Brian Wynter: Quarterly Monetary Policy Report – latest economic developments in Jamaica

Remarks by Mr Brian Wynter, Governor of the Bank of Jamaica, at the press briefing for the June 2013 Quarterly Monetary Policy Report, Kingston, 21 August 2013.

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Good Morning Ladies and Gentlemen:

In presenting today's release of the Quarterly Monetary Policy Report for the June 2013 quarter I will take the opportunity to share with you the outturn for the quantitative performance criteria which were agreed under the programme with the International Monetary Fund (IMF). I will then highlight the Bank's policy actions over the review quarter and some of the main economic developments which had an impact on these decisions. I will also share the Bank's perspective on the near term outlook for some of the main economic variables. Also, this quarter's report includes two special articles: *The Evolution of Jamaica Dollar Liquidity and Its Impact on Money Market Interest Rates – January to June 2013* and *Recent Developments in Remittance Inflows*, both of which should be of interest.

Performance under the IMF Extended Fund Facility (EFF) – June 2013 quarter

The monetary targets under the EFF for end-June 2013 were comfortably met. In particular, the net international reserves (NIR) amounted to US$1003.2 million relative to the target of US$873.9 million. The target for net domestic assets (NDA) was also met. Information from the Ministry of Finance indicates that we also met the fiscal and debt targets. In addition, the structural benchmarks due to be achieved during the period were met.

Against this background, a team from the IMF is presently in Jamaica conducting the first review of the country's performance under the Extended Fund Facility (EFF). Their review will inform consideration by the IMF Executive Board in September. Approval of the review by the Executive Board will facilitate the next drawdown from the IMF. This will also serve to provide reassurance to other multilateral partners and the financial markets about the Government's commitment to the reforms that are necessary to improve the country's competitiveness and growth.

Economic developments in the June 2013 quarter

Monetary and foreign exchange policy

Turning to economic developments during the June 2013 quarter, the Bank maintained its monetary policy rate at 5.75 per cent during the June quarter. The monetary policy rate is the interest rate paid by the Bank on 30-day certificates of deposit (CDs). This policy stance reflected the context of little change to the near-term outlook for inflation and some improvements in investor confidence following the approval of the four-year EFF by the IMF's Executive Board. During the quarter, the Bank offered nine variable rate CDs and two US-dollar indexed notes to the market. These instruments shifted $21.8 billion into longer-tenor securities (that is, between six and 18 months) and offset the Bank's purchase from the market of US$196.3 million, equal to about $19.3 billion.

Against the background of these developments, the weighted average selling rate of the US dollar depreciated by 2.5 per cent for the review quarter. This adjustment followed a depreciation of 6.0 per cent in the March 2013 quarter. The slower pace of depreciation in the June quarter also reflected the impact of lower demand for foreign currency to meet current account transactions.

Inflation

It is encouraging to be able to report that headline inflation was 1.2 per cent for the June 2013 quarter, below the outturn of 2.7 per cent for the March 2013 quarter and well below the forecast range for the June quarter of 2.0 to 3.0 per cent that we announced when we last met in May. The inflation outturn for the review quarter was largely due to the lagged pass-through of the depreciation in the exchange rate and the impact of drought conditions on the prices of some agriculture items. However, the impact of these factors was lower than the Bank had anticipated. The lower than projected inflation also reflected the impact of a sharp reduction in energy costs, which was not expected, and the effect of weaker than anticipated demand conditions.

For the September quarter, the Bank is projecting inflation to be in the range of 2.0 per cent to 3.0 per cent. The materialization of this forecast would be below the inflation outturn for the September quarters of the last five years. Inflation in this quarter is expected to be driven by increases in the prices of domestic agricultural produce and processed foods. In addition, inflation in the period is expected to reflect the impact of higher prices for crude oil and the effect of the seasonal increase in demand related to the summer holidays and back-to-school preparations. However, the announced reduction in communication costs and persistent weak demand conditions are expected to moderate the impact of these factors on the overall price level. Headline inflation for July, at 0.5 per cent, exhibited this muting effect.

