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PRIVATE SECTOR ORGANISATION OF JAMAICA

Monthly Analysis of the Jamaican Economy

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Overview

The excitement in the foreign exchange market hadhardly died down before the country was faced with another major development in the financial system. The closure of the Century National financial institutions in July by the Minister of Finance sent shock waves through the banking sector and put thousands of depositors and customers to severe inconvenience. This action has been the subject of much public debate but unfortunately not much of it has been very objective.

CNB's latest crisis really began with the run on the bank which occurred last July when the finance minister's rescue plan/shotgun wedding fell through. While the poor financial state of the group is what lead to the minister's intervention and the undeniable need for additional equity, it was not in and of itself, the reason for CNB's closure. The flight of depositors or the run on thee bank is what really sealed is fate. It is extremely important that we bear this in mind as we attempt to assess the implications of CNB's closure for the rest of the financial system. The bottom line is that a bank can lose money and continue in business for a number of years, but not even the most profitable institution can withstand a sustained run on its deposits.

This last point is most important as CNB's closure has created a fair amount of anxiety among the banking public and this has lead to some amount of shifting of deposits among institutions. As a consequence of this, sound institutions have come under some cash flow pressure through no fault of their own. Fortunately, these fears seem to be subsiding and one hopes that things will soon return to normal.

If nothing else, CNB's closure should signal to the local banking sector that a paradigm shift has taken place. In an environment of high real interest rates, collateral-based lending and speculative investment in real estate are unlikely to be the routes to profitability and prosperity. Cash is king and good treasury management is the key to success!

The macro-economic impact of CNB's closure is likely to compound somewhat the micro level difficulties mentioned above. Its major effect will be a tightening of liquidity as the deposits at the instituions have now been locked out of the financial system for at least the next two months. This is good news for the BOJ's anti-inflation fight and its attempts to control money supply, but the authorities must ensure that there is sufficient liquidity to keep the financial system afloat.

Money growth has been kept under such excellent control for the first few months of this year, that the BOJ now has some leeway to ease the liquidity situation without prejudicing its money supply targets for this year. The ministry of finance must also begin to play a greater role in liquidity absorption. While there have been major improvements in their cash flow management, the public sector must begin to contract the share of national resources which it consumes. The heavy reliance on monetary policy places the burden of adjustment (ie contraction) on the private sector.

The optimists among us can be encouraged by the June inflation numbers, if the present trend holds, calender year inflation could be in the mid-teens and the fiscal year outturn could be close to single digits. Even if the real interest rate offered to depositors remains the same, this would still mean a significant drop in deposit rates and some downward adjustment in lending rates.

Net International Reserves

The Net International Reserve stood at US$598.3 million at the end of June. That is, US$40.42 million more than at the end of May. For the first six months of 1996, the Net International Reserves has shown an overall increase of US$177.12 million or 42.0% over December 1995 and compares with a US$52.7 million or 13.2% over the first six months of 1995.

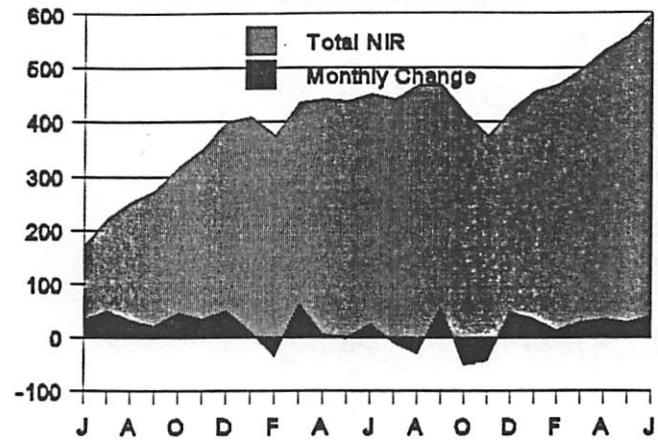
Although the net increase for the first six months of 1996 was US$177.1 million, the Bank of Jamaica was both a buyer and a seller during this period, so that total purchases may well have been more than this amount.

The stated objective of the Government was to increase the Net International Reserves for 1996 by only US$95 million, however, it has almost doubled that target in half of the year.

Will the Authorities now stop purchasing foreign exchange or will they continue to pile up funds? The inflows of foreign exchange to the market have shown a dip in June, so maybe, the rate of accumulation may slow as the leaner months of August, September, and October approach.

