

# New Confidential Economic Bulletin

## *Private Sector Organisation of Jamaica*

### **Monthly Analysis of the Jamaican Economy**

*Vol. 7 No.1, January 2001*

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## **Overview**

In late January, the IMF's technical team arrived in the island to conduct a review of the government's performance in relation to the economic policies agreed under the Staff Monitored Programme (SMP), through which the government is receiving US\$325m of loans

from the IDB, the World Bank and the CDB. The team included economists from the World Bank and the IDB, as well as the outgoing head of the IMF team which is responsible for Jamaica and his successor. The meetings with the IMF personnel were very informative and seem to reveal quite a different approach to economic reform from that which prevailed in the 1980's and early 1990's. Although the officials were as usual very circumspect in their comments on government policy, we did form the following impressions of what position they might put forward to their colleagues in Washington.

Firstly, they seemed to accept as a given the policy position of the Bank of Jamaica with respect to interest rates and the exchange rate, as this was the policy position of the government. It appeared also that adherence to the targets in the SMP were of secondary importance and that there was the flexibility to modify these from time to time. Their major concern appeared to be the achieving of a fiscal surplus which would be large enough to provide funds that could be used to start paying down the domestic debt and thereby reverse the build up of it. They seemed to feel that a greater fiscal effort was required for the policy framework to be internally consistent and implicitly accepted

the BOJ's argument that it was government demand for credit that was keeping interest rates high and the domestic debt growing. Their analysis did not appear to have taken into account the fact that government borrowing has been driven not by fiscal needs but rather by the BOJ's need to sterilise the Jamaican dollars which it has created in order to acquire foreign reserves.

The bottom line of all this is that there appears to be very little pressure on the government from the multi-laterals to shift away from their current policies which focus on high interest rates and minimal depreciation of the local currency. However, the multi-laterals do seem to be insisting on a greater fiscal effort, which means that the drive to balance the budget must continue and indeed must grow stronger. This might mean that they may be pushing for a substantial tax package to be introduced in the upcoming budget, in order to cover the cost of the FINSAC debt servicing as well as the increased cost of servicing the rest of the domestic debt that is already on the books. With the country virtually in an election mode, this point is likely to be a bone of contention with the government. Reports in the press are that the taxes, which are under consideration for an increase, include GCT and both personal and corporate income tax, areas which are likely to be very unpopular with the general public.

Apart from the political considerations, there is the solid experience here in Jamaica that lower marginal rates of taxation usually yield much higher rates of compliance and there is the distinct possibility that significant increases in the above taxes may not yield the returns that are anticipated, due to lower levels of compliance. Despite these very valid reservations, the size of the additional fiscal burden due to the cost of servicing the domestic debt and the desire to eliminate the fiscal deficit, will dictate that a large package of additional taxes be included in next year's budget, if these objectives are to be achieved.

The other conclusion that can fairly safely be drawn is that very little relief from the high interest rates seems to be in sight. In fact the pattern that has emerged in the last quarter of 2000 is likely to continue for most of 2001, with the risk that rates may spike even higher in the latter half of this year. Reports from the market indicate that demand for hard currency is strong and that the BOJ is once again intervening heavily in the market. The IMF, in their release on their discussions with the government may once again mention the risks associated with the policy path that the government has chosen, indicating the possibility that the consequences of these policies may not coincide entirely with the intended objectives.

