased by 20.4 per cent primarily reflected increased prices of cooking gas and kerosene. *Household Supplies* increased by 18.1 per cent and was mainly reflected in consumer items such as powdered soap, candles and batteries, among others.

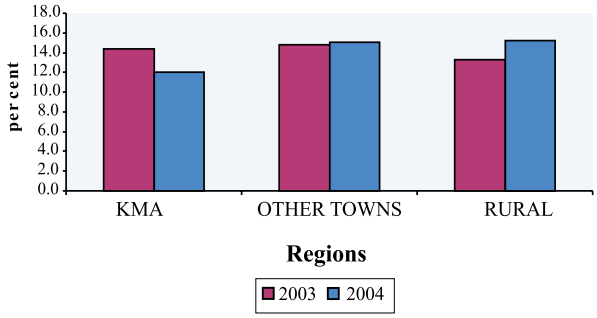
Increases in utility rates were an important factor in *Housing & Other Housing Expenses*. These emanated from both domestic administered adjustments as well as, external factors. Administered price changes were related to increased electricity and telephone charges. The adverse movements in international oil prices affected the fuel charges in electricity. Additionally, the increased cost of electricity was influenced by an annual adjustment in the energy tariff, which was intended to recover the maintenance cost of the electricity plant. For telephone charges, there was a significant increase in rental rates for landline service.

The impact of *Miscellaneous Expenses* on inflation mainly reflected adjustments in postal rates, higher preparatory school fees, school related expenses and higher admissions fees to cinemas.

7.2.5. Regional Inflation

For the calendar year, **Rural Areas** and **Other Towns** experienced similar rates of inflation, while the rate was lower in the **Kingston Metropolitan Area** (**KMA**). The respective outturns were 15.3 per cent, 15.1 per cent and 12.0 per cent (**see Chart 23**). Of note, inflation in **Rural Areas** and **Other Towns** exceeded the overall increase in the All Jamaica index. The stronger inflationary impulses in the rural areas were as a result of a greater impact of the Hurricane on these areas.

Chart 23: Regional Inflation 2002 and 2003



The disparity across regions was mirrored in three of the eight groups, with the most significant divergence in *Food & Drink* (**see Table 64**). This category reflected respective increases of 18.4 per cent, 17.9 per cent and 13.4 per cent in **Rural Areas**, **Other Towns** and **KMA**. There was also disparity in *Fuels & Other Household Supplies* and *Healthcare & Personal Expenses*. For *Fuels & Other Household Supplies*, price increases were weakest in the **KMA**, primarily reflecting lower increases in the price of kerosene. Price increases in *Healthcare & Personal Expenses* in **Rural Areas** and **Other Towns** were almost twice that for the **KMA**. The greater increase in the **Rural Areas** and **Other Towns** was caused in part by increases in optician and doctor fees. Another disparity of note occurred in *Household Furnishings & Furniture*, where **KMA** experienced significantly stronger impulses than the other regions, resulting from a significant increase in the prices of furniture.

Table 64

REGIONAL INFLATION

Groups / Sub-groups	Weight in CPI	KMA (%)	Other Towns (%)	Rural (%)
FOOD & DRINK	**0.5563**	**13.4**	**17.9**	**18.4**
- Meals Away From Home	**0.0741**	8.0	9.4	10.8
- Meat Poultry & Fish	**0.1613**	9.2	13.4	10.6
- Dairy Products Oils & Fats	**0.0668**	11.1	9.7	11.1
- Baked Products Cereals & Breakfast Drink	**0.0864**	5.8	11.9	10.3
- Starchy Foods	**0.0525**	44.7	59.6	45.4
- Vegetables & Fruits	**0.0650**	30.5	27.2	24.5
- Other Food & Beverages	**0.0502**	5.4	8.0	8.0
FUELS & OTHER HOUSEHOLD SUPPLIES	**0.0735**	**18.5**	**22.5**	**19.2**
- Household Supplies	**0.0482**	25.5	15.2	9.3
- Fuels	**0.0253**	13.6	27.7	27.3
HOUSING & OTHER HOUSING EXPENSES	**0.0786**	**17.0**	**18.2**	**16.9**
- Rental	**0.0209**	13.0	19.1	19.1
- Other Housing Expenses	**0.0577**	18.6	18.1	16.7
HOUSEHOLD FURNISHINGS & FURNITURE	**0.0283**	**14.7**	**4.5**	**9.2**
- Furniture	**0.0068**	28.0	3.6	3.3
- Furnishings	**0.0215**	9.6	5.0	12.5
HEALTHCARE & PERSONAL EXPENSES	**0.0697**	**5.7**	**10.9**	**11.1**
PERSONAL CLOTHING FOOTWEAR & ACC.	**0.0507**	**3.2**	**5.6**	**4.1**
- Clothing Materials	**0.0055**	0.1	2.7	2.1
- Readymade Clothing & Accessories	**0.0242**	2.9	3.4	2.4
- Footwear	**0.0159**	3.6	8.3	8.2
- Making & Repairs	**0.0051**	5.0	7.8	1.4
TRANSPORTATION	**0.0644**	**3.6**	**5.7**	**3.0**
MISCELLANEOUS EXPENSES	**0.0785**	**9.8**	**10.5**	**9.2**
ALL GROUPS	**1.0000**	**12.0**	**15.1**	**15.3**

7.2.6. Summary & Outlook

Given the relatively stable macroeconomic environment in 2004, the inflation rate for the first nine months of the year was 6.9 per cent. This trajectory implied single digit outturn for 2004. However, the year was marred by unanticipated shocks, Hurricane Ivan and high international oil prices, which led to a double-digit outturn. Continued stability in the macroeconomic environment, by way of foreign exchange market stability, favourable fiscal performance and prudent demand management by the Central Bank, should result in containment of core inflation to targeted levels.

8. Banking and Currency Operations

8.1. Banking Services

The Bank of Jamaica provides banking services to the Government, commercial banks, primary dealers and regional central banks. It also provides support and oversees the principal payment and settlement systems in Jamaica. In addition, limited over-the-counter services are provided to the general public.

The Bank's oversight role is facilitated through the Bank of Jamaica Act, the Banking Act, the Financial Institutions Act as well as Currency Issue and Redemption Statutes. In addition, Clearing House Rules codify the arrangements between member banks (including the BOJ) with respect to the local clearing of instruments drawn in Jamaica Dollars and the four major foreign currencies: US and Canadian dollars, the Euro and Pound Sterling.

The Bank continues to provide vaulting and settlement services to the Jamaica Central Securities Depository (JCSD), a wholly owned subsidiary of the Jamaica Stock Exchange Limited. The JCSD's main functions are to provide safekeeping of shares and certificates and to facilitate more efficient equities-trading with a shorter turnaround time for settlement and delivery of certificates.

The Bank also facilitates the settlement of regional payments through CARICOM bilateral arrangements with central banks as well as the exchange of CARICOM currencies.

8.2. Payment System Developments

The Bank of Jamaica remains committed to ensuring the integrity and efficiency of the systemically important payment systems as a critical element of its mandate to ensure the soundness and stability of the Jamaican financial system. Accordingly, the Bank continues to initiate and facilitate developments designed to enhance the efficiency of these systems.

In Jamaica, the most common payment instruments are cash, cheques, cards (debit, credit, stored value) and inter-bank transfers. There have been innovations with electronic payment instruments and a wide array of banking products and services are being delivered through electronic banking (e-banking) channels. Despite these developments, cheques remain the most commonly used payment form in Jamaica as they are used for a wide variety of payment transactions, retail and wholesale.

The two main payment systems in operation locally are the Central Bank-owned electronic funds transfer system, the Customer Inquiry and Funds Transfer System (CIFTS) and the Automated Clearing House (ACH), through which local cheques are cleared and settled. For cheques, multilateral netting takes place twice daily and balances are settled on the books of the Central Bank while CIFTS payments are settled gross. Both cheques and CIFTS payments are settled in Central Bank assets at the end of the day through a deferred settlement arrangement.

Having successfully implemented the first phase of the ACH two years ago for cheque clearing and settlement, the clearing banks are now in the process of implementing the second phase, which will see the electronic processing of direct debits and direct credits (for payroll, dividends, pensions, etc.). The project is scheduled for implementation in 2005 and supports the Bank's objective for payment system modernization.

8.2.1. Payment System Transactions

a) Cheques

In 2004, the Bank provided cheque clearing and settlement facilities through the ACH for 11.1 million[29] items valued at J$1 808.8 billion. This compares to 13.6 million items valued at J$2 009.6 billion exchanged in the clearing in 2003.

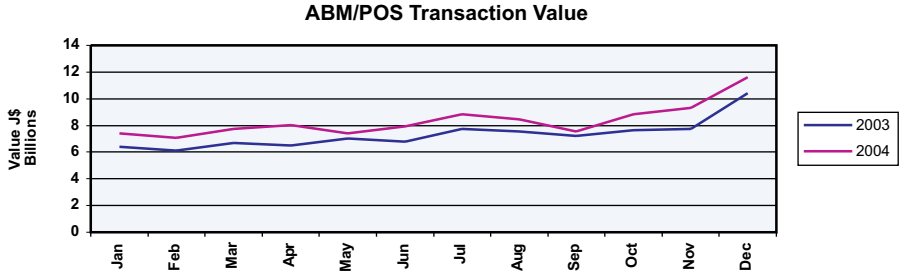
The cheques processed through the ACH represent a fraction of the overall cheque usage as they exclude proprietary transactions, that is, those items encashed or deposited at the bank on which they are drawn. Proprietary transactions in 2004 were approximately J$1 700 billion, accounting for approximately 48 per cent of total local currency cheques paid. In 2003, proprietary transactions were approximately $1 200 billion or 40 per cent of cheques processed. Total cheque payments increased by 10 per cent to $3 519 billion in 2004.

b) Automatic Banking Machines/Point of Sale Terminals

Automated banking machines (ABMs) and point of sale terminals (POS) transactions reflected the most significant growth in 2004 when compared to other payment forms, such as cheques and cash. There were 11.1 million ABM/POS transactions across the Multilink network, 25.2 per cent over the level in 2003. This may be reflective of buoyancy in retail activity in the economy and the increasing acceptance of electronic payment media. In 2004, transaction values increased by 12 per cent to $100 billion (**see Chart 24**).

A total of 40 ABM's and 1 796 POS terminals were installed in 2004, an increase of 14.9 per cent and 20.7 per cent, respectively, over the previous year. This brings the total number of ABM and POS terminals to 302 and 10 484, respectively.

