

New Confidential Economic Bulletin

*The Private Sector Organisation of Jamaica
Monthly Analysis of the Jamaican
Economy*

September 1995

Number 1

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Overview

The continuing strong growth in base money and the difficulty which the authorities are having in getting M2 growth to come down under 30%, do not augur well for the containment of inflation and the relief of pressure on the exchange rate.

The proposed imposition of a liquid assets ratio on the merchant banks and the imposition of the special deposits on the commercial banks are indicative of the government's intention to shift more of the cost of its monetary policy to the financial sector and the borrowing public. This move will also maintain or widen the spread between deposit and lending rates, thus keeping a damper on economic activity.

With deposit rates hovering around 30% and the exchange rate still adjusting downwards, we are unlikely to see as yet the private capital inflows which occurred in 1994. Even when the exchange rate settles down, the spread between deposit rates and the inflation may be too narrow to encourage the level of interest rate arbitrage that fuelled the substantial inflows of foreign exchange in 1994.

The government must therefore look more to fiscal policy in its quest for economic stability.

The continuing decline in activity in the construction sector suggests that the economy is sinking into recession. The government's preoccupation with the exchange rate and their inability to end their reliance on credit from the central bank combine to make the near-term prospects for the economy rather bleak. Companies would be well advised to batten down the hatches and prepare for a pretty

rough 6-12 month period.

Further contraction of the economy and further pressure on profitability from cost-push inflation are likely to be the major factors with which local businesses will have to contend. The banking sector will be particularly affected by these developments.

The good news and the bad news is that next year is likely to be an election year. The Prime Minister has hinted strongly that he'll be going to the polls in the latter half of 1996, precisely when though, is anybody's guess.

General elections in Jamaica usually mean increased expenditure by government and a general loosening of economic policy to create an atmosphere of prosperity in the economy. With its open access to the Bank of Jamaica, finding the Jamaican dollars to spend will not be a problem for the government. However, ensuring that there is an adequate supply of US dollars to prevent the exchange rate from collapsing is another matter.

If government finances are handled carefully this may not prove to be too difficult in the short run as bauxite/alumina should do well next year and if the Net International Reserves are preserved until then, they could also provide a temporary cushion.

In this scenario, the bottom line for business is that there could be an easing of the economic squeeze in the second quarter of next year, followed by a short bubble of heightened activity. After that, we would probably be back to another round of adjustment and austerity.

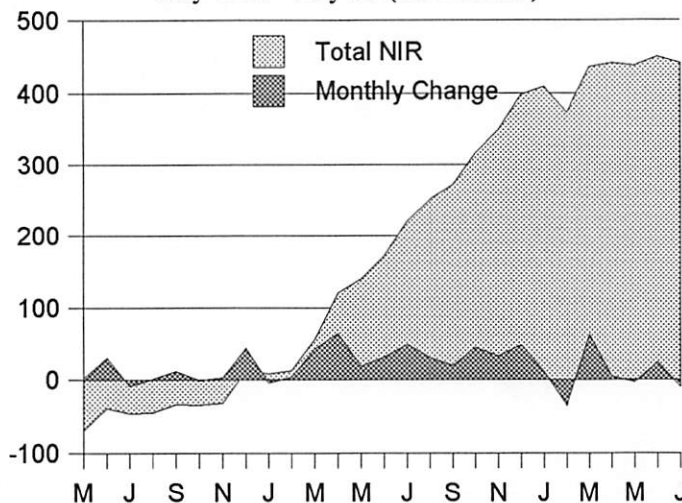
Net International Reserves

After increasing rapidly during 1994 to reach about US\$400 million by year end, the Net International Reserves have hovered around \$430 million for the first half of 1995. This has been a direct result of government policy as the Bank of Jamaica has been gradually reducing its purchases from both the authorized dealers and the cambios.

The government has finally realized that the build up of the Net International Reserve was primarily responsible for the strong growth of money supply last year which in turn kept the inflation rate high. The high inflation has now lead to the Jamaican dollar being somewhat overvalued and the exchange rate is again under pressure.

