## Brian Wynter: Economic issues and short-term trends for Jamaica

Speech by Mr Brian Wynter, Governor of the Bank of Jamaica, at the Quarterly Press Briefing, Kingston, 10 November 2010.

* * *

Ladies and Gentlemen:

This morning we are releasing the Quarterly Monetary Policy Report for the three months ended 30 September 2010. Similar to the previous reports, we have outlined the economic developments that characterised the review quarter and some insights into the Central Bank's view of the near-term. In addition, we have updated and reprinted some articles on issues which have been in the forefront of many discussions in recent months. These articles relate to the role of a credit bureau in enhancing the efficiency of credit markets as well as the Bank's role in preserving financial stability.

### Review of the September 2010 quarter

The process of transformation in the economy has largely continued in line with the objective of less volatility in domestic prices, lower interest rates and stable financial markets. Indeed, economic developments in the September 2010 quarter were, in the main, positive. Annual inflation continued to fall in line with expectations, interest rates trended down, the foreign exchange market was relatively stable, net international reserves increased substantially and the process of fiscal consolidation continued. However, real GDP is estimated to have continued to decline in the review quarter, albeit at a slower rate than in the June quarter. The Bank is also estimating that the pace of recovery in the international economy slowed in the review quarter.

### Monetary policy

In the context of these developments, the Bank continued to ease monetary policy in the review quarter. The Bank's actions continued to be supported by the strengthening of investor confidence, which has been reinforced by Jamaica meeting successive performance targets under the Stand-by Arrangement with the International Monetary Fund. In this regard, the interest rate payable on the Bank's 30-day certificate of deposit was reduced by an additional 1-percentage point to 8.00 per cent per annum during the quarter. The interest rate on overnight placements was also reduced by a quarter of a percentage point from an already very low 0.5 per cent per annum. In addition, the Bank reduced the cash reserve requirement on Jamaica Dollar prescribed liabilities of deposit taking institutions by 2 percentage points to 12 per cent and the liquid assets requirement also by 2 percentage points to 26 per cent.

### Financial markets

The foreign exchange market was relatively stable for the review quarter despite some demand pressures in September. This stability was evidenced by the marginal depreciation of 0.27 per cent in the weighted average selling rate for the review period as investors, in the main, continued to exhibit a preference for Jamaica Dollar assets. The demand pressures in September resulted in a 0.78 per cent depreciation for the month and occurred in the context of reduced net private inflows as well as lower foreign exchange supplies from tourism.

The Bank sold approximately US$20.0 million net to the market during the quarter. Despite this, the NIR increased by US$177.9 million resulting mainly from the proceeds of an Inter-

American Development Bank loan of US$200.0 million to the Government. At end-September the NIR stock was US$1.91 billion, substantially exceeding the end-September target under the IMF Stand-by Arrangement. At that date, gross reserves amounted to US$2.79 billion, representing 20.5 weeks of projected goods and services imports, comparing favourably with the international benchmark of 12 weeks.

In the context of relatively buoyant Jamaica Dollar liquidity conditions, stability in the foreign exchange market and improved investor sentiment, market-determined interest rates continued to decline in the September quarter. At the end of September the average yield on the benchmark 6-month Treasury bill was ***7.99 per cent*** a decline of ***1.27 percentage points*** relative to the yield at the end of June**.** Similarly, the average yields on the 1-month and 3-month instruments fell by 0.72 percentage points and 0.77 percentage points to 8.26 per cent and 7.75 per cent, respectively.

## Inflation

Headline inflation for the September quarter was ***1.3 per cent***, below the range of ***1.5 per cent – 2.5 per cent*** that we were projecting when we met in August. The out-turn for the quarter is also significantly below the rate of 2.6 per cent recorded for the June 2010 quarter as well as the 3.8 per cent average inflation for the previous five September quarters. Similar to headline inflation, the Bank's measures of core inflation were all below the rates in the previous quarter as well as the rates in the corresponding quarter of 2009.

The lower than expected inflation for the review quarter was against the background of a decline in energy prices, relative stability in the exchange rate and continued weak consumer demand. Lower energy prices in the quarter were typified by a 2.6 per cent decline in the average West Texas Intermediate crude oil price. Partly offsetting the impact of the lower energy prices, however, were increases in the prices of some agricultural products, particularly in July. This mainly reflected the lagged impact on food prices of drought conditions from late-2009 to mid-2010.

