

## MONEY AND BANKING

The focus of monetary policy during 1995 was basically three-pronged. These were:

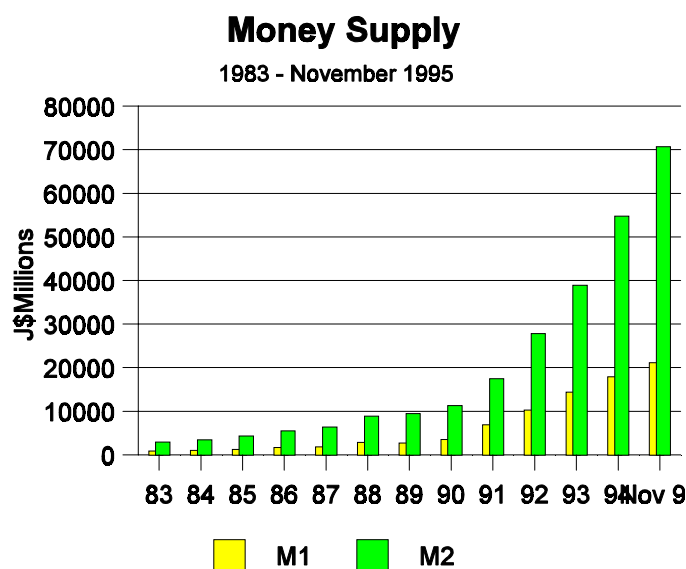
1. Maintaining adequate levels of foreign reserves,
2. Fostering exchange rate stability,
3. Controlling inflation.

To this end there was considerable activity in the foreign assets account of Bank of Jamaica. Reserve levels showed monthly fluctuations. These were at times significant, a US\$62million increase in March and a decline of US\$57million in October as the government sought to maintain comfortable levels of reserves while intervening in the foreign exchange market to prevent serious deterioration and maintaining stability. With relative stability in the foreign exchange market in the first quarter of the year, BOJ's accumulation of reserves slowed. This contributed to a slow-down in money supply growth and a moderation in the monthly inflation rates which hovered around the 1% mark. However, the reduced accumulation of reserves by BOJ, facilitated increased accumulation by the Commercial Banks, who in the light of some uncertainty in the foreign exchange market, increased their overseas investment in an attempt to reduce the risk of loan default and to assist in interest payments on their foreign currency accounts. This activity was over-extended and contributed to a decline in the local supply of US dollars triggering a series of depreciations in the local exchange rate as well as in the resurgence of the informal foreign exchange market. By August, the BOJ began its intervention in the foreign exchange market by selling quantities of the NIR to financial institutions, and later in the year it began reducing its percentage intake from authorised dealers in order to increase market supply.

Open market operations slowed in the first quarter of the year as Certificates of Deposit valuing J\$950 million in January 1995 were phased out by February. This led to a trending down of the interest rates and a build up of liquidity in the system. Coupled with moderated inflation rates and the effecting of wage increases in excess of local output and productivity - these prompted increased demand/consumption in the economy.

The statutory liquid asset reserves of Commercial Banks were reduced from 50% to 47% and given the other prevailing economic conditions, fostered an increase in private sector credit which continued to year end.

In order to counter the increase in liquidity in the system, Bank of Jamaica intensified its trading in the secondary market. Larger offerings in LRS and TBs were made and the maturity structure on these securities shifted to longer short term and medium term spans.



