

# New Confidential Economic Bulletin

*Private Sector Organisation of Jamaica*

## Monthly Analysis of the Jamaican Economy

Vol. 2 No. 10 July 1997

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## Overview

July was another relatively quiet month in terms of developments at the macro-economic level. The BOJ continues to sell into the foreign exchange market in order to maintain the average selling rate at about J\$35.50, but this has not had a major impact on the Net International Reserves. Interest rates on government paper have edged up to just under 20% while the point to point inflation rate to June '97 came in at 8.3%.

Lending rates remain very high in both real and nominal terms, ranging from the low 30's to the low 50's, depending on the institution and the type of loan facility.

The high real deposit and lending rates are the biggest single source of uncertainty and instability in the economy at present as they cannot be maintained indefinitely and there is no indication from the policy makers that they have any plans for bringing these rates down without causing disruption to some other aspect of the economic programme. On the other hand, to maintain this policy much longer is to continue to sow the seeds of its own demise, as the cost of the domestic debt servicing and the financial sector bailouts are having a most negative impact on the fiscal budget. Credit to the public sector has been growing at a very high rate and is now the single largest factor behind the growth in the money supply (M2), which as of May 1997, was growing at 22.8% per annum. The second and third quarters of the fiscal year are usually the most difficult in terms of cash flow and with the added burden of the financial sector problems,

government's need for credit could grow further.

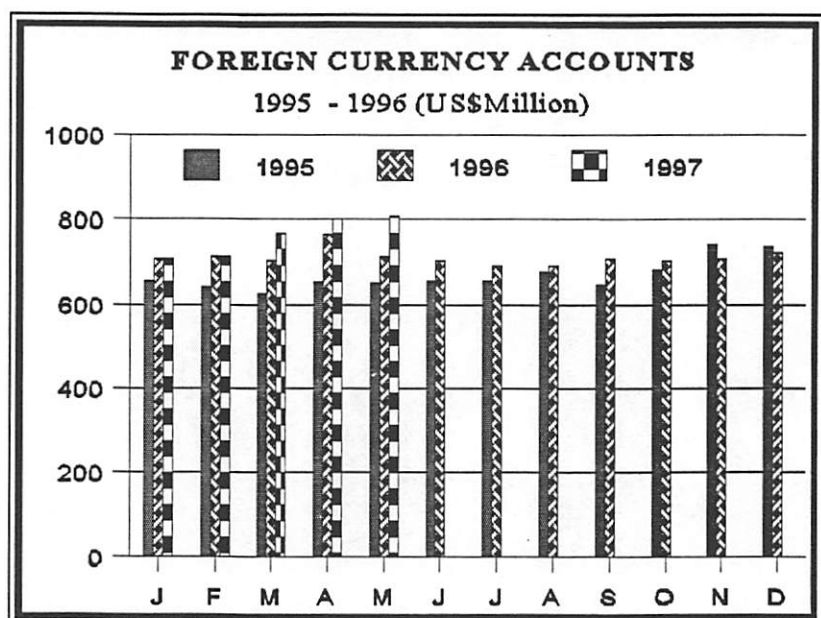
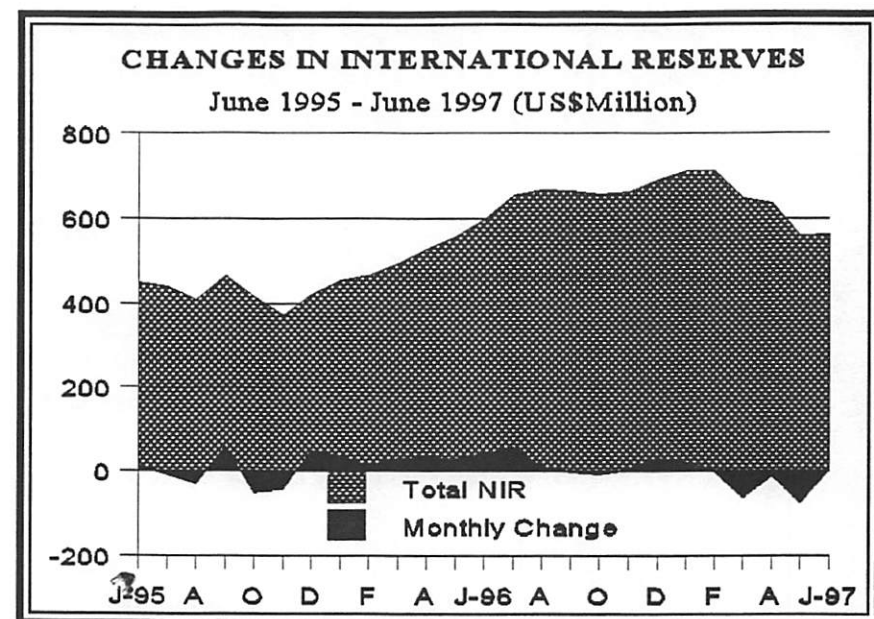
Higher rates of money supply growth will of course have negative consequences for the achievement of the inflation target. Lower interest rates would have the benefit of easing the cost of domestic debt servicing for the government and would also ease the burden on the clients of the financial institutions that the government is assisting through FINSAC. This would lower the amount and cost of the assistance and thus provide an additional benefit to the already overburdened public purse. While it is unlikely that anything will be done to rock the policy boat before the elections, one can only hope that the new administration will deal swiftly with the present policy conundrum before it results in even greater economic fallout.

