



JAMAICA ECONOMIC UPDATE

WORLD BANK RESIDENT MISSION

SEPTEMBER 1995

MAJOR ECONOMIC DEVELOPMENTS

During September, against the background of the mini financial crisis in August, pressure continued to mount for an independent Central Bank. Government's credit from the BOJ has been a major source of the growth in money supply, which has been consistently above the target. In the wake of intense pressure from the Private Sector Organization of Jamaica (PSOJ) and the Jamaica Labor Party (JLP), the Government announced it will freeze its J\$23 billion deposit in the Bank of Jamaica and end all borrowing as of October 1, 1995. This will shift all government borrowing to the private capital market, where it will sell Special Cash Management Bonds when necessary to close the gap between projected revenues and expenditures. All bonds will be retired in the fourth quarter of each fiscal year when the bulk of revenue is generated.

Government is moving aggressively to attract foreign investment. In September, Jamaica Promotions Corporation (JAMPRO) hosted an investment seminar in New York. The primary purposes of the seminar were to brief potential investors on economic conditions and present a portfolio of some 10 projects requiring investments of US\$400 million. Projects covered sectors such as tourism (hotel development), mining and infrastructure including railways and airport.

Finally, during September there was a major political development that could have far reaching implications over the next two to three years. The heir-apparent to the Jamaica Labor Party (JLP), Bruce Golding, resigned from the JLP to form his own political party. This party will be launched on October 29, 1995.

INFLATION

As predicted last month, the inflation rate for August at 1.7% was again above the Government's target of 1%. The fact that inflation in August was the same as for July represents a departure from the typical seasonal pattern of a significantly lower rate for August. (see Figure 1). Prices were pushed up by the depreciation of the exchange rate as well as increased prices for a number of basic commodities including; chicken, starchy foods such as yams and potatoes (as a result of drought) and flour and its associated products. Additional inflationary pressure in August was generated by retroactive wage settlements for some public sector workers including teachers and nurses. On a 12-month point-to-point basis, inflation at August stood at 15.0%. This compares to 38% for the similar period of 1994. From January to August 1995, the rate of inflation was 10.7%, compared with 22% for the same period of 1994. For the fiscal year to date, inflation stood at 7%, compared with 13% for the similar period of 1994.

Figure 1

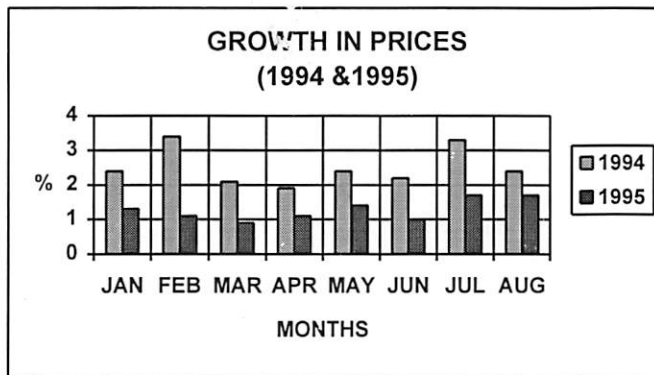
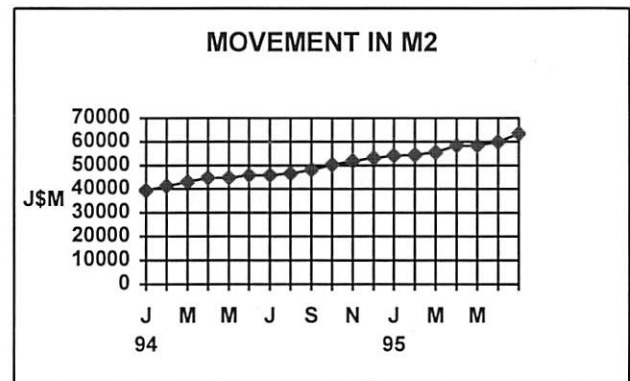