**Money Supply 1983 - 1995**  
**J\$Million**

YEAR	M1	TIME DEPOSIT	SAVING DEPOSIT	QUASI MONEY	M2
1983	884.3	975.0	1122.2	2097.2	2981.5
1984	1012.4	1134.1	1304.7	2438.8	3451.2
1985	1210.4	1091.7	2007.5	3099.2	4309.6
1986	1667.6	1183.3	2646.8	3830.1	5497.7
1987	1874.8	1119.4	3378.1	4497.5	6372.3
1988	2908.8	1625.5	4365.8	5591.3	8900.1
1989	2739.4	1843.5	4882.7	6726.2	9465.6
1990	3516.0	2281.8	5499.0	7780.8	11296.8
1991	6867.1	2464.2	8135.2	10599.4	17466.5
1992	10283.6	4409.8	13124.0	17533.8	27817.4
1993	14398.7	6340.5	18179.6	24520.1	38918.8
1994	17896.7	12153.6	24733.2	36886.8	54783.5
Nov 1995	21148.5	15782.4	33778.5	49560.9	70709.4

**Note: M1 = Currency in Circulation + Demand Deposits**  
**Quasi-Money = Time + Saving Deposits**  
**M2 = M1 + Quasi-Money**

*Source: Bank of Jamaica*

These measures were late in coming and not effective in drying up the liquidity in the system. The destabilization in the exchange rate persisted, and trading in the informal market foreign exchange resumed. Towards the beginning of the fourth quarter of 1995 interest rates began trending up. By the year end the yield on Treasury Bill was 42.5% up from 20.4% in April, and this helped to pull in a significant amount of funds from the system as the last offer of TBs for the year was not significantly over subscribed.

Money Supply

At the end of October 1995, broad money, that is M2 stood at J\$69.5 billion, indicating a J\$19.2 billion or 38.04% point to point increase over October 1994. For the first six months of 1995, M2 rose by J\$6.6 billion or by 12.6% with its steepest monthly increase of 4.93% in April. However, between July and October (4 months) there was a J\$9.7 billion or 16.2% increase, with October showing the largest monthly rise of 6.33% and September a decline of 1.2%. In July, Bank of Jamaica extended J\$3 billion in liquidity support to Century National Bank. This also contributed to the increase in Money Supply by way of increase in overall demand deposits levels and in overdrafts from the Bank of Jamaica.

Figure 1

**Factors Behind Increase in Money Supply**

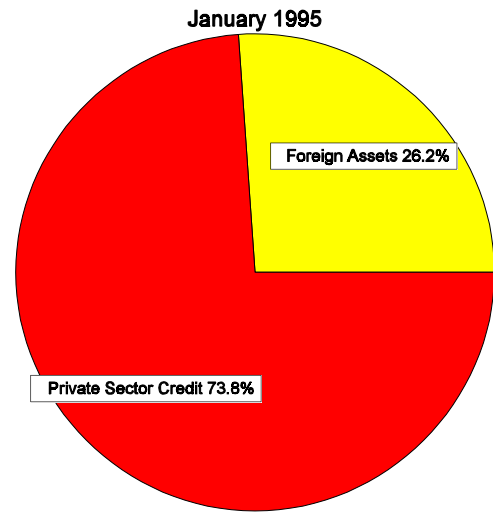
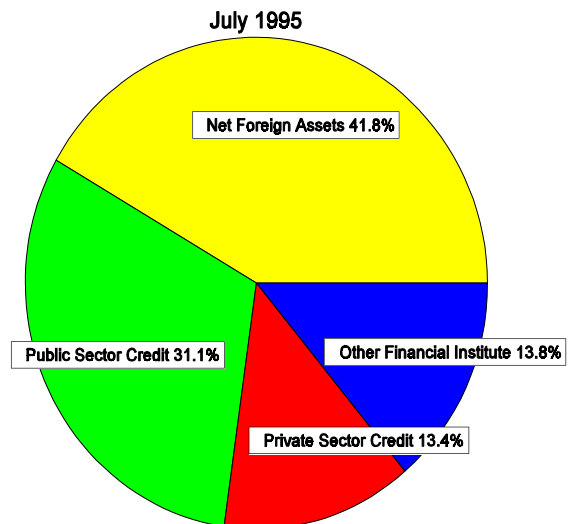


