

New Confidential

Economic Bulletin

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

December

Vol. 1

No. 3

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Overview

Macro-economic policy continues to be gripped in the high interest rate/high money supply growth conundrum and there has not yet been any indication from the relevant authorities that they have identified a way out of this paradox.

The problem has arisen because we have consistently confused a high interest rate policy with a tight monetary policy when the two are not at all synonymous. A tight monetary policy implies a strict control of the growth of money supply so that it complies with the planned targets for economic growth and inflation. In our recent experience, money supply growth has continued at way above the programmed levels for inflation, and registered an annual growth rate of over 35% as of September 1995.

Monetary policy has therefore continued to be very loose, despite the high nominal deposit rates and very high real lending rates which have been imposed from time to time. This explains the continuing high inflation and periodic devaluations which the economy has been suffering.

Breaking out of this cycle will involve doing at least two things. The first is putting an end to the government's ability to create money through taking credit from the Bank of Jamaica. The second is accepting the fact that we have to compromise on the exchange rate. The adjustment process can be made less painful if we can also reduce the size of government operations as a share of the gross domestic product which they consume.

If it's any consolation, Mexico is also caught in the same conundrum. Perhaps this is the model that we are following, and if it is, let's hope they find a solution soon.

Looking ahead to 1996, we are unlikely to see a lowering of interest rates in the first half of the year as the point to point inflation rate will continue to climb during this period. Interest rates may even increase somewhat if the Jamaican dollar comes under pressure in the first or second quarter of the year. The Minister of Finance has stated unequivocally that maintaining the existing exchange rate is his first priority.

In this regard he faces a trade-off between the preservation of the Net International Reserves (NIR) or the preservation of the present parity of the Jamaican dollar for the time being. The alternative is a devaluation now and the preservation of the Net International Reserves for use later.

The point to point inflation rate is likely to rise from the mid-twenties in the first quarter to the low thirties by mid-year and will probably finish the year in the low to mid-twenties. This is a fairly optimistic projection and assumes that there are no dramatic shifts in policy during the course of the year. Inflation could be higher if money supply growth is not reduced significantly.

In the high interest rate environment that will prevail for at least the first half of 1996, the equity and real estate markets are likely to remain soft although consumer spending power will get a boost as annual wage increases kick in. Most sectors of the economy will feel the impact of the high interest rate policy and real output is likely to fall again in 1996.

The commitment to high interest rates is likely to have implications for the budget also. Unless there is a fairly radical effort to reduce government expenditure, the high cost of servicing the internal debt, plus the high wage increases awarded to public sector workers, are likely to require increased taxation to finance them. Given our already high level of taxation, this is not particularly good news for anyone.

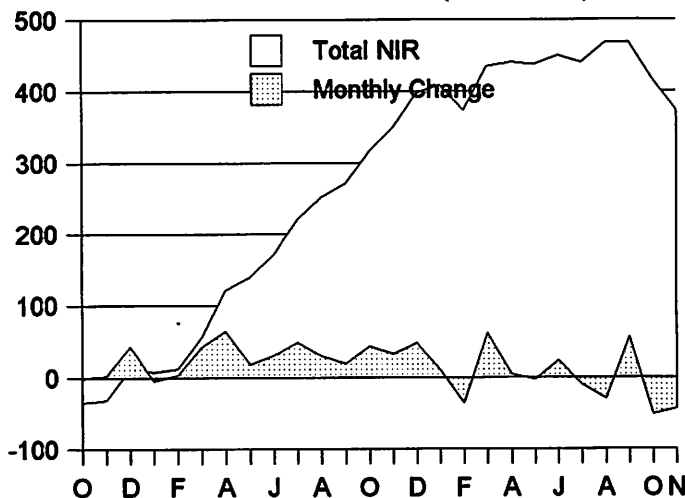
In closing, we must thank you, our subscribers for supporting this new venture of ours and hope that you have found it useful and will continue to do so in the future. We welcome your comments, suggestions, criticisms and encourage you to give us your feedback by fax or phone or otherwise.

We wish you all the best for a happy and prosperous 1996. Despite the difficult times ahead we have every confidence in the Jamaican private sector and we know that your companies will pull through, no matter what happens!!

