

NEW CONFIDENTIAL ECONOMIC BULLETIN

PRIVATE SECTOR ORGANISATION OF JAMAICA

Monthly Analysis of the Jamaican Economy

Vol. I No. 7; April 1996

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Overview

This month saw the presentation of the 1996/97 budget and a rather one-sided budget debate as the Jamaica Labour Party boycotted the proceedings. The J\$100 billion budget was in many respects a carbon copy of the 1995/96 budget, from the fact that it accounts for approximately 61% of GDP, as well as to the share of the various expenditure and revenue heads.

The budget out-turn for 1995/96 showed some worrying results. There was a \$10 billion shortfall between total revenue and total expenditure. The Ministry of Finance claims that this was due to the accrual of expenditure, but the inflows and outflows from the consolidated fund show a deficit of about \$3 billion. The Bank of Jamaica balance sheet also shows a substantial fall in public sector deposits and an increase in advances to the government. This does not augur well for the control of the money supply and lower inflation. The revenue shortfall was primarily due to reduced borrowing, both domestically and internationally.

Looking at the 1996/97 budget, there are a number of issues to note. As might be expected in a pre-election period, project-related capital expenditure is up 40% over last year and the Ministry of Construction gets a

big chunk of this. The cost of servicing the internal debt continues to grow and will cost just under \$20 billion this year, some 75-80% more than the wage bill for the entire central government.

Another interesting feature of the budget is the fact that for the first time in the past few years, foreign borrowing in the financing of the budget. It was proposed in the budget to raise foreign loans and use the proceeds to retire high cost local debt, but one wonders whether the impact of this on the money supply and inflation, has been carefully considered. The past few years have seen a gradual decline in our foreign debt but it seems that this trend is about to be reversed.

A major area of concern relates to the large projected increase in revenue from Income Tax, GCT and Education Tax. These are projected to increase by 46%, 46% and 51% respectively, in an environment where government is projecting inflation of 11-15%. By its own admission, there is a revenue gap of \$8.3 billion which will be closed by increased compliance. This is a very worthwhile objective and one would much rather see government revenue increased in this manner rather than by raising marginal tax rates or imposing new taxes. But the increase projected seems rather ambitious and with the best will in the world it is unlikely to be realised in the current economic climate.

Consequently, if close control of expenditure is not maintained, we could see more Bank of Jamaica accommodation of government in the coming financial year, with a negative impact on money supply growth and inflation. AOs presented, the 1996/97 budget implies an inflation rate in the low to mid twenties and excessive money creation will only make things worse.

All in all it was a budget of continuity, signalling that there is not likely to be much change in macro-economic policy for this financial year. High interest rates are here to stay (at least for the remainder of the year) and we'd all better learn to live with it!!

Net International Reserves

During March, the Net International Reserves grew by US\$28.71 million to reach US\$496.26 million, however, the Minister of Finance stated in his budget speech that the Net International Reserves had reached the US\$500 million mark. This implies that for the first quarter of 1996, the Net International Reserves grew by 17.8% compared with 9.4% growth over the similar period in 1995.

During March, while the total foreign assets of Bank of Jamaica grew by US\$18.8 million its liabilities mainly with the International Monetary Fund declined by US\$9.94 million thereby helping to support the level of increase in the Net International Reserves. This current level of the Net International Reserves, is capable of supporting 13.52 weeks of imports for the country.

Foreign Exchange Accounts

The value of foreign currency deposits at the end of March 1996, is estimated at US\$710.0 million, indicating a US\$3 million decline from February 1996. However, compared with the stock position of US\$652.7 million in March 1995, these current figures indicate an 8.8% increase over that period. The trends relating to these accounts project some fluctuations occurring in their levels around this time of year and these are likely to continue into the second quarter of the year.

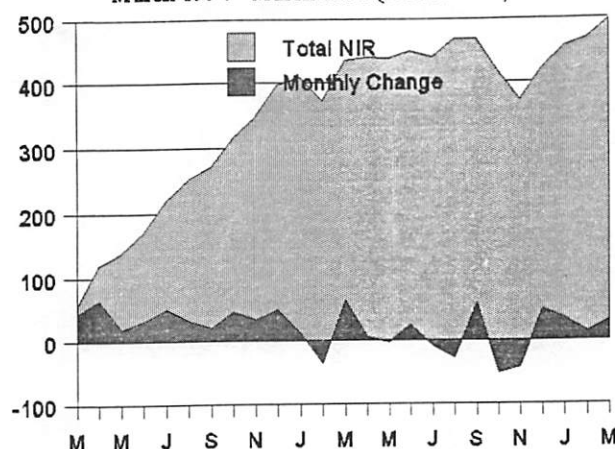
Exchange Rate

The exchange rate at the end of April appears to be at the J\$40 to US\$1. While for previous months the rate was between J\$39 and 40, towards the end of April it was edging over J\$40 to US\$1. As a scenario is emerging, the threat of exchange rate movements looms larger and the following situations have to be considered.

