ANNUAL REPORT

2005

Report and Statement of Accounts for the
Year Ended 31 December 2005

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.

The Governor

Bank Of Jamaica
Nethersole Place
Kingston, Jamaica, W.I.

31 March 2006

Dr. The Hon. Omar Davies
Minister of Finance & Planning
Ministry of Finance
30 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 2005 and a copy of the Statement of the Bank's Accounts as at 31 December 2005 duly certified by the Auditors.

Yours sincerely,

Derick Latibeaudiere

PRINCIPAL OFFICERS

GOVERNOR

The Hon. Derick Latibeaudiere, O.J.

SENIOR DEPUTY GOVERNOR

Mrs. Audrey Anderson, C.D.

DEPUTY GOVERNORS

1.	Mr. Rudolph Muir	-	General Counsel & Bank Secretary,
2.	Mrs. Myrtle Halsall (Acting)	-	Research & Economic Programming and Banking & Market Operations Divisions
3.	Mrs. Gayon Hosin (Acting)	-	Financial Institutions Supervisory Division

GENERAL MANAGER

Mr. Kenloy Peart

DIVISION CHIEFS

1.	Mrs. Natalie Haynes	-	Banking & Market Operations Division
2.	Mr. John Robinson	-	Research & Economic Programming Division
4.	Mrs. Faith Stewart	-	Payment Systems and Risk Management

FINANCIAL CONTROLLER

Mr. Herbert Hylton - Finance & Technology Division

DEPUTY GENERAL COUNSEL

Mr. Randolph Dandy - Senior Legal Counsel, Legal Department

CHIEF INTERNAL AUDITOR

Mrs. Evadnie Sterling - Internal Audit Department

CONTENTS

1. Overview

The Bank of Jamaica (BOJ), in 2005, operated within a context of contrasting macroeconomic circumstances. The generally stable conditions that prevailed in 2004 were mirrored in the first half of 2005. However, the economy was adversely affected by three hurricanes and steeper international oil prices in the second half of the year. Although these shocks resulted in a less favourable economic out-turn than anticipated, there was an improvement in the major macroeconomic targets relative to 2004. Headline inflation moderated during the year to 12.9 per cent from 13.7 per cent while there was acceleration in economic growth to 1.4 per cent from 0.9 per cent. In fulfilling its mandate of price stability, core inflation was contained to 5.2 per cent for the year. At the same time, all the indicators of the banking sector surpassed international benchmarks, reflecting the Bank's continued maintenance of financial stability. During the year, Jamaica participated, for the first time, in the IMF/IBRD Financial Sector Assessment Programme (FSAP) in conjunction with the continued Intensified Surveillance Programme (ISP). The release of findings of the FSAP assessment by the IMF is pending but the rounds of discussions and preliminary reports point to a very satisfactory rate of compliance with international norms and best practices.

In the first half of the year, investor confidence was buoyed by a relatively stable exchange rate, the expansion of economic output, a strong net international reserves (NIR) position, fiscal stability and expectations of lower inflation. As a result of this confidence, the Bank purchased a large volume of foreign currency from the market as investors switched from foreign currency investments to local currency assets. This contributed to a build-up of US$298.3 million in the NIR to US$2 156.8 million by the end of June. Concurrently, given the increased demand for local currency assets, the Bank absorbed approximately $37.0 billion through its open market window resulting in a much faster contraction in the monetary base, relative to programme. At the same time, the policy challenges from the Government's demand for financing were minimal. The issue of a US$300.0 million 10-year Eurobond by the Government on 25 May, at a historically low coupon rate of 9.0 per cent, also highlighted investors' confidence in the macroeconomic programme and allowed the Government to issue domestic debt at lower rates.

These developments enabled the Bank to reduce interest rates on its entire spectrum of open market instruments, as well as to reduce the special deposit requirement. Interest rates were lowered on three occasions, two of these reductions occurring in the March quarter and the final reduction on 26 May. The rate on the 365-day tenor, the longest tenor, was cut by 1.9 percentage points to 13.60 per cent by the end of the period. The special deposit requirement for commercial banks and institutions licensed under the Financial Institutions Act (FIAs) was reduced to 1.0 per cent from 5.0 per cent during the first half of the year.

During the second half of the year, policy challenges arose mainly from the adverse impact of severe weather conditions. Two hurricanes, Dennis and Emily, affected the country from as early as July. These developments

led to expectations of a very active hurricane season and the cancellation of a number of bookings in the tourist industry from as early as July. The situation was exacerbated by the passage of Hurricane Wilma in October, which lingered around the island for an extended period causing heavy rainfall and significant damage to agriculture and road infrastructure.

The fall-off in visitor arrivals and the accompanying reduction in inflows to the foreign exchange market prompted some end-users to bring forward their purchases of foreign currency. The damage to agriculture resulted in sharp increases in the prices of agricultural commodities. This worsened the inflation outturn, changed inflation expectations and engendered concerns about real returns on Jamaica Dollar assets. The situation was compounded by a spike in annual inflation to 19.2 per cent in September, rising international oil prices and international interest rates. The cumulative effects resulted in a 4.4 per cent depreciation in the exchange rate in the second half of the year in contrast to a depreciation of 0.3 per cent in the first six months.

As a result of these developments, the Bank halted the series of interest rate reductions and employed a two-pronged approach to stabilize the foreign exchange market. This comprised the sale of foreign exchange and securities from the Bank's portfolio. Notwithstanding the sales to the market, the NIR at end December was US$2 087.4 million. This outturn was US$69.4 million lower than the outturn at end June and US$5.1 million above the programme target.

Headline inflation in 2005 continued the downward path observed since 2004. Inflation moderated to 12.9 per cent in the year in comparison to 13.7 per cent and 14.1 per cent in 2004 and 2003, respectively. The rate for 2005 was influenced by a number of factors including severe weather conditions, administrative price increases and rising international oil prices. The prices of agricultural supplies, mainly fruits and vegetables, were adversely affected by bushfires and severe drought conditions early in the year, followed by excessive rainfall associated with the passage of the hurricanes. In addition, a shortfall in beef supplies also led to a sharp increase in beef prices.

Administrative price adjustments during the year included increases in the national minimum wage, bus fares and revenue enhancement measures by the Government. The national minimum wage was increased by 20.0 per cent early in the year, while bus and taxi fares were adjusted by approximately 33.6 per cent in September due to increased operating costs arising from movements in international oil prices, insurance rates and maintenance costs. The revenue enhancement measures which had the most significant impact on prices were increases in the General Consumption Tax (GCT) and the Special Consumption Tax (SCT) on tobacco products, the removal of zero-rated GCT status from a number of items, as well as increased property taxes.

International oil prices increased to unprecedented levels with the average price of the benchmark West Texas Intermediate (WTI) crude oil increasing by 36.2 per cent in 2005 to approximately US$56.47 per barrel following a sharp increase of 34.8 per cent in 2004. This had a noticeable effect on the prices of domestic household and automotive fuels, as well as utility rates, mainly electricity. Within this context, the Bank was able to maintain core inflation at 5.2 per cent in 2005.

The monetary base increased by 9.7 per cent in 2005, relative to an increase of 11.2 per cent in 2004. This was reflected in lower growth in both the stock of currency issue and the commercial banks' local currency statutory reserves. The slower growth in the statutory reserves mainly reflected a deceleration in the growth of all categories of deposits in a context of a decline in real wages in the public sector, as well as a switch to higher yielding financial assets. An increased use of alternative means of payment such as point of sale transactions (POS) would have explained the slower growth in currency.

The pattern of growth in the deposit base of the commercial banks was replicated across the building societies' savings fund while the deposits of the FIAs recorded a decline. Notwithstanding the slowdown in the major source of financing for these institutions, loan portfolios expanded at a faster rate during the year. Commercial banks' loans and advances to the private sector grew by 19.2 per cent in 2005, relative to an increase of 16.5 per cent in 2004. The growth in 2005 was primarily reflected in *Personal Loans* and *Tourism*. The FIAs also recorded a faster expansion in loans and advances relative to 2004 and similar to the commercial banks, the expansion was driven by *Personal Loans* and loans to *Tourism*. New mortgage loans extended by building societies increased by 21.3 per cent in 2005, marginally above the increase of 21.0 per cent in 2004. Commercial mortgages more than doubled during the year while residential mortgages increased at a slower rate, relative to 2004. The increase in loans across institutions occurred in a context of aggressive marketing as reflected in a decline in loan rates. The decline in rates was in keeping with the rate reductions by the Central Bank early in the year.

In the context of declining interest rates, deposit-taking institutions (DTIs) continued to rebalance their portfolios towards loans, a trend observed over the previous four years. The growth in loans facilitated economic expansion and allowed institutions to improve their profitability during the year in contrast to a decline in profitability in 2004. The improved position was also influenced by an increase in non-interest income and containment in expenditure due to a reduction in the cost of borrowing. All DTIs reported an improvement in capital adequacy ratios during the year while commercial banks and building societies reported improvement in the quality of loan portfolios. In addition, stress tests conducted during the year indicated that the banking system would remain robust in the event of interest rate, exchange rate, liquidity and credit shocks of sizeable magnitudes.

Gross Domestic Product (GDP) is estimated to have grown by 1.4 per cent in 2005, relative to growth of 1.0 per cent in 2004. The expansion emanated from both the goods producing and services sectors which increased by 1.5 per cent and 1.4 per cent, respectively. Within the goods producing sectors, growth was recorded in *Construction* and *Mining* and was partially offset by declines in *Agriculture* and *Manufacturing*.

Growth in *Construction* and *Mining* stemmed largely from expansions in the hotel and bauxite sectors led by continued foreign direct investments. In addition, there was continued road expansion, improvement and modernization of the sea and air ports, construction related to the inner-city housing project as well as post hurricane reconstruction activity. Production in *Agriculture* was severely affected by the adverse weather conditions which influenced a decline in both domestic and export crops, traditional crops being primarily affected.

The service sectors continued to be the larger contributor to growth, accounting for 70.6 per cent during the year. Growth in services was mainly fuelled by the continued expansion of the *Communication* sub-sector. The recovery in tourism influenced an expansion in *Miscellaneous Services* and *Transport*.

The current account deficit of the balance of payments (BOP) is estimated to have widened by US$465.6 million to US$975.0 million or 9.7 per cent of GDP in 2005, reflecting the effects of the hurricanes on real sector activities as well as developments in the global economy. This was in contrast to the improvement observed over the previous two years. The deterioration was reflected in the goods and income accounts due mainly to an increase in the value of fuel imports and net outflows from investment income, respectively. The services balance recorded an improvement due primarily to an increase on the *Travel* account as gross earnings from tourist expenditure increased in the year. There was also growth in *Current Transfers* as the economy continued to benefit from significant inflows of remittances, which increased by 11.8 per cent in 2005.

The total surplus on the capital and financial accounts was sufficient to finance the current account deficit and allowed for an increase in the NIR for the year. This surplus was due mainly to net private investment flows, mainly foreign direct investments and portfolio investments which grew to US$875.3 million or 19.3 per cent in the year.

During the year, performance of the stock market was adversely affected by the impact of the hurricanes, rising international oil prices as well as the downward adjustments in the benchmark interest rates by the Bank of Jamaica. The delisting of Dyoll Group Limited by the JSE in February severely affected the psychology in the market. In this context, all the indices on the stock exchange declined during the year. There was one initial public offering in 2005, Mayberry Investments Ltd.

The BOJ, in 2005, continued the process to modernize the payment and settlements infrastructure in order to improve efficiency and preserve the integrity, soundness and stability of the financial system. In this regard, the National Payments Council (NPC) was established in November under the chairmanship of the BOJ and comprises the major payment system stakeholders. The Bank will lead the reform and supervise the preparation of supporting legislation and infrastructure. A key element of this process will be the introduction of a Real Time Gross Settlement System (RTGS) which will lead to reduced credit and settlements risks, while promoting better liquidity management in domestic financial markets.

In order to ensure improved collection, processing and analysis of data from the commercial banks and other financial intermediaries, the Bank in 2005, embarked on the development of the Financial Institution Supervision Information System (FISIS). The adoption of a more efficient information system is critical given an increase in the number of supervised DTIs, more emphasis on risk based supervision as well as increased emphasis on risk based financial forecasting and modelling by the Bank.

Within the cambio and remittance markets, 13 new cambio locations were approved while the licenses of 3 locations were voluntarily surrendered. Effective 05 July 2005, under the Bank of Jamaica Act, companies seeking to engage in the money transfer and remittance

business must be granted approval by the BOJ. Licenses were issued to 10 companies in 2005 while approval for 7 was pending. On 6 June 2005, the Terrorism Prevention Act which imposes reporting and other operational control requirement on all financial institutions was implemented.

During the year, there were major changes in the senior management of the Bank following the appointment of Deputy Governor Colin Bullock as Financial Secretary in the Ministry of Finance and Planning. Mrs.Audrey Anderson, Deputy Governor, Financial Institutions Supervisory Division (FISD) was appointed to the position of Senior Deputy Governor, with responsibility for supervision of deposit taking institutions, as well as risk management and business continuity. Mrs. Myrtle Halsall was appointed Acting Deputy Governor, Banking and Market Operations/ Research and Economic Programming, a portfolio held by the former Deputy Governor while Mrs. Gayon Hosin was appointed Acting Deputy Governor, FISD.

The Bank maintained a stable industrial climate in 2005 in the context of the Public Sector Memorandum of Understanding (MOU), effective April 2004 to March 2006, which imposed a two-year wage freeze on public sector workers. During the year, the Bank increased its staff complement by 6 to 490, relative to 539 establishment positions. Training seminars were held for 370 members of staff. The Bank also reviewed and upgraded its disaster management programme with the objective of mitigating risk to staff, visitors and the plant's infrastructure.

The BOJ continued to improve the transparency of the Bank and public understanding of monetary policy through its various publications and presentations. In particular, quarterly press briefings outlining the Bank's thinking on the economy and the context in which monetary policy decisions were made, were held concurrently with the release of the Bank's Quarterly Monetary Policy Report. In addition, the Bank continued its School's Education Programme and its Annual Economics Essay Competition for high school students, designed to stimulate interest in economics. There was also increased use of the Bank's website during the year.

With respect to currency notes, during the year the Bank enhanced the security of both the paper and print features of bank notes in order to maintain their integrity. In this regard, the watermark for all denomination was changed from the doctor bird and each given a unique watermark similar to the portrait on that denomination. A unique image was also added to each denomination close to the watermark. In addition, the $1000 and $500 notes were fitted with a broader, brighter security thread printed with the acronym "BOJ" as well as the denomination. The incidence of counterfeit banknotes declined in 2005 and when compared to notes redeemed, the value of counterfeit bank notes remained well below the international benchmark. A public education campaign was also held to inform the public about these new security features on the Bank's notes.

The Jamaican economy is poised to realize accelerated economic growth in 2006, given continued expansions in the hotel and mining industries. In the absence of any shocks, inflation should further moderate in 2006 while the NIR is expected to remain adequate to underwrite near term stability. Domestic macroeconomic policy is expected to support these objectives through the maintenance of stable monetary conditions as well as continued fiscal discipline.

2. The Financial System

2.1. Monetary Policy Management

2.1.1. Introduction

Monetary policy was conducted within the context of contrasting economic conditions during 2005. Favourable macroeconomic conditions and positive investor sentiment allowed the Bank to relax monetary policy during the first half of the year. However, deterioration of some of the macroeconomic fundamentals during the second half of the year, resulting from a series of external shocks, caused the Bank to halt the interest rate reductions and concentrate on stemming instability which emerged in the foreign exchange market. This tighter monetary policy stance facilitated a moderation in inflation to 12.9 per cent in 2005 from 13.7 per cent in 2004.

2.1.2 Developments and Challenges

The year 2005 began with an optimistic outlook for economic growth, inflation as well as the fiscal and external accounts. These positive factors generated strong investor confidence. Against this background, the Central Bank effected two interest rate reductions in the first quarter and reduced the Special Deposit requirement for the first time since it was implemented in January 2003.

In the second quarter, inflationary impulses arising mainly from the impact of drought conditions on the real economy, as well as administered price increases, warranted a more cautious approach to loosening the monetary policy stance. Consequently, there was only one interest rate reduction in the second quarter, as well as another reduction of the Special Deposit requirement. Investor confidence remained high and was reflected in the continued stability of the financial markets. This confidence was underpinned, in part, by the Government's successful debt raising activities on the international capital market in May.

However, in the third quarter, rising global oil prices in tandem with the impact of three major hurricanes triggered an acceleration in inflation. In addition, the hurricanes had a negative impact on tourist arrivals and other real sector activities, which contributed to a decline in inflows to the foreign exchange market. These conditions heightened concerns about real rates of return on Jamaica Dollar assets, prompting investors to increase demand for instruments that provide a hedge against inflation. The resulting instability in the foreign exchange market prompted the Bank to focus on removing excess Jamaica Dollar liquidity through sales of Government of Jamaica securities from its holdings while augmenting the supply of foreign currency to the market.

2.1.3 Base Money Management

The Bank's proactive policy stance resulted in the containment of base money expansion to 9.7 per cent in 2005 relative to 11.2 per cent in 2004. This was reflected in lower growth in the stock of currency issue as well as a sharp deceleration in the growth of the commercial banks' local currency statutory reserves (see **Table 1B**). The financial programme had anticipated an expansion of 8.6 per cent for base money at end December 2005. In the context of rising retail prices, the tendency would have been for the base money target to be exceeded. However,

with the tightening of monetary policy, base money exceeded the target by $507.7 million (see **Table 1A**). The relatively small deviation in the monetary base was mainly reflective of a higher than programmed expansion in the net domestic assets (NDA). At the end of the year the NIR was US$2 087.4 million, US$5.1 million higher than the programme target (see **Table 1A**).

For the first half of the year, the monetary base contracted by 11.0 per cent or $4 975.6 million with the first three months accounting for 68.5 per cent of this decline. Absorption of $36 792.9 million through open market operations (OMO) was the main influence on the decline in the monetary base during the six-month period. This relatively large absorption was partly due to the sterilization of direct foreign currency purchases from the market during the period. These purchases contributed to growth of US$298.3 million in the NIR during the first half of the year.

The build-up in the NIR, the strong demand for Jamaica Dollar assets, as well as a generally favourable macroeconomic environment allowed the Bank to reduce interest rates on OMOs on three occasions between January and June (see **Table 2**). These adjustments included reductions in the premiums on the longer tenors, with the sharpest reductions applied to the 270-day and the 365-day tenors that were reduced by 44 and 55 basis points, respectively. The Bank also reduced the Special Deposit requirement to 1.0 per cent from 5.0 per cent. The adjustment was made in 2 stages of 2 percentage points each, the first on 1 March and the second on 16 May.

The Bank changed its monetary policy stance during the second half of the year to counter foreign exchange market instability associated with heightened inflation expectations related to the impact of external shocks on the economy. Accordingly, the Bank did not effect further reductions in interest rates between July and December. This policy stance was complemented by the Bank's sale of GOJ securities from its holdings as well as the sale of foreign currency.

In this context, there were net maturities of $17 678.5 million in open market instruments, the main source of liquidity during the second half of 2005 (see **Table 1B**). These occurred mainly in December to meet the seasonal demand for currency and for settlement of foreign currency sold by the Bank. The sale of foreign currency contributed to a decline of US$69.3 million in the NIR, which absorbed $4 301.6 million. In addition, the sale of securities absorbed $8 679.4 million. Against this background, the monetary base expanded by 23.3 per cent for the July to December period.

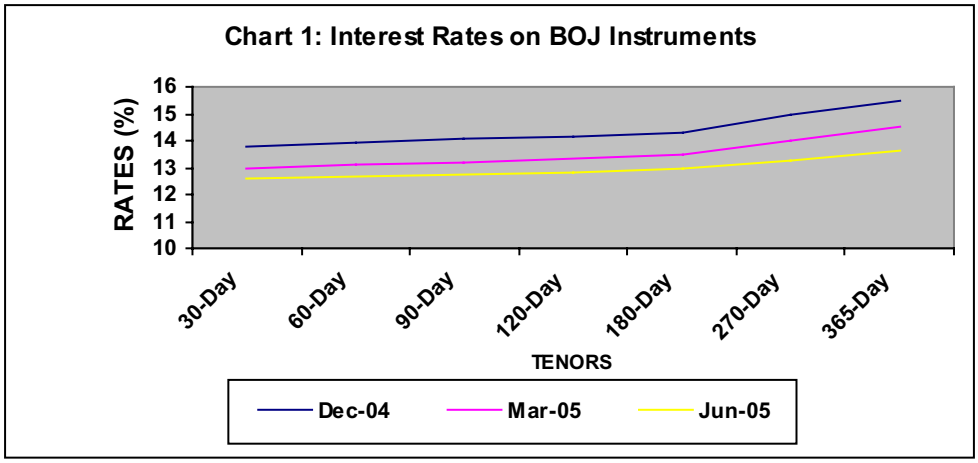


TABLE 1A

BANK OF JAMAICA-ECONOMIC PROGRAMME TARGETS STOCKS J$M December 2005			
	TARGET	OUT-TURN	DEVIATION FROM TARGET
Net International Reserves (US$)	2 082.3	2 087.4	5.1
NET INT'L RESERVES (J$)	134 772.0	135 056.1	284.1
NET DOMESTIC ASSETS	-85 862.0	-85 638.4	223.6
MONETARY BASE	48 910.0	49 417.7	507.7

TABLE 1B

BANK OF JAMAICA- SUMMARY FLOWS J$M	2004	2005				2005
	Total	Jan- Mar	Apr- Jun	Jul- Sept	Oct-Dec	Total
Net International Reserves (US$)	**693.5**	**43.1**	**255.2**	**-37.8**	**-31.6**	**228.9**
NET INT'L RESERVES (J$)	**42 516.4**	**2 671.6**	**15 821.8**	**-2 345.5**	**-1 956.1**	**14 191.8**
-Assets	42 029.8	2 615.2	15 821.8	3 946.9	-4 583.0	17 800.8
-Liabilities	486.6	56.4	0.0	-6 292.4	2 626.9	-3 609.0
NET DOMESTIC ASSETS	**-37 987.1**	**-6 080.4**	**-17 388.6**	**2 639.7**	**10 999.6**	**-9 829.7**
Net Claims on Public Sector	**12 819.1**	**4 600.2**	**3 431.3**	**3 983.8**	**-6 884.4**	**5 130.9**
- Central Govt. Deposits	-4 491.1	-863.1	-1 493.1	2 120.2	512.1	276.1
- Govt. Securities	7 132.9	2.4	-21.0	4 901.9	-8 679.4	-3 796.1
- Other	10 198.4	5 460.8	4 945.4	-3 038.3	1 283.0	8 650.8
Net Credit to Banks	**-1 732.9**	**2 449.1**	**2 845.4**	**-504.7**	**-582.4**	**4 207.1**
Open Market Operations	**-48 722.7**	**-13 162.7**	**-23 630.2**	**-623.1**	**18 301.6**	**-19 114.4**
Other	**-350.6**	**33.1**	**-34.8**	**-216.3**	**164.7**	**-53.3**
MONETARY BASE	**4 529.3**	**-3 408.8**	**-1 566.8**	**294.2**	**9 043.5**	**4 362.1**
- Currency Issue	2 971.5	-3 723.2	-1 679.9	406.4	8 243.1	3 246.4
- Cash Reserve	1 388.1	380.0	261.0	-19.6	188.2	809.6
- Current Account	169.6	-65.6	-147.9	-92.6	612.2	306.1
Memo:						
NIR Stock (US$MN) e.o.p.	1 858.5	1 901.6	2 156.8	2 119.0	2 087.4	
Growth in Monetary Base (%)	11.2	-7.6	-3.8	0.7	22.4	9.7
Inflation (%)	13.7	1.5	5.7	4.3	0.9	12.9

TABLE 2

BOJ REVERSE REPURCHASE RATES (%) 2005			
	7 Feb.	**7 Mar.**	**26 May**
30 Days	13.50	12.95	12.60
60 Days	13.65	13.10	12.70
90 Days	13.75	13.20	12.75
120 Days	13.85	13.30	12.85
180 Days	14.00	13.45	13.00
270 Days	14.50	14.00	13.25
365 Days	15.00	14.50	13.60

2.2. Money Supply

During 2005, growth in broad money supply, M3*[1] decelerated to 8.6 per cent from 16.4 per cent in 2004 (see **Table 4**). Both components of M3* reflected slower rates of growth with M2* registering the sharper rate of deceleration.

Narrow Money, M1*[2], increased by 7.2 per cent, a slower rate of growth than the 22.8 per cent recorded in 2004. The deceleration was reflected in both currency in the hands of the public and demand deposits. Growth in currency with the public decelerated to 11.2 per cent in 2005 from 15.1 per cent in 2004. This translated into a real reduction of 3.6 per cent for 2005, relative to a real growth of 1.3 per cent for 2004. Increased use of alternative means of payment such as point of sale transactions (POS) would have contributed to the real reduction in currency in the hands of the public in 2005 (see **Table 3**). The growth in POS was driven by increased use of credit cards as growth in debit card transactions slowed. Debit card transactions are financed from demand or savings deposits which also showed a deceleration in growth.

TABLE 3

Alternative Means of Payment to Cash

Point of Sale		
	Annual Growth (Pt.-to-Pt.)	
	Dec. 2004	Dec. 2005
Value (%)	-12.4	45.2
Volume (%)	10.5	13.6
Value (J$MN)	3 578.0	5 196.5

1 Money supply M3* is defined as M2* plus Other Deposits. 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. Other deposits are largely comprised of commercial banks reserves.

2 M1*also referred to as narrow money, is comprised of notes and coin and demand deposits.

Demand deposits grew by 4.7 per cent, relative to an increase of 28.3 per cent in 2004. The slowdown reflected a 19.1 per cent reduction in demand deposits denominated in foreign currency as well as a slower rate of growth in the local currency component. The reduction in foreign currency demand deposits occurred in the first half of the year when stable foreign exchange market conditions and the expectation that foreign currency supply would remain adequate induced investors to convert some of their foreign currency holdings to Jamaica Dollar financial assets.

Similar to M1*, Quasi money (Savings and Time deposits) grew at a reduced rate, reflecting an increase of 8.3 per cent in 2005, relative to 12.3 per cent in 2004 (**see Table 4**). This outturn resulted from slower growth in both savings and time deposits. Both local and foreign currency components of these deposits grew at a slower rate with the local currency component recording the sharper deceleration. Concerns about real rates of return, which induced a switch to alternative investment products, would have contributed to the deceleration in the local currency component.

In the context of the stable macroeconomic conditions that prevailed during the first half of 2005, investors reduced their holdings of foreign currency deposits. With deterioration in the macroeconomic conditions during the September quarter, investors readjusted their investment portfolio in favour of foreign currency deposits. Consequently, the foreign currency component of both time and savings deposits increased during that quarter. Savings deposits in foreign currency recorded further increases during the December quarter while there was a reduction in time deposits in foreign currency as investors switched to higher yielding assets.

TABLE 4

MONEY SUPPLY, M3*
(DOMESTIC AND FOREIGN CURRENCY)
FLOWS (J$M)

	2004 (J$M)	2005 (J$M)	2004 %	2005 %
COMPONENTS OF MONEY SUPPLY				
Money Supply (M2)*	**28 314.2**	**16 889.0**	**15.5**	**8.0**
Money Supply (M1)*	**12 585.3**	**4 913.4**	**22.8**	**7.2**
Currency with the public	3 497.5	2 987.1	15.1	11.2
Demand Deposits	9 087.8	1 926.3	28.3	4.7
Quasi Money	**15 728.9**	**11 975.6**	**12.3**	**8.3**
Savings Deposits	11 662.3	8 233.6	12.2	7.7
Time Deposits	4 066.6	3 741.9	12.7	10.4
Other Deposits	7 193.1	4 799.4	21.6	11.9
Total Money Supply (M3)*	**35 507.3**	**21 688.4**	**16.4**	**8.6**
SOURCES OF MONEY SUPPLY				
Net Foreign Assets	**38 483.6**	**1 894.8**	**55.1**	**1.7**
Bank of Jamaica	42 618.2	14 224.7	63.5	12.4
Commercial Banks	-4 134.6	-12 329.9	-128.5	1346.1
Loans and Advances to Private Sector	**14 461.0**	**11 809.6**	**19.6**	**13.4**
Local Currency	8 945.6	5 970.5	18.6	10.5
Foreign Currency	5 515.4	5 839.0	21.4	18.6
Net Claims on Public Sector	**-5 617.3**	**12 188.6**	**-3.0**	**6.8**
Net Claims on Financial Institutions	**5 728.1**	**-424.7**	**-36.4**	**4.2**
BOJ Open Market Operations	**-48 722.7**	**-19 114.4**	**59.4**	**14.6**
Other Items (Net)	**31 174.6**	**15 334.5**	**-152.2**	**141.3**
TOTAL	**35 507.3**	**21 688.4**	**16.4**	**8.6**

During the review year, the main sources of monetary expansion were increases in banking sector credit to the private and public sectors. Growth in private sector credit slowed to 13.4 per cent in 2005 from 19.6 per cent in 2004. Although total loans and advances grew at a faster rate, this was partly offset by a reduction in loans issued through private debentures. The faster growth in total loans and advances reflected an increased use of foreign currency credit in the context of further investment in the real economy, particularly in the tourism sector (see **Commercial Banks**). The increase in credit to the public sector was concentrated in the second quarter of the year and reflected commercial bank loans to Central Government and other public sector entities.

The growth in money supply was also influenced by an unwinding of commercial banks repurchase agreements,

which was largely reflected in one commercial bank. The institutions continued to replace these instruments acquired at a relatively high cost in 2003 with cheaper sources of financing from abroad. This, in turn, contributed to a reduction in the net foreign assets of the commercial banking sector.

The major countervailing influence on money supply was a build-up in BOJ open market instruments. Despite a lowering of the rates of return on these instruments in the first half of the year, in the context of stable foreign exchange market conditions and strong investor confidence, there was strong demand for the securities during that period. However, with heightened inflation expectations as well as the need to pay for currency orders in December, there was a net unwinding of the instruments in the second half of the year, which partially offset the earlier expansion.

2.3. Commercial Banks

2.3.1. Overview

The assets of the commercial banking sector grew at a slower rate in 2005. There was strong growth in loans and advances in the context of more aggressive marketing by the institutions. However, this was partly offset by the banks' reduced holdings of cash and bank balances, as well as securities purchased for resale. The resources that became available from these reductions facilitated the repayment of private repurchase agreements, thus contributing to a slower growth in total liabilities. There was also a slow-down in the growth in deposits, partly reflecting investors' concerns about the real rate of return on these financial assets. During the year there was an improvement in the banks' asset quality, attributed to a continued decline in past due loans.

2.3.2. Assets and Liabilities

The commercial banking sector's asset base increased by $22 944.7 million or 6.7 per cent in 2005, relative to an expansion of 10.2 per cent in 2004. There was a faster rate of growth in loans in 2005 (see **Table 5**), reflecting a continued realignment of the banks' asset base towards loans (see **Chart 2**). In the context of the faster growth, the stock of loans accounted for 35.5 per cent of total assets at end December 2005, relative to 32.3 per cent at end 2004 (see **Chart 3**).

Deterioration in the macroeconomic conditions during the second half of the year occasioned a rebalancing of the banks' portfolio towards hedged instruments. This was evident in a reduction in the institutions' holdings of securities purchased for resale and a lower build-up in BOJ securities, relative to an increase in GOJ foreign currency securities (see **Table 5**). The net effect was an increase of 7.6 per cent in the total stock of securities[3] during the year. As a proportion of assets, these increased marginally to 36.2 per cent in 2005 and still accounted for the largest share.

3 Total Securities = Investments + Securities Purchased for Resale

Reductions in the banks' holdings of cash and bank balances as well as securities purchased for resale were the main influences on the slower growth of the sector's asset base. The lower holding of cash and bank balances largely reflected reductions in the banks' *Special Deposits*. This decline in the *Special Deposits* was against the background of reductions in the Special Deposit requirement on 7 February and 16 May, which occurred in the context of the favourable macroeconomic conditions that characterized the first half of the year.

Chart 2: Loans and Securities as a Proportion of Total Commercial Banks' Assets

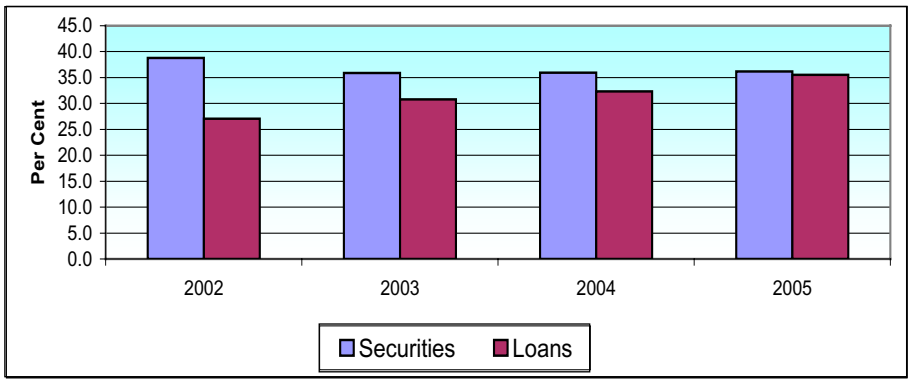


Chart 3: The Composition of Commercial Banks' Assets at 31 December 2004 and 31 December 2005

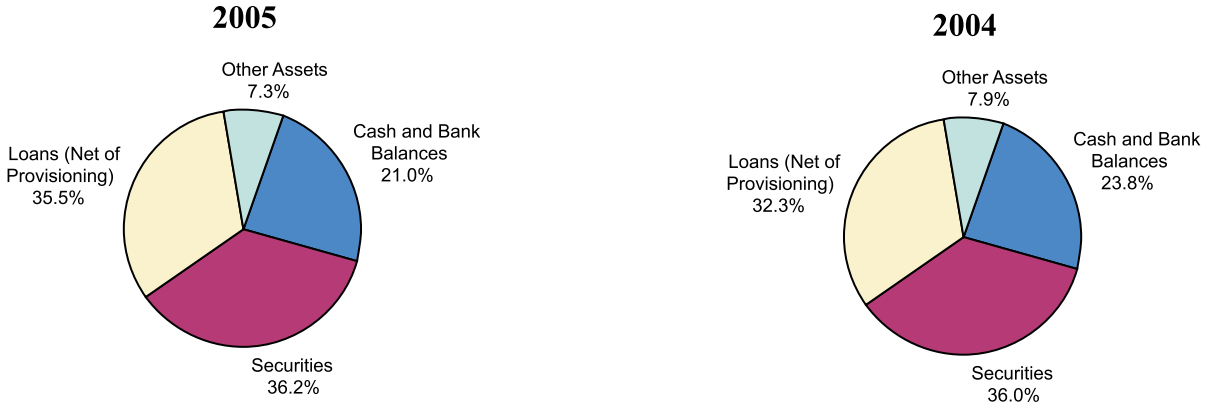


TABLE 5

COMMERCIAL BANKS
SUMMARY OF ASSETS AND LIABILITIES (J$MN)

	Stock 2005	Flows 2003	Flows 2004	Flows 2005	% Change 2003	% Change 2004	% Change 2005
ASSETS	**364 222.7**	**50 933.2**	**31 637.8**	**22 944.7**	**19.7**	**10.2**	**6.7**
Cash and Bank Balances	76 467.6	10 501.2	15 304.4	-4 712.3	19.0	23.2	-5.8
o.w. Special Deposits	1 458.4	6 071.2	771.2	-5 383.9	100.0	12.7	-78.7
Investments	127 261.5	8 866.3	-1 833.0	10 522.6	8.1	-1.5	9.0
-Domestic Currency	90 942.5	3 053.3	-4 383.7	5 021.7	3.5	-4.9	5.8
BOJ securities	30 495.9	-3 332.9	11 341.0	6 511.8	-20.9	89.7	27.2
Jamaica Government Securities	54 863.9	6 199.0	-17 859.7	223.2	9.3	-24.6	0.4
Other Public Sector	1 254.0	-176.2	-542.1	- 555.6	-7.0	-23.1	-30.7
Other Local	4 328.7	363.4	2 677.1	-1 157.7	14.9	95.3	-21.1
-Foreign Currency	36 319.0	5 813.0	2 550.7	5 500.8	25.9	9.0	17.8
o.w. Ja. Gov. Foreign Securities	33 856.9	6 229.6	2 091.0	4 334.3	29.4	7.6	14.7
Securities Purchased for resale	4 732.7	-1 476.9	797.3	-1 227.6	-22.2	15.4	-20.6
Loans (Net of provisioning)	129 240.0	25 201.3	14 994.6	18 971.7	36.0	15.7	17.2
Domestic	77 118.9	12 411.0	5 884.8	9 266.4	25.0	9.5	13.7
Foreign	54 976.4	12 795.7	8 334.1	9 460.1	52.5	22.4	20.8
Accounts Receivable	7 032.8	2 179.3	-854.7	1 458.1	51.3	-13.3	26.2
Fixed Assets	7 722.9	223.6	467.9	176.8	3.3	6.6	2.3
Other Assets	11 765.2	5 438.4	2 761.4	-2 244.6	93.6	24.5	-16.0
LIABILITIES & CAPITAL	**364 222.7**	**50 933.2**	**31 637.8**	**22 944.6**	**19.7**	**10.2**	**6.7**
Deposits	246 264.9	19 795.3	29 415.7	18 074.4	11.1	14.8	7.9
Domestic	148 878.4	-1899.8	16 539.2	9 363.0	-1.5	13.4	6.7
Foreign	97 386.5	21 695.1	12 876.5	8 711.4	40.1	17.0	9.8
Due to Bank of Jamaica	234.467	32.9	62.2	4.5	24.4	37.1	2.0
Due to Commercial banks	26 991.5	2 322.6	11 462.7	3 885.4	24.9	98.4	16.8
o.w. Head Off./Parent Co.	5 119.0	0.0	3 061.6	2 057.4	0.0	100.0	67.2
Due to Specialised Institutions	3 925.0	1 593.7	-5 039.1	94.9	21.9	-56.8	2.5
Securities sold under Repurchase Agreements	16 529.9	16 149.4	-15 317.6	-5 808.7	75.1	-40.7	-26.0
Other Liabilities	25 358.1	5 154.9	4 265.2	3 046.8	40.0	23.6	13.7
Capital Account	44 918.8	5 884.4	6 788.7	3 647.3	20.6	19.7	8.8

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

Despite the slower rate of growth, deposit liabilities and borrowings from overseas banks continued to be a major source of financing for commercial banks in 2005 (see **Table 5**). The deceleration in the growth of deposits reflected a lower build-up in all categories of deposits held by the local private sector, as well as a reduction in Government deposits (see **Table 6**). This was however, partly offset by a significant build-up in *Other Deposits* which comprises funds held by overseas residents in the institutions. The deceleration in the rate of growth in deposit liabilities was in a context of the relative attractiveness of other investment options towards the end of the year. The instability that emerged in the foreign exchange market during that period would have also influenced the slow-down in borrowings from overseas banks. At the same time, commercial banks continued to unwind private repurchase agreements acquired at relatively higher rates of return.

There was a significant slow-down in the growth in foreign currency private sector deposits during 2005 (see **Table 7**), which influenced a decline in the ratio of foreign currency private sector deposits to total private sector deposit liabilities. The ratio declined to 30.0 per cent at end December 2005 from 31.0 per cent at end 2004 and was the lowest since the 29.9 per cent recorded in July 2003. There was a steady decline in the ratio between January 2005 and September 2005 to 30.8 per cent but following foreign exchange market instability which emerged during the second half of the year, the ratio peaked at 31.2 per cent at end October 2005 (see **Chart 4**). The ratio at end October reflected strong demand for foreign currency deposits by investors as a hedge against inflation. The decline between November and December coincided with the issue of a relatively attractive GOJ US Dollar instrument issued in the local market in December.