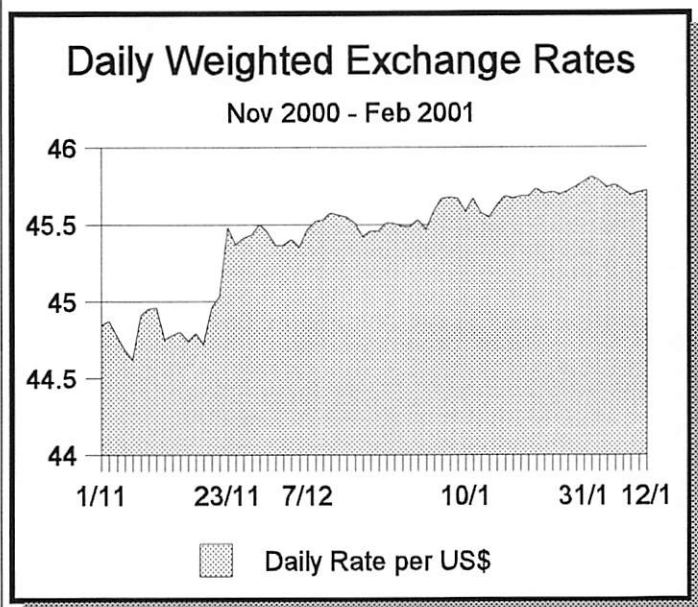
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### Exchange Rates

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The Jamaican dollar has continued to lose ground against the currencies of its three major trading partners in January 2001 - the US\$ by J\$0.30, the CAN\$ by J\$0.57 and the GB£ by J\$0.57. This is in comparison to losses of J\$0.16, J\$0.59 and J\$3.06 respectively, for December 2000. The weighted average selling rate of the Jamaican dollar to the US dollar for the month of January was \$45.67, J\$0.19 more than the average for December.

The J\$/US\$ exchange rate (average weighted selling rate) remained relatively stable for most of the month, fluctuating mainly between J\$45.60 and J\$45.70. However, the domestic currency lost J\$0.20 during the first three days of trading, and has shown signs of increase during the last few days of the month, closing at J\$45.77.



**Figure 1: Daily Weighted Average Selling Exchange Rates (US\$ / J\$)**

#### Summary of Exchange Rates:

The weighted average selling rates of the local currency vis-a-vis its major trading partners as at February 12<sup>th</sup>, 2001 were:

US\$1 = J\$45.72

CDN\$1 = J\$29.86

GB£1 = J\$65.

#### Exchange Rate Forecast

The exchange rate at the end of January 2001 was \$45.77, and falls within our "forecasted" range for the first time, due mostly to the fact that the exchange rate remained relatively stable for most of the month. Current projections (*Table 1*) for February to April have been revised as usual, given current market conditions, and the Government's record high net international reserves. There may be increased market activity from the BOJ during the upcoming month, as the exchange rate approaches the psychological J\$46 barrier - a barrier below which the authorities may wish to hold the rate for

**Table 1: Short Term Exchange Rate Forecasts for the end of the Months of February, March and April (J\$/US\$).**

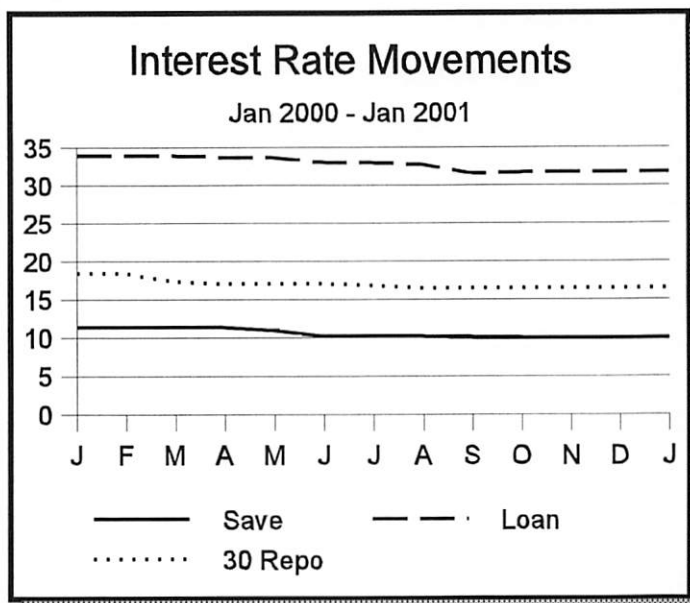
	Predict	Actual	Diff
Nov	44.96 - 45.02	45.45	0.43
Dec	45.60 - 45.75	45.53	0.1
Jan	45.71 - 45.88	45.77	0
Feb	45.82 - 45.89	----	----
Mar	46.03 - 46.09	----	----
Apr	46.19 - 46.25	----	----