Chart 24



[29] *Jamaica Dollar items only are processed by Automated Clearing House (ACH).*

c) CIFTS

During the year, 24 581 large value payments amounting to J$1 601.7 billion were executed through CIFTS. This compares with 25 085 CIFTS payments valued at J$1 700.7 billion executed in 2003, a decrease by volume and value of 2 per cent and 6 per cent, respectively. The combined value of Jamaica Dollar payments effected by cheques and via CIFTS in 2004 was $5 111 billion, a 4 per cent increase over the previous year.

d) Foreign Currency Items

The Bank of Jamaica oversees the manual exchange of foreign items issued by or drawn on local commercial banks.

Foreign currency items totalling US$2.4 billion were cleared locally in 2004. This represents an increase of approximately 4 per cent over the US$2.3 billion exchanged in 2003.

In January 2004 the foreign currency clearing exchange was expanded to include items issued by or drawn on local commercial banks in the major non-US foreign currencies, namely Canadian dollar, Euro and Pound Sterling. Foreign Currency items are not settled in the Central Bank using central bank assets but are settled bilaterally on a net basis by wire transfers to/from correspondent bank accounts held by the clearing banks. Items valued at CDN$18.37 million, GBP57.7 million and Euro1.06 million were exchanged during the year.

8.3. Currency Operations

8.3.1. Currency in Circulation

At end 2004 the total value of notes and coins in circulation was $32.8 billion, 10 per cent above the value at end of 2003. Of this amount, banknotes accounted for 95.4 per cent, the same as in 2003.

The $1 000 denomination accounted for 68.3 per cent of currency circulation value and 20 per cent of volume. By comparison, the $1 000 notes in circulation at the end of 2003 were valued at $18.4 billion or 66.5 per cent of circulation value and 19 per cent of volume.

8.3.2. Currency Issued

During the year 218.4 million banknotes valued at $99.2 billion were issued. This was 35.89 per cent above the value issued in 2003. The $1 000 and $500 notes accounted for 61 per cent and 31 per cent, respectively, of total value of notes issued.

Of the $1 000 and $500 notes issued, approximately 40 per cent were new, with the balance being ABM-fit. This is reflective of the increasing useful life of these denominations. For the lower denominations, $100 and $50, the situation was different as 79 and 93 per cent, respectively, of these notes were new. These lower denominations have shorter average useful lives, approximately eight months, compared to the high value notes, which have average useful lives of more than twelve months.

Coins issued were valued at $421 million, marginally less than the $426.2 million issued in 2003. The $20 denomination accounted for 49 per cent of the total value followed by the $10 with 26 per cent. Demand for the $1 denomination remained strong as 37.9 million pieces were issued, 20 per cent above 2003. This was largely to meet the growing needs of the retail sector.

Chart 25a

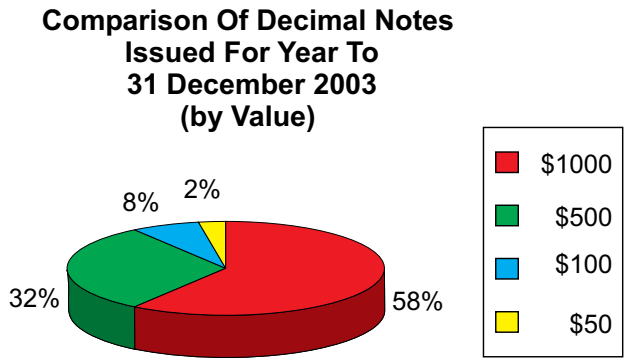


Chart 25b

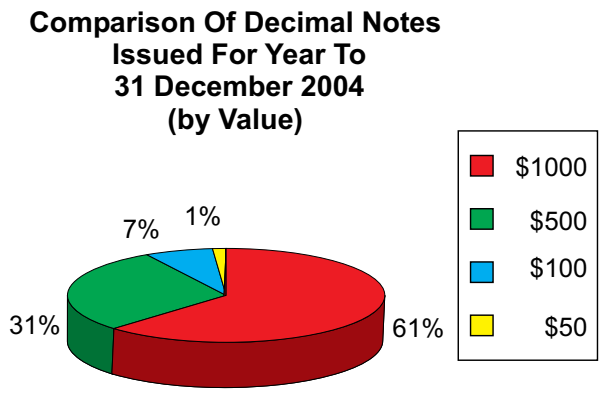


Chart 26a

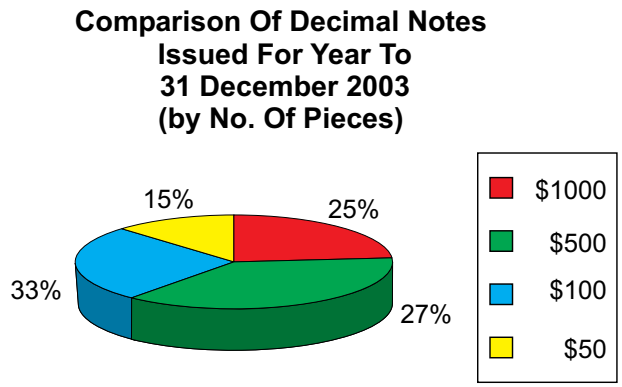
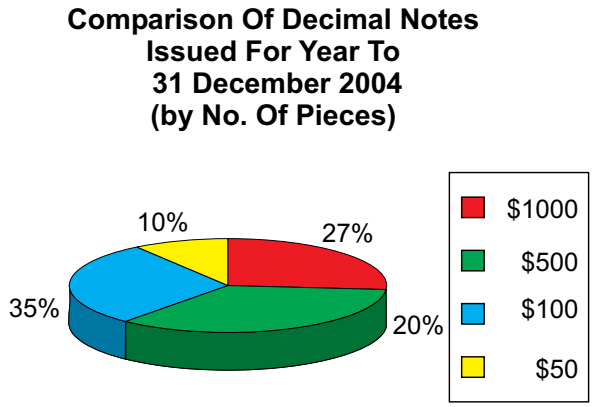


Chart 26b



8.3.3. Redemptions and Banknote Processing

A total of 213.4 million banknotes valued at $96.3 billion were redeemed during 2004. This was an increase of 41.5 per cent over 2003. The $1 000 note accounted for 59.4 per cent of redemptions while the $500 note was 32 per cent of total redemption. These higher value denominations accounted for 26.8 and 28.9 per cent, respectively, by volume. On the other hand, the $100 denomination accounted for only 7.4 per cent of the redemption value but the largest volume, with 70.9 million pieces or 33.2 per cent. The $100 denomination continued to be the most highly used of notes in circulation.

All banknotes redeemed are processed through an electronic scanning machine to verify denomination, authenticity and fitness. Banknotes verified as genuine and deemed fit for re-circulation are packaged for reissue to the public. Those deemed unfit for re-circulation are shredded automatically.

In 2004, banknotes totaling 196.3 million pieces valued at $93.2 billion were processed. Of this number, 53.6 per cent were destroyed and the remainder reissued as ABM-fit.

Coins totaling 31.6 million pieces and valued at $233.3 million were redeemed and processed during the year.

The $1 coin was the volume leader with 8.2 million pieces or 25.9 per cent.

8.3.4. Public Detection and Counterfeit Education

The number of counterfeit notes processed by the Bank of Jamaica increased by 93.7 per cent in 2004 as 4 612 counterfeit $1 000, $500 and $100 notes were identified. As in previous years most of these notes (63 per cent) were detected by the commercial banks at their counters. By value the counterfeits detected increased to $3.8 million in 2004 from $1.6 million in 2003. While the percentage increase appears high the proportion of counterfeit notes is still insignificant, averaging less than 0.002 per cent of notes processed and redeemed.

The $1 000 note continues to be the target of counterfeiters accounting for 73 per cent and 88 per cent of the volume and value of counterfeits, respectively. Generally, the quality of counterfeit notes in circulation remains poor and members of the public easily recognize the notes if they are transacting business in a properly lit area.

Against this background, the Bank intensified its public education programme to enable large volume cash handlers to better authenticate their banknotes. Through a series of seminars the employees of commercial banks, bill payment companies and other agencies were trained to recognize the public and inspector levels of security features embedded in the banknotes.

9.1. The Bank of Jamaica (Amendment) Act 2004

On 13 February 2004, the Bank of Jamaica Act, 19 60 was amended to give the Bank of Jamaica regulatory powers in respect of the operations of Money Transfer and Remittance Agents and Agencies.

The Banking (Licences Form of Application and Fees) Regulations, 1973 (Validation and Indemnity) Act, 2004

The Banking (Licences Form of Application and Fees) Regulations, 1973 (Validation and Indemnity) Act, 2004, was passed into law on 8 December, 2004 and came into effect in January 2005. This Act will validate and indemnify the Bank from liability for acts done in good faith in enforcing the provisions of the Banking (Licences) (Form of Application and Fees) Regulations, 1973.

The Bank of Jamaica Act, 1960, The Banking Act, 1992 (BA), The Financial Institutions Act, 1992 (FIA) and The Building Societies Act, 1897 (BSA)

By virtue of amendments passed in December 2004, the following changes were effected to the abovementioned statutes:-

(i) The Bank of Jamaica Act was amended to include more comprehensive provisions in relation to the sharing of information with overseas regulators with the appropriate mechanisms for control. This Act was also amended to increase the penalties applicable for breach of the confidentiality obligations on the part of the Bank in relation to disclosures other than for the purposes of this Act, the Banking Act, or the Financial Institutions Act, any information regarding the affairs of a customer of a commercial bank or specified financial institution, obtained in consequence of the performance of duties under the Bank of Jamaica Act.

(ii) The Banking Act, Financial Institutions Act and Building Societies Act were amended to include a definition of 'competent authority'. These statutes were also amended to give the Supervisor of Banks the power to take regulatory action (including the revocation of licences) in any case where a licensee is found to be in breach of criminal statutes relating to money laundering or any other statute relating to financial crime.

Amendments were made to the Banking Act, the Financial Institutions Act and the Building Societies Act to address the following shortfalls and errors:-

(i) **In respect of the Banking Act, the Financial Institutions Act and the Building Societies Act-**

The definition for "*regulated or supervised institution*" was expanded to include financial institutions in foreign jurisdictions that are regulated or supervised by authorities bearing similar supervisory or regulatory responsibilities as those carried out by the Bank of Jamaica or the Financial Services Commission.

(ii) In respect of the Banking Act and the Financial Institutions Act -

(a) An offence-making provision was inserted in Section 19 of the Banking Act and the Financial Institutions Act by amendments effected in 2002. However, the relevant amendment addressed only the instance of non-compliance with the obligation to submit audited financial statements as required under Section 19, and omitted to address the situation where a bank or licensee under the Financial Institutions Act does not comply with the directions of the Supervisor issued under Section 19.

