New Confidential Economic Bulletin

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

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Overview

Towards the end of this month, the downward slide in the exchange rate accelerated, with the spread between the official and parallel markets widening to about 10-12%. While the official market traded between J$38 and J$39 to US$1.00, the parallel market traded large blocks of funds at rates up to about J$43.50 to US$1.00. Foreign exchange remained in short supply within the official market.

Despite the fact that we continue to be surprised and concerned everytime the Jamaican dollar enters another round of devaluations, we should really be quite accustomed to it by now. Since 1974, the J$ has lost value at an annual compound rate of 16.4%, and since 1990 the pace of devaluation has accelerated to an annual average compound rate of approximately 30%. Put another way, the exchange rate of the J$ versus the US$, has been increasing at an annual average rate of 43% compounded, since 1990. You don't need a PhD in Mathematics to figure out what the exchange rate will be in the year 2000 if we continue on this path.

Unfortunately, there is very little in the way of public policy development to suggest that we will be halting the long-term slide anytime soon. The government remains opposed to the idea of a truly independent Bank of Jamaica and thus the likelihood of a really effective monetary policy remains rather remote. Despite the high interest rates, money supply continues to grow at about 40% per annum and herein lies the central problem facing the economy.

Government also continues to resist the down-sizing of the public sector, even as the civil servants demand large wage increases way above the budgeted provisions. At the same time government is having to find more money to service its huge local debt, the cost of which is being driven even higher by the present round of interest rate increases. Fiscal policy must be tightened if the country is to break the current cycle of inflation, devaluation and stagnation and cutting expenditure must be the first step in this direction.

Next year is looking like a year of significant contraction in the economy, as inflation is on the rise and the declining exchange rate will cut consumption. The Minister of Finance has vowed to keep interest rates higher for longer and that will provide a further brake on economic activity.

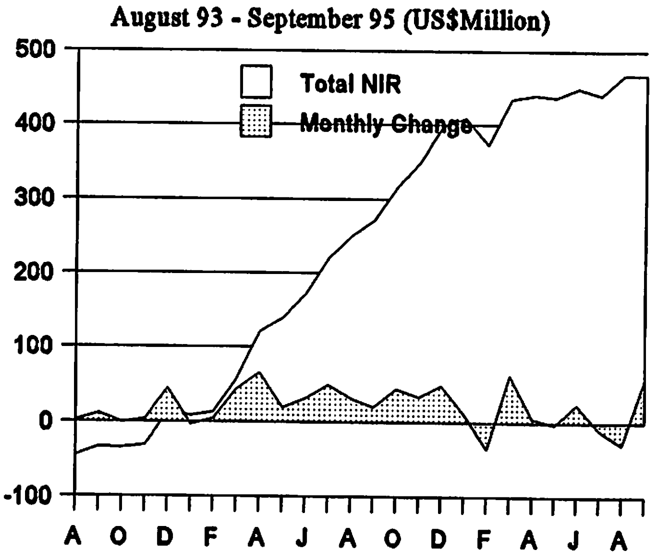
A major challenge for private businesses will be the control of wage costs. The present policy framework will put pressure on margins at the best of times and if government does manage to achieve even a moderate reduction in the rate of growth of money supply, many firms could experience a significant fall in real income. In such a scenario it will be very difficult to absorb a significant increase in real wage costs. These costs have been growing quite strongly over the last two years and have been validated somewhat by the poor control of the money supply. If and when this ceases to be the case, the consequences for private businesses could be quite awkward.

Net International Reserves

The Net International Reserves which grew by 3062.9% during 1994, amounted to just under US$400 million by December of that year. However, January to September 1995, saw a significant decline in its rate of growth and the reserves now appear to be levelling off. At the end of September they reached US$468 million growing by 17.6% since January. During 1995, the Net International Reserves showed monthly fluctuations - as some of these funds were used for external debt - servicing as well as for intervention in the foreign exchange market in order to support the local dollar. Although the increase in the Net International Reserve was not as strong as in 1994 it accounted for about 30% of the gross increase in M2 over the first eight months of this year.

CHANGES IN INTERNATIONAL RESERVES

August 93 - September 95 (US$Million)



Government has stated that it is only planning a small increase in the Net International Reserves for this year, so that it is unlikely to grow much more by year end and there may be some fluctuation in the levels before then.

