



News Release
19 November 2008

Quarterly Press Briefing
Hon. Derick Latibeaudiere,
Governor, Bank of Jamaica
19 November 2008

Good Morning Ladies and Gentlemen:

Thank you for joining us as we release the Bank's Quarterly Monetary Policy Report for the quarter ended September 2008. As usual, I will review the economic developments in the September quarter and give you the Bank's near-term outlook. But before I do that, I want to speak briefly on the challenges posed by current international financial market crisis and indicate some of the steps that have been taken to mitigate its impact on the Jamaican economy. You will notice that the Report includes a special section on the current international financial market crisis and the possible implications for Jamaica.

Recent Developments

As you all know, the global financial crisis was triggered by the problems in the sub-prime mortgage market in the USA in 2007. The crisis escalated in September 2008 with the collapse of a large US financial institution and this resulted in heightened uncertainty in the global markets, especially with regard to the direct exposure of financial institutions to sub-prime mortgage linked assets. The escalation in the crisis has led to severe tightening in global liquidity and some firms have been finding it increasingly difficult to meet their obligations. Many international financial institutions suffered losses which reduced their ability to lend and this triggered a chain reaction as firms that lost access to credit responded in like manner to their clients.

In all of this, Jamaica's financial institutions have remained relatively sound and well capitalized. However, since the middle of September the Jamaican foreign exchange market has come under increasing demand pressures in the context of the global financial crisis. This has been reflected in a sharp depreciation in the exchange rate. The pressures are largely a reflection of the increased demand for foreign exchange to satisfy margin calls and to meet maturing obligations in the context of the withdrawal of credit lines by some overseas institutions. The demands for foreign exchange were also compounded by the fall-off in supplies to the market from some foreign exchange earners.

The Bank has actively sought to alleviate the demand pressures in the market and to maintain stability in the financial system through a number of policy responses, including the sale of foreign exchange to

supplement liquidity in the market. On October 15 the Bank implemented a temporary US dollar loan facility for the affected institutions. Specifically, this facility allowed securities firms facing the risk of losing credit facilities in respect of GOJ bonds, to have these credit arrangements transferred to BOJ along with the collateral formerly held by the overseas creditors. This arrangement has had the effect of tempering the price movement of GOJ bonds while at the same time easing the demand for foreign exchange by the institutions affected.

The Bank also increased interest rates on the full spectrum of its open market instruments on the October 17. This was the first increase since the June quarter. This action was followed on 31st October by an offer by the Bank to oversee and facilitate the flow of credit among local financial institutions. In this arrangement, banks with funds available for inter-bank lending can place these funds with the BOJ who will then on-lend to borrowing institutions with the appropriate collateral. These actions moderated some of the pressures in the foreign exchange market and assisted in the continued functioning of the inter-bank credit market.

However, since late last week, there has been an increase in demand pressures in the foreign exchange market. This has been largely due to a build-up in Jamaica liquidity associated with the maturity of both BOJ and GOJ securities. In order to remove this excess liquidity and maintain stability in the financial markets, the Bank has offered a Special Certificate of Deposit to Primary Dealers and commercial banks for the period 18 – 19 November 2008. The instrument will mature on 3 December 2008 with interest payable at 20.50 per cent.

Further, effective December 03, on the expiration of a 15-day notice period, the cash reserve requirement of commercial banks, merchant banks and building societies will be increased to 11.0 per cent of Jamaica Dollar liabilities from the current requirement of 9.0 per cent. The liquid asset requirement will therefore rise to 25.0 per cent from 23.0 per cent. The Bank of Jamaica will continue to actively monitor the market and will increase these requirements by a further 3.0 percentage points if it becomes necessary.

Against this background, I will now briefly review developments in the September quarter and share with you some of the near-term concerns that we have.

I turn first to *Inflation*

When we met in August, I indicated that we were expecting inflation to remain elevated into the September quarter, continuing the trend that we were seeing since the June quarter. At that time we were expecting the prices of some international commodities to continue to increase.

As it has turned out, *headline inflation for the September quarter was 4.7 per cent. This was below the Bank's forecast range of 5.5 per cent to 6.5 per cent for the quarter and was also lower than the inflation rate for the June quarter.*

Inflation in the September quarter was largely due to the lagged pass-through of increases in international energy and grains prices as well as some administrative price adjustments, and to a lesser extent, the impact of Tropical Storm Gustav on reducing domestic agricultural supplies.