The financial sector continued to be in the news this month and the news coming out of the sector was not good. The kiting scam which started out in the FE market seems to have spread to

include the commercial paper market. An authorised securities dealer has had its license revoked and has been at the centre of a potential default on its commercial paper obligations. Senior staff at a couple of other financial institutions have also been implicated in wrongdoings surrounding the issue of commercial paper. These developments do not appear to have set off a crisis of confidence in the market, and for the sake of the companies that rely heavily on this instrument for financing their operations, we certainly hope that there will be no such fallout. The distortions caused by the high cash reserve and the high withholding tax on deposit interest, are two powerful forces which have contributed to the financial disintermediation which has led to the development of the commercial paper market. The players in the market will have to tighten up their management systems dramatically in order to ensure that there are no further losses in the market, and that fraudulent deals are eliminated.

## Net International Reserves

The Net International Reserves (NIR) experienced a slight increase for the first time in five (5) months, when it rose by US\$2.8 million to stand at US\$563.9 million at the end of June 1997. This has reversed the trend so far, this year which saw the NIR declining by US\$151.3 million for the first three months



of fiscal year 1997/98. The current stock of NIR, however, covers 11.95 weeks of imports compared to 12.03 weeks at the end of May 1997.

In June, the gross foreign assets decreased by US\$4.33 million to stand at US\$717.08 million. This was however, offset by a larger

decline in the foreign liabilities, which fell by US\$7.17 million to stand at US\$153.16 million.

## Foreign Exchange Accounts

The newly revised figures for the stock of funds in foreign currency

accounts at the end of May 1997 stood at US\$807.87 million suggesting an US\$8.23 million increase over April's figure of US\$799.64 million.

Activities in foreign exchange accounts in May show US\$688.22 million in withdrawals, as against US\$695.45 million in lodgements, indicating a slow down in activity compared with April which saw withdrawals of US\$731.02 million and lodgements of US\$746.24 million.

## Exchange Rates

There was relative stability in the foreign exchange market during the month of July as the Jamaican Dollar showed some stability against its foreign counter parts. The Jamaican Dollar exchanged for J\$35.59 to US\$1, J\$25.67 to Canadian \$1 and J\$56.51 to 1 pound sterling at the end of trading on August 6, 1997.

The Bank of Jamaica resumed random selling during the month, with its ability to do so boosted by the successful placement of the Government of Jamaica Eurobond on the Euro-market. Despite the relative stability in the overall market, there is still an uncomfortably wide spread between the rate at which the Cambios and the authorized dealers are selling foreign exchange. The foreign exchange market should continue its

current stability into the coming month.

## Interest Rates

Deposit rates in the commercial banking sector seem to be on the rise again with the upper limit for the 3-6 months tenure of fixed deposits increasing from 16% in May to 20% in June. This is however, in contrast with savings rates which saw the average saving rates falling from 14.22% to 14.08% over the same period.