Table 6

COMMERCIAL BANKS TOTAL DEPOSITS (J$M)

	Stocks 2005	Flows 2003	Flows 2004	Flows 2005	% Change 2003	% Change 2004	% Change 2005
Deposits	246 723.0	20 825.8	30 310.9	17 412.8	11.1	14.8	7.6
Private Sector	198 690.5	15 312.0	24 816.6	13 901.9	10.6	15.5	7.5
Demand /1	43 106.1	971.4	9 087.7	1 926.4	3.1	28.3	4.7
Savings	115 794.6	14 608.2	11 662.3	8 233.6	18.0	12.2	7.7
Time	39 789.8	-267.6	4 066.6	3 741.9	-0.8	12.7	10.4
Government	21 652.9	-431.8	4 012.7	-1 182.0	-2.2	21.3	-5.2
Other	26 379.6	5 945.6	1 481.6	4 692.9	41.7	7.3	21.6

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

Chart 4: Foreign Currency Deposits to Total Deposits
December 2002 to 2005

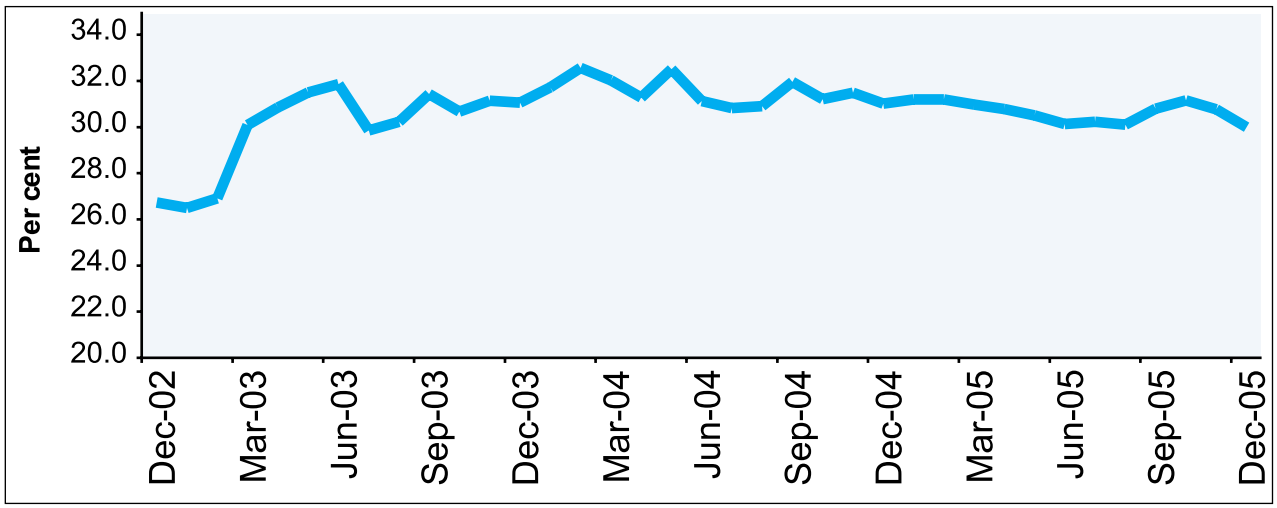


TABLE 7

COMMERCIAL BANKS
LOCAL AND FOREIGN CURRENCY DEPOSITS /1
(PRIVATE SECTOR) (J$M)

	Stocks 2005	Flows 2003	Flows 2004	Flows 2005	% Change 2003	% Change 2004	% Change 2005
Private Sector Deposits	198 690.5	15 312.0	24 816.6	13 901.9	10.6	15.5	7.5
Local Currency	125 617.9	980.2	14 951.4	10 721.8	1.1	15.0	9.3
Foreign Currency	73 072.6	14 331.8	9 865.2	3 180.1	32.0	16.4	4.5

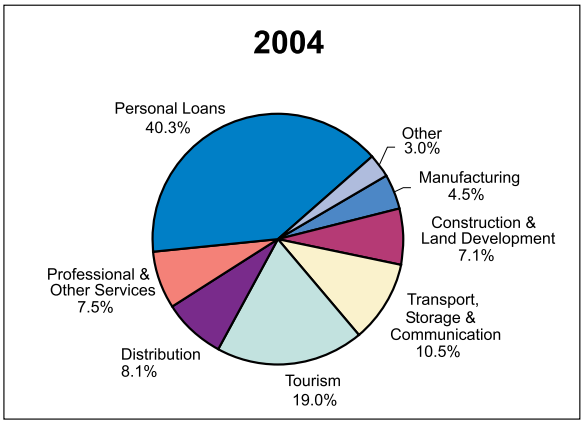
/1 Deposits adjusted for Net Items in the Process of Collection

2.3.3. Loans and Advances

The stock of commercial bank loans and advances outstanding at end December 2005 reflected a faster growth of 16.5 per cent, relative to the increase in 2004 (**see Table 8**). In real terms, the growth in loans and advances accelerated to 3.2 per cent in 2005, compared to 0.5 per cent in 2004. The growth in loans and advances was in a context of an increase in real sector activity, particularly the Tourism and Distribution sectors, during the second half of the year. The stock of loans outstanding to the private sector continued to dominate the commercial banks' loan portfolio, accounting for 74.9 per cent at end December 2005, compared to 73.2 per cent at end December 2004.

The commercial banks' private sector loan portfolio grew by 19.2 per cent in 2005, relative to an increase of 16.5 per cent in 2004. The growth in 2005 was primarily reflected in *Personal Loans* and *Tourism*. The higher growth in loans extended to the *Tourism* sector was consistent with the developments in the hotel sector. However, during the year, loans to the *Transport, Storage & Communication* sector declined by $3 524.4 million, due mainly to a reclassification of loans outstanding to the national air carrier from private sector to public sector in June. *Personal Loans, Tourism*, *Distribution* and *Professional & Other Services* continued to dominate the share of private sector loans outstanding, accounting for 81.3 per cent as at 31 December 2005, relative to 74.9 per cent at end December 2004 (see **Chart 5**).

Chart 5: Distribution of Private Sector Loans and Advances at 31 December 2004 and 31 December 2005



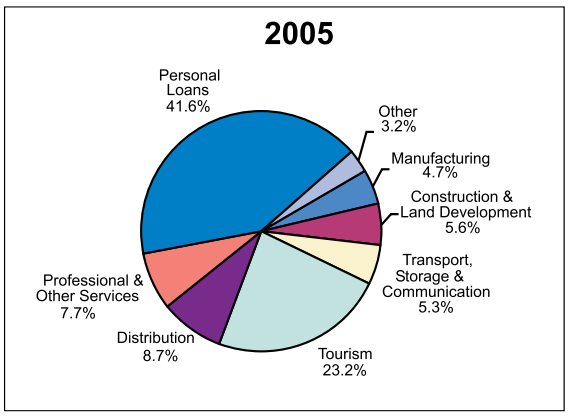


TABLE 8

COMMERCIAL BANKS
TOTAL LOANS AND ADVANCES (J$MN)

	Stocks 2004	Stocks 2005	Flows 2003	Flows 2004	Flows 2005	% Change 2003	% Change 2004	% Change 2005
Public Sector	29 810.5	32 551.1	4 450.3	2 299.0	2 740.6	19.3	8.4	9.2
Other Financial Instituions	588.7	613.9	-1 727.6	157.7	25.2	-80.0	36.6	4.3
Private Sector	82 969.6	98 930.2	22 484.0	11 762.2	15 960.6	46.1	16.5	19.2
Agriculture and Fishing	1 227.5	1 831.6	-316.3	-194.1	604.1	-18.2	-13.7	49.2
Mining and Quarrying	223.4	253.0	306.0	-185.0	29.6	298.8	-45.3	13.2
Manufacturing	3 746.4	4 678.0	284.7	283.6	931.6	9.0	8.2	24.9
Construction & Land Development	5 875.7	5 512.3	1 854.3	695.0	-363.4	55.7	13.4	-6.2
Transport, Storage & Communication	8 733.6	5 209.2	4 093.8	-803.3	-3 524.4	75.2	-8.4	-40.4
Tourism	15 741.8	22 917.7	4 867.6	3 833.3	7 175.9	69.1	32.2	45.6
Distribution	6 753.8	8 651.0	2 738.1	-496.6	1 897.2	60.7	-6.8	28.1
Professional & Other Services	6 194.9	7 680.8	945.8	1 012.8	1 485.9	22.3	19.5	24.0
Personal Loans	33 429.8	41 159.7	8 867.9	7 514.7	7 729.9	52.0	29.0	23.1
Electricity, Gas & Water	769.6	746.3	-1 040.8	-15.9	-23.3	-57.0	-2.0	-3.0
Entertainment	241.1	274.1	-88.0	137.4	33.1	-45.9	132.5	13.7
Overseas Residents	31.9	16.4	-28.9	-19.8	-15.5	-35.8	-38.3	-48.6
TOTAL	**113 368.8**	**132 095.2**	**25 206.7**	**14 218.8**	**18 726.4**	**34.1**	**14.3**	**16.5**

Loans and advances denominated in United States dollars grew at a slower rate in 2005. This deceleration was most apparent in loans to the private sector, particularly the *Transport, Storage & Communication* and *Manufacturing* sub-sectors (see **Table 9**). The proportion of foreign currency loans to total loans and advances increased to 41.8 per cent at end December 2005 from 40.1 per cent at end December 2004.

Notwithstanding the deceleration in the growth in foreign currency loans to the private sector, there was a significant acceleration in the growth in loans to the *Tourism* sector. Most of this increase occurred between August and November and was in a context of the commencement of several projects in the sector. In addition, the need to finance repairs to properties in the industry in the aftermath of an active hurricane season also contributed to the increased demand for these loans. There was also expansion in foreign currency loans to *Distribution*, *Construction & Land Development* and *Agriculture*. At end December 2005, the proportion of private sector foreign currency loans to total foreign currency loans outstanding decreased to 70.0 per cent, from 72.9 per cent at end December 2004.

The ratio of non-performing loans to total loans outstanding declined to 2.3 per cent at end December 2005, from 2.7 per cent at end December 2004. These ratios compare favourably with the international benchmark of 10.0 per cent. Also, the ratio of

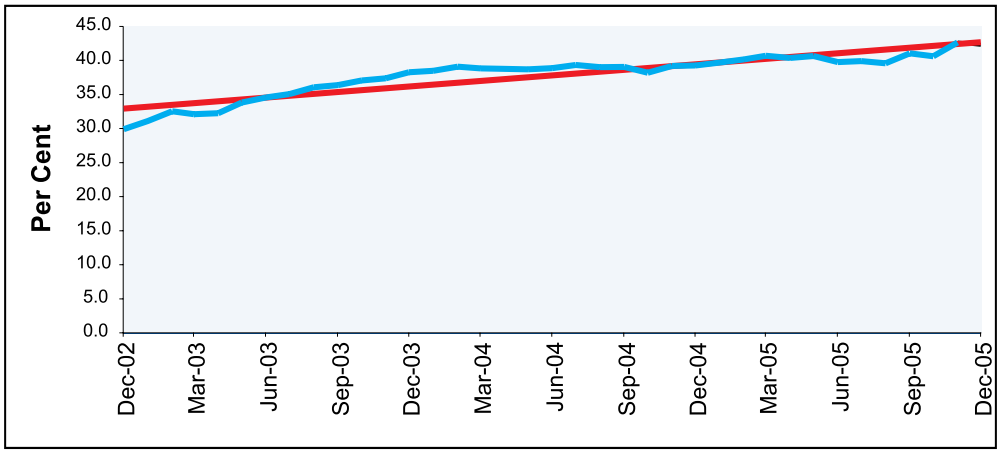
TABLE 9

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

	Stocks 2004	Stocks 2005	Flows 2003	Flows 2004	Flows 2005	% Change 2003	% Change 2004	% Change 2005
Public Sector	191 906	245 927	63 374	40 978	54 021	72.4	27.2	28.1
Other Financial Instituions	8 274	10 480	-23 837	3 496	2 206	-83.3	73.2	26.7
Private Sector	539 813	597 340	93 279	79 083	57 527	25.4	17.2	10.7
Agriculture	870	4 185	-283	-589	3 315	-16.2	-40.4	381.0
Mining & Quarrying	0	14	4 617	-4 689	14	6412.5	-100.0	100.0
Manufacturing	28 537	24 495	-1 341	10 195	-4 042	-6.8	55.6	-14.2
Const., & Land Development	35 609	40 518	-954	-4 383	4 909	-2.3	-11.0	13.8
Transport, Storage & Comm.	122 050	35 181	20 448	8 802	-86 869	22.0	7.8	-71.2
Electricity, Gas & Water	10 299	10 018	-15 105	-46	-281	-59.4	-0.4	-2.7
Distribution	31 101	54 269	6 005	11 559	23 168	44.4	59.1	74.5
Tourism	232 635	345 770	72 259	35 308	113 135	57.8	17.9	48.6
Entertainment	1 801	1 911	-780	1 602	110	-79.7	805.0	6.1
Professional & Other Services	31 989	33 055	1 149	15 793	1 066	7.6	97.5	3.3
Personal Loans	44 922	47 924	7 268	5 531	3 002	22.6	14.0	6.7
Loans to Overseas Residents	0	0	-4	0	0	-100.0	0.0	0.0
TOTAL	**739 993**	**853 747**	**132 816**	**123 557**	**113 754**	**27.5**	**20.0**	**15.4**

commercial banks' advances to deposits increased to 42.3 per cent at end December 2005, from to 39.3 per cent at end December 2004 (see **Chart 6**). It is envisaged that the ratio should continue its trend increase during 2006 in the context of an expected increase in demand for loans from the Tourism sector.

Chart 6: Commercial Bank Advance to Deposits Ratio
December 2002 to December 2005



2.3.4. Liquidity

The statutory cash reserve and liquid asset requirements for commercial banks remained unchanged at 9.0 per cent and 23.0 per cent, respectively, during 2005. While the commercial banks' liquid assets increased by $4 100.0 million in 2005, as a proportion of prescribed liabilities, the ratio remained at 38.4 per cent, the same level as at end 2004. The ratio peaked at 42.3 per cent in June 2005, largely reflecting relatively high holdings of BOJ open market instruments and domestic currency cash reserves (see **Table 10**). This was in a context of positive investor confidence, underpinned by relative stability in the financial markets. Consequent on the maintenance of the ratio, the banks' excess reserves increased to $23 100.0 million at end December 2005 from $21 200.0 million at end December 2004.

TABLE 10

COMMERCIAL BANKS LIQUID ASSETS

	2003 Dec	2004 Dec	2005 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 (%)	33.2	38.4	34.6	42.3	41.2	38.4
Liquid Assets (J$BN)						
Notes and Coins	6.3	5.8	5.1	4.0	3.3	6.0
Current Account	0.4	0.4	0.4	0.3	0.0	1.1
Cash Reserve	10.9	12.3	12.7	13.0	12.9	13.1
Treasury Bills	1.5	1.0	0.9	1.2	1.3	1.0
Local Registered Stocks*	6.3	3.1	1.1	0.1	-0.8	0.2
Other Government Securities	0.0	1.0	2.7	3.1	4.3	4.1
BOJ Open Market Instruments	17.0	29.0	30.3	39.0	34.1	31.1
Total	42.4	52.6	53.2	60.7	55.2	56.7
Prescribed Liabilities (J$BN)	121.4	136.8	141.1	144.0	143.8	145.8
Excess Reserves	14.5	21.1	20.8	27.6	22.1	23.1

**Net of securities pledged as collateral*

2.3.5. Interest Rates and Spreads

During 2005, there was a notable decline in commercial banks' overall average weighted rates on loans and deposits. The reductions in loan and deposit rates were influenced by BOJ's monetary policy actions during the first half of the year. During that period, the BOJ reduced interest rates on three occasions. The Special Deposit requirement was also reduced. Nonetheless, the institutions were able to attract deposits at the lower cost throughout the year due to the Government's reduced demand for domestic financing. Although commercial banks' rates declined for the year, tight liquidity conditions during the second half of 2005 influenced an increase in private money market rates during that period. This contributed to higher loan rates and higher yields on GOJ Treasury Bills during the second half of the year (see **Table 11**).

TABLE 11

INTEREST RATES IN THE DOMESTIC MARKET (End of Period)

	2003 Dec	2004 Dec	2005 Mar	Jun	Sep	Dec
COMMERCIAL BANKS						
INTEREST RATE SPREAD	**12.62**	**11.68**	**11.39**	**10.97**	**11.99**	**11.71**
Overall Average Weighted Loan Rate	**19.32**	**17.72**	**17.35**	**16.43**	**17.41**	**17.08**
Foreign Currency Average Weighted Loan Rate	**8.79**	**9.13**	**9.21**	**9.28**	**9.39**	**9.23**
Overall Average Weighted Deposit Rate	**6.70**	**6.04**	**5.96**	**5.46**	**5.43**	**5.37**
Demand	3.52	3.31	3.11	3.07	3.16	3.39
Savings	6.33	5.71	5.63	4.92	4.92	4.97
Time	8.68	7.78	7.54	7.34	7.11	6.92
Certificates of Deposit						
1-month	10.06	7.71	6.95	6.87	6.99	6.55
3-month	10.85	8.45	8.52	7.89	7.38	7.30
12-month	10.65	7.17	7.00	7.32	7.10	6.86
Foreign Currency Average Weighted Deposit Rate	**3.33**	**3.32**	**3.26**	**3.27**	**3.34**	**3.27**
Demand	3.05	3.27	3.11	3.02	2.98	2.99
Savings	2.28	2.27	2.23	2.24	2.28	2.30
Time	5.45	5.27	5.15	5.10	5.07	4.86
GOJ 6-MONTH TREASURY BILL RATE	**22.05**	**14.94**	**13.46**	**12.88**	**13.15**	**13.55**
BOJ 180-DAY REPURCHASE AGREEMENT RATE	**21.00**	**14.30**	**13.45**	**13.00**	**13.00**	**13.00**
PRIVATE MONEY MARKET RATE	**21.25**	**14.10**	**13.10**	**12.85**	**12.90**	**13.75**

During 2005, commercial banks' interest rate spread increased by 3 basis points (see **Table 11**). This was largely attributed to a faster reduction in the weighted average deposit rate, relative to the reduction in the weighted average loan rate. The increase in the overall spread for 2005 was largely reflected in the categories of mortgages, other public sector entities and commercial borrowers (see **Table 12**).

TABLE 12

COMMERCIAL BANK INTEREST RATE SPREADS (BY SECTOR)

	2003 Dec	2004 Dec	2005 Mar	Jun	Sep	Dec
OVERALL AVERAGE WEIGHTED LOAN RATE	**19.32**	**17.72**	**17.35**	**16.43**	**17.41**	**17.08**
OVERALL AVERAGE WEIGHTED DEPOSIT RATE	**6.70**	**6.04**	**5.96**	**5.46**	**5.43**	**5.37**
OVERALL SPREAD	**12.62**	**11.68**	**11.39**	**10.97**	**11.99**	**11.71**
Installment Credit	17.31	17.82	17.69	18.09	17.86	17.94
Mortgage	14.49	14.12	13.87	14.04	14.80	15.00
Personal	23.04	24.15	23.96	22.58	23.90	23.90
Commercial	8.79	8.09	8.06	7.86	8.80	8.34
Central Government	17.05	12.23	10.96	11.10	10.65	10.71
Other Public Sector	10.08	5.59	5.49	5.54	5.87	5.88

2.4. Other Financial Intermediaries

2.4.1. Financial Institutions Act Licensees (FIAs)[4]

Following four years of robust growth, FIA licensees recorded a significant decline in assets during 2005. The decline in assets was largely reflected in a reduction in the institutions' holdings of foreign currency securities, which was partially offset by an acceleration in the growth in Loans and Advances. The expansion in loans was financed mainly by *Securities Sold under Repurchase Agreements* as there was a notable reduction in *Borrowings from Other Financial Institutions (OFIs)*, which had been the entities main source of financing during the last four years. There were further increases in the institutions' deposit and capital base, albeit lower than that observed in 2004. Although the institutions continued to be heavily dollarized, the ratio of assets denominated in foreign currency to total assets fell during the review period.

TABLE 13

ASSETS AND LIABILITIES OF FIAs
2004 AND 2005
(J$M)

	December 2005*	Flows 2004	Flows 2005	% Change 2004	% Change 2005
ASSETS					
Cash and Bank Balances with Commercial Banks	1 838.6	105.2	-803.6	4.1	-30.4
Balances with Other Financial Institutions	5.7	0.4	0.5	8.3	10.2
Balances with Bank of Jamaica	535.0	272.8	-208.7	57.9	-28.1
Investments	29 576.5	10 503.4	-6 473.1	41.1	-18.0
Securities Purchased with View of Resale	2 495.7	-5 011.1	92.3	-67.6	3.8
Loans & Advances (net of provision)	8 621.7	1 040.8	1 840.7	18.1	27.1
Accounts Receivable	990.1	-349.4	-317.9	-21.1	-24.3
Other Assets	412.5	25.3	-91.4	5.3	-18.1
TOTAL	**44 475.8**	**6 587.5**	**-5 961.2**	**15.0**	**-11.8**
Foreign Assets	29 813.4	9 445.1	-6 568.1	35.1	-18.1
LIABILITIES					
Deposits	12 139.9	3 157.4	703.6	38.1	6.2
Balances due to Commercial Banks	815.3	219.0	-133.9	30.0	-14.1
Balances due to Specialised Institutions	337.0	-101.0	40.9	-25.4	13.8
Borrowings from Other Financial Institutions	1 636.3	6 537.2	-21 315.3	39.8	-92.9
Securities sold under Repurchase Agreements	21 706.1	-3 755.4	13 751.6	-32.1	172.9
Other Liabilities	729.0	-336.0	-330.7	-24.1	-31.2
Capital & Reserves	7 112.2	866.4	1 322.7	17.6	22.8
TOTAL	**44 475.8**	**6 587.5**	**-5 961.2**	**15.0**	**-11.8**
Foreign Liabilities	12 903.1	9 603.3	-21 205.1	39.2	-62.2

* *Provisional Data*

4 *Includes Merchant Banks and Trust Companies.*

2.4.1.1. Assets & Liabilities

The assets of the FIAs decreased by 11.8 per cent during 2005, relative to an expansion of 15.0 per cent during the 2004. The reduction in assets during the period was largely underpinned by an 18.0 per cent decrease in the investment holdings of the FIAs, particularly foreign government and other foreign currency securities. The reduction largely reflected the general unwinding of foreign currency securities acquired under margin financing arrangements by one large institution. Concurrently, the institutions increased their holdings of Jamaica Government foreign currency securities by 40.8 per cent. Most of this increase occurred during the last three months of the review period when the attractiveness of these securities was heightened within a context of relative instability in the foreign exchange market. Given the overall decline in the entities' investment holdings, securities accounted for 66.5 per cent of total assets at end December 2005, relative to 71.5 per cent at end December 2004.

Growth in *Loans and Advances* accelerated to 27.1 per cent during the review period from 18.0 per cent in the previous year. The increase in *Loans and Advances* was largely concentrated in foreign currency loans. This was in contrast to 2004 when the growth in loans was largely domestic currency denominated. The strong growth in 2005 reflected a greater thrust toward lending.

Despite the increase in foreign currency loans, the entities' holdings of foreign assets decreased by 18.1 per cent during the review period, reflecting the large decline in foreign currency securities. The reduction in foreign assets was in sharp contrast to growth of 35.1 per cent during 2004. Consequent on the reduction in foreign assets, the entities recorded a reduction in the ratio of foreign currency assets to total assets to 67.0 per cent at end 2005, from 72.1 per cent at end 2004.

The reduction in the liabilities of FIA licensees was largely underpinned by a significant decline of 92.9 per cent in borrowings from OFIs, specifically from overseas institutions, which had been partly used to acquire foreign securities under margin arrangements. The repayment of these borrowed funds from overseas institutions was also financed by a significant jump in the stock of securities sold under repurchase agreements.

Deposits of the FIA licensees increased by 6.2 per cent during the review period, noticeably slower than the growth of 38.1 per cent during 2004. The outturn in 2005 was mainly influenced by an unwinding of foreign currency deposits in the first half of the year, in preference for local currency securities. During the second half of the year, institutions were attracted to GOJ variable rate instruments and higher yielding securities that provided a hedge against inflation.

The capital base of the entities continued to grow, increasing by 22.8 per cent in 2005 vis-à-vis a 17.6 per cent increase during 2004. The expansion in the capital accounts largely reflected increases in capital paid up and assigned, share premium and also the entities' retained earnings for the review period (see **Table 13**).

2.4.1.2. Sectoral Distribution of Loans

Loans to the private sector by FIA licensees recorded robust growth of 36.9 per cent during 2005, relative to an expansion of 19.4 per cent during 2004. Consequently, the share of these loans within the total loan portfolio

increased to 94.4 per cent at end December 2005 from 87.2 per cent at the end of the previous year (see **Table 14**). Concurrently, there was a reduction in the proportion of public sector loans largely reflecting net repayments of central government loans during the review period.

Table 14

SECTORAL DISTRIBUTION OF LOANS AND ADVANCES OF INSTITUTIONS LICENCED UNDER THE FINANCIAL INSTITUTIONS ACT AT DECEMBER 2004 AND 2005

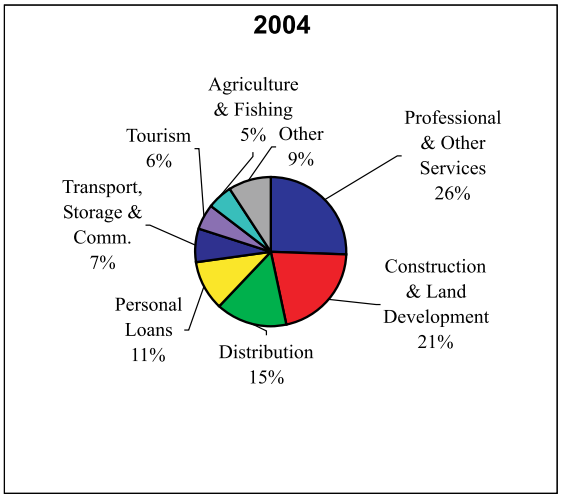
(J$M)

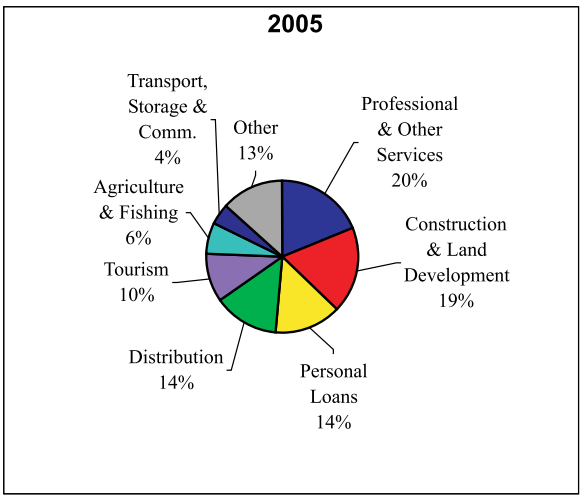
	2004 Stock	Share of Total (%)	Annual Change in Stock	2005* Stock	Share of Total (%)	Annual Change in Stock
Public Sector	**684.0**	**10.0**	**-230.3**	**475.7**	**5.5**	**-208.3**
Financial Institutions	**190.1**	**2.8**	**189.3**	**9.4**	**0.1**	**-180.8**
Private Sector	**5 978.4**	**87.2**	**971.5**	**8 185.2**	**94.4**	**2 206.7**
Agriculture & Fishing	315.5	4.6	221.6	531.0	6.1	215.5
Mining & Quarrying	20.4	0.3	-6.6	27.5	0.3	7.1
Manufacturing	269.3	3.9	14.6	474.8	5.5	205.5
Construction & Land Development	1 266.0	18.5	499.1	1 489.2	17.2	223.2
Transport, Storage & Communication	427.9	6.2	410.8	361.3	4.2	-66.6
Tourism	335.6	4.9	-89.8	847.2	9.8	511.6
Distribution	921.0	13.4	476.4	1 132.2	13.1	211.2
Professional & Other Services	1 521.4	22.2	-583.5	1 548.8	17.9	27.4
Personal Loans	650.3	11.0	-36.9	1 174.6	14.0	524.4
Electricity	176.3	2.6	13.2	177.3	2.0	1.0
Entertainment	68.9	1.0	61.0	71.8	0.8	2.9
Overseas Residents	6.0	0.1	-8.4	349.6	4.0	343.6
TOTAL	**6 852.6**	**100.0**	**930.5**	**8 670.3**	**100.0**	**1 817.7**

** Provisional*
Totals include provisions for loan losses

Chart 7

Distribution of Private Sector Loans and Advances





Within private sector loans, with the exception of *Transport, Storage & Communication*, all categories recorded an expansion in credit during the review period. *Personal Loans*, which expanded by 80.6 per cent, accounted for the largest proportion of the increase in credit. This occurred within the context of aggressive marketing by the institutions. Loans to *Tourism* also expanded significantly within a context of robust construction and refurbishing within the hotel industry.

Professional & Other Services continued to account for the largest proportion of the stock of outstanding private sector credit despite net repayments during the review period. There was a significant increase in the proportion of *Personal Loans* to 14.0 per cent at the end of the review period from 11.0 per cent at end 2004. The share of outstanding loans to *Tourism* and *Agriculture & Fishing* also increased, while all other sectors recorded a decline (see **Chart 7**).

The ratio of past due loans (over three months) to total loans increased to 5.3 per cent at end December 2005 from 2.2 per cent at end December 2004. Notwithstanding, the ratio remained well within the 10.0 per cent international benchmark.

2.4.2. Building Societies

The assets of the four building societies continued to grow in 2005, albeit at a slower rate than 2004. This deceleration largely reflected slower growth in *Investments* due to significant unwinding of local securities held by the building societies. On the other hand, there was acceleration in the growth of mortgage loans.

The asset base of building societies increased by 11.1 per cent in 2005, relative to 22.4 per cent in 2004. The slower rate of growth was largely reflected in the entities' holdings of *Investments* that grew at a reduced rate due to significant decline in equities in the context of the lacklustre performance of the stock market. This decline was however, offset by increases in the entities'

holdings of foreign currency securities, particularly GOJ's.

Growth in total assets largely emanated from a significant expansion in *Loans and Advances*, which accounted for 80.9 per cent of the total increase in the asset base. *Loans and Advances* expanded by 25.1 per cent during the review period, relative to an increase of 23.9 per cent during 2004. Of the increase in total loans, mortgage loans grew by 24.9 per cent, relative to 22.9 per cent during 2004.

The main source of financing during 2005 was a 9.0 per cent increase in the savings funds, which grew at a slower rate than the previous year. This was augmented by increased financing from specialized institutions and other financial institutions. The building societies expanded their capital base by 5.8 per cent, mainly reflecting an increase in the Statutory Reserve Fund. This outturn was, however, less than the increase of 38.4 per cent during the previous year.

During the year, the building societies improved their liquidity position as reflected by an increase in the liquid assets to total assets ratio and the liquid assets to savings funds ratio at end December 2005. The robust growth in loans resulted in a 696 basis point increase in the mortgage loans to savings fund ratio. In addition,

TABLE 15

ASSETS AND LIABILITIES OF BUILDING SOCIETIES
2004 AND 2005
(J$M)

	STOCK December 2004	STOCK December 2005	FLOWS Annual Change 2004	FLOWS Annual Change 2005	Per Cent Change 2004	Per Cent Change 2005
ASSETS						
Cash and Balances with Commercial Banks	11 019.2	12 039.6	2 457.1	1 020.4	29.2	9.3
Balances with Other Financial Institutions	0.0	0.0	-922.6	0.0	-100.0	0.0
Balances with Bank of Jamaica	1 266.6	1 373.6	185.6	107.1	17.2	8.5
Investments (net of provision)	18 703.7	20 269.0	4 794.3	1 565.3	34.5	8.4
Securities Purchased with View to Resale	14 894.6	14 431.8	1 465.8	-462.8	10.9	-3.1
Loans and Advances (net of provision)	28 696.0	35 893.9	5 534.4	7 197.9	23.9	25.1
- of which Mortgages	28 093.8	35 081.3	5 240.4	6 987.5	22.9	24.9
Accounts Receivables	3 310.4	2 628.4	718.9	-682.1	27.7	-20.6
Fixed Assets	1 825.7	1 952.3	240.8	126.6	15.2	6.9
Other Assets	623.2	651.9	227.9	28.7	57.7	4.6
TOTAL	**80 339.3**	**89 240.5**	**14 702.3**	**8 901.2**	**22.4**	**11.1**
LIABILITIES						
Savings Fund	58 791.8	64 076.2	9 354.7	5 284.4	18.9	9.0
Due to Bank of Jamaica	0.0	0.0	0.0	0.0	0.0	0.0
Due to Commercial Banks	837.9	1 659.0	465.2	821.1	124.8	98.0
Due to Specialized Institutions	1 863.8	3 284.3	565.5	1 420.5	43.6	76.2
Due to Other Financial Institutions	649.8	1 418.3	64.3	768.5	11.0	118.3
Securities Sold Under Repurchase Agreement	0.0	0.0	-131.7	0.0	-100.0	0.0
Other Liabilities	2 791.2	2 504.0	108.2	-287.3	4.0	-10.3
Capital and Reserves	15 404.8	16 298.8	4 276.1	894.0	38.4	5.8
TOTAL	**80 339.3**	**89 240.5**	**14 702.3**	**8 901.2**	**22.4**	**11.1**
INDICATIVE RATIOS (Per Cent)						
Liquid Assets : Total Assets	12.8	12.9				
Liquid Assets : Savings Find	17.5	17.9				
Advance : Savings Fund	49.8	57.0				
Mortgage Loans : Savings Fund	47.8	54.7				

TABLE 16

Building Societies New Mortgage Loans 2004 and 2005

	2004	2005	Flow	% Change
Value of New Accounts (J$M)				
Residential	7 009.7	8 110.9	1 101.2	15.7
Commercial	114.3	355.1	240.8	210.7
Agricultural & Other	189.3	402.2	212.9	112.5
TOTAL	7 313.4	8 868.2	1 554.9	21.3
Number of New Accounts				
Residential	3 065	3 250	185	6.0
Commercial	30	36	6	20.0
Agricultural & Other	78	252	174	223.1
TOTAL	3 173	3 538	365	11.5
Overall Weighted Average Mortgage Loan Rate (%)	15.62	15.35*	-0.28	

the advance to savings ratio increased to 57.0 per cent at end 2005 from 49.8 per cent at end 2004 (see **Table 15**).

2.4.2.1. New Mortgage Loans

The number of new mortgage loans grew by 11.5 per cent during the review period. This increase was primarily due to expansions within the *Residential* and the *Agricultural & Other* categories. There were also 36 new commercial loans during 2005 compared to 30 in the previous year.

The value of new mortgage loans increased by 21.3 per cent in 2005, relative to an increase of 21.0 per cent during 2004. Residential mortgages accounted for 91.5 per cent of the increase in the value of new mortgage loans. The *Commercial* and *Agricultural & Other* categories also enjoyed robust growth in the value of new mortgage loans. At end-December 2005, the average size of new mortgage loans increased to $2.5 million from $2.3 million at end December 2004.

Consistent with the competitive marketing strategies of the building societies, the overall mortgage rate declined by 28 basis points during 2005 (see **Table 16**). This is relative to a 44 basis point decline during 2004. The increase in the threshold of the loan limit per applicant by the National Housing Trust (NHT) should stimulate an increase in the demand for joint lending arrangements with the building societies for new mortgage accounts during 2006.

Table 17

DEVELOPMENT BANK OF JAMAICA ASSETS AND LIABILITIES (J$M)				
	2004	**2005**	**Change**	**% Change**
ASSETS				
Cash and Bank Balances	26.6	279.2	252.6	949.6
Receivables and Prepayments	6 737.1	6 994.7	257.6	3.8
Investments	75.9	74.6	-1.3	-1.7
Securities - Resale Agreements	60.8	201.9	141.1	232.1
Loans to Financial Institutions	7 311.0	7 043.5	-267.5	-3.7
-Loans to Co-operative Banks	751.7	757.5	5.8	0.8
-Loans to AFIs	5 623.4	5 769.2	145.8	2.6
-Other Loans	935.8	516.8	-419.0	-44.8
GOJ Infrastructural Loan Programmes	9 051.5	5 732.2	-3 319.3	-36.7
Other Assets	758.7	0.0	-758.7	-100.0
Fixed Assets	341.2	384.2	43.0	12.6
TOTAL	**24 362.8**	**20 710.3**	**-3 652.5**	**-15.0**
LIABILITIES AND SHAREHOLDERS' EQUITY				
Shareholder's Equity	5 294.4	5 398.0	103.6	2.0
Current Liabilities	1 403.2	1 196.3	-206.9	-14.7
Long-term Liabilities	13 155.0	10 149.0	-3 006.0	-22.9
Short-term Liabilities	1 668.7	2 368.4	699.7	41.9
Other Liabilities	2 841.5	1 598.6	-1 242.9	-43.7
TOTAL	**24 362.8**	**20 710.3**	**-3 652.5**	**-15.0**

2.5. Development Banks

2.5.1. Development Bank of Jamaica

The Development Bank of Jamaica (DBJ) typically provides medium and long-term financing at concessional interest rates, with the view to fulfilling its mandate of fostering economic growth and development.[5] In 2005, the DBJ extended new loans in both local and foreign currency but there was a reduction in loans outstanding due to repayment associated with a large infrastructural development project. Local currency loan disbursements were made largely to the Agriculture sector, while foreign currency loan disbursements were made solely to the Tourism sector. The operations of the institution during the year resulted in profits of approximately $117.0 million for 2005, which was 19.2 per cent below that recorded for 2004.

Total assets of the DBJ declined by $3 652.5 million, or 15.0 per cent, during the year (see **Table 17**). This decline largely reflected a 36.7 per cent net reduction in the stock of loans extended for the GOJ Infrastructural Loan Programme consequent on the repayment of these loans.

Total loans to financial institutions declined by $267.5 million. This decline was influenced largely by a 44.8 per cent fall in loans to 'direct borrowers' and agricultural institutions, which outweighed increases of 2.6 per cent and 0.8 per cent in loans to Approved Financial Institutions (AFIs) and Peoples' Cooperative (PC) banks, respectively. The outstanding stock of loans extended to AFIs, the major channel through which loans are distributed, stood at $5 769.2 million at end 2005.

Cushioning the decline in assets were increases of $257.6 million in Receivables and Prepayments and $252.6 million in Cash and Bank Balances. These movements came against a background of increases in interest receivables on loans made to the government and various institutions, while Cash and Bank Balances increased largely as a result of inflows from loan repayments.

The main contributors to the decline in total Liabilities and Shareholders' Equity were the 22.9 per cent decline in long-term liabilities to $10 149.0 million, relating to the pay-down on a road rehabilitation loan, and the 43.7 per cent decline in Other Liabilities from $2 841.2 million. The decline in Other Liabilities emanated largely from a reduction in payables corresponding to the aforementioned pay-down on the road rehabilitation loan.

2.5.1.1. Loan Approvals and Disbursements

Local currency loan approvals for the year totalled $1 065.7 million (see **Table 18**). Of this amount, the Agriculture, Manufacturing and Agro-Industry sectors received the bulk of the approvals (see **Table 19**). Total foreign currency loan approvals amounted to US$12.8 million and were largely for the Tourism sector. There were no foreign currency loan approvals in 2004.

5 The loans can be accessed via Approved Financial Institutions (AFIs), which include commercial and merchant banks as well as People's Co-operative (PC) banks. The DBJ also continued to organize financing for Government of Jamaica (GOJ) programmes.

TABLE 18

LOAN APPROVALS AND DISBURSEMENTS TO AFI's AND PC BANKS BY SECTOR JANUARY - DECEMBER 2005

APPROVALS

	Local Currency J$M			Foreign Currency US$M		
Sector	**2004**	**2005**	**% change**	**2004**	**2005**	**% change**
Agriculture	242.6	348.9	43.8	0.0	0.0	0.0
Agro-Industry	494.9	151.0	-69.5	0.0	0.0	0.0
Manufacturing	310.0	238.2	-23.2	0.0	0.0	0.0
Mining & Quarrying	54.1	78.9	45.8	0.0	0.0	0.0
Other Services	158.7	138.7	-12.6	0.0	0.2	100.0
Tourism	218.9	110.0	-49.7	0.0	12.6	100.0
Total	**1 479.2**	**1 065.7**	**-28.0**	**0.0**	**12.8**	**100.0**

DISBURSEMENTS

	Local Currency J$M			Foreign Currency US$M		
Sector	**2004**	**2005**	**% change**	**2004**	**2005**	
Agriculture	148.3	320.1	115.8	0.0	0.0	0.0
Agro-Industry	262.1	265.6	1.3	0.0	0.0	0.0
Manufacturing	400.2	173.7	-56.6	0.0	0.0	0.0
Mining & Quarrying	36.9	94.7	156.6	0.0	0.0	0.0
Other Services	124.3	0.8	-99.4	0.0	0.0	0.0
Tourism	294.3	121.0	-58.9	13.4	6.7	-50.0
Total	**1 266.1**	**975.9**	**-22.9**	**13.4**	**6.7**	**-50.0**

Local and foreign currency loan disbursements amounted to J$975.9 million and US$6.7 million, respectively. The Agriculture, Agro-Industry and Manufacturing sectors accounted for 32.8 per cent, 27.2 per cent and 17.8 per cent of the total local currency distribution, respectively. Tourism was the sole beneficiary of foreign currency loan disbursements.