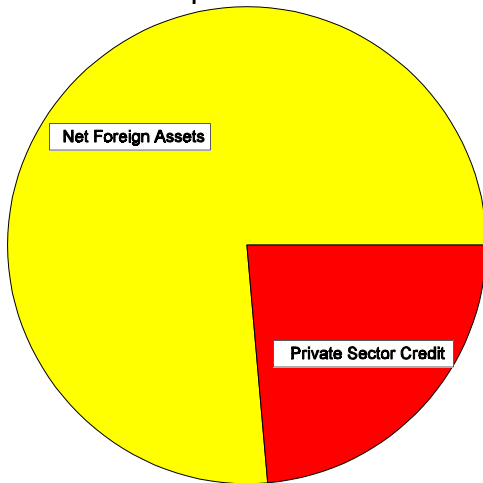
Figure 2

**Factors Behind Increase in Money Supply**



### Factors Behind Increase in Money Supply

September 1995



### Factors Behind Increase in Money Supply

October 1995

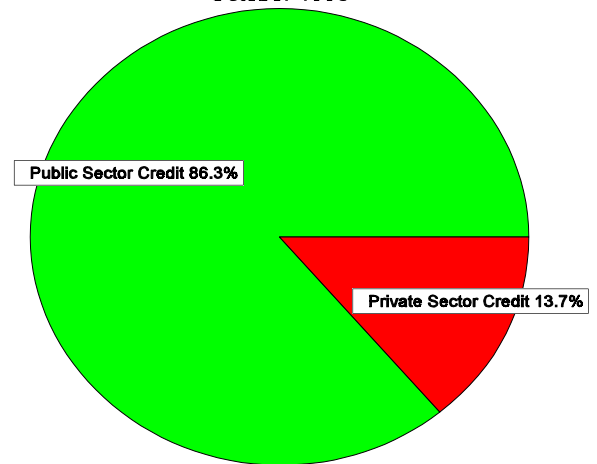


Figure 3

Contributing to the rise in broad money (M2) were changes in its components M1 and Quasi-Money. Throughout the period, Money Supply (M1) rose by 19.9%. Its components Currency with the Public and Demand Deposits rose by 19.2% and 20.4% respectively. However, while Quasi-Money rose by 32.2% overall, its components, that is, Time and Savings Deposits showed larger increases of 27.5% and 34.5% respectively. Saving deposits growing by J\$1.7 billion every three months directly influencing the overall increase in M2 experienced in these months.

Also affecting money supply growth through the period were, movement in the level of foreign assets as well as in both public and private sector credit.

The graphs below indicate the impact of these factors on M2 growth. Throughout the year,

Figure 4

except in February 1995, the Net Foreign Assets of the Bank of Jamaica increased - and as such have always had an expansionary effect on M2, see figures 1,2

and 3. This is so, as funds are pushed into the system when purchasing foreign exchange to build up these reserves. Between January and October the Net Foreign Assets of Bank of Jamaica rose by 52.5% and between February and October 78.1%, while its highest monthly increase was in September of J\$4.3 or by 18.6%.

Private Sector Credit - expanded by 13.1% in the first 6 months of 1995, but accelerated by 13.2% in the three months July to September. As such, it had a continuous expansionary effect on Money Supply as can be substantiated by the graphical representations in the Figures. Although the expansionary trend in the Private Sector Credit had its beginnings in January 1993, it gathered momentum in April 1995 fostered by declines in interest rates, dips in inflation rates and the decline in the liquidity ratio of Commercial Banks.

The extent of the influence of Public Sector Credit on money supply expansion is reflected in changes in the levels of its credit balances. As these fluctuate, monthly declines and increases in their values indicate disbursements and reimbursement respectively of these funds. The

disbursements regardless of their form, destination have an expansionary effect on money supply (see July 1995 graph).

Other factors influencing M2 growth include, 'Credit to Other Financial Institutions' 'Quasi-Money' and 'Other Items Net'. The data indicates that throughout the year, all these factors have also had some expansionary impact on money supply.