We are projecting that there will be an up-tick in inflation in the December quarter with headline inflation expected to be within the range of 2.0 per cent to 3.0 per cent. The projected acceleration in inflation in the December quarter is largely influenced by the above average rainfall experienced by the Island at the end of September caused by the passage of Tropical Storm Nicole, which led to severe damage to local crops and the road network. In this context, there is expected to be some increase in the prices of select agricultural commodities, particularly in November and December. However, the Government has announced plans to import certain food items, which could partly mitigate some of these increases. In addition, the recent increases in the prices of oil, corn and wheat on the international market are expected to continue in this quarter.

## Real sector

Economic activity is estimated to have remained weak during the September quarter, with real GDP contracting in the range of 0.0 per cent to 1.0 per cent relative to the sharp decline in the June 2010 quarter. In fact, real GDP contracted by 2.0 per cent in the June quarter relative to the Bank's estimate of a decline in the range 0.0 per cent to 1.0 per cent. The decline in the June quarter followed three consecutive quarters of deceleration in the pace of decline. The areas in which the declines were sharper than we had estimated were *Agriculture, Forestry & Fishing, Manufacture, Transport Storage & Communication* and *Financing & Insurance Services.*

The estimated out-turn in the review quarter reflected continued contraction in the nontradable industries as the tradable industries are estimated to have recorded marginal growth. In particular, ***Construction, Manufacture, Finance & Insurance*** and ***Electricity &***

***Water Supplies*** are estimated to have been the major industries to decline in the quarter. ***Mining & Quarrying*** was the major influence on growth in some tradable industries.

In the context of the excessive rainfall at the end of September, the Bank's projections indicate that real GDP will marginally contract or expand in the December quarter in the range –0.5 per cent to 0.5 per cent. Most industries are projected to contract, with the exceptions being ***Mining & Quarrying*** and ***Hotels & Restaurant.***

## Outlook

Looking ahead, there are concerns about the continued weakness in the international economy. However, the consensus forecast is that the prospects for global growth for 2010 have not changed for the worse. Growth in this year is largely expected to come from the emerging market economies, such as China and India, as the advanced economies are projected to experience low to moderate growth.

In light of the outlook for the global economy and recent adverse weather conditions, the Bank has revised its projection of the performance of the domestic economy for this fiscal year. The domestic economy is currently being forecasted to contract marginally in the range of ***0.0 per cent to 1.0 per cent*** for fiscal year 2010/11. This is in contrast to our earlier forecast of marginal growth for the fiscal year. The change in projection is largely due to the extent of the fall-out in the June quarter and the impact of Tropical Storm Nicole in the December quarter. The forecast for a marginal decline in the fiscal year as a whole therefore depends on there being growth in the March 2011 quarter.

Domestic inflation for FY2010/11 is expected to be at the upper end of the revised forecast range of 6.0 per cent to 8.0 per cent and within the original target range of 7.5 per cent to 9.5 per cent. This projection is underpinned by continued low consumer demand, a stable exchange rate and continued moderation in inflation expectations. The risks to the inflation projection are balanced. The downside risks continue to be a greater than anticipated contraction in demand due to sharper than expected reductions in real incomes. The upside risks include adverse weather conditions and higher than anticipated increases in international commodity prices.

Given the above factors, the Central Bank will remain vigilant in monitoring developments in the international and domestic economy. In addition, despite the projected uptick for inflation in the December quarter, the medium-term outlook indicates a resumption of the downward path. Against this background, the Bank will continue to be cautious in easing its monetary policy stance.

## Conclusion

Ladies and Gentlemen, the successes we have had to date in the macroeconomic indicators have been assisted by the on-going consolidation of the fiscal accounts. The fiscal authorities have been meeting their targets under the IMF Stand-by Arrangement and from all indications the quantitative targets under the September review have also been met.

Both local and foreign investors continue to monitor the country's progress carefully. They have so far indicated their approval by the preference shown for Jamaican financial assets. This must not be taken for granted. The success we expect hinges on implementation of the full slate of reforms that will support lasting stability in the economy. In this regard, the orderly financial markets and stable consumer prices fostered by the Bank of Jamaica's efforts in collaboration with its partners and stakeholders will provide the foundation for sustainable growth and development.

Thank you.