TABLE 19

LOAN APPROVALS AND DISBURSEMENTS TO AFI's AND PC BANKS BY SECTOR

JANUARY - DECEMBER 2005

	PROPORTIONS							
	APPROVALS				DISBURSEMENTS			
	Local Currency	Foreign Currency	Local Currency	Foreign Currency	Local Currency	Foreign Currency	Local Currency	Foreign Currency
	2004		2005		2004		2005	
Sector								
Agriculture	16.3	0.0	32.7	0.0	11.7	0.3	32.8	0.0
Agro-Industry	33.5	0.0	14.2	0.0	20.7	0.0	27.2	0.0
Manufacturing	21.0	0.0	22.4	0.0	31.6	0.0	17.8	0.0
Mining & Quarrying	3.7	0.0	7.4	0.0	2.9	0.0	9.7	0.0
Other Services	10.7	0.0	13.0	1.6	9.8	0.0	0.1	0.0
Tourism	14.8	0.0	10.3	98.4	23.3	99.7	12.4	100.0

2.5.2. National Export-Import Bank of Jamaica

The National Export-Import Bank of Jamaica (Ex-Im Bank) remained the only institution in Jamaica offering export credit insurance to protect non-traditional exports against losses due to non-payment by foreign buyers. While this facility is recognized as an indispensable tool, particularly in the area of export expansion, usage continues to be low, reflecting a general decline in non-traditional exports. Notwithstanding the low usage during 2005, the Ex-Im Bank insured exports valued at approximately J$1.0 billion. The institution continued to explore the feasibility of the introduction of domestic credit insurance to complement export credit insurance. This was based on feedback from existing policyholders and exporters utilising Ex-Im Bank's loan programmes. There were indications that there were benefits to be accrued from the introduction of such a product. The new product, if found to be feasible, is projected for implementation in 2006.

In recognition of the urgent need to expand export earnings, particularly in anticipation of the new trade regimes, CARICOM Single Market (CSM) and the Free Trade Area of the Americas (FTAA), the Ex-Im Bank in collaboration with the Jamaica Exporters' Association (JEA) and its main stakeholder, the Government of Jamaica, in 2005, continued the Export Growth Initiative Fund (EGIF) which was introduced in December 2004. The purpose of the fund is to provide refinancing as well as to facilitate retooling, expansion and modernization of businesses as well as technical assistance. These funds were made available at attractive interest rates of 5-7 per cent on a medium-term basis to exporters, linkage companies and businesses engaged in import substitution. The Ex-Im Bank also introduced a General Trade Line that allows for the financing of goods not normally funded by Ex-Im Bank such as educational books/stationery, pharmaceuticals, motor vehicle parts and restaurant supplies. The Line attracts interest rates at 16.0 per cent and 12.0 per cent for local and foreign currency transactions, respectively. The institution also relaxed its collateral requirements to accept a wider mix of collateral, thereby adopting a greater tolerance for risk while improving responsiveness to its customers. This action was aimed at supporting Ex-Im Bank's thrust to assist the productive sectors that have demonstrated both the propensity and the capacity for growth.

2.5.2.1. Review of Lending Operations

The operations of the Bank during 2005 resulted in un-audited profits of J$132.0 million being recorded for the institution.

Local and foreign currency disbursements of J$1.7 billion and US$11.5 million, respectively, brought total disbursement for the year to J$2.5 billion, marginally above that recorded in 2004. Foreign currency loans increased by 17.5 per cent, offsetting the reduction of 6.0 per cent in local currency disbursements. The decrease in local currency loans was due to relatively low demand, particularly for short-term working capital for agriculture and agro-processing in the first quarter of 2005, due to the disruptions caused by the hurricane which affected the island in the latter part of 2004. However, there was a marked increase in demand for loans in the latter part of 2005.

TABLE 20

LOCAL CURRENCY DISBURSEMENTS (J$MN)				
Facilities	**2004**	**2005**	**Change**	**% Change**
Bankers' Export Credit Facility	521.0	409.5	-111.4	-21.4
Export Credit Facility	664.0	675.9	11.9	1.8
Insurance Policy Discounting Facility	46.6	69.2	22.5	48.3
Pre-Shipment/CoPack Facilities	358.4	285.7	-72.7	-20.3
Apparel Sector Financing	28.1	21.8	-6.3	-22.4
Modernization Fund for Exporters	137.4	122.0	-15.4	-11.2
Small Business Facility	49.1	114.3	65.2	132.7
Ornamental Fish	2.9	1.5	-1.4	-49.0
Export Growth and Incentive Fund	0.0	0.0	0.0	0.0
JMA/ExBed	3.2	0.0	-3.2	-100.0
JEA/ExBed	16.9	16.8	-0.1	-0.6
Information Communication Technology (ICT)	0.0	1.1	1.1	100.0
Total	**1 827.6**	**1 717.8**	**-109.8**	**-6.0**

Loan disbursement in 2005 was 6.0 per cent below disbursements recorded for 2004 (see **Table 20**). The decrease was due largely to low demand for the Banker's Export Credit and Pre Shipment Facilities, particularly in the first quarter of the calendar year 2005.

Notably, the Small Business facility benefited from the largest increase in local currency disbursements and as such cushioned the decline in overall local currency disbursements.

TABLE 21

APPROVED LOANS BY INDUSTRY				
	2004		2005	
Industry	**J$M**	**Share (%)**	**J$M**	**Share (%)**
Agro Processing	396.7	21.7	468.1	27.3
Food & Beverage	1 113.7	60.8	955.5	55.6
Textile & Apparel	29.1	1.6	22.6	1.3
Other Manufacturing	227.8	12.4	134.7	7.8
Distribution/Services	64.5	3.5	136.9	8.0
Total	**1381.7**	**100.0**	**1 717.8**	**100.0**

While the Food and Beverage industry continued to be the major user of Ex-Im Bank's local currency funding, the sector recorded a decline in demand over 2004 due to continued competition from imported products and the decision of some large companies to self-finance. However, the Agro Processing industry, which is one of the growth areas targeted by the Ex-Im Bank, showed improvement in loan disbursements.

TABLE 22

FOREIGN CURRENCY DISBURSEMENTS				
	2004	2005		
Facility	**US$M**	**US$M**	**Change**	**% Change**
Lines of Credit	9.0	9.8	0.8	8.2
Bankers Export Credit Facility	0.5	0.7	0.2	29.4
Export Growth Initiative Fund	0.0	1.0	1.0	100.0
Total	**9.5**	**11.5**	**2.0**	**17.5**

In 2005, foreign currency disbursements were bolstered by the demand for the EGIF and contributed to a 17.5 per cent increase in utilization over the corresponding period in 2004 (see **Table 22**). It should be noted that there were no foreign currency loan disbursements from the Ex-Im Bank's Cuban Lines of Credit which was affected by the trade impasse between a local exporter and the Cuban authorities. The impasse was resolved and Ex-Im Bank expects that foreign currency disbursements through this facility will resume shortly.

3.1. Money Market Operations

3.1.1. Bank of Jamaica Operations

The Bank of Jamaica continued to utilise open-market operations as the main tool for the management of Jamaica Dollar liquidity in the financial system during 2005. The primary dealers (PDs) group remained the main agent through which open-market operations were conducted, accounting for 70.9 per cent of new agreements in 2005, relative to 69.0 per cent in 2004. The number of PDs increased to 15 at end-2005 from 12 at the end of 2004. This reflected the addition of two new entities and the resumption of activity by one securities dealer following the completion of administrative arrangements as stipulated by the regulatory authority.

The primary instrument of open market operations was Certificates of Deposit (CDs), which replaced the traditional reverse repurchase agreements[6]. All the terms and conditions that were applicable to reverse repurchase transactions apply to CDs except that these instruments are not collateralised by the Bank's holdings of Government securities but are direct claims on the Central Bank. Liquidity absorption was primarily effected through the issuance of CDs, which was supported by the sale of securities on the secondary market. These operations resulted in net absorption of $9 087.9 million for 2005.

During the first half of the year, $24 621.0 million was net absorbed from the system (see **Table 23**). This absorption was necessary in a context where Jamaica Dollar liquidity was buoyed by:

- The BOJ's net purchase of foreign currency equivalent to J$33 845.5 million, which contributed to an increase of US$298.3 million in the NIR during the first half of the year.
- The injection of $5 546.0 million into the system arising from the 4.0 percentage point reduction in the special deposit requirement for commercial banks and FIA licencees.

Table 23

Bank of Jamaica Open Market Operations 2005 (J$MN)

	Q1	Q2	Q3	Q4	Total
A. Net Outright Sales (+)/Purchases (-)	-	-	-	9,032.5	9,032.5
B. Net Reverse Repurchase	(21,984.0)	(13,036.1)	-	0.0	(35,020.1)
C. Net CDs	30,09 2.7	29,548.4	(2,956.9)	(21,608.7)	35,075.5
(A+B+C). Net Absorption (+)/ Injection (-)	8,108.7	16,512.3	(2,956.9)	(12,576.1)	9,087.9

Data include principal and interest payments

6 The Bank phased out its Reverse Repurchase Agreements as at 27 May 2005. This facilitated consistency in the accounting treatment (under IFRS) of open-market instruments by holders.

The performance of open-market instruments during this period reflected strong investor confidence, which was underpinned by favourable macroeconomic developments and outlook. This investor confidence was manifested in the conversion of foreign currency to invest in Jamaica Dollar instruments, particularly the BOJ's 365-day offer.

However, during the second half of the year market conditions changed following adverse weather conditions and persistent increases in world oil prices, which fuelled concerns regarding the attainment of macro-economic targets, particularly inflation. Against this background, the demand for Jamaica Dollar denominated instruments became notably skewed towards variable rate instruments, which offered a hedge against interest rate risk. Further, foreign currency demand pressures that emerged in the September quarter, intensified in the final quarter, as investors sought to increase their holdings of US dollar denominated assets. Consequently, there was a reduced demand for fixed-rate Jamaica Dollar instruments. Coupled with the seasonal demand for currency in December, these factors resulted in net injection of $24 565.6 million through BOJ open market instruments during the second half of the year. Hence, in an effort to restore stability, the Bank enhanced its liquidity management operations, through the sale of securities from its holdings of GOJ variable-rate instruments, which absorbed $9 032.5 million. In this context, there was net injection of $15 533.0 million through open market operations.

3.1.2. Government Operations

The Government continued to pursue its objective of reducing debt to sustainable levels, issuing debt at lower costs and minimising exposure to interest and exchange rate risks. In order to achieve these objectives the GOJ aimed to maintain a 60:40 ratio of fixed-rate to variable-rate debt, extend and smooth the maturity profile of its debt and target a balanced budget for fiscal year 2005/06.

Domestic Public Issues

In 2005, the Bank acting as fiscal agent for the Government, administered 54 public debt issues in the domestic market relative to 46 in 2004 (see **Table 24**).

Investors demand for variable rate instruments, particularly in the latter half of the year, significantly constrained the Government's ability to meet its objective of reducing the debt portfolio's sensitivity to adverse interest rate movements. In this regard, variable rate securities comprised 55.1 per cent of the value of Jamaica Dollar instruments issued during the year compared to 15.4 per cent in 2004 (see **Table 25**). Consequently, as at end-December 2005, the ratio of variable rate instruments in the GOJ's debt portfolio increased to 49.2 per cent, relative to 42.0 per cent at end-December 2004.

In the review year, the Government was more successful in elongating the maturity profile of its debt with 21.6 per cent of the nominal value issued within the year offering tenors of over 5 years, relative to 2.9 per cent in 2004. However, it was noted that investors required a higher coupon as well as a hedge to go long-term. Hence, 86.8 per cent of issues with tenors in the '*over 5 years*' category offered variable coupons.

During the year, the GOJ issued US dollar denominated debt totalling US$246.5 million to coincide with

TABLE 24

NUMBER OF GOJ PUBLIC OFFERS BY INSTRUMENT TYPE : 2004 AND 2005

Instrument Type	2004 Number of Offers Tenor <=1 year	1-5 years	>5 years	Total	2005 Tenor <=1 year	1-5 years	>5 years	Total
Fixed Rate Investment Debenture	-	10	-	**10**	-	4	-	**4**
Fixed Rate Registered Bond	-	1	2	**3**	-	3	1	**4**
Fixed Rate Investment Bond	-	-	-	**0**	-	1	-	**1**
Local Registered Stock	19	6	-	**25**	-	4	5	**9**
Treasury Bill		-	-	**0**	22	-	-	**22**
Variable Rate Investment Bond	-	5	1	**6**	-	8	3	**11**
Variable Rate LRS	-	-	-	**0**	-	-	1	**1**
FRUS$ Bond	-	1	1	**2**	-	2	-	**2**
Eurobond *	-	-	3	**3**	-	-	2	**2**
* The Bank of Jamaica does not act as fiscal agent for these offers.								
Total	**19**	**23**	**7**	**49**	**22**	**22**	**12**	**56**

TABLE 25

COMPARATIVE PROFILE OF GOJ PUBLIC OFFERS IN THE DOMESTIC CAPITAL MARKET - 2004 & 2005

(Nominal Outstanding in J$ Millions)

Quarter		2004 Tenor <=1 year	1-5 years	>5 years	Total	2005 Tenor <=1 year	1-5 years	>5 years	Total
March	Fixed Rate Instruments	0.0	5,493.0	0.0	**5,493.0**	0.0	13,852.0	300.0	**14,152.0**
	Variable Rate Instruments	0.0	7,882.7	0.0	**7,882.7**	0.0	2,492.4	0.0	**2,492.4**
	Treasury Bill	1,550.0	0.0	0.0	**1,550.0**	2,150.0	0.0	0.0	**2,150.0**
Sub-Total		***1,550.0***	***13,375.7***		***14,925.7***	***2,150.0***	***16,344.5***	***300.0***	***18,794.5***
June	Fixed Rate Instruments	0.0	25,943.4	1,492.5	**27,435.9**	0.0	7,192.3	0.0	**7,192.3**
	Variable Rate Instruments	0.0	2,705.4	0.0	**2,705.4**	0.0	7,483.2	10,079.4	**17,562.6**
	Treasury Bill	1,850.0	0.0	0.0	**1,850.0**	1,750.0	0.0	0.0	**1,750.0**
Sub-Total		***1,850.0***	***28,648.8***	***1,492.5***	***31,991.3***	***1,750.0***	***14,675.5***	***10,079.4***	***26,504.9***
September	Fixed Rate Instruments	0.0	13,356.0	0.0	**13,356.0**	0.0	5,111.1	2,218.0	**7,329.1**
	Variable Rate Instruments	0.0	0.0	1,114.0	**1,114.0**	0.0	12,358.9	0.0	**12,358.9**
	Treasury Bill	1,950.0	0.0	0.0	**1,950.0**	2,000.0	0.0	0.0	**2,000.0**
Sub-Total		***1,950.0***	***13,356.0***	***1,114.0***	***16,420.0***	***2,000.0***	***17,470.0***	***2,218.0***	***21,688.0***
December	Fixed Rate Instruments	0.0	21,436.9	0.0	**21,436.9**	0.0	3,507.6	0.0	**3,507.6**
	Variable Rate Instruments	0.0	2,816.0	0.0	**2,816.0**	0.0	9,147.6	6,424.9	**15,572.5**
	Treasury Bill	1,750.0	0.0	0.0	**1,750.0**	2,100.0	0.0	0.0	**2,100.0**
Sub-Total		***1,750.0***	***24,252.9***		***26,002.9***	***2,100.0***	***12,655.2***	***6,424.9***	***21,180.1***
	Total	***7,100.0***	***79,633.5***	***2,606.5***	***89,339.9***	***8,000.0***	***61,145.1***	***19,022.3***	***88,167.4***
	Memo Items US Dollar Denominated Issues (US$ Millions):								
September	FR US$ Bond	0.0	115.8	86.1	**201.9**	0.0	150.0	0.0	**150.0**
December	FR US$ Bond	0.0	0.0	0.0	**0.0**	0.0	96.5	0.0	**96.5**
	Total	***0.0***	***115.8***	***86.1***	***201.9***	***0.0***	***246.5***	***0.0***	***246.5***

maturities of similar instruments (see **Table 25**). The new instruments were issued with lower coupons averaging 8.125 per cent compared to 10.24 per cent in 2004.

The stock of Treasury Bills declined to $3.5 billion at end 2005 from $3.75 billion at end-2004. Prior to September 2005, the 6-month weighted average Treasury Bill yield (WATBY) was the only benchmark

for the re-pricing of Government variable rate securities, making this tenor the most frequently issued. However, in September the GOJ began using the 3-month WATBY to re-price instruments which offered quarterly coupons. Subsequently, there was an increase in the frequency of the issue of 3-month Treasury Bills. In this regard, there were nine (9) issues of 3-month Treasury Bills in 2005 compared to four (4) in 2004.

Foreign Debt Issues

In 2005, the Government offered Eurobonds totalling US$550.0 million. The bonds were issued at successively longer tenors of ten (10) and twenty (20) years with coupons of 9.0 per cent and 9.25 per cent, respectively (see **Table 26**).

The 10-year Eurobond was issued in May 2005 and was priced to yield 9.125 per cent (see **Table 26**). The coupon on this bond represented the lowest ever offered on GOJ global bonds. In response to overwhelming demand for this offer, the Government increased the initial offer from US$200.0 million to US$300.0 million.

In October, the GOJ issued a US$250.0 million 20-year bond at a yield of 9.375 per cent. This issue was also oversubscribed, resulting in the initial offer being increased from US$200.0 million.

The success of these issues was reflective of the continued endorsement by international investors of the Government's macroeconomic policies and demonstrated commitment to prudent fiscal management.

TABLE 26

GOJ EUROBONDS

Quarter	Tenor (years)	Amount (MN)	Coupon (%)	Yield to Maturity at Time of Issue(%)
		2005		
June	10	US$300	9.00	9.125
December	20	US$250	9.25	9.375
		2004		
March	5	€ 200	10.5	10.63
"	4.5	US$50	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. Total take-up $425MN

3.1.3. Interest Rates

Given the favourable market conditions up to May, the BOJ effected 3 rounds of interest rate reductions. In this regard, by end-May, interest rates on the 180-day and 365-day instruments were lower by 130 and 190 basis points, respectively, relative to December 2004. The applicable interest rates on these tenors were 13.00 per cent and 13.60 per cent on the respective tenors (see **Table 27**). These reductions influenced a further flattening of the yield curve on OMO instruments (see **Chart 8**) and brought interest rates on these tenors to their lowest levels since September 2002.

However, changing market conditions in the second half of the year necessitated that the BOJ adopt a more conservative stance and hence there were no further adjustments to BOJ's spectrum of interest rates.

Market-determined interest rates also reflected a declining trend that was consistent with the rates on OMO instruments during the first two quarters of the calendar year. This was reflected in the WATBY on the 6-month tenor declining to 13.46 per cent by end-March, relative to 14.94 per cent at end-December 2004. Further reductions in the June quarter resulted in a WATBY of 12.88 per cent at end-June 2005 (see **Table 28**). Consistent with the deterioration in market conditions during the second half of the year, the 6-month WATBY reflected gradual increases, closing the year at 13.55 per cent. A similar trend was observed for the 3-month WATBY (see **Table 28**).

TABLE 27

Rates on OMO Instruments (%)
(End December 2004- December 2005)

End Month	30 days	180 days	365 days
December '04	13.80	14.30	15.50
January	13.80	14.30	15.50
February	13.50	14.00	15.00
March	12.95	13.45	14.50
April	12.95	13.45	14.50
May	12.60	13.00	13.60
June	12.60	13.00	13.60
July	12.60	13.00	13.60
August	12.60	13.00	13.60
September	12.60	13.00	13.60
October	12.60	13.00	13.60
November	12.60	13.00	13.60
December '05	12.60	13.00	13.60

The coupons offered on GOJ medium-term debt instruments also declined during the year. Early in the March quarter, a 2-year instrument offered a coupon of 15.75 per cent relative, to 16.50 per cent on a similar offer in the December 2004 quarter.

CHART 8

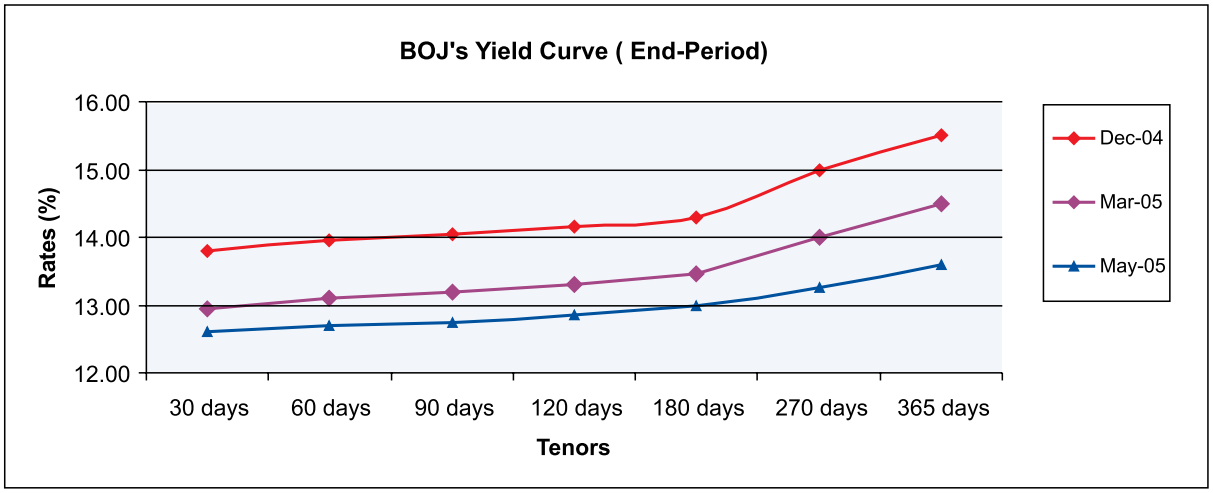
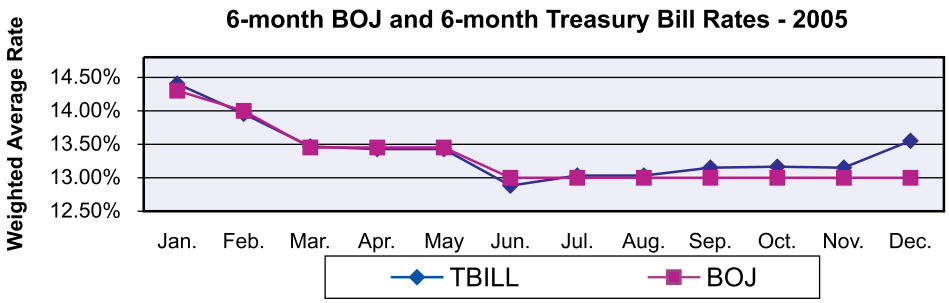


TABLE 28

Weighted Average Treasury Bill Yields (End Period - 2005)		
	3-month	6-month
End Month		
January	n/a	14.40%
February	13.83%	13.95%
March	13.21%	13.46%
April	n/a	13.43%
May	13.19%	13.43%
June	12.85%	12.88%
July	n/a	13.03%
August	12.78%	13.03%
September	12.96%	13.15%
October	12.95%	13.16%
November	12.98%	13.15%
December	13.34%	13.55%

The coupons on these instruments continued to decline throughout the year and by the December 2005 quarter, the coupon on a 3-year offer was 13.65 per cent.The decline was also evidenced by an average yield of 14.16 per cent on a 5-year LRS during the September quarter, relative to 16.37 per cent on a similar offer at the beginning of 2005.

CHART 9



4. Supervision Of Deposit -Taking Financial Institutions

4.1. Introduction

Bank of Jamaica, in 2005 continued the supervision and periodic examination of deposit taking financial institutions by virtue of the provisions contained in Section 34A of the Bank of Jamaica Act. The following institutions comprise the supervised population:

- 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.

Regulations to establish a formal supervisory framework for credit unions, designated specified financial institutions under the Bank of Jamaica Act, are still being finalised. Regulatory responsibility for non-deposit taking financial institutions rests with the Financial Services Commission which has supervisory oversight of insurance companies, securities dealers, unit trusts, pension management companies and mutual funds. (See Section **4.11. Supervisory Cooperation and Interaction.**)

4.2. Legislative Framework

Table 2.9 – 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 Banking (Establishment of Branches) Regulations • The Banking (Amalgamation and Transfers) Regulations • The Banking (Capital Base) Regulations • The Banking (Licence Fees) Regulations, 2003 • The Financial Institutions (Establishment of Branches) Regulations • The Financial Institutions (Amalgamation and Transfers) Regulations • The Financial Institutions (Capital Base) Regulations • The Financial Institutions (Licence Fees) Regulations, 2003 • The Building Societies (Licences) Regulations

Licensees also have statutory responsibilities which may or may not be peculiar to their nature of business, which devolve from other pieces of legislation which include, but are not limited to, the Companies Act, the Deposit Insurance Act, Drug Offences (Forfeiture of Proceeds) Act, the Money Laundering Act and related Regulations and Guidance Notes issued by the Supervisory Authority and the Drug Offences (Forfeiture of Proceeds) Act. (See Section **4.9. Legislative Developments.**)

4.3. Supervisory Methodology

Supervisory responsibilities under the Bank of Jamaica Act are discharged through the Financial Institutions Supervisory Division (FISD) of the Bank. The supervisory methodology that has been traditionally applied combines annual on-site examinations along with on-going off-site monitoring, which allow for continuous and timely review of developments in the financial condition of supervised entities both at the micro institutional level as well as at the macro or wider systemic level.

On-site examinations of each licensee are conducted once per year as required by statute or more frequently, if deemed necessary by the Supervisor. Traditionally, the examination exercise has incorporated standard reviews and assessments 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 inclusive of anti-money laundering and anti-terrorism financing arrangements. On-site review of licensees' framework for anti-money laundering and anti-terrorism financing (AML/CFT) is 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. (See Section **4.10.2. CFATF Mutual Evaluation.**)

In recent years, the Bank of Jamaica has, however, been implementing a more risk based approach to supervision which involves enhanced off-site and pre-examination procedures, with increased scrutiny of licensees' corporate governance frameworks, risk management and operational/group structures. The outcome of these assessments identifies those areas that pose the greatest potential risk to each institution's operations and determines the institution's overall risk rating, as well as the level and focus of supervisory resources to be assigned to examination. The on-site examination involves:

- review and physical inspection of the documentation of each entity's framework and structures including policies, procedures, reports generated by internal and external/ independent reviewers, and other records;
- interviews with senior management and relevant operations personnel; and
- sample tests and observations to assess effectiveness of implementation of documented systems, structures and processes which facilitate informed estimations of the real value of assets and the final assessment of the overall financial condition.

The Bank of Jamaica continued its off-site assessments, primarily facilitated by prudential returns which licensees

are required to submit to the Bank of Jamaica at weekly, monthly, quarterly and annual intervals. The Bank also reviewed the audit and other external reports. The off-site review involved analysis of the prudential returns for trends in operations and financial condition. It also included an 'Early Warning System' whereby various financial and prudential indicators were monitored and subjected to scenario and stress tests to allow for forward looking assessments to facilitate proactive supervisory responses. In this regard, the Financial Stability Department of the Research and Economic Programming Division of the Bank generated forecasts and scenario reports based on prudential information and, in collaboration with FISD, reviewed and assessed system vulnerabilities arising from cross cutting risks, macro-economic policy and real sector developments, in addition to other exogenous influences.

Other intrinsic features of the supervisory approach included reviewing compliance with legal requirements and prudential regulations; provision of formal guidance through the dissemination of Best Practice Standards and Guidelines; promoting the highest degree of disclosure through the Bank's publication of quarterly un-audited balance sheet data for each licensee as well as a suite of prudential indicators for each financial sub-sector and the combined deposit-taking system.

The Central Bank continued to provide feedback from its various reviews and assessments to licensees' management and Boards through a combination of formal meetings, official correspondence and formal written reports on examination findings, highlighting issues of concern and requiring remedial actions within specified time frames as may be necessary. Where there is evidence of 'unsafe and unsound' practices, the Bank of Jamaica has the power to utilize sanction powers/ measures as provided under the respective financial legislation and in accordance with its supervisory "Ladder of Enforcement" which sets out the graduated series of supervisory actions in response to specified prudential concerns.

4.4. Current Issues In Banking Supervision

BOJ continued to review supervisory methodologies to ensure that they conform to international best practices and remain relevant and effective in response to changes in the risk appetite of supervised entities as they seek to compete in the domestic and international markets. During 2005, the Bank's Action Plan in terms of policy direction for banking supervision in the near to medium term were significantly influenced by the following developments:

- Developments in banking and financial markets – including local, regional and global developments in particular the continued growth of financial conglomerate structures in Jamaica, the advent of the Caribbean Single Market (CSM) coupled with significant cross border expansion of banking and financial groups within the Caribbean region; and
- Evolution in international best practice standards for banking supervision such as the Basel Core Principles for Effective Banking Supervision (Basel Core Principles or BCPs), and Basel II;

4.5. Standards of Best Practice

During 2005, the Bank undertook a comprehensive review of its existing suite of Standards of Best Practice

with a view to upgrading or issuing new standards as necessary. In that regard, comprehensive work was done on the revision of the following Standards of Best Practices in:

1. Credit Risk Management
2. Foreign Exchange Risk Management and Interest Rate Risk Management, which are being combined into a single Market Risk Management Standard
3. Internal Controls – which have been widened to address Operational Risk Management.

Work was also far advanced at the end of 2005 in the formulation of new Standards covering:

1. Corporate Governance;
2. Electronic Banking; and
3. Large Exposures

These Standards will be issued to the industry during 2006 for comment and dialogue prior to adoption. The Bank of Jamaica will also be developing additional Standards in 2006 to specifically address issues relating to the Management of Group Relationships and Risks, Transparency and Disclosures and Derivative Transactions.

The Standard on 'Country and Transfer Risk' which had been previously issued for comment was officially implemented in January 2005 and further substantial amendments/upgrades to the 2004 Anti-Money Laundering Guidance Notes were issued to the industry in March and July 2005, to take account of the new 9th Recommendation on Combating the Financing of Terrorism (CFT) issued by the FATF and to bring the Guidelines more fully in line with accepted international standards.

4.6. Consolidated Supervision

During 2005, the Bank of Jamaica in keeping with legislative amendments, continued to promote, where necessary, the restructuring of financial group structures in order to facilitate supervisory reach to all members of the group. In this regard, work towards that end has commenced. (See Section **4.9.2. Legislative Framework for Conglomerate/Consolidated Supervision.**)

4.7. Basel II Implementation

In June 2004, the Basel Committee on Banking Supervision[7] introduced a new capital adequacy framework for internationally active banks (Basel II) for implementation by its member countries by end 2007. This framework for determining the adequacy of a bank/banking group's capital, seeks to align regulatory capital more closely to risk and to an entity's economic capital. The framework is based on three (3) Pillars:

- Pillar I – Quantitative Measurement of Capital
- Pillar II – Supervisory Review
- Pillar III – Transparency and Disclosures

In 2005 the Bank of Jamaica continued to advance the development of a Basel II Roadmap to Implementation, which should be finalised in 2006. This roadmap will set out the intermediate objectives and timelines under the Supervisory Authority's target for full Basel II implementation by end 2010. This is to be accomplished in four phases, as listed below:

- Phase I – implementation of preconditions for Basel II, including full compliance with the Basel Core

7 The Basel Committee on Banking Supervision is the international standard setting body for banking supervisors worldwide. The Committee is represented by central banks and bank regulators from Belgium, Canada, France, Germany, Italy, Japan, Luxemburg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States.

Principles and fullest possible implementation of consolidated supervision;

- Phase II – implementation of Pillar II
- Phase III – implementation of Pillar III
- Phase IV – full adoption of Basel II with the full implementation of Pillar I.

With regard to Pillar I, the Bank intends to proceed with the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk in the initial stages until the prerequisites for adoption of the advanced methodologies are satisfactorily in place for the system. Throughout the process, the Bank of Jamaica will be involved in extensive discussion with the industry with a view to promoting a successful transition to the new regime.

4.8. Revision to Basel Core Principles

As a pre-cursor to a public consultation process scheduled for Spring 2006, during October 2005 the Basel Committee on Banking Supervision invited comments from regional supervisory groups on its proposed revision to the Basel Core Principles[8]. The Bank of Jamaica prepared and submitted comments directly to the Basel Committee in its capacity as Secretariat to the Caribbean Group of Banking Supervisors, and additionally provided comments to the Association of Banking Supervisors of the Americas[9] (ASBA) for inclusion in the latter's submission to Basel. (See Section **4.10.1.1. Observance of the Basel Core Principles** and Section **4.11. Supervisory Co-operation and Interaction.**)

4.9. Legislative Developments

Given the dynamism in local and international markets and the evolving nature of international best practice standards, the Bank of Jamaica continually reviews the financial legislation to ensure its continued relevance and, as necessary, makes recommendations to the authorities for appropriate amendments. In that regard, current proposals for legislative reform include:

- Amendments to enable fullest possible compliance with the Basel Core Principles;
- The amalgamation of the various pieces of legislation governing banking and other deposit-taking institutions, into an 'Omnibus' statute to create a level playing field across deposit-taking entities, while preserving the peculiarities of each sub-sector. It should however, be noted that although credit unions fall under the designation of deposit-taking entities, it is not now contemplated that the sector will be caught under the proposed omnibus legislation; and
- Explicit promulgation of Financial Holding Company legislation under the proposed Omnibus statute.

4.9.1. Consolidation of financial legislation

During 2005, the Bank of Jamaica commenced the drafting proposal of an Omnibus Bill which is expected to be completed in 2006. This bill will consolidate the Banking Act, the Financial Institutions Act and the Bank of Jamaica (Building Societies) Regulations, in tandem with related subsidiary regulations, to remove inconsistencies

8 The Basel Committee on Banking Supervision has been revising the Core Principles to bring them more in line with other international best practice standards including its own Basel II framework. The revised Core Principles should come into effect during 2006. The Bank of Jamaica will also be seeking to incorporate such revisions into its compliance plan.

9 The Association of Supervisors of Banks of the Americas (ASBA) of which Jamaica is a founding member now comprises some 34 countries stretching across South, Central and North America and the Caribbean.

in the existing legal requirements for deposit-taking entities and eliminate occasion for regulatory arbitrage. It will also seek to include all legislative amendments necessary to achieve fullest possible compliance with the Basel Core Principles for Effective Banking Supervision.

4.9.2. Legislative Framework for Conglomerate/ Consolidated Supervision

During 2005 work began toward the framing of 'Holding Company' Regulations under the proposed Omnibus legislation. This was further to legislative amendments effected in 2002, which gave the BOJ certain enhanced powers for consolidated supervision (e.g. power to issue directions in relation to capital adequacy, large exposures and intra-group transactions as well as power to require the restructuring of a banking group to make its structure less opaque and hence more supervisable). These Regulations are intended to allow the Supervisory Authority to regulate not only the activities of the licensed deposit taking entity, but also of the financial holding company, as well as facilitate supervisory reach to the entire financial group of which the licensee is a part.

4.9.3. 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. The objective is to promote the safety, soundness and integrity of Jamaica's financial system and to comply 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 anti-money laundering and the combating of the financing of terrorism. The Bank through the Deputy Supervisor of Banks continued to be actively involved in the development of AML/CFT legislation, i.e. The Terrorism Prevention Act, The Financial Investigations Division Bill, The Proceeds of Crime Act (see **Financial Legislation**). That mandate was more recently expanded to include the monitoring of compliance with international best practice standards in these areas by relevant public sector agencies.

4.9.4. Subsidiary Legislation/Regulations

During the year, the Bank continued to be involved in the development of the following supporting Regulations:

- **Credit Classification and Provisioning Regulations** were in the process of redrafting to take full account of Basel Guidelines on Loan Accounting and Disclosure, as well as the impairment requirements prescribed under International Financial Reporting Standards (IFRS). These Regulations will among other things, codify the Bank of Jamaica's approach to classifying credits into defined loan categories and also stipulate specific minimum provisioning levels for bad and doubtful debts, as well as, other related matters (e.g. credit renegotiations).
- **The Qualifications of Auditors Regulations** which are expected to take effect during 2006. This will specify the standards for auditors in undertaking an external audit of a supervised financial institution.

4.10. External Assessments

During 2005, the Bank was extensively involved two major country assessments by external organisations:

1. The IMF/World Bank Financial Sector Assessment Program (FSAP)
2. The Caribbean Financial Action Task Force (CFATF) Mutual Evaluation of Jamaica's Anti-Money Laundering and Combating of Terrorist Financing Activities (AML/CFT) Programme.

4.10.1.The Financial Sector Assessment Programme

The Financial Sector Assessment Program (FSAP), a comprehensive assessment of the country's financial system, was conducted by the IMF and the World Bank in two phases over the period 9 – 27 May and 5 – 13 July 2005[10]. This was done to achieve the following objectives:

1. Identify the strengths and vulnerabilities of the country's financial system.
2. Identify how key sources of risk are being managed.
3. Ascertain the developmental and technical needs of the financial sector.
4. Assist in the prioritization of policy responses.

The FSAP process involved detailed assessments of 'Observance of Standards and Codes' the reports on which are referred to as 'ROSCs'. The core output from the FSAP process is the Financial System Stability Assessment (FSSA), which provides summary findings of the FSAP along with recommendations. Jamaica's FSAP mission scope was focussed on the following areas:

- Financial Sector Supervision (Banking, Insurance and Securities)
- Financial System Stability Indicators (FSIs)
- Financial Safety Nets (Deposit Insurance, Crisis Management)
- Monetary and Financial Policy Transparency
- Systemically Important Payment Systems
- Creditor Rights System

The Bank was charged with the responsibility for overall coordination of the country's FSAP exercise inclusive of the updated evaluation of the country's observance of the Basel Core Principles.

4.10.1.1. Observance of the Basel Core Principles (BCPs)

The Basel Committee on Banking Supervision has established twenty-five core principles for effective banking supervision as well as (5) preconditions. The five (5) preconditions for effective banking supervision are not formally a part of the BCPs, as they are usually beyond and outside of the jurisdiction of supervisors. They are however seen as crucial for effective banking supervision and include:

1. Sound and sustainable macro-economic policies;
2. A well developed public infrastructure – this includes issues such as the existence of a proper credit culture and sound accounting standards;
3. Effective market discipline based on financial transparency and effective corporate governance;
4. Procedures for the efficient resolution of problems in banks;
5. Mechanisms for providing either an appropriate level of systemic protection or a public safety net such as a deposit insurance scheme.

The FSAP mission in its report concluded that preconditions for effective banking supervision were largely in place in Jamaica, but noted areas of weaknesses to be addressed including the level of government debt and its potential impact on macroeconomic policy effectiveness, absence of a credit bureau to facilitate better management of

10 The Programme required the participation of several public and private sector bodies including the Bank of Jamaica, the Ministry of Finance and Planning, the Financial Services Commission, The Solicitor General's Department, The Registrar of Companies, The Registrar of Titles, the Jamaica Deposit Insurance Corporation and representative entities and associations across the banking, building society, credit union, insurance, securities, pensions, legal and accounting sectors.

credit risk and the need for the upgrading of payments and settlement systems. The Mission Team however, also recognised and acknowledged that there was major work in progress towards effectively addressing these issues.

The final report is expected during the first quarter of 2006 following its presentation to the Boards of the IMF and World Bank. With specific regard to the Basel Core Principles review, the preliminary report indicates an overall improvement in ratings as against the earlier 2002 assessment concluded by the IMF. In the 2005 assessment Jamaica was adjudged either 'compliant' or largely 'complaint' with 90 per cent of the principles, which compares with the 80 per cent average achieved in 2002, both results being above the international average based on IMF assessments to date.

It is the Bank of Jamaica's goal to achieve fullest possible compliance with the Basel Core Principles by end 2007 which will be a critical component in the roadmap for seamless transition to Basel II (see Section **4.7.**).

