New Confidential Economic Bulletin

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Monthly Analysis of the Jamaican Economy

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Overview

At the beginning of the month, the Prime Minister made another televised address to the nation, in which he outlined further steps which were to be taken to stabilize the exchange rate. The measures included more aggressive open market operations to drive up interest rates, the deferral of government expenditure in order to increase the public sector surplus, the freezing of public sector deposits at the Bank of Jamaica and the cessation of government borrowing from the Bank of Jamaica. He also expressed the government's intention to continue its use of the Net International Reserves to sell into the foreign exchange market.

The results of these measures have been a dramatic tightening of liquidity in the financial system and a convergence in the foreign exchange markets (official and parallel) at a selling rate of between J$40 - J$41 to US$1. The volume of funds flowing through the official market has also increased significantly in recent weeks. The latest Treasury Bills issue has cleared at about 42% and it may be that some reverse capital flows are now taking place. Lending rates are also moving up rapidly and overdraft rates are back in the high 50's and low 60's in some institutions.

We're back to the ultra high interest rate policy of late 1993 and early 1994 and the same questions which arose then are again applicable:

What will happen when interest rates fall again, as they must in-evitably do, and

Is the cost of this policy really worth the benefit of a mere postponement of the unavoidable adjustment in the real exchange rate.

At the moment these questions are somewhat rhetorical as government has set its course and for the foreseeable future appears to be committed to a high interest rate policy. Interest rate arbitrage and the money market could therefore again become major economic opportunities.

One also has to wonder how tight will fiscal policy be since government has agreed to some large wage settlements with public sector workers. When these payments fall due, they will test severely the commitment to cease borrowing from the Bank of Jamaica and could increase the money supply if they're not financed responsibly.

Private companies will also find themselves under fairly intense pressure, especially those that are carrying substantial debts. After two and a half years of high real lending rates, these companies are in a very poor financial state and the financial institutions which hold their debt are also being affected by the resulting non-performance of these loans.

In a shrinking economy where the equity market is moribund and the real estate market is very soft, there are not many options open to highly-indebted companies that are losing money. Those that are asset rich can presumably have a fire sale and reduce their debt load, but for those that are not, the only option may be aggressive cost control.

But how long is this new phase of high interest rates likely to last? The Minister of Finance has said "as long as necessary" and the initial indications are that it will be a minimum of 8 months and quite possibly 12 or 15 months. A major factor in this regard is the impact which the policies will have on the economy in general and business in particular. As the economic and social pressure increases, there will be mounting pressure on the government to lower interest rates.

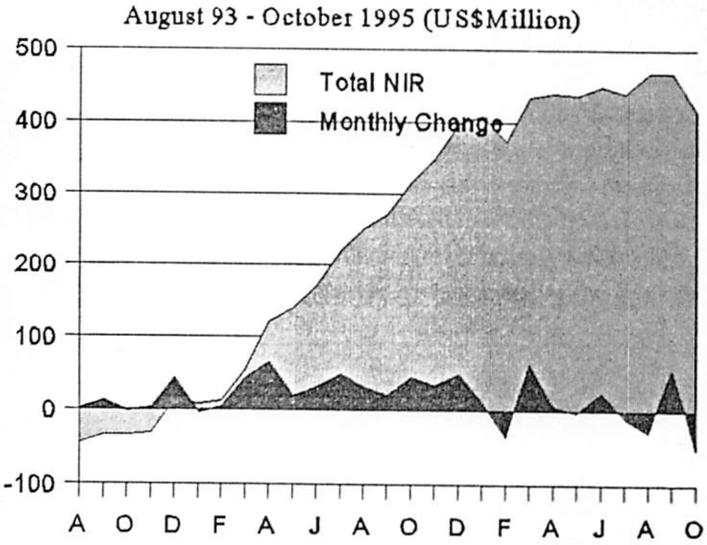
The timing of the next general election will be a critical factor in determining when and to what extent there will be a relaxation of the present policy. Government obviously wants to minimise the decline in the exchange rate between now and the next elections and so we're unlikely to see much change before they are about to be called.

