GOVERNOR'S QUARTERLY PRESS BRIEFING

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Ladies and Gentlemen

It is a pleasure to welcome you once again to the launch of another in our series of Quarterly Monetary Policy Reports.

As most of you would have realized, the July – September quarter was awash with challenges that necessitated a relatively tight monetary stance. The challenges that we faced during the quarter derived mainly from the severe weather conditions experienced both here and abroad, and from the sharp increases in international oil prices.

This morning I will take you briefly through the main issues discussed in the Report and give you our perspectives on those issues that are likely to influence the Bank's policy in the near-term.

<u>Overview of September Quarter</u>

The passage of two hurricanes during the quarter severely affected domestic agricultural output, and this together with the increases in international oil prices contributed to higher than anticipated levels of inflation.

Additionally, interest rates in the US continued to increase, thus narrowing the interest rate differential between Jamaica dollar and US dollar denominated assets. This, combined with expectations of increased inflation and concerns about the effect of the 'fall-out' in revenues on the fiscal accounts, contributed to some switching and repositioning of investment portfolios as a hedge against inflation. As a consequence, there was a strong demand for variable rate instruments and US dollar denominated assets.

<u>Foreign Exchange Market</u>

The increased demand for foreign currency assets contributed to some instability in the foreign exchange market in the quarter, resulting in a depreciation of 1.7 per cent in the weighted average selling rate of the domestic currency *vis-à-vis* the US dollar. This is in contrast to the marginal appreciation of 0.02 per cent recorded in the previous three quarters.

In an effort to ease the demand pressures the Bank sold a significant amount of foreign exchange to the market and kept the expansion in the monetary base well below programme.

In recent weeks, the foreign exchange market has come under further pressure. This is largely due to investor concerns, which have generated additional demand for foreign exchange, over and above the normal seasonal demand for the December quarter. This additional demand has coincided with a period when the supplies of foreign exchange to the market have been lower than usual.

The Bank has continued to sell foreign exchange to the market in order to ensure that the foreign exchange flow needed to sustain commerce and other current transactions remains adequate. At the same time, the Bank has also sold securities from its own stock to the market so as to reduce the excess Jamaica Dollar liquidity that would facilitate increase demand for foreign exchange.

Going forward, we expect the foreign exchange supplies to the market to increase by December, as tourism and private sector flows improve.

With the instability that emerged in the foreign exchange market during the quarter, the net international reserves (NIR), was US$2.12 billion at the end of September, declining by US$37.8 million relative to the end of June.

Inflation

Headline inflation was 4.3 per cent for the September quarter, or 1.2 percentage points above the seasonal average of the past five years. Domestic inflation continued to be affected by the upward movement in the price of crude oil on the international market. The benchmark West Texas Intermediate (WTI) crude oil reached a record price of US$69.82 per barrel during the quarter, pushing the average price for the period to US$63.05 per barrel.

The protracted elevation in the price of oil had an impact on the prices of fuels such as charcoal, which rose sharply during the quarter. Higher oil prices also contributed to increases in utility rates because of the automatic adjustment for fuel charges. The increase in utility rates was also influenced by a 5.8 per cent annual inflation adjustment to electricity prices that was granted to the power company.

Oil price increases also contributed to a significant rise in the cost of public transportation during the review quarter. In particular, bus fares increased by 45.5 per cent, with smaller adjustments in taxi fares.

Another significant factor influencing the inflation out-turn was the higher cost for domestic agricultural products that resulted from supply shortages caused by the adverse weather conditions.

With inflationary impulses unfolding from as early as the June quarter, the Bank maintained a conservative policy stance. Consequently, core inflation was contained to 1.4 per cent for the September quarter, slightly below the 1.7 per cent that was estimated for the previous quarter. The containment of core inflation was consistent with the continued decline in the stock of base money since the start of the fiscal year.

Despite the anticipated fall-out in ***Agriculture***, we are still expecting inflation to fall in the second half of the fiscal year (October to March), relative to the April to September period. Headline inflation should be in the range of 3.0 per cent to 4.0 per cent for the December quarter, and should fall further to between 1.0 per cent and 2.0 per cent in the March quarter. Our forecast for the full fiscal year therefore remains in the 15 to 16 per cent range.

Growth

Ladies and Gentlemen, this year has been one of natural disasters for the entire world. Thankfully, we have been spared the full brunt of a natural disaster, but the passage of three hurricanes within a four-month period has left a great deal of damage.

When we met in August, we were concerned about the possible fall-out from the passage of Hurricanes Dennis and Emily. Since then, further damage has been caused by several days of heavy rains and flooding, mainly associated with Hurricane Wilma. Significant damage has been done to road infrastructure and the vulnerable agriculture sector has again been adversely affected.

In the circumstances we have to acknowledge that so far, the Government has done well in managing to limit the deviation from the original target for the deficit. The Bank has taken into consideration the increased demand that will be placed on the fiscal authorities to redress the damage to infrastructure that was caused by the adverse weather conditions and has factored this into its assessments.

We estimate that the economy recorded moderate growth in the September quarter, and that all sectors recorded growth, with the exception of *Agriculture, Forestry and Fishing* and *Miscellaneous Services*.

We are expecting that growth will continue in the December quarter. However, we are not anticipating growth to be as robust as we had originally expected. ***Agriculture*** is forecasted to record a marginal decline relative to the full recovery that was previously projected. However, all other sectors are expected to register growth in the quarter. We expect that expansion in the December quarter will be driven largely by ***Mining*** and ***Construction***. Notably, we are also expecting a rebound in ***Tourism***.

Ladies and gentlemen, it appears we are never without serious challenges. However, despite the difficulties I want to assure you that the central bank remains committed to the objectives of preserving stability and returning the economy to lower levels of inflation.

In closing, let me draw your attention to the two special features that we have included in this Quarterly Report. The first explores the main developments in the international economy that had a notable influence on our economy over the last three months and the second looks at inflation across the Caribbean. I trust that you find these helpful.

I will now welcome your questions and comments on the issues raised.

Thank you.