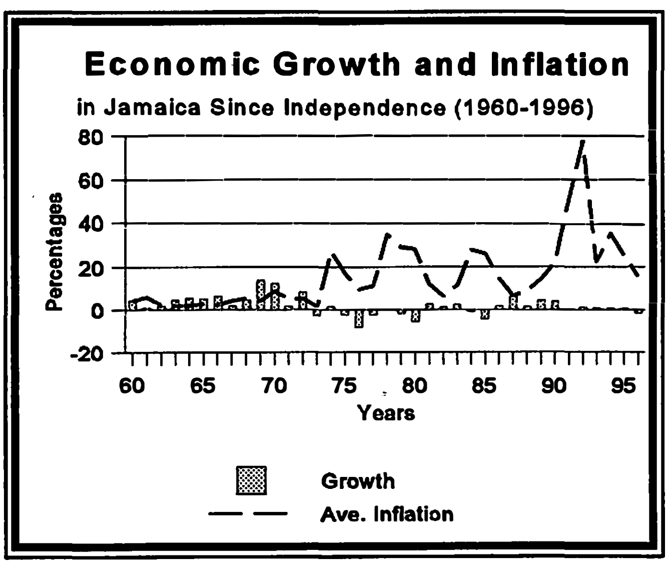
THE JAMAICAN ECONOMY

For 1996, three (3) sectors, agriculture, mining and tourism showed some growth. However, trading difficulties, some erosion of the country's export competitiveness in regional and extra-regional markets and continued difficulties in the financial and monetary sectors had a dampening effect on the country's overall economic performance. The Jamaican economy therefore, experienced a 1.7% decline in GDP and that economic scenario continued into 1997.



1996 was characterised by high interest rates for the most part of the year, tight money supply and liquidity as well as declining inflation and adequate supplies of foreign exchange which fostered some appreciation in the exchange rate and a loss of competitiveness in most exports.

The high interest rate policy saw rates as high as 70% on loans and 45% on deposits which crowded out the private sector and ~~lead~~ led to a fall in investments and declines in credit to the real sectors. Real overall output also fell. However, credit to consumers rose and this impacted on the Balance of Payments as import levels increased.

The high interest rates also translated into massive business failures as well as loan and mortgage defaults, which had adverse implications for the financial, real estate and construction sectors. Job losses and unemployment rose.

On the other hand, the high interest rates attracted increased arbitrage activity giving rise to significant inflows of foreign exchange which were converted to J$ to buy high yielding Government paper. The increased supply of foreign exchange led to a revaluation of the J$, increases in the Net International Reserves (NIR) and a massive increase in Government's debt and debt-servicing obligations.

During the year, broad money, M2, expanded by 12.3% and compared with 38.5% growth in 1995 represented a 300% contraction in its growth rate. Money supply growth during the year and continuing into early 1997, was spasmodic with monthly increases followed by declines. In this way, the compounded effect of its expansion was avoided. Consequently, there was tight liquidity in the system. Inflation was kept in check as there was not the proverbial 'too much money chasing too few goods'. However, the tight liquidity situation undermined credit expansion in the financial system and contributed to upheavals in the sector.

A direct outcome of the restrained growth in money supply was a lower level of inflation which for calendar year 1996 was 15.8%. This compares with 26.6% for 1995. The average monthly rate for 1996 was 1.2% with 2.1% for 1995 and has come the closest to achieving the projected 1% monthly target set for the past five years.

The fiscal year rate 1996/97 was 9.5%. The tight monetary policies which included high interest rates, low M2 growth and falling inflation resulted in a softening of demand - which coupled with an appreciating exchange rate, brought some measure of price stability in the economy and overall, lower levels of wage settlements.

The exchange rate of the J$ to US$ began at J$39.86 in January 1996 but by March a 0.65% depreciation moved that rate to $40.12. However, by May, a revaluation set in and picked-up pace as the year progressed so that by September the exchange rate was J$34.88. With BOJ's intervention then, the rate settled at J$34.80 - $35.00 at year end. The impact of the high interest rate policy on effecting the currency revaluation has already been stated. As the currency appreciated its uncompetitiveness to the export sector was evident. The apparel sector lost companies and foreign exchange earnings and local unemployment rose by the attendant job losses. In the tourism sector, there were many closures mainly of small plants, jobs were lost and other plants forced to improve their efficiencies in order to survive. A rescue package was put in place for these sectors to stem their decline. To date, the loss of apparel firms has abated but the earnings of the sector is significantly below that of 1996.

