

# New **CONFIDENTIAL ECONOMIC BULLETIN**

## **PRIVATE SECTOR ORGANISATION OF JAMAICA**

*Monthly Analysis of the Jamaican Economy*

**Vol. I No. 5; February 1996**

### **CONTENTS**

Forecast & Current Trends  
Interest Rates  
Exchange Rate  
Money Supply & Inflation  
Foreign Exchange Accounts  
Tourism and Merchandise Trade  
Balance of Payments  
Net International Reserves

### **Overview**

Last month we reported that Jamaica had failed the last IMF test but the government team that visited Washington in early February, seemed to have convinced the Fund to reverse that initial verdict and give us a passing grade. This does not however remove all the concerns that the multi-lateral agencies have concerning the state of the Jamaican economy, and like many of us that live here, there are concerns about the sustainability of the present situation and how we will manage the transition to low inflation and growth.

Having at last ended its borrowing relationship with the IMF, the government may now be looking to the Net International Reserves to provide it with security and comfort as far as the country's external account is concerned. This is the only explanation for the rapid rebuilding of the Net International Reserves in the face of the government's own admission that this activity boosts the growth of money supply and so exacerbates the problem of reducing and controlling inflation. The belief that the Net International Reserves is an invincible security blanket is quite misplaced as no country, least of all a small open developing economy such as ours can sustain for long an exchange rate which defies market forces.

The unfortunate fact of life is that it is the soundness of our macro-economic policies and our ability to dramatically reduce our inflation rate which are going to give us medium to long-term stability in our exchange rate. In any case, creating Jamaican dollars to buy foreign currency is just about the worst way to go about increasing the NIR.

The argument about the appreciation of the nominal exchange rate if the Bank of Jamaica did not buy the extra foreign exchange coming into the system is also a non-starter. The authorities could simply make an appropriate reduction in interest rates to stimulate demand in the private sector which would then take up the excess inflows and remove the tendency for the rate to appreciate. This would have the added benefit of lowering the cost of monetary policy to the public purse.

Developments in the financial sector continue to attract a fair degree of concern. The number of building societies is contracting under the weight of the new capital requirements but eleven more licences have been issued, bringing the total to fifteen (15). The level of profitability in the financial sector seems to have fallen somewhat and there is an increasing burden of non-performing loans in the commercial and merchant banking institutions.

The growing problem with non-performing loans should not come as a surprise given the long period of high interest rates, but it is being compounded by the softness in the stock and real estate markets.

This has eliminated increasing equity as an option for companies to reduce their debt and has made it difficult for banks to liquidate the collateral which they are holding and thereby collect on their non-performing loans. These markets have ironically

both been depressed as a result of the high interest rate policy.

Another major area of concern with regard to the financial sector is the proposed "Money Laundering Bill" which was tabled recently in Parliament. This Bill seems to be another piece of financial legislation which seeks to give the government huge discretionary powers over most types of financial institutions in the country, with regard to the disclosure of information regarding their clients' business transactions. The legislation therefore gives the government unprecedented power to enquire into and investigate the private affairs of Jamaican residents.

### Net International Reserves

The end of January 1996, saw the Net International Reserves of the Bank of Jamaica strengthening to reach US\$455.8 million, increasing by US\$34.5 million over the month. This scenario is in keeping with the authority's expressed intention to rebuild the Net International Reserve to a comfortable position, after having used up close to US\$100 million in reserves to gain stability in the exchange market. This build-up is to facilitate not only servicing of its fixed obligations, but also to enable the Bank of Jamaica to intervene in the market should the necessity arise. This stance is also a signal to the market re Bank of Jamaica capabilities as well as to foster some level of confidence in the currency and the exchange rate. The Bank of Jamaica will continue to build its reserves as the market is now liquid.