- a) As March marks the end of the official tourist season, what effect will this have on foreign exchange supply? As well, the trade statistics

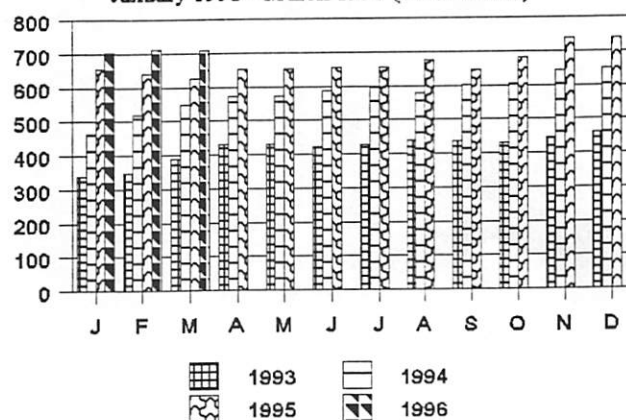
CHANGES IN INTERNATIONAL RESERVES

March 1994 - March 1996 (US\$ Million)



FOREIGN CURRENCY ACCOUNTS

January 1993 - March 1996 (US\$ Million)



from January show a decline in exports - and in the apparel export sector in particular. How will a decline in these earnings affect foreign exchange supply?

- b) How does the demand for foreign currency stack-up against supply given the above?
- c) Will the momentum of the expectation of exchange rate movements drive an actual devaluation of the currency?
- d) What will the extent of the movement be?
- e) Will the Government intervene early in the market, and how sustained will be this process?

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We should note however, that with 500 million in the Net International Reserves and 200-250 being sought through interest loans, the government is building up the capability for sustained and fairly prolonged intervention in the foreign exchange market.

Interest Rates

During April, there were five offers of Tbills with maturity dates ranging between 26 and 265 days. At the time of writing, the three issues which were closed yielded rates of 43.95 to 44.88%. The 26 day issue was grossly under subscribed. It offered J\$1.3 billion and only J\$427 million was taken up. The other longer term issues were over subscribed by J\$0.3 and 0.5 billion respectively.

The LRS offers which closed during this month were of short and medium term maturities and offered a base rate of 44.5% in the first year. The rates offered on these securities indicate the expectation of a continued high interest rate policy by the administration for 1996.

However, Commercial Rates have edged slightly upwards in March over February.

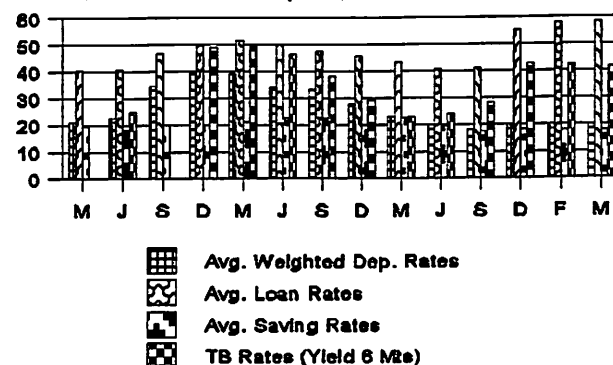
Fixed Deposit Rates went from 18-42% in February to 18-44% in March; Average Loan Rates from 57.95% to 58.27%. While Savings Rate remained at 17.82%.

In an environment of economic decline and rising levels of non-performing loans in the commercial sector, is it prudent to increase interest rates? Or are increased rates sectorally applied and to the consumer/consumption type loans in particular in an effort to decrease overall demand?