As you will recall, there were sharp increases in the prices of international commodities such as oil, rice, corn and wheat earlier in the year. The lagged impact of the increase in oil contributed to the sharp movement in electricity rates and the more moderate increases in the cost of household and automotive fuels during the quarter. The higher grain prices were reflected in the upward movement in the food-related division of the CPI, which was compounded by the impact of the storm.

I should note that during the review quarter, the price of the West Texas Intermediate crude oil declined to an average of US\$117.96 per barrel, 4.8 per cent below the average price in the June quarter. The price of oil has continued to decline sharply and is presently below US\$60.00 per barrel. Similarly, the prices of rice, corn and wheat declined by 18.5 per cent, 9.7 per cent and 8.0 per cent, respectively, for the September quarter. In the context of a protracted global slowdown, the Bank is not expecting any strong reversal of the current trend in these prices.

We are therefore anticipating that over the near-term consumer prices will continue to reflect the impact of the decline in international commodity prices. There could, however, be some countervailing movement arising from the recent depreciation in the exchange rate. Against this background, we are *forecasting headline inflation in the range of 1.3 per cent to 2.3 per cent for the December quarter*. In fact, headline inflation for October was down 0.3 per cent, largely in line with our forecast for the month, and continuing the downward trend since August

For the **fiscal year**, the Bank is expecting inflation in the range 14.0 per cent to 16.0 per cent. We have lowered our forecast range in light of the downward trend in the prices of international commodities and the expectation of an increase in domestic agricultural supplies. However, given the pass-through of movements in the exchange rate to domestic prices, there is likely to be some countervailing impact from the depreciation in the exchange rate.

Foreign Exchange Market

The foreign exchange market was relatively stable in the September quarter in spite of some demand pressures in July and September. The instability in July was associated with uncertainties regarding a maturing Government US dollar indexed bond, while the demand pressures in the latter part of September were related to the global financial crisis. In the context of these developments, *the weighted average selling rate of the Jamaica Dollar vis-à-vis the US dollar depreciated by 1.08 per cent at the end of the quarter.*

Real Sector Performance

The Bank estimates that there was marginal real growth in the economy in the September 2008 quarter, a continuation of the weak performance observed since the September 2007 quarter. Growth

for the review quarter is estimated to be below the long-run trend average of 1.1 per cent observed since the March 1998 quarter. The performance of the economy was adversely affected by the continuing uncertainty in the global economy and the passage of Tropical Storm Gustav in August.

The main areas of growth during the review period were, the *Distributive Trade, Electricity & Water* and *Mining & Quarrying, Agriculture, Transport, Storage & Communication* and *Manufacturing* as well as the *tourism* industry are estimated to have contracted.

For the December quarter the Central Bank is forecasting continued weak economic growth. This forecast is predicated largely on a recovery in *Mining & Quarrying* and *Agriculture*. *Agriculture* is expected to recover after five consecutive quarters of contraction. In the case of *Mining & Quarrying*, the risk is that the slowdown in world growth could lead to a fall-off in demand for alumina and hence lower production in the sector.

For fiscal year 2008/09, the Bank's revised forecast suggests that economic growth will be relatively flat compared with our previous projection of growth in the range of 1.2 per cent to 2.2 per cent. The downward revision for the fiscal year is based on the expected impact of a protracted slowdown in the global economy.

Conclusion

Ladies and Gentlemen:

We saw over the past few weeks, that the Jamaican economy is not immune to the unfolding crisis in the global financial system, which has led to a sharp slowdown in world growth. The domestic financial market has experienced some instability, which the Central Bank has acted expeditiously to curtail. The uncertainties in the global financial markets continue to pose serious challenges and the possibility of a fall-off in the demand for Jamaica's goods and services exports could have a negative impact on the performance of the economy and the outcome with regard to the external current account.

Notwithstanding these challenges, we expect that the continued decline in commodity prices will lead to a fall-off in the demand for foreign exchange to meet payments for current account transactions. At the same time savings from the lower import prices should more than offset any slow down in export earnings and this should contribute to an improvement in the external current account.

Ladies and Gentlemen: these difficult times require the full cooperation of all economic agents to minimize the impact of the global crisis on our economy. We are therefore depending on everyone to act in the best interest of the country and to assist the Central Bank and the fiscal authorities in overcoming the challenges that we face. For its part, the Bank of Jamaica will continue to closely monitor the developments in the markets and will take the appropriate action to maintain a stable domestic economic environment.

Thank you.