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PRIVATE SECTOR ORGANISATION OF JAMAICA

Monthly Analysis of the Jamaican Economy

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OVERVIEW

It seems that a month does not go by without some new and disconcerting development in the financial sector. February's major crisis was the run on the Eagle financial institutions that occurred after the Gleaner carried a headline which declared that CEO Paul Chen Young was to step down and be replaced by a consultant in the Minister of Finance's office. Confidence was not helped by the fact that the consultant was also an official on the Minister's constituency committee. The headline had followed earlier speculation in the media that the minister's brother Dr. Carlton Davis was to be appointed as Chairman of the board of Mutual Life, as one of the conditions for government assistance. Unfortunately, it seems that after the CNB debacle, the public have now interpreted government intervention in financial institutions to be the kiss of death rather than the preservation of life. The low level of confidence in government and some financial institutions will certainly make the rescue job in the insurance a very sensitive and difficult one.

The good news however, is that for the most part, the extent of the problems in the sector have been somewhat exaggerated, to say the least. The short term indebtedness of even Mutual Life, which is supposed to be on the critical list, is far less than the numbers which have been bandied about in the press. Furthermore, as interest rates come down, the cash crunch in which this and other institutions find themselves will ease considerably and the outlook for the firms will improve. The greatest threat to their long term viability will come from how government handles monetary and fiscal policy over the next 12 months. If fiscal is too loose (i.e., too much of a bail out and too much election spending), then the government may be tempted to raise interest rates later in the year and this will set back the recovery of the insurance companies.

Despite the fact that the problems in the sector may not be as large as have been suggested in public, the sector does face a very challenging few years as it seeks to recover from mistakes of the recent past. Some companies are well on the way to making the adjustments that will set them on the road to recovery and others are just getting started on that road. How long and how difficult that road is, will depend on the skill of management and the political decisions that are taken with regard to macro-economic policy and the manner and extent of government assistance to the sector.

Interest rates are coming down a little faster than we had anticipated and this is precisely what is needed at the present time. The real interest rate is coming down very slowly as we anticipate the point to point inflation rate in February to be about 10.5%. With T-Bill rates at about 18%, this gives a real interest rate of about 7.5% on trailing inflation, down from about 9% last month. We expect fiscal year inflation to come out at about 9.5% and so T-Bill rates are likely to fall another 3 or 4% before levelling off in the mid-teens for a while. The next big question for the BOJ will be whether and by how much, to reduce the cash reserve ratios in the merchant and commercial banks. This issue will have to be addressed in the next 3 to 6 months.

Looking a little further down the road, this year is likely to be divided into two distinct periods as far as economic policy is concerned, the pre-election and the post-election periods. In the former period, the prime objective of policy is likely to be the preservation of the existing exchange rate and the creation of a feeling of relative prosperity through the government spending. Everything is in place for them to accomplish this for the next few months. How long it can be sustained without some immediate fallout will depend on the extent to which they indulge themselves with regard to election spending. Post election the chickens will come home to roost. The best that we can hope for is that the pre election excesses are moderated and that post election we do not simply resort to the high interest rate regime, but allow the economy to adjust to a sustainable equilibrium from which strong economic growth is possible.

Net International Reserves

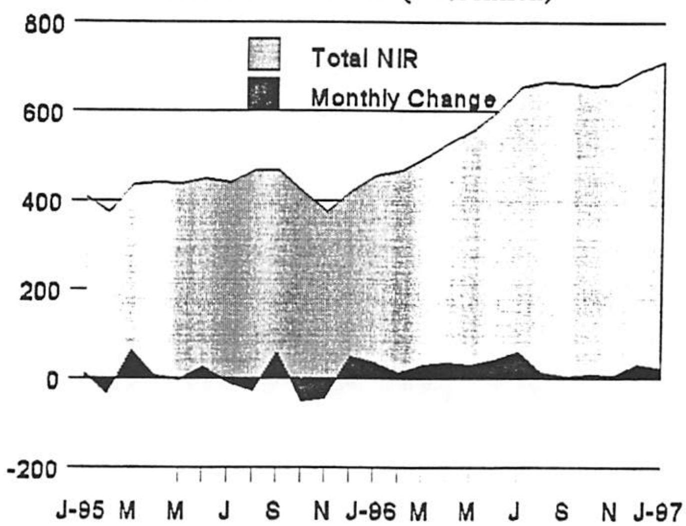
The Net International Reserves (NIR) continued to increase in January as they rose by US$21.03 million to US$713.03 million at the end of January 1997. This stock of NIR reflects 16.26 weeks of imports up from 15.92 at the end of December 1996. This is the highest level ever obtained since the NIR returned to positive levels.