(b) By virtue of amendments effected in 2002 to Section 25, Section 25(6)(a) was deleted and replaced with the Subsections 6A, 6B and 6C. Consequential amendments should also have been made to any other references in these statutes to sub-section 25(6)(a). However, these consequential amendments were not done. There was a further error under the FIA in that the reference in paragraph 1(1) of Part D of the Second Schedule of the Financial Institutions Act was made to section 25(3)(c) instead of section 25(6)(a) which, prior to the amendments effected in 2002, would have been the correct provision to which reference should have been made.

(c) Under the Fifth Schedule, a typographical error was identified in the reference to the section 16(4) offence which indicated a fixed penalty of $15,000.00 instead of the intended $150,000.00.

(iii) **In respect of the Banking Act -** the Third Schedule erroneously refers to an offence under section 9(5) whereas the reference should be to an offence under section 9(3).

(iv) **In respect of the Financial Institutions Act –**

(a) In Sub-section 25(1) the

brackets around the numerals should have been deleted and the reference in this subsection to Part B of the Second Schedule should have been revised to refer to Part C of the Second Schedule, (which is the correct reference) as Part B was deleted by virtue of amendments made in 1997 to this Act.

(b) In Sub-section 25(6) the brackets around the numerals referred to therein should have been deleted.

(c) In relation to the Third Schedule, there was an erroneous reference in the Section 16(4) offence to an applicable fine of $25,000 on conviction instead of the intended fine of $250,000.00.

(d) In relation to the Third Schedule there was a repetition of an offence that was already incorporated in the Third Schedule; and an erroneous reference therein to a Section 25(6) offence instead of the correct reference to a Section 25(4) offence.

(e) Revision of the Fifth Schedule whereby the erroneous reference in the section 19(5) offence to a "*bank*" and its subsidiaries was amended to the correct reference which is to "*a licensee*" and its Subsidiaries.

(v) **In respect of the Building Societies Act**, the penalties applicable for offences under the Building Societies Act were not synchronized with those applicable to similar offences under the Banking Act and the Financial Institutions Act.

PENDING AMENDMENTS TO THE FINANCIAL LEGISLATION

The Cooperative Societies (Amendment) Bill

The Cooperative Societies (Amendment) Bill will seek to restrict the deposit-taking activities of cooperative societies to those cooperative societies which operate as credit unions. Secondly, this Bill will seek to bring credit unions under the regulatory ambit of the Minister of Finance and the Bank of Jamaica.

NEW REGULATIONS

The Banking (Capital Adequacy) Regulations, 2004
The Financial Institutions (Capital Adequacy) Regulations, 2004

These Regulations came into effect on 8 March, 2004 and establish a risk based method of assessing capital adequacy of financial institutions, with the requisite capital requirement being prescribed by the risk attached to the institution's assets. The passage of

these Regulations repeals The Banking (Capital Base) Regulations, 1997, and the Financial Institution (Capital Base), Regulations, 1997.

PENDING FINANCIAL REGULATIONS

The Bank of Jamaica (Building Societies) Regulations

These Regulations are being revised to place building societies on an even footing with other regulated deposit-taking financial institutions (i.e. banks and merchant banks). These revised regulations will therefore :

(a.) incorporate some of the amendments already effected to the BA and FIA in March 2002 including introducing a regime for building societies to pay fixed penalties for certain breaches of the Regulations;

(b.) correct existing inconsistencies in the penalty provisions in the existing regulations and update fines; and

(c.) simplify the arrangement of the Regulations.

The Building Societies (Licence Fees) Regulations

These Regulations will be revised to bring the fees payable in line with the applicable fees under the 2003 Licence Fees Regulations under the Banking Act and the Financial Institutions Act.

The Banking (Qualification of Auditors) Regulations

These regulations will create a framework for ensuring that auditors who are proposed as the statutory auditors of financial institutions, are independent of the financial institutions being audited.

The Banking (Credit Classification and Provisioning) Regulations

These regulations will formally impose the measures that banks are required to take in assessing credit, taking security and making provisions for the possibility of default.

Bank of Jamaica (Credit Union) Regulations

These regulations will establish the Bank's regulatory jurisdiction over the operations of credit unions and cover areas including licensing, capital, reserves, prohibited business, remedial and intervention processes, and the role of credit union associations.

Non-Financial Legislative Amendments

The Bank is involved in the process of formulating certain items of non-financial legislation by virtue of the fact that the Deputy Supervisor of Banks, chairs the Financial Crimes Legislative Task Force which was established in November 2002 by the Minister of Finance. This Task Force is charged with the responsibility of identifying and pursuing legislative reforms needed to boost Jamaica's fight against money laundering and other financial crimes.

The Money Laundering Act, 1998
The Money Laundering Regulations, 1998

The Money Laundering (Change of Name and Amendment) Bill was tabled in Parliament in October 2004 and submitted to the Joint Select Committee of Parliament in December 2004. However, as there

were still some outstanding issues with this Bill. Consequently, the Joint Select Committee process was suspended to facilitate the Technical Committee's resolution of these issues. The Technical Committee comprises the members of the Financial Crimes Legislative Task Force and the Legal Committee which provides technical and legal advice throughout the course of the legislative process.

The Money Laundering Act (MLA) is being amended to incorporate requirements mandated by the Financial Action Task Force (FATF's) revised 40 (AML) Anti-money Laundering recommendations and the FATF's, (Combating the Financing of Terrorism) (CFT) special recommendations. The Money Laundering Regulations are also being revised to provide more specific details of the anti-money laundering practices and procedures that financial institutions are expected to have in place.

There have already been related amendments in the financial legislation to enhance the ability of the financial regulators to share information with other supervisory authorities and law enforcement agents. This will also expressly allow supervisory authorities to take regulatory action in response to the non-compliance of financial institutions with their statutory obligations under statutes such as the Money Laundering Act.

The Terrorism Prevention Bill

The Terrorism Prevention Bill was tabled in Parliament during October 2003 and then placed before the Joint Select Committee of Parliament for debate. The Joint Select Committee process ended in October 2004 and the report of that Committee was tabled in Parliament in November 2004. A minority report containing the concerns some members of the Joint Select Committee still had with the proposed Terrorism Prevention Bill, was also tabled in Parliament in November 2004.

If this Bill is passed into law, it will, among other things, specifically impose reporting and other procedural requirements on financial institutions to minimise the possibility of the services of the financial sector being used in any way to facilitate the financing of terrorist activities. The passage of this Bill will be a major step in the satisfaction of Jamaica's obligations to act in concert with other nations in combating terrorism, including fully implementing United Nations Resolution 1373 (2001) and other international instruments relating to terrorism.

The Financial Investigations Division Bill

The Financial Investigations Division Bill seeks to satisfy Jamaica's obligation to comply with recommendation 26 of the (FATF) 40 (revised) Recommendations which states that:-

> *"Countries should establish a Financial Intelligence Unit that serves as a national center for the receiving, analysis…and dissemination of suspicious transaction reports and other financial information regarding money laundering or terrorist financing".*

Allied to this Recommendation is the FATF advisory that such unit when established, should consider applying for membership in the Egmont Group[30].

[30] "*The Egmont Group is an informal group of financial intelligence units (FIUs) established in 1995. The group was so named for the location of the first meeting at the Egmont-Arenberg Palace in Brussels. The goal of this group is to provide a forum for FIUs to improve support to their respective national anti-money laundering programmes.*

10. Administration

10.1. Overview of the Year 2004

In 2004, the Bank's management experienced several operational challenges. These included the retention and recruitment of experienced and qualified staff; the maintenance of a harmonious industrial relations environment in the context of public sector wage restraint and ensuring that the main plant and external properties were safe and secured from the effects of natural disasters and environmental hazards. Accordingly, during the year, renewed efforts were devoted to strengthening industrial relations in the Bank, particularly through improved internal communications. Upgrading of the plant and physical infrastructure and a review of the organization's contingency plans and the articulation of a strategic plan for business continuity took place in 2004.

10.2. Staffing

Against the background of the Memorandum of Understanding (MOU) signed on 16 February 2004 between the Government of Jamaica and the Jamaica Confederation of Trade Unions (JCTU), which imposed a two (2) year freeze on public sector salaries, the Bank was further constrained in its efforts to recruit qualified staff, particularly financial analysts, economists and information technology specialists. The MOU, which will remain in effect from April 2004 to 31 March 2006, coincides with the Bank's two-year Labour/Management contract cycle with the Bustamante Industrial Trade Union (BITU), which represents the unionized staff.

During the year, the Bank recruited thirty-four (34) permanent and eight (8) contract officers. The new recruits included eleven (11) persons with post-graduate training, sixteen (16) with bachelor's degrees, while the remaining fifteen (15) possessed a combination of administrative and clerical skills. The Bank's staff complement totalled four hundred and eighty-four (484) at 31 December 2004, relative to an establishment of five hundred and thirty-nine (539).

It is important to note that notwithstanding recruitment efforts in 2004, the attrition rate increased to 6.2 percent in 2004 from 4.2 per cent in 2003. The increasing attrition rate is an area of concern to the Bank's management, moreso in the context of the current salary restraint and the relative attractiveness of Bank of Jamaica trained personnel in the local and overseas markets.

10.3. Training & Development

To further enhance the staff's skill-set and competencies, the Bank hosted several training and staff development programmes during the year. Training interventions were by way of seminars, workshops, conferences and attachments with international organizations. These exposed members of staff to areas such as international best practices in financial institution supervision, new approaches in financial assessment and analysis, economic policy formulation and management, as well as, plant management and maintenance.

A notable feature of the Bank's training programme conducted in 2004 was the continuation of in-country training programmes. During the year, the Bank hosted

four (4) in-country programmes. These were held in collaboration with international organizations with which the Bank has established strong partnerships. Among the institutions were the Centre for Latin American Monetary Studies (CEMLA), Crown Agents of London, the Board of Governors of the Federal Reserve System and the International Advisory Group of the Office of the Superintendent of Financial Institutions (OSFI).

In-country training programmes attracted participants from the Caribbean and Latin American Region including Guatemala, Venezuela, Uruguay, Mexico, the Bahamas, British Virgin Islands, Trinidad & Tobago, the Netherlands Antilles, Barbados and Guyana. The collaborative efforts provided staff and participants from local and overseas institutions with information on current trends and practices in their respective disciplines, and the experiences of other institutions.

Other training interventions included overseas participation in courses on economic policy and programming, bank supervision, payment systems, currency management, credit analysis, financial risk management and reserves management. The Bank's Training Institute also arranged several Speakers' Forum presentations. These were held on a quarterly basis, and addressed topical issues such as emotional intelligence and security awareness. Human resource management, safety and health, as well as, personal and professional development programmes also received special attention. For the calendar year, there were 446 participants in 133 training programmes, conducted locally and overseas.

