BANK OF JAMAICA

Quarterly Press Briefing

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Bank of Jamaica

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Good Morning Ladies and Gentlemen:

There have been a number of important economic developments since we last met in November and particularly in the last few weeks. The National Debt Exchange was launched two weeks ago. On the same day, Parliament passed a set of tax measures, some of which will become effective in March. These developments complemented expenditure cuts announced the week before. Together, these actions paved the way for a conclusion of negotiations with the International Monetary Fund (IMF). A Staff Level Agreement was reached between the IMF team and the Jamaican authorities on 15 February which, subject to implementation of the remaining prior actions, paves the way for consideration of Jamaica's programme by the IMF's Board next month.

Against the background of these recent developments, I will first briefly reiterate some of the objectives and key elements of the macroeconomic programme which will influence the direction of monetary policy in the near to medium term. Then, I will give a synopsis of some of the external and domestic economic developments in the December 2012 quarter which influenced both the outlook for the short term and the Bank's policy stance. Of note, in the context of the current focus on fiscal consolidation, the Bank has included a special article on *Fiscal Expenditure Multipliers and Economic Growth*.

The Medium-term Macroeconomic Programme

As we are all aware, Jamaica has had a long history of low growth, high inflation, low levels of productivity and declining external competitiveness. The persistence of these factors has been associated with large fiscal deficits over successive years which have resulted in high and unsustainable levels of debt. The size of Government's debt service limits public investment that is needed to create the enabling environment for sustainable growth and development. The unsustainable debt level makes Jamaica more vulnerable to shocks and has eroded investor confidence.

There is an overwhelming case for reform in Jamaica. The debt/GDP ratio is now above 140%, growth has stagnated, productivity has declined, the deficit on the external current account has increased and gross international reserves have fallen close to the international benchmark of 12 weeks of goods and services imports. This is the context for the medium term macroeconomic programme which forms the basis for the recent agreement with the staff of the IMF. The central objective of the programme is to generate on a sustained basis meaningful economic growth over the medium term by removing the key economic bottlenecks of high debt and low competitiveness. In this regard, the programme is characterised by fundamental reforms, most of which are front-loaded.

The Government has committed to a process of extensive structural reforms which should lead to increased efficiency in the use of public resources, the strengthening and stabilization of the macroeconomic framework, higher levels of productivity in the economy and marked improvements in the country's external competitiveness. These commitments will require the central government to exercise restraint in expenditure while enhancing its revenue collections to deliver a primary balance of 7.5% of GDP over the medium term. The achievement of this very challenging target will contribute to a significant reduction in the debt/GDP ratio. With the welcome success of the National Debt Exchange, interest costs for central government have been lowered and financing pressures have been relieved by pushing out debt maturities by several years. The resulting substantial reduction in Government's appetite for debt will leave more resources for private sector investment and ultimately provide the basis for sustainable growth. Additionally, the structural reforms being undertaken by the Government will result in improvements in productivity and the business environment, thus creating the foundation conducive to private sector led growth and higher incomes over the medium to long term.

The reduction in fiscal dominance arising from steadfast implementation of these measures will enhance the Bank's ability to maintain single digit inflation. The Bank's long-term inflation objective is to reduce the annual rate of price increases to levels that are enjoyed by our trading partners. The Bank will continue to conduct monetary policy within the framework of a flexible exchange rate such that orderly adjustments in the exchange rate are reflective of the economic fundamentals. Of these fundamentals one that is vital for raising overall economic growth and employment is the maintenance of a competitive exchange rate that will facilitate investment for export growth and the expansion of import substituting industries.

With steadfast implementation of these measures, we will see a gradual rebuilding of net international reserves as the return of investor confidence should be accompanied by increased private and official inflows. It is anticipated that approval of the four-year Extended Fund Facility by the IMF Board and continued adherence to the medium-term economic programme will also encourage both foreign and domestic capital investments which should lead to the creation of increased employment.

Against that background, I will now briefly outline some of the contents of the Quarterly Monetary Policy Report (QMPR).

Review of Developments in the December 2012 Quarter

There was uncertainty in domestic financial markets during the December 2012 quarter. This was against the background of the continuing negotiations between the Government and the IMF, which contributed to acceleration in the pace of depreciation of the Jamaica Dollar vis-à-vis the US dollar and a further reduction in the NIR. In spite of these developments, the outlook for inflation remained favourable, due to lower than expected international commodity prices and persistently weak domestic demand as well as the containment of inflation expectations. Against this background, the Bank maintained the rate on its 30-day certificate of deposit at 6.25 per cent for the quarter.

Headline inflation was 2.6 per cent for the review quarter, in line with the average for the previous five December quarters but below the Bank's forecast range of 3.0 per cent to 4.0 per cent which was outlined in the QMPR for the September 2012 quarter. The deviation from forecast mainly reflected lower than anticipated international commodity prices as well as a lower-than-expected impact on domestic agricultural prices from the passage of Hurricane Sandy. In particular, there was an unexpected fall in fuel prices in the quarter and a slower than anticipated pass-through of the exchange rate depreciation.

There was an increased pace of depreciation in the exchange rate for the December quarter primarily reflecting excess demand for foreign currency for portfolio purposes. Of note, the net demand for balance of payments current account transactions, that is, external trade in goods and services, declined during the quarter. However, there was a decline of US$131.7 million in the NIR to US$1 125.6 million at end-2012. Accordingly, at the end of the year, the Bank's gross reserves amounted to US$1 980.8 million, representing 13.2 weeks of projected goods and services imports.

In the context of the persistent weak external and domestic demand conditions, Jamaica's real GDP is estimated to have registered a fourth quarter of contraction in the range of 0.0 per cent to 1.0 per cent. The impact of the passage of Hurricane Sandy on the domestic economy and the USA contributed to the estimated decline in economic activity in the quarter. The Bank estimates that there were contractions for all major industries with the exception of *Construction* and *Finance & Insurance Services*. Preliminary data for the agriculture sector indicate that domestic crop production contracted by 14.9 per cent relative to an average quarterly expansion of 6.7 per cent for the preceding three quarters.

Short-term Outlook

The Bank is expecting some recovery in the domestic economy in this quarter, albeit marginal, with growth projected in the range 0.0 per cent to 1.0 per cent. Given the forecast for the quarter, real GDP growth for FY2012/13 is projected in the range of negative 0.5 per cent to positive 0.5 per cent. The forecast is predicated on continued recovery in the global economy as well as favourable weather conditions.

Domestic inflation is projected to fall in the range of 2.0 per cent to 3.0 per cent for the March 2013 quarter. This forecast is largely due to an expected moderating impact from persistently weak domestic demand conditions, partly associated with the generally tight fiscal stance. In this regard, the main inflationary impulses in the quarter are expected to emanate from imported prices, mainly oil, as well as annual upward adjustments in the domestic economy to service fees and contracts such as rent. Given the forecast for the quarter, the Bank's forecast for inflation for FY2012/13 is unchanged in the range of 7.5 per cent to 9.5 per cent.

Monetary Policy Action

With respect to monetary policy action, the Bank recently announced a 50-basis-points cut in its policy rate from 6.25 per cent to 5.75 per cent effective today. This decision was informed by the relative weakness in the economy, the implementation of a further large fiscal consolidation during fiscal year 2013/2014, expectations of a tempered economic expansion in the next fiscal year and an outlook that inflation, though possibly somewhat higher than current levels, will remain within single digits. This action is aimed at supporting a recovery in the economy without igniting inflation.

Thank you.