The higher level of gross foreign assets and lower level of gross foreign liabilities both contributed to the increase in the NIR. Gross foreign assets increased by US$18.42 million to stand at US$893.39 million while gross foreign liabilities decreased by US$2.0 million to stand at US$180.36 million at the end of January 1997.

The substantial increase in the NIR experienced in January could be due to the inflow of arbitrage money pursuing the relatively high real interest rates on government securities. It could also have been affected by the conversion of the proceeds of the Mechala debt placement (US$75 million) on the US Market, a substantial portion of which was taken up by the Bank of Jamaica. As well, the winter tourist season brought its usual increase in inflows and the Bank of Jamaica would have sought to temper the effect of these funds on the foreign exchange market.

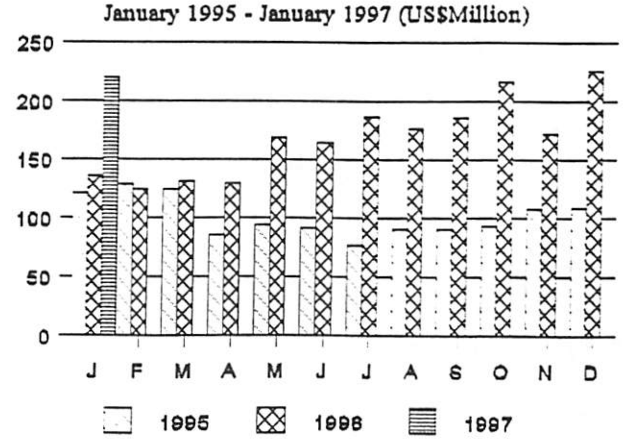
CHANGES IN INTERNATIONAL RESERVES

Jan. 1995 - Jan. 1997 (US$Million)



FOREIGN CURRENCY PURCHASES(MTHLY)

January 1995 - January 1997 (US$Million)



Foreign Exchange Accounts

The preliminary figure for the funds in the foreign currency accounts at the end of January 1997 was US$707.83 million suggesting a US$20.28 million decrease over December's figure of US$728.11 million.

Activities in foreign exchange accounts in January show US$619.34 million in withdrawals, as against US$654.61 million in lodgements, this is in contrast with withdrawals of US$626 million and lodgements of USS654.61 million in December 1996.

The Interbank Market for authorized dealers in foreign exchange showed continued buoyancy in January 1997. Foreign Exchange purchases for the month in the spot market were US$219.57million while Sales were USS220.60 million. This represents an increase of approximately 63% in activities in this market over the same period last year.

This is a continuance of the trend experienced in the past two (2) years which saw total purchases by authorised dealers for 1996 of US$2.0 billion or 66% higher than 1995 and total purchases by Cambios of US$1.2 billion increased by 272.9% over 1995.

Exchange Rate

The Jamaican Dollar showed mixed fortunes vis-a-vis its foreign counterparts during February. It showed a slight devaluation against the US$ and Canadian Dollar to sell at an average of JS35.02 to US$1 and JS25.3 to Canadian $1. While the pound sterling showed a slight revaluation to sell for an average of J$55.2 to 1 pound sterling at the end of trading on February 26, 1997.

The Bank of Jamaica continues to intervene in the market as it endeavours to hold the exchange rate at about JS35 to US$1. This is inspite of the obvious over valuation of the JS. As interest rates continue to fall, the BoJ is likely to step up its intervention in support of the Jamaican Dollar.