10.4. Plant and Physical Infrastructure

In 2004, the Bank continued efforts at upgrading and maintaining the physical infrastructure of the main plant and external properties. There were also initiatives aimed at promoting safety and health at the workplace, consistent with the proposed Occupational Safety & Health Act (OSHA), expected to be implemented in 2005. In addition, an environmentally friendly fire suppression system was installed and significant upgrades made to the Bank's security system.

By year-end, the Bank had made significant progress in effecting rehabilitation work following the adverse impact of Hurricane Ivan on the main plant and other external properties in the second half of the year. While much has been accomplished to date, substantial work remains to be done to upgrade the Bank's infrastructure to withstand more powerful weather systems (category 5 hurricanes) and other natural disasters.

11. Compensation of Executive Management

Salary Range of Executive Management

$5 370 181 - $8 321 216

Allowances of Executive Management

(a) Governor

$1 800 000

(b) Deputy Governors

$328 867

Notes

Executive Management includes the Governor and three (3) Deputy Governors. In the case of the Governor, a maintained residence and an official car are provided, as is customary for Governors of the Bank of Jamaica. For Deputy Governors a fully maintained motor vehicle is provided. Each member of the Executive Management is eligible for benefits including a non-contributory pension plan, health insurance, life insurance, and staff loans.

12. Calendar of Monetary Policy Developments

09/01/04 Interest rates on Bank of Jamaica 90-day 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 16.00 per cent, 18.00 per cent, 19.50 per cent, 21.00 per cent and 22.00 per cent, respectively.

21/01/04 Interest rates on Bank of Jamaica 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 15.20 per cent, 15.50 per cent, 17.00 per cent, 18.25 per cent, 20.00 per cent and 21.00 per cent respectively.

26/01/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 14.85 per cent, 15.00 per cent, 15.10 per cent, 16.00 per cent, 17.25 per cent, 18.75 per cent and 20.00 per cent, respectively.

16/02/04 Interest rates on Bank of Jamaica 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 15.50 per cent, 16.25 per cent, 17.75 per cent and 19.00 per cent, respectively.

27/02/04 Interest rates on Bank of Jamaica 180-day, 270-day and 365-day open market instruments were reduced to 16.00 per cent, 17.25 per cent and 18.50 per cent, respectively.

10/03/04 Interest rates on Bank of Jamaica 270-day and 365-day open market instruments were reduced to 16.95 per cent and 17.95 per cent, respectively.

10/03/04 Pursuant to Section 15 (2) (h) of the Banking Act and the Financial Institutions Act, and Regulation 38 (h) of the Bank of Jamaica (Building Societies) Regulation, the Minister of Finance determined that all debt securities or instruments issued by the Government of Jamaica, whether denominated in Jamaican dollars or in a foreign currency and irrespective of their original maturity terms, shall, within nine months of their maturity date be designated Liquid Assets.

02/04/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 14.60 per cent, 14.70 per cent, 14.80 per cent, 15.10 per cent, 15.60 per cent, 16.50 per cent and 17.40 per cent, respectively.

19/04/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-

day, 270-day and 365-day open market instruments were reduced to 14.40 per cent, 14.50 per cent, 14.60 per cent, 14.85 per cent, 15.30 per cent, 16.00 per cent and 16.90 per cent, respectively.

05/05/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 14.20 per cent, 14.30 per cent, 14.40 per cent, 14.55 per cent, 15.05 per cent, 15.65 per cent and 16.40 per cent, respectively.

03/09/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 14.00 per cent, 14.10 per cent, 14.20 per cent, 14.35 per cent, 14.80 per cent, 15.35 per cent and 16.00 per cent, respectively.

28/12/04 Interest rates on Bank of Jamaica 30-day, 60-day, 90-day, 120-day, 180-day, 270-day and 365-day open market instruments were reduced to 13.80 per cent, 13.95 per cent, 14.05 per cent, 14.15 per cent, 14.30 per cent, 15.00 per cent and 15.50 per cent, respectively.

(Footnotes)

Auditors' Report

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Chartered Accountants

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TO BANK OF JAMAICA

Auditors' Report

Pursuant to Section 43(1) of the Bank of Jamaica Act, we have audited the financial statements of Bank of Jamaica (the Bank), set out on pages *ii* to *xxvii*, and have obtained all the information and explanations which we required. The financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, proper accounting records have been kept and the financial statements, which are in agreement therewith and have been prepared in accordance with International Financial Reporting Standards, give a true and fair view of the state of affairs of the Bank as at December 31, 2004, and of its results of operations and cash flows for the year then ended and comply with the provisions of the Bank of Jamaica Act.

KPMG Peat Marwick

April 5, 2005

Balance Sheet

December 31, 2004

	Notes	2004 J$'000	2003 J$'000
ASSETS			
Foreign assets			
Notes and coins		7,911	22,013
Cash resources	3	15,848,943	9,221,708
Interest in funds managed by agents		2,608,781	2,533,834
Investments	4	97,399,803	60,099,207
International Monetary Fund - Holding of Special Drawing Rights		4,483	3,198
		115,869,921	71,879,960
Local assets			
Notes and coins		46,707	44,374
Investments	5	85,131,057	78,308,002
International Monetary Fund - Quota Subscription	6	2,738,720	2,454,750
Investment property	7	87,000	87,000
Investments in financial institutions	8	3,200	3,210
Due from Government and Government Agencies	9	8,913,883	4,563,331
Property, plant and equipment	10	1,624,717	1,629,927
Employee benefits	11	1,549,200	837,200
Other	12	2,273,580	1,447,268
		102,368,064	89,375,062
		218,237,985	161,255,022

The accompanying notes form an integral part of the financial statements.

Balance Sheet (cont'd)

December 31, 2004

	Notes	2004 J$'000	2003 J$'000
LIABILITIES, CAPITAL AND RESERVES			
Liabilities			
Notes and coins in circulation	13	32,391,311	29,424,600
Deposits and other demand liabilities	14	41,996,095	33,204,508*
Open market liabilities	15	125,814,825	79,103,353*
International Monetary Fund - Allocation of Special Drawing Rights	16	3,573,578	3,203,044
Foreign liabilities	17	275,218	332,588
Employee obligations	11	573,600	474,400
Other	18	10,540,764	13,112,117
		215,165,391	158,854,610
Capital and reserves			
Share capital	19	4,000	4,000
General reserve fund	20	20,000	20,000
Special stabilisation account	21	376,637	329,600
Other reserves	22	2,671,957	2,046,812
		3,072,594	2,400,412
		218,237,985	161,255,022

The financial statements on pages 2 to 27 were approved by the Board of Directors on April 5, 2005, and signed on its behalf by:

_____ Governor
Derick Milton Latibeaudiere

_____ Division Chief, Finance and Technology
Herbert A. Hylton

_____ Director, Accounting Services Department
Angela E. Foote

* Reclassified to conform to 2004 presentation

The accompanying notes form an integral part of the financial statements.

Statement of Income and Expenses

Year ended December 31, 2004

	Notes	2004 J$'000	2003 J$'000
Operating income			
Interest		18,686,661	18,508,389
Foreign exchange gain, net	23	1,816,313	11,415,229
Other		173,280	110,637
Total		20,676,254	30,034,255
Operating expenses			
Interest		23,059,296	21,635,766
Salaries and other staff costs	24	996,093	881,145*
Currency expenses		407,978	290,858
Property expenses, including depreciation		317,318	223,916
Other operating expenses		304,078	290,509
Total	25	25,084,763	23,322,194*
Net operating (loss)/profit		(4,408,509)	6,712,061*
Other gains/(losses)			
Pension, medical and life insurance	11(c)	554,200	(14,100)*
Impairment provision, net		(3,998)	(1,269)
(Loss)/gain on remeasurement of staff loans and promissory note		(23,036)	106,157
Loss on revaluation of securities		(40,486)	(363,923)
Gain on disposal of property, plant and equipment		2,299	583
Gain on disposal of investment property		-	6,458
Change in value of investment property		-	8,724
Expenditure on behalf of Government of Jamaica not reimbursed	9	(67,678)	(89,181)
Net (loss)/profit for the year		(3,987,208)	6,365,510
Transferred to pension equalisation reserve	**22(c)**	**(688,800)**	**(73,900)**
Transferred to general reserve fund		(4,676,008)	6,291,610

* Reclassified to conform to 2004 presentation

The accompanying notes form an integral part of the financial statements.

Statement of Changes in Equity
Year ended December 31, 2004

	capital J$'000 (Note 19)	Share fund J$'000 (Note 20)	General reserve account J$'000 (Note 21)	Special stabilisation reserves J$'000 (Note 22)	Other Total J$'000
Balances at December 31, 2002	4,000	-	287,244	2,008,626	2,299,870
Net profit for the year	-	6,291,610	-	-	6,291,610*
Surplus arising on revaluation of property, plant and equipment	-	-	-	154,313	154,313*
Transfer of surplus on defined benefit pension scheme	-	-	-	73,900	73,900*
Change in fair value of available-for-sale securities	-	-	-	(190,027)	(190,027)*
Transfer from coins in circulation	-	-	42,356	-	42,356
Net profit due to consolidated fund	-	(6,271,610)	-	-	(6,271,610)
Balances at December 31, 2003	4,000	20,000	329,600	2,046,812	2,400,412
Net loss for the year	-	(4,676,008)	-	-	(4,676,008)*
Transfer of surplus on defined benefit pension scheme	-	-	-	712,000	712,000*
Change in fair value of available-for-sale securities	-	-	-	(86,855)	(86,855)*
Transfer from coins in circulation	-	-	47,037	-	47,037
Net loss due from consolidated fund (note 9)	-	4,676,008	-	-	4,676,008
Balances at December 31, 2004	4,000	20,000	376,637	2,671,957	3,072,594

*Total recognised losses J$4,050,863,000 (2003: gains J$6,329,796,000).

The accompanying notes form an integral part of the financial statements.

