

**Quarterly Press Briefing**

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**Governor**

Bank of Jamaica

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Good Morning Ladies and Gentlemen:

This morning we are releasing the Quarterly Monetary Policy Report for the June 2012 quarter. As is customary, the report sets out economic developments both in the external and domestic economies over the review quarter as well as the Bank’s response to these developments. The report also offers a perspective on the Bank’s outlook for economic developments in the current quarter and for the rest of the fiscal year. In view of the important role that expectations play in influencing economic outcomes, a special article on *The Importance of Managing Expectations* is also included in the report.

**Monetary Policy**

It is well understood that we have been operating in an unusually uncertain economic environment over the past few quarters related to developments both in the external and domestic economies. Monetary policy has had to exert a steadying influence during this period. Domestic policy uncertainties during the 12 months to June 2012 included the consequences of the IMF Stand-By Arrangement going awry, the change of prime minister under the previous party in power and general elections leading to a new administration in January this year. Uncertainties included the questions whether fiscal sustainability would continue to be pursued and whether the programme of structural reforms would be tackled. External uncertainties were numerous but centred on debt and fiscal sustainability challenges in the Euro area and in the United States. Against this background, the Bank maintained its signal rate at 6.25 per cent throughout the quarter.

While the external uncertainties remain as challenging as ever, the questions relating to the domestic policy environment were decisively answered in the affirmative in the fiscal budget for 2012/13 which was approved in June. On key elements of fiscal sustainability (in other words, debt reduction) we saw the medium-term outlook improved by concrete progress on fiscal adjustment that substantially makes up for ground lost during the previous 12 months. With agreements on wage restraint for the 2010-2012 period, the fiscal risk represented by unconstrained public expenditure on wages was significantly eroded. Significant work remains but is well in train and we are looking forward to policy decisions and agreements being settled on the remaining elements, in particular on public pensions and tax reform (including tax waivers and incentives).

**Inflation**

Headline inflation was 1.5 per cent for the June 2012 quarter, at the lower end of the range the Bank announced in May 2012. However, the outturn was significantly lower than the revised forecast in the range of 3.0 per cent to 5.0 per cent which we announced on 14 June 2012 subsequent to the imposition of the tax measures in the FY2012/13 budget. The more favourable outturn relative to the revised forecast was largely due to the lower than anticipated impact of the tax measures implemented in June. This was complemented by the effect of lower crude oil prices which led to reduced cost for electricity and automotive fuel. Of note, there was no noticeable pass-through to prices of the increased pace of depreciation in the exchange rate in the June quarter because of lower international commodity prices and competitive pressures in an environment of weak domestic demand.

The Bank is expecting that inflation for the September quarter will be largely similar to the outturn in the June quarter in the range of 1.0 per cent to 2.0 per cent. This forecast is reinforced by the reported deflation of 0.3 per cent in July. The July outturn reflected the impact of the sharp reduction in the cost of cell phone calls on the overall price level, lower water and electricity rates and the persistent influence of competitive pressures in the face of weak domestic demand. These factors offset the inflationary impulses from the tax measures.

For the rest of the quarter, the Bank is expecting further reductions in communication and electricity costs. However, the impact of these factors is expected to be offset by some upward pressure on food prices from the tax measures and from increases in the prices of international grains. Adverse weather conditions in major producing countries, particularly the USA, have led to growing concerns about the supply of grains and consequently higher prices over the next few quarters. The usual increase in prices associated with the demand for back-to-school items is also expected later in the quarter. There should be negligible pass through to prices of the recent depreciation in the exchange rate as persistently weak demand conditions continue to restrain increases in prices.

Inflation for FY2012/13 is tending towards the lower end of forecast range of 10.0 per cent to 12.0 per cent and, based on current circumstances, may fall well below this range. The more benign outlook largely reflects the anticipated impact of the generally tight fiscal stance as well as the forecast for most international grains prices to remain elevated for the rest of the fiscal year. Increases in oil prices are projected to be moderate for the rest of the fiscal year in the context of the relatively weak global demand. Despite the better-than-expected outturn for the year to date and the current outlook for relatively muted price pressures in the next few quarters, the Bank intends to assess additional data, particularly relating to volatile international food prices, before considering a downwards adjustment to the inflation target for 2012/13.