Net International Reserves

As at October Net International Reserves stood at US$416.42 million indicating an 11.03% decline over September. This partly reflects Governments intervention in the foreign exchange market by way of sales to Authorized Dealers as well as its reduction in foreign exchange purchases from the Cambios.

CHANGES IN INTERNATIONAL RESERVES

August 93 - October 1995 (US$Million)



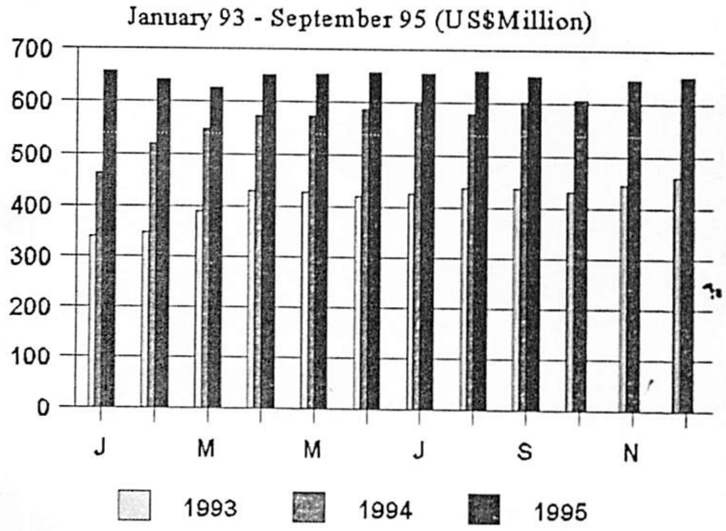
Government's intervention in the foreign exchange market has continued in November and it will be interesting to see the impact of this on the Net International Reserves at the end of the month. It should be noted that a fall in the level of the Net International Reserve has a contractionary effect on money supply as local funds flow into the Bank of Jamaica and out of circulation in the economy.

Foreign Exchange Accounts

The Estimated value for foreign exchange accounts at the end of October stood at US$630 million, indicating no change over that for September. Accounts balances appear to be levelling off but should show some increases December into January following the trend of previous years. Lodgements and withdrawals to these accounts in October were US$478.0 and US$472.42 respectively, compared with US$330.5 in 1994. Outstanding foreign currency loans stood at US$351.3 million at the end of October, 49.64% higher than in October 1994. Interest rates on these ranged between 11.5% and 16.0% as existed in October 1994. While Deposit rates moved marginally from 2.8% to 7.5% in October 1994 to 3.25% to 8.0% currently.

FOREIGN CURRENCY ACCOUNTS

January 93 - September 95 (US$Million)



Exchange Rate

The Jamaican dollar has experienced a 16.6% depreciation on the official market between January and October of 1995. However, from March this year, there was the re-emergence of activity in the informal foreign exchange market. By September there had emerged about a 10% spread between the official and parallel markets' rates. However, this spread has now been narrowed to less than 5% and both markets appear to be converging.

If there is continued intervention in the foreign exchange market and the supply side picks up from the effects of seasonal factors, there could be an official exchange rate of J$39 to 40 to US$1 by the end of the year.

Interest Rates

As Government continues to use interest rates quite vigourously to achieve its monetary policy objectives, a cyclical trend in interest rate movement appears to be developing, so that the current upward movement in rates is likely to hit a high by year end to first quarter next year only to be gradually reduced by mid-year to third quarter.