Differential interest rates for a select few are unlikely to make a meaningful contribution to either GDP growth or the Balance of Payment

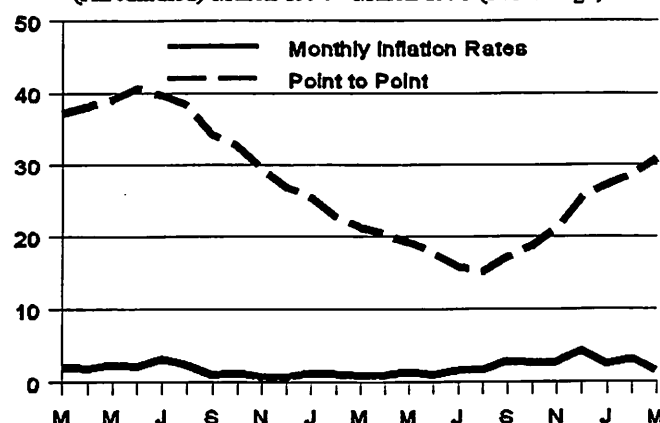
Comparative Interest Rates

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



CHANGES IN INFLATION

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



Inflation

The movement in the CPI for March showed a 1.6% rate of inflation for that month. This follows a 3.3% and 2.6% rise in February and January respectively. This movement in March signifies a trending down of the inflation rates. Which coincides with a similar downward trend in Money Supply also.

For the period March 1995 to March 1996 that is fiscal year 1995/96, the inflation rate is 30.8% and compares with fiscal year 1994/95 inflation of 21.2% and calendar year 1995 inflation of 25.5%.

For the first quarter of 1996 inflation rate was 7.7%, compared with first quarter 1995 rate of 3.4%. However, the expectation is that rates will trend down for the rest of 1996. In house projection of inflation for 1996 is in the range of 22-28%.

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Base Money

With the implementation of dual reserve ratios of one and three percent (1% and 3%) for Building Societies effected at the beginning of 1996, data adjustments for this showed up in the February 1996 computations and was to a great extent responsible for rising trend in the figures. For February, base money rose by 4.17% following an 8.5% fall in January 1996. For March, a 2.89% rise in base money was experienced.

The point to point and fiscal year change in the variable was 24.21% which reflects a significant decline from the point to point rates of high thirties to low forties experienced in the early half of 1995. This lower trend in base money should reflect in lower money supply growth in this period also.

Money Supply

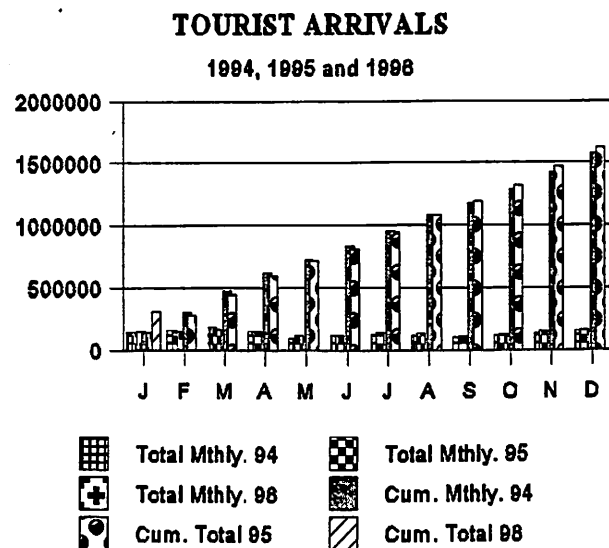
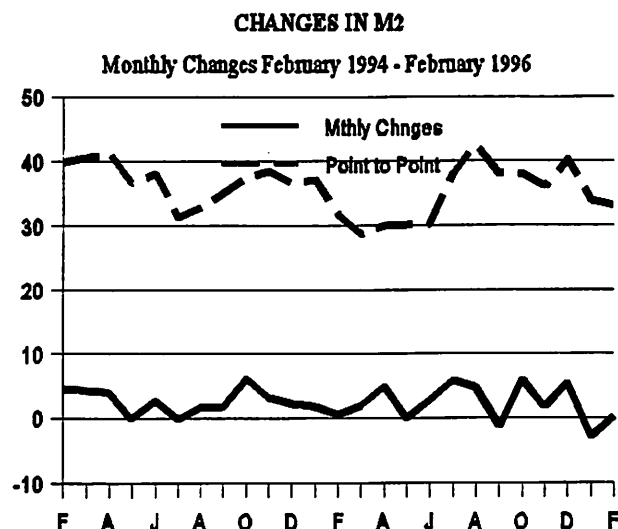
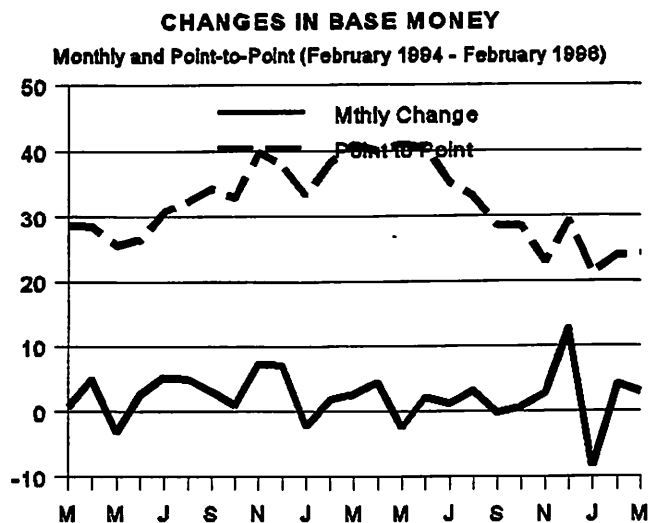
After a decline of 2.8% in Money Supply in January, February saw a marginal rise of 0.27%. This brought the point to point change to 33.64% which is indicating a move back to the declining trend of late 1995 which was broken in December by the influence of seasonal demand on this variable.