Figure 2



MONEY SUPPLY

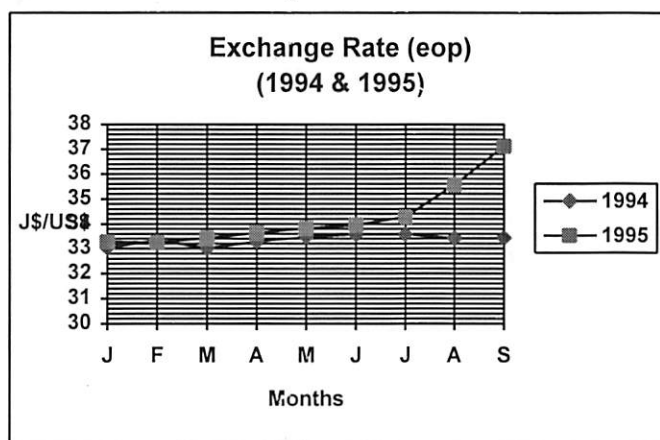
Growth of M2 (broad money) accelerated in July by 6%, following the growth of 3% in June (Figure 2). Although there was a marginal decline in currency in circulation, demand deposits grew by 9% and time and savings deposits grew by 10% and 4%, respectively. The primary factor underlying the July growth was a significant (21%) increase in domestic credit. This was due largely to significant drawdowns on the deposits of the Public Sector and the "other financial institutions" of 31% and 32% respectively. Between January and July 1995, broad money (M2) increased by 19% compared with 18% for the similar period of 1994. The rate of growth between January to July 1995, annualized at 35% compared with a growth of 36.6% for the same period in 1994. In order to restrain the growth of money supply, the Government has announced that it will sterilize approximately J\$23 billion of its own deposits at the BOJ and will cease borrowing as of October 1, 1995.

EXCHANGE RATE

The gradual depreciation of the exchange rate which started in February 1995 accelerated in July, August and September with the rates of depreciation being 1%, 3.6% and 4% respectively (See Figure 3). At the end of September, the Jamaican dollar was trading at \$37.11/US\$1, reflecting a depreciation of 10.5% since February 1995. There continues to be a general shortage of foreign currency in the market and some banks have resorted to a quota system for allocating the limited foreign currency available.

After pumping about US\$32 million of reserves into the system to choke off any speculative pressure, the BOJ has reduced its intervention in the market. This probably reflects more the need to preserve the level of the Net International Reserve (NIR) in order to pass the final IMF test in September rather than any measurable increase in inflows of foreign exchange.

Figure 3



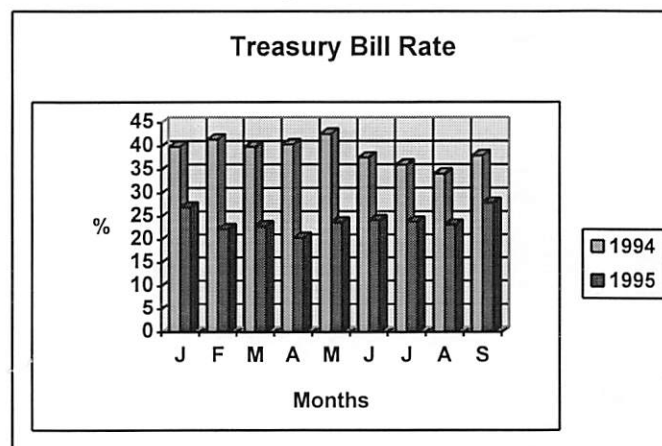
INTEREST RATES

At the end of September, the GOJ Treasury Bill rate stood at 28%, down from the 38% registered for September 1994, but up from its August 1995 low of 23%. (Figure 4). The September increase was a direct result of the liquidity tightening measures instituted in August (See August Economic Update). Interest rates on six-months fixed deposits also increased from 17% in August to 22% at the end of September. Nevertheless, there was no increase in the average savings deposit rate which at 17% is close to zero in real terms and may even be negative if there is no slowdown in inflation. The average commercial bank lending rate has also remained at about 48%, the level it was in July and August. This reflects the informal agreement of the bankers not to raise lending rates as well as fears that higher rates would increase non-performing loans. Given the trend in the annualized inflation rate, real interest rates remain high (30%). The rate of interest on commercial paper was 29% at the end of September.

Figures available for July 1995, showed commercial bank loans to the productive sector increased by 35% to J\$19.4 billion when compared with the same period of 1994. Consumer loans and loans to Government increased by 42% and 157% respectively over the same period. A large portion of the consumer credit is attributable to the purchase of imported vehicles, particularly second hand motor vehicles. At the end of July 1995, the productive sector accounted for 47% of the total commercial bank loans while consumer loans and loans to government services accounted for 36% and 12%, respectively.