Net International Reserves

In November, the Net International Reserves declined by 43.2 million (over October) to US\$373.2 million, the lowest level since February 1995. Firstly, this is a continued reflection of Government's foreign exchange sales to Authorized Dealers and possibly its reduction in purchases. There are indicators of resurgence of capital flight from the economy. For example, average annual unofficial capital flight (pre-financial liberalisation period) has been estimated at about US\$122.6 million. There had been some reversal of this trend since

CHANGES IN INTERNATIONAL RESERVES
October 93 - November 1995 (US\$Million)

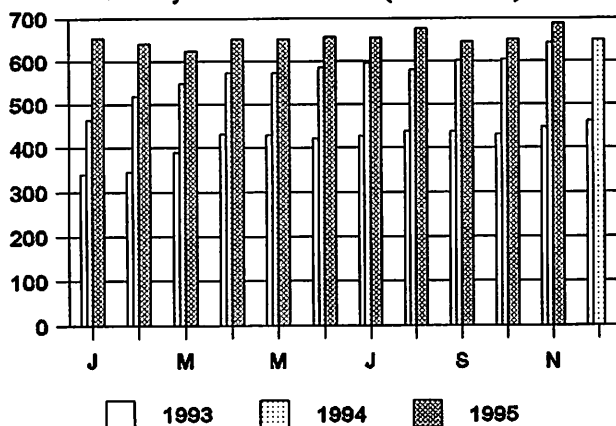


financial liberalisation in 1991 with inflows averaging US\$65.3 million annually up to 1992. However, it appears that we may be returning to the pre-liberalisation trend. Capital outflow between 1993-94 averaged US\$164 million annually. This trend seems to have continued into 1995 negatively affecting the supply-side of the foreign exchange market.

Foreign Exchange Accounts

At the end of November, the estimated value for foreign exchange accounts was US\$688 million, a 5.6% increase over the previous month. However compared with December 1994, it represents a 5.8% increase indicating a rather slow growth trend for the year - which was also

FOREIGN CURRENCY ACCOUNTS
January 93 - November 95 (US\$Million)



characterised by monthly fluctuations from this level. The seasonal variation of December inflows to these accounts could push the outstanding balance to about US\$700 million by the end of 1995.

Exchange Rate

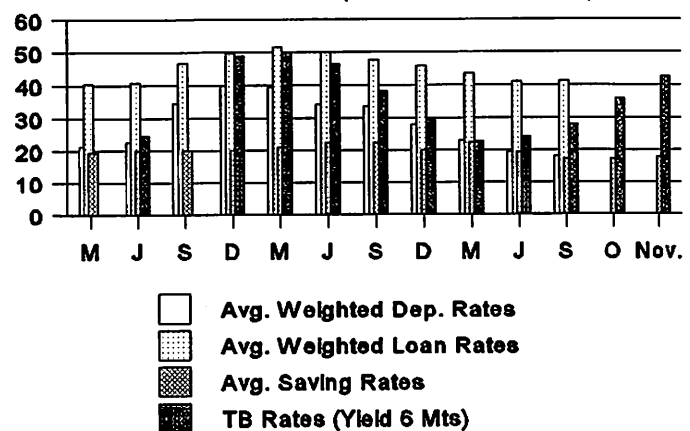
Between January and October of 1995, the Jamaican dollar experienced a 16.6% depreciation on the official market. But during December the rates seem to have stabilised and the spread between the official and informal markets seem to have converged between J\$38.9 and J\$40.0 to US\$1.00. It is likely that the exchange rate will hold at about J\$40.00 = US\$1.00 well into 1996.

However, this is dependent upon the performance of the leading export commodities - primarily tourism, bauxite/alumina among others, and the extent to which capital flight abates, money supply growth is restrained, overall consumption demand declines, and seasonal foreign currency inflows (remittances) increase as well as Government's commitment to future intervention in the foreign exchange market.

Interest Rates

December saw a continuation of Government's high interest rate policy, with deposit and loan rates moving upwards. The December issue of

Comparative Interest Rates
of Commercial Banks (1993, 1994 and 1995)



Treasury Bills yielded an average 42.5% interest rate and 43% to primary dealers. As this rate is the bench mark for other interest rates, significant upward movements in commercial bank rates are imminent.

Fixed deposit and loan rates moved upwards at an average of 3-4% between October and November.. It is expected that loan rates will continue to rise especially as liquidity tightens and loanable funds dry up. This policy will cut consumer demand and should ultimately ease the pressure on the exchange rate and the balance of payments.