as long as they possibly can. Further, despite the fact that selected interest rates have been hiked twice to protect the dollar, it has still continued its upward trend, - it has not remained stable for any length of time after the rate hikes without central bank intervention - clearly alluding to the weakness of economic fundamentals (*Vol. 06, No 12, December 2000*), rather than an attack on the dollar by speculators. If the central bank intervention scenario plays out, actual rates may end up on the lower end of our "forecasts".

#### **Interest Rates**

The latest results of the most recent benchmark Treasury Bill issue were as follows:

On January 26, 2001, a 182 day Treasury Bill offer was made to raise \$350 Mn. The offer was oversubscribed by \$886,283,700, with an average yield of 19.41% (*Table 2*). This average yield of



*Figure 2: Interest Rate Changes*

19.41% represents a reduction of 0.75 percentage points when compared the previous months's issue. It is also only 1.43 percentage points below January 2000's issue, demonstrating the slow decline in interest rates.

With only two months remaining in the financial year, the key BOJ 30 day repo target of 13.5 percent and six month T-Bill target of 14% are almost certainly out of reach.

### Inflation Rate

The all Jamaica 'All Group' Consumer Price Index for December 2000 was 1342.6, compared to the 1352.4 reported for the previous month. This translates into a 0.7 percent decline in the inflation rate for December 2000, following two consecutive months of low 0.1 increases. The largest negative movement in the inflation figures previous to December 2000, was the negative 1.1 percent recorded in February 1999.

*Table 2:*

Selected Interest Rates (%)		
	2000 - 2001	Dec Jan
30 Day Repo		16.45 16.45
365 Day Repo		21.00* 20.5**
Savings Deposits (avg)		9.86 9.86
Loan (avg)		31.67 31.67

T-Bill Yields (%)		
	2000 - 2001	Dec Jan
6 Month		20.16 19.41
9 Month		19.67 19.0**
12 Month		20.98 ----

\* as of January 09, 2001

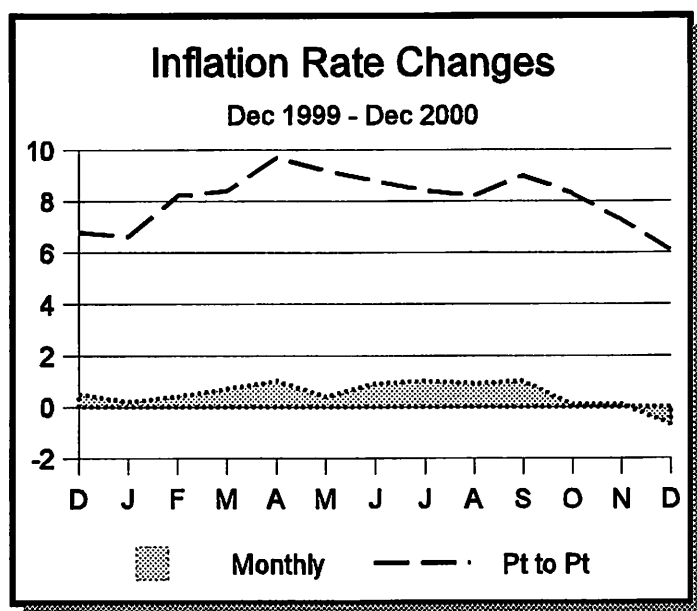
\*\* as of February 2001

The annual point-to-point rate of inflation for Calendar 2000, (December 1999 to December 2000) is 6.1%, compared to 6.8% recorded for the previous year, while the annual average rate is 8.2% for 2000, compared to 6.0% for 1999. The fiscal year-to-date (March to December) rate of inflation is 4.7%, compared to the 7.1% recorded for the previous year.