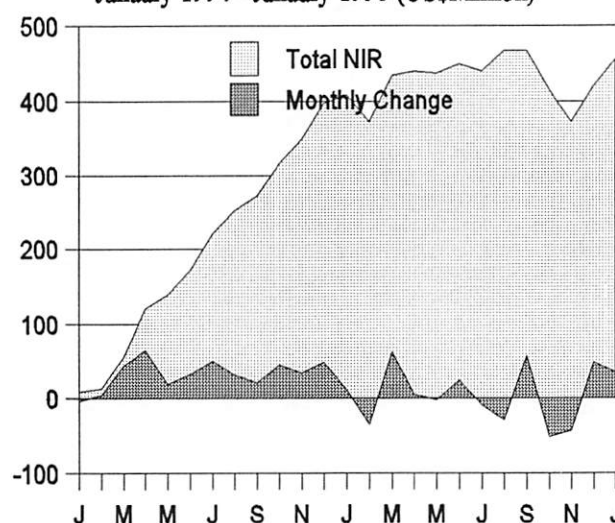
The impact of this activity on money supply expansion has been countered somewhat by Bank of Jamaica's expansion of the amount of reverse-repos that it has outstanding. However, the rapid rebuilding of the NIR has helped to maintain the expansion of the money supply.

What about a citizens right to privacy? What about the presumption of innocence until guilt is proven? What about safeguards against abuse and the arbitrary exercise of these powers? Very little consideration has been given to these issues. There is no doubt that, as a country we must do whatever we can to stop the scourge of the drug trade and the money laundering that goes with it, but this cannot be the best way to go about it.

As the end of the fiscal year approaches, attention is shifting to the Budget and what's in store for us there. Next month we'll attempt to anticipate some of that. In the interim look out for a 95/96 fiscal year inflation rate of 28-30% as the point to point inflation rate continues to rise even as the monthly rates may fall.

### CHANGES IN INTERNATIONAL RESERVES

January 1994 - January 1996 (US\$Million)



### Foreign Exchange Accounts

Balances in foreign currency accounts for the latter months of 1995 showed a 12.7% increase, moving from US\$646.13 million in September to US\$728.0 million in December. The provisional estimate for January 1996 is US\$705.0 million. The account balances fell markedly in January, suggesting that people may be converting their foreign exchange holdings to Jamaican dollars in

order to take advantage of the high J\$ interest rates and the exchange rate stability. These conversions could be adding significantly to the liquidity in the foreign exchange market and contributing to both the stability of the exchange rate and the rapid build-up of the Net International Reserves.

When interest rates fall below a certain level, these funds are likely to flow out of the market again as people convert their holdings back into hard currency. This will most likely have a profound impact on the foreign exchange market and the exchange rate.

### Exchange Rate

January 1996, saw the exchange rate experiencing some level of stability - a spill over trend from the last two months of 1995. The Jamaican dollar continued to exchange throughout the month at rates of J\$39-40 to US\$1 buying and selling. The level of liquidity and stability experienced at this time of the year results from seasonal factors and the high interest rates which have encouraged people to hold J\$ instead of US\$.

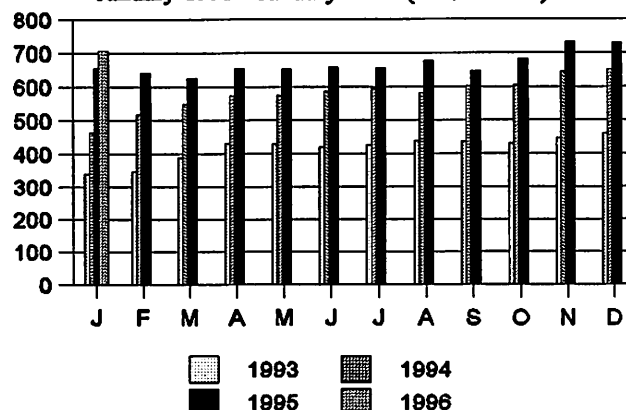
As to how long this stability will hold is dependent on the continued high levels of inflows, interest rate levels and continued buoyancy in the tourism industry. The authorities seem set to maintain at all costs stability in the exchange rate - one can therefore envisage a less turbulent foreign exchange market during the first half of 1996.