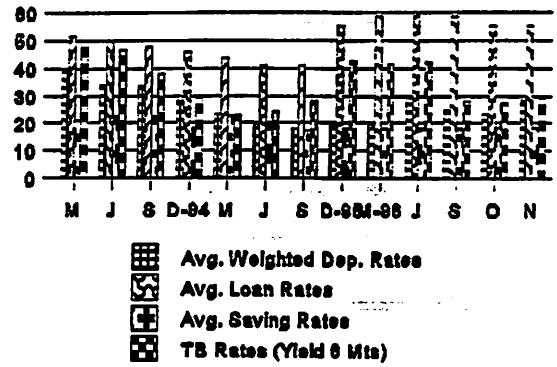
Interest Rates

Interest rates in the commercial banking sector continued their slow downward trend with average saving rate remaining constant at 17.96% and average lending rate moving down from 55.22% to 53.67% at the end of January 1997.

The Bank of Jamaica has come to the market with the three (3) medium to long-term instruments. There is a five year LRS instrument which pays an

Comparative Interest Rates

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



initial 23% yield and there after pays a variable rate of 2.5% above the weighted average T-Bill yield.

The other LRS is of a seven year tender and initially pays 23% rate of return, and thereafter the yield will be 3% points above the weighted average T-Bill yield.

The third instrument is a one year debenture which will provide a 22.5% rate of return.

From the one (1) new T-Bill offer for the month of February, the result was as follows:

* For the offer of J$550 million for 184 days it was over-subscribed by JS3.55 billion and yielded 18.13% interest on average.

Inflation

For January 1997, general price levels as measured by the CPI rose by 0.6%. With the exception of the 1.1% rise in the CPI in September 1996, monthly inflation rates have been below 1.0% since June 1996. This trend is likely to continue for the next few months, so the fiscal year out-turn is likely to be below 11%, the lower end of the target. The inflation for the first ten months of the fiscal year is 8.25%.

As interest rates on T-Bills and the inflation rate trend downwards, the policymakers will have to lower the cash reserve ratio to enable lending rates to fall faster and further. This will require compensating adjustments in fiscal policy in order to keep inflation in check.

Base Money

After showing a 10.05% increase in December, base money rose further by 2.4% in January 1997. This appears to be an unusual trend, since, after seasonal factors in December induced the increase in Base Money, mainly through the growth of 'currency with the Public', a continued control of money supply should have prompted a fall in base money and M2 in January. In fact, that has been the trend for the past two (2) years.

However, the data suggests that in January 'Currency with the Public' fell by 14.5% but a 1% and 548.3% increase respectively in Commercial Banks Statutory reserves and their Current accounts were influential in fostering the growth in base money. Overall, base money grew almost 20% on a point to point basis, January 1997 over January 1996. This is a worrying development.

The rise in the Current Accounts of the Commercial Banks was mainly attributable to them holding increased funds to cover their end of the month clearing transactions, as well as their purchases of T-Bills from BOJ.

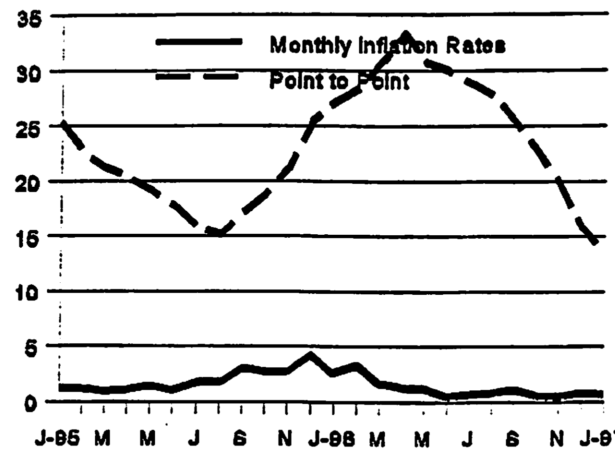
Money Supply

During November 1996, Money Supply (M2) grew by 1.1% following on a similar growth rate in October. This has brought the overall growth in M2 for the eleven months of 1996 to 2.4%, while the point-to-point, that is November 1995 to November 1996 growth rate continued its declining trend to reach 6.66% down from 9.69% in October.