4.10.2. CFATF Mutual Evaluation

The Bank played an integral role in the Mutual Evaluation of Jamaica's Anti-Money Laundering (AML) and Counter Financing of Terrorism (CFT) framework carried out by the Caribbean Financial Action Task Force (CFATF). This evaluation assesses member countries' laws and the effectiveness of their institutional frameworks as regards AML/CFT matters, against the international benchmark standards set by the FATF. The evaluation was the first in the Caribbean region to be carried out using the new September 2004 Evaluation Methodology developed by the FATF, IMF and World Bank and approved for implementation by the FATF in 2004.

The Mutual Evaluation Team visited Jamaica from 4 – 13 April 2005, during which time they met with several officials of government and public sector agencies including the Bank of Jamaica, Financial Investigations Division and the Financial Services Commission. The team also met with representatives of the private sector.

The Bank also led the negotiations as regards the team's final conclusions and ratings and the report of the team was presented to the membership of the CFATF at its Plenary Meeting held in Montego Bay, Jamaica from October 31 to November 4, 2005. The Bank coordinated the arrangements and hosted the meeting jointly with the Jamaican Government. At this meeting, Government of Jamaica assumed the Chair of the CFATF in the person of Jamaica's Solicitor General.

Jamaica's framework satisfied 23 out of the 40 Recommendations of the FATF on Money Laundering and 5 of the 8 Special Recommendations of the FATF on Terrorism Financing. The majority of areas of non-compliance are expected to be addressed with the passage of the Proceeds of Crimes Bill and the Financial Investigations Division Bill currently before Joint Select Committees of Parliament as well as the draft Terrorism Prevention Regulations currently being prepared (see **Financial Legislation**).

4.11. Supervisory Cooperation And Interaction

4.11.1. Financial Regulatory Council

The Council continued to meet during 2005 to examine issues affecting the financial industry as well as issues specific to dually licensed entities.

4.11.2. Regional Interaction – The Caribbean Group of Banking Supervisors

The Bank of Jamaica continued to administer the Secretariat for the Caribbean Group of Banking Supervisors (CGBS).[11] The Chair of the Group, which is rotated among CARICOM Central Banks on a two-year cycle, passed from Jamaica to Trinidad & Tobago in January 2005.

During the year, the activities of the CGBS were devoted to detailed examination of issues relating to the implementation of the CARICOM Single Market & Economy. Bank of Jamaica chaired a Technical Working Group (TWG) mandated to review the draft Banking and Financial Institutions Act prepared by the CARICOM Legislative Drafting Facility (CLDF) and examine other related issues. The report of the TWG which identified challenges to the implementation of a common legislation and made related recommendations, was formally presented to the CARICOM Central Bank Governors at their December 2005 meeting. The report endorsed the need for harmonization in financial sector regulation among CARICOM members consistent with international best practice standards, to ensure proper coordination in approaches and an avoidance of the harmful effects of regulatory arbitrage across the region. Identified challenges to a common financial legislation include:

- existing differences in legal and institutional frameworks;
- differences in key policy and technical positions affecting the requirements for banking operations among jurisdictions;
- the fact that countries are already engaged in their own reform agendas based on respective self assessments and the assessments of the IMF/ World Bank via various FSAP exercises; and
- the fact that a number of key supervisory issues relating to the design of financial sector frameworks are still to be settled regionally and, in fact, globally.

The report proposed an alternative mechanism for consideration being the establishment of regional machinery for the issue of EU-type[12] Banking Directives. This indicates the broad parameters and objectives for banking supervision reform, but which will leave the specific design and implementation issues to the national supervisory agencies. Subject to the endorsement of the Authorities within respective jurisdictions, these recommendations would be referred to the relevant arm of CARICOM.

4.11.3. Information Sharing

Acting under the provisions of a formal Information Sharing Agreement (MOU), signed by eight CGBS members including Jamaica, the Bank of Jamaica participated in the examination of a holding company located in Barbados during 2005. Based on a bilateral agreement with the Cayman Islands, the Bank of Jamaica also participated in the conduct of an examination of a subsidiary company in that country.

4.11.4. International Interaction

The Bank of Jamaica remains committed to applying the highest international standards in its supervisory processes.

11 The CGBS 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. The CGBS was later extended to banking supervisors from non-CARICOM Caribbean territories and now comprises membership from fourteen regional jurisdictions, nine of which are presently members of CARICOM.

12 EU – European Union

In addition to policy enhancement and implementation work being undertaken, the FISD participated in international conferences and accessed specialist training opportunities for its supervisory staff from overseas regulatory authorities such as the Federal Reserve, the World Bank, the Toronto Leadership Centre, The Financial Services Authority (UK), the Financial Stability Institute at the Bank for International Settlements (BIS).

The Deputy Supervisor of Banks' Deputy Chairmanship of The Association of Supervisors of Banks of the Americas (ASBA) ended in June 2005. The Deputy Supervisor of Banks also continued to serve as the Principal Contact for Jamaica to the Caribbean Financial Action Task Force (CFATF).

The Bank also maintained interaction with the Basel Committee on Banking Supervision both in its own capacity and that of Secretariat for the CGBS and during the year coordinated the regional response to BCBS' proposed revision of the Basel Core Principles.

4.12. Administrative Developments

During December 2005, the Bank of Jamaica executed a contract for the delivery of an upgraded information technology solution to underpin bank supervision functions, the Financial Institutions Supervisory Information System (FISIS). The new-web based system will incorporate a data warehouse that will support critical business intelligence applications. The system is also expected to be sufficiently scalable and flexible to accommodate future and evolving supervisory needs such as Basel II and enhancements in consolidated supervision, as well as support the Bank's proactive supervisory stance. It is expected that the system will be operational before the end of 2006.

4.13. The Supervised Deposit Taking System

Both the number and market composition of licensed deposit-taking entities (commercial banks, FIA licensees and Building Societies) remained unchanged during the year (see **Tables 30** and **31**).

Table 30 – Licensed Deposit-Taking Institutions as at 31 December 2005

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

TABLE 31 - Market Composition – Number of Deposit-taking Entities

Supervised Entities	2001	2002	2003	2004	2005
Commercial Banks	6	6	6	6	6
FIA Licensees	11	10	7	5	5
Building Societies	4	4	4	4	4
Total	**21**	**20**	**17**	**15**	**15**

4.13.1. Authorised Foreign Exchange Dealerships

FirstCaribbean International Building Society was licensed as a foreign exchange dealer in 2005. Hence, at end December all licensed deposit taking institutions were authorised not only to buy and sell foreign currencies, but also accept deposits, make loans and conduct other dealings in foreign currencies. While Cambio licences allow for the buying and selling of foreign currencies, only licensed deposit takers are eligible for authorised foreign currency dealerships.

4.13.2. System Performance Review

The commercial banks sub-sector continued to dominate the market accounting at year-end for 73.7 per cent of total assets, with building societies controlling 17.5 per cent while FIA Licensees represented a shrinking share of 8.8 per cent as compared to 10.6 at end 2004. This contraction in FIA Licenses was predominantly influenced by a strategic balance sheet restructuring that was undertaken by one licensee.

TABLE 32 MARKET SHARE OF LICENSED DEPOSIT TAKERS

	31-Dec-03		31-Dec-04		31-Dec-05	
	J$BN	Per Cent	J$BN	Per Cent	J$BN	Per Cent
Commercial Banks	320.2	74.4	350.5	72.7	375.9	73.7
Building Societies	65.7	15.3	80.4	16.7	89.3	17.5
FIA Licensees	44.4	10.3	51.1	10.6	44.9	8.8
SYSTEM TOTAL	430.3	100.0	482.0	100.0	510.1	100.0

Total assets of licensed deposit-taking institutions expanded at a slower rate during 2005, relative to 2004. Assets grew by or 5.8 per cent to total $510.1 billion as at 31 December 2005, compared to increases of 12.0 per cent in 2004 and 22.1 per cent in 2003, respectively. Growth in 2005 was largely funded from increased deposits and to a lesser extent equity, which facilitated expansion of the loan portfolio. Asset growth in 2003 and 2004 were to a material extent reflective of significant asset revaluations arising from first time implementation of International Accounting Standards/International Financial Reporting Standards IAS/IFRS) and exchange rate movements.

Commercial banks continued to dominate the system and accounting for 90.4 per cent of asset growth. All commercial banks reported larger asset bases with Bank of Nova Scotia Jamaica Limited and National Commercial Bank Jamaica Limited remaining market leaders which together accounted for over 62 per cent of the asset growth for that sub-sector in 2005. All four building societies also reported growth in respective asset bases with JNBS and VMBS maintaining market leadership. Asset accretion in the building societies sub-sector was however, also at a slower rate of 11.1 per cent compared to the previous two years, 22.4% in 2004 and 22.1% in 2003. Growth was reflected mainly in new mortgages funded from deposit inflows and borrowings. In contrast, FIA Licensees reported contraction of 12.1 per cent in assets for the review year, relative to growth of 15.1 per cent in 2004. The decline in the assets of the FIA licensees was influenced by contractions in two institutions, the most significant of which reflected a strategic balance sheet restructuring to achieve and maintain strong capital ratios.

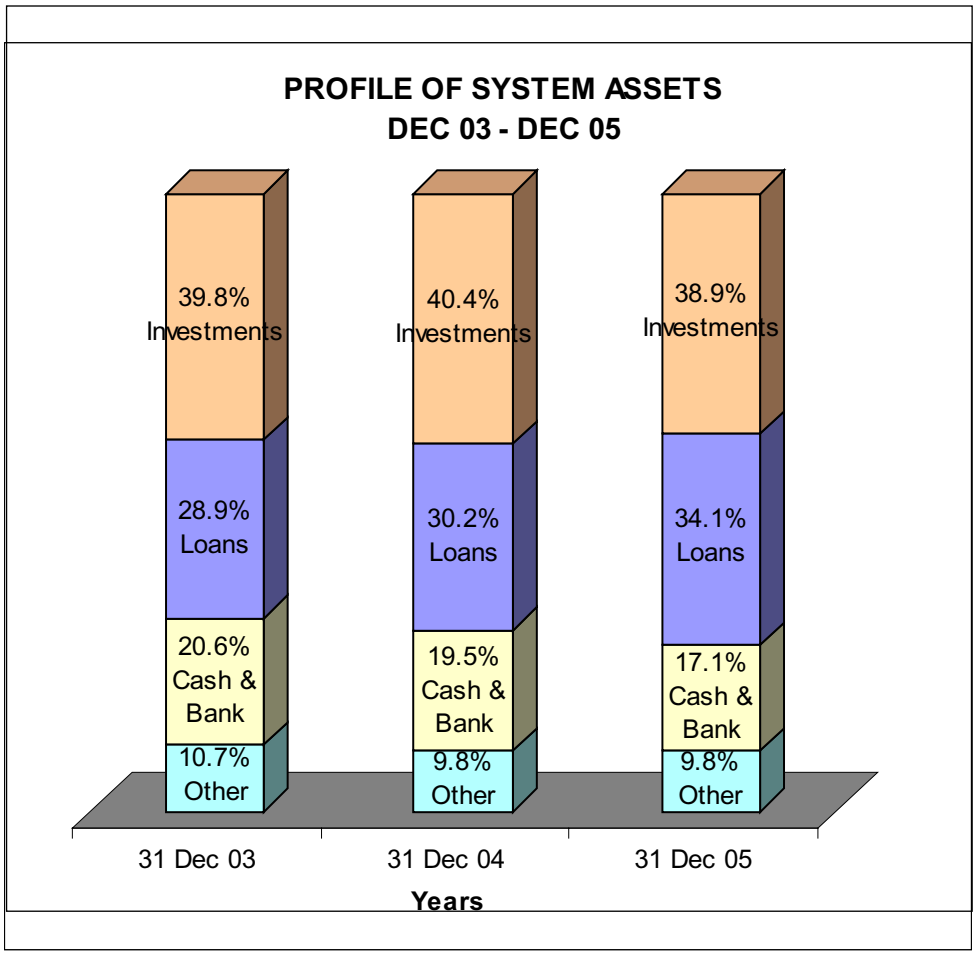
Foreign currency assets of the system increased by US$35.0 million or 1.1 per cent during the review year, with commercial banks and building societies expanding portfolios by US$109.0 million and US$44.0 million, respectively, while FIA Licensees reported contraction of US$118.0 million. The contraction in the FIA's which reversed growth trends seen in that sub-sector in previous years, was also influenced by the strategic balance sheet restructuring undertaken by one licensee.

Although trending downwards, investments continued to dominate the balance sheet profile of licensees, largely reflecting government paper held for bad debt substitutions and capital injections arising from government interventions

during the late 1990s. Investments represented 39.0 per cent of total assets, down from 40.4 per cent at end December 2004. Over 70 per cent of total investments continued to be categorised as 'available for sale'.

As the asset mix continued to gradually normalise in the post intervention period, the stock of loans and advances expanded to 34.1 per cent of total assets in 2005, up progressively from 30.2 per cent and 28.9 per cent at the end of 2004 and 2003, respectively. With the increased credit activity, liquid funds in the form of cash and bank balances represented 17.1 per cent of total assets at year end, down from 19.5 per cent at the end of 2004. This contraction was also impacted by the reduction in the Central Bank's 'Special Deposits' requirement from 5 per cent to 1 per cent, which also facilitated growth in credit.

CHART 10

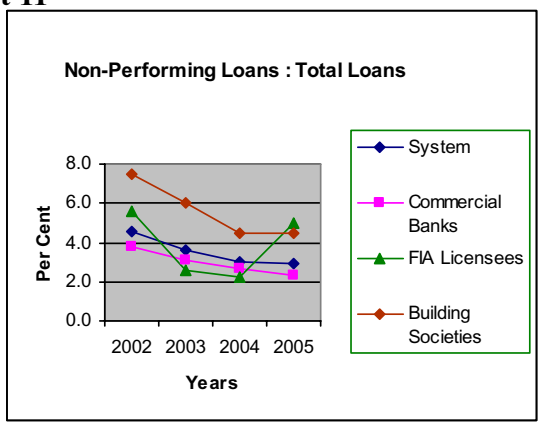


Lending activity accelerated with the system's stock of loans growing by 18.8 per cent for the year ended December 2005, up from or 15.8 per cent for the year ended December 2004. Commercial banks exhibited the most significant increase in outstanding credit accounting for more than half of the current year's increase being $19.0 billion (16.7 per cent) followed by Building Societies $7.3 billion (24.8 per cent) and FIA licensees $1.8 billion (26.5 per cent).

4.13.3. Asset Quality

The system continued to exhibit improved asset quality despite nominal growth of $0.6 billion in non-performing loans (NPLs) 3 months and over. NPLs represented 2.9 per cent of the total loans booked at December 2005, slightly lower than the 3.0 per cent recorded at the end of the previous year. The FIA Licensees showed deterioration, which was predominantly reflective of a single customer exposure at one licensee. No loss is, however, envisaged as that exposure was fully collateralised.

Chart 11



Despite some lessening in the relative provisioning levels, system-wide provisions for loan loss continued to offer adequate coverage for delinquent portfolios, being 100.0 per cent at December 2005 (114.4 per cent at Dec 2004), remaining well above the prudential floor of 50.0 per cent.

4.13.4. Liquidity

The statutory minimum Cash Reserve and Liquid Assets requirements for the system have remained unchanged since August 2002 at 9 per cent and 23 per cent, respectively. Building Societies that satisfy a residential mortgage threshold of 40 per cent in relation to respective deposit bases qualify for lower Cash Reserve and Liquid Asset requirements of 1 per cent and 5 percent, respectively. Licensees, in general, maintained a ratio of 35.7 per cent, well above the statutory requirement of 23 per cent.

Most licensees maintained comfortable margins of liquidity in all currencies, over and above the statutory minimum, throughout 2005. During the year, however, there were a few instances where licensees failed to maintain the required level of liquid assets as well as the required foreign currency Cash Reserve Ratio. This resulted from inaccurate computations of reservable liabilities and from untimely monthly adjustments to Cash Reserve Accounts. On such occasions, penalty charges pursuant to the relevant statutes were imposed on the value of the shortfalls at the rate of 45.0 per cent on domestic currency and 20.0 per cent on foreign currency.

4.13.5. Capital

Licensees continued to bolster permanent capital resources during the year, which was reflected in improved capital adequacy ratios. The statutory capital base increased by $7.4bn (18.3 per cent) comprising $6.4 billion in mandatory and discretionary transfers from internally generated realised earnings to statutory reserves and an injection of $1.0 billion from external sources arising from a rights issue of shares at one licensee.

The wider measure of shareholders' equity grew more slowly by $5.9 billion or 9.4 per cent. This was due in part

to a decline in reserves particularly among the building societies, due to fair value accounting valuations[13], as well as distributions by way of dividend payments to shareholders.

Consistent with Capital Adequacy Regulations promulgated in 2004, the Bank of Jamaica implemented a new quarterly 'Capital Adequacy Return' that allowed for a precise measure of the risk-weighted capital adequacy ratio which was previously estimated by the Central Bank based on existing prudential reporting. The new return allows for regulatory capital {permanent Tier 1 sources supplemented by a limited amount of non-permanent Tier 2 sources such as redeemable preference shares (the value of which is discounted as the redemption date approaches), general provisions for loss etc.} to be measured in relation to assessed credit risk and foreign currency exposures. As at December 2005, the system recorded a capital adequacy ratio of 18.8 per cent compared to 16.7 per cent at the end of 2004. During the year, all licensees maintained risk capital ratios over and above the minimum 10 per cent requirement.

Given a faster rate of increase in the capital base, relative to assets, the system's primary ratio also strengthened to 9.4 per cent at year-end 2005, from 8.5 per cent at the end of 2004, being satisfactorily above the prudential benchmark of 6.0 per cent. There were, however, two instances of breach during the year for which immediate remedial actions were taken by licensees as required by the Bank of Jamaica.

13 Bank of Jamaica has directed adoption of the option under IFRS for the supervised entities to carry fair value differences on investments as a reserve (in equity) pending the realisation of profits/losses of these differentials upon disposal/maturity of these assets.

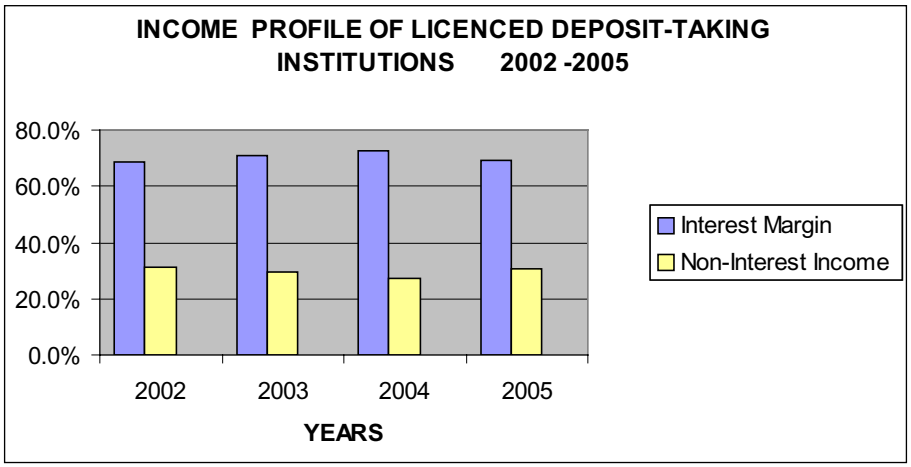
4.13.6. Profitability

Despite a lower interest rate environment, the supervised system showed stronger returns based on quarterly un-audited Earnings and Expenditure Statements submitted to the Bank of Jamaica. The system recorded a pre-tax profit margin of 26.3 per cent for 2005 (22.1 per cent for 2004) which translated to a return on average assets of 3.5 per cent (3.1 per cent for 2004).

As market interest rates declined, interest income from investments fell to $16.9 billion, 33 per cent of interest income in 2005, from $21.8 billion or 42.3 per cent of interest income in 2004. To boost profit margins, some institutions arbitraged on rate differentials in local and overseas markets by sourcing lower cost foreign currency funds to invest in higher yielding domestic investments and loans. This resulted in several licensees maintaining foreign currency short positions at various points during the year which were however, adequately supported by capital resources. As a result, the relative cost of borrowings fell by $1.7 billion in 2005 and represented 22.5 per cent of interest expense, relative to 27.6 per cent in 2004.

For the review year, interest margin represented 69.2 per cent of gross income, down from 72.7 per cent reported for 2004. At the same time, non-interest expense (including administrative expenses) inched up to 66.5 per cent in 2005 up from 65.9 per cent in 2004.

Chart 12



4.13.7. Credit Unions

In anticipation of the licensing process that will be implemented under the imminent Credit Union Regulations, the Bank has continued to gather data/ information on the credit unions sector as provided under the Bank of Jamaica Act, by way of on-site examinations, as well as through monthly and quarterly prudential reporting. Since late 2003, credit unions have been required to submit a monthly balance sheet and a quarterly earnings and expenditure return directly to the Central Bank to inform on-going off-site supervisory assessments of each entity and the system. It is expected that as soon as the Regulations are passed into law, a comprehensive suite of prudential returns for credit unions will be introduced on a phased basis, to bring reporting requirements on par with the rest of the deposit-taking sector.

The programme of on-site examinations of credit unions which commenced in the latter half of 2003, continued during the year. At year end, the Bank had examined credit unions accounting for approximately 90 per cent of total assets. The remaining credit unions (inclusive of one that is not a member of the industry association - The Jamaica Co-operative Credit Union League) are scheduled for examination during the course of 2006. The findings from the on-site examinations will play a vital role in the Bank of Jamaica's recommendations to the Minister of Finance regarding each credit union's eligibility for licensing, under the pending regulations.

There was further consolidation in the sector with the number of credit unions contracting to 48, from 50 at the previous year end. Two credit unions were merged into two existing entities.[14] It is likely that mergers and consolidations will continue during 2006 as credit unions seek to strengthen their operations to be in a state of readiness for licensing, as well as to enhance their relative competitiveness within the financial sector.

4.13.7.1. Credit Union Performance Highlights

Despite the contraction in the number of entities as at 31 December 2005, total assets of credit unions increased by

14 Carreras Co-operative Credit Union Ltd. merged into Lascelles Co-operative Credit Union Ltd. and St. Mary's Co-operative Credit Union Ltd. was assumed by St. Ann Co-operative Credit Union Ltd.

14.1 per cent to $32.6 billion. Growth in the credit unions reflected a 6.9 per cent increase in membership.

Total loans increased by 22.7 per cent to $21.3 billion in 2005 and continued to represent the major component of overall assets with its relative share increasing to 65.3 per cent from 60.8 per cent at end December 2004. The increase in loan demand was primarily funded by a 13.3 per cent augmentation in overall savings by to $25.5 billion. Loans accounted for 83.5 per cent of total savings compared to 77.3 per cent in 2004. The following table provides selected credit union indicators over the past five years.

Table 33 Selected Credit Union Data 2001-2005

Year End	No. of Credit Unions	Membership	Total Savings ($bn)	Total Loans ($bn)	Loans/Savings Ratio (%)	Total Assets ($bn)
2001*	58	637,257	14.2	9.1	64.4	17.3
2002*	56	680,338	16.4	11.1	68.0	20.0
2003*	52	728,447	19.0	13.3	69.7	23.8
2004	50	759,532	22.5	17.4	77.3	28.6
2005	48	811,655	25.5	21.3	83.5	32.6

*Source of data: Jamaica Co-operative Credit Union League

Table 34

ANNUAL PRUDENTIAL INDICATORS OF COMMERCIAL BANKS, LICENSEES UNDER THE FINANCIAL INSTITUTIONS ACT (FIA) AND BUILDING SOCIETIES

31-Dec-05

	COMMERCIAL BANKS			F I A LICENSEES			BUILDING SOCIETIES			INTERIM SYSTEM TOTAL (AGGREGATE OF ALL 3 SECTORS)		
	Dec-03	Dec-04	Dec-05	Dec-03	Dec-04	Dec-05	Dec-03	Dec-04	Dec-05	Dec-03 [a]	Dec-04	Dec-05
Number of institutions in operation	6	6	**6**	7	5	**5**	4	4	**4**	17	15	**15**
JSMN												
[1] Total Assets (**incl. contingent accounts**)	320,165	350,463	**375,859**	44,420	51,124	**44,913**	65,696	80,401	**89,304**	430,281	481,988	**510,076**
[2] Total Assets (**excl. contingent accounts**)	309,640	341,278	**364,223**	43,849	50,437	**44,476**	65,637	80,339	**89,240**	419,126	472,054	**497,939**
Total Deposits	198,775	228,190	**246,265**	8,279	11,436	**12,140**	49,437	58,792	**64,076**	256,491	298,418	**322,481**
Borrowings (**incl. repos**)	59,218	53,959	**54,773**	29,252	32,151	**24,495**	2,388	3,352	**6,362**	90,858	89,462	**85,630**
Total Loans (**gross**)	99,150	113,369	**132,353**	5,922	6,853	**8,670**	23,986	29,279	**36,551**	129,058	149,501	**177,574**
Total Loans (**net of prov** .) [a]	95,274	110,268	**129,498**	5,740	6,781	**8,622**	23,162	28,696	**35,894**	124,176	145,745	**174,014**
Cash & Bank	74,923	78,342	**71,527**	3,013	3,391	**2,379**	10,566	12,286	**13,413**	88,502	94,019	**87,319**
Investments [incl. Securities Purch.] (**net of prov** .)	111,092	122,699	**131,995**	32,961	38,452	**32,072**	27,338	33,598	**34,701**	171,391	194,749	**198,768**
Non-Performing Loans [NPL] (3 mths & >)	3,100	3,020	**3,071**	153	148	**432**	1,435	1,319	**1,628**	4,688	4,487	**5,131**
Provision for Loan Losses	3,876	4,098	**4,047**	185	155	**140**	824	882	**944**	4,885	5,135	**5,131**
[3] Capital Base	26,179	30,678	**32,972**	3,410	3,554	**4,748**	5,502	6,525	**10,481**	35,091	40,757	**48,201**
Contingent Accounts [Accept.LC's & Guarantees]	10,525	9,185	**11,636**	571	687	**437**	59	62	**64**	11,155	9,934	**12,137**
Funds Under Management	0	0	**0**	163	176	**168**	0	0	**0**	163	176	**168**
Repos on behalf of or for on-trading to clients	2,003	0	**0**	0	0	**0**	0	0	**0**	2,003	0	**0**
%												
Rate of Asset [1] Growth	19.0%	9.5%	**7.2%**	49.9%	15.1%	**-12.1%**	22.1%	22.4%	**11.1%**	22.1%	12.0%	**5.8%**
Rate of Deposit Growth	11.1%	14.8%	**7.9%**	-1.1%	38.1%	**6.2%**	14.4%	18.9%	**9.0%**	11.2%	16.3%	**8.1%**
Rate of Loans Growth (**gross**)	34.1%	14.3%	**16.7%**	66.2%	15.7%	**26.5%**	18.7%	22.1%	**24.8%**	32.1%	15.8%	**18.8%**
Rate of Capital Base Growth	17.6%	17.2%	**7.5%**	14.0%	4.2%	**33.6%**	13.3%	18.6%	**60.6%**	16.5%	16.1%	**18.3%**
Rate of NPL (3 Mths &>) Growth	11.3%	-2.6%	**1.7%**	-22.7%	-3.3%	**191.9%**	-5.7%	-8.1%	**23.4%**	4.1%	-4.3%	**14.4%**
Investments :Total Assets [1]	34.7%	35.0%	**35.1%**	74.2%	75.2%	**71.4%**	41.6%	41.8%	**38.9%**	39.8%	40.4%	**39.0%**
Fixed Assets:Total Assets [1]	2.2%	2.2%	**2.1%**	0.4%	0.3%	**0.4%**	2.4%	2.3%	**2.2%**	2.0%	2.0%	**1.9%**
Loans (net of prov.):Total Assets [1]	29.8%	31.5%	**34.5%**	12.9%	13.3%	**19.2%**	35.3%	35.7%	**40.2%**	28.9%	30.2%	**34.1%**
Loans (**gross**) : Deposits	49.9%	49.7%	**53.7%**	71.5%	59.9%	**71.4%**	48.5%	49.8%	**57.0%**	50.3%	50.1%	**55.1%**
Liquidity												
Average Domestic Currency Cash Reserve: Average Prescribed Liabilities [4]	9.0%	9.0%	**9.0%**	8.9%	9.1%	**9.0%**	1.0%	1.0%	**1.0%**	7.2%	7.1%	**7.0%**
Average Domestic Currency Liquid Assets : Average Prescribed Liabilities [4]	33.2%	38.4%	**38.4%**	66.1%	127.2%	**78.0%**	31.2%	24.8%	**26.2%**	33.0%	35.9%	**35.7%**
Asset Quality												
Prov. for loan losses:Total Loans (**gross**)	3.9%	3.6%	**3.1%**	3.1%	2.3%	**1.6%**	3.4%	3.0%	**2.6%**	3.8%	3.4%	**2.9%**
Prov. For Loan Losses:NPL(3 Mths &>)	125.0%	135.7%	**131.8%**	120.9%	104.7%	**32.4%**	57.4%	66.9%	**58.0%**	104.2%	114.4%	**100.0%**
NPL (3 Mths &>):Total Loans (**gross**)	3.1%	2.7%	**2.3%**	2.6%	2.2%	**5.0%**	6.0%	4.5%	**4.5%**	3.6%	3.0%	**2.9%**
NPL (3 Mths &>): (Total Assets [1] + Provision for loan losses)	1.0%	0.9%	**0.8%**	0.3%	0.3%	**1.0%**	2.2%	1.6%	**1.8%**	1.1%	0.9%	**1.0%**
Capital Adequacy												
Deposits + Borrowings: Capital (:1)	10.0	9.3	**9.2**	11.3	12.4	**7.8**	9.6	9.7	**6.8**	10.0	9.6	**8.5**
Capital Base:Total Assets [1]	8.2%	8.8%	**8.8%**	7.7%	7.0%	**10.6%**	8.4%	8.1%	**11.7%**	8.2%	8.5%	**9.4%**
[5] Risk Asset Ratio **[RAR] (estimated)**	14.0%	17.7%	**17.8%**	23.9%	14.2%	**25.0%**	19.2%	14.5%	**20.5%**	15.2%	16.7%	**18.8%**
NPL(3 mths &>) :Capital Base+Prov for loan losses	10.3%	8.7%	**8.6%**	4.3%	4.0%	**8.8%**	22.7%	17.8%	**14.2%**	11.7%	9.8%	**9.6%**
Profitability												
[6] Pre - tax Profit Margin (for the Calendar Quarter)	25.2%	21.2%	**24.6%**	8.4%	24.3%	**27.7%**	33.5%	44.3%	**18.1%**	24.1%	25.8%	**23.7%**
Pre - tax Profit Margin (for the Calendar Year)	25.2%	21.6%	**26.4%**	16.4%	16.4%	**27.6%**	30.4%	26.7%	**25.3%**	25.3%	22.1%	**26.3%**
Return on Average Assets (for the Calendar Quarter)	1.1%	0.7%	**0.9%**	0.6%	0.5%	**0.7%**	1.5%	1.7%	**0.6%**	1.1%	0.9%	**0.8%**
Return on Average Assets (for the Calendar Year)	4.3%	3.1%	**3.6%**	2.6%	1.5%	**2.6%**	5.3%	4.0%	**3.1%**	4.3%	3.1%	**3.5%**
[7] Income Assets/Expense Liabilities (as at 31 Dec.)	100.4%	101.2%	**101.6%**	109.0%	107.3%	**113.7%**	109.2%	109.0%	**110.4%**	102.7%	103.1%	**104.2%**

Notes:

n.a. data not available
n/a not applicable

- Based on unaudited data submitted to BOJ by supervised institutions up to 17 February 2006. Prior years indicators may have revisions arising from amendments, which in instances include IFRS restatements.

[a] - Effective January 2004, the Bank of Jamaica revised its reporting requirements in line with International Financial Reporting Standards (IFRS) and in this regard the following changes were effected:

(a) The composition of "Provision for Loan Losses", is now segregated into two (2) distinct components being:

i) provision for losses computed in accordance with IFRS; and

ii) any incremental provisioning necessary under prudential loss provisioning requirements.

Consequently, "Total Loans (net of prov.)" for the respective years represents:

- for 2004 and 2005; gross loans net of IFRS loss provisions per (i) above

- for comparative years 2003 and prior; gross loans net of total prudential loss provisions (equivalent to the aggregate of (i) and (ii) above).

(b) BOJ Certificate of Deposits (CDs) previously included in "Cash and Bank Balances" now reclassified as Investments.

[b] - During the period 31 December 2003 to 31 December 2005, two (2) merchant banks surrendered their deposit taking licences consequently reducing the total number of FIA Licensees to five (5). See details below:

- Effective 1 June 2004, Manufacturers Sigma Merchant Bank merged with Pan Caribbean Merchant Bank. The merged entity will continue as Pan Caribbean Merchant Bank Ltd.

- Effective 1 April 2004, George & Branday Finance Ltd. merged with First Global Bank Ltd. The merged entity will continue as First Global Bank Limited.

- Significant increase in non-performing loans for FIA licensees was primarily reflective of a delay in repayment by a client of one entity, pending legal resolution of a dispute between that client and a third party. The licensee's exposure is fully collateralised and no loss is envisaged.

[1] Total Assets and Liabilities reflected net of Provision for Losses and include Contingent Accounts (Customer Liabilities for Acceptances, Guarantees and Letters of Credit). In keeping with IFRS, total assets and liabililities were redefined to include contingent accounts and in this regard, current year ratios were computed in accordance with this principle and prior years were restated.

[2] Total Assets net of Provision for Losses and Contingent Accounts (Customer Liabilities for Acceptances, Guarantees and Letters of Credit).

[3] Capital Base - Banks & FIA Licensees: (Paid - up Capital + Reserve Fund + Retained Earnings Reserve Fund + Share Premium) less impairment by net losses of individual institution.

- Building Societies: (Permanent Capital Fund + Deferred Shares + Capital Shares + Reserve Fund + Retained Earnings Reserved Fund) less impairment by net losses of individual society.

[4] Prescribed Liabilities include:

(i) deposit liabilities, (ii) reservable borrowings and interest accrued and payable on (i) & (ii).

[5] Risk Assets Ratio (RAR): Qualifying Capital in relation to Risk Weighted Assets and Foreign Exchange Exposure.

- As at December 2004, the Bank of Jamaica implemented new Quarterly Capital Adequacy Returns which provide more precise ratios. Note, 2003 rates are estimated.

[6] Data includes extraordinary income/expenditure and adjustments for prior period.

[7] Income Assets comprise FC Cash Reserves, Placements, Investments, Repo Assets and Loans less Non-Performing Loans (3 months & over). Expense Liabilities comprise Deposits and Borrowings including Repo Liabilities (from BOJ, Banks, OFI etc).

	COMMERCIAL BANKS			FIA LICENSEES			BUILDING SOCIETIES**		
	Dec-03	Dec-04	Dec-05	Dec-03	Dec-04	Dec-05	Dec-03	Dec-04	Dec-05
Required Special Deposit Ratio*	5.0%	5.0%	1.0%	5.0%	5.0%	1.0%	n/a	n/a	n/a
Required Cash Reserve ratio	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	1% / 9.0%	1% / 9%	1% / 9%
Required Liquid Assets ratio (incl Cash Reserve)	23.0%	23.0%	23.0%	23.0%	23.0%	23.0%	5% / 23.0%	5% / 23%	5% / 23%

* 5% Special Deposit requirement imposed on Commercial Banks and FIA Licensees Jan 2003 in accordance with Section 28 A (1) of the Bank of Jamaica Act.
Effective 16 May 2005, the required special deposit ratio was further reduced to 1%. This is the second reduction for the year, the first to 3% effected 1 March.

**** The requirements are differentially applied to societies not meeting the prescribed threshold of residential mortgage lending in relation to savings funds. Societies that meet the prescribed 'qualifying assets' threshold attract the lower reserve requirements indicated above. Societies which do not, are requested to meet the requirements which apply to banks and FIA licensees.**

5. Supervision of Cambios and Remittance Companies

The Operating Directions which govern the supervision of Cambios and Money Transfer and Remittance Agents and Agencies (Remittance Companies) were influenced by the Terrorism Prevention Act which came into effect in 2005 (see Financial Legislation). Accordingly, the Bank of Jamaica Guidance Notes on the Detection and Prevention of Money Laundering and Terrorist Financing Activities were enhanced to include, inter alia, clarification and guidance on combating the financing of terrorism.

5.1. Cambios

The BOJ continued to perform the function of supervisor of the operations of cambios during 2005. This process entailed both semi-annual on-site inspection and in-house monitoring of the cambios, to assess the operators' adherence to the BOJ Operating Directions for Cambios as well as the reporting requirements under the Money Laundering legislation. In this regard, two hundred and fifty-six (256) on-site inspections were conducted.

During 2005, 13 new locations were approved while the licences for 3 locations were voluntarily surrendered. This brought the total number of locations to 148, representing 69 entities at the end-December 2005.

Table 35 below provides comparative data on the status of cambio licences for 2004 and 2005.

As at end-December 2005, Kingston & St. Andrew continued to account for the largest concentration of cambios. This was followed by St. James, St. Ann and St. Catherine. (see **Table 36**).

Cambios continued to play a significant role in the foreign exchange market, accounting for approximately

TABLE 35

Status of Cambio Licences
as at end-December 2006

	2004	2005
Applications Approved	12	13
Cambios Closed	22	3
Total Cambios Licensed	138	148
Number of Entities	64	69

TABLE 36

Geographic Distribution of Cambios
as at end-December 2005

Parish	2004	2005
	%	%
Kingston & St. Andrew	25.5	27
St. James	16.3	13.5
St. Ann	13.5	12.8
St. Catherine	9.9	10.8
Manchester	9.9	8.8
Clarendon	7.1	8.1
Westmoreland	6.4	6.8
Others	11.4	12.2
Total	**100**	**100**

32.0 per cent of volume traded in the market in 2005. This compares to 34.0 per cent in 2004.

The process of granting approvals for the operation of cambios includes, inter alia, the assessment of the Operators (directors and majority shareholders of the company and the managers) under the Bank's prescribed 'Fit and Proper' criteria. In 2005, one hundred and twenty two (122) persons were assessed.

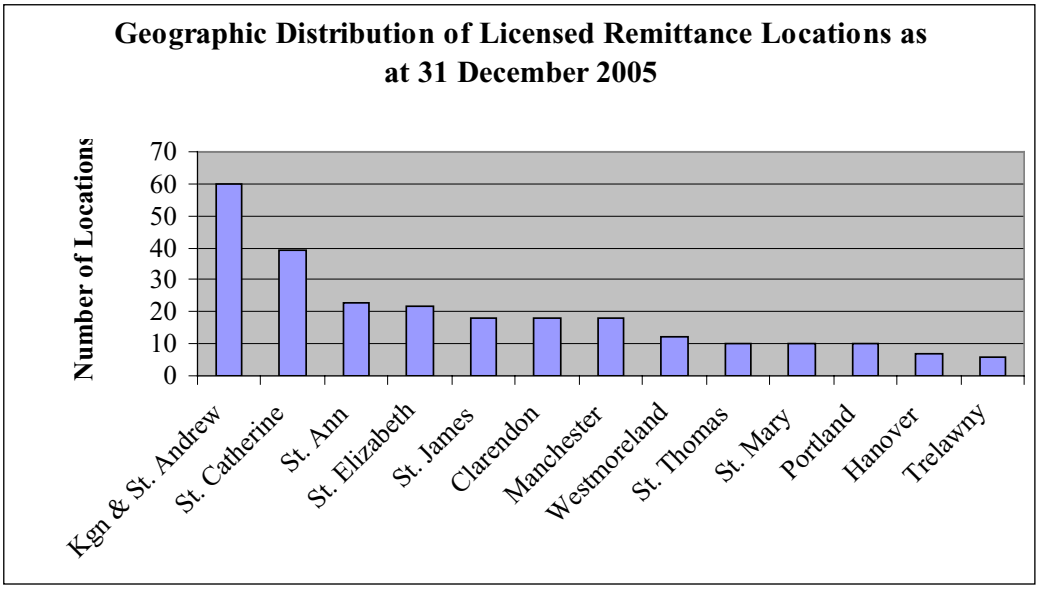
5.2. Remittance Companies

In 2005, following the passage of the legislation, the Bank was designated the Competent Authority to regulate Remittance Companies under the Money Laundering Act (see **Financial Legislation**). This designation confers on the BOJ, the responsibility to ensure that remittance companies establish and implement programmes, policies, procedures and controls for the purpose of preventing and detecting money laundering.