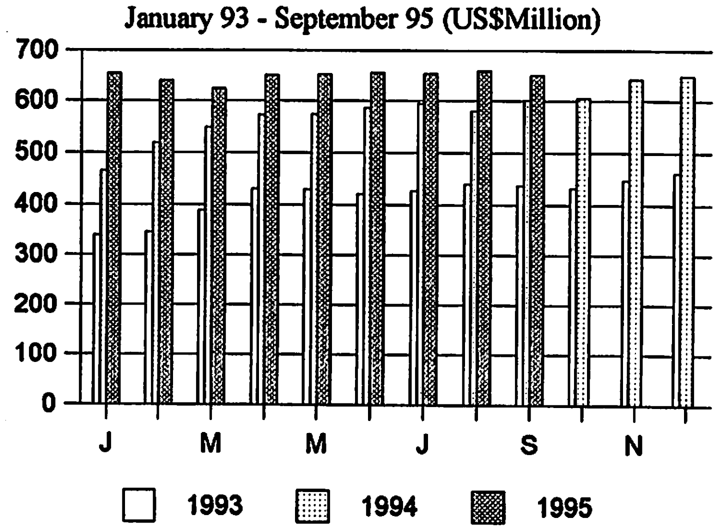
Foreign Exchange Accounts

At September, the value of Foreign exchange accounts stood at US$651 million, indicating a marginal decline over August's - US$660 million. However, deposit levels for 1995, are overall, about 1.5 to 2 times that of the monthly average of 1993 and about equal that of the last quarter of 1994.

Although the 1995 monthly levels have shown some measure of fluctuation, there is no evidence of a declining trend. However, there still appears to be a preference to keep funds in US dollars in order to maintain the store of value, hedge against inflation and ensure availability when needed. Resultingly, less is made available for spot sales.

FOREIGN CURRENCY ACCOUNTS

January 93 - September 95 (US$Million)



After nine months in 1995, activities in the foreign currency accounts, have intensified as average monthly withdrawals and lodgements have significantly increased, these by 32.6% and 23.2% respectively - September 1995 and 1994 compared. As well, foreign currency loans outstanding at September 1995 were 46.64% higher than at September 1994. However, spot purchases and sales - September 1995 versus September 1994 show declines of 15.5% and 16.7% respectively.

The combination of these trends in activities on the foreign exchange market could be indicating a growing dollarization of the economy with activity in US dollar running parallel to and competing with J$ denominated activities, and if the trend intensifies, there might eventually be no need for Government legislation to effect a dollarized Jamaican economy.

Exchange Rate

At the end of September 1995, the US$ exchanged at J$37.35, indicating an 11.9% depreciation since the start of the year. Although the Jamaican dollar appreciated 0.41% between January and February. Depreciation has been at the average rate of 1.7% monthly for the seven months March to September, with the steepest declines of 2.63% and 5.71% in August and September respectively.

Government's intervention in the foreign exchange market July through mid October does not appear to have been overly vigorous and may have been aimed more at slowing the decline of the local currency rather than in actually stabilizing it.

As the exchange rate continues its fall, it appears that it is correcting for past periods of seeming stability during which local inflation was much higher than that of our major trading partners. This being the case, the J$ appears to have some way to fall before achieving its equilibrium value.

The pending winter tourist season although being touted as having great prospects in terms of foreign exchange earnings offers very little prospect of a halt in the decline in the exchange rate as it is the excess of J$ which is driving the rate, rather than a shortage of US dollars.

An interbank rate of J$40 - 42 for the US$ by December 1995, therefore is not likely.

Interest Rates

As Government continues to pursue monetary policies designed to dry up liquidity and stem the demand for foreign exchange in order to stabilize the exchange rate; it continues to offer large tenders of treasury bills and actively engage in reverse repo transactions on the local short-term money market.

By the end of September T-Bills rates had risen to 30.22% and by late October the tender was clearing at just under 37%. Resultingly, deposit rates in the financial sector continue to climb. Between July and September average fixed deposit rates moved from 14.5 - 26% to 17 - 30%. However, average saving and loan rates have tended to stabilize at 17.35% and 48.23% respectively. Although average overall rates are climbing they are significantly lower than they were at the similar period in 1994. Average fixed deposit rates at September 1994 were 21-35%, Savings 19.33% and Average loan rates were 61.30%.

