

Brian Wynter: Bank of Jamaica foreign exchange intervention and trading tool - an improved foreign exchange market for an improving economy

Remarks by Mr Brian Wynter, Governor of the Bank of Jamaica, at the Jamaica Chamber of Commerce Breakfast Meeting, Kingston, 18 October 2017.

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Introduction

Moderator and JCC Past President, Mr Milton Samuda; President, Larry Watson; other Past Presidents, Directors, Executive members and members of the Jamaica Chamber of Commerce; members of the media, ladies and gentlemen, good morning.

I am grateful for this opportunity to speak to your members. The invitation was to discuss Bank of Jamaica's Foreign Exchange Intervention and Trading Tool, or "B-FXITT", and I would like to do so in the context of the foreign exchange market in general and in relation to the wider economy.

B-FXITT

B-FXITT is still a work in progress but it is already a significant upgrade and refinement of the way Bank of Jamaica trades foreign exchange with authorised dealers and cambios. For you, the end user, it delivers a more transparent and efficient market that more accurately reflects true market conditions.

This is part of our thrust to have a twenty-first-century market that meets the two objectives that any market must satisfy if it is to be truly considered a market. A buyer or seller must be able to do the transaction that they want **when** they want to and in the **amount** that they want; in other words, it must be **liquid**. And he or she should leave the market having done a transaction with confidence that it was done at a **fair price**; in other words, **price discovery**.

This is quite a change from the past, as Jamaicans have become accustomed to viewing the exchange rate as a subsidised public good instead of the fair market-determined price of the foreign currency that is available in the country. Unsurprisingly, as with any poorly understood new thing, B-FXITT has been praised for the bouts of appreciation and vilified for periods of depreciation.

However, B-FXITT only augments supply or demand in order to reduce episodes of disruptive volatility. The key change from the previous intervention method is that B-FXITT is more transparent and predictable with intervention amounts preannounced up to four weeks in advance. There are controls in place to ensure equal access for all qualified intermediaries such as the maximum aggregate bid per dealer of **20 per cent** of the offer size. This limit helps to make smaller dealers and participating cambios more competitive and puts pressure on larger institutions to improve their margins and the quality of their service in order to keep their market share. Additional measures will be implemented to improve the service delivery of dealers to end users, including limits

on the size of open positions dealers are allowed to take and the adoption of a foreign exchange market code of conduct governing the behaviour of intermediaries with their customers.

All that is required from you, the end-user, is that you provide your dealer with good information about your foreign currency demand and supply over a four-week horizon. That information helps to inform us about what supply or demand augmentation may be needed. However, please be aware that it is not, as I have been hearing in some reports, an order that you are placing for your share of the intervention funds.

Therefore, B-FXITT is designed to foster more competitive behaviour amongst authorised dealers and cambios, rewarding the dealers who provide the best service and margins to customers and disadvantaging those who do not. How well this will work to your benefit, as with all consumer-oriented measures in competitive markets, depends on you. Are you reaping your rewards by getting the best service and margins from your dealer, whether you are selling or buying US dollars, pounds or euros, or even renminbi?

Speaking of disadvantaging those who make poor decisions, during the month of May this year, before B-FXITT was introduced, BOJ intervened in the market with sales of **US\$240 million** despite all indications that there was adequate supply. We sold those funds at over **J\$130.00**. Perhaps you heard about this. We bought back most of it in the months that followed and at cheaper rates closer to **J\$129.00**. Someone lost millions of Jamaican dollars on a bad bet but I would not be surprised if you never heard about that.

Since the introduction of B-FXITT, market participants apparently failed to learn from the experience and failed to pay attention to the increase in available information. During August, in the face of moderate movements in the exchange rate, net demand pressures began to build up in the system. By September, some people lost their nerve, aided, I am sure, by another unhealthy dose of fear-mongering designed to support passionate exhortations for the Government or BOJ to "do something", meaning "sell more US dollars" or "stabilise the rate". Predictably, the exchange rate went above **J\$131.00** again despite increases in Bank of Jamaica's preannounced interventions, the Government's one-month notice to prepay **US\$500 million** in bonds to the local market and, similar to the May episode, indications that US dollar supply was in fact adequate. Yet again, someone paid a heavy price for their bad decisions as the exchange rate has once more fallen below **J\$129.00**.