In discharging this regulatory function, the BOJ finalized and published Operating Directions for Remittance Companies and continued to process applications for licences to offer remittance services in Jamaica. In this regard, in addition to the 15 companies which submitted applications in 2004, the BOJ received and processed applications from 2 companies in 2005, which sought approval to offer remittance services in Jamaica.

As at end-December 2005, the BOJ had received applications from 17 primary agents representing 34 overseas-based remittance service providers at 509 locations island wide. Ten (10) primary agents were issued with licences to operate from 253 locations, with 60 located in Kingston and St. Andrew (see **Chart 14**). The applications in relation to the remaining 256 locations are being processed.

Chart 14



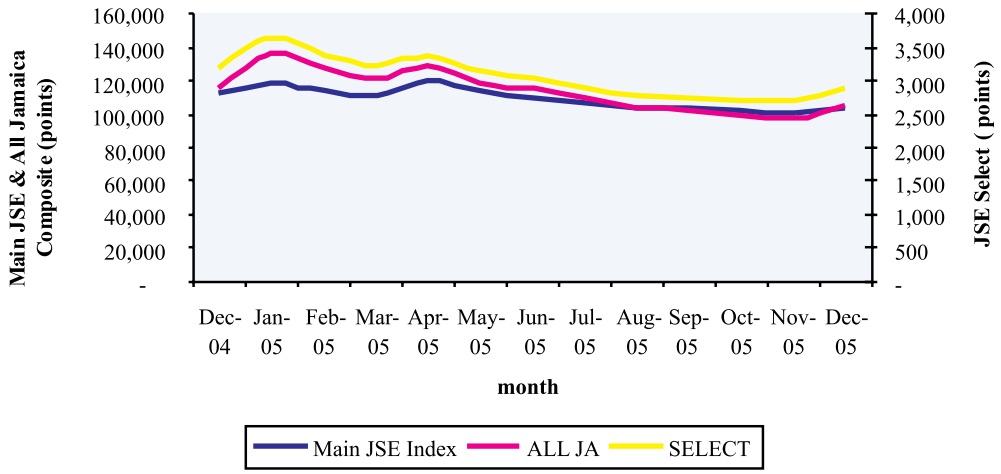
In keeping with standard procedures, licences are issued to companies whose principals (directors and shareholders holding a minimum of 10 per cent of the shares of the company and the manager of each location) have satisfied the BOJ's 'Fit & Proper' criteria. A total of 402 persons were assessed under these criteria during the year. Of this number 396 persons satisfied the criteria.

The operations of the remittance companies will be monitored through semi-annual on-site inspections of primary agents and in-house assessment of their performance.

The Jamaica Stock Exchange (JSE) Index declined in 2005, primarily reflecting the macroeconomic impact of successive hurricanes and higher oil prices. These shocks influenced higher inflationary expectations and reduced real disposable incomes which adversely affected the earnings of many of the listed companies. In addition, the downward adjustments in the benchmark interest rates by the Bank of Jamaica affected the earnings of financial institutions listed on the stock exchange. The market was also affected by the delisting of Dyoll Group Ltd by the JSE in February.[15]

During 2005, the Main Jamaica Stock Exchange Index declined by 7.2 per cent to close at 104 510.39 points, while the Jamaica Select Index and the All Jamaica Composite Index fell by 11.1 per cent and 10.8 per cent, respectively (see **Chart 15**). There was also a marked reduction of 41.1 per cent in the volume of shares traded while the value of shares traded declined by 8.7 per cent (see **Charts 16 and 17)**.

Chart 15
Stock Market Indices



15 The company was delisted for failing to submit its financial statements in accordance with the rules of the Jamaica Stock Exchange.

CHART 16

Total Volume of Shares Traded 2001-2005

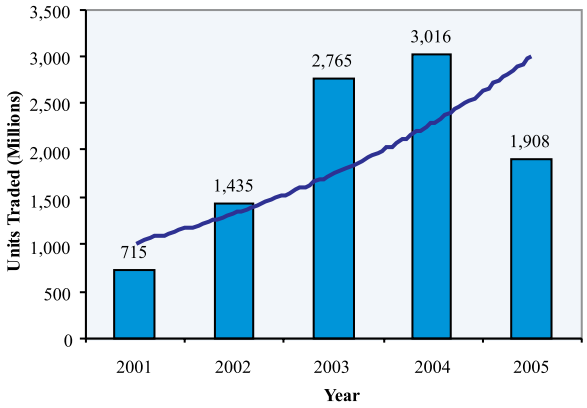
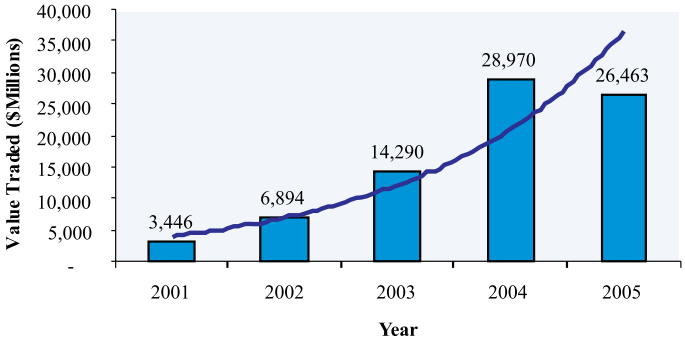


CHART 17

Total Value of Shares Traded 2001-2005



At the beginning of the year, the stock market was expected to continue the strong growth trend observed in 2004. This was predicated on the expectation of continued lowering of domestic interest rates and the continuation of strong positive earnings results for listed companies. The anticipated initial public offerings (IPOs) of several companies, including Mayberry Investments Ltd,[16] would also spur market activity. These factors influenced the strong gains in all three indices in January. However, with the exception of the buoyancy exhibited in January and April when investors responded to favourable earnings reports and attractively priced stocks, the Main JSE Index recorded continuous declines until December.

The downturn reflected the adverse impact of increasing oil prices and the passage of several hurricanes. These shocks restricted the revenue growth for many of the listed companies. In addition, the lower interest rate environment also reduced the interest income margins of some financial stocks. These factors contributed to less than favourable earnings results for many of the listed companies. The downturn was also catalyzed by the delisting of Dyoll Group Ltd. on 15 February 2005 which adversely affected market sentiment. The company was eventually relisted on the market on 11 October 2005 after submitting its financial statements in accordance with the rules of the Exchange.

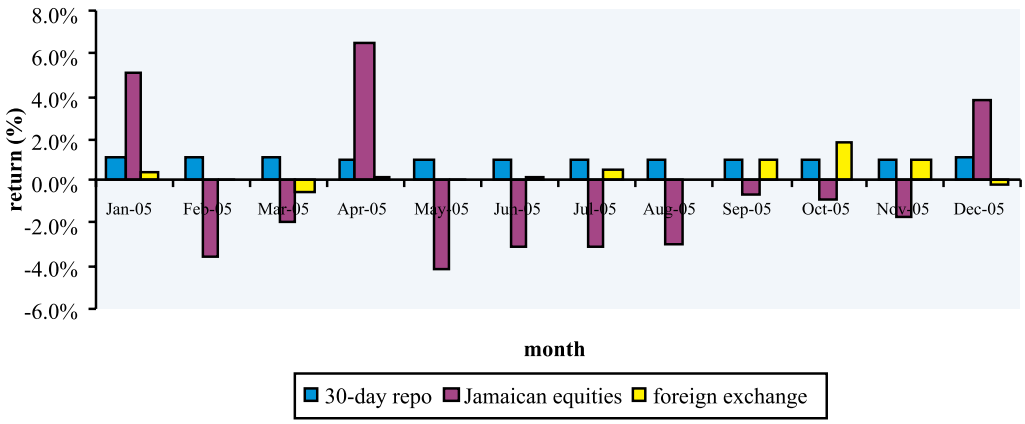
In December, however, the market experienced a strong rebound with growth of 3.8 per cent in the Main JSE Index. This primarily reflected the increased demand for stocks by institutional investors who were expectant of the seasonally strong first quarter of the New Year. This led to significant price gains for many stocks that had experienced declines for most of the year.

The decline in the stock market, took place against the backdrop of relative stability in the foreign exchange and

16 Mayberry Investments Ltd. was listed on the JSE on April 21, 2005 and accounted for 54.1 per cent of total shares traded on the market between that date and the end of the month.

CHART 18

Monthly Returns From Equities, Fixed Income And Foreign Exchange 2005



further declines in interest rates, particularly in the first half of the year. The stock market recorded an average monthly loss of 0.6 per cent compared to average monthly gains of 1.1 per cent from fixed income instruments and 0.4 per cent from foreign currency investments (see **Chart 18**).[17] In the context of the monthly declines in returns on equities, as well as lower real returns from fixed income investments, there was greater demand for foreign currency assets as a source of stable returns, as well as a hedge against rising inflation

Stocks from the **Manufacturing** sector were among the best performers in terms of price movements (see **Table 37**). These included Seprod Ltd., Trinidad Cement Ltd. and Desnoes and Geddes. The stocks with the largest declines included Dyoll Group Ltd., Capital & Credit Merchant Bank Ltd., Pan Caribbean Financial Services and Salada Foods Ltd. Despite the price declines for several financial entities, the **Financial** sector continued to account for most of the market capitalization during the year, followed by the **Manufacturing** sector (see **Chart 19**).

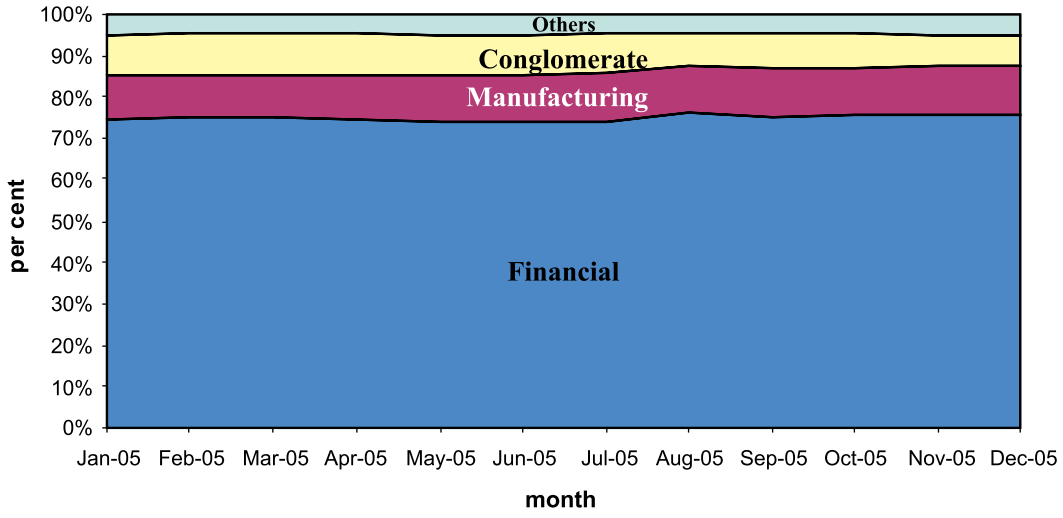
17 The secondary 30-day repo rates and the rate of depreciation of the Jamaican Dollar vis-à-vis the US dollar are used as proxies for fixed income and foreign currency investments, respectively.

Table 37

Price Performers in 2005		
	Price at end 2005 ($)	**Price Change (%)**
Top 5 Advancing Stocks		
Manufacturing Sector		
Seprod Ltd.	16.00	31.7
Trinidad Cement Ltd.	105.00	31.3
Desnoes & Geddes	10.20	27.5
Carreras	36.00	12.5
Conglomerates		
Lascelles de Mercado	228.00	12.8
10 Largest Declining Stocks		
Insurance		
Dyoll Group Ltd.	1.85	-88.9
Retail		
Hardware & Lumber	18.00	-39.7
Financial		
Capital & Credit Merchant Bank	22.50	-29.7
Pan Caribbean Financial Services	24.30	-28.7
First Caribbean Int'l Bank Ja.	18.01	-18.1
Manufacturing		
Salada Foods Ltd.	10.01	-50.0
Berger Paints (Ja.)	3.78	-33.3
Caribbean Cement Company	9.50	-26.4
Conglomerates		
Grace, Kennedy & Co.	87.45	-25.9
Jamaica Producers Group	34.51	-17.8

Chart 19

Share of Market Capitalization by Sector/Category
January 2005-December 2005



Regionally, stock market performances were mixed. In Trinidad and Tobago, the Composite Index declined by 0.7 per cent while the Local Index in Barbados recorded the best performance for the region with a gain of 5.8 per cent. The decline in stock market in Trinidad & Tobago contrasted the gains of 2004 when the Composite Index had registered a robust increase of 54.8 per cent.

The expected improvements in the macro-economic environment should provide an amenable climate for equity investors in 2006 (see **Real Sector**). This will also be supported by anticipated new public listings that will provide more depth to the Jamaican stock market during the year.

6. External Sector Developments

7.1 International Economic Developments

7.1.1. Overview

Global economic growth is estimated to have moderated by 0.6 percentage point to 4.5 per cent in 2005, driven by slower growth in both the major industrialised and emerging market economies. The moderation in growth in the advanced economies was reflective of the impact of higher oil prices, particularly in the latter half of the year. For the developing countries as a group, the reduction in growth was influenced by China where the authorities attempted to stem the potential overheating of the economy. Notwithstanding, the fastest rate of expansion was recorded in the Asian region, led by China. Trinidad and Tobago recorded the highest growth in the Caribbean.

World inflation during the year was higher than the previous year due mainly to the effects of the oil price shock. Annual average inflation in the advanced economies increased by 0.2 percentage point in 2005, led by the USA. Inflation in the developing countries also accelerated by 0.1 per cent.

The currencies of selected large economies appreciated, on average, against the US dollar, but at a slower pace than in 2004. This slowdown in the rate of appreciation was influenced by regular increases in US interest rates, which made US dollar-denominated assets relatively more attractive, despite the persistence of disjuncture in the major economic accounts.

Commodity prices increased during the year, influenced mainly by the higher energy prices. The average price of crude oil increased by 36.2 per cent during the year. The price of metals and beverages such as coffee also recorded notable growth in 2005.

During the review year, there was some progress made in the WTO Ministerial Conference on the issues of agricultural subsidies, non-agricultural market access (NAMA) negotiations and the acknowledgment of the plight of small developing states. However, decisions in the WTO signalled the end of preferences, particularly for sugar and banana.

7.1.2. Industrial Countries

Real output growth among the advanced economies was 2.6 per cent in 2005, relative to the 3.3 per cent expansion recorded in 2004. This falloff was reflected in the performance of the USA, Euro area and the United Kingdom (UK) (see **Table 38**). For the USA, the deceleration was related to a slowdown in the expansion of business investment and consumer spending, associated with the energy shock and tighter monetary policy. The slower growth in the Euro area was primarily attributed to weak domestic demand, particularly in Germany and Italy. Reflecting higher interest rates, oil prices and a cooling housing market, the deceleration in the UK was mainly influenced by a slowdown in private consumption growth in the first half of the year. In contrast, faster growth in the Japanese economy in 2005 was driven by strong expansion in private domestic demand as well as increased exports to Asia. For Canada, real GDP growth was driven primarily by strong private consumption, which was underpinned by robust employment gains, strong wage increases and rising house prices.

Table 38

INDUSTRIAL ECONOMIES Real GDP, Consumer Prices and Unemployment Rates (Annual percentage change and per cent of labour force)								
Country	**GDP**		**Unemployment Rate**		**Inflation Rate**		**Current Account (% of GDP)**	
	2004	2005*	2004	2005*	2004	2005	2004	2005*
Advanced Economies	3.3	2.6	6.3	6.1	2.0	2.2	-1.0	-1.3
of which								
US	4.2	3.5	5.5	5.2	2.7	3.4	-5.7	-6.1
UK	3.2	1.8	4.8	4.7	1.3	2.0	-2.0	-1.9
Euro area	2.1	1.3	8.9	8.7	2.1	2.2	0.5	0.2
Canada	2.9	2.9	7.2	6.8	1.8	2.2	2.2	1.5
Japan	2.3	2.8	4.7	4.3	-1.2	-0.3	3.7	3.3

Source: The World Economic Outlook, September 2005, Statistics Offices of individual countries

** Estimates*

The impact on inflation of increases in oil price was most pronounced in the USA, the UK and Canada (see **Table 38**). For the Euro area, inflation increased marginally, partly attributable to the weakness in domestic demand, which countered the effect of the oil price shock. Despite higher oil prices and negative real interest rates, Japan continued to experience negative inflation in 2005.

In order to rein in inflation expectations, the monetary authorities in the USA and Canada maintained a tight monetary policy stance. For the year, the US federal funds rate was increased by 200 basis points to 4.25 per cent at end December 2005, while the Canadian overnight rate was increased by 75 basis points to reach 3.25 per cent.

The currencies of selected industrialised economies appreciated against the US dollar by an average of 1.8 per cent during 2005, following appreciation of approximately 8.2 per cent the previous year. This increase in value reflected considerable strengthening in the Canadian dollar owing to robust growth in the economy. The US dollar, however, strengthened slightly against the British Pound and Japanese Yen (see **Table 39**).

TABLE 39

ADVANCED ECONOMIES: EXCHANGE RATES				
	US Dollars per unit of national currency		**Annual percent Change**	
	2004	**2005**	**2004**	**2005**
Canadian Dollar	0.768	0.825	7.9	7.4
Japanese Yen	0.009	0.009	-7.2	-1.8
Pound Sterling	1.83	1.82	12.1	-0.7
Euro	1.24	1.24	10.0	0.01

Source: US Federal Reserve

The overall strengthening of the exchange rate of the major currencies, relative to the US dollar, reflected investors' concerns about the sustainability of the US current account and fiscal deficits. In 2005, the US current account deficit was estimated to have widened to approximately 6.1 per cent of GDP, compared with 5.7 per cent in 2004. However, the fiscal deficit was estimated to have narrowed marginally to 3.7 per cent of GDP for the year, compared with approximately 4.0 per cent in 2004. More severe depreciation in the US dollar was mitigated by monetary tightening, which resulted in US dollar-denominated assets being attractive to international investors.

7.1.3. Developing Economies

The developing countries continued to experience robust growth in 2005, but at slightly lower rates (see **Table 40**). The Asian economies within this group grew the fastest, averaging 7.8 per cent in 2005, albeit slower than the 8.2 per cent recorded in the previous year. This outturn was largely influenced by a slowing in China's rate of expansion, particularly the growth in investment expenditure. This reflected administrative changes and adjustments to monetary policy aimed at addressing the rapid rate of expansion in the economy. However, net exports continued to increase significantly, reflecting significant growth in manufacturing exports – aided by the ending of textile quotas – along with a sharp downturn in import growth.

Table 40

SELECTED DEVELOPING COUNTRIES Real GDP & Consumer Prices (Annual Percent Change)				
Country	GDP		Inflation Rate**	
	2004	2005*	2004	2005
Developing Countries	7.3	6.5	5.8	5.9
Western Hemisphere	**5.6**	**4.1**	**6.5**	**6.3**
Latin America				
Argentina	9.0	7.5	4.4	9.5
Brazil	4.9	3.3	6.6	6.8
Chile	6.1	5.9	1.1	2.9
Colombia	4.1	4.0	5.9	5.2
Costa Rica	4.2	3.2	12.3	12.6
Dominican Republic	2.0	4.5	51.5	3.7
Ecuador	6.9	2.7	2.7	2.0
Mexico	4.4	3.0	4.7	4.3
Paraguay	4.0	3.0	4.3	4.8
Uruguay	12.3	6.0	9.2	5.2
Venezuela	17.9	7.8	21.7	16.6
Caribbean				
Antigua & Barbuda	4.1	2.4	-1.3	-
Barbados	4.8	4.1	1.4	3.2
Dominica	3.7	2.8	2.4	1.3
Guyana	1.6	-2.6	4.7	6.0
Jamaica	0.9	1.6	13.6	15.3
St. Kitts/Nevis	4.0	3.5	2.1	1.8
St. Lucia	4.0	5.1	1.5	3.0
Trinidad & Tobago	6.5	7.0	3.7	5.3
Developing Asia	**8.2**	**7.8**	**4.2**	**4.2**
China	9.5	9.0	3.9	3.0
India	7.3	7.1	3.8	3.9
Indonesia	5.1	5.8	6.1	8.2
Malaysia	7.1	5.5	1.4	3.0
Philippines	6.0	4.7	6.0	8.2
Thailand	6.1	3.5	2.7	4.2

Sources: The World Economic Outlook, September 2005, Statistics Offices of individual countries,
* Estimates, **Annual average

Growth in the Caribbean slowed in 2005 in the context of an over-active hurricane season that affected the tourism and agricultural sectors. In particular, real output in Guyana was estimated to have declined by 2.6 per cent, relative to a 1.6 per cent expansion in 2004. Severe flooding at the beginning of the year caused significant production disruptions in the agricultural and mining sectors.

Overall, inflation in developing countries accelerated by 0.1 percentage point during 2005. However, average annual inflation in China moderated by 0.9 per cent, owing to monetary tightening to prevent overheating of the economy. Average inflation rates for the Caribbean rose, relative to the previous year, given rising oil prices.

Table 41

SUMMARY OF WORLD COMMODITY PRICES		
Annual per cent change		
	2004	2005
All Primary Commodities	26.4	29.3
1. Non-fuel Commodities	18.5	10.4
1.1 Edibles	13.2	1.5
(a) Food	14.3	-0.4
(b) Beverages	3.0	21.0
1.2 Industrial Inputs	23.5	17.9
(a) Agricultural Raw Materials	5.5	2.3
(b) Metals	36.1	26.4
2. Energy	30.9	38.8
Petroleum /1	33.1	36.2

/1 West Texas Intermediate measure

7.1.4. Commodity Markets

Commodity prices, measured by the IMF's index of primary commodity prices, recorded an increase of 29.3 per cent in 2005, following a 26.4 per cent rise in 2004. The increase in the index was primarily attributed to a significant hike in energy prices and, to a lesser extent, continued growth in the prices of non-fuel commodities such as metals (**see Table 41**). For the year, the average price of crude oil, as measured by the West Texas Intermediate index, increased by 36.2 per cent. Oil prices reached a record high of US$69.82 per barrel on 30 August 2005 in the wake of Hurricane Katrina.

The significant increase in oil prices for 2005 was underpinned by excess demand in particular regions. The International Energy Agency (IEA) reported an increase of 1.3 per cent in world demand, reflecting continued strong growth in demand from Asia, and non-OPEC Middle Eastern economies. World supply also rose by a similar 1.3 per cent over the year in a context of increased supply from Latin American countries such as Venezuela and Mexico. Excess demand pressures were, however, most evident among the North American states where fuel imports grew by 5.9 per cent in 2005 to 11.4 million barrels per day (bpd).

The oil market was also adversely affected by expectations of future tightness. These expectations were based on forecasts of continued robust global economic growth, low spare capacity among OPEC producers and limited investments in oil exploration. In this context, geopolitical developments, fears of supply disruptions and speculation all played a part in the price increases. At the start of the year, instability in the oil market was precipitated by an OPEC decision to curb production. Prices rose strongly in the first half of the year on concerns of possible sabotage of Iraqi oil facilities by insurgents. Fears of insufficient oil supplies were also fuelled by the threat of damage to oil rigs in the Gulf of Mexico as a result of the passage of Hurricane Dennis. The situation was exacerbated by the passage of Hurricane Katrina, which temporarily stopped 95.0 per cent of production in the Gulf of Mexico and forced the

shut down of oil refineries in Louisiana and Mississippi[18]. Some of the upward pressure on crude oil prices was mitigated by the efforts of the US Government and the IEA in releasing a combined total of sixty million barrels of oil from official reserves to compensate for reduced output from the Gulf.

With respect to non-fuel commodities, metal prices grew by 26.4 per cent in 2005, following an increase of 36.1 per cent in 2004. The prices of iron ore, copper and zinc recorded the strongest increases, reflecting robust demand for construction and manufactured products in both the United States and China[19]. Growth in aluminium prices, however, slowed to approximately 11.0 per cent, reflecting the impact of increases in Chinese exports during the first half of the year, which helped to assuage some of the additional demand for the metal.

The beverages sub-index of the non-fuel group also increased by 21.0 per cent, relative to 2004, principally reflecting significant growth in the price of coffee (robusta). Severe drought conditions in Vietnam, the largest producer of the robusta variety, exacerbated the overall shortage of the product on the international market. Flooding from Hurricane Stan in early October also caused serious damage to infrastructure in coffee-producing areas in Mexico and Central America, which resulted in temporary fallout in coffee exports.

18 The oil and gas infrastructure in the gulf region is responsible for approximately 20.0 per cent of daily U.S. crude oil production and 50.0 per cent of its total refining capacity.

19 With respect to iron ore, the increase was precipitated by the signing of a new contract between steel producers and their suppliers to purchase the metal at prices which were significantly above what prevailed in 2004.

7.1.5. Trade Negotiations

7.1.5.1. World Trade Organisation (WTO)

The Sixth WTO Ministerial Conference was held in Hong Kong over the period 13-18 December 2005. The goal of the Ministerial was to set a roadmap for completing the Doha work programme by some time in 2006. The main outcomes of the meeting included the declaration on agricultural subsidies, the adoption of a formula to guide the non-agricultural market access (NAMA) negotiations, more recognition of the problems of small developing states – although the explicit adoption of policies for special and differential treatment (S&D) was not realised – and the incorporation of the concept of "Aid for Trade" into the WTO work programme.

With respect to the negotiations on agriculture, the Ministerial agreed to the parallel elimination of all forms of export subsidies by the end of 2013. For the NAMA negotiations, agreement was reached on the "Swiss formula" for reducing tariffs on industrial goods. The modalities to achieve these objectives were to be determined by 30 April 2006, and it was mandated that a comprehensive draft schedule, based on these modalities, be submitted no later than 31 July 2006. The Ministerial also agreed that a substantial part of the adjustments was to be realized by the end of the first half of the implementation period.

The WTO conference also afforded greater recognition to the concerns of small vulnerable economies. WTO members were urged to adopt specific measures that would facilitate the fuller integration of small, vulnerable economies into the multilateral trading system, without creating a sub-category of WTO Members. The Ministerial also agreed to review all 'special and differential' provisions with a view to strengthening them and making them more precise, effective and operational.

For much of 2005, there were discussions in various fora at the IMF and World Bank on the expanding practice

of some more developed countries (MDCs) providing aid in exchange for trade liberalization policies in less developed countries (LDCs). Based on these discussions, the Ministerial formally created a task force to provide recommendations on how to operationalise "Aid for Trade" at the multilateral level. The expectation was that the task force would provide recommendations on how to secure additional financial resources for "Aid for Trade", the appropriate mechanisms for disbursement such as grants and concessional loans, and to explore how the practice could contribute most effectively to the development dimension of the Doha Round.

7.1.5.2. Sugar Reforms

On 24 November 2005, European Union agriculture ministers reached agreement on a wide-ranging reform of the Common Market Organization for sugar, based on a proposal tabled by the European Commission (EC) in June 2005. It was agreed that the guaranteed price for white sugar would be cut by 36.0 per cent over four years. The proposed changes would take effect from July 2006. The price for raw sugar would also be reduced by the same proportion to €335.2 per tonne, from €523.7 per tonne[20]. In the first year, the price would fall by approximately €26.9 per tonne, or 5.1 per cent, to €496.8 per tonne. There would be no change to the price in the second year. The third year would witness a cumulative reduction of 17.1 per cent to €434.1 per tonne and finally, the price would fall to €335.2 per tonne in the fourth year.

Under the Sugar Protocol, eighteen ACP countries, including Jamaica, export sugar to the EU and would be affected by price reductions on the EU market. The commitment of the EC to assist these countries was outlined in an "Action Plan" in January 2005. The EU consequently decided that, for 2006, an assistance plan valued at €40.0 million be implemented, which would act as a precursor for other financial interventions.

The ACP countries opposed the reforms on a number of grounds. Firstly, they argued that the reforms breached existing EU legal obligations under the Protocol. Secondly, the changes would have a significant negative socio-economic impact on all ACP countries. Thirdly, the states argued that the reforms did not provide sufficient compensation for their losses. Fourthly, the reform process was to start too soon and finally, the proposed implementation period was not sufficiently gradual.

7.1.5.3. Bananas

On 30 March 2005, the WTO was petitioned by five Latin American countries – Honduras, Colombia, Costa Rica, Panama and Guatemala – for a formal arbitration in a dispute over Europe's banana regime. The decision to seek arbitration followed notification to the WTO by Europe that it intended to introduce a €230.00 per tonne levy on banana imports from non-ACP countries in January 2006[21]. Latin American producers protested that they would lose market share in the EU at the proposed tariff and suggested a tariff of €75.00 per tonne[22]. The ACP producers, for their part, informed the EC that they were seeking a new tariff of €275.00 per tonne.

20 The other elements of the decisions included the following: (1) EU farmers would be compensated for, on average, 64.2 per cent of the price cut through a decoupled payment - which would be linked to the respect of environmental and land management standards; (2) countries which gave up more than half of their production quota would be entitled to pay an additional coupled payment of 30 per cent of the income loss for a temporary period of five years; (3) a voluntary restructuring scheme would be established to provide incentives for less competitive producers to leave the sector; (4) intervention buying of surplus production would be phased out after four years.

21 The Latin American producers invoked an arbitration clause, agreed in 2001 when the EC was seeking a WTO waiver for the preferential trade provisions of the EU/ACP Cotonou Convention.

22 Latin American producers supplied about 70.0 per cent of the EU market in 2004, while ACP and EU producers supplied 16.0 per cent and 14.0 per cent, respectively. The previous regime allowed ACP countries duty free access up to 750 000 tonnes, while Latin American exporters pay a tariff of €75.00 up to 3.1 million tonnes.

On 1 August 2005, the EC-proposed tariff of €230.00 per tonne on imported bananas was rejected by the WTO arbitrators on the basis that the proposed tariff would not maintain market access for Most Favoured Nation (MFN) banana suppliers. The EC subsequently proposed two new tariff rates of €187.00 and €176.00 per metric tonne, both of which were again rejected by the WTO in October and November 2005, respectively.

7.1.5.4. The Central American Free Trade Agreement (CAFTA)

CAFTA was signed into law by the US Congress on 2 August 2005. The proposed agreement seeks to lower trade barriers, open markets and promote greater transparency among its member states[23]. Other objectives of CAFTA include the facilitation of increased intra-regional investment and the strengthening of intellectual property rights. The agreement requires market liberalization for the majority of goods and services produced in Central America – including agriculture, manufacturing, public services and government procurement. In return, the USA has guaranteed increased market access for certain sectors in Central America, including textiles and a limited increase in sugar quotas.

CAFTA was modelled after the North American Free Trade Agreement (NAFTA) and is widely considered as a stepping-stone to the larger Free Trade Area of the Americas (FTAA).

7.1.5.5. The PetroCaribe Agreement

The PetroCaribe Agreement was signed on 6 September 2005 between Heads of States and Government of the Caribbean[24] and Venezuela. Under the Agreement, short-term credit for oil imports will be given for 90-days. In addition, agreed proportions of the cost of fuel will be financed under a deferred payment arrangement. The percentage that will be financed will depend on the price of oil on the world market and there will be a moratorium of 2 years on all repayments.

The Agreement also stipulates the formation of a fund geared towards the social and economic development of Caribbean countries. It is anticipated that the fund will be financed from the savings that accrue to the individual countries. In addition to the Agreement, a bilateral Memorandum of Understanding (MOU) was signed by Venezuela and Jamaica. The MOU stipulates that the Petrojam refinery is to be upgraded and will result in an expansion of the refinery's capacity by about 40.0 per cent.

7.2. Balance of Payments

7.2.1. Overview

Following two consecutive years of improvement, the current account deficit of Jamaica's balance of payments is estimated to have widened in 2005 by US$465.6 million to US$975.0 million or 9.7 per cent of GDP (see **Chart 20** and **Table 42**). This reflected deterioration in the deficits on the goods and income accounts, partly offset by expansions in net receipts from services and current transfers.

The performance of the current account reflected, in part, developments in the global economy, as well as the effects of a very active hurricane season. Fuel imports were affected by a 36.1 per cent increase in oil prices, as measured by the WTI crude index (see **International Economic Developments**). The effect of this was

23 The members of CAFTA include USA, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic.

24 Signatories from the Caribbean included Antigua and Barbuda, Bahamas, Belize, Cuba, Dominica, Grenada, Guyana, Jamaica, St. Vincent and the Grenadines, St. Kitts and Nevis, St. Lucia and Suriname.

exacerbated by the temporary closure of the Petrojam refinery, necessitating the importation of more expensive refined products. There was also a significant increase in food imports in the context of a fall-off in domestic agricultural production due to hurricane damage.

The widening of the current account deficit was, however, partly constrained by the impact of increased metal prices on the international market. In this context, there was a modest increase in the price of alumina over the year, which resulted in higher earnings from mining exports. Earnings from travel also increased in 2005, due in part to the active hurricane season, which resulted in visitors to other destinations being diverted to Jamaica.

More than adequate financing for the current account deficit was provided by net private and official investment inflows. In this context, the NIR of the BOJ increased by US$228.9 million to close the review year at US$2 087.4 million, with gross reserves representing 18.8 weeks of imported goods and services.

7.2.2 Merchandise Trade

Exports

Total export earnings grew by 3.6 per cent to US$1 658.6 million or 16.4 per cent of GDP in 2005. This growth, which represented the third consecutive year of increase, largely reflected an expansion of 9.0 per cent (US$127.1 million) in *general merchandise exports*. A decline of 55.2 per cent (US$70.1 million) in *free zone exports* served as a partial countervailing influence. Growth in the general merchandise group emanated from estimated increases of US$94.6 million and US$58.4 million in *major traditional* and *non-traditional exports,* respectively. Earnings from *re-exports*, however, fell by US$9.4 million during the review period (see **Table 43**).

The performance of *major traditional exports* in 2005 was influenced primarily by respective expansions in earnings from alumina and bauxite as receipts from sugar and bananas declined due to adverse weather conditions. The growth in earnings from alumina export was attributed to respective increases of 9.0 per cent and 3.6 per cent in the average price and volume exported, while higher bauxite earnings reflected growth of 21.6 per cent (or 720 thousand tonnes) in the volume exported. Amidst global production shortfalls and strong demand for aluminium, alumina prices rose to a historically high average of US$220.9 per tonne for the review year (see **International Economic Developments**). The fall-off in global alumina production was mainly influenced by the closure of a number of smelters in Canada, USA and Europe due to the impact of rising energy cost. The growth in Jamaica's exports of

CHART 20

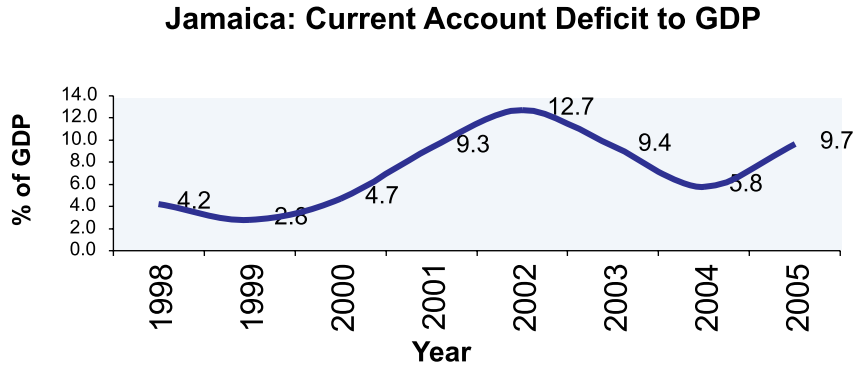


TABLE 42

SUMMARY OF BALANCE OF PAYMENTS (US$M)			
	2004[1/]	2005[2/]	Change
CURRENT ACCOUNT	**-509.4**	**-975.0**	**-465.6**
A. GOODS BALANCE	**-1 944.4**	**-2 587.1**	**-642.7**
Exports (f.o.b.)	1 601.6	1 658.6	57.1
Imports (f.o.b.)	3 546.0	4 245.7	699.7
B. SERVICES BALANCE	**571.7**	**669.7**	**98.0**
Transportation	-150.3	-216.9	-66.6
Travel	1 151.5	1 295.6	144.1
Other Services	-429.5	-409.0	20.5
GOODS & SERVICES BALANCE	**-1 372.7**	**-1 917.4**	**-544.7**
C. INCOME	**-582.6**	**-636.9**	**-54.3**
Compensation of employee	84.5	81.2	-3.3
Investment income	-667.1	-718.1	-51.0
D. CURRENT TRANSFERS	**1 445.9**	**1 579.3**	**133.4**
General Government	159.7	122.3	-37.4
Other Sectors	1 286.2	1 457.1	170.9
2. CAPITAL & FINANCIAL A/C	**509.4**	**975.0**	**465.6**
A. CAPITAL ACCOUNT	**-9.7**	**-23.0**	**-13.3**
General Government	2.1	-11.3	-13.4
Other Sectors	-11.8	-11.7	0.2
B. FINANCIAL ACCOUNT	**519.2**	**998.0**	**478.8**
Official Investment	479.1	351.6	-127.5
Private Investments [3/]	733.6	875.3	141.7
Change in Reserves [4/]	-693.5	-228.9	464.6

1/ Revised

2/ Estimates

3/ Includes Errors & Omissions

4/ Minus denotes increase

alumina and bauxite reflected a normalization of production activities, following the disruptions caused by Hurricane Ivan in 2004 (see **Production and Prices**).

The decline in the value of sugar exports was primarily due to a 27.6 per cent reduction in volume, the effect of which was partly offset by a 8.1 per cent increase in the price on the export market. Lower export volumes were related, *inter-alia*, to the effect of adverse weather on the crop, which prevailed over the course of the 2004/05 crop year[25] (see **Production and Prices**). The increase in the average price per tonne of sugar exported reflected the appreciation in the value of the Euro vis-à-vis the US dollar during 2004 (see **International Economic Developments**). Adverse weather in 2005 also occasioned a 57.6 per cent fall in banana exports.

The value of *other traditional exports* declined by 21.8 per cent, mainly reflecting a contraction in earnings from coffee exports (see **Table 43**). Lower earnings from coffee exports were associated with significant crop damage due to adverse weather conditions. An expansion of US$5.7 million in receipts from the export of rum, principally associated with increased marketing activities of local distillers, served as the main countervailing factor in this group.

Total earnings from *non-traditional* exports expanded by US$58.4 million in 2005, representing the third consecutive year of growth for this group. The increase in earnings from *non-traditional* exports was driven by exports of chemicals (including ethanol), mineral fuels and beverage and tobacco exports (excluding rum).

TABLE 43

TRADITIONAL & NON-TRADITIONAL EXPORTS (US$MN)

	2004[1/]	2005[2/]	Change	% Change
GENERAL MERCHANDISE EXPORTS	**1 404.5**	**1 531.5**	**127.1**	**9.0**
DOMESTIC EXPORTS	1 365.2	1 501.7	136.5	10.0
Major Traditional Exports	1 005.9	1 100.6	94.6	9.4
Bauxite	80.4	98.8	18.4	22.9
Alumina	814.6	920.3	105.7	13.0
Sugar	98.1	76.8	-21.3	-21.7
Bananas	12.8	4.7	-8.1	-63.4
Other Traditional Exports	76.0	59.5	-16.6	-21.8
Citrus	2.2	1.6	-0.7	-29.5
Cocoa	1.9	1.4	-0.6	-30.0
Coffee	39.5	17.3	-22.1	-56.1
Pimento	2.2	2.9	0.7	32.0
Rum	28.5	34.3	5.7	20.1
Gypsum	1.8	2.1	0.4	20.9
Non Traditional Exports	283.3	341.6	58.4	20.6
RE-EXPORTS	39.2	29.8	-9.4	-23.9
FREEZONE EXPORTS	126.8	56.8	-70.1	-55.2
GOODS PROC. IN PORTS	70.3	70.3	0.0	0.0
GRAND TOTAL	**1 601.6**	**1 658.6**	**57.0**	**3.6**

1/ Revised

2/ Estimates

25 Sugar cane production is seasonal, with the crop 'year' occurring between the months of December and July.

Imports

Spending on total imports (c.i.f.) increased by US$761.2 million in 2005. This increase largely emanated from an expansion of US$812.3 million in the value of *general merchandise imports*, reflecting increased imports of mineral fuels, manufactured goods, chemicals and food (see **Table 44**). Spending on fuel imports largely reflected a 30.2 per cent increase in the average price per barrel of crude oil on the international market. Increased spending on manufactured goods and food imports reflected higher global prices in 2005, as well as higher imports of agricultural products following the adverse weather conditions experienced in 2005.