These figures indicate that a disproportionate share of commercial bank lending is geared towards consumption rather than productive investment. This is encouraged by the fact that in a number of banks, the lending rate on consumer loans is more attractive than that for business loans. This could be related to the high inflation-risk premium Banks place on the longer term business loans.

Figure 4

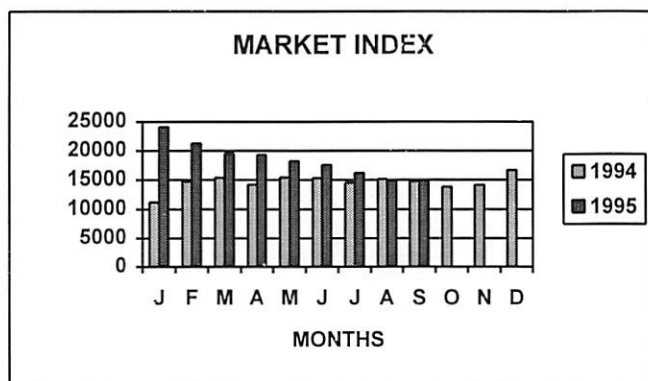


THE STOCK MARKET

During September, the stock market continued the decline seen since January 1995. At the end of September, the index stood at 14,925 down slightly from 14,983 at the end of August. Volume traded declined by 49% to 15 million while value declined by 43% to J\$86 million. The banking sector continued its poor showing with all but three banks (CIBC, Scotiabank and Dehring Bunting & Golding Limited) registering declines. Notably, two of these three banks are foreign owned banks.

For the year to date, the index is down 38%. With the notable exception of "other services", all other sectors of the stock market have generally been in decline. The market appears to be reflecting the general sluggishness of the economy, the fragility of the financial sector as well as the increase in the Treasury Bill rate. The buoyancy of the "other services" category largely reflects the good performance of Kingston Wharves which is in turn linked to the increased import and export activities (See Trade).

Figure 5



TRADE

For the period January to June 1995, the merchandise trade gap widened relative to the same period in 1994. Imports jumped by 27% to US\$1,286 million while exports increased by 18% to US\$717 million (see Tables 1 & 2). On the import side, consumer goods showed the largest increase of 49% followed by capital goods with an increase of 45%. A breakdown by sections (Table 2) showed a 42% increase in the imports of manufactured goods, a 34% increase in the imports of Machinery and Transport equipment (mainly motor cars) and a 25% increase in the imports of fuel. On the export side, traditional exports increased by 12% to US\$460 million while non-traditional exports showed a strong 28 % increase to US\$234 million. All categories of traditional exports showed increase with the largest being agriculture, up 23%. Notably, exports of coffee increased by 56%. In the non-traditional export category, food showed the largest increase of 39%. The apparel sector continues to do well, registering a growth of 37% relative to the same period in 1994.

Generally, the performance of the export sector continues to mirror the relatively good performance of the export agriculture and apparel sub-sectors. The manufacturing sector continues to lag as manifested by the 6% fall in the exports of manufactured goods.

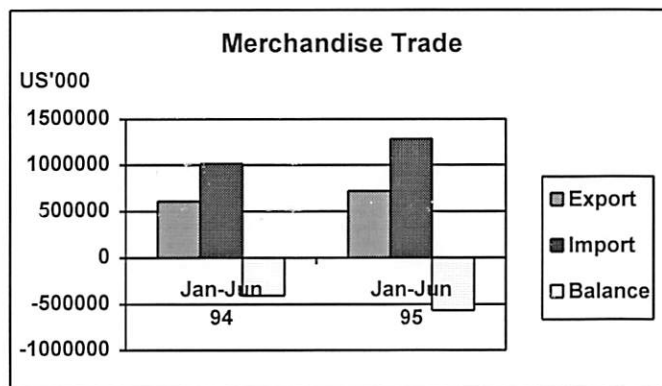
Table 1

Categories	IMPORTS (US\$'000)		% Change
	Jan-Jun 1994	Jan-Jun 1995	
Consumer Goods	199,036	296,287	49
Raw Materials	649,534	745,658	15
Capital Goods	167,580	243,531	45
Total	1,016,150	1,285,476	27