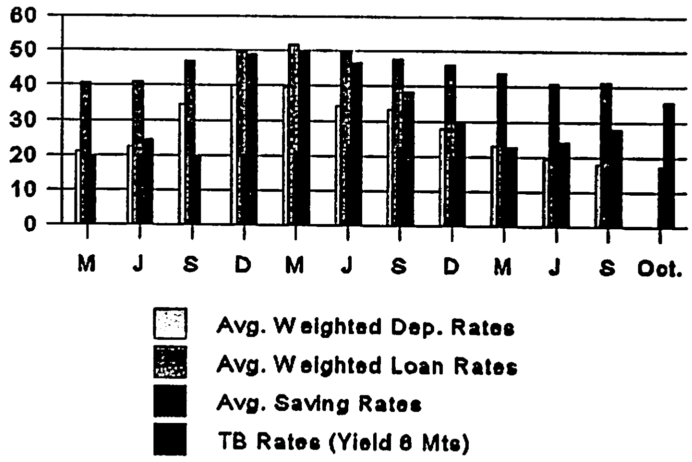
The pace, direction and movement in interest rates are set by offerings on gilt-edged government securities. The latest issue of T Bills yielded 42.5% and the November offer on LRS for seven (7) years was 42.84%. This together with Government's expressed intention to maintain a high interest rate policy until its obejectives are achieved, portends an increasing trend in interest rates and currently sets real deposit interest rates in the 15-20% range.

This high interest rate policy not only acts as a deterrant to investment and growth but causes Government to accumulate a heavier debt burden on the country which will be repaid only at a great economic and social cost to its citizens. This type of activity should be accompanied by prudent fiscal management and the implementation of programmes for eliminating these debts.

As interest rates trend upwards, and the instability in the foreign exchange market continues, overall activity on the stock market remains sluggish. However, for the first two weeks in November, the market was fairly active and by mid month the advance-decline-unchanged ratio was 5:19:24 compared with 6:16:26 in mid October.

Comparative Interest Rates

of Commercial Banks (1993, 1994 and 1995)



Inflation

The official figures on inflation have not yet been released. However, in-house projections on inflation predict a 2.75% inflation rate for October. These are based on the assumption that the following have affected prices/costs and in turn had a positive effect on inflation.

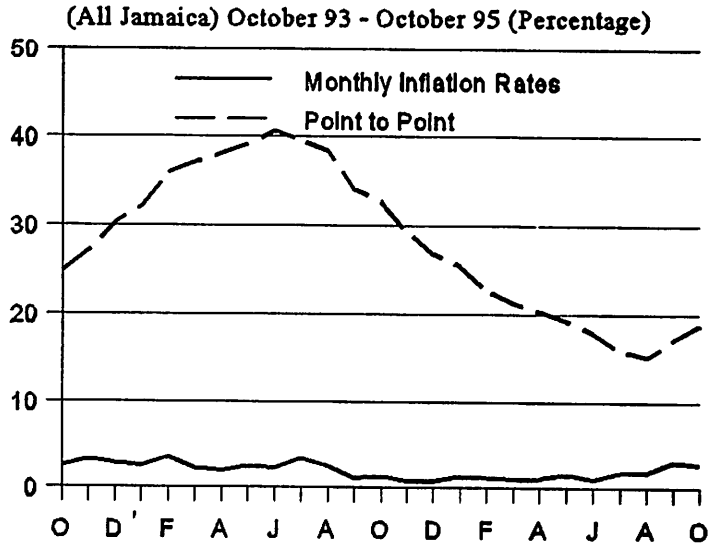
a. rising interest rates have caused increased costs.

b. the depreciation of the local currency which will express itself in rising prices.

c. prices of many food items have risen - eg. chicken, milk, starches and imported vegetables.

CHANGES IN INFLATION

(All Jamaica) October 93 - October 95 (Percentage)



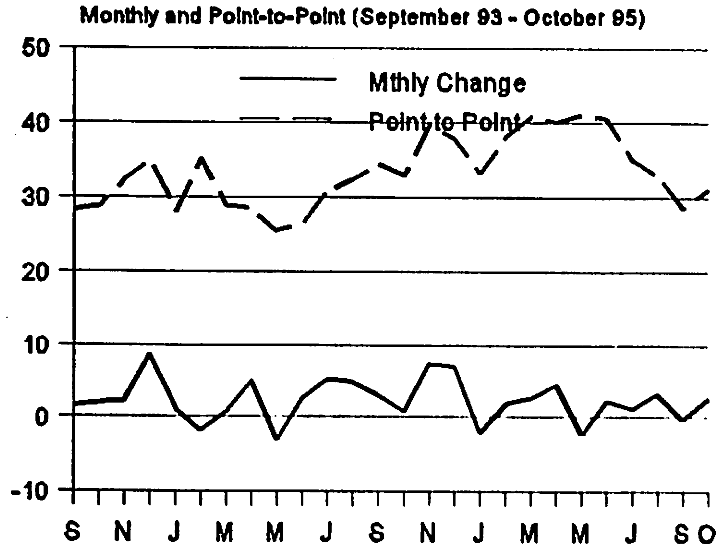
The continuing depreciation of the Jamaican dollar, coupled with salary increases and bonuses and increased seasonal expenditure will combine to foster a higher level of inflation in the economy for the rest of the year. To this end the inflation rate for 1995 could reach 21-25%.