Statement of Cash Flows

Year ended December 31, 2004

	2004	2003
	J$'000	J$'000
Cash provided by operating activities:		
Net (loss)/profit for the year	(3,987,208)	6,365,510
Adjustments to reconcile net (loss)/profit for the year to net cash (used)/provided by operating activities:		
Depreciation	147,918	84,063
Gain on disposal of property, plant and equipment	(2,299)	(583)
Gain on disposal of investment property	-	(6,458)
Employee benefits, net	(589,600)	(42,700)
Change in fair value of investment property	-	(8,724)
Unrealised exchange gain on International Monetary Fund - Quota subscription	(283,970)	(567,918)
Unrealised exchange loss on International Monetary Fund - Allocation of SDR's	370,534	741,038
Net cash (used)/provided by operating activities	(4,344,625)	5,515,370
Cash flows from investing activities:		
Investment in Financial Institutions	10	-
International Monetary Fund - Holding of Special Drawing Rights	(1,285)	36,719
Interest in funds managed by agents	(74,947)	(467,476)
Foreign currency denominated investments	(37,387,451)	11,523,591
Local currency denominated investments	(6,823,055)	(18,461,119)
Proceeds of disposal of investment property	-	36,958
Due from Government and Government Agencies	325,456	(4,966,428)
Additions to property, plant and equipment	(154,963)	(175,792)
Additions to investment property	-	(276)
Proceeds of disposal of property, plant and equipment	14,554	1,407
Other assets	(826,312)	(16,875)
Net cash used by investing activities	(44,927,993)	(11,440,433)
Cash flows from financing activities:		
Notes and coins in circulation	3,013,748	5,102,203
Deposits and other demand liabilities	8,791,587	(37,294,245)
Open market liabilities	46,711,472	31,370,953
Foreign liabilities	(57,370)	28,414
Other liabilities	(2,571,353)	7,930,810
Net cash provided by financing activities	55,888,084	7,138,135
Net increase in cash resources	6,615,466	1,213,072
Cash resources at beginning of year	9,288,095	8,075,023
Cash resources at end of year	15,903,561	9,288,095
Cash resources at end of year comprise:		
Foreign notes and coins	7,911	22,013
Foreign currency cash resources	15,848,943	9,221,708
Local notes and coins	46,707	44,374
	15,903,561	9,288,095

The accompanying notes form an integral part of the financial statements.

Notes to the Financial Statements
December 31, 2004

1. Identification

Bank of Jamaica (hereafter "the Bank") was established under the Bank of Jamaica Act (hereafter "the Act"). The Act was amended effective December 23, 2003 [see note 2(f)]; and on December 8, 2004, to validate and confirm acts done in good faith by the Bank in enforcing the provisions of the Banking (Licenses) (Forms of Application and Fees) Regulations, 1973, from the period of Deember 31, 1992, to November 4, 2003, notwithstanding the repeal of the Banking act, 1960, under which the regulations were made; and to indemnify persons from liability in respect of such acts. The Bank is domiciled in Jamaica and its registered office is located at Nethersole Place, Kingston, Jamaica, W.I.

The principal objects of the Bank, as set out in the Act, are to issue and redeem notes and coins; to keep and administer the external reserves of Jamaica; to influence the volume and conditions of supply of credit so as to promote the fullest expansion in production, trade and employment, consistent with the maintenance of monetary stability in Jamaica and the external value of the currency; to foster the development of money and capital markets in Jamaica; and to act as banker to the Government of Jamaica.

2. Basis of preparation and significant accounting policies

(a) Basis of preparation:

The financial statements are prepared in accordance with the provisions of the Bank of Jamaica Act and International Financial Reporting Standards (IFRS) and their interpretations adopted by the International Accounting Standards Board (IASB).

The preparation of the financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amount of assets, liabilities, contingent assets and contingent liabilities at the balance sheet date and the income and expenses for the year then ended. Actual amounts could differ from these estimates.

The financial statements are presented in Jamaica dollars (J$) and are prepared under the historical cost convention, except for the inclusion of available-for-sale investments, investment property and certain classes of property, plant and equipment at fair value.

(b) Foreign currencies:

The rate of exchange of the Jamaica dollar for the United States dollar is determined by the average of the weighted average rate at which the commercial banks trade in U.S. dollars and the rate at which the Bank itself buys US dollars. The rates of exchange for other currencies are derived from the U.S.$ rate, thus determined, using rates published by the Federal Reserve Bank and the Financial Times.

Foreign currency balances at the balance sheet date are translated at the rates of exchange prevailing at that date. Transactions in foreign currencies are converted at the rates of exchange ruling at the dates of those transactions.

Gains and losses arising from fluctuations in exchange rates are included in the statement of income and expenses.

(c) Financial instruments:

(i) Classification of investments:

Management determines the classification of investments at the time of purchase and takes account of the purpose for which the investments were purchased. Investments are classified as originated loans and receivables and available-for-sale.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(c) Financial instruments (cont'd):

(i) Classification of investments:

Originated loans and receivables are created by the Bank by providing money to a debtor other than those created with the intention of short-term profit taking. Originated loans and receivables are recognised on the day they are transferred to the Bank.

Available-for-sale instruments are those that are not held for trading purposes, or originated by the Bank. Available-for-sale instruments are recognised on the date the Bank commits to purchase the instruments. From this date, any gains and losses arising from changes in fair value of the instruments are recognised in equity.

(ii) Measurement:

Financial instruments are measured initially at cost, including transaction costs.

Subsequent to initial recognition, all available-for-sale investments are measured at fair value, except that any instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably determined, is stated at cost, including transaction costs, less impairment losses [note 2 (j)].

All non-trading financial liabilities and originated loans and receivables are measured at amortised cost, less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

Based on the above guidelines, the Bank's investments are measured as follows:

[i] Loans are classified as originated loans and receivables and are stated at cost (amortised cost), less provision for losses and impairment as appropriate.

[ii] Government of Jamaica securities purchased on the primary market and interest-bearing deposits are stated at historical or amortised cost.

[iii] Government of Jamaica securities purchased on the secondary market are classified as available-for-sale and measured at fair value.

[iv] US Government bonds purchased on the primary market are classified as originated loans and those purchased on the secondary market are classified as available-for-sale. US Government bonds are measured at amortised cost for originated loans and fair value for available-for-sale securities.

[v] Securities sold under repurchase agreements:

A repurchase agreement ("Repo") is a short-term transaction whereby securities are sold with simultaneous agreements for repurchasing the securities on a specified date and at a specified price. Repos are accounted for as short-term collateralised borrowing and are carried at cost.

The difference between the sale and repurchase considerations is recognised on an accrual basis over the period of the agreements, using the effective yield method, and is included in interest.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(c) Financial instruments (cont'd):

(ii) Measurement (cont'd):

[vi] Investments in financial institutions:

Investments in financial institutions are stated at cost less provision for losses. A provision for loss is made where, in the opinion of the directors, there has been a permanent impairment in the value of an investment. Consolidated financial statements are not prepared because the directors are of the view that, at this time, the cost is out of proportion to the benefit to be derived having regard to, *inter alia*, the nature of the activities of the investees. The only remaining subsidiary is in voluntary liquidation (see note 8).

(iii) Fair value measurement principles:

The fair value of financial instruments classified as available-for-sale is based on their quoted market price at the balance sheet date without any deduction for transaction costs. Where a quoted market price is not available, the fair value of the instrument is estimated using pricing models or discounted cash flow techniques or a generally accepted alternative method.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

(iv) Gains and losses on subsequent measurement:

Gains and losses arising from a change in the fair value of available-for-sale assets are recognised directly in equity. When the financial assets are sold, collected or otherwise disposed of, the cumulative gain or loss recognised in equity is transferred to the statement of income and expenses.

(v) Cash resources:

Cash resources, including short-term deposits with maturities ranging between three and twelve months from balance sheet date, are shown at cost.

(vi) Other assets:

These are stated at their cost, less impairment losses [note 2 (j)].

(vii) Other liabilities:

Other liabilities, including provisions, are stated at their cost. A provision is recognised in the balance sheet when the Bank has a legal or constructive obligation as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation, and a reliable estimate of the amount can be made. If the effect is material, provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(c) Financial instruments (cont'd):

(viii) Derecognition:

A financial asset is derecognised when the Bank loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expired or are surrendered. A financial liability is derecognised when it is extinguished.

Available-for-sale assets that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Bank commits to sell the assets.

Originated loans and receivables are derecognised on the day they are transferred by the Bank.

(d) Property, plant and equipment:

(i) Items of property, plant and equipment are stated at cost less accumulated depreciation and impairment losses [note 2 (j)], except for freehold land and buildings which are stated at market value.

(ii) Property, plant and equipment are depreciated on the straight-line method at annual rates estimated to write off the assets over their estimated useful lives. Leasehold property is amortised in equal instalments over the shorter of the lease term and the property's estimated useful life. Land, works of art, statues and museum coins are not depreciated. The depreciation rates are as follows:

Buildings	5% and 10%
Leasehold property	Shorter of lease term and useful life
Furniture, plant and equipment	10%
Computer and software	20%
Motor vehicles	20%

(e) Notes and coins in circulation:

The nominal value of numismatic coins sold is included in notes and coins in circulation. The net proceeds from such sales are included in the statement of income and expenses.

Notes and coins in circulation is stated after a deduction of 25% of the value of coins in circulation in accordance with the Bank of Jamaica (Value of Coins in Circulation) Order 1973, as permitted under Section 22 of the Act. The deductions are credited to the special stabilisation account.

(f) Taxation:

Section 46 of the Act, which exempted the Bank from income tax, stamp duties and transfer tax, was repealed on December 23, 2003 (see note 1). The Bank is still exempt from income tax under Section 12(b) of the Income Tax Act. The Bank's supplies are substantially exempt from general consumption tax (GCT); it incurs GCT at standard rates on taxable supplies acquired.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(g) Employee benefits:

Employee benefits are all forms of consideration given by the Bank in exchange for service rendered by employees. These include current or short-term benefits such as salaries, NIS contributions, annual leave, and non-monetary benefits such as medical care and life insurance; post-employment benefits such as pension and medical care; other long-term employee benefits such as termination benefits.

Employee benefits that are earned as a result of past or current service are recognised in the following manner: Short-term employee benefits are recognised as a liability, net of payments made, and charged as expense. The expected cost of vacation leave that accumulates is recognised when the employee becomes entitled to the leave. Post employment benefits are accounted for as described below.

Employee benefits comprising pensions and other post-employment assets and obligations included in these financial statements have been actuarially determined by a qualified independent actuary, appointed by management. The appointed actuary's report outlines the scope of the valuation and the actuary's opinion. The actuarial valuations were conducted in accordance with IAS 19, and the financial statements reflect the Bank's post-employment benefit asset and obligations as computed by the actuary. In carrying out their audit, the auditors relied on the actuary's report.

The cost of employee benefits is the cost to the Bank of its administration of, and contributions to, the pension scheme established to provide retirement benefits, and its payments to pensioners to supplement the basic pensions to which pensioners are entitled under the rules of the scheme (see note 11). The contributions are a percentage of the members' salaries; the percentage is determined by the scheme's actuaries using the *aggregate actuarial cost* method. Administration costs are charged when incurred, and supplemental payments are charged when paid.