CHANGES IN INTERNATIONAL RESERVES

May 1993 - July 95 (US\$Million)



In the short-term the Net International Reserve may fall somewhat depending on the extent of the Bank of Jamaica's intervention in the foreign exchange.

Foreign Exchange Accounts

During 1994, with a relatively stable exchange rate, inflows to foreign currency accounts rose by 41%, moving from US\$460.7 million to US\$649.9 million over the period. Seasonal factors additionally helped to boost these inflows between October 1994 and January 1995 and balances rose by US\$47.2 million or 7.35%. However, February and March saw some declines accompanied by exchange rate slippage. Deposit levels picked up in April and levelled off over June and July. The provisional balance for August is US\$660 million.

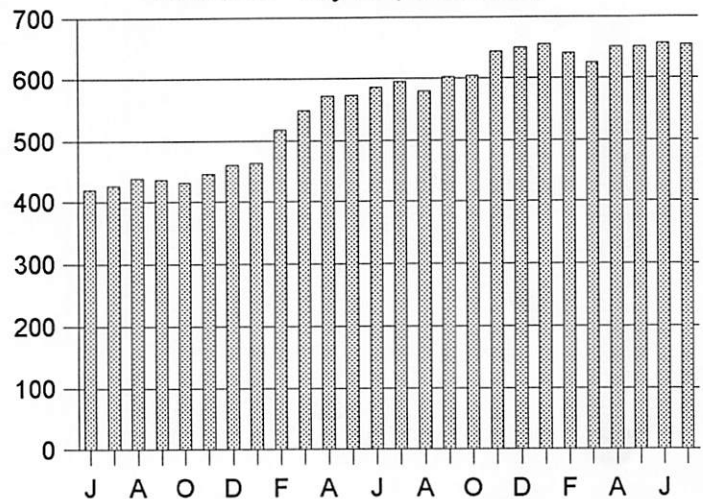
Exchange Rate

During 1994 the weighted average foreign

exchange rate of the Jamaican dollar to the US\$ remained more or less stable at about J\$33.40 to US\$1.00. It appreciated marginally

FOREIGN CURRENCY ACCOUNTS

June 1993 - July 95 (US\$Million)



in January to February 1995 similarly to the early months of 1994 - probably in response to seasonally influenced inflows. However, between

March and August 1995 an 8.2% depreciation of the rate occurred. The J\$ exchanged at 35.98 to the US\$1.00 at the end of August. The Bank of Jamaica's selling of foreign exchange into the market is likely to prolong the period over which the exchange rate adjusts and stability returns to the market. By year-end an inter-bank exchange rate of J\$38.00-J\$40.00, would represent a fairly optimistic outcome.

Interest Rates

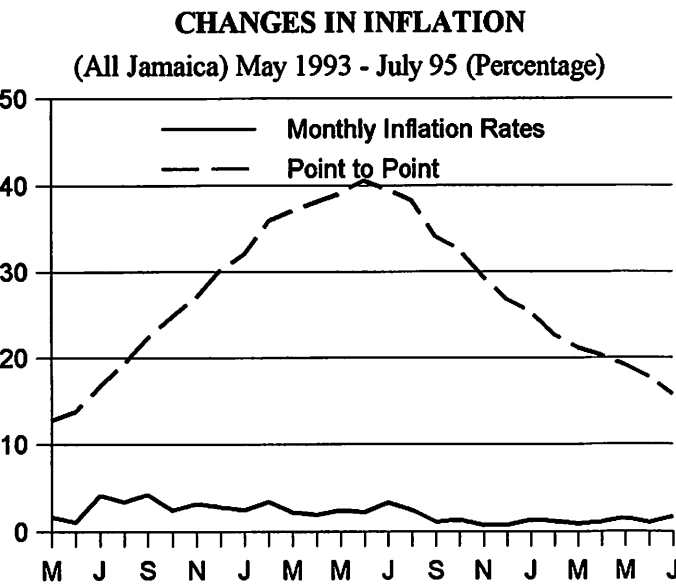
During 1994 as Government paper rates increased short-term investors were attracted and some foreign exchange inflows occurred to capitalize on the high returns. Commercial Banks' in order to survive were forced to increase their rates. Average loan rates therefore peaked at 67%, savings rates 40% and deposit rates at 52% during 1994. Towards the latter half of 1994, and continuing into 1995, as Government paper rates trended down commercial rates followed the trend. The lagged effect of this on the foreign exchange market became evident as in the early months of 1995, foreign exchange inflows fell and the exchange rate came under pressure by mid-year.