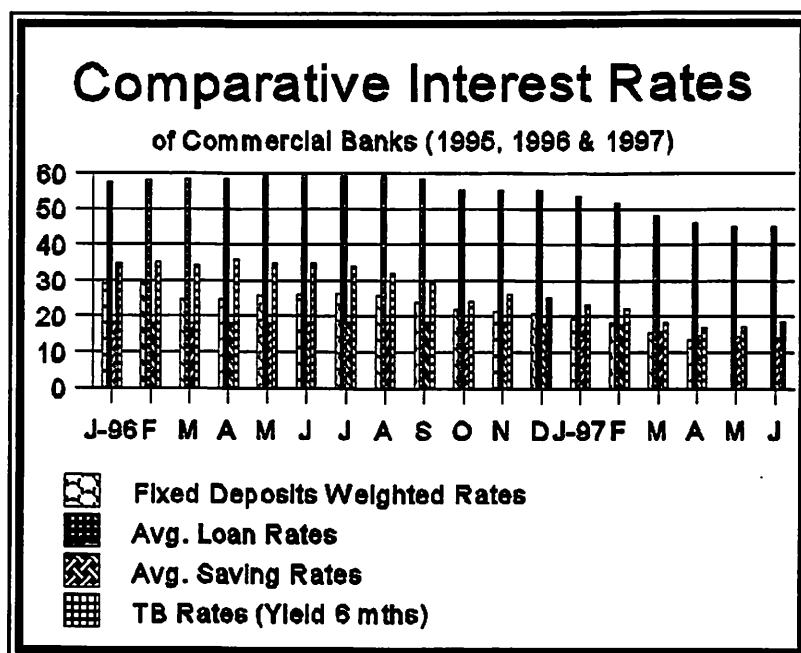
The most disturbing aspect however, is that it seems as if loan rates are on the rise again with average loan rates increasing from 44.78% to 44.94%. This is not a good indicator however, and the better indicator - the weighted average loan rates are only available up to April and showed a decline of 2.63 percentage points over the March

figure to stand at 33.48%.

The results of the two (2) new T-bills offers for the month of July, were as follows:

- \* The offer of J\$500 million for 364 days was oversubscribed by J\$295.3 million and yielded 19.51% on average.
- \* The offer of J\$700 million for 181 days was oversubscribed by J\$1,690.6 million and yielded 17.72% on average.

The two (2) new issues of LRS this month, opened July 28, 1997 and will close on August 15, 1997. The first is a variable rate LRS which will mature on February 28, 2000. This instrument offers an 18% per annum initial yield for the first 13 months. Thereafter, interest will be paid semi-annually at a



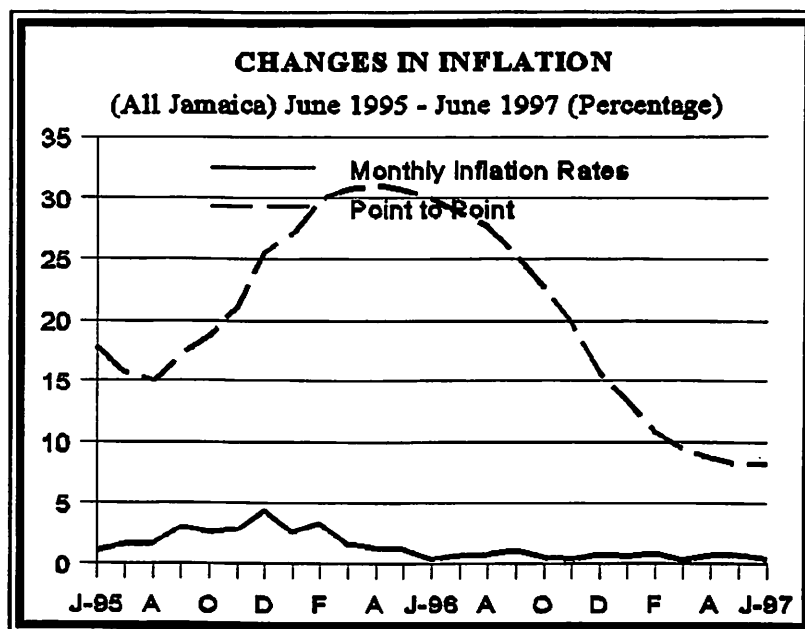
variable rate of 0.75% points above the weighted average yield rate applicable to the Jamaica T-bills tender. This issue can be called at 3 months notice and will qualify as a liquid asset.

The second, is a variable rate LRS which will mature on August 15, 2002. It will offer an initial yield of 19.5% per annum and thereafter, interest will be paid semi-annually at a variable rate of 1.5% above the weighted average yield rate applicable to the Jamaican T-bills tender. This issue can be called at three (3) months notice and will not qualify as a liquid asset.

## Inflation

June 1997, had a monthly inflation rate of 0.4% indicating the continuing trend of monthly rates remaining below 1%. This trend produced a half year inflation rate of 3.6% compared with 10.9% for the first 6 months of 1996. For the first quarter of the fiscal year 1997/1998 the rate was 1.7% and compares with 2.4% for the first quarter for 1996/97. Both semi-annual and fiscal quarter rates are suggesting that, if these trends continue, the 1997 and fiscal year 1997/98 inflation rates could be close to 8%.