The Bank's net obligation in respect of the defined benefit pension plan is calculated by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods; that value is discounted to determine the present value, and the fair value of any plan assets is deducted. The discount rate is determined by reference to the yield at the balance sheet date on long-term government bonds with maturities approximating the terms of the Bank's obligation. The calculation is performed by a qualified actuary, using *the projected unit credit method.*

When the benefits of the plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the statement of income and expenses on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are vested immediately, the expense is recognised immediately in the statement of income and expenses.

To the extent that any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefits obligation and the fair value of plan assets, that portion is recognised in the statement of income and expenses over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(g) Employee benefits (cont'd):

Where the calculation results in a benefit to the Bank, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

(h) Statutory transfer of profits and losses:

Section 9 of the Act provides for each financial year's net income to be credited, or net loss charged, to the General Reserve Fund, and for the balance on the General Reserve Fund in excess of five times the Bank's authorised share capital to be transferred to the Consolidated Fund. Likewise, any losses not covered by reserves are required by the Act to be funded by Government out of the Consolidated Fund.

(i) Investment property:

Investment property is stated at fair value determined annually by an independent registered valuer. Fair value is based on current prices in an active market for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in the statement of income and expenses. In carrying out their audit, the auditors relied on the valuators' report.

(j) Impairment:

The carrying amounts of the Bank's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated at each balance sheet date. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the statement of revenue and expenses.

(i) Calculation of recoverable amount:

The recoverable amount of loans receivable is determined as indicated in accounting policy note 2(c)(ii).

The recoverable amount of the Bank's investment in originated securities and other assets is calculated as the present value of expected future cash flows, discounted at the original effective interest rate inherent in the asset. The recoverable amount of other assets is the greater of their net selling price and value in use.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(ii) Reversals of impairment:

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

Notes to the Financial Statements (cont'd)
December 31, 2004

2. Basis of preparation and significant accounting policies (cont'd)

(j) Impairment (cont'd):

(ii) Reversals of impairment (cont'd):

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, if no impairment loss had been recognised.

3. Cash resources

	2004 J$'000	2003 J$'000
Current accounts and money at call with foreign banks	15,589,924	9,024,572
Current accounts with local banks	259,019	197,136
	15,848,943	9,221,708

4. Foreign currency denominated investments

	2004 J$'000	2003 J$'000
Originated securities:		
US Government bonds	25,025,614	20,107,054
Available-for-sale securities:		
US Government bonds	3,836,076	6,663,425
Barbados Government bond	36,993	36,631
	28,898,683	26,807,110
Short-term deposits with foreign banks	68,501,120	33,292,097
	97,399,803	60,099,207

5. Local currency denominated investments

	2004 J$'000	2003 J$'000
Originated securities:		
Jamaica Government Securities:		
Local registered stock	63,872,767	60,060,232
Bonds	8,029,843	5,038,547
Debentures	11,497,508	10,619,264
	83,400,118	75,718,043
Available-for-sale securities:		
Jamaica Government Securities:		
Local registered stock	1,708,782	2,202,536
Treasury bills	225	227
Bonds	16,192	14,634
Debentures	5,740	372,562
	1,730,939	2,589,959
	85,131,057	78,308,002

Notes to the Financial Statements (cont'd)
December 31, 2004

6. International Monetary Fund – Quota Subscription

This represents the portion of Jamaica's fee for membership of the International Monetary Fund (IMF), based on its quota, which was paid by the Bank (the other portion having been subscribed by the Government of Jamaica).

Quotas are reviewed every five years, when adjustments may be considered.

	SDR'000	2004 J$'000	2003 J$'000
Amount subscribed (net of reserve tranche of J$Nil):			
At beginning of year	31,125	2,454,750	1,886,832
Effect of exchange rate fluctuation	-	283,970	567,918
At end of year	31,125	2,738,720	2,454,750

7. Investment property

	2004 J$'000	2003 J$'000
Balance at beginning of year	87,000	108,500
Additions	-	276
Disposals	-	(30,500)
Increase in fair value	-	8,724
Balance at end of year	87,000	87,000

The carrying amount of the investment property is the fair value of the property as initially determined by C. D. Alexander Limited in 2003, registered independent valuator having an appropriate recognised professional qualification and recent experience in the location and category of the property being valued. The property was valued as at the year-end by management, who took account of the location of the property. The fair value arrived at by management was determined having regard to recent market transactions for similar properties in the same location as the Bank's investment property and was the same as the independent valuator [note 2 (i)].

8. Investments in financial institutions

Equity	financial earnings/ 2004 J$'000	2003 J$'000	holding %	Latest audited statements	Retained (deficit) J$'000
Subsidiary company:					
Jamaica Export Credit Insurance Corporation Ltd. (in voluntary liquidation)	3,200	3,200	100.00	31.12.96	45,106
Other:					
Jamaica Development Bank Limited	-	10	17.35	31.03.97	(263,614)
	3,200	3,210			

By virtue of Section 23(j) of the Act, the Bank is empowered to, with the approval of the Minister, subscribe to, hold and sell shares in any corporation which, with the approval, or under the authority, of the Government, is established for the purpose of promoting the development of a money market or securities market in Jamaica or of improving the financial machinery for the financing of economic development.

Notes to the Financial Statements (cont'd)
December 31, 2004

9. Due from Government and Government Agencies

	Dec. 31, 2003	Movements during the year: Advances/ Losses	Profit/ Settlements	Charged to expenses	Dec. 31, 2004
	J$'000	J$'000	J$'000	J$'000	J$'000
Expenditure on behalf of Government:					
Payment of exchange losses and interest on foreign liabilities [see (b) below]	-	67,678	-	(67,678)	-
Other expenditure on behalf of Government	1,690	2,299	(1,690)	-	2,299
Withholding tax refund due	1,120,411	2,042,383	-	-	3,162,794
Accrued interest on Government securities	8,653,363	6,418,650	(8,653,363)	-	6,418,650
Overdrafts – Government and Government Agencies	133,735	-	(133,735)	-	-
Net profit payable to/Net loss due from Consolidated Fund	(5,345,868)	4,676,008	-	-	(669,860)
	4,563,331	13,207,018	(8,788,788)	(67,678)	8,913,883

(a) By virtue of Section 36 of the Act, the Bank is empowered to make advances to the Government up to thirty percent of the estimated revenue of Jamaica for that financial year of the Government, which are to be repaid within three months after the financial year. Where advances are not duly repaid, the power of the Bank to grant further advances in any subsequent financial year is not exercisable until the outstanding advances are repaid.

Except for temporary overdrafts, no advances were made to the Government during the Bank's financial years ended December 31, 2004 and 2003.

(b) Exchange losses paid and interest on foreign liabilities comprise:

(i) advances to cover exchange losses realised on repayment of Government of Jamaica foreign liabilities, and

(ii) interest paid on Government of Jamaica foreign liabilities.

(c) Government is required by the Act to pay to the Bank, out of the Consolidated Fund, the losses incurred by the Bank. Section 9 (3) provides that if, in the opinion of the Minister, a payment to the Bank to clear the losses cannot be made from the Consolidated Fund, then such losses may be cleared by the issue to the Bank of securities charged to the Consolidated Fund.

Notes to the Financial Statements (cont'd)
December 31, 2004

10. Property, plant and equipment

	Freehold land and buildings J$'000	Leasehold property J$'000	Furniture, plant and equipment J$'000	Motor vehicles J$'000	Work-in-progress J$'000	Total J$'000
At cost or valuation:						
December 31, 2003	1,234,000	1,208	706,873	99,913	36,200	2,078,194
Additions	29,437	-	68,328	49,858	7,340	154,963
Transfers	-	-	36,200	-	(36,200)	-
Disposals/write-offs	-	-	-	(33,793)	-	(33,793)
December 31, 2004	1,263,437	1,208	811,401	115,978	7,340	2,199,364
At cost	-	1,208	811,401	115,978	7,340	935,927
At valuation	1,263,437	-	-	-	-	1,263,437
	1,263,437	1,208	811,401	115,978	7,340	2,199,364
Depreciation:						
December 31, 2003	-	784	413,630	33,853	-	448,267
Charge for the year	63,212	57	74,331	10,318	-	147,918
Eliminated on disposals	-	-	-	(21,538)	-	(21,538)
December 31, 2004	63,212	841	487,961	22,633	-	574,647
Net book values:						
December 31, 2004	1,200,225	367	323,440	93,345	7,340	1,624,717
December 31, 2003	1,234,000	424	293,243	66,060	36,200	1,629,927

The Bank's land and buildings were revalued in 2003 by The C. D. Alexander Company Realty Limited, Real Estate Broker, Appraiser and Auctioneer on the open-market, existing-use basis. A revaluation was not done during the year as management is of the opinion that there was no significant change in the value of the land and buildings. The surplus arising on revaluation, inclusive of depreciation no longer required, is included in property revaluation reserve (note 22).

11. Employee benefits

The Bank operates a non-contributory defined benefit pension scheme, and medical and life insurance schemes for all its permanent eligible employees and funds retirement benefits, except as set out at (e) below. Benefits under the pension scheme are computed by reference to final salary. The assets of the scheme, which are held separately from those of the Bank, are under the control of a board of trustees, with day-to-day management by employees of the Bank.

(a) Employee benefits asset/obligation:

	Asset		Obligation	
	2004 J$'000	2003 J$'000	2004 J$'000	2003 J$'000
Present value of funded obligations	1,449,500	1,133,400	-	-
Present value of unfunded pension obligations, medical and life insurance	-	-	761,500	652,200
Fair value of plan assets	(4,199,100)	(3,710,400)	-	-
Unrecognised actuarial losses/(gains)	443,100	531,500	(187,900)	(177,800)
Unrecognised assets due to limitation	757,300	1,208,300	-	-
Net (asset)/obligation at end of year	(1,549,200)	(837,200)	573,600	474,400

Notes to the Financial Statements (cont'd)
December 31, 2004

11. Employee benefits (cont'd)

(b) Movements in the net (asset)/obligation recognised in the balance sheet:

	Asset		Obligation	
	2004	2003	2004	2003
	J$'000	J$'000	J$'000	J$'000
Net (assets)/obligations at January 1	(837,200)	(763,300)	474,400	443,200
Contributions	(23,200)	(21,300)	(35,400)	(35,500)
(Income)/expense recognised in the statement of income and expenses	(688,800)	(52,600)	134,600	66,700
Net (assets)/obligations at end of year	(1,549,200)	(837,200)	573,600	474,400

(c) (Income)/expense recognised in the statement of income and expenses:

	Asset		Obligation	
	2004	2003	2004	2003
	J$'000	J$'000	J$'000	J$'000
Current service costs	38,400	35,100	19,500	11,700
Interest on obligation	161,600	130,400	91,200	55,000
Expected return on plan assets	(463,100)	(306,000)	-	-
Net actuarial (gains)/losses recognised	(10,700)	-	7,500	-
Change in disallowed assets	(451,100)	87,900	-	-
Past service costs	36,100	-	16,400	-
Total included in staff costs	(688,800)	(52,600)	134,600	66,700
Actual return on plan assets	11.89%	17.65%		

(d) Principal actuarial assumptions at the balance sheet date (expressed as weighted averages)

	2004	2003
	%	%
Discount rate at January 1	12.5	14.0
Expected return on plan assets at January 1	11.0	12.5
Future salary increases	9.0	9.5
Future pension increases	3.0	3.0
Medical claims growth	11.0	12.5

(e) The Bank granted increases to pensioners as a supplement to the pensions paid by the scheme. An actuarial valuation disclosed that for the scheme to take over these supplemental payments currently being paid by the Bank, in addition to increases proposed with effect from December 31, 2001, a special contribution of J$168,700,000 would be required from the Bank as of the valuation date. No provision for this lump sum amount is included in the financial statements, as the scheme is already overfunded.