7.2.3 Services

Net earnings from *services* increased by an estimated US$98.0 million in 2005 (see **Table 42**). This improvement reflected an expansion in the surplus on the *travel* sub-account, as well as a narrowing of the deficit on the *other services* sub-account. However, there was a partial offsetting increase in the deficit on the *transportation* sub-account.

Transportation

Net payments for *transportation* services were estimated at US$216.9 million in 2005, relative to US$150.3 million in 2004. The widening of the deficit on the *transportation* sub-account was influenced by an increase of US$66.6 million in gross payments, mainly associated with freight charges on higher volumes of imported goods. Higher inflows, stemming from an increase in stopover arrivals as well as a 2.7 per cent increase in fares by the national carrier, partially offset the increase in outflows.

Travel

Gross earnings from visitor expenditure were estimated to have increased by 7.4 per cent to US$1 544.9 million (15.3 per cent of GDP) in 2005. This was complemented by a decline of US$37.2 million in the total expenditure of Jamaicans travelling overseas, including temporary workers abroad.

The expansion in gross earnings from tourism resulted from growth of 4.0 per cent in total visitor arrivals, influenced by respective increases of 4.5 per cent and 3.3 per cent

TABLE 44

VALUE OF IMPORTS BY SITC (C.I.F.) (US$MN)

	2004[1/]	2005[2/]	Change	% Change
TOTAL GENERAL IMPORTS	**3 927.2**	**4 739.4**	**812.3**	**20.7**
0. FOOD	527.3	602.9	75.6	14.3
1. BEVERAGE. & TOBAC.	46.2	55.9	9.7	21.1
2. CRUDE MATS.	68.0	79.2	11.2	16.4
3. MINERAL FUELS	910.5	1360.1	449.6	49.4
4. ANI. & VEG. OIL	32.4	27.7	-4.7	-14.6
5. CHEMICALS	403.2	555.3	152.1	37.7
6. MANUF. GOODS	563.1	637.8	74.7	13.3
7. MACH. & TRANSP.	880.7	870.0	-10.8	-1.2
8. MISC. MANUF. GOODS	426.4	477.2	50.8	11.9
9. MISC. COMMDS.	69.4	73.3	4.0	5.7
FREEZONE	**66.7**	**15.5**	**-51.1**	**-76.7**
GOODS PROC. IN PORTS	**112.3**	**112.3**	**0.0**	**0.0**
GRAND TOTAL	**4 106.1**	**4 867.3**	**761.2**	**18.5**

1/ Estimates
2/ Provisional

in stopover and cruise visitor arrivals (see **Table 45**). The expansion in earnings also reflected an increase of 5.6 per cent in the average daily expenditure of stopover visitors.

The growth in tourist arrivals occurred in the context of an aggressive marketing campaign by the Jamaica Tourist Board (JTB). While the local industry was negatively affected by adverse weather conditions towards the middle of the year, the diversion of visitors from Cozumel, Mexico later in the year outweighed the earlier dislocation. In addition, new airlift capacity provided by US Airways and Spirit Airlines bolstered arrivals to the Island. Notwithstanding, the rationalization of the operations of the national carrier affected arrivals from some destinations, while capacity within the industry was temporarily affected by refurbishing work during the year.

Visitor arrivals from the USA, Jamaica's main source market, increased by 6.2 per cent in 2005. There was also a noteworthy improvement in arrivals from the Canadian market, which grew by 11.2 per cent in the review period, relative to an average increase of 0.7 per cent over the period 2001-2004. The performance in 2005 was driven by the resumption of Air Jamaica flights to that destination, as well as additional airlift by American Airlines to non-traditional markets such as Calgary. Tourist arrivals from Europe declined by 3.3 per cent in 2005. In particular, there was a decline of 5.6 per cent from the U.K., Jamaica's second largest source market. This was principally related to the decision by Air Jamaica to discontinue flights to Manchester, as a part of its rationalization plans.

Growth in stopover arrivals to Jamaica continued to lag behind the average for the region in 2005 (see **Table 46**).

Table 45

VISITOR ARRIVAL STATISTICS

	2004[1/]	2005 [2/]	% Change
Total Stopovers	**1 414 786**	**1 478 699**	**4.5**
Foreign National Stopovers	1 326 918	1 386 997	4.5
Non-resident Jamaican Stopovers	87 868	91 702	4.4
Cruise Passengers & Armed Forces	**1 099 773**	**1 135 856**	3.3
Total Visitors	**2 514 559**	**2 614 555**	4.0
Gross Estimated Expenditure (US$M)	**1 438.0**	**1 544.9**	7.4

[1/] *Revised*
[2/] *Provisional*

The available data indicate relatively strong arrivals to Cuba, the Dominican Republic and St. Lucia. However, Jamaica outperformed St. Lucia, Bahamas, and Belize in cruise arrivals (see **Table 47**). Growth in cruise arrivals occurred largely in the second half of the year when the Island benefitted from diversions from other ports due to hurricanes.

Table 46

Stopover Visitor Arrivals (Selected Caribbean Countries)			
	2004	**2005**	**% Change**
Bahamas*	1 241.5	1 270.0	2.3
Barbados**	498.4	489.5	-1.8
Cuba*	1 776.3	1 906.0	7.3
Dominican Republic**	3 439.6	3 690.7	7.3
Jamaica* **	**1 415.0**	**1 478.7**	**4.5**
St Lucia**	271.9	290.4	6.8
Total	**8 642.7**	**9 125.3**	**5.6**

Source: Caribbean Tourism Organization

**Jan-Oct*
***Jan-Nov*
****Jan-Dec*

Table 47

Cruise Visitor Arrivals (Selected Caribbean Countries)			
	2004	**2005**	**% Change**
Bahamas*	2 555.9	2 438.3	-4.6
Belize*	611.3	605.2	-1.0
Cayman Islands**	1 502.4	1 598.6	6.4
Jamaica* **	**1 099.6**	**1 135.8**	**3.3**
St Lucia**	408.0	336.6	-17.5
Total	**6 177.2**	**6 114.6**	**-1.0**

Source: Caribbean Tourism Organization
**Jan-Sep*
***Jan-Nov*
****Jan-Dec*

Other Services

The deficit in *other services* narrowed by US$20.5 million in 2005. This improvement was influenced by a reduction of US$17.3 million in outflows, supported by a marginal increase of US$3.2 million in inflows.

The estimated fall in Jamaican expenditure for *other services* in 2005 mainly reflected a decline of US$46.8 million in payments for computer and information services, which was partly offset by increased spending of US$30.5 million on other business services. The increase in spending for other business services reflected an expansion in the payment of commissions by the travel sector, associated with the increased visitor arrivals during the year.

7.2.4 Income

The deficit on the *income* account widened by US$54.3 million in 2005. This higher deficit reflected an expansion of US$51.0 million in *net investment income* outflows, supported by a decline of US$3.3 million in net inflows from *compensation of employees* (see **Table 42**). The expansion in net investment income outflows was influenced primarily by an increase of US$66.3 million in Central Government's interest payments on its foreign debt. A growth of US$25.0 million in BOJ's interest income on its foreign assets partially offset the increased payments.

Total earnings by Jamaicans working abroad rose by US$4.3 million in 2005, due primarily to an estimated increase in income receipts by seasonal workers. Payments to non-resident employees by local entities expanded by US$7.6 million during the year.

7.2.5 Current Transfers

The balance on the current transfers account improved by US$133.4 million in 2005. Gross inflows to the private sector, which represent respective shares of 18.4 per cent of GDP in 2005, increased by 8.1 per cent, relative to 2004 (see **Table 48**). There was, however, a slowdown in the rate of increase in inflows to the Island in the context of the non-repetition of reinsurance flows in the aftermath of Hurricane Ivan in 2004. Gross outflows from the private sector declined by 6.7 per cent in 2005.

Remittance companies continued to account for the major share of private transfer inflows in 2005[26]. These agencies acted as a conduit for 51.4 per cent of total remittances in 2005, relative to 44.2 per cent in 2004. The share of inflows through the postal system remained at 0.07 per cent in 2005, relative to 2004. The respective shares of inflows through financial institutions and the other agencies, however, declined to 35.5 per cent and 13.0 per cent in 2005 from 40.6 per cent and 15.2 per cent in 2004.

Gross transfer inflows to the Government declined by US$37.4 million in 2005 in the context of a delay in expected receipts of grant flows. Gross government donations abroad remained flat in 2005.

7.2.6 Capital and Financial Account

The *capital account* recorded a deficit of US$23.0 million in 2005, relative to a deficit of US$9.7 million in 2004. The surplus on the *financial account*, however, increased by US$478.8 million in 2005 (see **Table 42**). Net *private investment* inflows of US$875.3 million and net *official investment* inflows of US$351.6 million were more

26 The USA and U.K. are the major source markets with respective shares of approximately 60.0 per cent and 25.0 per cent of total remittances inflows.

Table 48

CURRENT TRANSFERS (US$MN)				
	2004[1/]	2005[2/]	Change	% Change
TOTAL RECEIPTS	**1 892.0**	**1 995.6**	**103.6**	**5.5**
General Government	163.4	126	-37.4	-22.9
Private Sector	1 728.6	1 869.6	141	8.2
TOTAL PAYMENTS	**446.1**	**416.3**	**-29.8**	**-6.7**
General Government	3.7	3.7	0	0.0
Private Sector	442.4	412.6	-29.8	-6.7
NET CURRENT TRANSFERS	**1 445.9**	**1 579.3**	**133.4**	**9.2**

1/ Revised

2/ Estimates

than sufficient to finance the deficit on the *current* and *capital accounts*. In this context, there was a build-up of US$228.9 million in the NIR. The build-up in the NIR reflected an increase of US$287.0 million in the Bank's gross foreign assets to US$2 169.1 million, representing an estimated 18.8 weeks of imported goods and services (see **Table 49**).

Table 49

FOREIGN EXCHANGE RESERVES (US$MN)			
	As at 31 December		
	2004[2/]	2005[2/]	Change
GROSS FOREIGN ASSETS	**1 882.1**	**2 169.0**	**287.0**
Bank of Jamaica	1 882.0	2 169.0	287.1
Central Government	0.1	0.0	-0.1
Other official Institutions	0.0	0.0	0.0
GROSS FOREIGN LIABILITIES	**23.5**	**81.6**	**58.1**
NET INTERNATIONAL RESERVES	**1 858.6**	**2 087.4**	**228.9**
Weeks of estimated imports of goods and services	18.1	18.8	

1/ Revised

2/ Provisional

Net *official investments* declined by US$127.5 million in 2005 (see **Table 50**). This performance was attributed to an increase in gross official payments, which was augmented by a fall in gross official inflows. Total outflows for the year amounted to US$923.2 million which included a maturing Eurobond of US$250.0 million, as well as payment on Air Jamaica's external debt following the re-acquisition of the local carrier by the Government in the first quarter. Gross official investment inflows, on the other hand, included two Eurobonds totalling US$546.4 million, as well as US$325.0 million secured through the debt raising activities of Air Jamaica.

Table 50

OFFICIAL INVESTMENT FLOWS

(US$MN)

	2004[1/]	2005[2/]	Change
GROSS OFFICIAL INFLOWS	**961.6**	**1274.8**	**313.3**
Donor Countries	0.0	0.0	0.0
Multilateral Institutions	0.0	0.0	0.0
Other Assistance	856.5	896.4	40.0
Project Loan	105.1	378.4	273.3
GROSS OFFICIAL OUTFLOWS	**482.5**	**923.2**	**440.8**
Government Direct	477.5	492.3	14.8
Bank of Jamaica	4.9	431.0	426.0
NET OFFICIAL INVESTMENTS	**479.1**	**351.6**	**-127.5**

1/ Revised

2/ Provisional

7.3. Foreign Exchange Management

7.3.1. Bank of Jamaica International Reserves

The gross foreign assets of the Bank of Jamaica was US$2 169.1 million as at end-December 2005, US$287.1 million higher than the stock at end-December 2004 (see **Table 51**. The growth in the stock was largely attributed to net cash inflows of foreign currency purchased from the market and the bauxite sector.

Foreign liabilities as at end-December 2005 was US$81.6 million, reflecting an increase of US$58.2 million, relative to end-December 2004. The increase in foreign liabilities occurred in the September quarter and reflected the receipt of funds totalling US$321.5 million from a Eurobond placement by Air Jamaica in July 2005. These funds were held on deposit at the BOJ, and consequent on periodic withdrawals during the year, the liability was reduced to US$59.1 million by end-December 2005. The receipt of these funds had no impact on the Bank's net international reserves (NIR) as the flows were also reflected in the gross foreign assets of the Bank.

The NIR of the BOJ was US$2 087.4 million at end-December 2005, reflecting an increase of US$228.9 million, relative to end-December 2004 (see **Table 52**). This growth was largely attributed to significant net purchases[27] from the market during the first half of the year.

The NIR increased by US$298.3 million during the first half of the year, peaking at US$2 156.8 million at end-June, but declined by US$69.4 million during the second half of the year. The growth during the first half of the year was influenced by relative stability in the foreign exchange market, which resulted in net purchases amounting to US$460.0 million by the Central Bank. The decline in the September and December quarters was attributed to excess demand pressures which resulted in the Bank's net sale of US$200.2 million to the market.

TABLE 51

BANK OF JAMAICA GROSS FOREIGN ASSETS As At End December 2005 US$MN	
Opening Gross Foreign Assets (GFA)	1,881.9
Inflows	2,547.4
Outflows	(2,234.0)
/1 Adjustment to GFA	(26.3)
Closing Gross Foreign Assets	**2,169.0**

/1 - Mainly reflects unrealized loss on foreign currencies and other investments.

27 BOJ purchases from the market (including funds purchased under the surrender arrangement) less sales to the market

TABLE 52

BANK OF JAMAICA NET INTERNATIONAL RESERVES (NIR) (end of period) US$MN						
	2004	2005				Annual Change
	Dec.	Mar.	June	Sept.	Dec.	($)
NIR	1858.5	1901.6	2156.8	2119.0	2087.4	228.9
Gross Foreign Assets	1881.9	1924.1	2179.3	2243.0	2169.0	287.1
Foreign Liabilities	23.4	22.5	22.5	124.0	81.6	58.2

7.3.1.1. Foreign Exchange Inflows and Outflows

Inflows

Foreign exchange inflows to BOJ for 2005 totalled US$2 547.4 million, US$435.5 million higher than 2004. The primary sources of inflows were purchases from the market and from GOJ loan proceeds (see **Table 53**).

Total market purchases increased by US$338.7 million to US$1 001.0 million in 2005. These purchases accounted for approximately 39.0 per cent of total inflows and comprised US$366.0 million and US$635.0 million purchased under the surrender arrangement[28] and through the trading room, respectively.

The BOJ purchased loan and grant proceeds of approximately US$902.0 million from the GOJ during 2005, US$271.9 million lower than 2004. The sources of the loan proceeds were mainly from two US dollar bonds issued in the domestic market and two Eurobonds.

Purchases of US$221 million from the bauxite sector during 2005 were US$62.4 million higher than 2004. The higher inflows largely emanated from additional foreign currency brought in by the companies to finance local cost operations relating to expansion in the sector during the review year.

28 Under the surrender arrangement, authorized dealers and cambios agree to sell to the BOJ 5% -10% of their purchases from the Clients segment of the market.

Table 53

INFLOWS OF FOREIGN EXCHANGE US$MN	Inflows 2004	Inflows 2005	Change ($)
Bauxite Receipts	**158.5**	**221.0**	**62.4**
Market Purchases	**662.4**	**1 001.0**	**338.7**
Surrenders to BOJ			
- Authorised Dealers	203.1	231.2	28.1
- Cambios	140.5	134.8	-5.7
Other purchases	318.8	635.0	316.3
Purchases from GOJ	**1 173.9**	**902.0**	**49.6**
- Eurobond	805.4	542.7	-262.7
- Local/Regional US$ bond	270.6	246.5	-24.1
- Other loans*	48.7	430.7	382.1
of which Air Jamaica	0.0	*321.5*	*321.5*
Grants	49.2	3.6	-45.6
Other Receipts**	**117.2**	**101.9**	**-15.3**
Total Cash Inflow	**2 112.0**	**2 547.4**	**435.5**

* Includes Air Jamaica's bond proceeds of US$321.54 million

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

7.3.1.2.Outflows

Foreign currency outflows for 2005 totalled US$2 234.0 million, US$807.6 million higher than 2004. Government debt payments and market sales accounted for 51.5 per cent and 33.2 per cent of total outflows, respectively (see **Table 54**).

During 2005 the BOJ sold US$741.2 million to the market compared to US$279.6 million in 2004. This occurred in the context of unstable market conditions during the second half of the year, which required the Bank to augment US dollar liquidity.

Other GOJ payments of US$332.5 million during 2005 largely represented withdrawals totalling US$262.4 million from the account of Air Jamaica.

Table 54

Outflows of Foreign Exchange US$MN			
	Outflows		
	2004 [/1]	2005	($)
Public Debt	**1075.8**	**1150.5**	**74.7**
- Principal	705.0	730.3	25.3
- Interest	370.8	420.3	49.4
Other GOJ Payments	16.9	332.5	315.6
Direct Sales	279.6	741.2	461.6
Other Payments	54.1	9.9	-44.2
Total Cash Outflow	**1426.4**	**2234.0**	**807.6**

[/1] **Revised**

7.3.2. Reserve Management

7.3.2.1. Performance

Bank of Jamaica's gross foreign assets amounted to US$2 169.0 million at the end of 2005, US$287.1 million higher than the stock at end 2004.

The Bank earned US$72.6 million on its foreign assets in 2005, an increase of US$29.7 million over that in 2004. This was due mainly to the increase in average foreign asset holdings, coupled with a 200 basis point increase (point-to-point) in US short-term interest rates during the year. Income earned over the period translated to a return on investment of 3.5 per cent per annum compared to a return of 2.7 per cent per annum in 2004 **(see Table 55).**

Table 55

FOREIGN INVESTMENT INCOME FOR YEAR ENDED 31 DECEMBER				
	2004		2005	
ASSETS	US$M	%	US$M	%
Money Market Investments	15.09	35.23	37.10	51.14
Bond Holdings	23.99	56.01	27.03	37.26
External Fund	1.46	3.41	1.75	2.41
Other	2.29	5.35	6.67	9.19
TOTAL	**42.83**	**100.00**	**72.55**	**100.00**
Portfolio Return	**2.70**		**3.49**	
Average Income Earning Assets	**1 585**		**2 079**	

7.3.2.2. Asset Distribution

The Bank continued to maintain a significant share of its reserves in US dollar denominated investments, influenced largely by the currency structure of Jamaica's international commerce and capital flows. Additionally, as the US dollar is the primary currency to which the Jamaica Dollar is benchmarked, the maintenance of third currency positions is largely regarded as suboptimal. Further, with the appreciation of the US dollar against other major currencies and the expectation of its continued strengthening, the major holdings of third currencies were converted to US dollars in August, a position retained for the rest of the year (see **Table 56**).

7.3.2.3. Investment Strategy

Investment in 2005 continued to be guided by the following priorities: (i) liquidity, (ii) capital preservation and (iii) maximization of return. This reflected the need for the Bank to respond to needs in the foreign exchange market as well as to effect debt payments on behalf of the government.

The investment strategy for 2005 targeted a weighting of between 35 – 40 per cent of total assets in the medium/long term investments by year-end. Developments in the bond market, however, dictated the maintenance of an underweight bond portfolio for most of the year. In the first quarter, the benchmark 10-year US Treasury yield rose sharply, moving from a low of 3.98 per cent to a high of 4.64 per cent. This development favoured a shift in weighting from the short-term to the 7-10 year sector of the curve earlier than anticipated. The duration of the portfolio was therefore increased by just under a year by the end of the quarter to 2.72 years. The second and third quarters saw a prolonged decline in the 10-year Treasury yield which ranged from 3.88 per cent to 4.48 per cent. This continued flattening of the US Treasury curve prompted a gradual reduction in bond exposure and as a result, the portfolio moved into a less defined barbell[29] structure with 67 per cent of the Bank's holdings concentrated in the short-term and 28 per cent in the long term. The trend in the 10-year Treasury yield was reversed in the fourth quarter when the yield increased by 78 basis points to 4.66 per cent.

Table 56

CURRENCY COMPOSITION OF FOREIGN ASSETS AT 31 DECEMBER 2004 AND 2005

	Currency (MN)		US$ Equivalent (MN)		% Share	
	2004	2005	2004	2005	2004	2005
US Dollar	1 616.37	2 155.73	1 616.37	2 155.73	85.88	99.39
Euro	122.08	2.19	165.26	2.60	8.78	0.12
Pound Sterling	29.91	2.49	57.30	4.28	3.05	0.20
Canadian Dollar	47.84	2.36	39.76	2.03	2.11	0.09
Yen	264.39	258.26	2.57	2.19	0.14	0.10
Other	-	-	0.67	2.21	0.04	0.10
TOTAL FOREIGN ASSETS			**1 881.93**	**2 169.04**	**100.00**	**100.00**

29 The barbell is a bond investment strategy whereby holdings are concentrated in both the very short-term and long-term maturities.

Table 57

Distribution of Investments by Asset Class at 31 December				
	2004		2005	
Asset Class	**US$ M**	**%**	**US$ M**	**%**
Money Market Investments	1 284.11	68.23	1 256.45	57.93
Bond Holdings	470.02	24.98	815.57	37.60
BHA	85.40	4.54	53.87	2.48
External Fund	42.40	2.25	43.15	1.99
Total Foreign Assets	**1 881.93**	**100**	**2 169.04**	**100**

This provided an opportunity for the repositioning of the portfolio and the proportion of medium and long-term holdings were increased accordingly.

Against this background, through strategic asset selection, this portfolio delivered a strong performance, accounting for approximately 39.9 per cent of income while averaging just over 30 per cent of foreign assets. 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 2005.

Table 57 shows the comparative breakdown by asset class at 31 December 2004 and 2005.

7.3.3. The Foreign Exchange Market

The favourable trends observed in the foreign exchange market during 2004 continued through to June 2005. However, during the second half of the year, with the market experiencing frequent episodes of instability, the Bank of Jamaica adopted a more aggressive liquidity management posture. Against this background, the weighted average selling rate depreciated by 4.6 per cent relative to the United States dollar to close the year at US$1.00 = J$64.58, compared to US$1.00 = J$61.63 at the end of 2004. For 2004, the Jamaica Dollar depreciated by 1.6 per cent. The Jamaica Dollar also depreciated against the Canadian dollar. However, the domestic currency appreciated against the Great Britain Pound, which was consistent with the general weakening observed in that currency internationally.

Exchange rate movements during the March quarter reflected the continuation of the appreciation that was evident during the December 2004 quarter. In this regard, the exchange rate appreciated by 0.1 per cent during the first quarter and was supported by buoyant foreign currency inflows. The daily purchases from earners averaged US$22.0 million in the March quarter, relative to US$20.2 million for the comparable period in 2004.

At the onset of the June quarter, the generally favourable outlook on the domestic economy was reinforced by the Government's stated commitment to achieve a balanced budget for fiscal year 2005/06. Further, there was a general expectation of continued buoyancy in foreign currency inflows from several projects in bauxite and tourism which would be financed through foreign direct investment. In addition, there were strong expectations for inflation to decline to single digit during the year. Consequently, investor confidence was boosted, evidenced by the conversion of US dollars for investment in Jamaica Dollar instruments.

The resulting excess supply of foreign exchange during the quarter influenced a US$255.2 million accumulation in the NIR. For the first six months of the year relative stability was reflected in a 0.3 per cent depreciation compared to the 1.0 per cent recorded for the first half of 2004.

In contrast, the second half of the year was characterized by increased demand pressures, with the exchange rate depreciating by 4.4 per cent, relative to 0.7 per cent for the comparable period in 2004. This largely reflected the response of market participants to:

- inflationary impulses associated with adverse weather conditions and rising world oil prices, and
- a steady narrowing of the interest differential between domestic and foreign assets.

In a context where the demand-supply imbalances persisted during July to December, the Bank sold US$689.8 million. This influenced total intervention of US$741.2 million for 2005 compared to US$279.6 million for 2004.

At the beginning of the September quarter, concerns about the higher than programmed inflation emerged following the passage of the hurricanes. In this context, real interest rates became increasingly negative as the 12-month point-to-point inflation rate ranged from 16.7 per cent to 19.0 per cent during the quarter while the BOJ 365-day rate held at 13.60 per cent. Concerns regarding the real rates of return on domestic assets culminated in increased demand for foreign currency instruments. In particular, there was heightened demand for US dollars in September to facilitate incremental investments in the GOJ 9.90 per cent Fixed Rate Local US dollar Bond 2010. The Jamaica Dollar depreciated by 1.7 per cent to end the quarter at US$1.00 = J$62.89.

During the December quarter, concerns regarding the relative return on Jamaica Dollar investments intensified. This stemmed from expectations that the interest differential could shrink below levels anticipated earlier, as domestic interest rates remained virtually unchanged since May 2005, while rates on US dollar denominated instruments increased in tandem with the cycle of monetary policy tightening in the US economy. In addition, following the passage of Hurricane Wilma, it became increasingly apparent that the authorities would be challenged to achieve the macroeconomic targets. Against this background, the strong demand for US dollar denominated assets observed in the previous quarter persisted in the December quarter and coincided with the GOJ's issue of a Eurobond and a US dollar denominated bond on the domestic market. In that regard, the foreign currency position of authorized foreign exchange dealers increased significantly. The exchange rate depreciated by 2.6 per cent during the December quarter compared to an appreciation of 0.4 per cent for the corresponding period in 2004.

Foreign exchange purchases and sales reported by authorized dealers and cambios increased significantly by 21.7 per cent and 20.9 per cent, respectively, in 2005 (see **Table 58**). Excluding intervention, daily purchase and sale volumes during 2005 averaged US$36.1 million and US$36.2 million, respectively, compared to US$31.0 million and US$31.3 million reported for 2004. The higher purchases reflected increased inter-dealer activity and to a lesser extent the higher flows from earners. The supply to the market from earners averaged US$21.5 million daily, relative to US$19.8 million in 2004. At the same time, foreign currency demand, reflected in sales to end-users was higher during the year, averaging US$21.6 million daily, relative to US$20.6 million in 2004 (see **Table 59**).

Notably, the higher incremental supply, relative to demand, influenced lower trading spreads of 0.45 per cent, relative to 0.47 per cent in 2004.

Authorized dealers increased their market share by 2.3 percentage points during 2005, accounting for 68.3 per cent of the total foreign exchange market activity, with cambios accounting for 31.7 per cent.

Table 58

Purchases and Sales of Foreign Exchange (US$MN)

Quarter	Purchases		Sales	
	2004	2005	2004	2005
March	2 009.4	2 177.4	2 059.7	2 156.9
June	2 061.1	2 328.2	2 074.6	2 453.4
September	1 905.8	2 517.5	1 891.1	2 500.4
December	2 056.5	2 754.0	2 070.9	2 680.6
Total	**8 032.8**	**9 777.1**	**8 096.3**	**9 791.3**

Includes BOJ intervention

TABLE 59

Daily Average Trading Volumes (US$MN)

2005						
Quarters	**from net earners**	**Inter-dealer**	**Total**	**to end-users**	**Inter-dealer**	**Total**
March	22.0	13.3	35.3	21.9	13.0	34.9
June	21.2	14.8	36.0	23.2	14.7	37.9
September	20.8	14.8	35.6	20.7	14.6	35.3
December	22.1	15.6	37.7	20.5	16.0	36.5
Average per diem	21.5	14.6	36.1	21.6	10.7	31.3
2004						
Quarters	**from net earners**	**Inter-dealer**	**Total**	**to end-users**	**Inter-dealer**	**Total**
March	20.2	11.3	31.4	21.5	10.8	32.2
June	19.9	11.5	31.4	20.8	10.8	31.6
September	18.5	10.8	29.3	18.9	10.2	29.0
December	20.5	11.4	31.9	21.2	10.9	32.1
Average per diem	19.8	11.2	31.0	20.6	10.7	31.3

Data exclude BOJ intervention

8.1. Production

Growth in the Jamaican economy is estimated to have accelerated to 1.4 per cent in 2005, relative to growth of 1.0 per cent in 2004 (see **Table 60**). This represented the seventh consecutive year of economic growth, not withstanding the impact of three hurricanes in the second half of the year.

During the year, growth emanated from both the goods producing and services sectors. Notably the growth from the services sectors made a greater contribution to the overall GDP outturn (**see Table 60**).

Table 60

SECTORAL CONTRIBUTION TO GDP GROWTH (%)

Sectors	Jan –Dec 2005	Contribution (2005)
1. GOODS	1.0	23.4
AGRICULTURE FORESTRY & FISHING	-7.2	-31.8
MINING & QUARRYING	3.4	13.4
MANUFACTURING	-1.3	-12.3
CONSTRUCTION & INSTALLATION	7.3	49.0
2. SERVICES	1.4	70.6
BASIC SERVICES	1.9	23.5
Electricity & Water	4.1	11.7
Transport Storage & Communication	1.2	11.8
OTHER SERVICES	1.3	47.2
Distributive Trade (Wholesale & Retail)	1.1	17.3
Financing & Insurance Services	0.4	2.4
Real Estates & Business Services	1.9	7.0
Producers of Government Services	0.3	2.1
Miscellaneous Services	3.1	17.8
Households & Private Non-Profit Instit.	0.4	0.1
3. IMPUTED SERVICE CHARGES	-1.2	-5.6
TOTAL GDP	1.4	100

Source: STATIN & BOJ

Expansion in the goods producing sectors during the year principally reflected growth in *construction* and *mining*. *Agriculture* and *manufacturing* recorded declines. For services, *miscellaneous services, distributive trade, electricity & water* and *transport, storage & communication* were the main areas of growth.

Economic activity in *construction & installation* increased by 7.3 per cent in 2005, the sixth consecutive year of expansion. The industry, the largest contributor to GDP growth, grew consistently throughout the year, registering the strongest growth of 12.1 per cent in the March quarter. Growth emanated primarily from continued work on the North Coast Highway project, as well as hotel construction. In addition, activities emanated from other on-going road works, the inner-city housing project, as well as the post hurricane reconstruction activity. Overall growth was further enhanced by public sector capital projects, such as the expansion of the port facilities in Kingston, expansion of the JAMALCO alumina plant and renovation at Norman Manley International Airport. Growth in the sector was constrained by the decline in the construction of residential housing. Housing completions by the National Housing Trust, the major provider of residential houses in Jamaica, declined by an estimated 4.1 per cent during the review year.

Mining expanded by 3.4 per cent in the review period, marginally above the average growth of 3.3 per cent recorded from 2001 to 2004. This growth was attributed primarily to the marginal increase in alumina which was dwarfed by considerable improvements in bauxite production. For the year, crude bauxite production grew significantly by 21.4 per cent, a normalisation over 2004, which was affected by damage to the loading gantry at the Bauxite Company. In this context, capacity utilisation in the industry expanded to 90.0 per cent from 74.1 per cent in 2004. Alumina production grew marginally by 1.6 per cent in the review year, compared to 4.6 per cent the previous year. For the first three quarters of the year, alumina production increased by 5.7 per cent but declined by 9.9 per cent in the last quarter due to mechanical problems experienced by two alumina processing plants. This brought the capacity utilisation rate to 86.3 per cent compared to 95.0 per cent during the first three quarters of the year. Against this background, there was a decline in capacity utilisation to approximately 92.8 per cent in the review year from 95.7 per cent in 2004.

The manufacturing sector declined by 1.3 per cent was recorded for the manufacturing sector in the review year, against an expansion of 2.7 per cent in 2004. This moderate decline was in contrast to the average growth of 0.5 per cent recorded over the previous five years and reflects, in part, the relocation of a number of manufacturing companies out of Jamaica. The year's performance was attributed primarily to the decline in *Food, Beverages & Tobacco* and was offset by the growth in *Other Manufacturing*.

The performance of *Other Manufacturing* mainly reflected the normalisation of production in the petroleum refining industry following reduced output levels over the same period in 2004. There were also strong contributions from the non-metallic mineral and chemical producing industries. The performance of the non-metallic mineral industry reflected an 8.6 per cent increase in cement production in 2005, stemming from reduced competition from imports, as well as growth in the domestic construction sector. The production of chemical products grew by 8.2 per cent, driven primarily by an increase in the manufacture of paints.

With regard to *Food, Beverages & Tobacco*, declines in food (excluding sugar), non-alcoholic beverages and sugar production were partly offset by growth in the production of alcoholic beverages. The deterioration in food processing stemmed primarily from the reduction in canning of ackees and fruits & vegetables, which offset the expansion in poultry meat, condensed milk and flour production (see **Table 61**). The production of flour and poultry was influenced by higher export and domestic demand, respectively. Increased demand from new and existing markets, partly influenced by enhanced promotional activities, was mainly responsible for the growth in production of alcoholic beverages. This was complemented by the aggressive promotion of stout in the domestic market. The reduction in the output of sugar & molasses was attributed to the fallout in sugar cane reaped during the year. For tobacco and tobacco products, the industry's performance reflected the reduction in cigarette production. This was in a context of reduced domestic demand arising from higher prices due to the increase in the rate of the Special Consumption Tax on 15 April 2005. The decline in non-alcoholic beverage stemmed in part from a fallout in export demand. In addition, there was a greater domestic demand for bottled water as against carbonated beverages.

Table 61

SELECTED MANUFACTURING

Items	Production ('000tonnes)		
	2004	2005	% Change
Poultry Meat	96.1	10.4	7.8
Edible Oils	17.5	16.7	-4.6
Cornmeal	11.6	11.6	0.4
Condensed Milk	14.2	15.1	6..5
Flour	128.8	135.4	5.1
Animal Feeds	345.9	367.6	6.3
Sugar	181.0	126.1	-30.3

Source: Planning Institute of Jamaica

The value added of *Agriculture* contracted by 7.2 per cent in 2005, following a decline of 8.7 per cent recorded the previous year. This contraction stemmed from declines in both the *Domestic* and *Export Agriculture* sub-sectors. Agriculture continued to be affected by unfavourable weather conditions, which occurred throughout the year. The sector was affected by severe drought conditions in the first quarter, which was exacerbated by bushfires in the main agricultural parish. This was followed by heavy rains in the second quarter and hurricanes in the third and forth quarters. These weather conditions significantly retarded the post-Hurricane Ivan recovery process that was anticipated for 2005.

Estimates compiled by the Ministry of Agriculture indicated that, for 2005, domestic crop production declined by 5.6 per cent (see **Table 62**). Reports from various organisations suggested that the combined damage to domestic production from the hurricanes amounted to approximately $643.0 million. 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.

Table 62

DOMESTIC CROP PRODUCTION

Crop Group	Production ('000 tonnes)		
	2004	2005	% Change
Yams	136.2	107.2	-21.2
Vegetables	138.5	145.1	4.8
Other tubers	32.4	27.6	-15.0
Fruits	35.2	34.7	-1.6
Condiments	22.7	27.1	19.5
Plantains	17.8	9.0	-49.6
Potatoes	25.1	33.0	31.1
Legumes	4.7	5.4	15.9
Cereals	1.6	1.9	20.5
Total	**414.8**	**391.7**	**-5.6**

Source: Ministry of Agriculture

Export Agriculture declined by 37.6 per cent in 2005 due to the significant contractions in the first three quarters. The growth estimated for the fourth quarter represented primarily the recovery in banana production, following the total destruction of the industry that occurred in September 2004.

Given the damage caused by Hurricane Ivan in 2004, output of banana, citrus, coffee and sugar was significantly reduced during the first three quarters of the review year (**see Table 63**). The fallout in sugar cane production arose primarily from unfavourable weather conditions throughout the planting season. This led to deterioration in the quality of the crop, which was evidenced by a rise in the tonnes cane to tonnes sugar (TC/TS) ratio to 10.97 in 2005 from 10.86 in 2004.

Table 63

EXPORT CROPS			
Crop	**2004**	**2005**	**% Change**
	Exports ('000tonnes)		
Banana	27.6	11.6	-58.2
Citrus	4.7	4.1	-11.9
Cocoa	1.0	0.7	-33.7
Coffee	1.8	1.0	-46.1
Pimento	0.4	0.5	20.3
	Production (000'tonnes)		
Sugar cane	1965.3	1445.2	-26.5

Sources: Bank of Jamaica Estimates & Sugar Corporation of Jamaica

With respect to services, all the sub-sectors grew in 2005. The *miscellaneous services* sector grew by 3.1 per cent for the year and, given its weight in GDP, was the second largest contributor to the overall economic expansion. This improvement was driven mainly by the performance in tourism (See **Balance of Payments**).

Distributive trade is estimated to have recorded moderate growth during the review period, consistent with the trend observed since 2000. One indicator of the growth in the sector was the real increase of 13.3 per cent in the stock of loans extended by commercial banks. The reconstruction process in the aftermath of the hurricanes also fuelled much of the activity in the sector.

For *Electricity & Water*, output grew at a robust 4.1 per cent in the review year, reflecting mainly the considerable increase in the second half. The performance of the sector in the latter half was attributed to the normalisation in electricity generation, relative to the depressed levels in the comparable period of 2004, due to Hurricane Ivan. For the review year, total electricity generation increased by 4.4 per cent, while sales increased marginally by 1.3 per cent. Augmenting the growth in *Electricity* was an increase of 4.9 per cent in water production in 2005.

Transport, Storage & Communication is estimated to have recorded growth of 1.2 per cent in 2005, relative to the average growth of 4.5 per cent noted over the previous five years. With the exception of the June 2005 quarter, the sector recorded moderate increases in all quarters. For the review year, although growth emanated from all sub-sectors, much of the development was fuelled by the expansion of the *Communication* sub-sector, in particular mobile telephone networks. In this context, the total number of telephone lines in service (mobile and 'plain old telephones') was estimated to have grown by approximately 6.0 per cent during the year, relative to an estimated growth of 17.0 per cent in 2004. For the *Transport* sub-sector, growth was driven, in part, by a 4.6 per cent increase in visitor arrivals in 2005. Additionally,

cargo movements through the main seaports, as well as the number of ships calling at Jamaican ports are estimated to have grown by approximately 6.3 per cent and 1.0 per cent, respectively.

The marginal growth of 0.4 per cent in the real value- added of *Financing & Insurance* services during the year primarily reflected the performance of *Banking Institutions*, in particular, commercial and merchant banks. (See **Supervision of Deposit-Taking Institutions**.)

8.2. Prices

8.2.1. Overview

Inflation moderated to 12.9 per cent in 2005 from 13.7 per cent in 2004. The outturn for the review year was influenced by a sequence of extraordinary exogenous factors. These included bush fires and severe drought conditions early in the year followed by excessive rainfall associated with the passage of three hurricanes that had adverse effects on agricultural supplies. There were also significant adjustments in administered prices such as the minimum wage and bus fares. In addition, international oil prices rose to unprecedented levels with an adverse impact on prices. Against this background, the Central Bank adopted a conservative stance in the second half of the year. Consequently, core inflation remained stable at 5.2 per cent in 2005.

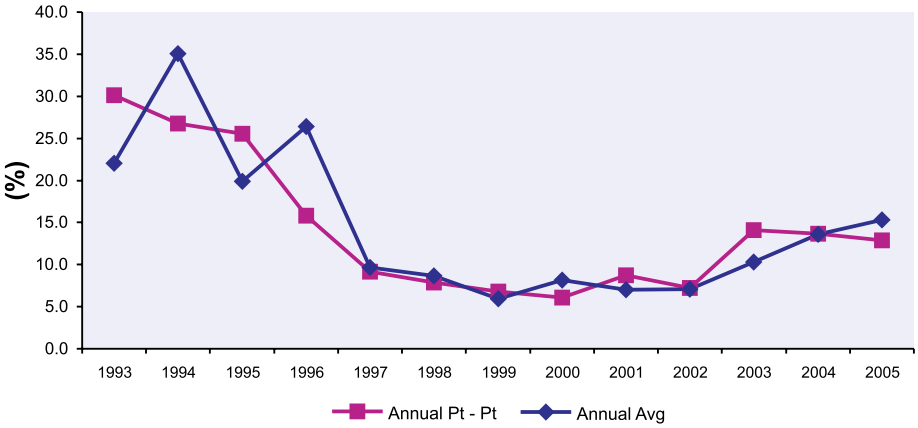
Domestic Shocks

Supply Shocks

The cattle industry experienced significant decline from 1992 to 2004[30]. Beef production fell by 41.6 per cent to 10.75 million kilograms in 2004 from 18.4 million kilograms in 1992. This development was brought into sharper focus in 2005 as beef prices rose by nearly 50.0 per cent on average over the year on the strength of the disjuncture between rising demand, particularly from the tourism sector, and waning supply. Largely as a result of this development, the *Meat, Poultry & Fish* sub-group accounted for approximately one-quarter of the year's inflation.