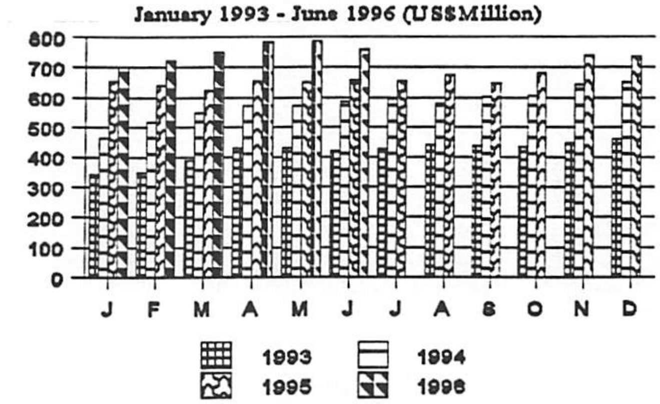
CHANGES IN INTERNATIONAL RESERVES

June 1994 - June 1996 (US$Million)



FOREIGN CURRENCY ACCOUNTS

January 1993 - June 1996 (US$Million)



Foreign Exchange Accounts

At the end of June, foreign currency accounts balances stood at US$759 million reflecting a US$28.0 million or 3.5% decline over the Stock balances at the end of May.

For the first six months of 1996, these account balances moved from US$737 million in December falling to US$702 million in January, increased monthly to peak at US$787 million in May and falling to US$759 million in June thereby reflecting an overall increase of 2.98% over the six month period. The trend in inflows for the similar period in 1995 was slightly different; inflows peaked in January 1995, fell to its lowest by March, then showed monthly increases up to October. The first six months increase was 1.02%.

These high levels of inflows currently experienced in the market have served to meet demand and facilitated the appreciation of the J$. With some level of upheaval in the banking system which can affect confidence in the system, as well as the intimation of lowering interest rates, these can serve to influence future inflows with some negative movements in the levels of these accounts and in the exchange rates.

Exchange Rate

The rate of exchange J$ to the US$ remained relatively stable during July, exchanging between J$35.30 to J$35.80, and this was the similar range being asked in the latter part of June. Inflows continue to be high and with the Government controlling the growth of the money supply and the subsequent reduction in the demand for foreign currency, the exchange rate has settled at its new parity. This is expected to continue for some time yet because there is no sign of the Authorities lowering interest rates. Inflows will also continue to be high because of government's plans to borrow US$ to help bail out heavily indepted companies which will increase the supply of foreign currency on the market. However, with inflation falling rapidly, there is no telling how long the present state of affairs will last.

Interest Rates

During July there were no issues of Local Registered Stock. There were however, four issues of Tbills, one for J$650 million, two for J$500 million and one for J$1.8 billion. The following were the tender results.

a. J$500m for 183 days yielded 40.81% interest was over subscribed by J$1.716 billion.

b. J$500 million for 245 days yielded 38.41% interest was over subscribed by J$2.06 billion.

c. J$650 million for 186 days yielded 38.14% was over subscribed by J$1.37 billion.

d. J$1.8 billion for 365 days yielded 41.86% was over subscribed by J$216 million.

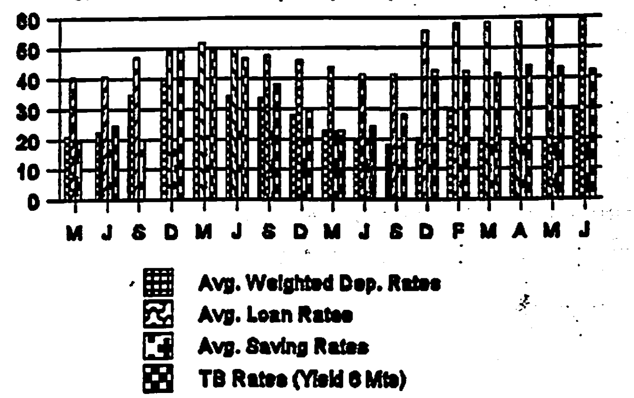
The TBill issues at "b" and "c" above were offered on July 31st, and the yields on these indicate a fall of 2-3% in rates. In June rates of up to 43% were offered, so, in over two months, TBill rates have declined by roughly 5%. The level of over subcription on these bills indicate the existence of high levels of liquidity in the system.

Commercial rates however, remained high, fixed deposit rates ranged between 18-46%, average loan rates remained high at 59.95% and savings at 17.96%.

