

JAMAICA

1. General trends

Jamaica's external-sector economic indicators improved in 2010 largely due to inflows from multilateral institutions and improved prospects in its major export markets. Economic policy was guided by a programme of fiscal consolidation under a 15-month stand-by agreement with the International Monetary Fund (IMF). This agreement, which sets a series of targets including fiscal targets, net international reserves and public debt, is monitored on a quarterly basis and is expected to result in inflows of some US\$ 1.2 billion over its duration. Even though there were substantial foreign-exchange inflows, the economy contracted by 1.3% in 2010. GDP is projected to grow by 1.5% in 2011 thanks to stronger demand for Jamaican exports and to the fact that domestic interest rates have been trending down, stimulating private investment.

However, there are risks, as credit demand by the private sector has yet to pick up and the debt burden continues to pose a severe challenge. In 2010, all sectors of the economy declined except for the agriculture, forestry and fishing sector and public services. This result was due to soft external and domestic demand on the heels of falling incomes and reduced consumer confidence.

The monetary policy of the central bank eased considerably as interest rates trended downward and inflationary expectations subsided. The rate of inflation rose to 11.7% in 2010 from 10.2% in 2009, but was far lower than the 16.8% rate recorded in 2008. On the other hand, the rate of unemployment inched up to 12.4%, a gain of 1 percentage point over the rate in 2009.

In the external sector, the current account deficit decreased while international reserves increased. In March 2011, reserves stood at US\$ 3.43 billion or 8.9 months' worth of imports. It should be noted that a significant proportion of these inflows came from multilateral sources.

2. Economic policy

(a) Fiscal policy

Under the IMF standby agreement and together with the government's Medium-Term Socio-Economic Policy Framework (MTF), a strategy of fiscal consolidation has been implemented. The outcome for fiscal year¹ 2010/2011 was a deficit of 6.1% of GDP, slightly below the MTF target of 6.5%, and significantly lower than the 10.9% deficit recorded in fiscal year 2009/2010. This outcome was possible because revenue growth outstripped that of expenditure. However, it exceeded by 1.5 percentage points the target set for the same period in the IMF stand-by agreement (a deficit of around 4.6% of GDP).

During fiscal year 2010/2011, expenditure exceeded the budget target by 4.5% while revenues and grants exceeded the target by 3.6%. Recurrent and capital expenditure grew by 3.1% and 12% respectively. At the same time, the revenue gains were due to a variety of tax increases early in 2010, which saw revenue as a share of GDP rise from 29.9% of GDP in fiscal year 2009/2010 to 32.2% in 2010/11. The General Consumption Tax (GCT) was raised from 16.5% to 17.5% and a special rate of 10% was set for GCT on residential and commercial electricity use.

¹ The fiscal year runs from April through March of the following year.

Central to the fiscal consolidation program was the reduction in the government debt which stood at J\$ 1.57 trillion at the end of fiscal year 2010/2011. Meanwhile, the debt to GDP ratio declined to 127.5% moving from 129.3% in fiscal year 2009/2010.

A number of important measures were pursued in 2010 in order to restructure public finances and create greater fiscal space over the medium term. These included negotiations to divest a number of State-run corporations, the adoption of the fiscal responsibility framework in March 2010, and the design of mechanisms for better treasury management. High on the agenda is the reform of the tax system through consolidation of a number of tax administration agencies and a variety of taxes. For example the payroll taxes, of which there are several, would be consolidated into a single form.

In order to reinforce the process of fiscal consolidation the government is also contemplating a 24-month extension of the IMF standby agreement. It is not yet clear what this extension would entail, but it would be designed to restore confidence in the economy, and the country would also benefit from increased multilateral financial flows for budgetary support.

(b) Monetary and exchange-rate policy

In the wake of the IMF agreement, a significant amount of resources from multilateral institutions including the Inter-American Development Bank (IDB) and the World Bank, were received for budgetary support. These funds boosted foreign-exchange inflows, stabilized the exchange rate and enabled the monetary authorities to adopt a more expansionary policy regime and to reduce interest rates. In addition, the successful launch of the Jamaica Debt Exchange (JDX) in early 2010, an exchange of high-cost debt for new instruments of longer duration, paved the way for a general decline in interest rates.