It is not expected that current levels of loan rates will hold for long. As the cost of funds (deposit rates) increase to compete with T-Bill rates, loan rates will rise so that by November/ December they could be in the high 50s to low 60s.

The high interest rates do not seem to be containing money supply growth and hence they are not really contributing much to the control of inflation. There is every reason to suspect that the cost of this policy is now part of the problem and less and less part of the solution.

Interest rates are likely to continue rising through the rest of the year and could approach the peaks of the 1993/94 period. They're unlikely to fall intil some degree of exchange rate stability is achieved.

SELECTED INTEREST RATES (%)

	1994			1995		
	Mar.	Jun.	Sept.	Mar.	Jun.	Sept.
Fixed Deposit 3-6mts	21-53	21-43	21-35	14.5-24	14.5-24.5	17-30
Saving Deposit	18.76	19.01	19.33	18.06	17.49	17.35
Loan Rates	66.90	65.00	61.30	48.82	48.73	48.23
GOJ Treasury Bills 6mts	50.04	44.36	38.07	22.95	24.24	27.96
12mts	—	—	41.30	—	—	30.22

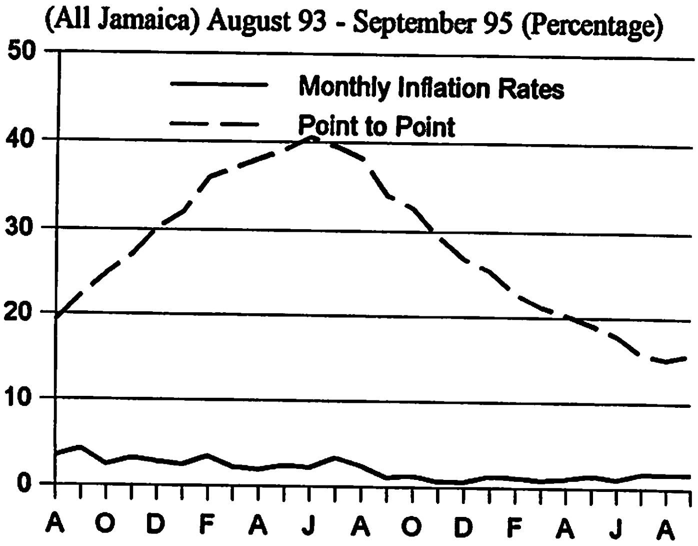
Inflation

In September 1995, the Consumer Price Index was 789.4, showing a 3.0% rise in inflation for the month. This was a 1.3 percentage points higher than that of July and August. Inflation for the year to date was 14.02% compared with 20.5% for the similar period in 1994, and the point to point rate - September 1994 to September 1995 stood at 17.2% in comparison to 34.8% for the previous period in 1994.

The rise in inflation for September appears to be influenced significantly by the effects of a depreciating exchange rate on prices/costs. Therefore the continuing depreciation of the J$ will foster and sustain a higher level of inflation in the economy than was evident in the earlier months of 1995. To this end, the inflation rate

CHANGES IN INFLATION

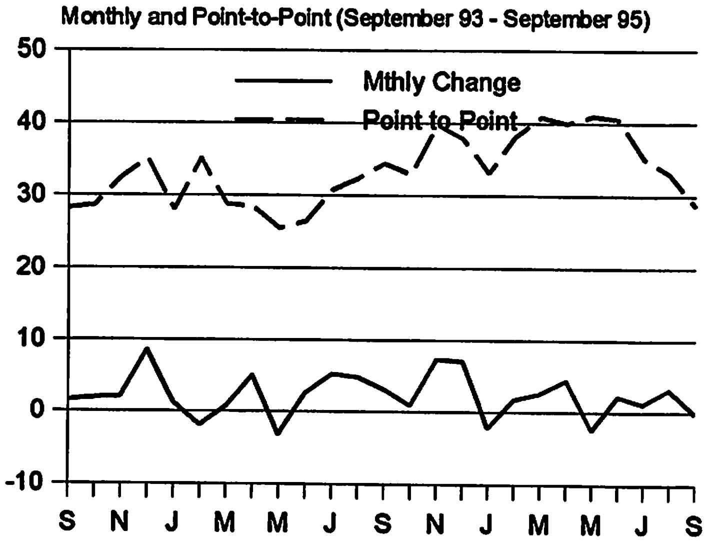
(All Jamaica) August 93 - September 95 (Percentage)



for 1995 could reach 25% and the monthly rates for early 1996 could closely mirror those for the later months of 1995. Fiscal year inflation could be in the region of about 30 - 34% and rising.