Base Money

Base Money for October showed a 2.75% rise over September and a point to point rate of increase of 31.12%. However, these figures still indicate a downward trend in its rate of increase compared with a 40% point to point trend for the first half of 1995. If this trend continues there will be some hope of slowing the rate of growth of the broader measure of money supply which should eventually influence inflation growth rates.

CHANGES IN BASE MONEY

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



Money Supply

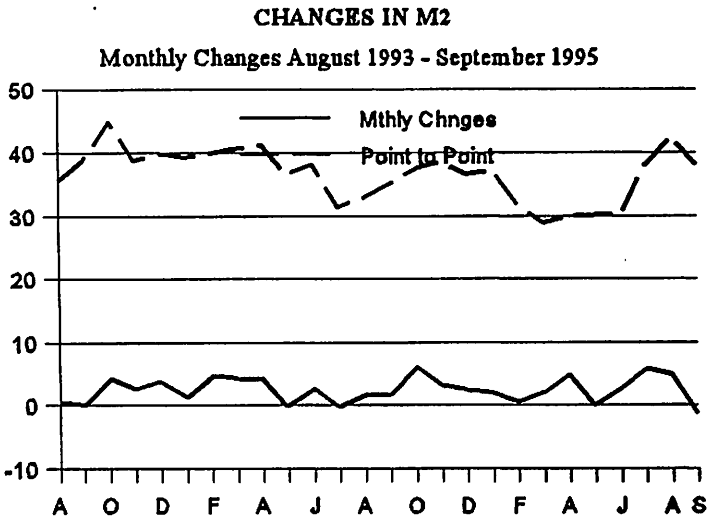
September saw a 1.29% fall in money supply, resulting in a point to point change of 38.19% compared with 42.4% change in August and reinforcing the up-side of the cyclical trend begun in July.

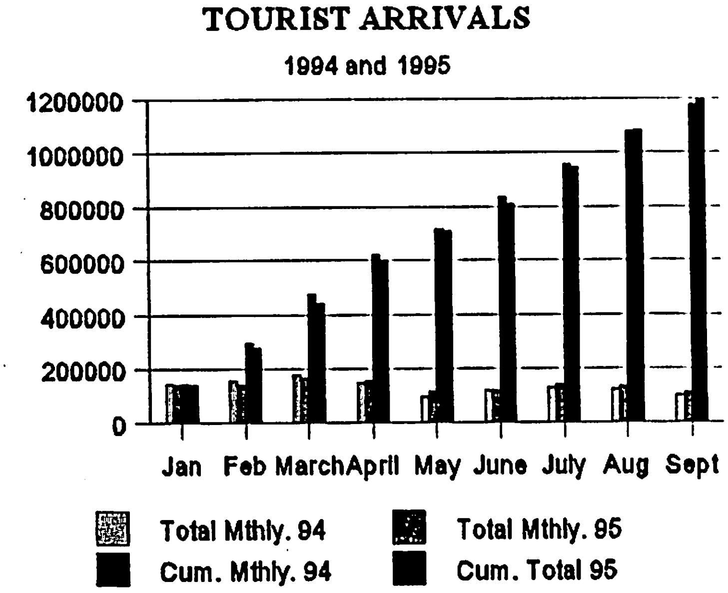
During September, the main factors influencing M2 growth were Bank of Jamaica's expansion in foreign assets by J$4.1 billion and credit increases by the private sector to the extent of J$1.3 billion. However,the following factors had an over riding negative impact on M2 growth:

a. increases in government deposit levels.

b. other activities reflected in the Other Item's Net account.