Agricultural production was affected by a particularly active hurricane season that had an adverse impact on the Island. The most significant impact arose from Hurricane Wilma, which meandered in close proximity to the Island for an extended period causing extensive and heavy rainfall. Vegetables and fruits were particularly affected with output levels of major crops such as tomato, pumpkin, cabbage and lettuce declining significantly, relative to 2004. Not surprisingly, the price index for the *Vegetables and Fruits* sub-

Chart 21: Jamaica's Headline Inflation Rate



30 See "The Current State of the Jamaican Cattle Sector" by Jabico Investments in association with P.G. Jennings, Ph. D., Jamaica Dairy Development Board. Available on the Jamaica Livestock Association website.

group increased by 18.4 per cent in 2005 and contributed 9.1 per cent to overall inflation.

8.2.2. Administered Prices

In 2005, new taxation measures, adjustments to the minimum wage and increases in bus and taxi fares were instituted. Early in the year, the national minimum wage was increased by 20.0 per cent. The revenue-enhancement measures which had the most significant impact on prices were related to the increase in General Consumption Tax (GCT), the removal of zero-rated GCT status from a number of items, higher property taxes and an upward adjustment in Special Consumption Tax (SCT). Increases in operationing costs, which were influenced by movements in international oil prices, insurance rates and maintenance costs, necessitated an increase in the cost of public transportation. An approximate 33.6 per cent increase was implemented with bus fares in the KMA increasing by over 50.0 per cent more than in the Other Towns and Rural Areas. The revenue-enhancement measures and the adjustments in bus fares contributed almost 20.0 per cent to the year's inflation (see **Table 64**).

External Shocks

The impact of increases in the international prices of petroleum products was significant on domestic inflation in 2005. The average price of the benchmark West Texas Intermediate (WTI) crude oil rose by 36.2 per cent in 2005 to approximately US$56.47 per barrel, relative to US$41.45 per barrel in 2004. This followed the sharp increase of 34.8 per cent in 2004. Crude oil prices rose to as high as US$69.82 per barrel in 2005, relative to a high of US$55.20 in 2004. 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.

Table 64

Stylized Decomposition of Inflation Outturn: Calendar Year 2005

	Inflation (%)	Contribution (%)
Non- Core	**7.7**	**59.6**
Administered Prices	*2.7*	*21.1*
Bus Fares	1.3	9.9
Minimum Wage	0.1	1.1
GCT/SCT	1.3	10.0
International Commodities	*0.4*	*3.2*
Household Fuel/Petrol	0.4	3.2
Agricultural Commodities	*4.1*	*31.7*
Meat, Poultry & Fish	3.0	23.2
Vegetables & Fruits	1.1	8.5
Other	*0.5*	*3.7*
Core	**5.2**	**40.4**
TOTAL	**12.9**	**100.0**

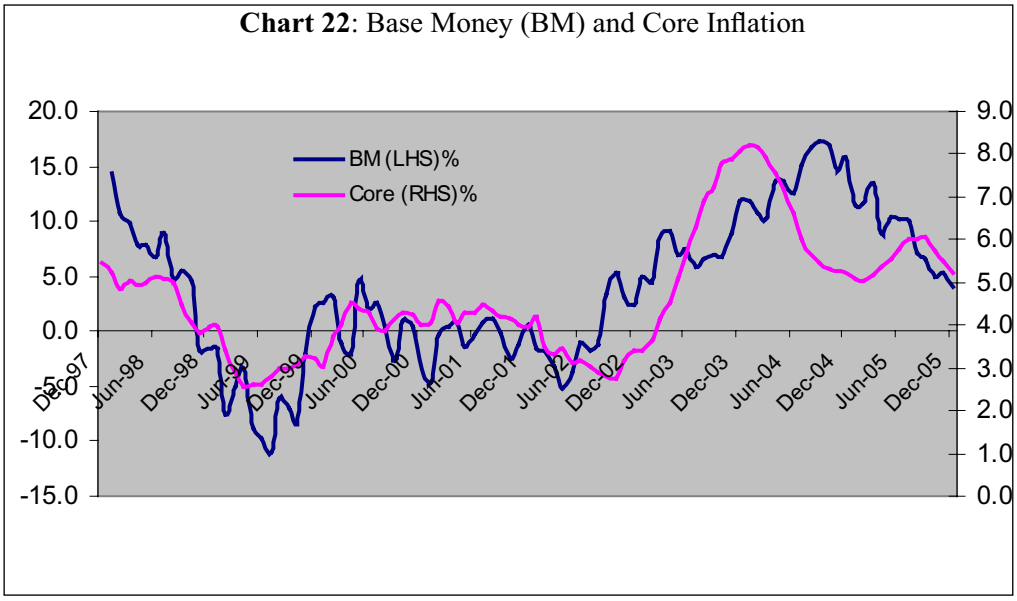
8.2.3. Core Inflation

Core inflation[31] was contained at 5.2 per cent in 2005, similar to the rate attained in 2004. This stability was achieved in a context of the relatively tight management of base money, in line with the programmed target (see **Chart 22**). The monetary base declined by an average of 3.5 per cent over the first three quarters of the year and as a result, after peaking in July, core inflation fell steadily towards the end of the year. The core inflation measure in June and July was skewed upwards against the backdrop of the pervasive impact of tax measures that filtered into the computation of underlying price changes.

8.2.4. Contribution to Inflation

The rise in the Consumer Price Index (CPI) in 2005 was largely reflected in increases in the *Food & Drink*, *Transportation* and *Housing & Other Housing Expenses* sub-indices. These sub-indices expanded by 12.3 per cent, 27.2 per cent, and 15.3 per cent, relative to increases of 16.2

31 measured by the change in the trimmed mean index



per cent, 3.9 per cent and 17.2 per cent, respectively in the previous year (see **Table 65**). Within the *Food & Drink* group, the main impetus to price increases came from the *Meat, Poultry & Fish*, *Vegetables & Fruits,* and *Baked Products, Cereals & Breakfast Drinks* sub-groups. The *Meat, Poultry & Fish* sub-group increased 20.3 per cent and contributed 25.1 per cent of the year's inflation. The sub-group was affected by adverse developments in the cattle sector as noted earlier, in addition to the impact of higher energy prices for processing and storage. The *Vegetables & Fruits* sub-group increased by 18.4 per cent and contributed 9.1 per cent of the overall inflation outturn. *Baked Products, Cereals & Breakfast Drinks* was principally affected by increases in the cost of wheat and, consequently, flour that fed into higher bread and baked products prices.

For the *Housing & Other Housing Expenses* group, the main sub-group that contributed to inflation was *Other Housing Expenses*, which increased by 15.6 per cent. The primary contributor to this sub-group was electricity rates consequent on the sharp movements in international oil prices that transpired over the year. The increase in the minimum wage also added upward impetus to the group.

The *Transportation* group largely reflected the impact of the administrative adjustment to bus and taxi fares that occurred in September. Strong increases in petrol prices as a result of the sharp movements in international oil prices were also significant in 2005.

Table 65

JAMAICA: COMPONENT CONTRIBUTION TO INFLATION; 2005				
	Group Weights	*Inflation (%) 2005*	*Weighted Inflation*	*% Contribution to Inflation*
FOOD & DRINK	**55.6**	**12.3**	**7.59**	**58.1**
- Meals Away From Home	7.4	11.0	0.82	6.3
- Meat Poultry & Fish	16.1	20.3	3.27	25.1
- Dairy Products Oils & Fats	6.7	11.8	0.79	6.0
- Baked Products Cereals & Breakfast Drinks	8.6	10.6	0.92	7.0
- Starchy Foods	5.3	0.6	0.03	0.2
- Vegetables & Fruits	6.5	18.4	1.19	9.1
- Other Food & Beverages	5.0	11.4	0.57	4.4
FUELS & OTHER HOUSEHOLD SUPPLIES	**7.4**	**12.6**	**0.55**	**4.2**
- Household Supplies	4.8	-0.1	0.00	0.0
- Fuels	2.5	21.8	0.55	4.2
HOUSING & OTHER HOUSING EXPENSES	**7.9**	**15.3**	**1.19**	**9.1**
- Rental	2.1	14.0	0.29	2.2
- Other Housing Expenses	5.8	15.6	0.90	6.9
HOUSEHOLD FURNISHINGS & FURNITURE	**2.8**	**9.7**	**0.25**	**1.9**
- Furniture	0.7	15.3	0.10	0.8
- Furnishings	2.2	6.9	0.15	1.1
HEALTHCARE & PERSONAL EXPENSES	**7.0**	**7.6**	**0.53**	**4.1**
PERSONAL CLOTHING FOOTWEAR & ACCESSORY	**5.1**	**6.5**	**0.33**	**2.5**
- Clothing Materials	0.6	2.9	0.02	0.1
- Ready-made Clothing & Accessories	2.4	5.5	0.13	1.0
- Footwear	1.6	8.8	0.14	1.1
- Making & Repairs	0.5	5.6	0.03	0.2
TRANSPORTATION	**6.4**	**27.2**	**1.75**	**13.4**
MISCELLANEOUS EXPENSES	**7.9**	**11.0**	**0.87**	**6.6**
ALL GROUPS	**100.0**	**12.9**	**13.1**	**100.0**

Source: STATIN & BOJ's Calculations

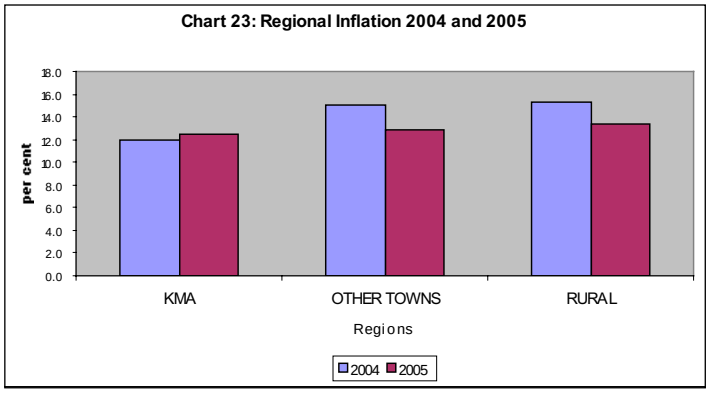
8.2.5. Regional Inflation

Inflation was higher in the Rural Areas compared with the Other Towns and Kingston Metropolitan Area (KMA). This was similar to the outturn in 2004 where inflation was highest in the Rural Areas and lowest in the KMA. During 2005, the index for the Rural Areas increased by 13.4 per cent, while the indices for the Other Towns and the KMA increased by 12.9 per cent and 12.5 per cent, respectively. This difference was largely reflective of disproportionate increases in the *Food & Drink* and the *Household Furnishings & Furniture* sub-indices. Within *Food & Drink*, the main areas of deviation were reflected in the *Vegetables & Fruits, Meat Poultry & Fish,* and the *Dairy Products, Oils & Fats* sub-groups. In *Vegetables & Fruits*, there were significantly sharper movements outside of the KMA. For the *Household Furnishings & Furniture* sub-index, stronger expansions in the *Furnishings* sub-group in the Rural Areas underpinned the deviation (see **Table 66**).

Table 66

REGIONAL INFLATION

Groups / Sub-groups	Weight in CPI	KMA (%)	Other Towns (%)	Rural (%)
FOOD & DRINK	0.5563	11.3	12.7	13.1
- Meals Away From Home	0.0741	11.0	12.5	9.8
- Meat Poultry & Fish	0.1613	16.9	22.3	23.0
- Dairy Products Oils & Fats	0.0668	10.5	12.0	13.2
- Baked Products Cereals & Breakfast Drink	0.0864	9.3	11.7	11.5
- Starchy Foods	0.0525	8.9	-8.9	0.1
- Vegetables & Fruits	0.0650	7.5	23.9	28.2
- Other Food & Beverages	0.0502	10.4	12.1	12.1
FUELS & OTHER HOUSEHOLD SUPPLIES	0.0735	3.3	22.8	20.7
- Household Supplies	0.0482	-11.2	14.9	9.1
- Fuels	0.0253	14.4	27.8	28.8
HOUSING & OTHER HOUSING EXPENSES	0.0786	16.5	13.4	13.7
- Rental	0.0209	17.1	2.2	2.2
- Other Housing Expenses	0.0577	16.2	14.7	15.0
HOUSEHOLD FURNISHINGS & FURNITURE	0.0283	7.2	10.6	11.5
- Furniture	0.0068	15.4	15.1	15.4
- Furnishings	0.0215	3.5	8.5	9.6
HEALTHCARE & PERSONAL EXPENSES	0.0697	6.4	10.4	7.8
PERSONAL CLOTHING FOOTWEAR & ACC.	0.0507	4.1	7.0	8.6
- Clothing Materials	0.0055	1.7	7.5	2.7
- Readymade Clothing & Accessories	0.0242	5.5	5.5	5.5
- Footwear	0.0159	4.0	8.8	13.8
- Making & Repairs	0.0051	1.8	7.4	9.9
TRANSPORTATION	0.0644	35.2	16.7	19.6
MISCELLANEOUS EXPENSES	0.0785	11.2	9.6	12.0
ALL GROUPS	1.0000	**12.5**	**12.9**	**13.4**



9. Economic Outlook

The prospects for accelerated domestic economic expansion in 2006 are encouraging in light of the buoyancy observed in the key sectors in the second half of 2005. In addition, the commencement of projects in mining and tourism is expected to boost economic activity. The performance in 2006 is expected to be supported by strong private capital inflows, continued expansion in loans from the financial sector and stable macroeconomic conditions. Continued strong growth in the international economy augurs well for expansion in export-related industries.

A resurgence of business confidence and improved consumer sentiment should serve to reinforce the positive environment. However, the Bank is cognizant of risks associated with international oil prices and adverse weather conditions. In addition, uncertainties related to the political landscape could influence market behaviour. The Bank will, however, remain committed to an economic programme geared towards single digit inflation and stable financial markets.

International Economy

The IMF's World Economic Outlook projects that world output will grow by 4.5 per cent in 2006, the same rate as in 2005. It is anticipated that the advanced economies will expand by 2.8 per cent, while the developing economies will grow by 6.4 per cent.

Despite possible increased inflationary pressures from likely rises in oil prices, world inflation for 2006 is expected to remain stable at 2.3 per cent. This is against the background of excess capacity in a context of moderated growth, the presence of slack in the labour market and monetary policy tightening, particularly in the United States.

In the area of international trade negotiations, there is 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 Doha Development Agenda. There also appears to be deeper recognition by both developed and developing countries of the need to protect sensitive and special products[32]. However, for Jamaica and the other ACP countries, the economic outlook is clouded by the impending impact of decisions related to their once-protected markets in the EU.

9.1. Real Sector

Expansion in world output and local economic initiatives will provide stimuli for accelerated economic activity in Jamaica during 2006, as the economy is expected to regain some of the momentum that existed prior to the adverse weather-related shocks in 2004. In this regard, the positive macroeconomic developments that emerged during the second half of 2005 should continue into 2006. Significant investments in public infrastructure, as well as in mining and tourism and improving credit conditions will be the major factors underlying the growth impetus. This outlook is also supported by continued confidence in the economy by both local and external investors.

32 There is no agreed list for these products. 'Sensitive' relates to commodities produced by developed countries; 'special' relates to products from developing countries, for example, agricultural produce. Jamaica would like to get banana and sugar on the sensitive list.

Both the goods producing and services sectors are expected to grow, with the former being stronger, reflecting robust expansion in agriculture and construction. Growth in agriculture is predicated on further recovery from the effects of adverse weather conditions that affected the sector in 2004 and 2005. Accordingly, the local economy is projected to grow within the range of 2.5 per cent to 3.5 per cent. However, the pace of economic growth will depend on the maintenance of a stable domestic macroeconomic environment.

9.2. Inflation

The moderation in the general price level that emerged in the final quarter of 2005, following extensive weather-related and other shocks earlier in that year, is expected to continue into 2006. This should result from the continued normalization in the prices of most agricultural produce, consequent on increased supplies. On the other hand, countervailing influences, including those related to rising international oil prices and administrative adjustments could partly offset the impact of reductions in agriculture-related prices. Against this background, it is anticipated that headline inflation could return to single digit in calendar 2006. Core inflation is also expected to return to its long run average of 4 per cent.

9.3. Monetary Policy

The Bank expects to maintain a conservative monetary policy stance consistent with a view to a return to single digit inflation. Further, substantial net international reserves, expected strong increases in tourism flows, and the anticipated deceleration in the general price level should improve the attractiveness of local currency-denominated assets, thereby contributing to financial market stability. The Bank will also continue to strengthen its supervisory and regulatory framework in order to enhance the efficiency and soundness of the financial system.

10. Banking and Currency Operations

10.1. Banking Services

During 2005, the Bank of Jamaica continued to provide a wide range of banking services and support to the principal payment and settlement systems in Jamaica, the two major ones being the Automated Clearing House (ACH) and Customer Inquiry Funds Transfer System (CIFTS)[33]. With regard to the ACH, the Bank functions in the following capacities:

- Settlement Bank – facilitating the settlement of clearing balances on the accounts of commercial banks in the BOJ;
- Participant – negotiating instruments drawn on commercial banks, routing them to and receiving them from the ACH Operator;
- Supervising the manual clearing exchange for items, which do not qualify for the ACH and returned items, as well as the exchange of cheques processed through the ACH and
- Providing oversight to the payment system.

The other major payment system, CIFTS, is owned and operated by the Bank of Jamaica. CIFTS is a Deferred Gross Settlement (DGS) System that allows the electronic transfer of funds between the accounts of commercial banks, primary dealers, the Jamaica Central Securities Depository (JCSD) and its broker members at the end of each day.

The Bank's main customers include the Government, licensed financial institutions, primary dealers, selected brokers and regional central banks. The services provided as fiscal agent for the Government include the settlement of all GOJ primary issues, the issue and redemption of Jamaica Treasury Bills and the settlement of external and domestic debt obligations.

The banking services department continued to facilitate settlement of accounts relating to open market operations, Government primary issues in the domestic capital market and orders for currency. The Bank also continued to maintain accounts to satisfy the cash reserve requirement for all licensed financial institutions.

In 2005 the Bank continued to provide settlement services for equities traded by selected brokers. In addition, the Bank provided vaulting services to the JCSD. This involved the safekeeping of shares and certificates and facilitating more efficient equities trading with a shorter turnaround time for settlement and delivery of certificates.

The Bank continued to hold accounts for regional central banks for settlement of regional payments through Caricom bilateral arrangements.

In addition, the Bank utilizes the Society for Worldwide Interbank Financial Telecommunications (SWIFT) as a platform for processing transactions with overseas correspondents as well as communicating with counter parties.

Limited over-the-counter services provided to the public included the exchange of withdrawn or mutilated Jamaica

33 This is the inter-bank electronic funds transfer system.

Dollar notes and coins and the conversion of foreign currency.

10.2. Payments System Developments

10.2.1. Payment System Reforms

During 2005, the Bank embarked on a comprehensive plan to modernize the payments and settlement infrastructure to bring the systems in line with international best practice in terms of the design, operation and the legal underpinnings. Legislation is being drafted towards vesting legal responsibility for oversight in the Central Bank with the necessary regulatory powers over the national payments system.

The goals of the reform are to strengthen the legal framework for the payment and settlement systems, reduce inefficiencies and minimise systemic risks. One of the major elements of the reform is the launch of a Real Time Gross Settlement (RTGS) system for the settlement of large value inter-bank payments. The RTGS system will form the core of the national payments system providing a crucial mechanism for reducing and controlling systemic risks.

As part of the reforms, the Bank has taken steps to enhance the governance arrangements for the payments system by establishing the National Payments Council (NPC) in November 2005. The NPC comprises the major stakeholders which includes financial institutions, financial regulators, the Ministry of Finance, with the Bank playing a leading and facilitating role.

The two main payment systems in operation locally are the Central Bank owned CIFTS and the ACH, which is owned and operated by the local commercial banks with the active participation and guidance of the Central Bank. Following the implementation of phase 1 which was implemented in 2002, the clearing banks are now in the process of implementing the second phase of the ACH to process direct debit and credit transactions. This should be completed in 2006.

10.2.2. Payment Transactions

a) Cheques

Total cheque payments, comprising ACH and proprietary transactions,[34] increased by 7.0 per cent to 3 752 billion in 2005. As in 2004, ACH transactions accounted for just over half of the total Jamaican Dollar cheques processed. In 2005, 10.8 million cheques valued at J$ 1 960 billion were processed through the ACH. This compares to 11.1 million items valued at J$1 808.0 billion exchanged in 2004. Proprietary transactions in 2005 were J$1 792.0 billion, a 5.4 per cent increase over 2004.

a) CIFTS

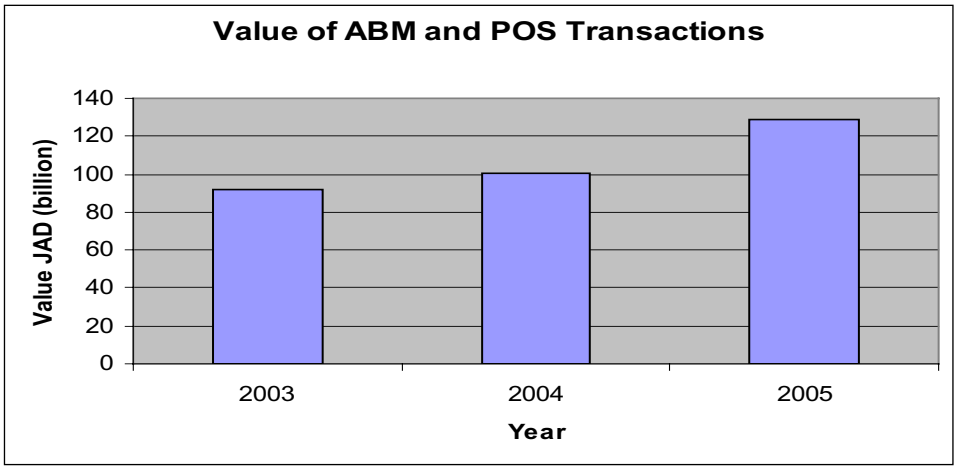
During 2005, the total value of transactions passing through CIFTS increased by 5.0 per cent to J$1 688.2 billion in 2005. This represented 24,615 transactions, similar to 2004. The combined value of Jamaican Dollar payments made by cheques and via CIFTS in 2005 was J$5 440.0 billion, approximately 6.0 per cent more than the previous year.

c) Automated Banking Machines/ Point of Sale Terminals

Non-cash transactions done through automated banking

34 Proprietary transactions are those items encashed or deposited at the bank on which they are drawn.

Table 24



machines (ABMs) and point-of- sale (POS) terminals have grown significantly in value and volume in recent years, reflecting the increasing acceptance of electronic payment media locally.

There were 13.1 million ABM/POS transactions across the Multilink network in 2005, an 18.0 per cent increase over 2004. By value, ABM and POS transactions increased by 28.0 per cent to J$ 128.0 billion in 2005 (see **Chart 24**).

A total of 29 ABMs and 1 987 POS terminals were installed in 2005. This brought the total number of ABM and POS terminals to 330 and 12 020, respectively.

d) Foreign Currency Items

The Bank continued to oversee the manual exchange of foreign currency cheques drawn on local commercial banks denominated in US dollar, Canadian dollar, Great Britain Pounds and Euro. These are cleared locally and are settled bilaterally on a net basis by wire transfers to/ from correspondent bank accounts held by the clearing banks in the respective currencies. Foreign currency items equivalent to approximately US$2.9 billion were cleared locally in 2005 (see **Table 67**) representing an increase of approximately 15.0 per cent over 2004. US dollar items continued to dominate, accounting, by value, for more than 95.0 per cent of the items cleared.

Table 67

FOREIGN CURRENCY ITEMS CLEARED (VALUE)		
Currency Units in Millions	2004	2005
USD	2 400.00	2 770.00
CDN	18.37	20.79
GBP	57.70	53.13
Euro	1.06	5.46

10.3. Currency Operations

In 2005, the Bank continued to discharge its statutory obligation to issue and redeem notes and coins within the framework of its clean note policy while maintaining integrity of the Jamaica bank notes. In achieving the latter objective, the Bank enhanced the security features of the bank notes and issued upgraded versions of all four denominations in August. Two elements of the security features were enhanced, namely paper and print features.

10.3.1. Upgraded Paper Features

The strategy was to make the security paper unique for each denomination to deter counterfeit activity. The main public security feature in a banknote is the watermark. Prior to the upgrade, the watermark for all four denominations was the Doctor Bird. This was replaced with a unique watermark for each note. In keeping with current international practice, the portrait on each denomination, as of 2005, also appears as its watermark.

To further enhance the security of the banknote, a unique ***electrotype*** was added to each denomination. This security feature appears in the bright, clear area close to the watermark in each note. It shows the denomination and a unique design for each note. The images for the denominations are:

$ 1000 - Butterfly;
$ 500 - Crocodile;
$ 100 - Flower and
$ 50 – Parrot.

Another paper security feature applies to the higher denominations only, that is, the $1000 and the $500. These denominations have been fitted with a broader, brighter security thread with printed text " BOJ $1000" and "BOJ $500," respectively.

10.3.2. Upgraded Print Features

The upgraded $1000 note now has an anti-copy feature, which is designed to distort scanned reproductions of this note. This feature was on the original design of the $500 and has been retained on that note.

Prior to the release of the upgraded notes, the Bank conducted a public relations campaign. This included nine seminars to train large-volume cash handlers in identifying counterfeits and authenticating the banknotes. The pre-upgraded bank notes remain in circulation but are projected to be phased out by mid-2007.

10.3.4. Counterfeits

In 2005, counterfeit banknotes valued at $2.05 million were detected throughout the banking system, compared to $3.8 million in 2004. The value of counterfeit bank notes as a percentage of notes redeemed was negligible. The commercial banking network detected 65.6 per cent of the counterfeit bank notes; the remaining 34.4 per cent was detected by the Central Bank through its note sorting activities.

10.3.5. Currency in Circulation

At end-December 2005 the total value of notes and coins in circulation was $36.1 billion. This figure represented a 10.0 per cent increase over the comparative figure for December 2004. Banknotes were valued at $34.4 billion or 95.3 per cent of total currency in circulation (see **Table 68**). The $1000 bank note accounted for 69.8 per cent of total notes in circulation, while the $500 accounted for 21.3 per cent.

Table 68

COMPARATIVE BANKNOTES IN CIRCULATION			
(In Billions of Dollars)			
As at end December 2005			
Denomination	**2004**	**2005**	**Percentage Change**
$1000	21.34	23.99	12.4
$500	6.96	7.34	5.5
$100	2.30	2.36	2.6
$50	0.45	0.49	8.9
Others[1]	0.21	0.21	-
Total	**31.26**	**34.39**	**10.0**

The value of coins in circulation at the end of December 2005 was $1.7 billion or 4.9 per cent of the total circulation value. This represents a 10.5 per cent increase, relative to 2004. The $20 and $10 denominations accounted for 53.0 per cent and 29.0 per cent, respectively, of the total value of coins in circulation.

10.3.6. Currency Issued

During 2005, the Bank issued 238.8 million bank notes valued at $110.5 billion. This was 11.4 per cent above the comparative figure for 2004. The $1000 and $500 notes accounted for 61.7 per cent and 29.9 per cent, respectively, of total value of notes issued. For the review year, the total value of new notes issued was $52.2 billion.

The value of coins issued in 2005 was $454.1 million, representing an 8.0 per cent increase over 2004. The $20 denomination registered the strongest growth – 11.0 per cent, the $10 denomination grew by 9.0 per cent while the $1 denomination grew by 5.0 per cent. All other denominations recorded declines.

Chart 25

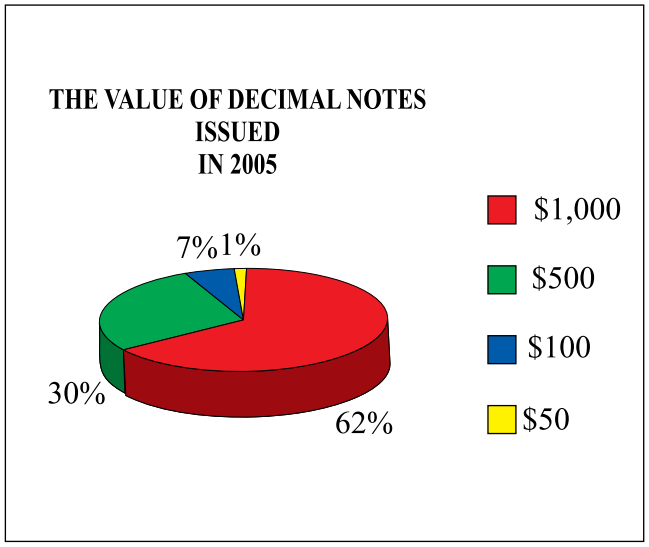
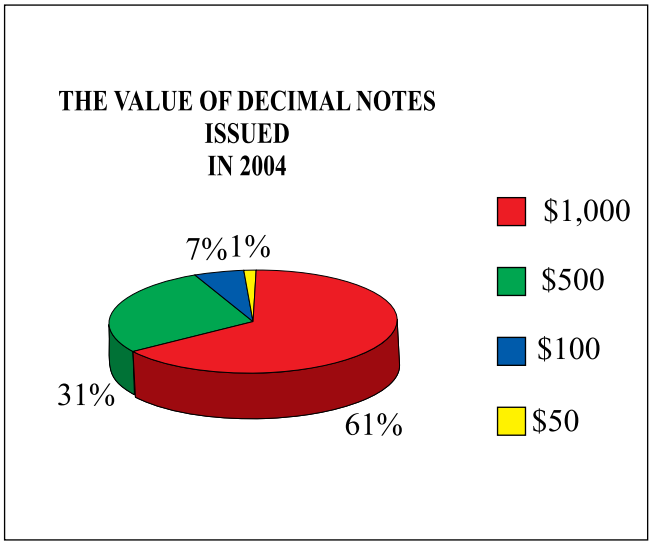


Chart 26



10.3.7. Banknotes Redeemed and Sorted

During 2005, the Bank redeemed 234 million banknotes valued at $107.4 billion. This quantity was an increase of 11.5 per cent over 2004. For 2004, a total of 215.5 million banknotes, valued at approximately $108.10 billion were sorted. Of the total banknotes sorted, 93.7 million or 43.0 per cent, valued at $57.83 billion, were deemed fit for reissue to the public while the remaining notes were destroyed. Of the notes destroyed, 55.0 per cent were $100 and $50 notes which was not unusual, as these lower denominations had a more rapid turnover than the $1000 and $500 notes.

Chart 27

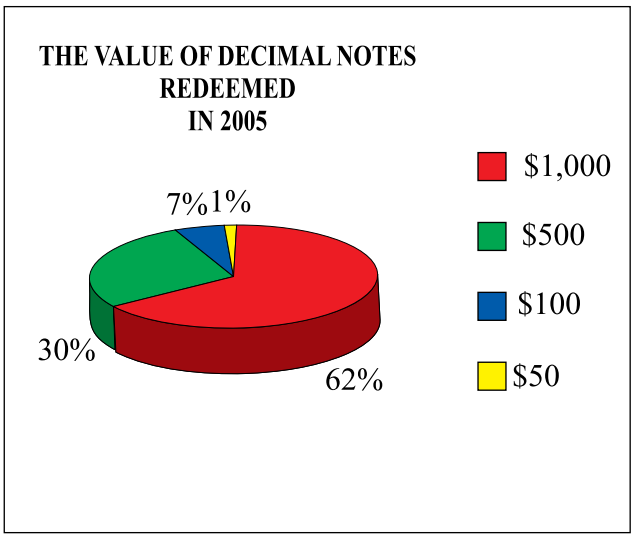
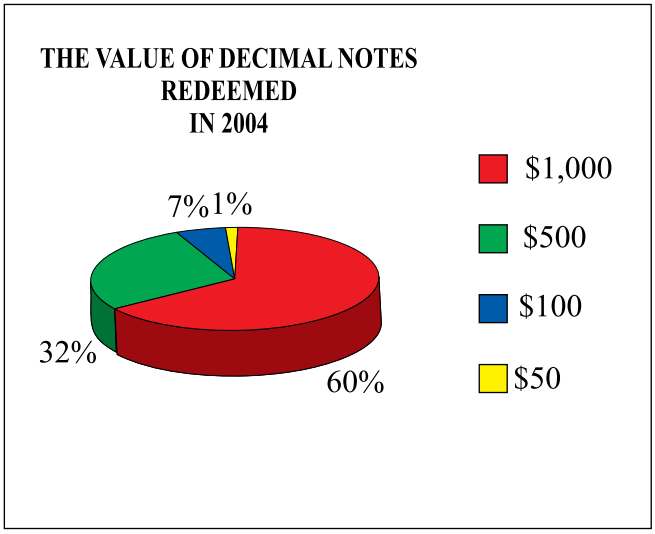


Chart 28



11. Financial Legislations

11.1. The Banking (Licences Form of Application and Fees) Regulations, 1973 (Validation and Indemnity) Act, 2004 was passed by both Houses of Parliament in December, 2004 and came into effect on 17 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, notwithstanding the repeal of those Regulations in 1992.

11.1.2. Amendments to **The Bank of Jamaica Act 1960**, which were passed in both houses of Parliament in December 2004, came into effect on 10 March 2005. Accordingly, this Act now contains provisions that enhance the information sharing powers of the Bank of Jamaica ("the Bank") and increased penalties for breaches of the Bank's confidentiality obligations in relation to information regarding the affairs of supervised entities and their customers.

11.1.3. On 13 February 2004, **The Bank of Jamaica (Amendment) Act**, 2004 was passed, giving the Bank regulatory powers in respect of the operations of Money Transfer and Remittance Agents and Agencies. On 5 July 2005, the regulatory regime came into effect. It requires companies seeking to engage in the money transfer and remittance business to obtain prior approval from the Bank of Jamaica in exercise of powers delegated by the Minister of Finance. The regime is enforced via Operational Directions issued to remittance companies by Bank of Jamaica.

11.2. Pending Amendments To Financial Legislation

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, it will seek to bring credit unions under the regulatory ambit of the Minister of Finance and the Bank of Jamaica.

11.3. Pending Financial Regulations

11.3.1. The Banking (Form of Application) Regulations and The Financial Institutions (Form of Application) Regulations

These regulations will comprise the prescribed application form under the respective Acts. The earlier format of licence fees regulations under the Banking Act and the Financial Institutions Act that dealt with both licences fees and the prescribed form of application was not retained. It was felt that the matter of the prescribed application form should be addressed via separate regulations so that the periodic upgrading of this form would not disrupt the licence fees aspect of the regulatory regime. These regulations will also include enhancements to the application form to capture certain basic particulars from applicants that were not captured under the old forms.

The revised form will also require the principals signing on behalf of the applicant company to certify that the information given in the form is accurate to the best of their knowledge and belief. Similar reforms to the application form under the Building Societies Act will be subsequently affected.

11.3.2. 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.

11.3.3. 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.

11.3.4. 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.

11.3.5. The Bank of Jamaica (Credit Union) Regulations

These regulations will bring the operations of credit unions fully under the BOJ's prudential supervisory regime. These regulations will therefore, among other things, cover licensing, capital, reserves, prohibited business, remedial and intervention processes and the role of credit union associations.

11.4. Non-Financial Legislative Acts

11.4.1. The Terrorism Prevention Act, 2005

The Terrorism Prevention Act came into effect on 6 June 2005. This Act, among other things, specifically imposes reporting and other operational control 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 Act is 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.

11.5. Pending Non-Financial Legislative Amendments

The Bank of Jamaica is involved in the process of formulating certain items of non-financial legislation. These include:

11.5.1. Payments and Settlement System Legislation

The Bank of Jamaica in conjunction with the Jamaica Bankers Association (JBA), is spearheading the introduction of legislation to deal with the regulation of payments and settlement system of Jamaica. This legislation will formally establish the legal framework for the oversight of the payment and settlement systems and will address matters such as:-

(ii) the finality of payments;

(iii) the effect of insolvency on payments already in the system and

(iv) upgrading of the settlement infrastructure by, inter alia, allowing for real-time gross settlement.

Passage of this Legislation will be the first step in ensuring that Jamaica's payment and settlement system operates in accordance with the Bank for International Settlements (BIS) Core Principles for Systemically Important Payment Systems. These Core Principles are the standards for payment systems used by international agencies such as the

World Bank and the International Monetary Fund (IMF), to assess the safety and soundness of payment systems generally.

11.5.2. The Electronic Transactions Act

The Ministry of Commerce, Science and Technology is spearheading the introduction of this Act as the first step to establishing an environment for the pursuit of e-commerce. Due to the impact this Act will have on financial services, particularly those that are transacted electronically, the Bank of Jamaica has taken an interest in the provisions to be included in this Act. The Bank of Jamaica met with the Jamaica Bankers Association and subsequently provided the Ministry with comments on the Bill. The Act when passed will deal with matters such as: -

- Electronic signatures;
- Formation and validity of contracts;
- Information retention requirements;
- Certification of the Service Provider;
- Liability of Intermediaries;
- Admissibility and evidential weight of information on electronic form, and
- Offences and Penalties.

11.5.3. The Proceeds of Crimes Act (POCA)

During the 2004/2005 legislative year a policy decision was taken to pursue the enhancements to the Anti-Money Laundering Framework through the passage of the Proceeds of Crimes Act. This statute will be based on the UK Proceeds of Crime Act and will be similar to the UK scheme of criminal and civil forfeiture. On its enactment the POCA will target all serious offences and in respect of convictions for such offences, will make available to prosecutors the post conviction options of forfeiture of any benefits derived from commission of a crime or forfeiture based on the presumption of "criminal lifestyle". The POCA will also seek to address all the loopholes currently hampering investigative and prosecutorial efforts to combat money laundering that exist under the current Drug Offences Forfeiture of Proceeds Act (DOFPA) and under the Money Laundering Act (MLA). On the passage of the POCA, the MLA and the Regulations thereunder and the DOFPA will be repealed. On the passage of the POCA, the reporting and other obligations that now obtain for financial institutions under the MLA and Money Laundering Regulations (MLR) will be transferred to the AML provisions under the POCA.

11.5.4. The Financial Investigations Division Act (FIDA)

The passage of this Act will satisfy Jamaica's obligation to comply with recommendation 26 of the Financial Action Task Force (FATF) 40 (revised) recommendations, which states that: -

"Countries should establish a Financial Intelligence Unit that serves as a national centre 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[35].

35 *"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. This support includes expanding and systemizing the exchange of financial intelligence information, improving expertise and capabilities of personnel of such organizations, and fostering better communication among FIUs through application of technology."* Source: Information Paper on FIUs and the Egmont Group – (See the FATF web site at WWW.fatf-gafi-org or see www1.oecd.org/fatf/ctry-orgpages/org-egmont_.htm

11.5.5. Terrorism Prevention (Reporting Entities) Regulations

These Regulations will be promulgated under the Terrorism Prevention Act and will outline the operational controls that must be maintained by financial institutions, particularly when contemplating the commencement of a business relationship or one-off transaction. As such, these regulations will therefore largely mirror the Know Your Customer (KYC) obligations contained in the regulations under the Money Laundering Act and will therefore require financial institutions to establish and maintain appropriate procedures in relation to identification, record-keeping (minimum 5 years retention period), internal controls, communication, and training of employees. These Regulations will also prescribe the requisite Declaration Forms for transactions which the reporting entity knows or suspects is one that constitutes a terrorism offence; and for the quarterly reports as to whether or not the reporting entity is holding property in respect of a person who is on the United Nations list of designated terrorists or in respect of a person who has links with terrorists or terrorist groups or organizations.