With the growth in M2 for the eight months of fiscal year 1996/97 at 4.04%, the current growth

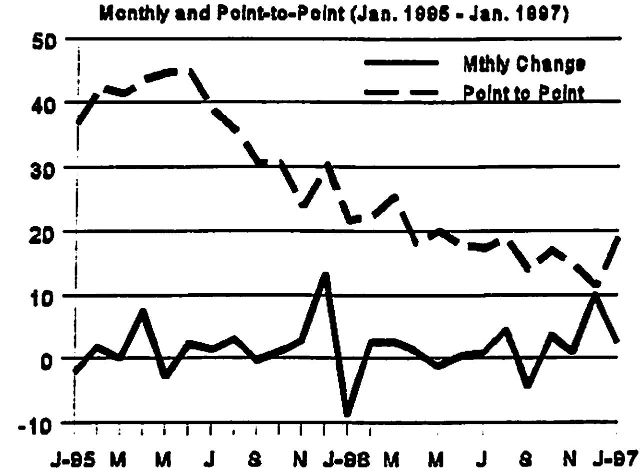
CHANGES IN INFLATION

(All Jamaica) Jan. 1995 - Jan. 1997 (Percentage)



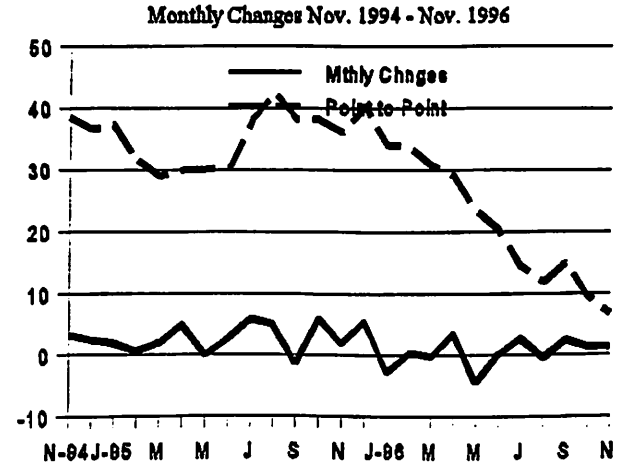
CHANGES IN BASE MONEY

Monthly and Point-to-Point (Jan. 1995 - Jan. 1997)



CHANGES IN M2

Monthly Changes Nov. 1994 - Nov. 1996



trends suggest that the targetted growth rate of 12-15% in money supply for fiscal year 1996/97 could be achieved if the present trend continues.

During November, Credit to the public sector rose by J$807.4 million or 29.1% and to the private sector by J$1.249 billion or by 2.6% and were most influential in fostering the growth in M2. However, as BOJ disposed of some of its foreign assets in November, this activity had a moderating effect on the rate of expansion in the money supply.

During the year the levels of the components of M1 and M2 have been characterised by increases and decreases as portfolio shifts are made. In November, the figures suggested a fall in demand deposits levels while time and saving deposits holdings rose. Against this background, as interest rates trend down, encouraging an increased demand for credit, the Bank of Jamaica needs to take a calculated look at how it manages its sale of foreign exchange, and should seek to use this as a tool of liquidity control.

Tourism

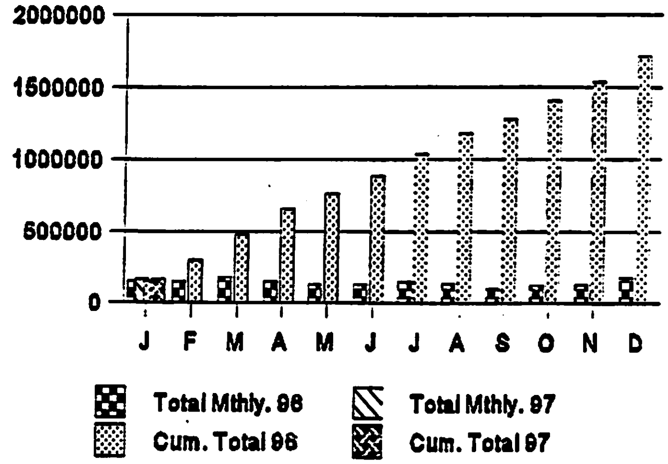
As the tourist winter season reached its halfway mark in January, tourist arrivals for that month, that is, stop-over and cruise passengers showed a 10.75% increase over January 1996 arrivals. Contributing to this was a 27.25% rise in cruise passengers visiting, and the number of stop-overs showed a 1.5% fall.