Money supply is expected to experience continued growth for the rest of the year, prompted by seasonal demand for money. Although,Government





announced a decrease in its planned expenditure for the remainder of the fiscal year in order to contain M2 growth, this looks far-fetched given the level of increased emoluments due to be paid to public sector employees. There is talk of postponing these payments until the next fiscal year, but increased interest payments due to high interest rates on T Bills and LRS will also have a negative impact.

Tourism

Total visitor arrivals for September reached 110,372 or 12.2% over arrivals for September 1994. Contributing to this was a 4% increase in stop over visitors and a 14.7% rise in cruise passengers.

However, arrivals for September 1995 over August 1995, showed a slightly different picture, as total arrivals for September were 17.1% less than the 132,198 visitors who arrived in August 1995. Stop-over visitors declined by 26.5% while cruise passenger rose by 3.0%. Comparing the periods January to September 1995 with 1994, showed a 0.85% increase this year in total visitor arrivals. Stop-over visitors rose by 3.7% while cruise passengers fell by 3.9%.

Earnings for the first eight months of 1995, are close to US$661.5 million showing a 4.93% rise over the US$630 million recorded for the similar period in 1994. The sector is expecting to achieve its target of US$1 billion in earnings this year.

The Jamaica tourism industry appears to be bouncing back from the set-backs it experienced in 1994 and early 1995 as well as to be benefitting from extraordinary circumstances experienced in the other Caribbean islands when their product was severely damaged by hurricane. The outlook for the rest of the year and the up coming winter season is one of optimism for good patronage and earnings. Government has increased its advertising expenditure to the sector in order to help achieve their objectives. However, continued work has to be done on improving and renewing the local product and more so on radically reducing the impact of crime, violence, tourist harassment and the deteriorating infrastructure.

Merchandise Trade

July's imports of US$239.1 million more than doubled exports of US$116.8 million and created the month's trade gap of US$122.3 million. This imbalance however, narrows slightly when the cumulative figures are compared. Total imports and exports for the period January to July 1995 were US$1524.6 million and US$862.8 million respectively, leaving a trade gap of US$661.8 million. This trade gap equates to 76.7% of exports and 43.4% of imports and is 158.9% of the Net International Reserves at October. Imports for January to July 1995 show a 29.3% jump over those in the comparative period in 1994. Exports also rose by 23.3% and the trade gap by 38.2% both periods compared.

The most significant contributions to the rise in exports were the apparel sector, non-traditional food exports, food and beverage exports and crude materials. Alumina exports showed a 21.6% increase in value and earned approximately US$356.9 million.

On the imports side, consumer goods increased by 47.1% and includes increased imports of food, non-durable goods and durable goods including motor cars. Raw material imports rose by 18.7% and include increased importation of fuels and lubricants, industrial supplies and spare-parts and accessories. Capital goods showed the largest increase, 49%, and includes the importation of transport equipment, machinery and construction materials.

If trade trends continue as is indicated by the out turn of first six month of the year, then, there will be a massive trade gap by the end of the year. Since the publication of the trade data lags so far behind, its usefulness to policy makers, is rather limited. This is one area of public sector operations which needs serious attention.

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.-July '94	-478.90	329.90	245.80	96.80	111.30	220.60
Jan-July '95	-661.90	304.90	341.20	-15.80	58.2	440.40

MONTHLY MACRO-ECONOMIC INDICATORS
(June 1994 - October 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	138624	101244	36780	5.88	38.15
Aug	3.21	32.95	411.23	660.00*	1.7	15.1	133198	90747	42451	4.84	42.44
Sept	-0.17	28.69	468.05	651.00*	3.0	17.2	110372	66663	43709	-1.29	38.19
Oct.	2.75	31.12	416.42	630.00*	2.7	18.8	--------	------	------	------	------

* Provisional

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