During 1996, the significant inflows of foreign exchange into the country, facilitated an increase in the NIR which moved from US$421.31 million at December 1995 to US$692.6 million in December 1996. However, the third quarter of 1996 and continuing into 1997, saw a continuing fall in the interest rates on Government paper which has led to a fall off in arbitrage activity and in the inflows of foreign exchange. This has put pressure on the exchange rate. The BOJ in its attempt to defend the local rates used significant portions of the NIR in this exercise. In May 1997 the NIR stock stood at US$561.1 million and moved to US$569.4 million in July.

The acquisition of the NIR in 1996 through early 1997 resulted in the ballooning of the country's local debt and debt-servicing costs. The local debt moved from J$59.6 billion at December 1995 through J$77.7 billion at December 1996 to J$98.0 billion in July 1997 and debt-servicing cost over these periods totalled over J$45.0 billion.

There was a deterioration in Government's finances during fiscal year 1996/97. Revenue collection showed a J$18.8 billion, shortfall reflecting the decline in economic activity. With the use of high interest rates by Government to garner funds, the internal debt rose and with it the debt-servicing costs. This increase in expenditure against declining revenues, coupled with the extension of financial aid to the troubled financial sector contributed to the Government running an overall deficit of J$54.5 billion or 27.0% of GDP. Fiscal GDP is estimated at J$202.0 billion.

There were serious upheavals in the financial sector during 1996. As the economy deflated quite rapidly under tight monetary policies, the resulting liquidity crunch took its toll on the sector. Century National Bank(CNB) which had been in overdraft with BOJ since July 1995, ran into liquidity problems and was taken over by the BOJ. The Bank was pronounced ~~prounced~~ insolvent and depositors were faced with the loss of their deposits. However, arrangements are currently being made for the recovery of these deposits without interest.

Insurance companies experienced serious cash flow problems also, due to a mis-match of long term assets with short term liabilities. The failure of, and take-over of CNB brought a loss of confidence in the sector which led to the considerable shifting of assets form the totally locally owned to the larger and foreign affiliated banks. Rumours of other banks' failures and take-overs prompted runs on Eagle Commercial and Citizens Banks. The sector experienced massive job losses and significant deterioration in their profitability.

The evidence of deep-seated problems in the financial sector prompted the authorities to create FINSAC, to investigate and offer assistance to the sector. Since then, other sectors of the economy have been seeking assistance under the 'bail-out' scheme.

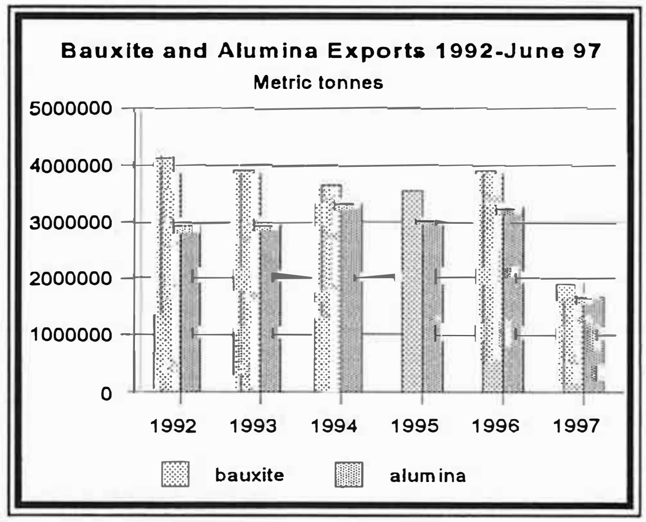
Despite favourable trends experienced in some macro-economic variables - inflation, M2 and an improved NIR position overall output and sectoral performance in 1996 into 1997 continued to be weak.

Manufacturing:

During 1996 and into 1997 this sector continued to record negative performances which was fostered by increased competition from cheap imports and the adverse effects of high interest rates and inefficient operations. There were closures and scaling down of a number of operations.