### Interest Rates

During February, there were three issues of Treasury Bills, each offering \$500, \$808 and \$550 million. These were significantly over subscribed by almost 230%, indicating significant liquidity in the system. The yields on these were 42.38% for the 6 months issue, 42.48% for the 55 days, and 41.49% for 185 days. The marginal decline in the yield to 41.49% cannot be interpreted as a signal of rates trending down, but is a reflection of the excess liquidity in the financial system.

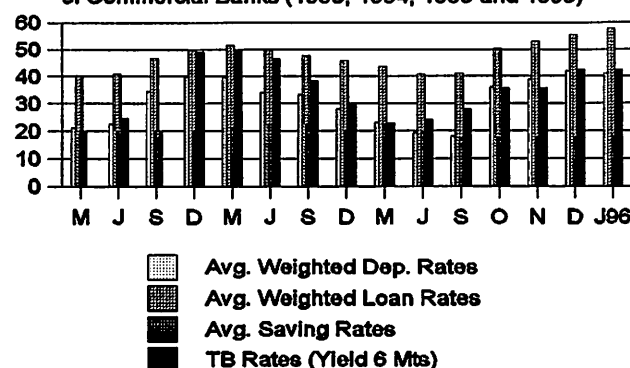
### FOREIGN CURRENCY ACCOUNTS

January 1993 - January 1996 (US\$Million)



### Comparative Interest Rates

of Commercial Banks (1993, 1994, 1995 and 1996)



This outcome resulted from the continuation of the high interest rate policy and as such the trend will be similar for the financial sector. Average lending rates at January 1996 for Commercial Banks rose to 57.64% and compares with 52.59% and 65.10% in January 1995 and 1994 respectively. Deposit rates however, which peaked at 19-42% per annum in December 1995 saw a marginal decline in January to 18-42% per annum for 3-6- months and 18-41% per annum for 6-12 months. Saving rates also dipped at the higher end to 15-21% per annum down from 15-24% per annum in December 1995.

As there is currently a ceiling on loans from Commercial Banks, due to the imposition of the special deposit scheme, the fall in deposit rates could be signalling a desire to decrease their deposit levels.

## Inflation

The published inflation rate for December 1995 was 4.3% which far exceeds the provisional figure of 2.5% used in the previous month's bulletin. The December figures reflects the influence of the removal of the subsidy on domestic kerosene and the effect of the price increase of this item as it filtered through usage in economic activity. These price movements contributed to a 61% rise in prices for the subgroup "Fuel". Price increases also in the groups - "Food and Drink", "Meat, Poultry and Fish" - in particular the price of imported cod fish, "Baked Products" and

"Vegetable and Fruit" helped to fuel the inflation rate. As a result, the point-to-point inflation rate for 1995 was 25.5% and compares with 26.7% for 1994 both years more than doubling the 12% p.a projected target.

For the month of January - the inflation rate should be less than December as the major factors influencing December's rate are not likely to be repeated. The in-house projection is for a 2.5% rate given that the exchange rate was stable. However, there were increases experienced in "Food and Drink" "education"- school-fees, "transportation and housing"- as rentals usually move up at the beginning of the year and these should be influential.

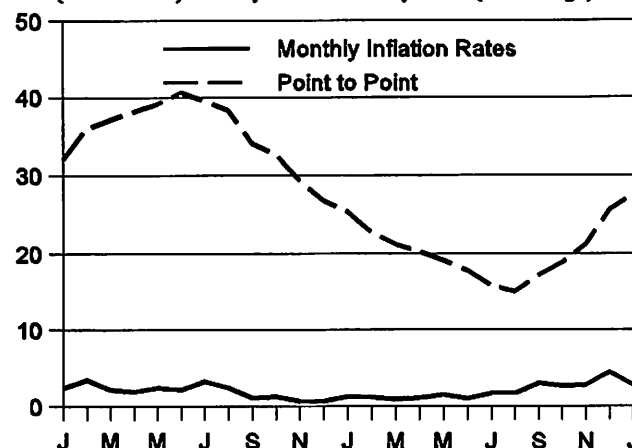
If there is continued stability in the exchange market then one could expect a 20-25% inflation rate for 1996.