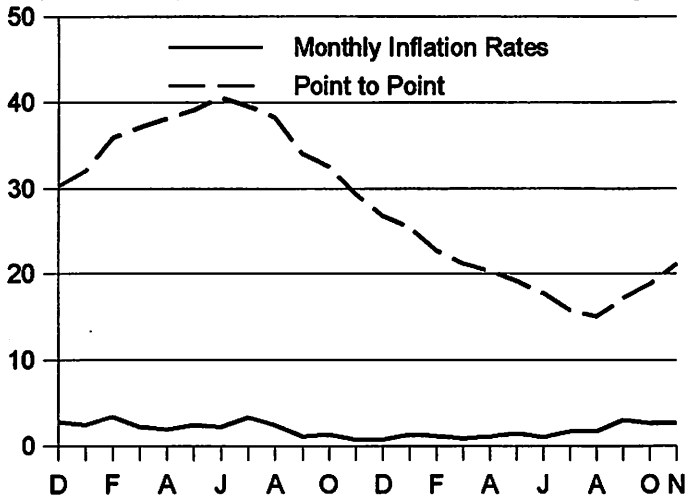
Activities on the stock market continued their declining trend. The index at the end of November stood at 14578.3, just 2.56% above November 1994 or 6.96% below October 1995's index.

Inflation

The All Jamaica Consumer Price Index for November showed a 2.8% rise in inflation and follows on a 3 and 2.7% rise for September and

CHANGES IN INFLATION

(All Jamaica) December 93 - November 95 (Percentage)



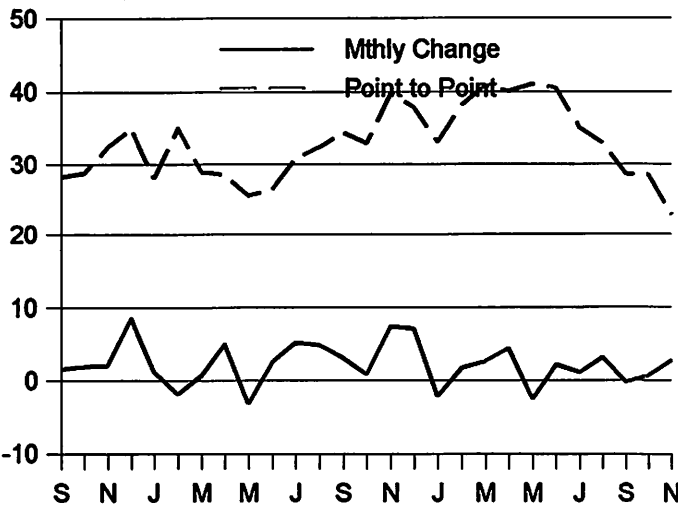
October respectively. These movements essentially reflect the effects of the exchange rate movement on prices, as the rate did not stabilize during November, but continued to slide into December. Prices/costs will continue to exhibit some upward movement. Therefore, as was evident in November, so in December the monthly inflation rate could be about 2.5%. The annual rate for 1995 could therefore end up at about 24% which is twice the Government's 12% projected rate.

Base Money

Base money for November showed a 2.7% increase over October. While this translates into a point-to-point increase of 22.9% it also indicates a continuing downward trend in the overall rate of increase in base money. If this

CHANGES IN BASE MONEY

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



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.

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.

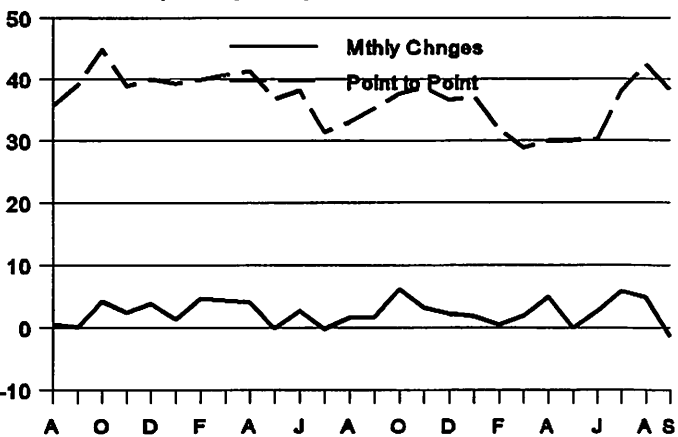
During September, the main factors influencing M2 growth were Bank of Jamaica's expansion in foreign assets by J\$4.1 billion and credit increases by the private sector to the extent of J\$1.3 billion. However, the following factors had an over riding negative impact on M2 growth:

- increases in government deposit levels.
- unspecified activities reflected in the Other Item's Net account.