Although inflation rates and Tbill rates are trending down, it is expected that it will take some time for

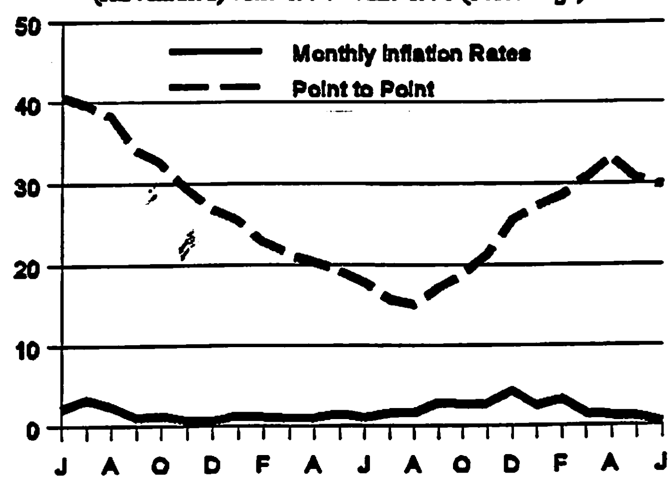
Comparative Interest Rates

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



CHANGES IN INFLATION

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



these to be reflected in the rates offered in the commercial sector. This means that the real interest rate is even higher than before.

Inflation

The inflation rate for June 1996, was 0.4%, a considerable improvement on the 1.2% registered for May. The June rate is said to be the lowest since February 1989 and is the continuation of a declining trend in the rate of price increases since, they peaked at 4.4% in December 1995.

Between January and June of this year the inflation rate was 10.89% and compared with 7.15% for the similar period in 1995, is significantly higher. However, if the monthly rates continue to trend down for the rest of 1996, then a 15%-18% annual rate could well be realized, given the influence of seasonal factors in prices.

The point to point inflation rate for June was 29.9% which is slightly lower than the point to point for May 30.7% but significantly higher than the 25.6% achieved at December 1995.

Contributing to the downward trend in prices were the appreciation in the exchange rate, the pass through of cost declines to the consumers as well as the decline in the growth of money supply.

Base Money

During June, Base Money rose slightly by 0.31% and follows on a decline of 1.22% in May. For the six months, January to June of 1996, Base Money showed an overall decline of 4.00% and contributed to a declining point to point trend which at June stood at 17.96% down from 30.58 in December 1995. The decline in the level and growth of Base Money contributed somewhat to the slow growth in money supply and in turn to the downward trend in inflation rates which is currently being experienced.

Money Supply

Money Supply grew by 3.66% in April. This however, follows on declines of 2.78% and 0.35% in January and March respectively and has contributed to an overall rise of only 0.69% in this variable for the first four months of 1996. In the first four months of 1995 M2 (money supply) grew by 9.59%.

During April, there was a J$2.09 billion growth in Bank of Jamaica foreign assets and a J$4.024 billion increase in Public Sector credit and these were the significant contributors to the growth in M2.

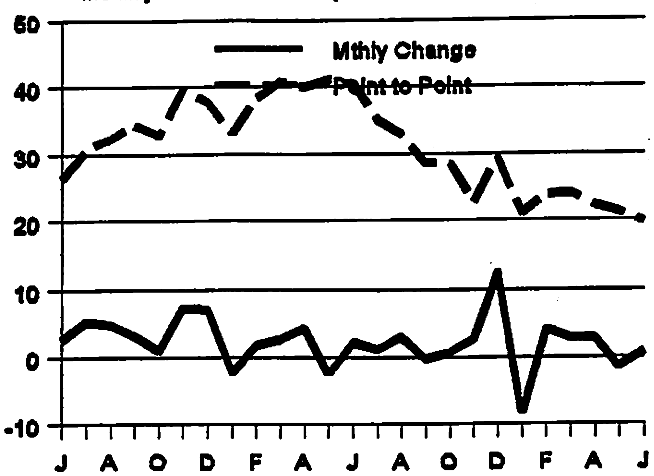
Tourism

Total Tourist arrivals during June, that is, cruise and stopovers amounted to 127,745 persons and while these figures indicate an 8.3% increase in arrivals over June 1995, they were 2.5% less than arrivals in May this year.

During June, stop over arrivals rose by 8.9% over those for May but Cruise Ship passengers fell by 22.3% and total arrivals including nationals fell by 0.5%.