## Base Money

In January Base Money showed an 8.5% decline over that of December. This movement is expected, as, prompted by seasonal demand, there was a 12.8% expansion in December. However, as the demand for money declines, then especially "currency with the public" should fall also. This component of base money showed a 17.5% reduction in January 1996 over December 1995,

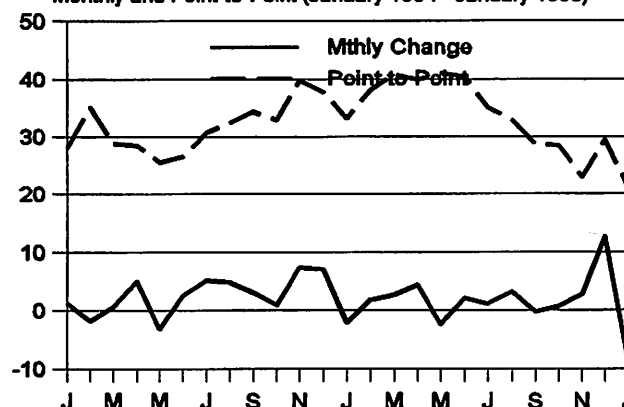
## CHANGES IN INFLATION

(All Jamaica) January 1994 - January 1996 (Percentage)



## CHANGES IN BASE MONEY

Monthly and Point-to-Point (January 1994 - January 1996)



and was the major factor influencing the overall decline in base money. The downward trend in the point to point rate of growth of base money is encouraging and we hope that it can be sustained.

## Money Supply

During November, Money Supply rose by 1.7%, initiating a marginal fall in the point to point index as it changed to 36.1% down from an average of 38.1% in the two previous months. The growth trend in money supply can be linked with increases in public sector credit, experienced in March, April, October and November; in private sector credit - in July and August and expansion in foreign assets in September.

In November, a J\$3.7 billion decline in Public Sector balances and a J\$1.2 billion increase in Private Sector Credit had some impact on the increase in M2 during that month.

### Tourism

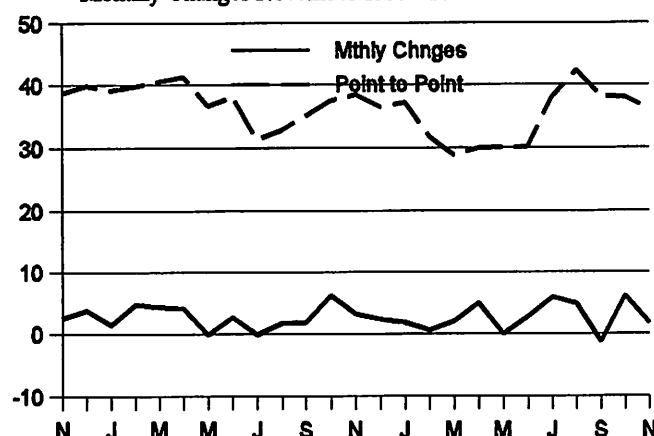
Tourist arrivals for December 1995 showed a 7.2% increase over December 1994. Contributing to this were 6.4% and 8.7% increases respectively in stopover and cruise ship passengers. Total non-nationals visitor arrivals for 1995 amounted to 1.62 million or 3.2% more than those arriving in 1994. If visiting nationals were included in this figure, then total arrivals for 1995 would be 1.75 million. For the year, stop over visitors showed a 4.3% rise over 1995, while cruise passengers rose by 1.4%. It is estimated that total expenditure from tourists could approximate to US\$975 million for 1995, a 2.9% increase over 1994. Comparing increased arrivals with increased expenditure show that visitor expenditure per head is declining and suggests the need for product improvement to attract a higher level of expenditure as this is the number one foreign exchange earner with a significant multiplier effect throughout the economy.

The winter tourist season is past mid-way and the comments about the season are varied. Interests in the sector with larger plants and offering all inclusive packages - indicate a good season while those with small plants, villas and guest homes complain of a poor season. Overall complaints are still made on the inadequacies of infrastructure and tourist harassment, indicating the need for focused attention on improving these.