Despite the significantly lower than expected outturn of inflation for the first four months of the fiscal year, the Bank is maintaining the FY2013/14 forecast for inflation to be in the range of 8.5 per cent to 10.5 per cent. Domestic prices are expected to reflect the impact of higher international commodity prices, particularly crude oil, and the pass-through of the depreciation in the exchange rate. Additionally, seasonal increases in the prices of domestic agricultural produce are expected to contribute to inflation for the period.

However, although the muting effect may well continue, a cautious assessment of the near term risks suggests that inflation may also end up close to the upper bound of the forecast range for the quarter and the fiscal year. These risks largely relate to the administrative adjustments to transportation costs (which were recently announced) and, possibly, adjustments to utility costs as well as higher than expected crude oil prices. Adverse weather, in the context of a forecast for an above average hurricane season, also remains an upside risk to the forecast. The existence of weaker than anticipated domestic demand conditions continues to be the main downside risk.

Real GDP growth

Real GDP is estimated to have contracted in the June quarter, albeit at a slower rate than in the previous quarter. Both the tradable and non-tradable sectors are estimated to have declined in the quarter. The contraction reflected the impact of drought conditions, continued weak domestic demand as well as the slow recovery in the global economy which contributed to lower remittance inflows and low demand for Jamaica's goods and services. Agriculture, Forestry & Fishing; Hotels & Restaurants and Electricity & Water Supplies were estimated to be the main industries which recorded declines.

Looking ahead, the Bank is projecting that real sector activities will improve in the remaining quarters of the fiscal year. This forecast largely reflects an expected recovery relative to the outturn for the corresponding period of FY2012/13 when the performance of the economy was negatively affected by Hurricane Sandy which was followed by drought conditions and a high level of investor uncertainty related to perceived delays in concluding an agreement with the IMF. Therefore, the projection for real GDP growth is predicated on improved investor confidence, continued expansion in the global economy and more robust growth in credit to the private sector given the release of resources as a result of reduction in demand from the public sector. Against this background, real GDP growth for the September quarter as well as FY2013/14 is projected to be in the range of 0.0 per cent to 1.0 per cent. The risks to the forecast are assessed to be on the downside and relate to weaker than expected external and domestic demand.

Near-term outlook

Monetary policy over the near term will continue to focus on maintaining single-digit inflation in the context of a flexible and competitive exchange rate regime. Further, given the current forecast for inflation and growth in the economy as well as continued fiscal consolidation, the Bank can be expected to maintain its current monetary policy stance, including the issue of a series of longer-dated instruments.

Over the longer term, the Bank's objective is to achieve a gradual reduction of inflation to a rate that is consistent with that of our main trading partners. We believe that the combination of low inflation and exchange rate flexibility is a valuable tool in maintaining the competitiveness of the export sector. Robust expansion in the export sector will contribute to sustained economic growth and improvements in real per capita incomes.

With respect to foreign exchange reserves, we expect to see a seasonal fall in reserves in the quarter and the next. This pattern has been factored into the setting of the targets under the EFF for September and December, a period when imports are highest. Thus, while we are likely to continue to exceed the NIR targets given the margin that we already enjoy, we should nevertheless expect to see a seasonal fall in the NIR in the September quarter.

Ladies and gentlemen: the world economy is gradually recovering from the depression which started in 2008. Jamaica must position itself to take hold of the opportunities which will be opened for growth and success. In this regard, I continue to urge you to take note of the catalytic and comprehensive reforms which the Government has been implementing, including enhancements in access to credit for the private sector and initiatives to diversify the sources of energy, thereby lowering production costs. These reforms are aimed at improving the macroeconomic environment and removing impediments to growth. In the context of historically low interest rates and on-going reforms to create a more business-friendly environment, I am encouraging all economic agents to strengthen their resolve and redouble their efforts.

Thank you.