Mining:

The output of bauxite and alumina for 1996 showed mixed results. Bauxite and alumina production rose by 2.53% and 1.11% respectively. However, earnings from the sector fell by 2.8% to US$695.5 million. This resulted from an over supply of alumina on the



market as a consequence of the December 1995 expiration of a pricing agreement among major producers together with slow economic growth in the aluminum markets of Japan and Germany. Although there were few industrial disputes occurring over the period, environmental issues between alumina plants and the surrounding communities surfaced periodically. The first six (6) months 1997 saw increased output in both the production and export of alumina and decline in bauxite production and export.

Tourism:

In tourism, total visitor arrivals rose by 3.9% to 1,820,627 during 1996. The number of stop-over visitors increasing by 1.3% and cruise passengers by 8.8%. Gross expenditure for the year was US$1.13 billion, 5.5% more than 1995. Up to mid 1997, visitor arrivals showed a 5.9% increase over the 1996 figures for the same period. Of this, cruise-ship passengers rose by 2.4% and stop-overs by 2.6%.

Agriculture:

The sector continued to show favourable performance experiencing a 5.5% growth in 1996. This, despite the effects of drought, high cost of inputs competition from imports and prohibitive interest rates. All major sub-sectors showed growth in output during the year. Earnings from export crops showed increases in 1996, however, with the dismantling of preferential arrangements in the offing the prospects of these exports need reviewing. Agricultural exports earned US$224.9 million in 1996.

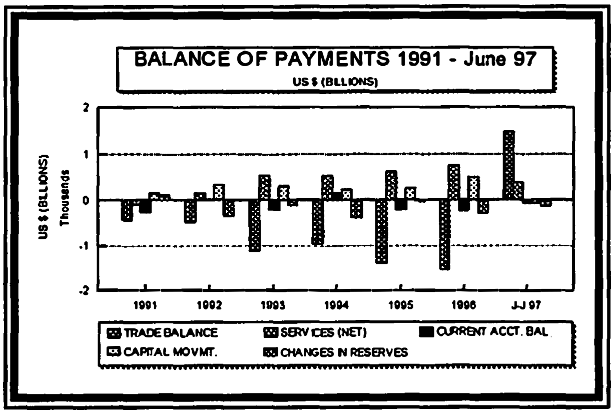
External Trade & Balance of Payments

Balance of Payments developments during 1996 were more favourable than in 1995. Although the year saw a significant rise in imports over exports, the performance of the services sector returned a level of earnings which offset just less than half the merchandise deficit. With lower net transfers in 1996 than in 1995 the current account deficit grew in 1996. However, the extraordinary performance of the capital account netted a 114% increase over 1995, and this offset the negative current account balance and contributed to a significant improvement in the Net International Reserves of the Bank of Jamaica.

The Balance of Payment Accounts up to June 1997 are however, reflecting a disconcerting dramatic change.

The Merchandise Trade gap has widened significantly to US$764.2 million which is 109.9% of export earnings. Imports continue to rise reaching US$1,459.6 million or 209.9% of exports earnings and also 6.1% above June 1995 figure. The fall in exports reflect lower output and earnings from traditional and non-traditional exports, while consumer goods imports rose to a greater extent than those for capital goods and imports of raw materials have fallen.

Earnings from the services sector are slightly above those at June 1996 and together with significant increases in the inflows from transfers, have offsett the merchandise gap leaving a current account deficit of -US$59.7 million.



However, the economy since March 1997, continues to experience a significant fall in capital inflows, and at June 1997, the net capital movements was -US$69.0 million which has resulted in a decrease of US$128.7 million in the Bank of Jamaica's reserves in order to balance the country's external accounts.

So far, for 1997 total production of goods and services continues to be on the decline, as no significant increase in output is being experienced. Although interest rates are trending down - this is a slow process and commercial rates are still unattractive to investment. The Jamaican dollar is considered uncompetitive to the export sector and the effect of this is being reflected in the decline in export volumes and earnings.

The Government's budgeted lower level of revenue intake is on target and it has made some effort to keep its expenditure within this range. Efforts were also made to reduce debt-servicing costs. However, credit by BoJ to the public sector keeps rising and coupled with FINSAC's potential infusion of funds into the system, these could be derailing factors in the efforts to control money supply and inflation in the months ahead.