In addition, the Bank granted a further supplement to pensioners: these supplemental pension payments amounted to J$31,261,099 for the year (2003: J$30,613,059), all of which have been included in staff costs in the statement of income and expenses.

Notes to the Financial Statements (cont'd)
December 31, 2004

12. Other assets

	2004 J$'000	2003 J$'000
Items in process of collection	2,610	20,203
Overdrafts	7,766	13,584
Staff and ex-staff loans, including interest receivable	822,621	765,728
Stock of unissued notes and coins	1,343,623	496,465
Accrued interest receivable other than on GOJ securities	361,616	372,558
Promissory notes	95,971	109,217
Other	22,252	26,137
	2,656,459	1,803,892
Less:		
Remeasurement of promissory note	(13,217)	(15,922)*
Impairment and remeasurement of staff and ex-staff loans	(369,662)	(340,702)*
	2,273,580	1,447,268

* Reclassified to conform to 2004 presentation

13. Notes and coins in circulation

	2004 J$'000	2003 J$'000
Notes	31,261,400	28,435,801
Coins	1,129,911	988,799
	32,391,311	29,424,600

Section 21 of the Act requires the Bank to hold assets of an amount in value sufficient to cover the value of the total amount of notes and coins in circulation as defined in that section. The assets held shall include, *inter alia*, (a) gold; (b) "hard currency" cash, bank balances or securities issued by a foreign government or international financial institution of which Jamaica is a member; or (c) Special Drawing Rights. Specified assets held by the Bank, as at December 31, 2004, were 3.58 (2003: 2.44) times the value of notes and coins in circulation at that date.

14. Deposits and other demand liabilities

	2004 J$'000	2003 J$'000
Government and Government agencies	3,765,105	2,530,657
Commercial banks and specified financial institutions	34,068,653	28,525,936
International Money Fund	58,828	58,828
Others	4,103,509	2,089,087
	41,996,095	33,204,508
Jamaica dollar equivalent of foreign currency deposits	9,709,279	9,063,798
Jamaica dollar deposits	32,286,816	24,140,710
	41,996,095	33,204,508

Notes to the Financial Statements (cont'd)
December 31, 2004

14. Deposits and other demand liabilities (cont'd)

Deposit liabilities of the Bank include cash reserves held in connection with the Bank's supervision of the prudential requirements of commercial banks and specified financial institutions under the provisions of section 28 of the Act, section 14 of the Banking Act and section 14 of the Financial Institutions Act.

In relation to its management of liquidity in the financial system, the Bank may, under section 28A of the Bank of Jamaica Act, require commercial banks and specified financial institutions to make special deposits with it in the form of cash or specified securities. Cash so deposited is also included in deposit liabilities of the Bank; securities so deposited are, however, excluded from the Bank's liabilities, as title is not transferred and the Bank merely holds them in safekeeping.

At the balance sheet date, the following obtained:

	2004 J$'000	2003 J$'000
Amounts included in deposit liabilities of the Bank, representing statutory reserves	28,845,363	25,488,221

15. Open market liabilities

As part of the process of controlling liquidity in the financial system, the Bank acquires funds from or makes funds available to financial institutions and this is effected by entering into short-term agreements with the institutions. The Bank, on taking delivery of the funds, delivers certificates evidencing transfer of interest in securities and agrees to repurchase them on a specified date and at a specified price ('repos'). When the Bank makes funds available, it receives securities and agrees to resell them on a specified date at a specified price ('reverse repos'). The Bank did not issue any new repos during the year. Open market activities are now being done using certificates of deposit.

The liability at the year-end is broken down as follows:

	2004 J$'000	2003 J$'000
Securities under repurchase agreements	30,845,486	56,705,566
Certificates of deposit	94,969,339	22,397,787
	125,814,825	79,103,353

At the balance sheet date, certificates evidencing temporary transfer of interest in the following securities were delivered as repos:

	2004 J$'000	2003 J$'000
Securities under repurchase agreements:		
Local registered stocks	23,912,457	51,674,103
Investment debentures	3,850,342	1,278,298
Investment bonds	3,082,687	3,753,165
	30,845,486	56,705,566

Notes to the Financial Statements (cont'd)
December 31, 2004

16. International Monetary Fund - Allocation of Special Drawing Rights

This represents the Bank's obligation for Special Drawing Rights (SDRs) allocated to it. This allocation does not change unless there are cancellations or further allocations. There have been no further allocations or cancellations during the year (2003: Nil) and, accordingly, the changes arise from exchange rate fluctuations.

	SDRs'000	2004 J$'000	2003 J$'000
At beginning of year	40,613	3,203,044	2,462,006
Effect of exchange rate fluctuation	-	370,534	741,038
At end of year	40,613	3,573,578	3,203,044

17. Foreign liabilities

	2004 J$'000	2003 J$'000
Borrowings - Principal	258,848	310,536
- Accrued interest	4,516	5,229
Unsettled balances on bilateral accounts for Caricom trade	11,854	16,823
	275,218	332,588

18. Other liabilities

	2004 J$'000	2003 J$'000
Interest payable	9,975,399	12,756,663
Staff and staff-related expenses	147,865	141,239
Other	417,500	214,215
	10,540,764	13,112,117

Staff, staff-related and other expenses include provisions broken down as follows:

	2004 J$'000	2003 J$'000
Balance at beginning of year	160,179	148,733
Provisions made during the year	75,618	68,985
Provisions used during the year	(64,721)	(57,539)
Balance at end of year	171,076	160,179

19. Share capital

Section 8 of the Act provides for the capital of the Bank to be J$4,000,000, which has been paid by Government of Jamaica.

Notes to the Financial Statements (cont'd)
December 31, 2004

20. General Reserve Fund

Section 9 of the Act provides that the Bank shall establish and maintain a General Reserve Fund:

(a) to which, at the end of each financial year, the net income for that year shall be transferred or the net losses charged;

(b) from which shall be paid to the Consolidated Fund the amount by which, at the end of the financial year, the balance thereon exceeds five times the Bank's authorised share capital;

(c) into which should be paid from the Consolidated Fund at the end of the financial year, the amount by which the Bank's net loss exceeds the balance in the General Reserve Fund.

21. Special stabilisation account

The special stabilisation account is maintained at 25% of the coins in circulation as a reserve against coins that are unlikely to be redeemed.

22. Other reserves

This represents the following:

	2004 J$'000	2003 J$'000
Securities revaluation reserve [see (a)]	(1,999)	84,856
Property revaluation reserve [see (b)]	1,124,756	1,124,756
Pension equalisation reserve [see (c)]	1,549,200	837,200
	2,671,957	2,046,812

(a) This represents the unrealised gains/losses on the revaluation of available-for-sale investments.

(b) The property revaluation reserve represents the surplus arising on the revaluation of certain freehold properties (see note 10).

(c) The pension equalisation reserve represents the pension surplus arising on the actuarial valuation, under IAS 19, of the Bank's pension scheme. Annual changes in the value of the scheme are shown in the statement of income and expenses, then transferred to this reserve.

23. Foreign exchange gain

	2004 J$'000	2003 J$'000
Net unrealised gain on translation of foreign currency assets and liabilities and realised gain on settlement of foreign assets and foreign liabilities	2,113,205	11,822,287
Exchange loss on purchases and sales of foreign currency	(296,892)	(407,058)
	1,816,313	11,415,229

Notes to the Financial Statements (cont'd)
December 31, 2004

24. Employee numbers and costs

The number of employees at the end of the year was 486 (2003: 473) full-time and 36 (2003: 39) contract. The related costs for these employees were as follows:

	2004 J$'000	2003 J$'000
Salaries and wages	833,514	754,152
Statutory payroll contributions	57,828	46,210
Uniforms	10,124	16,759
Staff welfare	48,844	42,735
Other	45,783	21,289
	996,093	881,145

25. Operating expenses

Operating expenses include the following charges:

	2004 J$'000	2003 J$'000
Depreciation	147,918	84,063
Auditors' remuneration	4,900	4,650
Payments for redundancies	12,478	62

26. Capital commitments

At the balance sheet date, the Bank had commitments for capital expenditure as under:

	2004 J$'000	2003 J$'000
Authorised and contracted	42,102	36,639
Authorised but not contracted	99,568	13,540
	141,670	50,179

27. Contingent liabilities

At December 31, 2004, the Bank was a defendant in various relatively minor suits claiming damages. The Bank is of the view that the claims are generally without merit and will not result in any significant losses to the Bank. There are no lawsuits pending with the Bank as plaintiff as at December 31, 2004.

Notes to the Financial Statements (cont'd)
December 31, 2004

28. Financial instruments

A financial instrument is any contract that gives rise to a financial asset of one enterprise and a financial liability or equity instrument of another enterprise.

(a) Fair value of financial instruments:

Fair value is the arm's length consideration for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties, who are under no compulsion to act and is best evidenced by a quoted market price, if one exists.

Determination of fair value:

The financial instruments held at the balance sheet date are: cash resources, interest in funds managed by agents, foreign and local currencies denominated investments, other assets, due from Government and Government Agencies, deposits and other demand liabilities, securities sold under repurchase agreements, International Monetary Fund – Allocation of Special Drawing Rights, foreign liabilities and other liabilities.

The fair value of foreign and local currencies denominated investments is assumed to be equal to the estimated market values as provided in notes 4 and 5, respectively. These values are obtained on the basis outlined in note 2(c)(iii).

The fair value of certain short-term financial instruments was determined to approximate their carrying value.