This trend is encouraging as sustained declines in the rate of money supply growth are critical in reducing the rate of inflation.

Tourism

For February 1996 tourist arrivals showed a 7.1% increase over the 1995 February figures. Contributing to this, were increases of 9.6% and 3.0% respectively in stop-over and cruise-ship visitors. There was however, a 9.0% decline in the number of nationals visiting the island. None-the-less there was an overall 6.4% rise in total visitor arrivals (nationals and non-nationals) to the island during this month.

For January and February - total tourist arrivals rose by 7.70%, supported by almost equal percentage increases in stop-over and cruise-passengers. Over this same period, total arrivals, nationals and non-



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nationals amounted to 313187 visitors showing a 6.8% increase over arrivals for January and February 1995. Estimated expenditure for January 1996 is about US\$91.8 million or 12.8% over January 1995.

During April, the extension to the Ocho Rios cruise shipping pier was officially opened. It is hoped that these facilities will foster increased cruise ship arrivals eventually boosting tourism earnings in the area.

Merchandise Trade

The trade figures for 1995, indicated a 17.3% increase in exports totalling US\$1.4 billion and imports which rose by 27.4% to reach US\$2.8 billion. This resulted in a trade gap of US\$1.4 billion the widest in the country's history. The major categories recording increased imports were consumer goods up by 51.6%; capital goods rose by 49.3%, while raw-materials and intermediate goods imports rose by 13.5%. This latter figure may be reflecting the slow

down in domestic manufacturing production. On the export side, all categories showed improved earnings during the year, with non-traditional agri-crops doing very well and apparel sector maintaining its dominance in non-traditional export earnings.

For January 1996, the trade figures are to some extent alarming - Imports for the month valued US\$256.7 million or 31.0% above January 1995 figures. Total exports fell by 7.0% to reach US\$99.3 million, thereby creating a trade gap of US\$157.4. If this trend continues, then by year-end the trade gap will be even wider than that for 1995.

The January 1996 figures may be distorted by a large jump in capital goods imports which suggests a one-off importation of a large piece or quantity of equipment. If this is so, the picture may not be as bad as it at first seems, but the fall in exports suggests that the external account is woefully out of balance.

BALANCE OF PAYMENTS PROFILE: US\$Mn

	Merchandise	Services	Transfers	Current A/c	Capital A/c	NIR A/c
Jan-Dec'94	-957.70	500.70	475.00	18.30	367.10	397.92
Jan-Dec '95	-1342.60	508.20	579.30	-255.10	278.50	421.31

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MONTHLY MACRO-ECONOMIC INDICATORS

(December 1994 - March 1996)

MONTHS	BASE MONEY		NET INT'L RESERVE	FOREX ACCTS.	INFLATION		TOURIST ARRIVALS			CHANGES IN M2 (MONEY SUPPLY)	
	Mthly. Chng.	Point to Point	Total NIR	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	740.06	2.8	21.20	148839	77419	71419	1.73	36.11
Dec.95	12.81	29.46	421.31	737.30	4.3	25.50	157819	100183	57636	5.53	40.40
Jan 96	-8.46	21.08	455.79	702.00*	2.6	27.22	150561	86184	64377	-2.78	34.00
Feb.	4.17	23.91	467.52	713.00*	3.3	29.94	150355	94449	55906	0.27	33.14
Mar.	2.89	24.21	496.26	710.00*	1.6	30.8	-----	-----	-----	-----	-----

* Provisional

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

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