CHANGES IN BASE MONEY

Monthly and Point-to-Point (September 93 - September 95)



Base Money

The September base money report, indicated that the commercial banks were in overdraft at the Bank of Jamaica, suggesting a considerable tightening of liquidity. These figures did not include the over $2 billion which was still outstanding on Century National's account.

Welcome news is the fact that the 12 month point to point rate of increase of base money has fallen back to 30% and if this trend continues then there will be some hope of slowing the rate of growth of the broader measures of money supply. This in turn would herald the hope of lower inflation in the short to medium term.

Money Supply

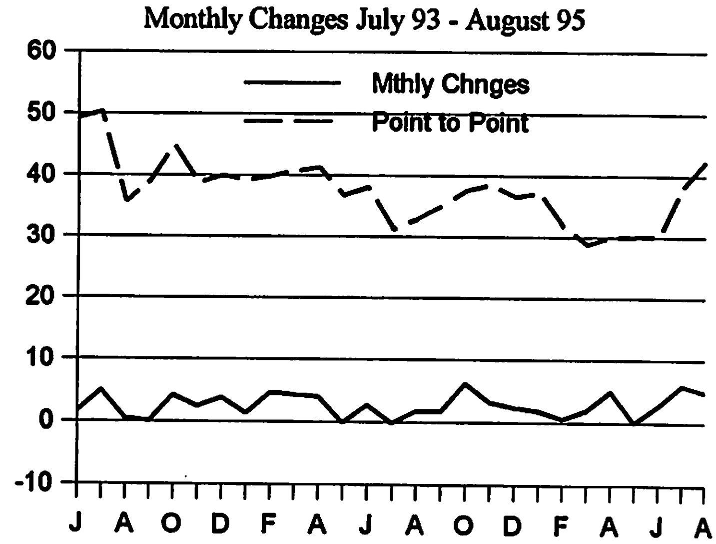
The period January to August 1995, saw a 24.9% growth in Money Supply. Monthly growth rates have fluctuated between 0% and 0.55% in February and April respectively and 4.93% and 5.88% in April and July. There was a 4.84% increase in money supply in August while the 12 month point to point movement was 42%. This movement in money supply in August was fueled by Bank of Jamaica actively purchasing foreign reserves, thereby putting additional money in circulation. There was also some 8.8% increase in credit extended by the private sector and other financial institutions.

Together these activities contributed to the overall increases in the levels of M2 for August.

As the Christmas season approaches, the attendant activities are expected to influence considerably the demand for money and hence have a positive effect on increasing money supply. Civil service back pay, salary increases and Christmas work could cause a big jump in public expenditure, thus further aggravating this problem.

CHANGES IN M2

Monthly Changes July 93 - August 95

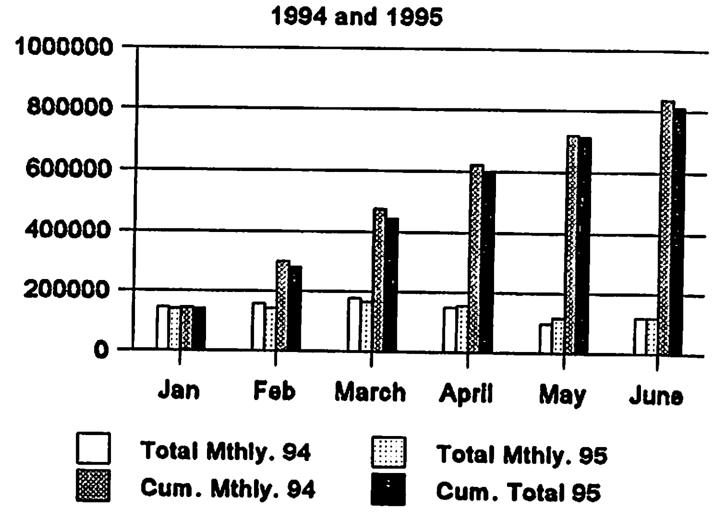


Tourism

For the period January to June 1995, tourist arrivals stood at 807,479 or 5.9% above total arrivals for the similar period in 1994. Stop-over visitors increased by 3.3% and cruise-passengers by 10.8%. If arrivals of nationals were to be included as was previously done, up to 1994, the overall total arrivals would be 858,977.