**Foreign Exchange Market and Net International Reserves**

During the review quarter, the foreign exchange market experienced periods of increased demand pressures which contributed to the value of the Jamaica Dollar depreciating by 1.6 per cent against the US dollar relative to a depreciation of 0.8 per cent in the March quarter. The depreciation in the review quarter was primarily influenced by net private capital inflows being insufficient to cover higher net demand for current account transactions. In this regard, the Bank sold US$134.9 million (net) to augment supplies in the market which contributed to a decline of US$236.7 million in the net international reserves (NIR) to end the quarter at US$1 540.4 million. Consequently, at end-June 2012, gross reserves were US$2 385.1 million representing 15.8 weeks of imports of goods and services. The Bank is expecting that investor confidence will begin to improve once stakeholders are able to assess the performance and implications of the full range of measures begun with the recent budget exercise. Improved investor confidence and official inflows unlocked by an agreement between the Government and the IMF later in the year should contribute to a recovery in the NIR to the level that it was at the start of the fiscal year.

**Real GDP Growth**

Real sector activity is estimated to have been relatively flat in the June 2012 quarter, reflecting the impact of persistent weak domestic demand as well as slower growth in the global economy. Growth is estimated for ***Agriculture***, ***Forestry & Fishing*** as well as ***Hotels & Restaurants***. However, ***Mining & Quarrying*** is estimated to have contracted due largely to disruptions in production as well as reduced global demand.

In the context of the forecast for continued weakness in domestic and global demand as well as the austere fiscal policy, the Bank is projecting that output growth will remain weak for the remaining quarters of the fiscal year. In particular, growth for the September quarter is expected to be largely similar to that of the June quarter. As such, for FY2012/13, growth is projected to be relatively flat.

At the same time, there has been an encouraging acceleration in the 12-month growth in credit to the private sector from commercial banks since December 2011 which augurs well for improved growth prospects in the medium term. As at June 2012, the 12-month growth in private sector credit was 17.0 per cent with expansion of 4.0 per cent for the June 2012 quarter. The continued growth in credit to the private sector has been supported by a trend decline in weighted average loan rates. Notably, there was a marked improvement in the ratio of non-performing loans to total loans in commercial banks as evidenced in a decline in the ratio to 6.7 per cent at end-June from 8.4 per cent at end-March 2012.

**Near-term Outlook**

The outlook is for continued macroeconomic stability in the domestic economy and hence the stance of monetary policy is conditioned on sustained strong fiscal performance. The fiscal budget for FY2012/13 is expected to result in a reduction in the deficit to 3.8 per cent of GDP from 6.2 per cent of GDP in FY2011/12. An alternative measure of the fiscal effort is the projected increase in the primary surplus to 6.0 per cent of GDP in this fiscal year from 3.1 per cent of GDP in the previous fiscal year. The achievement of these targets is contingent on the announced tax measures yielding the budgeted revenue. Provisional data for the June quarter indicate that the performance of the fiscal accounts surpassed the budget. In particular, the fiscal deficit for the quarter was 0.6 per cent of GDP relative to the budget of 0.8 per cent of GDP while the primary balance was in line with the budget at 0.9 per cent of GDP. The implementation of a strong budget and the achievement of the targets bode well for the economy, given the need to reassure investors, international rating agencies and the IMF that the Government is committed to a policy of fiscal prudence and debt sustainability over the medium-term.

In addition to the fillip to confidence that the achievement of the fiscal targets will provide, it also forms the basis for sustaining low interest rates. Such an environment allows the Bank to manage inflation expectations more actively to achieve low and stable inflation in the medium term, in line with that of our main trading partners. In this regard, I encourage you to read the special article in this quarter’s report on ***The Importance of Managing Inflation Expectations.***

In conclusion, there are some uncertainties which could threaten the Bank’s inflation and growth forecasts. In particular, international commodity prices could be higher than the level we are currently forecasting. Further, we are currently in the height of the hurricane season and adverse weather could be disruptive to both growth and inflation. On the other hand, if external demand is weaker than projected, crude oil prices could be lower which would be positive for our inflation forecast but the reduced global demand would result in lower demand for Jamaica’s goods and services.

Ladies and gentlemen, we are indeed burdened with challenges both in the external and the domestic economic environment. However, with determination and application, there are opportunities for growth and success. I urge you therefore to take note of the comprehensive reforms which the Government is implementing which are all aimed at removing the impediments to growth. At the end of the day, national economic success will be driven by your individual efforts to take advantage of these opportunities.

Thank you.