During January industrial action by NWC workers led to islandwide disruption in the water supply which effected premature tourist departures and visitor cancellations. Recent riots in Negril also affected the country's and in particular the area's image. In light of the level of increasing competition that the country faces in its tourism industry, there is need for serious focused attention on the industry before the country loses its major foreign exchange earner.

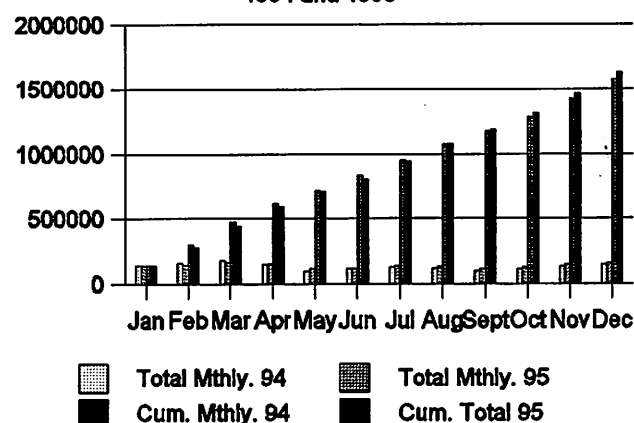
### CHANGES IN M2

Monthly Changes November 1993 - November 1995



### TOURIST ARRIVALS

1994 and 1995



### Merchandise Trade

Between January and October 1995, Jamaica's exports valued US\$1229.9 million and its imports US\$2274.6 million. These were 22.1% and 27.8% more than its exports and imports for the similar period in 1994. The January to October 1995 trade gap was US\$1044.7 million and compared with US\$773.0 million in the 1994 period, indicating a widening of the trade-gap by US\$271.6 million. Although the earnings from exports have been quite impressive, the highest so far ever experienced, they have however, paled in the face of an even more significant rise in imports.

For the review period, all categories of exports except bauxite and cocoa showed increased earnings over the comparable 1994 period. Earnings from alumina and the non-traditional sectors which includes apparels provided 42.9% and 32.9% respectively of total export earnings.

Imports of machinery and transportation equipment which includes motor cars formed 27.8% of all

imports followed by manufactured goods (17.1%) miscellaneous manufacturing goods (14.5%) mineral fuels (12.9%) food (11.8%) and chemicals (9.8%). The largest increases in imports, when the 1995 and 1994 periods are compared, was in the machinery and transport category (47.3%) followed by food (39.1%) and manufactured goods (36.7%).

#### BALANCE OF PAYMENTS PROFILE: US\$Mn

	Merchandise	Services	Transfers	Current A/c	Capital A/c	NIR A/c
<b>Dec. 1994</b>	-957.80	502.70	571.70	116.60	268.80	397.92
<b>Jan-Oct '94</b>	-773.10	422.90	375.20	25.00	278.50	316.04
<b>Jan-Oct '95</b>	1044.70	383.40	478.40	-182.90	201.40	416.42

**MONTHLY MACRO-ECONOMIC INDICATORS**  
*(December 1994 - January 1996)*

MONTHS	BASE MONEY		NET INT'L RESERVE	FOREX ACCTS.	INFLATION		TOURIST ARRIVALS			CHANGES IN M2 (MONEY SUPPLY)	
	Mthly Chng	Point to Point	Total MRR	Total Balances	Mthly Chng	Point to Point	Total Visitors	Stop-overs	Cruise	Mthly Chng	Point to Point
Dec.94	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	652.66	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. 95	1.17	35.06	440.35	654.51	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.	0.69	28.49	416.42	682.86	2.7	18.80	128394	72803	55591	6.03	38.04
Nov.	2.71	22.87	373.22	733.17*	2.8	21.20	148839	77419	71419	1.70	36.10
Dec.95	12.81	29.46	421.31	728.00*	4.4	25.60	157819	100183	57636	-----	-----
Jan 96	-8.46	21.08	455.79	705.00*	2.5*	27.50	-----	-----	-----	-----	----

\* Provisional

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