### Loans and Advances

At November 1995, total assets and liabilities of Commercial Banks were J\$115.3 billion. Of this, J\$44.74 billion or 38.8% of its assets were extended in credit and J\$84.9 billion held in deposits. Loans and Advances in November 1995 were 36.64% higher than the J\$32.74 billion outstanding in November 1994, and indicates a higher growth in value and percentage than was experienced in 1994.

The growth in credit experienced in 1995, was facilitated by declines in interest rates as well as in inflation and the acquisition of increased wages which enabled the servicing of increased credit - be it for personal consumption or business activities.

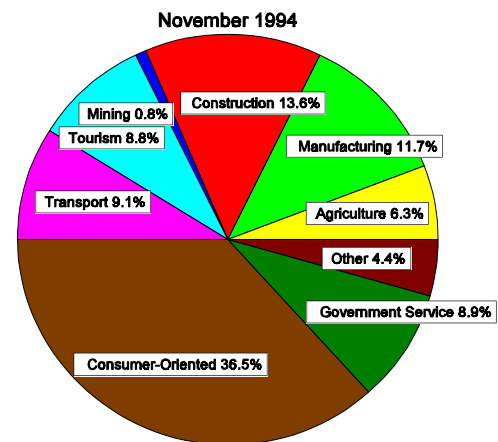
The Near Banks and Building Societies at November 1995, held assets totalling J\$46.8 billion. Of this loans outstanding valued J\$15.1 billion and deposits and savings were J\$32.4 billion. For these institutions, their assets grew by J\$8.0 billion or by 20.7% and their loans and deposits by 31.1% and 12.4% respectively.

A review of the sectoral allocation of credit extended by the Commercial Banks, indicates that in 1995 consumer oriented loans made up 39.9% of the Commercial Banks' credit portfolio. This was followed by loans to construction (13.5%)

manufacturing (13.3%) transport (8.9%) and tourism (8.3%). This order of ranking follows a similar trend as in 1994.

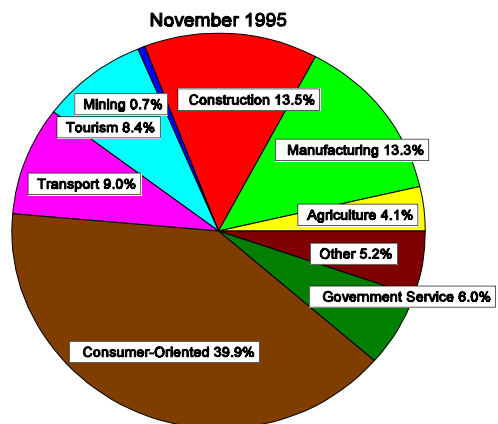
However, the loan portfolio of the near banks shows the greater share of their loans going to consumers oriented credit (42.5%) followed by construction (24.3%) and Tourism (8.2%). Credit to Government Services from Commercial Banks and the

### **Commercial Bank's Loans and Advances**



Near Banks in 1995 declined by 7.41% and 52.5% respectively.

### **Commercial Bank's Loans and Advances**



**Loan and Advances by Sector/Share 1994/95 (J\$Mn)**

<b>Loans</b>	<b>November 1994</b>	<b>Real Share %</b>	<b>November 1995</b>	<b>Real Share %</b>
Agriculture	2073.3	6.3	1849.2	4.1
Manufacturing	3823.7	11.7	5934.1	13.3
Construction	4443.2	13.6	6024.8	13.5
Mining	247.4	0.8	309.2	0.7
Tourism	2875.0	8.8	3739.8	8.4
Transport	2977.8	9.1	4004.9	9.0
Consumer-Oriented	11948.2	36.5	17837.7	99.
Government Service	2910.6	8.9	2694.8	6.0
Others	1444.7	4.4	2347.0	5.2
<b>Total</b>	<b>32743.9</b>	<b>100</b>	<b>44741.5</b>	<b>100</b>