The lower level of inflation has been mainly due to the tight monetary policy of last year, in particular the significant reduction in the growth rate of



money supply. At present the growth of money supply is significantly higher than last year's and this could have an adverse impact on inflation for the second part of 1997.

## Base Money

During June, base money continued its increasing trend, although at a slower pace, as it showed a 0.7% rise, down from an increase of 3.16% in May.

For the first six (6) months of 1997, base money grew by 3.8%, while for the comparable period in 1996, it contracted by 4%.

The increasing trend in base money in 1997 has translated into the increases in money supply (M2) during that period and contrasts with the declines in the rate of increase in both base money and M2 for the similar period in 1996.

The point to point movement in base money at June 1997 was 20.49% which is higher than the point-to-point rate of 17.96% at June 1996 and highlights the increasing growth of base money.

If this trend continues for 1997, both M2 and base money levels should show comparatively higher growth rates than in 1996 and these could have an impact on the inflation rate.

A review of the components of base money show that during June both a J\$36.2 million (.33%) and J\$23.2 million (0.12%) increase respectively in currency issue and Commercial Banks' statutory cash reserves helped to effect the marginal change in base money levels.

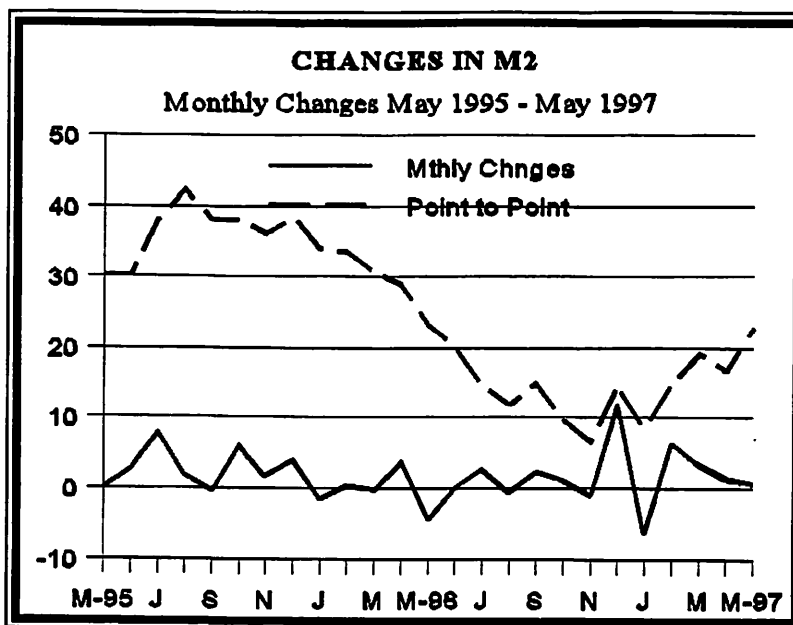
## Money Supply

The provisional figures for Money Supply relating to May 1997 indicate continued expansion in that variable as a marginal increase of 0.6% was experienced. This follows on a 1.4% increase in April. The slower growth rate of M2 in May is probably the outcome of the Central Bank's response to pressure on the exchange rate.

Money Supply has grown between January and May 1997 by 4.6%. For comparison, the Money Supply growth between January and May 1996 was 2.42%. While the point to point increase for May 1997 was 22.77% comparable to 23.31% for May 1996.

*"So that, while the BOJ is using in 1997, a strategy similar to that used in 1996 to control money supply, the variable is none-the-less experiencing higher levels of growth and if this is allowed to get out of control, it could throw off inflation targets set for both calendar and fiscal years."*

During May 1997, Domestic credit expanded by 5.6%, effected mainly by increased credit to the public sector and to a lesser



extent to other financial institutions. However, net foreign asset balances fell and almost negated the increases in credit thereby moderating the expansion effects on the money supply.

Credit to public sector is by far the main contributor to M2 growth in the first five (5) months of 1997.

## Tourism

*"The statistics on tourist arrivals for June 1997, indicate an improving trend. Stop-over visitors and cruise passengers for the months of June 1997 showed increases of 6.5% and 21.6% respectively over June 1996, while total tourist arrivals rose by 10.6%, the highest*

*increase so far, for the year for both groups of visitors."*

The number of foreign nationals visiting in June 1997 increased by 8.3% compared June 1996, while the year to date figure shows an increase of 1.4%.