The main contributors to the decline in the index for December were declines in "Food and Drink" (-1.5%) and "Housing and Other Expenses" (-0.1%) categories. Decline in the "Food and Drink" group was influenced by reduced prices for starchy foods (-6.7%) and vegetables and fruits (-8.5%), following a partial recovery of the agricultural sector after a prolonged drought.

The Government has been successful in keeping inflation under control and below last years figures up to this point. They are also now within

striking distance of the 4 to 6 percent target for the end of the fiscal year, and January may report favorable inflation figures. However, the recent 9.8% increase in electricity rates, effective



**Figure 3: Inflation Rate Changes**

February 1<sup>st</sup> and a probable increase in bus fares may see a slight increase in inflation later on.

Maintaining single digit inflation is a noble achievement and stable prices are necessary for economic growth, as investors are able to plan effectively for the future. However, stable inflation whether single digit or otherwise, though necessary, is not a sufficient condition for economic growth, which is the real goal that needs to be achieved. Maintaining 1% or 2% inflation in of itself cannot generate growth if the other fundamentals are not addressed - namely, improving productivity and the balance of payments, lowering interest rates, and reducing government debt.

### Base Money

Provisional figures from the BOJ showed that the monetary base increased by 12.7% to J\$34,954.3M at the end of December 2000, from the J\$31,027.8M reported at the end of November 2000. For the period December 1999 to December 2000, there was a 6.4% decline, compared to the 4.0% increase recorded for the previous period. Over the January to December 2000 period, the monetary base has increased by 7.0%, compared to an 8.0% increase recorded for the corresponding period in 1999.

The sudden increase in base money recorded for December 2000 was expected, due to excessive spending during the yuletide season. The monetary base has recorded sudden increases in excess of 7.0% every December since 1990. A decrease is expected in the out-turn for January, following the end of the yuletide season.

### Money Supply

The nominal money supply stock increased by 0.3% for October 2000 (provisional), as measured by the M2 (local and foreign currency) monetary aggregate. The M2 aggregate recorded J\$128,484.5M at the end of October 2000, compared to J\$128,043.3M recorded for the previous month. The nominal money supply grew by 6.6% from October 1999 to October 2000, which is less than the 19.8% growth recorded for the previous period. The net growth rate of M2 for the January to October period was 6.6%, compared to 16.2% for the corresponding period in 1999, implying that monetary policy has continued to be tighter. This trend of maintaining a tight monetary policy is expected to continue as

the Government seeks to achieve its inflation target of 4 to 6 percent for the fiscal year.

### Production of Selected Commodities

**Mining:** Total alumina production for the month of December 2000 was 309,128 metric tons. This represents only 0.03% above production in 1999 and 3.88% above 1998's production figures.

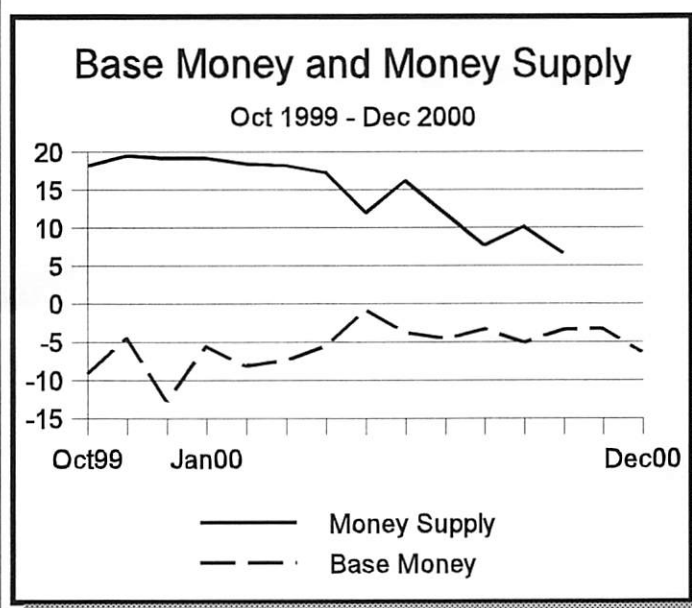


Figure 4: Monthly Monetary Movements

The year to date production is 3,600,125 metric tonnes which is only 0.85% and 4.65% above the year-to-date outcomes of 1999 and 1998 respectively.