In August the government announced a package of measures designed to return stability to the foreign exchange market. Chief among these was an increase in the Reverse

Repo and Treasury Bill rates to about 29%. In addition, a special deposit scheme was announced for the commercial banks, the objective of which will be to sterilize a larger portion of the banks' deposits at the Bank of Jamaica.

Both actions are intended to dry up liquidity and drive up lending rates. The special deposits, on which below market interest rates will be paid, will have the effect of further widening the gap between deposit and lending rates. Unless government's attitude toward the protection of the exchange rate changes dramatically, this policy is unlikely to be relaxed any time soon.

While these initiatives will have the desired effect of stifling economic activity, unless deposit rates rise dramatically, we are unlikely to see the significant hard currency inflows such as occurred during 1994.

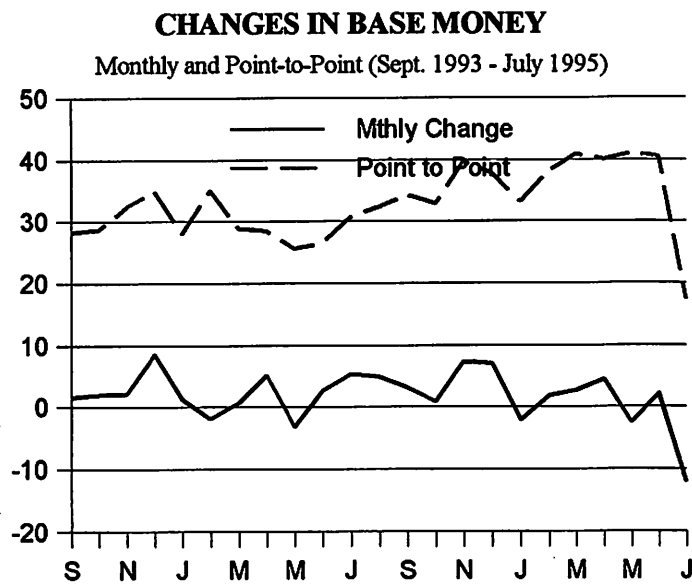


Inflation

Between January and August 1994 monthly inflation rates ranged between 1.9% and 3.4%, peaking in February at 3.4% and July at 3.3%. A declining trend began in September and continued for the rest of the year. The rates for November and December were below the projected rate of 1.0%. The point to point inflation rate however for 1994 turned out to be 26.8%.

The monthly point to point rates for most of the year indicated a higher level of price increases being experienced. These ranged between 32.7% and 40.6%. For the first four months of 1995, monthly inflation rates have kept more in line with last quarter months of 1994. Although May showed an upward movement in the rate, June was as projected.

However, July's rate showed an upward trend to 1.7%, resulting from downward movement in the Jamaican dollar which resulted in all round price increases. If the slide of the dollar continues or is even halted somewhat - prices will keep rising for some time possibly to the end of the year, so that average monthly inflation should be between 2% and 2.5% for the rest of the year achieving an annual rate of 18-20% for 1995.



Base Money

The cumulative change in base money for 1994 was 37.8%. The most significant contributor to this was a 43.6% rise in Commercial Banks' Statutory Cash Reserves held at Bank of Jamaica. The period January to June 1995, reflected the seasonal influence of December with Commercial Banks' Cash Reserves and Base Money increasing by 15.5% and 6.4% respectively. In 1995, all three variables, currency issues, commercial banks' cash reserves and current account rose by 8.6%, 8.7% and 8.9% respectively.