12. Administration

12.1. Overview

During 2005 the management of the Bank was confronted with significant administrative challenges. Among the major challenges experienced were:

- The maintenance of an industrial relations environment conducive to high levels of productivity in the context of a two-year wage freeze imposed under the Public Sector Memorandum of Understanding (MOU), effected April 2004 to March 2006;
- The retention and attraction of qualified and competent staff in a more competitive labour market in a context of strong global and regional demand for talented and skilled personnel; and
- The debilitating effects of an unprecedented number of weather systems that had a significant impact on members of staff and their families, as well as the Bank's plant and physical infrastructure.

Against the background of these challenges, the Bank's management instituted measures aimed at enhancing the development, safety and security of members of staff. In addition, the Bank implemented a rigorous disaster management programme and strengthened efforts to maintain a healthy work environment consistent with international health and safety standards.

12.2. Staffing

In May 2005, the Bank reorganized its senior management staffing structure following the appointment of Deputy Governor Colin Bullock as Financial Secretary in the Ministry of Finance and Planning. The restructuring allowed for further strengthening of the organization's managerial and technical capabilities, while facilitating the process of succession planning. Mrs. Audrey Anderson, Deputy Governor, Financial Institutions Supervisory Division (FISD) was appointed to the position of Senior Deputy Governor, with responsibility for supervision of deposit taking financial institutions, as well as risk management and business continuity. Other appointments were: Mrs. Myrtle Halsall and Mrs. Gayon Hosin as Acting Deputy Governors, Banking & Market Operations and Research and Economic Programming and Financial Institutions Supervisory Divisions, respectively, and Mr. Herbert Hylton as Financial Controller.

At December 2005, the Bank's staff complement totalled four hundred and ninety (490) employees, an increase of 1.2 per cent. The number of establishment positions remained at five hundred and thirty-nine (539).

During the year, the Bank sought to enhance the efficiency of the recruitment and selection process with increased utilization of on-line applications for recruitment purposes. The Bank received one thousand five hundred and sixty-six (1,566) job applications, an increase of 2.0 per cent above applications for employment in 2004. The attrition rate for the year was 5.9 per cent, influenced primarily by migration. However, this rate represents a decline of 0.3 percentage point, relative to 2004.

The industrial relations environment within the organization remained fairly stable during the year. Efforts by the Bank's management, in collaboration with the Bustamante Insustrial

Trade Union representing unionized staff, were effective in ensuring industrial relations stability. In addition, the management of the Bank sought, where possible, to ensure that members of staff adversely affected by the salary freeze occasioned by the implementation of the MOU, were provided some measure of assistance primarily through the Bank's staff financed welfare assistance programme.

12.3. Training Development

During 2005, the Bank's Training Institute continued to provide an extensive menu of training programmes aimed at further developing and equipping members of staff and members of the local and regional financial sectors with skills, knowledge and techniques needed to raise the quality and levels of individual and organizational performance. Seminars, workshops, technical meetings and conferences constituted the majority of training programmes conducted by the Training Institute. A total of three hundred and seventy (370) members of staff attended training programmes. Of this number, three hundred and twenty-six (326) participated in local programmes while forty-four (44) attended overseas technical programmes.

One of the Institute's major initiatives in 2005 was the hosting of in-country training programmes which provided training for employees and external participants from local and regional financial institutions. These programmes provided a forum for presenters and participants to share experiences and ideas on standards and international best practices used by central bankers and other business practitioners. Over the years, in-country programmes have proven to be a cost effective method of facilitating staff training, exposure and development. In addition, by extending these programmes to the wider local and regional financial community, the Bank achieved significant cost recovery. The in-country programmes conducted by the Institute in 2005 included a Procurement Workshop and a seminar on International Best Practice in Financial Journalism.

The Institute hosted several technical programmes of interest to regional central banks. These programmes, executed in collaboration with the Association of Supervisors of Banks of the Americas (ASBA), Office of the Comptroller of the Currency (OCC), the Caribbean Financial Action Task Force (CFATF) and the Caribbean Group of Bank Supervisors (CGBS) served to deepen the process of institutional strengthening and international cooperation. Courses and workshops were conducted by the Financial Stability Institute of the Bank for International Settlements (Switzerland), the Basel Committee on Bank Supervision, the Board of Governors of the Federal Reserve System (USA), the Federal Deposit Insurance Corporation (USA), the International Accounting Standards Board (UK) and PriceWaterhouseCoopers (USA). Programmes conducted included a seminar on International Accounting and Auditing of Banks, and a Workshop on the 2004 IMF/ World Bank Anti Money Laundering /Combating Financial Terrorism Assessment Methodology.

In 2005, the Bank expanded the use of technology in facilitating training interventions. Members of staff utilized the internet via e-learning to participate in courses, notably in bank supervision and the management of bank risks. This method of training allowed for the realization of greater efficiencies in training delivery and administration. In particular, this facilitated savings in the area of foreign travel and increases in the number of staff trained. At the end of the year, plans were well advanced for further use of technology such as for videoconferencing.

4.4. Plant and Physical Infrastructure

The Bank's plant and physical infrastructure were adversely affected by several severe weather systems in the second half of the year. However, in all instances the Bank was able to recover with minimum disruptions to its operations. Against the background of an active 2005 hurricane season, and predictions for hurricane systems of greater intensity and frequency, the Bank reviewed and upgraded its disaster management programme with the objective of mitigating risk to staff, visitors and the plant's infrastructure. Two elements of this programme are the establishment and commissioning of the Bank's warm site and the launch of an on-going staff education programme on the importance of disaster preparedness and management.

In addition to ensuring the protection and maintenance of the Bank's plant and physical infrastructure, significant effort was devoted to the maintenance of internationally recognized occupational health and safety standards. Accordingly, the Bank maintained a vigorous programme of elevator maintenance, indoor air and water quality checks, and where necessary, instituted measures to ensure that health and safety conditions were consistent with international standards.

13. Compensation of Executive Management

	$		$
Salary Range of Executive Management	4 637 884	-	8 321 216

Allowances of Executive management

(a)	Governor	1 987 875
(b)	Deputy Governors	328 867

Notes

Senior Executive Management includes the Governor, the Senior Deputy Governor, a Deputy Governor, two (2) Acting Deputy Governors and a General Manager. 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. The Deputy Governors and General Manager are provided with fully maintained motor vehicles. Each member of the Senior Executive Management is eligible for benefits including a non-contributory pension plan, health insurance, life insurance and staff loans.

07/02/05 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 13.50 per cent, 13.65 per cent, 13.75 per cent, 13.85 per cent, 14.00 per cent, 14.50 per cent and 15.00 per cent, respectively.

07/02/05 The Bank of Jamaica reduced the Special Deposit holdings for commercial banks and FIA licensees by two (2) percentage points. Accordingly, these institutions, until further notified, are required to maintain with the Bank of Jamaica, as a Special Deposit, an amount wholly in the form of cash, representing three (3) percent of their prescribed liabilities.

07/03/05 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 12.95 per cent, 13.10 per cent, 13.20 per cent, 13.30 per cent, 13.45 per cent, 14.00 per cent and 14.50 per cent, respectively.

These rate adjustments were underpinned by continued stability in the exchange rate, reflecting buoyant foreign exchange inflows from tourism and remittances. Also, the Bank's net international reserves remained around US$1.8 billion, a level that was more than adequate to underwrite near term stability. In addition, inflation in the first quarter of 2005 was expected to continue on a downward trend engendering a return to single digit inflation in the forthcoming fiscal year.

16/05/05 The Bank of Jamaica reduced the Special Deposit holdings for commercial banks and FIA licensees by two (2) percentage points. Accordingly, these institutions, until further notified, are required to maintain with the Bank of Jamaica as a Special Deposit, an amount wholly in the form of cash, representing one (1) percent of their prescribed liabilities.

26/05/05 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 12.60 per cent, 12.70 per cent, 12.75 per cent, 12.85 per cent, 13.00 per cent, 13.25 per cent and 13.60 per cent, respectively.

The adjustments were consistent with the steady improvement in Jamaica's economic environment as reflected in buoyant foreign exchange inflows, stability in the money and foreign exchange markets and a strong international reserve position. Furthermore, the near-term prospects for production and prices continued to be very favourable with strong recovery

expected in domestic agriculture as well as ongoing expansion in tourism and mining activities. In addition, it was expected that the normalization of food supplies and continued stability in the foreign exchange market would help to contain inflation during the 2005/2006 fiscal year.

27/05/05 The Bank phased out its reverse repurchase agreements. This facilitated consistency in the accounting treatment (under International Financial Reporting Standards) of open market instruments by holders.

KPMG Peat Marwick
Chartered Accountants

P.O. Box 76
Kingston
Jamaica

The Victoria Mutual Building
6 Duke Street
Kingston
Jamaica

Telephone +1 (876) 922-6640
Telefax +1 (876) 922-7198
+1 (876) 922-4500
email:firmmail@kpmg.com.jm

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"), as at and for the year ended December 31, 2005, set out on pages *i* to *xxxi*, 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, 2005, and of its results of operations, changes in capital and reserves and cash flows for the year then ended and comply with the provisions of the Bank of Jamaica Act.

KPMG Peat Marwick

March 29, 2006

Balance Sheet

December 31, 2005

	Notes	2005 J$'000	2004 J$'000
ASSETS			
Foreign assets			
Notes and coins		5,236	7,911
Cash and cash equivalents	3	15,863,272	15,848,943
Interest in funds managed by agents		2,789,112	2,608,781
Investments	4	120,561,845	97,497,971*
International Monetary Fund - Holding of Special Drawing Rights		395	4,483
		139,219,860	115,968,089
Local assets			
Notes and coins		44,796	46,707
Investments	5	81,794,037	86,154,834*
International Monetary Fund - Quota Subscription	6	2,906,624	2,738,720
Investment property	7	87,000	87,000
Investments in financial institutions	8	3,200	3,200
Due from Government and Government Agencies	9	12,941,466	8,913,883
Property, plant and equipment	10	1,612,658	1,624,717
Employee benefits	11	1,591,400	1,549,200
Other	12	2,562,762	2,273,580
		103,543,943	103,391,841
		242,763,803	219,359,930

* - Restated (See note 29)

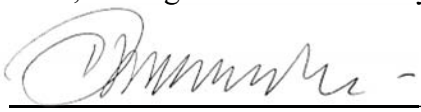
The accompanying notes form an integral part of the financial statements.

Balance Sheet (cont'd)

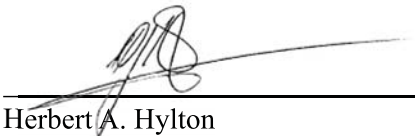
December 31, 2005

	Notes	2005 J$'000	2004 J$'000
LIABILITIES, CAPITAL AND RESERVES			
Liabilities			
Notes and coins in circulation	13	35,643,220	32,391,311
Deposits and other demand liabilities	14	40,319,676	41,996,095
Open market liabilities	15	147,206,515	125,814,825
International Monetary Fund - Allocation of Special Drawing Rights	16	3,792,666	3,573,578
Foreign liabilities	17	184,513	275,218
Employee benefits obligation	11	656,600	573,600
Other	18	11,952,415	10,540,764
		239,755,605	215,165,391
Capital and reserves			
Share capital	19	4,000	4,000
General reserve fund	20	20,000	20,000
Special stabilisation account	21	416,102	376,637
Other reserves	22	2,568,096	3,793,902*
		3,008,198	4,194,539
		242,763,803	219,359,930

The financial statements on pages 2 to 30 were approved for issue by the Board of Directors on March 29, 2006, and signed on its behalf by:



_____ Governor
Derick Milton Latibeaudiere



_____ Financial Controller
Herbert A. Hylton

_____ Senior Director, Accounting Services Department
Angela E. Foote

* - Restated (See note 29)

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

Statement of Income and Expenses

Year ended December 31, 2005

	Notes	2005 J$'000	2004 J$'000
Operating income			
Interest		18,833,573	18,686,661
Foreign exchange gain, net	23	4,230,382	1,816,313
Other		50,771	173,280
Total		23,114,726	20,676,254
Operating expenses			
Interest		23,481,006	23,059,296
Salaries and other staff costs	24	1,047,631	996,093
Currency expenses		566,002	407,978
Property expenses, including depreciation		366,853	317,318
Other operating expenses		290,819	304,078
Total	25	25,752,311	25,084,763
Operating loss		(2,637,585)	(4,408,509)
Other gains/(losses)			
Pension, medical and life insurance	11(c)	(107,800)	554,200
Impairment provision, net		(2,567)	(3,998)
Loss on remeasurement of staff loans and promissory note		(49,212)	(23,036)
Loss on revaluation of securities		(33,943)	(40,486)
Gain on disposal of property, plant and equipment		1,650	2,299
Expenditure on behalf of Government of Jamaica not reimbursed	9	(91,449)	(67,678)
Loss for the year		(2,920,906)	(3,987,208)
Transferred to pension equalisation reserve	**22(c)**	**(17,000)**	**(688,800)**
Transferred to general reserve fund		(2,937,906)	(4,676,008)

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

Statement of Changes in Capital and Reserves
Year ended December 31, 2005

	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, 2003	4,000	20,000	329,600	2,046,812	2,400,412
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
Loss due from consolidated fund	-	4,676,008	-	-	4,676,008
Balances at December 31, 2004, as previously reported	4,000	20,000	376,637	2,671,957	3,072,594
Change in accounting policy (note 29)	-	-	-	1,121,945	1,121,945
Balances at December 31, 2004, as restated	4,000	20,000	376,637	3,793,902	4,194,539
Loss for the year	-	(2,937,906)	-	-	(2,937,906)*'
Transfer of surplus on defined benefit pension scheme	-	-	-	42,200	42,200*'
Change in fair value of available-for-sale securities	-	-	-	(1,268,006)	(1,268,006)*'
Transfer from coins in circulation	-	-	39,465	-	39,465
Loss due from consolidated fund (note 9)	-	2,937,906	-	-	2,937,906
Balances at December 31, 2005	4,000	20,000	416,102	2,568,096	3,008,198

*' - Total recognised losses J$4,163,712,000 (2004: J$4,050,863,000).

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

Statement of Cash Flows

Year ended December 31, 2005

	2005 J$'000	2004 J$'000
Cash flows from operating activities:		
Loss for the year	(2,920,906)	(3,987,208)
Adjustments for:		
Depreciation	157,556	147,918
Gain on disposal of property, plant and equipment	(1,650)	(2,299)
Employee benefits, net	15,600	(589,600)
Unrealised exchange gain on International Monetary Fund - Quota subscription	(167,904)	(283,970)
Unrealised exchange loss on International Monetary Fund - Allocation of SDR's	219,088	370,534
Interest income	(18,833,573)	(18,686,661)
Interest expense	23,481,006	23,059,296
Operating profit before changes in other assets and other liabilities	1,949,217	28,010
Interest paid	(21,699,216)	(25,840,560)
Other assets	47,280	(837,254)
Other liabilities	(370,139)	209,911
Due from Government and Government Agencies	(1,651,943)	(1,909,257)
Net cash used by operating activities	(21,724,801)	(28,349,150)
Cash flows from investing activities:		
Interest received	19,042,376	20,932,316
Investment in Financial Institutions	-	10
International Monetary Fund - Holding of Special Drawing Rights	4,088	(1,285)
Interest in funds managed by agents	(180,331)	(74,947)
Foreign currency denominated investments	(23,403,532)	(37,387,451)
Local currency denominated investments	3,499,849	(6,823,055)
Additions to property, plant and equipment	(154,188)	(154,963)
Proceeds of disposal of property, plant and equipment	10,342	14,554
Net cash used by investing activities	(1,181,396)	(23,494,821)
Cash flows from financing activities:		
Notes and coins in circulation	3,291,374	3,013,748
Deposits and other demand liabilities	(1,676,419)	8,791,587
Open market liabilities	21,391,690	46,711,472
Foreign liabilities	(90,705)	(57,370)
Net cash provided by financing activities	22,915,940	58,459,437
Net increase in cash and cash equivalents	9,743	6,615,466
Cash and cash equivalents at January 1	15,903,561	9,288,095
Cash and cash equivalents at December 31	15,913,304	15,903,561
Cash and cash equivalents at December 31 comprise:		
Foreign notes and coins	5,236	7,911
Foreign currency cash resources	15,863,272	15,848,943
Local notes and coins	44,796	46,707
	15,913,304	15,903,561

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

Notes to the Financial Statements
December 31, 2005

1. Identification

Bank of Jamaica (hereafter "the Bank") was established under the Bank of Jamaica Act (hereafter "the Act"). The Act was amended 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 December 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.

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. Statement of compliance, basis of preparation and significant accounting policies

(a) Statement of compliance:

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).

(b) Basis of preparation:

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

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

The accounting policies set out below have been applied consistently to all periods presented in these financial statements and comply in all material respects to IFRS.

(c) 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 US$ rate, thus determined, using rates published by the Federal Reserve Bank and the Financial Times.

Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the foreign exchange rates prevailing at that date. Transactions in foreign currencies are translated at the foreign exchange rates ruling at the dates of those transactions.

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

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(d) 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 loans and receivables and available-for-sale securities.

Loans and receivables are securities acquired by the Bank with fixed or determinable payments and which are not quoted in an active market. An active market is one where quoted prices are readily and regularly available from an exchange, dealer, broker or other agency and those prices represent actual and regularly occurring market transactions on an arm's length basis. Loans and receivables are recognised on the day they are acquired by the Bank.

Other financial instruments held by the Bank are classified as available-for-sale. Available-for-sale instruments are recognised on the date the Bank commits to purchase the instruments.

(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 (k)].

All non-trading financial liabilities and 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 loans and receivables and are stated at cost (amortised cost), less provision for losses and impairment as appropriate.

[ii] Local currency denominated Government of Jamaica securities which do not have a quoted market price in an active market and whose fair values cannot be reliably determined, and interest-bearing deposits are stated at historical or amortised cost.

[iii] Local currency denominated Government of Jamaica securities with quoted prices in an active market are classified as available-for-sale and measured at fair value.

[iv] US Government bonds are classified as available-for-sale and are measured at fair value.

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(d) Financial instruments (cont'd):

(ii) Measurement (cont'd):

[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.

[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, except for impairment losses and, in the case of monetary items such as debt securities, foreign exchange gains and losses. When the financial assets are sold, collected or otherwise disposed of, the cumulative gain or loss recognised in equity is recognised in the statement of income and expenses.

(v) Cash and cash equivalents:

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

(vi) Other assets:

Other assets are stated at cost, less impairment losses [note 2 (k)].

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(d) Financial instruments (cont'd):

(vii) Other liabilities:

Other liabilities, including provisions, are stated at cost.

(viii) Provision:

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.

(ix) 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.

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

(e) Property, plant and equipment:

(i) Owned assets:

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

(ii) Depreciation:

Property, plant and equipment are depreciated on the straight-line basis 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 estimated useful lives are as follows:

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

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(f) 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.

(g) Taxation:

Section 46 of the Act, which exempted the Bank from income tax, stamp duties and transfer tax, was repealed on December 23, 2003. 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.

(h) Employee benefits:

Employee benefits comprise 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 vacation 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.

(i) General 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.

(ii) Defined-benefit scheme and post employment benefits:

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.

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(h) Employee benefits (cont'd):

(ii) Defined-benefit scheme and post employment benefits: (cont'd)

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.

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.

(i) 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.

(j) Investment property:

Investment property is stated at fair value determined annually by an independent registered valuer. Fair value is based on market value, being the estimated amount for which the property could be exchanged on the date of valuation between a willing buyer and a willing seller, in an arms length transaction, after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion.

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.

(k) 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 income and expenses.

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(k) Impairment (cont'd):

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that has been recognised directly in equity is recognised in the statement of income and expenses even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in the statement of income and expenses is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in the statement of income and expenses.

(i) Calculation of recoverable amount:

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

The recoverable amount of the Bank's investment in loans and receivables 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. Receivables with a short-term duration are not discounted.

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:

An impairment loss in respect of loans and receivables carried at amortised cost is reversed, if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. For all other assets, an impairment loss is reversed, if there has been change in the estimate used to determined the recoverable amount.

An impairment loss in respect of an investment in an equity instrument classified as available-for-sale is not reversed through the statement of income and expenses. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the statement of income and expenses, the impairment loss shall be reversed, with the amount of the reversal recognised in the statement of income and expenses.

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.

Notes to the Financial Statements (cont'd)
December 31, 2005

2. Statement of compliance, basis of preparation and significant accounting policies (cont'd)

(l) Related party balances and transactions:

A party is related to an entity if:

(i) directly or indirectly the party:
- controls, is controlled by, or is under common control with the entity;
- has an interest in the entity that gives it significant influence over the entity, or
- has joint control over the entity;

(ii) the party is a member of the key management personnel of the entity.
(iii) the party is a close member of the family of any individual referred to in (i) or (ii) above;
(iv) the party is a post-employment benefit plan for the benefit of employees of the entity, or any entity that is a related party of the entity.

3. Cash and cash equivalents

	2005 J$'000	2004 J$'000
Current accounts and money at call with foreign banks	15,614,567	15,589,924
Current accounts with local banks	248,705	259,019
	15,863,272	15,848,943

4. Foreign currency denominated investments

	2005 J$'000	2004 J$'000
Available-for-sale securities:		
US Government bonds	52,027,554	28,959,858
Barbados Government bond	37,494	36,993
	52,065,048	28,996,851
Short-term deposits with foreign banks	68,496,797	68,501,120
	120,561,845	97,497,971

5. Local currency denominated investments

	2005 J$'000	2004 J$'000
Loans and receivables:		
Jamaica Government Securities:		
Local registered stock	42,451,484	37,546,662
Available-for-sale securities:		
Jamaica Government Securities:		
Local registered stock	22,619,164	28,315,556
Treasury bills	85,101	225
Investment bonds	5,309,389	8,057,378
Investment debentures	11,123,941	12,235,013
Registered bond	204,958	-
	39,342,553	48,608,172
	81,794,037	86,154,834

Notes to the Financial Statements (cont'd)
December 31, 2005

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	2005 J$'000	2004 J$'000
Amount subscribed (net of reserve tranche of J$Nil):			
At beginning of year	31,125	2,738,720	2,454,750
Effect of exchange rate fluctuation	-	167,904	283,970
At end of year	31,125	2,906,624	2,738,720

7. Investment property

	2005 J$'000	2004 J$'000
Investment property	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 amount determined by the independent valuator in 2003 [note 2 (j)]. Direct operating expenses during the year were $1,137,136 (2004: $1,003,834).

8. Investments in financial institutions

Equity	financial earnings/ 2005 J$'000	2004 J$'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

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, 2005

9. Due from Government and Government Agencies

	Dec. 31, 2004 J$'000	Movements during the year: Advances/ Losses J$'000	(Settlement)/ Profit J$'000	Charged to expenses J$'000	Dec. 31, 2005 J$'000
Expenditure on behalf of Government:					
Payment of interest on foreign liabilities [see (b) below]	-	91,449	-	(91,449)	-
Other expenditure on behalf of Government	2,299	-	-	-	2,299
Withholding tax refund due	3,162,794	1,634,942	-		4,797,736
Accrued interest on Government securities	6,418,650	5,873,385	(6,418,650)	-	5,873,385
Net profit payable to/net loss due from Consolidated Fund	(669,860)	2,937,906	-	-	2,268,046
	8,913,883	10,537,682	(6,418,650)	(91,449)	12,941,466

(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, 2005 and 2004.

(b) Interest on foreign liabilities comprises 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, 2005

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
Cost or valuation:						
December 31, 2004	1,263,437	1,208	811,401	115,978	7,340	2,199,364
Additions	14,708	95	79,462	48,419	11,504	154,188
Transfers	4,666	-	2,674	-	(7,340)	-
Disposals/write-offs	-	-	(2,375)	(21,361)	-	(23,736)
December 31, 2005	1,282,811	1,303	891,162	143,036	11,504	2,329,816
At cost	48,811	1,303	891,162	143,036	11,504	1,095,816
At valuation	1,234,000	-	-	-	-	1,234,000
	1,282,811	1,303	891,162	143,036	11,504	2,329,816
Depreciation:						
December 31, 2004	63,212	841	487,961	22,633	-	574,647
Charge for the year	64,192	62	77,572	15,730	-	157,556
Eliminated on disposals	-	-	(1,915)	(13,130)	-	(15,045)
December 31, 2005	127,404	903	563,618	25,233	-	717,158
Net book values:						
December 31, 2005	1,155,407	400	327,544	117,803	11,504	1,612,658
December 31, 2004	1,200,225	367	323,440	93,345	7,340	1,624,717

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, as well as medical and life insurance schemes, for all its permanent eligible employees and funds supplemental 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	
	2005 J$'000	2004 J$'000	2005 J$'000	2004 J$'000
Present value of funded obligations	(1,638,700)	(1,449,500)	-	-
Present value of unfunded pension, medical and life insurance obligations	-	-	(1,069,600)	(761,500)
Fair value of plan assets	5,326,300	4,199,100	-	-
Unrecognised actuarial (gains)/losses	(1,127,800)	(443,100)	413,000	187,900
Unrecognised assets due to limitation	(968,400)	(757,300)	-	-
Net asset/(obligation) at December 31	1,591,400	1,549,200	(656,600)	(573,600)

Notes to the Financial Statements (cont'd)
December 31, 2005

11. Employee benefits (cont'd)

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

	Asset		Obligation	
	2005 J$'000	2004 J$'000	2005 J$'000	2004 J$'000
Net assets/(obligations) at January 1	1,549,200	837,200	(573,600)	(474,400)
Contributions	25,200	23,200	41,800	35,400
Income/(expense) recognised in the statement of income and expenses	17,000	688,800	(124,800)	(134,600)
Net assets/(obligations) at December 31	1,591,400	1,549,200	(656,600)	(573,600)

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

	Asset		Obligation	
	2005 J$'000	2004 J$'000	2005 J$'000	2004 J$'000
Current service costs	(55,600)	(38,400)	(24,700)	(19,500)
Interest on obligation	(178,700)	(161,600)	(92,600)	(91,200)
Expected return on plan assets	461,000	463,100	-	-
Net actuarial (gains)/losses recognised	1,600	10,700	(7,400)	(7,500)
Change in disallowed assets	(211,200)	451,100	-	-
Past service costs	(100)	(36,100)	(100)	(16,400)
Total included in staff costs	* 17,000	*688,800	*(124,800)	*(134,600)
Actual return on plan assets	21.47%	11.89%		

* Net ($107,800,000) [2004: $554,200,000] taken to statement of income and expenses.

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

	2005 %	2004 %
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	9.0
Future pension increases	3.0	3.0
Medical claims growth	11.0	11.0

(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$37,654,484 for the year (2004: J$31,261,099), 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, 2005

12. Other assets

	2005 J$'000	2004 J$'000
Items in process of collection	14,872	2,610
Overdrafts	7,833	7,766
Staff and ex-staff loans, including interest receivable (note 26)	983,414	822,621
Stock of unissued notes and coins	1,114,285	1,343,623
Accrued interest receivable other than on GOJ securities	698,078	361,616
Promissory notes	81,339	95,971
Other	97,601	22,252
	2,997,422	2,656,459
Less:		
Re-measurement of promissory note	(10,570)	(13,217)
Impairment and re-measurement of staff and ex-staff loans	(424,090)	(369,662)
	2,562,762	2,273,580

13. Notes and coins in circulation

	2005 J$'000	2004 J$'000
Notes	34,394,915	31,261,400
Coins	1,248,305	1,129,911
	35,643,220	32,391,311

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, 2005, were 3.91 (2004: 3.58) times the value of notes and coins in circulation at that date.

14. Deposits and other demand liabilities

	2005 J$'000	2004 J$'000
Government and Government agencies	3,599,887	3,765,105
Commercial banks and specified financial institutions	28,826,793	34,068,653
International Money Fund	63,852	58,828
Others	7,829,144	4,103,509
	40,319,676	41,996,095
Jamaica dollar equivalent of foreign currency deposits	14,712,408	9,709,279
Jamaica dollar deposits	25,607,268	32,286,816
	40,319,676	41,996,095

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, section 14 of the Financial Institutions Act and section 31 of the Building Societies Regulations.

Notes to the Financial Statements (cont'd)
December 31, 2005

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

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:

	2005 J$'000	2004 J$'000
Amounts included in deposit liabilities of the Bank, representing statutory reserves	25,579,437	28,845,363

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 undertaken using certificates of deposit.

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

	2005 J$'000	2004 J$'000
Securities under repurchase agreements	-	30,845,486
Certificates of deposit	147,206,515	94,969,339
	147,206,515	125,814,825

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

	2005 J$'000	2004 J$'000
Securities under repurchase agreements:		
Local registered stocks	-	23,912,457
Investment debentures	-	3,850,342
Investment bonds	-	3,082,687
	-	30,845,486

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 (2004: Nil) and, accordingly, the changes arise from exchange rate fluctuations.

	SDRs'000	2005 J$'000	2004 J$'000
At beginning of year	40,613	3,573,578	3,203,044
Effect of exchange rate fluctuation	-	219,088	370,534
At end of year	40,613	3,792,666	3,573,578

Notes to the Financial Statements (cont'd)
December 31, 2005

17. Foreign liabilities

	2005	2004
	J$'000	J$'000
Borrowings - Principal	171,142	258,848
- Accrued interest	3,505	4,516
Unsettled balances on bilateral accounts for Caricom trade	9,866	11,854
	184,513	275,218

18. Other liabilities

	2005	2004
	J$'000	J$'000
Interest payable	11,757,189	9,975,399
Staff and staff-related expenses	149,526	147,865
Other	45,700	417,500
	11,952,415	10,540,764

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.

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:

	2005	2004
	J$'000	J$'000
Securities revaluation reserve [see (a) and note 29]	(148,060)	1,119,946
Property revaluation reserve [see (b)]	1,124,756	1,124,756
Pension equalisation reserve [see (c)]	1,591,400	1,549,200
	2,568,096	3,793,902

Notes to the Financial Statements (cont'd)
December 31, 2005

22. Other reserves (cont'd)

(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, net

	2005 J$'000	2004 J$'000
Net unrealised gain on translation of foreign currency assets and liabilities and realised gain on settlement of foreign assets and foreign liabilities	4,062,437	2,113,205
Exchange gain/(loss) on purchases and sales of foreign currency	167,945	(296,892)
	4,230,382	1,816,313

24. Employee numbers and costs

The number of employees at the end of the year was 469 (2004: 486) full-time and 21 (2004: 36) contract. The related costs for these employees were as follows:

	2005 J$'000	2004 J$'000
Salaries and wages	882,601	833,514
Statutory payroll contributions	59,256	57,828
Uniforms	4,699	10,124
Staff welfare	53,786	48,844
Other	47,289	45,783
	1,047,631	996,093

25. Operating expenses

Operating expenses include the following charges:

	2005 J$'000	2004 J$'000
Depreciation	157,556	147,918
Auditors' remuneration	5,390	4,900
Payments for redundancies	-	12,478

Notes to the Financial Statements (cont'd)
December 31, 2005

26. Related party balances

The Bank has a related party relationship with its board of directors, the members of the Executive Council and the Bank of Jamaica pension scheme. Membership of the Executive Council is limited to fifteen (15) persons.

The balance sheet includes balances arising in the ordinary course of business, with related parties, as follows:

	2005	2004
	J$'000	J$'000
Loans (included in note 12)	55,621	35,135

The interest rate applicable to the above loans range from 3% - 5%. In addition, a deemed taxable income is computed on the interest saved by virtue of the concessionary interest rate. No non-executive director receives emoluments or is in receipt of a BOJ staff loan.

The statement of income and expenses includes income earned from/expenses incurred in transactions with related parties, in the ordinary course of business, as follows:

	2005	2004
	J$'000	J$'000
Interest expense – pension scheme	48,640	71,960
Interest income – Executive Council	1,202	1,094
Pension scheme	67,797	58,970

Executive Council compensation is as follows:

	2005	2004
	J$'000	J$'000
Short-term employee benefits included in staff costs (note 24)	86,177	80,293

27. Commitments

At the balance sheet date the Bank had:

(a) Capital commitments as follows:

	2005	2004
	J$'000	J$'000
Authorised and contracted	77,908	42,102
Authorised but not contracted	402,140	99,568
	480,048	141,670

(b) Operating lease commitment payable as follows:

	2005	2004
	J$'000	J$'000
Within one year	2,811	2,559
Subsequent years	14,353	-
	17,164	2,599

Notes to the Financial Statements (cont'd)
December 31, 2005

28. Contingent liabilities

At December 31, 2005, 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, 2005.

29. Change in accounting policy

As a result of a change in accounting policy, following amendments to, and adoption of, IAS 39, *Financial Instruments: Recognition and Measurement*, investments previously classified as loans and receivables and measured at amortised cost, have been reclassified. These investments are now classified as available-for-sale and are measured at fair value. This has been treated as a prior year adjustment, and the comparative figures restated accordingly. As it was impracticable to determine the cumulative effect of the change to all prior periods, the new accounting policy was applied to the carrying amounts of assets and liabilities at the earliest date.

The change had the following impact:

	Foreign currency denominated investments	Local currency denominated investments	Securities revaluation reserve (note 22)
	J$'000	J$'000	J$'000
Balances at December 31, 2004, as previously reported	97,399,803	85,131,057	(1,999)
Impact of restating gain arising from changes in fair value	98,168	1,023,777	1,121,945
Balances at December 31, 2004, as restated	97,497,971	86,154,834	1,119,946

30. 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 and cash equivalents, 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, open market liabilities, International Monetary Fund – Allocation of Special Drawing Rights, foreign liabilities and other liabilities.

Notes to the Financial Statements (cont'd)
December 31, 2005

30. Financial instruments (cont'd)

(a) Fair value of financial instruments (cont'd):

The fair value of foreign and local currency 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(d)(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:

	2005 J$'000	2004 J$'000
Foreign currency assets	142,821,121	119,046,756
Foreign currency liabilities	(18,753,836)	(13,616,898)
Net foreign currency assets	124,067,285	105,429,858

	2005	2004
Exchange rates at December 31:		
US$1 to J$	64.40	61.52
UK£1 to J$	110.68	117.87
CDN$1 to J$	55.25	51.12
€ to J$	76.26	83.29

At March 29, 2006, the exchange rates were US$1 to J$65.32, UK£1 to J$114.19, CDN$1 to J$56.06 and € 1 to J$79.00.

(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, at least, matched by that of its financial liabilities.

Notes to the Financial Statements (cont'd)
December 31, 2005

30. Financial instruments (cont'd)

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

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

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.

	2005						
	Within 3 months	Three to 12 months	Over 12 months	Payable after notice	Non-rate sensitive	Total	Weighted average interest
	J$'000	J$'000	J$'000	J$'000	J$'000	J$'000	%
Assets							
Notes and coins	-	-	-	-	50,032	50,032	-
Cash and cash equivalents	-	-	-	-	15,863,272	15,863,272	-
Interest in funds managed by agents	-	-	-	2,789,112	-	2,789,112	4.2
Foreign currency denominated investments	68,496,797	-	52,065,048	-	-	120,561,845	4.39
International Monetary Fund - Holding of Special Drawing Rights	-	-	-	-	395	395	-
Local currency denominated investments	5,228	12,650,578	69,138,231	-	-	81,794,037	15.2
International Monetary Fund – Quota Subscription	-	-	-	-	2,906,624	2,906,624	-
Investment property	-	-	-	-	87,000	87,000	-
Investments in financial institutions	-	-	-	-	3,200	3,200	-
Due from Government and Government agencies	-	-	-	-	12,941,466	12,941,466	-
Property, plant and equipment	-	-	-	-	1,612,658	1,612,658	-
Employee benefits	-	-	-	-	1,591,400	1,591,400	-
Other assets	-	-	-	81,339	2,481,423	2,562,762	-
Total assets	68,502,025	12,650,578	121,203,279	2,870,451	37,537,470	242,763,803	8.73
Liabilities							
Notes and coins in circulation	-	-	-	-	35,643,220	35,643,220	-
Deposits and other demand liabilities:							
Jamaica dollar equivalent of foreign currency deposits	4,401,395	-	-	10,311,013	-	14,712,408	-
Jamaica dollar deposits	10,255,269	-	-	15,351,999	-	25,607,268	-
Open market liabilities	63,678,960	83,527,555	-	-	-	147,206,515	14.04
International Monetary Fund – Allocation of Special Drawing Rights	-	-	-	-	3,792,666	3,792,666	-
Foreign liabilities	-	-	171,142	-	13,371	184,513	8.25
Employee benefits obligation	-	-	-	-	656,600	656,600	-
Other liabilities	-	-	-	-	11,952,415	11,952,415	-
Capital and reserves	-	-	-	-	3,008,198	3,008,198	-
Total liabilities	78,335,624	83,527,555	171,142	25,663,012	55,066,470	242,763,803	14.13
Total interest rate sensitivity gap	(9,833,599)	(70,876,977)	121,032,137	(22,792,561)	(17,529,000)	-	-
Cumulative gap	(9,833,599)	(80,710,576)	40,321,561	17,529,000	-	-	-

Notes to the Financial Statements (cont'd)
December 31, 2005

30. Financial instruments (cont'd)

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

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

	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 and cash equivalents	-	-	-	-	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	-	28,996,851	-	-	97,497,971	2.55
International Monetary Fund - Holding of Special Drawing Rights	-	-	-	-	4,483	4,483	-
Local currency denominated investments	927,292	4,796,150	80,431,392	-	-	86,154,834	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	69,428,412	4,796,150	109,428,243	2,704,752	33,002,373	219,359,930	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	12,305,769	-	-	19,981,047	-	32,286,816	-
Open market liabilities	57,277,103	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 benefits obligation	-	-	-	-	573,600	573,600	-
Other liabilities	-	-	-	-	10,540,764	10,540,764	-
Capital and reserves	-	-	-	-	4,194,539	4,194,539	-
Total liabilities	70,266,071	68,537,722	258,848	29,007,127	51,290,162	219,359,930	12.10
Total interest rate sensitivity gap	(837,659)	(63,741,572)	109,169,395	(26,302,375)	(18,287,789)	-	-
Cumulative gap	(837,659)	(64,579,231)	44,590,164	18,287,789	-	-	-

(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, 2005

30. 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 and cash equivalents 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:

	2005 J$'000	2004 J$'000
Jamaica	82,616,536	86,154,834
U.S.A. and other industrialised countries	138,680,227	115,339,200
Barbados	37,494	36,993
Multilateral Institutions	2,907,018	2,743,203
Other	275,488	360,061
Total financial assets	224,516,763	204,634,291

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, 2005

30. 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.

31. New and revised IFRS and interpretations

At the date of approval of the financial statements for issue, certain new and revised standards and interpretations were in issue but were not effective until after balance sheet date. Those which are considered relevant to the Bank and their effective dates are as follows:

1FRS 7	Financial Instruments: Disclosure	January 1, 2007
IFRIC 4	Determining whether an Arrangement Contains a Lease	January 1, 2006

Notes to the Financial Statements (cont'd)
December 31, 2005

31. Adoption of new and revised IFRS and interpretations (cont'd)

IAS 19 Amendment	Actuarial Gains & Losses, Group Plans and Disclosures	January 1, 2006
IAS 39 Amendment	The Fair Value Option	January 1, 2006
IAS 39 Amendment	Financial Guarantee Contracts	January 1, 2006
IFRIC 9	Reassessment of Embedded Derivatives	June 1, 2006

The adoption of IFRS 7 and the IAS 19 amendment is expected to result in additional disclosures for financial instruments and the defined benefit pension scheme. Except for these additional disclosures, the adoption of these standards and interpretations are not expected to have a material impact on the financial statements.

32. Accounting estimates and judgements

Judgements made by management in the application of IFRS that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next financial year are discussed below:

(a) Pension and other post-retirement benefits

The amounts recognised in the balance sheet and income statement for pension and other post-retirement benefits are determined actuarially using several assumptions. The primary assumptions used in determining the amounts recognised include expected long-term return on plan assets, the discount rate used to determine the present value of estimated future cash flows required to settle the pension and other post-retirement obligations and the expected rate of increase in medical costs for post-retirement medical benefits.

The expected return on plan assets is assumed after considering the long-term historical returns, asset allocation and future estimates of long-term investment returns. The discount rate is determined based on the estimate of yield on long-term government securities that have maturity dates approximating the terms of the company's obligation; in the absence of such instruments in Jamaica, it has been necessary to estimate the rate by extrapolating from the longest-tenor security on the market. The estimate of expected rate of increase in medical costs is determined based on inflationary factors. Any changes in these assumptions will impact the amounts recorded in the financial statements for these obligations.

It is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from these assumptions could require a material adjustment to the carrying amount reflected in the financial statements.