In this context, the central bank lowered the interest rate on its 30-day certificate of deposit (CD) by some 300 basis points and reduced its cash reserve requirement and liquidity asset requirement against Jamaica dollar-prescribed liabilities of deposit-taking institutions from 14% to 12%. The rates for foreign currency liabilities were also lowered by 2 percentage points. As a result, market-determined rates declined. For example the yield on 30-day treasuries declined by 247 basis point to 7.48%. In addition, the overall average weighted loan rate fell from 24.64% in March to 20.43% in December 2010 while the overall weighted deposit rate over the same period declined from 4.31% to 2.95% and the interest rate spread also declined from 19.33 percentage points to 17.44 percentage points.

In 2010, nominal growth in M1 decelerated to 4.1%, compared with 7.8% in 2009. Growth in currency with the public was 6.2% in 2009 and 8.7% in 2010 while demand deposits grew by 8.1% and 20% respectively in 2009 and 2010. The weakness in real economic activity explains the decline in these indicators of financial activity and it would take some time for the private sector to adjust to an environment of lower returns given the high returns that were previously available for government securities.

In 2010, the stock of commercial loans and advances decreased by 2% in contrast to an increase of 4.2% in 2009. This reflected declines in loans to both the public and private sectors. However, given that loans to the private sector accounted for 87.6% of all loans, the softening of domestic economic activity is evident.

The significant financial flows released by the signing of the IMF agreement helped stabilize the exchange rate and the average selling rate of the Jamaican dollar relative to the United States dollar (US\$) showed a 4.4% appreciation in 2010, in sharp contrast with the 10.2% depreciation in 2009. The exchange

rate ended the year at J\$ 85.860 to 1 US\$. For 2011, a slight depreciation in the Jamaican dollar against the United States dollar is projected.

3. The main variables

(a) Economic activity

The contraction of the Jamaican economy was estimated at 1.3% in 2010, an improvement from the decline of 2.7% the previous year. Among the many reasons were the lacklustre economic growth among Jamaica's trading partners, especially the United States, weak domestic demand, and uncertainty among the private sector in terms of areas of investment. In addition, employment fell in some sectors.

Within the goods sector, agriculture, forestry and fishing was the only sector that experienced positive growth (2.2%), albeit far lower than the 12.1% recorded in 2009. The contribution of agriculture to GDP was just over 6%. Adverse weather conditions accounted for the fall-off in growth despite an aggressive programme of agricultural promotion.

Mining and quarrying, which contributed 1.7% to GDP, declined by 4% in 2010, but this was a far cry from the precipitous decline of 50.2% in the previous year, which was due to plant closures following a slump in international demand. The reopening of one of the three alumina plants that had been closed, together with increased production at the sole bauxite plant, augurs well in the medium term, but production may be limited in the short run owing to the build-up of substantial bauxite inventories.

Manufacturing and construction were down by 3.2% and 4.2 % respectively, but both sectors showed smaller declines than in 2009 and this may reflect an easing of the recessive conditions in the economy. These sectors contributed 7% and 6.6%, respectively, to real GDP in 2010.

Within the services sector, positive growth occurred in the hotel and restaurant subsector, attributable to fairly robust tourism performance, as growth in this sector was positive throughout the crisis period. Total stopover tourist arrivals grew by 4.9% and visitors from major markets such as Canada (12%) and the United States (6%) showed improvements in 2010, while Europe saw a small decline of 2%. However, cruise passenger arrivals declined for the fourth straight year, this time by 1.4% and have yet to begin to recover from the crisis. The tourism sector directly contributed 6% of GDP but this underestimates the true impact of the sector on the economy.

The largest overall decline occurred in indirect financial intermediation services (9.5%), followed by electricity, gas and water (4.3%) and finance and insurance (2.5%) and this reflected depressed domestic demand and low economic activity. These sectors contributed 4.1%, 3.3% and 18.4%, respectively, to real GDP in 2010. The economic forecast for 2011 calls for growth of 1.5%, spearheaded by the goods-producing sector with the service sector lagging behind. The leading contributors to this growth are expected to be mining and quarrying, agriculture, forestry and fishing, and hotels and restaurants.

