Quarterly Press Briefing

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Governor

Bank of Jamaica
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Good Morning, Ladies and Gentlemen:

I am pleased to welcome you to the release of the Quarterly Monetary Policy Report for the quarter ended December 2009.

This press briefing is coming on the heels of the commencement of the Government's economic programme which is built on a series of far-reaching policy initiatives aimed at refocussing the economy towards growth and development. As you know, two vital but highly challenging elements of this programme were recently achieved: the Government's Debt Exchange Offer (the JDX) and approval by the Board of the International Monetary Fund of Jamaica's application for a loan of US$1.27 billion. The JDX (with acceptances now at 97% of the bonds eligible for exchange) is expected to yield interest savings of as much as $40 billion, while the first tranche of the IMF loan has already been disbursed and is now in the Bank of Jamaica's accounts, a sum of US$640 million.

Before turning to the developments in the review quarter and the near-term outlook for the economy, I would like to direct your attention to three special articles in the Report which seek to clarify some of the issues that are now being discussed. **Box 1** – *Bank of Jamaica's Liquidity Support to Government* – sets out the terms under which the Bank is allowed to lend to the Government as well as the amount that has been loaned since the December quarter. **Box 2** – *The Dynamics of Jamaica's Interest Rate* – should help to guide discussions regarding where rates can or should go. **Box 3** – *Jamaica's Medium-term Economic and Financial Programme* – highlights the main targets, conditionalities and measures contained in the Stand-by Arrangement with the IMF.

I will now turn to the Report starting with ***inflation*** - the prime focus of monetary policy.

Headline inflation was 2.8 per cent for the quarter, a decline relative to the 3.1 per cent recorded in the September 2009 quarter. This out-turn was within the range forecasted by the Bank in the previous report and was below the five-year average of 3.1 per cent for a December quarter. Annual point-to-point inflation at December 2009 was 10.2 per cent, a marked reduction from the 16.8 per cent recorded at December 2008. Similarly, for the fiscal-year-to-December, inflation fell to 8.8 per cent from approximately 11.0 per cent for the corresponding period of fiscal year 2008/09.

The decline in inflation for the quarter was largely due to increased supplies of some domestic agricultural items, weak domestic demand and a stable foreign exchange rate. These factors partly negated the impact on the general price level of higher energy related costs and increased costs of some short-term agriculture products and some household services.

For the March 2010 quarter, the Bank is forecasting an increase in headline inflation, albeit temporary. Inflation is expected to be in the range of 3.5 to 4.5 per cent for the quarter. The forecast for a higher level of inflation relative to the December quarter is based on the expected impact of Government's revenue measures and the pass-through of higher imported prices, mainly oil related. At the same time, weak domestic demand, continued stability in the exchange rate and lower prices for domestic agricultural commodities are expected to moderate the general rate of consumer price inflation.

For the fiscal year, inflation is expected to be in the range of 11.5 to 13.5 per cent. The upside risks to the inflation target are the second round effects of the Government's recent tax measures, stronger than expected increases in international oil prices and adverse weather conditions. This is balanced by the downside risks to the forecast which include a greater than anticipated contraction in demand due to the reduction in real incomes.

Foreign Exchange Market

The foreign exchange market was relatively stable in the December quarter. This was reflected in the marginal depreciation of 0.58 per cent in the weighted average selling rate. Most of this depreciation occurred in November (0.39 per cent) and was associated with increased demand to meet current account transactions, an increase in margin calls on certain financial institutions and net private capital outflows. However, direct sales of US$115 million (net) by the Bank, restrained trading activity by financial institutions and the retention of the foreign exchange facility for public entities helped to maintain stability in the market.

In the context of these developments, the level of the Net International Reserves was US$1,729 million at the end of December 2009, a decline of approximately US$204 million relative to the end of September 2009. Notwithstanding the decline in the NIR, gross reserves represented 13.4 weeks of projected goods and service imports, which was still above the international benchmark of 12 weeks. With the receipt of US$640 million from the IMF, gross reserves at the close of business on 8 February 2010 were US$2,390 million, or 16.9 weeks of imports.

Monetary Policy

With respect to monetary policy, the Bank reduced the interest rates payable across the spectrum of open market instruments by 200 basis points on 18 December 2009. The decision to reduce interest rates was taken in the context of favourable trends in some macroeconomic indicators such as inflation, the exchange rate and the current account of the balance of payments. The Bank's decision was also supported by the prospect of the early conclusion of a loan agreement with the IMF.

On 12 January 2010, the Bank removed all tenors over 30 days from its open market operations. This is a temporary action which should allow the market to establish a new yield curve in the post-JDX environment that is consistent with the expected improvement in the Government's fiscal and debt profiles. The Bank's recently adjusted 30-day rate of 10.0 per cent is consistent with the rates offered on the bonds under the JDX. Further adjustments in interest rates are contingent on continued improvements in the macroeconomic fundamentals and investor confidence.

Real Sector

Real GDP is estimated to have contracted in the range of 2.0 to 3.0 per cent for the December 2009 quarter, continuing the trend we have been observing since 2008. This was due mainly to the decline in the ***Mining & Quarrying, Transport, Storage & Communication, Manufacture*** and ***Construction*** sectors. However, it is estimated that there was strong growth in ***Agriculture, Forestry & Fishing***.

Against the background of continued weak demand in the global and domestic economies, we expect continued decline in the March 2010 quarter. The domestic economy is projected to decline in the range of 1.0 to 2.0 per cent. Continued contraction is expected in the ***Mining & Quarrying*** and ***Construction*** sectors while robust growth is projected for ***Agriculture, Forestry & Fishing.*** For fiscal year 2009/10, the forecast is for domestic output to contract in the range of 2.0 to 3.0 per cent.

Ladies and Gentlemen:
Let me now turn to the **27-month Stand-by Arrangement** for Jamaica that was approved by the Executive Board of the IMF on Thursday last week.

Under this Arrangement, Jamaica will receive a loan of US$1.27 billion. The IMF agreement paves the way for an additional US$1.1 billion from other multilateral financial institutions. These funds together with the successful completion of their accompanying conditionalities are intended to return the economy to a path of sustainable growth.

As you all know the Jamaican economy has been through tremendous difficulty, no doubt precipitated by the global economic and financial crisis. This is forcing us to change the way that we do business. Consequently, the fiscal authorities have committed to a package of policy measures which represent a break with the past. Measures are to be implemented to eliminate the overall public sector deficit over the medium term and put the debt to GDP ratio on a downward path. This will involve a process of fiscal consolidation aimed at streamlining expenditure and reforming the public sector. A Fiscal Responsibility Framework is being developed to place effective limits on borrowing and to establish rigid standards for accountability. There is also a requirement for the development of a comprehensive debt management strategy, a component of which is the JDX programme which most Jamaican bondholders have supported. There will also be reforms to further strengthen the financial sector.

With regard to monetary policy, this will be aimed at reducing inflation to mid-single digits over the medium term in the context of a flexible exchange rate. Against this background, the balance of payments is expected to improve significantly over the medium term.

Conclusion

We are all being called on to make sacrifices to ensure that we can achieve sustainable growth. We have already seen the market's commitment to lower interest rates with the exceptionally high level of participation in the JDX and the subsequent results of the Treasury Bill auction in January. A low interest rate environment will require all economic agents to make changes. Some of these changes will be far-reaching and it will no doubt take some time for us to become accustomed to them. But as time passes, the path to sustainable growth and development that is now being defined will become clearer.

Thank you.
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