Money supply is expected to experience continued growth for the rest of the year,

CHANGES IN M2

Monthly Changes August 1993 - September 1995



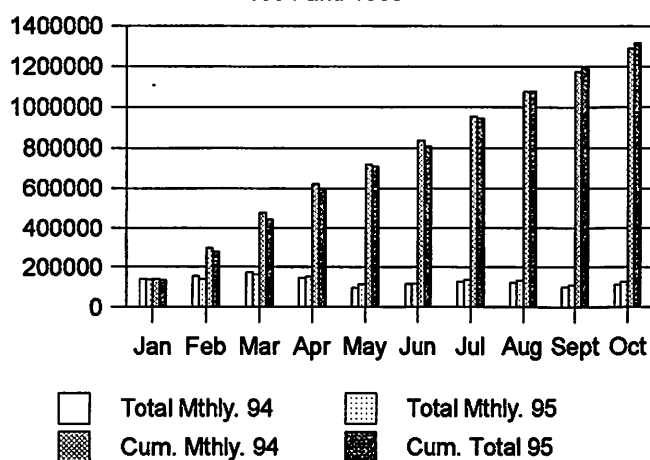
prompted by seasonal demand for money. Although, Government announced a decrease in its planned expenditure for the remainder of the fiscal year in order to contain M2 growth, this looks far-fetched given the level of increased emoluments due to be paid to public sector employees. There is talk of postponing 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

In October 1995, there was a 12.4% increase in tourist arrivals over October 1994. The number of Stop-over visitors rose by 5.3% and Cruise passenger by 23.3%. Year to date total arrivals (i.e. January to October 1995) rose by 2.1% - with Stop-over visitors rising by 3.8%, although Cruise passengers fell by 0.6%.

TOURIST ARRIVALS

1994 and 1995



In terms of monthly change, overall visitor arrivals in October 1995 showed a 16.3% compared with September 1995. This was supported by a 27.1% rise in Cruise ship passenger and a 9.2% rise in Stop over visitors.

The official tourist winter season which began in mid-December appears to hold some promise for for a busy season. The worsening cold weather in the northern hemisphere should contribute to increased arrivals as North Americans seek warmer environments. However, there may be missed opportunities if Government does not act quickly to resolve the New Air Jamaica - FAA crisis. It is estimated that this problem is resulting in lost income to Air Jamaica of about US\$60,000 daily.

Merchandise Trade

Up to August 1995, export earnings improved marginally by about 3%, however, this increase has not narrowed the trade gap. This situation is highlighted by the fact that export earnings (for the review period) are only 55.4%, of imports compared with 58.9% for the similar period in 1994. The increases in imports are driven by consumer goods and raw material imports.

Evidently, we need to increase export output and earnings if we are to significantly close the merchandise trade gap. In order to achieve this objective, policies must be implemented to encourage more production for export. In fact, the export thrust should be to attain a trade surplus in the medium-term.

In terms of specific sectors, earnings from traditional exports increased by US\$83.0 million between January and August 1995 over the same period for 1994. Alumina earnings, benefitting from more favourable world prices accounted for 78.3% of this increase. Earnings from "Other traditional exports" grew by 40.1% over the review period. 'Non-traditional exports' earnings grew by US\$56.0 million or 21.7%. This overall growth continues to be driven by the apparel sector earnings.

BLANCE 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-Aug '94	-565.70	367.20	290.70	92.20	146.80	251.49
Jan-Aug '95	-781.90	321.30	385.70	-74.90	88.20	411.23

MONTHLY MACRO-ECONOMIC INDICATORS
(June 1994 - November 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	676.25	1.7	15.10	133198	90747	42451	4.84	42.44
Sept	-0.17	28.69	468.05	646.13	3.0	17.20	110372	66663	43709	-1.29	38.19
Oct.	2.75	31.12	416.42	651.00*	2.7	18.80	128394	72803	55591	-----	-----
Nov.	2.70	22.90	373.20	688.00*	2.7	21.10	-----	-----	-----	-----	-----

* Provisional

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