The number of stopover visitors for January to June 1997 increased marginally by 1% over the comparable period of 1996, while cruise passengers increased by 15.8% for the comparable period of 1997.

Between January and June 1997 total visitor arrivals rose by 6.6% when compared with January to June 1996. A 15.8% rise in cruise passengers significantly influenced this.

Tourist expenditure for the period January to June 1997 was US\$445.8 m or 2% above the 1996 figure for the similar period.

Recently, Air Jamaica transferred its airline hub to Montego Bay, this in an effort to garner a larger slice of the region's tourism traffic, as well as to strategically position itself as a gateway to North America and the Caribbean.

On the other hand, the Montego Bay business and tourism interests have come together to focus on finding solutions to the problems of tourist harassment, a poor tourism product and the high head tax levied on cruise passengers, which are seriously affecting the industry in Montego Bay.

The Tourism Product Development Company has recently proposed to undertake a comprehensive beautification programme in sections of Ocho Rios, along with a tree planting campaign, side-walk upgrading and the development of the Ocho Rios Marine Park in an effort to improve the product in that resort town.

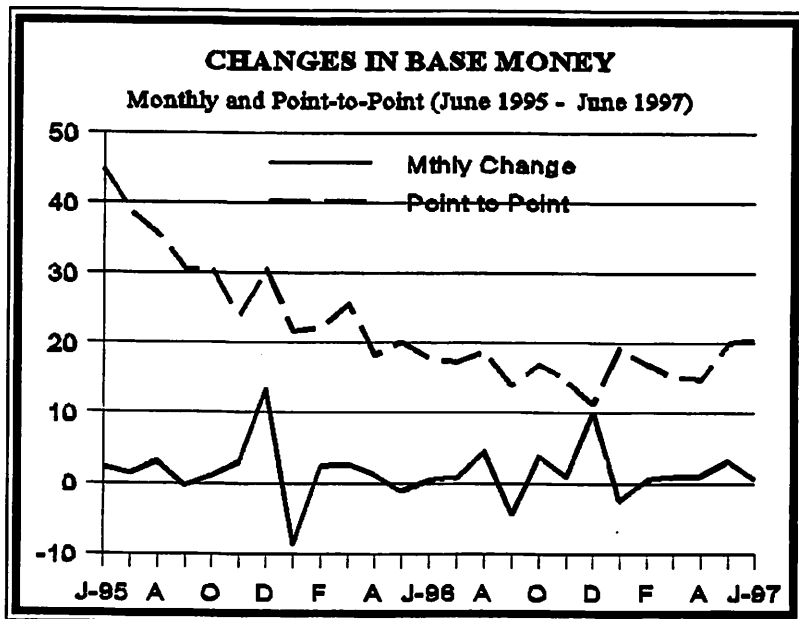
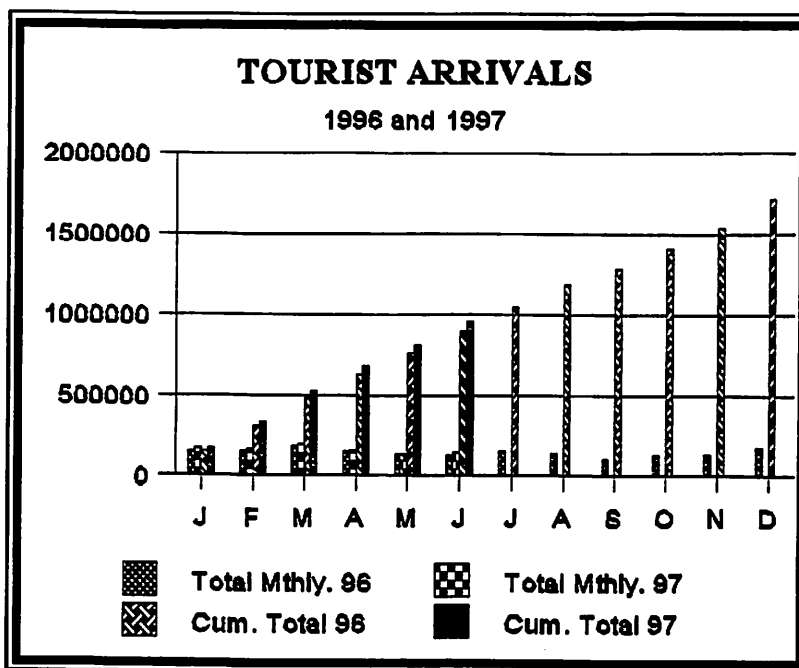
## External Trade/Balance of Payments

**Merchandise Trade:** Total exports for the first four months of 1997, were valued US\$449.4 million which was US\$34.3 million or 7.9% less than exports for the similar period in 1996.