Total Crude Bauxite production was 219,281 metric tons, 92.14% more and 24.78% less than production in December 1999 and 1998, respectively.

The year to date production of Crude Bauxite is 2,062,011 metric tons which is 26.21% and 48.89% below 1999 and 1998's production figures respectively.

Alumina exports were 321,527 metric tons for the review period, which represents a 3.28% reduction and a 8.42% increase over the export figures for December 1999, and 1998 respectively. The year-to-date alumina exports amounted to 3,642,538 metric tons, rising by a mere 0.98% and 4.77% over 1999 and 1998, respectively.

Exports of crude bauxite for December 2000 were 209,610 metric tons and represented a whopping increase of 94.08% and a decrease of 23.96% from the recorded exports in 1999 and 1998, respectively. Total year-to-date exports were 2,118,908 metric tons, 24.20% and 47.29% below the corresponding period in 1999 and 1998, respectively.

The major contributing factor to the sluggish production figures in 2000, was the explosion at Kaiser's Gramercy Louisiana plant early in late 1999. Gramercy is a major purchaser of the country's bauxite, and its return to full operation should see vastly improved production figures for 2001. However, amid this rosy outlook came the shocking news of Alcan's pullout from the sector. One can only hope that the transition to new management will not affect production and thus foreign exchange earnings, upon which the country depends greatly for achieving economic growth.

**Cement:** Total cement production for the month of January 2001 was 51,916 tonnes, 898 tonnes (-1.70%) less than the 52,814 tonnes produced in January 2000. Domestic sales of cement for the review period declined by 7.81 percent, recording 50,107 in January 2001, compared to the 54,354 tonnes recorded the previous period.



### Tourism

Stopover tourist arrivals continue to maintain a strong outlook, posting a 9.9 % increase for December 2000, when compared to the same month in 1999 (*Table 3*).

The January to December 2000 period also recorded a 6.0% increase over the similar period in 1999. There has been a slight setback in stopover arrivals of non-resident Jamaicans, which has seen three consecutive months of decline - October to December 2000, in comparison to the similar period in 1999. The largest decline of 26.5% was recorded in November 2000, and this has impacted on long run performance, as the January to December period only recorded a net gain of 2.1% over the corresponding period in 1999.

Cruise passenger arrivals also continue to maintain their strong growth, with the year 2000 recording an 18.7% increase over 1999. The healthy cruise arrival figures have been bolstered by the 504 cruise ships that have called on Jamaican ports, in comparison to 489 reported for 1999 period. However, there were two fewer ships arriving in Jamaica in 2000, when compared to the 55 that arrived in 1999. The trends in stopover visitor arrivals and cruise passenger arrivals have combined to report continued growth in the total number of tourist arrivals, with the year 2000 reporting a 10.7% increase over 1999.

**Table 3:**  
**Tourist Arrivals December 2000**

	Jan-Dec 99	Jan-Dec 00	(%)	Dec (%)
<b>Stopover</b>	1248397	1322690	6	9.9
<i>Foreign</i>	1147135	1219311	6.3	13
<i>National</i>	101262	103379	2.1	-10
<b>Cruise</b>	764341	907611	19	6.5
<b>Total</b>	2012738	2230301	11	8.4

