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BUILDING A RESILIENT ECONOMY

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Introduction

Building a resilient economy is of enormous importance to countries, like Jamaica, that are highly exposed to negative external shocks. The vulnerabilities of our economy include, but are not limited to, its high degree of economic openness, its dependence on a narrow range of exports, its inability to influence international prices, and the high import content, especially of strategic imports such as food and fuel. This kind of exposure in small open economies has been amply discussed and explored in various publications and international forums held on the matter. The important question for us now therefore is to propose ways and means by which we may overcome these inherent or inherited vulnerabilities.

What is a resilient economy?

The term “resilience” with respect to an economy refers to the capacity of the economy to remain on a stable economic path in the face of negative external shocks. In other words, domestic prices, financial markets and financial institutions are able to continue to carry out their respective functions in a smooth and continuous manner once confronted with a negative economic event of significance.

‘Economic resilience’ has been defined in the literature as a country's ability to withstand the effect of the shock (shock absorption), recover quickly from a shock (shock counteraction) or avoid the shock altogether. In other words, economic resilience captures a country's ability to move on economically in spite of exposure to downside risks. For Jamaica, this means pursuing policies that reduce the risks associated with exposure to economic shocks, including the economic impact of natural events such as hurricanes.

Put another way, how do we build up the economic resilience of the Jamaican economy in order to withstand such shocks? The simple answer is an increased and sustained focus on policies that promote macroeconomic stability and microeconomic policies that enhance the flexibility of market adjustments. My presentation will focus on the economic factors that influence economic resilience. Please note, though, that economic resilience does not depend exclusively on these factors. Indeed, good governance, social cohesion and environmental management are also important for building economic resilience.

The Jamaica Debt Exchange (or JDX), by significantly altering the composition, interest costs and maturity profile of the domestic debt stock, was one such pivotal policy initiative which has moved the Jamaican economy towards greater economic resilience.

What fundamental challenge to economic resilience did the JDX address?

One of the systemic challenges which the pre-JDX debt dynamics posed to Jamaica's economic resilience is this: both the structure of the debt and the burden of the debt complicated the conduct of monetary policy the principal aim of which is to secure price stability.

Fiscal dominance caused by the high debt overhang severely constrains the conduct of monetary policy. In the event of a domestic shock to prices, when public debt is high and the real rate of return on government securities exceeds the economy's growth rate,

tightening monetary policy can have as an unhelpful consequence higher rather than lower inflation. This is because one of the consequences of contractionary monetary policy in this scenario can be a dramatically worsened fiscal outturn resulting in, at least initially, the need to issue additional debt. The resulting increases in fiscal deficits unleash a series of cascading pressures on government financing which has, in many countries, left governments and central banks to contemplate the invidious and, in the long run, viciously destructive alternative of pursuing distortionary measures such as the rapid increase in the supply of money, which is in itself inflationary. This scenario describes the environment called 'fiscal dominance of monetary policy.'

How did the JDX address this challenge to economic resilience?

The JDX, by altering the structure, composition and interest costs arising from the domestic debt stock, addressed this fundamental challenge to the resilience of the Jamaican economy by making the structure of the debt more sustainable, making the cash flow requirements of the government more certain and reducing the roll-over risks associated with the decline in the age of domestic debt. The net result of the JDX was to reduce significantly the likelihood of the periods of market instability which were experienced before the JDX.

The JDX therefore played a pivotal role in moving Jamaica from a 'bad equilibrium', characterised by high inflation, high interest rates and bouts of sharp depreciation, towards a 'good equilibrium' with low inflation, low real interest rates and a stable currency.

The broader economic programme in relation to building economic resilience

But the success of the JDX must be seen in the context of a broader set of reforms aimed at addressing fiscal dominance once and for all. These reforms include a comprehensive fiscal consolidation effort as well as reforms aimed at strengthening the stability of the financial sector. For its part, the Bank of Jamaica remains committed to conducting its

monetary policy operations within a context of a managed floating exchange rate system. That is, the Bank will continue to allow the exchange rate to move freely while using its instruments to ensure that volatility in this market is minimised.

Monetary policy will focus on reducing and maintaining single-digit inflation over the medium term. One way the Bank can help to build a resilient economy is by moving towards an inflation-targeting regime in which the Bank responds to changes in the probability of large swings in future inflation by adjusting its policy rate. In this regard, the Bank is evaluating the path to an inflation-targeting mechanism to manage inflationary expectations. This is where the Bank would pre-announce targets for the inflation outturn and give regular publicly disclosed reports on the performance of monetary policy in relation to these targets. These reforms would be aimed at ensuring that inflation expectations continue to trend downwards and the inflation rate itself declines to single-digit levels.

What is the desired outcome of these initiatives and where are we now?

Altogether, these reforms have the overarching objective of improving Jamaica's economic resilience by putting the debt ratio on a sustainable downward path, entrenching fiscal discipline and accountability and significantly increasing real growth rates in the real sector, which is where we all live. We are currently heading in the right direction, with inflation for the fiscal year to date heading towards single digit levels, a narrowing of Jamaican government international bond spreads relative to other sovereign debt and comfortable levels of net international reserves. In addition, the decline in real economic activity is showing signs of bottoming out.

However, the prospect of successfully moving Jamaica towards an inflation-targeting regime is far from certain as there continue to exist significant threats to the achievement of a fiscally responsible environment such as demands for special exemptions to benefit one sector or another. Similarly, natural and man-made disasters of one kind or another are amongst the constellation of threats that the reform programme faces. Significant

resolve on the part of the many and varied elements that make up the economy and the body politic will be required in order to ensure that this opportunity to transform the economic environment is not squandered. So also is significant energy required to seize the opportunities that a resilient Jamaican economy will provide.

Thank you.

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