The fall in export earnings reflected volume as well as price factors. There was a fall in both the export volume and prices obtained for alumina, sugar and bananas, so the earnings from the traditional export sector fell by 8.8%. The earnings from the non-traditional sector continue to decline due mainly to a

downturn in the apparel sector.

Over the same period, the cost of imports rose by US\$15.1 million or 1.7% to US\$925.9 million. This resulted in a US\$49.4 million expansion in the trade gap when compared with the January to April 1996 period.



**Services:** Although the economy's earnings from trade in services remained positive for the period January to April 1997, compared with the similar period in 1996, these were US\$26.5 million or 9.9% less. This resulted from US\$22.4 million lower earnings from foreign travel receipts in addition to increased payments of US\$6.2 million in relation to investments.

**Transfers:** *The Net balance of transfers for the period, January to April 1997 was US\$77.7 million greater than for the same period in 1996. This resulted mainly from buoyant receipts of*

***US\$215 million in private transfers, which were US\$86.5 million greater than in 1996.***

**Current Account:** The Current Account balance for the period January to April 1997, was US\$-5.7 million reflecting a US\$1.8 million improvement over January - April 1996. This improvement in the current account was facilitated by the increase in Net Transfers which almost erased the gap created in the trade of Goods and Services.

**Capital Account:** The Capital Account at April 1997 continues to feature a marked reduction in net capital inflows, which for the first four months of 1997 was an outflow

of US\$50 million compared with inflows of US\$115.6 million over the similar period in 1996.

For the current review period, private capital inflows fell to US\$22.4 million compared with US\$211.3 million at the 1996 period and official capital movement showed a net outflow of US\$72.2 million in the 1997 period compared with US\$95.7 million for the 1996 period. These activities fostered a decline in the Net International Reserves of the BOJ of US\$55.5 million as at April 1997 and contrasts with its improvement of US\$108.1 million at April 1996.

BALANCE OF PAYMENTS

	Merchandise	Services	Transfers	Current A/c	Capital A/c	NIR A/c
1996	-1527.30	746.60	542.30	-238.40	509.70	692.60
Jan-April '96	-427.10	267.70	151.90	-2.50	115.60	529.40
Jan-April '97	-476.50	241.20	229.60	-5.70	49.80	697.10

## MACRO-ECONOMIC INDICATORS

(December 1995 - June 1997)

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
Dec. 95	13.43	30.58	421.31	737.30	4.3	25.50	157819	100183	57636	5.53	40.40
Jan. 96	-8.92	21.63	455.79	706.09	2.6	27.22	152574	86184	66390	-2.78	34.00
Feb.	2.38	22.36	467.52	713.21	3.3	29.94	150355	94449	55906	0.278	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	-4.40	23.31
June	0.32	17.96	598.43	703.90	0.4	29.90	127745	90366	37379	0.10	20.23
July	0.82	17.32	656.55	692.00	0.7	28.80	148901	96742	52159	2.80	14.55
Aug.	4.50	18.89	667.09	691.00	0.8	27.70	139629	89910	49719	-0.50	11.90
Sept.	-4.40	14.04	665.32	708.00	1.1	25.30	100543	66219	34324	2.40	15.04
Oct.	3.70	17.10	658.57	689.50	0.5	22.68	126110	68726	57384	1.10	9.69
Nov.	0.87	14.82	663.11	699.50	0.4	19.83	128119	78231	49888	-1.10	6.66
Dec. 96	10.05	11.40	692.60	728.11	0.8	15.80	176366	101866	74500	11.80	14.49
Jan. 97	-2.40	19.32	713.03	707.83	0.6	13.50	166754	84833	81921	-6.60	8.49
Feb.	0.45	17.08	712.34	712.75	0.9	10.80	164481	89701	74780	6.30	14.98
Mar.	0.95	15.18	648.48	763.24	0.3	9.50	191733	117554	74197	3.40	20.93
Apr.	1.03	14.92	637.12	778.46	0.6	8.70	156769	87710	69059	1.41	16.67
May	3.16	20.03	561.08	801.87	0.7	8.2	130258	81676	48577	0.6	22.79
June	0.7	20.49	563.9		0.4	8.3	143333	97869	45464		

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

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