*Source: Bank of Jamaica*

Commercial Banks Liquidity

Commercial Banks began the year with the statutory minimum liquidity ratio at 50%. This ratio being enforced since July 1992. However, effective June 15, 1995, the ratio decreased to 47%, to be constituted of 25% in cash reserves and 22% in non-cash or other liquid assets. This enabled some reduction in the holdings of excess liquidity which averaged about 11.0% between January to March and about 3.4% for the rest of the year. Penalties for breaches of the liquidity ratio moved also from 90% to 65% per annum. During the year, the liquid assets ratio of Financial Institution Act rose from 17% to 20% and constituted 17% in cash reserves and 3% in non-cash reserves. This ratio is applicable to both domestic and foreign currency deposits. Most institutions held considerable excesses over these minimum requirements throughout the year.

In the later part of 1995, in a further effort to decrease the liquidity in the system Commercial Banks were required to maintain at Bank of Jamaica a special

deposit representing a specified percentage of their prescribed liabilities. The deposits could be wholly cash or a mix of cash and Treasury Bills (TB). Cash deposits would attract interest of 22% per annum and the interest on Treasury Bill would be .00001% per annum off the instrument's market value at the date of its deposit with Bank of Jamaica.

<b>Interest Rates</b>
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The declining trend in interest rates which began in mid-1994 continued onto the end of the year and into mid-1995. In fact, the years 1992 to 1995 have been characterized by months of high and low interest rates moving from one year to the next and now appears to be evolving into a cycle. This scenario no doubt helped to contribute to the non-productive growth cycle in the economy as high interest rates do not foster an environment for planning and investment.

In January 1995, interest rate yield on Treasury Bills stood at 27.6% and fluctuated

in the high to low twenties up to September 1995 when the yield moved to 30.2% and by year end it was at 42.5%.

Commercial rates followed in this trend. Deposit rates which began the year at 19-31% declined to 14.50-23.00% by April and moved up to 17-30% by September to close the year back at 19-42%. While loan rates varied with institutions movements in the overall average weighted rate as displayed in the table below, follows a similar trend with a lag in its movement.

Movements in the savings rate however, were not as volatile during 1995. Since 1991, when saving rates in the banking sector were deregulated, the floor rate of 15% per annum evolved and continues to be effective. So during 1995 savings rates moved from 15-30% in January to 15-24% by September 1995.

As the country moves through a cycle of relatively lower interest rates to higher ones there were implications for borrowers, lenders and the economy overall:

1. Although the rates trended down, they were not that low and sustained for a period long enough to encourage investment. However it fostered increased consumerism which had an adverse effect on the Balance of Payments.
2. The high interest rate regime makes cost of funds expensive. It narrows the spread between interest paid and interest earned, thereby lowering the profitability to lending entities. Its results in high levels of loan default and bad debts and company failure.
3. High interest rates are therefore a strong deterrent to investment, production and economic growth.

Policy makers should be aware of the outcomes to such policy initiatives and utilize more a mix of growth oriented policies to achieve the growth objectives of the economy.

### Commercial Banks' Weighted Loans and Deposit Rates

Weighted Loan Rates	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Instalment Credit	43.7	46.3	46.8	49.6	50.8	51.1	54.9	55.1	53.3	50.1	47.8	
Mortgage Credit	40.3	31.6	29.8	29.5	35.6	36.4	10.5	10.5	10.5	24.4	25.7	
Personal Credit	41.8	41.1	49.6	52.9	56.9	57.8	53.8	53.6	47.6	47.1	47.0	
Commercial Credit	39.7	39.6	46.2	49.1	50.2	47.7	45.8	43.0	41.2	39.1	40.6	
Local Government and Other Public Entities	35.7	29.2	40.2	46.1	50.5	49.5	32.3	30.2	32.0	34.7	33.2	
Central Government	40.5	40.2	51.2	52.0	55.6	53.6	45.2	45.0	37.7	28.1	26.9	