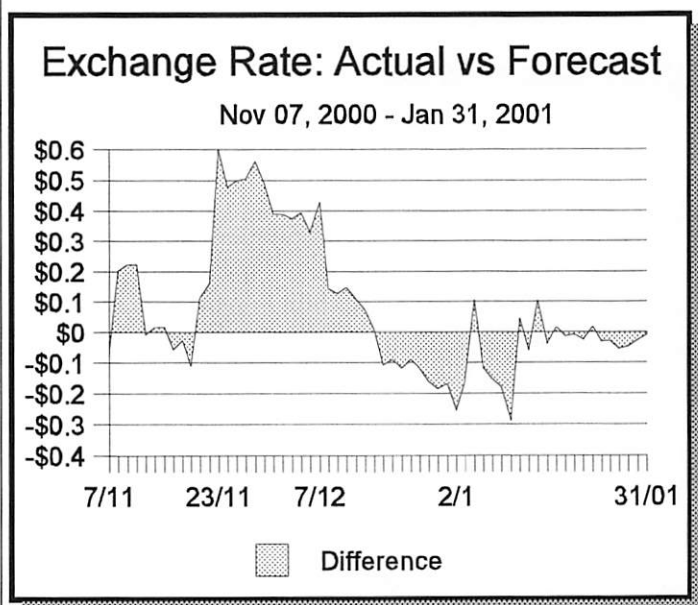
Provisional figures provided by the BOJ for the January - October 2000 period showed total cumulative tourist expenditure at US\$1,100.2Mn or 4.0% above the performance for the corresponding period in 1999.

The current growth trends in the tourism sector are expected to continue over the next year. However, there are concerns about the effect the slowdown in the US economy, our major tourist customer, may have on the sector.

### Outlook

The growth target of 2.0% for the current financial year certainly seems to be out of reach, and the more realistic high risk 0.5% target may also not be realized, given the current interest rate exchange rate tradeoff. This would indicate that the targets for the 2001 financial year may have to be revised downwards. To be fair to the authorities they did outline in the SMP program that for 2000, "first, domestic interest rates may not decline as rapidly as assumed and, second, the real GDP growth assumption may not be realized."

The authorities are well aware that economic growth for the upcoming year (2001) is highly dependent on reducing interest rates in a sustainable manner, in order to stimulate private and government consumption and private investment. However, reducing interest rates will invariably lead to a sliding dollar (*see Vol. 6, No. 12, December 2000*), if not fully backed. To fully back the rate, the government would have to borrow, which would only worsen our debt position. Given the government's stance on the exchange rate / interest rate trade off, we may assume that interest rates, when they do resume



**Figure 5: Exchange Rate Forecast vs Actual Values**

their downward path, may not attain the required levels necessary to significantly spur economic growth within the next twelve months.

In the SMP, the government had outlined that "total public debt (including FINSAC liabilities) will decline from 144% of GDP at the end of 1999/2000 to 125 percent at end 2001/02." However, at the end of 2000, the debt to GDP ratio is 150%. The true cost to the economy of maintaining a relatively stable exchange rate as a first best policy, versus that of reducing interest rates will be seen at the beginning of the next financial year, when the FINSAC debt is added to the books. This could be further compounded if the government has to borrow in order to fill any anticipated fiscal deficit for the 2001/2002 budget. Although the authorities have provided for such a scenario in the SMP by proposing the "cutting of expenditure and increasing of revenues", actual measures taken may not be sufficient to close the gap, which may lead to more borrowing.

The question of how the authorities will repay the debt is

also important to our growth prospects. In fact there does not seem to be an easy solution to this problem. Monetizing the debt will lead to higher inflation levels, a scenario which would stifle productivity growth, and increasing already high tax rates may lead to social unrest, the true cost of which would be much higher than the initial debt itself.

There was significant growth in the tourism sector in 2000, and more of the same is expected for 2001. However, a perceived slowing US economy, and by extension the world economy, could possibly dampen some of these gains in 2001, but the outlook is still very optimistic. Overall, the Services Sector is expected to continue its strong contribution to GDP for 2000, given that it has recorded negative growth only once, -2.4% in 1997, in the last six years.

On the contrary, the Goods Sector has not registered positive growth since 1994, when it recorded 1.4%. More of the same may be expected when the growth figures for 2000 are released, given the drought experienced by the Agricultural sub-sector during the year. Further, the Construction and Installation sub-sector has also chalked up four consecutive years of negative growth, one less than the Manufacturing sub-sector, which has registered five. However, 1999's growth figures for these sub-sectors have been the best in the past four years, which may indicate that the 2000 out-turn for these sub-sectors may be much better. The Mining and Quarrying sub-sector is expected to show a much stronger performance in 2001, following 2000's sluggish production figures, given the return to full production of Kaiser's Gramercy plant.