The differences shown between both periods for the movement of currency issues indicate the impact of seasonal demand for money and the amount of currency issued. The figures for the first half of the year also indicate low and continued growth in cash reserves, base money and currency issue. In July the 12.1% or J\$3.0 billion fall in base money resulted mainly from Bank of Jamaica's J\$3.0 billion liquidity support to Century National Bank. The twelve months point to point rate of change in base money dipped to 17.35% in July 1995 and compared with a point to point rate of 40.15% in June 1994 and 30.78% in June 1995. This fall in the rate of base money

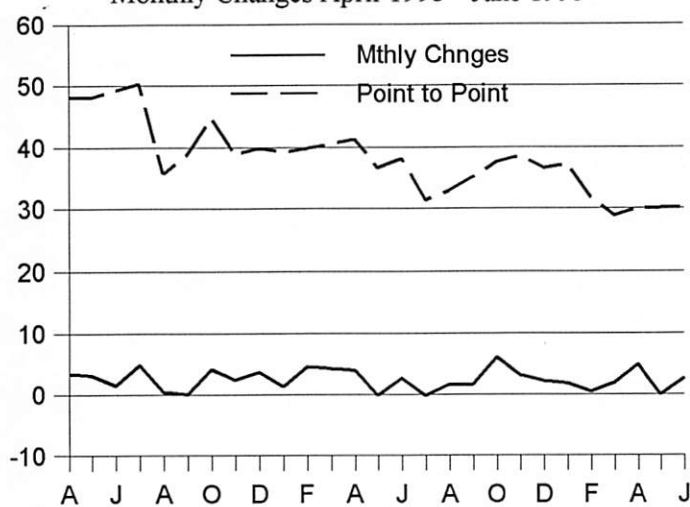
growth is misleading as it comes about due to the \$3 billion O.D. of the commercial banks at Bank of Jamaica. This is actually likely to fuel money supply growth unless Bank of Jamaica steps up its open market operations.

Money Supply

Although there was a 36.6% overall growth in M2 in 1994. The five month period January to May 1995 indicate a slight slow down in its growth and coincides with the trend of the point to point changes over a two year period. A review of activities in the variables determining changes in M2, indicate that there

CHANGES IN M2

Monthly Changes April 1993 - June 1995



is a decline in the growth rate of the acquisition of foreign assets as well as in the utilization of credit by the private sector. However, large monthly fluctuations in net public sector credit balances suggest high levels of Government expenditure - either by way of loans or deposit drawn downs or combinations of both.

The implications for this scenario, could be: (1) that movements in interest and foreign exchange rates may be prompting general caution and conservation in credit use. (2) That, if Government's expenditure is by way of utilizing loans - this could be both expansionary and inflationary.

Tourism

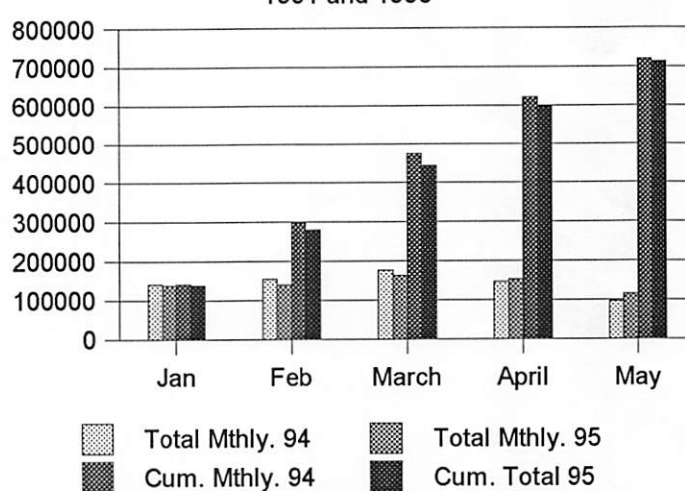
Total visitor arrivals for 1994 showed a 2.5% decline over 1993, and earnings from the sector were US\$925 M for 1994 or 2.7% less than the US\$951 M earned in 1993. For the period January to May 1995 total arrivals stood at 730,528 or 2.4% above total arrivals for similar period in 1994. Comparing May 1995 and 1994, stop over visitors totalled 80,121 up by 16.8% and cruise ship arrivals

were 34,827, also up by 19.9%. Arrivals for the period April and May 1995, have shown some increases over that of similar months in 1994; Jamaica's carnival and West Indies/Australia Cricket matches being the major factors behind April's increased arrivals.