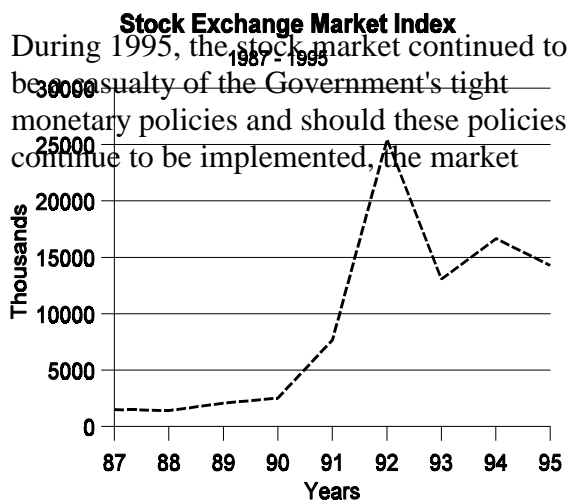
Overall Average/Weighted Loan Rate	40.4	40.7	46.7	49.6	51.5	50.0	47.6	45.8	43.5	40.9	41.4	
Overall Average/Weighted Deposit Rate	21.2	22.6	34.4	39.8	39.3	34.1	33.4	27.9	23.0	19.4	19.7	
Average Lending Rates	45.8	44.0	57.0	61.3	66.9	65.0	61.3	56.1	48.8	48.7	48.2	55.3

*Source: Bank of Jamaica*

### Stock Market Developments

#### **Stock Market Index (1987 - 1995)**

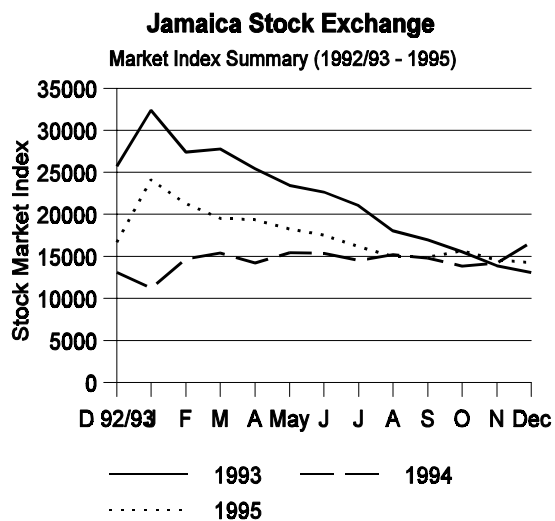
<b>Years</b>	<b>Volume</b>	<b>Value</b>	<b>Index</b>
1987	71,878,234	399,971,277	1,515.09
1988	43,251,904	136,739,278	1,439.09
1989	95,202,452	516,456,318	2,075.85
1990	57,960,234	230,781,846	2,539.36
1991	144,259,019	1,156,608,055	7,681.50
1992	395,900,000	4,688,400,000	25,475.90
1993	567,454,280	8,346,769,977	13,099.68
1994	743,793,646	5,168,796,309	16,676.70
1995	463,050,165	3,664,855,984	14,266.99



appears destined to stagnation or decline.

The year began with the market showing

bullish tendencies as the index climbed to 24127.7 points during January, moving from 16676.7 points at the end of December 1994 - a rise of 44.7%. However, by the end of February the index declined by 11.9%, beginning a bearish trend which was maintained for the rest of the year. This trend continued despite the existence of lowering interest and inflation rates during the first half of the year. By the end of December 1995, the index fell to 14267 points declining by 14.5% over the year.