Overall, if growth is achieved for 2000, it may be minimal, in line with the high risk 0.5% scenario



outlined in the SMP. The year 2001 may see the authorities playing "catch-up", rather than cementing on the gains that should have been made in 2000.

*Note: Updated data on Net International Reserves, Foreign Currency Deposits, Balance of Payments and Trade were unavailable.*

**MACRO-ECONOMIC INDICATORS**  
(Oct 1998 - Dec 2000)

MTH	BASE MONEY		NIR	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	Mthly chng	Point to Point
Oct.	0.14	5.6	605.61	928.82	-0.3	7.14	119388	82254	37134	0.45	8.5
Nov	-4.38	-0.62	576.27	912.52	0.1	6.6	146462	94469	51993	-1.35	7.29
Dec.	7.06	-0.8	581.96	905.07	1.05	7.86	201256	118098	83158	3.44	7.35
Jan. 99	-3.69	-0.04	578	921.11	0.4	7.5	183049	96959	86090	-0.68	8.21
Feb.	-5.18	-6.19	578.53	929.03	-1.1	6.3	179193	102545	76648	0.79	9.85
Mar.	-3.66	-2.8	581.53	960.31	0.5	5.4	220295	131503	88792	1.2	11.96
Apr	0.8	-3.04	587.41	979.26	-0.1	5.49	175389	106611	68778	2	11
May	-4.2	-7.8	590.5	965.84	0.9	5.61	139367	100066	39301	3.93	14.21
June	-0.06	-8.5	590.57	956.82	1.3	5.04	158466	110425	48041	2.14	11.75
July	1.73	8.24	486.98	1032.64	1.2	5.09	172289	125343	46946	3.56	15.54
Aug	-0.7	-7.07	490.76	1033.34	1.1	5.09	158800	113695	45105	4.71	18.5
Sept	-1.6	-8.74	526.24	1014.73	0.3	5.3	124446	75987	48459	-0.68	15.55
Oct	0.37	-9.2	492.82	1016.24	0.8	6.43	136848	83638	53210	2.57	18.48
Nov	0.6	-4.456	506.73	949.27	1	7.4	168992	95278	73714	-0.53	19.52
Dec	16.46	3.96	450.17	956.52	0.5	6.8	195604	106347	89257	3.04	19.06
36524	-12.48	-5.51	453.09	990.11	0.2	6.57	180356	96100	84256	-0.5	19.18
Feb	-2.3	-8.24	590.61	1057.59	0.4	8.18	201436	108723	92713	0.17	18.45
Mar	-2.77	-7.41	703.51	1047.12	0.7	8.42	247225	137408	109817	0.9	18.1
Apr	2.88	-5.49	743.98	1052.9	1	9.57	197760	119419	78341	1.2	17.2
May	0.58	0.76	776.25	1047.26	0.4	9.2	163592	103266	60326	-0.7	11.9
Jun	3.59	3.73	756.48	1042.08	0.9	8.8	175744	120091	55653	1.6	16.2
Jul	0.8	4.61	788.68	1050.27	1	8.5	188329	137771	50558	-0.3	11.83
Aug	0.6	-3.34	935.5	1082.5	0.9	8.2	196159	118339	77820	0.87	7.68
Sep	-3.4	-5.07	935.49	1072.39	1	9	134685	79422	55263	1.8	9.14
Oct	1.36	-3.42	845.71	1065.01	0.1	8.3	147268	88001	59267	0.3	6.6
Nov	0.9	-3.22	831.67	n/a	0.1	7.3	185797	97235	88562	n/a	n/a
Dec00	12.7	-6.4	969.25	n/a	-0.7	6.1	211950	116915	95035	n/a	n/a

n/a - Not Available

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

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