Optimism is also being expressed regarding a good summer season and 1995 being a better year for tourism than 1994. Earnings for the January to May period of 1995 are estimated at US\$378.6 million, 0.5% below the similar period in 1994.

TOURIST ARRIVALS

1994 and 1995



Merchandise Trade

For the first five months of 1995, the value of imports amounted to US\$1026.9 million; a US\$176.5 million or 20.7% increase over the comparable 1994 period; while exports totalling US\$593.4 million rose by US\$104.0 million or by 21.3%. The trade gap for the period was US\$433.5 million showing a US\$72.5 million wider deficit than at the similar period in 1994. While both imports and exports show growth, the persistence of a widening trade deficit, is indicating a worsening of our external account and a trend which could have a negative impact on the Net International Reserves (NIR) and the exchange rate.

Factors driving import growth include increased imports of Consumer Goods of which 'food' rose by US\$23.3 million. Imports of Industrial Supplies, Raw Material and Intermediate Goods rose by US\$41.0 million, while Capital Goods experienced a US\$63.4 million increase. Of this, increased imports of motor car accounted for US\$8.3 million. During the period, earnings from all

categories of exports experienced some level of increase which contributed to the overall rise in the value of exports. The apparel sector continues to dominate with its US\$116.6 million contribution to earnings for the non-traditional category over the period.

BALANCE OF PAYMENTS PROFILE: US\$Mn

	Merchandise	Services	Transfers	Current A/c	Capital A/c	NIR A/c
1994	-957.80	502.70	571.70	116.60	268.80	397.92
Jan-May '94	-361.00	207.50	165.40	11.90	115.40	139.82
Jan-May '95	-433.50	178.10	248.90	-6.50	46.10	437.60

MONTHLY MACRO-ECONOMIC INDICATORS

(June 1994 - July 1995)

MONTH S	BASE MONEY		NET INT'L RESERVE	FOREX ACCTS.	INFLATION		TOURIST ARRIVALS			CHANGES IN M2	
	Mmly Chng	Point to Point	Total NIR	Total Balances	Mmly Chng	Point to Point	Total Visitors	Stop- overs	Cruise	Money Supply	Point to Point

Jun. 94	2.60	26.48	171.19	585.98	2.2	40.61	117300	79330	37625	2.65	38.14
Jul.	5.25	30.78	220.62	595.38	3.3	39.59	127554	94963	32370	-0.20	31.38
Aug	4.85	32.40	251.49	579.61	2.4	38.29	120728	88518	32108	1.68	32.95
Sept	3.13	34.40	271.68	601.83	1.1	34.08	98369	64106	34052	1.75	35.12
Oct.	0.86	32.98	316.04	604.92	1.3	32.60	114263	69130	44862	6.15	37.59
Nov	7.40	39.80	349.41	643.55	0.7	29.40	137119	71983	65136	3.18	38.52
Dec	7.07	37.83	397.92	649.76	0.7	26.80	147290	94127	53017	2.31	36.57
Jan 95	-2.13	33.19	408.70	655.12	1.3	25.40	138969	81385	57570	1.85	37.22
Feb.	1.79	38.18	373.13	640.34	1.1	22.70	140787	86147	54281	0.55	31.82
Mar	2.64	40.85	435.30	625.15	0.9	21.20	164222	96378	67844	1.99	28.89
Apr	4.43	40.01	440.41	651.30	1.1	20.76	153604	98342	55262	4.93	30.01
May	-2.43	41.09	437.55	651.40	1.5	19.20	114948	80121	34827	0.00	30.16
Jun.	2.17	40.51	449.89	656.30	1.0	17.80	-----	-----	30773	2.70	30.22
Jul.	-12.1	17.35	440.35	654.50	1.7	15.80	-----	-----	36780	5.88	38.15

Source: Compiled from National Statistics as Supplied by Bank of Jamaica, Planning Institute of Jamaica and Jamaica Tourist Board.

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