TOURIST ARRIVALS

1994 and 1995



Comparing visitor arrivals for June 1995 and 1994, cruise ship passenger were 30,773 or 18.2% less than in 1994. However, stop-over arrivals (non-nationals) totalled 87,480 or 10.3% more than in 1994.

The mid-year figures having verified an increasing trend in the number of total arrivals, there is the expressed hope that this recovery will continue. In fact with the recent hurricanes having destroyed the tourism plant in some Caribbean destinations, Jamaica, offering a comparable if not superior product, could see increased arrivals in winter 1996. The industry should therefore look forward to surpassing its 1993 achievements in arrivals and earnings.

Estimated earnings for the industry up to June 1995 was US$ 458.9 million or 2.32% over earnings for the similar period in 1994.

Merchandise Trade

The periods January to June 1995 and 1994 when compared, saw the merchandise trade gap widen by US$159.4 million or 39% to reach US$568.1 million. This resulted from a 26.5% rise in imports to reach US$1285.5 million and a smaller 18.1% rise in export earnings to reach US$717.4 million. At the end of June 1995 total exports valued just 44.2% of total imports.

The export sectors continued to register increased earnings. The most significant growth in the non-traditional sector was in the

apparel sector (37%) food exports (22%) and in the traditional sector - mining (alumina) 8.5%, sugar 22.4%, coffee 56% and bananas 8.9%.

However consideratble improvement in export output and earnings needs to be achieved to help narrow the consistently widening trade gap.

All categories of imports showed increases when the periods January to June 1995 over 1994 are compared. Consumer goods rose by 48.9% - this was fueled by a 69.4% rise in food imports, a 28.4% growth in motor car imports and 55.5% increase in imports of non-durable consumer items. Raw material imports rose by 14.8%, and capital goods by 45.3%.

As the focus now, is on economic growth and development, there needs to be less imports of consumer goods and more imports of capital goods and raw materials. At June 1995, consumer goods had a 23% share of total imports, raw materials 58% and capital goods 18.9%. It should be noted that a significant portion of raw material imports is food, oil and spare parts which also have a high consumer demand. Increased imports of capital goods for manufacturing, retooling etc, could foster increased output to boost export earnings, as well as provide import substitutes to effect cuts in the import bill and ultimately be less damaging to the Balance of Payment account.

Unfortunately, monetary policy seems to be depressing investment while leaving consumption growing strongly.

BALANCE OF PAYMENTS PROFILE: US$Mn

	Merchandise	Services	Transfers	Current A/c	Capital A/c	NIR A/c
Dec. 1994	-957.80	502.70	571.70	116.60	268.80	397.92
Jan-June '94	-408.70	238.20	203.10	32.60	126.10	171.19
Jan-June '95	-568.10	219.60	304.70	-43.80	95.80	449.90

MONTHLY MACRO-ECONOMIC INDICATORS
(June 1994 - September 1995)

MONTHS	BASE MONEY		NET INT'L RESERVE	FOREX ACCTS.	INFLATION		TOURIST ARRIVALS			CHANGES IN M2	
	Mthly Chng	Point to Point	Total NIR	Total Balances	Mthly 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	652.68	1.1	20.76	141814	86552	55262	4.93	30.01
May	-2.43	41.09	437.55	651.42	1.5	19.20	106772	71945	34827	0.00	30.16
Jun.	2.17	40.51	449.89	656.38	1.0	17.80	118253	87480	30773	2.70	30.22
Jul.	1.17	35.06	440.35	654.50	1.7	15.80	------	------	36780	5.88	38.15
Aug	3.21	32.95	411.23	660.00*	1.7	15.1	------	------	42451	4.84	42.44
Sept	-0.17	28.69	468.00	651.0*	3.0	17.2	------	------	------	----	------

* Provisional

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