(b) Prices, wages and employment

The year-end 12-month inflation rate for 2010 was 11.7%, a slight increase from 2009, when inflation was 10.2%, but in general inflationary expectations have subsided due to the appreciation of the currency and the adjustments to expectations already internalized as a result of tax increases earlier in the

year. In fact, the 12-month inflation rate in May 2011 had declined to 6.8%. Core inflation, which excludes the volatile components of food and fuel, stood at 8.2% for the 12 months through December 2010.

Higher prices in 2010 were due to escalating food and energy prices, which resulted from pressures at both the local and international levels. At the international level, supply constraints and higher crude oil prices pushed up grain prices, while at the domestic level, the tax package of 1 January 2010 caused price increases. These included rises in tax rates and higher bus and taxi fares plus weather-related shocks, which impacted on the cost of food. The sharpest increases were in transport, (25.7%), and housing, electricity, water, gas and other fuels (8.4%). Within the food category, alcoholic beverages and tobacco rose by 14.4% due to tax hikes.

Under the medium term macroeconomic plan, inflation in 2011 is targeted to be no more than 7%. Accumulated inflation during the first quarter 2011 was just 1%, and barring any significant increase in fuel prices, the inflation target should be met.

In terms of wages, under an agreement in April 2009, public-sector wages were effectively frozen for three financial years, which will come to an end in March 2012, although scheduled increments to public servants have continued to be paid. In light of several rounds of price hikes last year, notably in the price of electricity, the government will ask IMF to revisit the possibility of amending this policy and raising wages. However, with the emphasis on fiscal consolidation, no significant wage increases are expected to be approved.

The impact of the recession is still being felt in terms of employment. The employed labour force declined by 30,600 persons, or 2.7%, while the unemployment rate increased by 1% to 12.4% in 2010. While the overall rate seems moderate, some age cohorts have higher than average unemployment rates. For example, the youth unemployment rate was 30%. In addition, while the male unemployment rate was virtually unchanged at about 9%, the female unemployment rose from 15.7% to 16.2% in 2010.

(c) The external sector

The IMF agreement stimulated a large flow of complementary funds from other multilateral agencies and these funds have helped to fund the deficit on the balance of payments. In 2010 concessional loans totalling US\$ 850 million were obtained from IDB, the World Bank and the Caribbean Development Bank (CDB). In addition, Jamaica received grants totalling US\$ 53 million. Foreign exchange inflows were also boosted by higher remittance inflows and tourist receipts. Net international reserves increased to US\$ 2.98 billion or 7.7 months of imports. As a consequence, the current account balance improved slightly from a deficit of US\$ 1.13 billion in 2009 to a deficit of US\$ 990 million in 2010 or 7% of GDP.

This was the result of improvements in the subaccounts with the exception of the merchandise trade subsector, which recorded a deficit of US\$ 3.26 billion, a deterioration of US\$ 171 million from 2009. However, in both 2009 and 2010 imports were only roughly 60% of imports in 2008, which suggests that the adjustment was being made by import compression due to reduced demand.

The services account increased by US\$ 75.1 million in 2010, which reflected higher tourism receipts and a reduction in expenditures by Jamaicans travelling abroad. Another improvement was the reduction in the deficit on the income subaccount, due to reduced official interest payments and profits remitted abroad.

The current transfers account also improved as a result of increases in net private transfers, which include higher remittances and grants from the European Union for growth enhancement and debt reduction. The balance on the current transfers account was US\$ 2 billion, an increase of 7.9% relative to 2009; however remittances have still not returned to their trend levels.

In 2010, there was an increase of US\$ 712.9 million in official investment and a decrease of US\$ 320.5 million in private investment in the financial account. The decline in private investment started in 2008 when it represented 15% of GDP and then fell to 6% in 2009 and later to 3% in 2010. Given the strong multilateral inflows and the desire on the part of the government to extend the IMF programme, confidence in the economy is likely to increase in the short term.