How has the economy changed?

Given Jamaica's history of prolonged and sustained foreign currency shortages, we have become accustomed to the "dollar slide" rhetoric even in a context where, for the 12 months to 13 October this year, the exchange rate appreciated by **0.4 per cent**, compared with a depreciation of **7.7 per cent** for the same period a year before. As of yesterday, the exchange rate, at **J\$127.97**, has in fact strengthened by **0.5 per cent** for the fiscal year to date. Some slide.

In the first half of FY2017/18, the Jamaican dollar depreciated on 60 days and appreciated on 66 days. Over the same period in the last fiscal year, the currency

depreciated on 104 days and appreciated on only 25 days. Clearly, we have moved away from a chronic one-way market to a more normal and more flexible market characterised by two way movements.

For nearly two years now, the Bank has steadfastly explained to a sceptical public that the Jamaican dollar is fairly valued but the dollar slide rhetoric, dogma and fear-mongering have drowned out this message. I would like to be quite clear about this: whenever the exchange rate is in a zone that is consistent with our overall economic performance relative to our trading partners, and particularly when our national earnings in foreign currency approximate our national spending, then the exchange rate is fairly valued. It will, however, fluctuate around this level as demand and supply change from day to day and from month to month. This will include changes in perception as well as real changes that are happening on the ground.

Signs that our foreign currency earnings are adequate have been evident for the last two fiscal years during which the current account of the balance of payments has recorded a deficit of less than **2.0 per cent** of GDP, which, for Jamaica, is well within the range that is considered to be sustainable. For FY2017/18 and into the medium-term future, the current account deficit is projected to remain sustainable in the range of **1.0 per cent** to **3.0 per cent** of GDP. With imports financed by foreign direct investment at around **3.0 per cent** to **4.0 per cent** of GDP each year, FY2017/18 will be the third year in a row where current account transactions will place no net pressure on the foreign exchange market. This has not occurred since the 1960's.

Now let me address an issue raised by one or two economic observers who speak of a central bank depreciation policy that has never worked and will never work for Jamaica. They state that it only leads to a worsening of the economy.

First, the central bank does not have a depreciation policy. The Government's policy is for there to be a flexible market-determined rate, which means that the price of US dollars will change based on supply and demand conditions like any good. Jamaica has postponed adjustments in the past through borrowing. But we need only glance at our history or study the current experience of some of our neighbours to remind us of the consequences of trying to dictate an exchange rate that is at odds with underlying economic or market conditions.

Second, there is no debate that depreciation benefits exporters and hurts importers. Therefore, if a larger proportion of businesses in the economy are importers then certainly business in a country will at first suffer when depreciation occurs. Improvement for business comes later from a change in behaviour that leads to a reduction in the proportion of import-dependent businesses.

Numerous media reports suggest that the change in behaviour is occurring as businesses that were once uncompetitive are now able to produce profitably for the domestic market or penetrate export markets. They have been replacing foreign inputs with local substitutes or importing raw materials and finishing the goods locally before using them in their productive processes. Those companies must have contributed to the more than 30,000 net new jobs created last year and more than 20,000 created this year.

Therefore, if for the first time in our independent history we can sustainably earn enough to pay our bills instead of perpetually borrowing; if we are seeing high-quality exports of goods and services and competitive import substitution; then do you think it is working?

Ladies and gentlemen, we are partners and stakeholders in this transformation and therefore we must be careful of the messages we send. We need to have frank and open dialogue on where we are going, how we get there, the remaining challenges we face and how to address them. The central bank remains committed to consultation with you and on that note, I want to thank your President for the way he has engaged the Bank as a key contributor to the Foreign Exchange Market Development Committee. He has been leveraging the wealth of information and expertise freely available at the Bank and we in turn have learned a great deal from him, which has helped to improve the service we deliver.

Thank you.