No fair value has been estimated on the amount due from Government and Government Agencies, as there is no practical means of estimating its fair value.

(b) Financial instrument risk:

Exposure to foreign currency, interest rate, credit, market, liquidity and cash flow risks arises in the ordinary course of the Bank's business. No derivative instruments are presently used to manage, mitigate or eliminate exposure to financial instrument risks.

(i) Foreign currency risk:
Foreign currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. At the balance sheet date, the Bank's net exposure to foreign exchange rate fluctuations was as follows:

	2004 J$'000	2003 J$'000
Foreign currency assets	118,948,588	74,615,244
Foreign currency liabilities	(13,616,898)	(12,665,353)
Net foreign currency assets	105,331,690	61,949,891

	2004	2003
Buying exchange rates at December 31:		
US$1 to J$	61.52	60.40
UK£1 to J$	117.87	107.77
CDN$1 to J$	51.12	46.74
€ to J$	83.29	76.09

At April 5, 2005, the buying exchange rates were US$1 to J$61.30, UK£1 to J$112.41, CDN$1 to J$49.58 and € 1 to J$78.72.

Notes to the Financial Statements (cont'd)
December 31, 2004

28. Financial instruments (cont'd)

(b) Financial instrument risk (cont'd):

(ii) Interest rate risk:

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The Bank manages this risk by monitoring interest rates daily and ensuring that, even though there is no formally predetermined gap limits, to the extent practicable, the maturity profile of its financial assets is matched by that of its financial liabilities.

The following table summarises the carrying amounts of balance sheet assets, liabilities and equity to arrive at the Bank's interest rate gap based on the earlier of contractual repricing and maturity dates.

	2004						
	Within 3 months J$'000	Three to 12 months J$'000	Over 12 months J$'000	Payable after notice J$'000	Non-rate sensitive J$'000	Total J$'000	Weighted average interest %
Assets							
Notes and coins	-	-	-	-	54,618	54,618	-
Cash resources	-	-	-	-	15,848,943	15,848,943	-
Interest in funds managed by agents	-	-	-	2,608,781	-	2,608,781	2.14
Foreign currency denominated investments	68,501,120	-	28,898,683	-	-	97,399,803	2.55
International Monetary Fund - Holding of Special Drawing Rights	-	-	-	-	4,483	4,483	-
Local currency denominated investments	954,138	4,390,290	79,786,629	-	-	85,131,057	15.99
International Monetary Fund – Quota Subscription	-	-	-	-	2,738,720	2,738,720	-
Investment property	-	-	-	-	87,000	87,000	-
Investments in financial institutions	-	-	-	-	3,200	3,200	-
Due from Government and Government agencies	-	-	-	-	8,913,883	8,913,883	-
Property, plant and equipment	-	-	-	-	1,624,717	1,624,717	-
Employee benefits	-	-	-	-	1,549,200	1,549,200	-
Other assets	-	-	-	95,971	2,177,609	2,273,580	0.22
Total assets	69,455,258	4,390,290	108,685,312	2,704,752	33,002,373	218,237,985	5.22
Liabilities							
Notes and coins in circulation	-	-	-	-	32,391,311	32,391,311	-
Deposits and other demand liabilities:							
Jamaica dollar equivalent of foreign currency deposits	683,199	-	-	9,026,080	-	9,709,279	-
Jamaica dollar deposits	12,305,770	-	-	19,981,047	-	32,286,816	-
Open market liabilities	57,277,102	68,537,722	-	-	-	125,814,825	15.99
International Monetary Fund – Allocation of Special Drawing Rights	-	-	-	-	3,573,578	3,573,578	-
Foreign liabilities	-	-	258,848	-	16,370	275,218	8.2
Employee obligations	-	-	-	-	573,600	573,600	-
Other liabilities	-	-	-	-	10,540,764	10,540,764	-
Capital and reserves	-	-	-	-	3,072,594	3,072,594	-
Total liabilities	70,266,071	68,537,722	258,848	29,007,127	50,168,217	218,237,985	12.10
Total interest rate sensitivity gap	(810,813)	(64,147,432)	108,426,464	(26,302,375)	(17,165,844)	-	-
Cumulative gap	(810,813)	(64,958,245)	43,468,219	17,165,844	-	-	-

Notes to the Financial Statements (cont'd)
December 31, 2004

28. Financial instruments (cont'd)

(b) Financial instrument risk (cont'd):

(ii) Interest rate risk: (cont'd)

	2003						
	Within 3 months J$'000	Three to 12 months J$'000	Over 12 months J$'000	Payable after notice J$'000	Non-rate sensitive J$'000	Total J$'000	Weighted average interest %
Assets							
Notes and coins	-	-	-	-	66,387	66,387	-
Cash resources	-	-	-	-	9,221,708	9,221,708	-
Interest in funds managed by agents	-	-	-	2,533,834	-	2,533,834	3.79
Foreign currency denominated investments	33,292,095	-	26,807,112	-	-	60,099,207	2.46
International Monetary Fund - Holding of Special Drawing Rights	-	-	-	-	3,198	3,198	-
Local currency denominated investments	1,904,412	5,108,873	71,294,717	-	-	78,308,002	24.80
International Monetary Fund – Quota Subscription	-	-	-	-	2,454,750	2,454,750	-
Investment property	-	-	-	-	87,000	87,000	-
Investments in financial institutions	-	-	-	-	3,210	3,210	-
Due from Government and Government agencies	-	-	-	-	4,563,331	4,563,331	-
Property, plant and equipment	-	-	-	-	1,629,927	1,629,927	-
Employee benefits	-	-	-	-	837,200	837,200	-
Other assets	-	-	-	109,217	1,338,051	1,447,268	0.22
Total assets	35,196,507	5,108,873	98,101,829	2,643,051	20,204,762	161,255,022	7.82
Liabilities							
Notes and coins in circulation	-	-	-	-	29,424,600	29,424,600	-
Deposits and other demand liabilities:							
Jamaica dollar equivalent of foreign currency deposits	1,095,042	-	-	7,968,756	-	9,063,798	0.58
Jamaica dollar deposits	2,866,001	-	-	17,670,745	3,603,964	33,204,508	-
Open market liabilities	32,074,789	47,028,564	-	-	-	79,103,353	26.85
International Monetary Fund – Allocation of Special Drawing Rights	-	-	-	-	3,203,044	3,203,044	-
Foreign liabilities	-	-	310,536	-	22,052	332,588	8.4
Employee obligations	-	-	-	-	474,400	474,400	-
Other liabilities	-	-	-	-	13,112,117	13,112,117	-
Capital and reserves	-	-	-	-	2,400,412	2,400,412	-
Total liabilities	36,035,832	47,028,564	310,536	25,639,501	52,240,589	161,255,022	11.94
Total interest rate sensitivity gap	(839,325)	(41,919,691)	97,791,293	(22,996,450)	(32,035,827)	-	-
Cumulative gap	(839,325)	(42,759,016)	55,032,277	32,035,827	-	-	-

(iii) Credit risk:

Credit risk is the risk of loss arising from a counter-party to a financial contract failing to discharge its obligations.

Credit risk in the foreign currency investment portfolio is managed by restricting the holdings of investments substantially to US Government securities, other highly rated sovereign issues, Jamaica Government US$ debentures and placements in highly rated supranational institutions.

Notes to the Financial Statements (cont'd)
December 31, 2004

28. Financial instruments (cont'd)

(b) Financial instrument risk (cont'd):

(iii) Credit risk (cont'd):

Credit risk for local securities is managed by investing primarily in Government of Jamaica securities. Other credit exposures consist mainly of staff loans for housing and motor vehicles.

Exposures to credit risk attaching to financial assets are monitored through credit rating and lending limits, which are regularly reviewed. In addition, securities issued or guaranteed by the Government of Jamaica are required to collateralise advances to financial institutions. Mortgages and liens are obtained for housing and motor vehicle loans to staff, respectively.

Cash resources are held in financial institutions which management regards as strong and there is no significant concentration. The Bank's significant concentrations of credit exposure by geographical areas (based on the entity's country of ownership) are as follows:

	2004 J$'000	2003 J$'000
Jamaica	85,857,435	78,622,100
U.S.A. and other industrialised countries	115,241,032	71,316,693
Barbados	36,993	36,631
Multilateral Institutions	2,743,203	2,457,948
Other	360,061	617,573
Total financial assets	204,238,724	153,050,945

Current credit exposure is the amount of loss that the Bank would suffer if every counterparty to which the Bank was exposed were to default at once; this is represented substantially by the carrying amount of financial assets shown on the balance sheet.

(iv) Market risk:

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices, whether those changes are caused by factors specific to the individual security, its issuer or factors affecting all securities traded in the market.

The Bank manages market risk on its foreign asset portfolio through:

- Its investment policy, which prescribes the quality of the issuer and limits investments to specific foreign government securities that are deemed to be virtually risk free.
- Its diversification of the portfolio into various instruments while limiting the maximum permitted exposure to any one security or issuer.
- Its policy of holding securities to maturity which in essence eliminates the possibility of loss arising from fluctuations in market price.

Notes to the Financial Statements (cont'd)
December 31, 2004

28. Financial instruments (cont'd)

(b) Financial instrument risk (cont'd):

(iv) Market risk (cont'd):

Market risk on the Bank's local asset portfolio of investments is minimised by restricting investments to securities issued or guaranteed by the Government of Jamaica.

(v) Liquidity risk:

Liquidity risk, also referred to as funding risk, is the risk that the Bank will encounter difficulty in converting its securities to cash at, or close to, its fair value or in raising funds to meet its commitments. Prudent liquidity management implies maintaining sufficient cash and marketable securities, and ensuring the availability of funding through an adequate amount of committed standby credit facilities to meet commitments.

The Bank's exposure to liquidity risk to meet foreign liabilities, as an institution, is limited due to the minimal amount owed to overseas creditors/lenders. Management of liquidity risk relates primarily to the availability of liquid foreign resources to sell to the Government of Jamaica and its agencies to repay their creditors and lenders. The Bank manages this risk through a combination of:

- Budgetary procedures to identify the timing of Government foreign payments.
- Scheduling the maturity of foreign deposits to coincide with the demands of Government and its Agencies.
- Maintaining a portion of its foreign assets in cash or near cash as precautionary funds to meet unforeseen demands.

The Bank, like all central banks, has no real liquidity risk in relation to its domestic financial obligations.

(vi) Cash flow risk:

Cash flow risk is the risk that future cash flows associated with a monetary financial instrument will fluctuate in amount.

The Bank manages this risk through budgetary measures ensuring, as far as possible, that financial assets and liabilities are matched to mitigate any significant adverse cash flows.