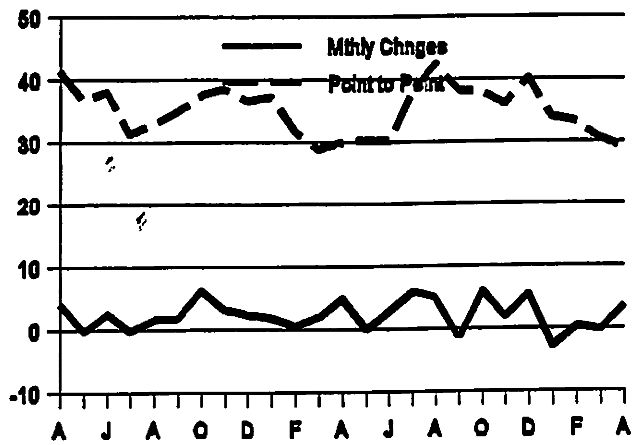
CHANGES IN BASE MONEY

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



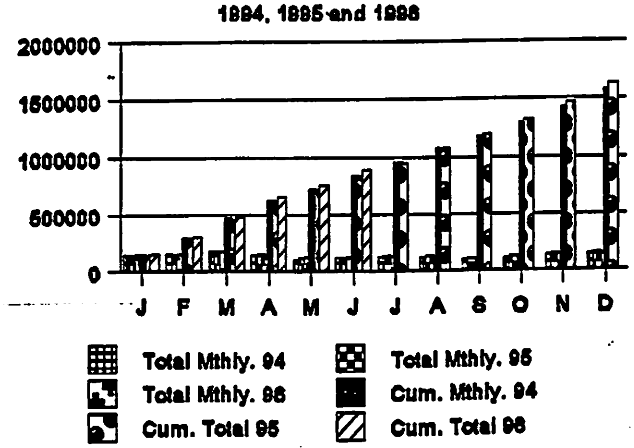
CHANGES IN M2

Monthly Changes April 1994 - April 1996



TOURIST ARRIVALS

1994, 1995 and 1996



Expenditure for January to March is estimated at US$286 million which was 18.0% more than the similar period in 1995.

For the first half of 1996 total tourist arrivals grew by 3.16% compared with January to June 1995. While stop-over arrivals declined by 2.3%, the 13.6% growth in Cruise Ship Passengers to the Island boosted the overall level of arrivals.

Consequent, on the revaluation of Jamaican dollar and in light of the effects of high interest rates on the profitability of the Tourism Industry, Government has now instituted a lower interest rate fund accessible through the National Development Bank to assist the sector with its debt-servicing needs.

Merchandise Trade

The trade data for January to April 1996 show imports totalling US$910.4 million and out pacing exports earnings of US$488.5 million, resulting in a trade gap of US$421.9 million. (The trade deficit is now just US$67.5 million less than current levels of export earnings.) Compared with the corresponding period in 1995, imports have increased by US$124.8 million or by 15.9%, while export earnings rose by only US$17.9 million or 3.8%.

A buoyant foreign exchange market, and a revalued local dollar have created the ideal environment to foster imports, hence an increased import bill could be a continued feature of the trade statistics in the coming months.

Exports:

Between January and April, earnings from traditional exports rose by 7.0% to reach US$334.7 million. Agricultural exports earned US$30.6 million increasing by 3.5% and the mining sector showed a 3.5% rise in earning to reach US$229.9 million. However, earnings from the non-traditional sector which includes apparel declined by 1.1% to earn US$142.5 million.

Imports:

The data indicates that all categories of imports rose over the review period. Consumer goods showed the highest increase of 34% over April 1995 figures to reach US$239.2 million. Raw Materials rose by 11% to US$498.4 million, while capital good rose by 9.4% to a value of US$172.8 million.

Food, including beverages, motor cars and consumer non-durables were the major consumer imports. Imports of machinery, and industrial supplies also increased compared with January to April 1995.

BALANCE OF PAYMENTS PROFILE: US$Mn

	Merchandise	Services	Transfers	Current A/c	Capital.A/c	NIR A/c
Dec '95	-1342.60	508.20	579.30	-255.10	278.50	421.31
Jan-Apr '95	-315.00	166.40	201.20	52.60	-10.10	440.41
Jan-Apr '96	-421.90	264.80	169.70	12.60	95.50	529.37

MACRO-ECONOMIC INDICATORS
(December 1994 - June 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	-8.92	15.09	455.79	702.00	2.6	27.22	150561	86184	64377	-2.78	34.00
Feb.	2.85	16.29	467.52	722.33	3.3	29.94	150355	94449	55906	0.27	33.14
Mar.	2.15	15.74	496.26	749.00*	1.6	30.80	180218	108407	71811	-0.35	30.58
Apr.	1.25	12.21	529.37	784.03*	1.3	31.30	149663	89030	60633	3.66	28.99
May	1.22	13.61	558.01	787.00*	1.2	30.64	131052	82967	48085	-------	--------
June	0.31	11.54	598.43	759.00*	0.4	29.9	127745	90366	37379	-------	--------

* *Provisional*

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