Table 2

Categories	EXPORTS (US\$ '000)			IMPORTS (US\$ '000)		
	Jan-Jun	Jan-Jun	% Change	Jan-Jun	Jan-Jun	% Change
	1994	1995		1994	1995	
Food	144,692	176,774	22	118,201	158,783	34
Beverage & Tobacco	18,913	22,565	19	15,409	13,409	-13
Crude Material	293,535	316,074	8	31,786	31,123	-2
Mineral Fuels etc.	3,146	4,164	32	149,326	187,231	25
Animal & Veg. Oils & Fat	6	856	NMF	8,724	9,416	8
Chemicals	12,244	13,517	10	104,007	125,272	20
Manufactured Goods	10,250	9,672	-6	162,911	230,806	42
Machinery & Transport Equip.	10,799	20,168	87	242,712	324,129	34
Misc. Manufacturers	113,814	153,605	35	169,096	180,676	7
Other	0	2	N/A	13,977	24,631	76
Total	667,399	717,398	18	1,016,149	1,285,476	27

Figure 6



TOURISM

During September, the tourist industry continued the improving trend seen since the second calendar quarter of 1995. Stopover arrivals (non nationals) showed a 8% increase over the level recorded in September 1994.

From January to September 1995, stopover arrivals were up 5%. This is a considerable improvement over the 0.2% decline registered for the similar period of 1994. Cruise passenger arrivals, which were significantly down for the first half of the year, made dramatic improvements in July and August, growing by 14% and 32%, respectively, over the corresponding period of 1994. Nevertheless, cruise passenger arrivals for the year to date are 5% below the level recorded for the similar period of 1994. The improvements in the industry during August and September were largely due to the re-routing of tourists and cruises from the Eastern Caribbean which was severely affected by hurricanes. During September, the Travel Tax Act was amended to increase the Ocho Rios cruise passenger tax from US\$13 to US\$15.

SELECTED ECONOMIC INDICATORS

Economic Indicators	Aug	Sep	Y-T-D 1995	Y-T-D 1994	% Change Y-T-D
<i>Energy</i>					
Electricity Sales					
Residential (MWh)	58,050	n/a	446,138	448,700	-0.6
Industrial & Others (MWh)	116,202	n/a	874,616	808,500	8.2
<i>Agriculture/Manufacturing</i>					
Banana	7,646	7,098	61,304	60,385	1.5
Sugar (MT)	0	0	211,539.0	220,350.0	-4.0
Rum ('000 litres)	1,178.2	n/a	16,759.1	n/a	n/a
Alcohol ('000 litres)	13.8	n/a	640.9	n/a	n/a
Total ('000 litres)	1,192	n/a	17,400	16,402	6.1
Cement Production(MT)	51,554	52,989	378,474	331,400	14.2
Cement Sales (MT)	50,914	53,941	444,765	n/a	n/a
<i>Mining</i>					
Bauxite/Alumina					
Alumina (MT)	274,720	n/a	2,015,964	2,158,679	-6.6
Crude Bauxite (MT)	211,516	n/a	2,464,769	2,461,026	0.2
<i>Tourism</i>					
Stopover (Non-Nationals)	94,000	69,000	775,718	741,395	4.6
Cruise Passengers	42,451	n/a	376,823	397,969	-5.3

¹OUTLOOK

Overall, most indicators of economic activity available up to August/September point to a fairly stagnant economy. Growth is expected to be below 1% for 1995. There are some bright spots. Although agricultural production is down overall, export agriculture, particularly coffee, citrus and some non-traditional fruit production, remains fairly buoyant. Bauxite and alumina production is down overall, but earnings are up due to improvement in prices. Cement production is significantly up by 14% suggesting some increased activity in the construction sector.

Advanced bookings for the tourist industry, suggest that the winter season could post significant growth relative to 1994. The industry in general and cruise arrivals in particular, should continue benefiting from the re-routing from the Eastern Caribbean due to hurricane

damage. However, these gains may only be temporary as underlying factors that have been negatively affecting the industry such as crime and tourist harassment persist.

On the labor front, pressure from the civil service to raise wages could build up, leading to work slow downs, work stoppages and possibly even strikes. The Government will try to maintain wage restraint despite its earlier promise to bring civil servants salaries to 80% of their private sector comparators.

For the rest of the year, inflation is not expected to fall significantly below the 1.7% recorded for July and August as the impact of the new borrowing policy of the Government will not be immediate. Expected increases in bus fares, electricity, sugar prices, chicken meat as well as further depreciation of the exchange rate are expected to impact negatively on the inflation rates for the remaining months of the year. We project inflation will be in the range of 17-18% for the year, above Government's original target of 12%.

¹ The views expressed are Mission views and not necessarily the official view of the World Bank.