The number of nationals visiting in January 1997, showed a 0.2% rise over the January 1996 figures, and this helped to contribute to a 10.3% rise in total visitor arrivals January 1997 and 1996 compared.

As the weather continues to be quite harsh in Jamaica's tourist market areas, it is hoped that the arrivals will continue to increase at least for the rest of the winter season.

TOURIST ARRIVALS

1996 and 1997



Merchandise Trade

At the end of the eleven month period for 1996, Jamaica's expenditure on imports stood at US$2,593.30 million, growing by 2.64% or US$6.66 million over January to November 1995. Total exports at November stood at US$1,271.0 million, indicating a decline of 4.7% or US$62.20 when compared with US$1,193.5 million at November 1995. The trade deficit stands at US$1,322.30 million compared with US$1,193.5 million at November 1995. This reflects an increase of US$126.8 million or 10.7% over the same period last year.

Imports: Total imports at November were valued at US$2,593.3 million, of which Consumer Goods had a 25.94% share, Raw Materials 56.34% and Capital Goods 17.72%. These categories of imports showed increases of 11.82%, 2.7% and a 8.5% decline respectively over comparable periods in 1995.

Exports: Total exports for January to November 1996 were valued at US$1,333.20 million. Of this, Traditional exports - bauxite, alumina, sugar, bananas - accounted for 58.9%, other traditionals, accounted for 5.34%, and non-traditionals Exports 31% and Re-exports 4.76%.

The reduction in exports is partly due to the over-valuation of the J$. According to the real effective exchange rate index compiled by the World Bank, the J$ is 40% overvalued. As a consequence of this a number of apparel factories have closed and this was partially responsible for the 4.7% decline in total exports over the same period last year. There is likely to be more fall out in the export sector if something is not done to correct this problem.

BALANCE OF PAYMENTS

	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-Nov'95	-1193.50	514.20	513.70	-165.60	140.90	373.22
Jan-Nov'96	-1322.30	655.00	480.40	-186.90	428.70	663.11

MACRO-ECONOMIC INDICATORS

(December 1995 - January 1997)

MONTHS	BASE MONEY		NIR	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.95	13.43	30.58	421.31	737.30	4.3	25.50	157819	100183	57636	5.53	40.40
Jan.	-8.92	21.63	455.79	706.09	2.6	27.22	150561	86184	64377	-2.78	34.00
Feb.	2.38	22.36	467.52	713.21	3.3	29.94	150355	94449	55906	0.27	33.64
Mar.	2.62	25.55	496.26	702.80	1.6	30.80	180218	108407	71811	-0.35	30.58
Apr.	1.26	18.27	529.37	765.60	1.3	31.30	149663	89030	60633	3.66	28.99
May	-1.23	20.18	558.01	713.30	1.2	30.64	131052	82967	48085	-4.4	23.31
June	0.32	17.96	598.43	703.90	0.4	29.9	127745	90366	37379	0.1	20.23
July	0.82	17.32	656.55	692.00	0.7	28.8	148901	96742	52159	2.8	14.55
Aug.	4.5	18.89	667.09	691.00	0.8	27.7	139629	89910	49719	-0.5	11.90
Sept.	-4.4	14.04	665.32	708.00	1.1	25.30	100543	66219	34324	2.4	15.04
Oct.	3.7	17.10	658.57	689.50	0.5	22.68	126110	68726	57381	1.1	9.69
Nov.	0.87	14.82	663.11	699.50	0.4	19.83	128119	78231	49888	1.1	6.66
Dec. 96	10.05	11.40	692.60	728.11	0.8	15.8	176366	101866	74500	--------	--------
Jan. 97	2.4	19.32	713.03	707.83	0.6	13.5	166754	84833	81921	--------	--------

* *Provisional*

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