As 1995 closed, interest yields on Treasury Bills was 42.5% and there is all the indication that these rates will hold for some time, so the stock market will remain essentially bearish. Accepting the existence of high interest returns, as well as the security of investment returns on gilt-edged paper, it is believed that the market will not be rejuvenated until the institutional investors get in on a big way, and they, having been burnt once will be very reluctant to return to the equities market. The road to market success therefore looks long.

During the year, the volume of shares traded

(excluding block transaction) decreased by 37.5% moving from 741.8 million to 463.1 million. The value also declined by 28.9% to J\$3.66 billion and this was probably buoyed by the higher share prices which prevailed at the beginning of 1995. Capitalization at the end of the year was J\$50,755.8 million moving from J\$58,018.1 million at December 1994.

From the year's trading, volume leader was Caldon followed by Telecommunications of Jamaica. Stocks recording the largest price appreciation were NCC followed by Courts Jamaica Limited. Those with the largest declines were WIPP and Goodyear. The advance/decline ratio for the year was 8:35. In July 1995, KLAS FM began trading on the Stock Exchange.

#### Foreign Exchange Developments

Throughout 1995, the country experienced continued high levels of inflows of foreign exchange into the system, however, the pace of growth in foreign exchange account balances grew by 41% from US\$460.7 million at the end of December 1993 to US\$649.8 at December 1994. In 1995, monthly balances moved from US\$649.8 million in December 1994 to US\$706.0 million in December 1995 - indicating a 8.6% growth. However, these balances were at a much higher level throughout 1995 than in 1994, and indicates more a consolidation around the US\$600 million during 1995. The period saw inflows somewhat higher than outflows effecting some positive balances.

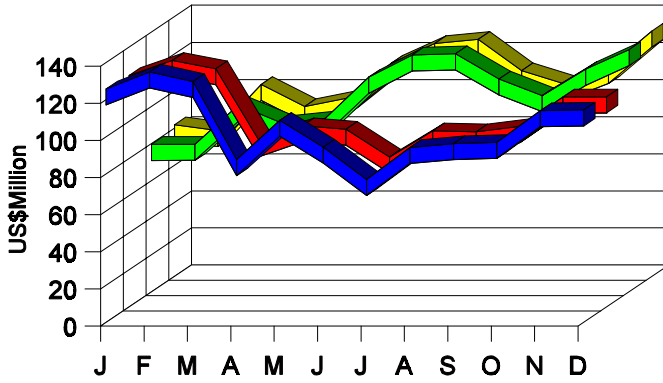
During the year, operations of these foreign currency accounts were affected by two major factors:

1. Towards the end of 1994 and early 1995, interest rates trended down to the extent that the profitability of arbitrage activities declined



### Authorized Dealers Foreign Currency

Inflows 1994 - 1995



- 1994 Purchases
- 1994 Sales
- 1995 Purchases
- 1995 Sales

## FISCAL POLICY AND ACCOUNTS

The budget for the fiscal year (FY) 1995/96 was formulated with the objective of creating and maintaining a favourable macro-economic environment conducive to the country's economic growth.

The budget, proposing an expenditure of J\$81,341.0 million represented 51.9% of projected (FY) GDP of J\$156.7 billion and was approximately 19% in nominal terms above the revised 1994/95 budget although smaller by 2% in real terms.

Recurrent expenditure was projected at \$49618.0 million or 61% of the total budget, up from 59% of previous fiscal year's.

Increases in recurrent expenditure were justified on the basis that for the fiscal year 1995/96, there were outstanding public sector wage settlements to be honoured, as well as additional ones to be executed. As well, provisions had to be made for servicing the increasing costs of the internal debt which for (FY) 1995/95 was estimated at 53.0% of the total budget.

Capital expenditure, estimated at J\$31,874 million was 7.5% above previous (FY) and equaled just 39.0% of total expenditure.

The reduction from previous year's share of 41.0% represents the decline in estimated amortization payments on the external debt.

### Annual Fiscal Accounts 1992/93 - 1995/96 (J\$Mn)

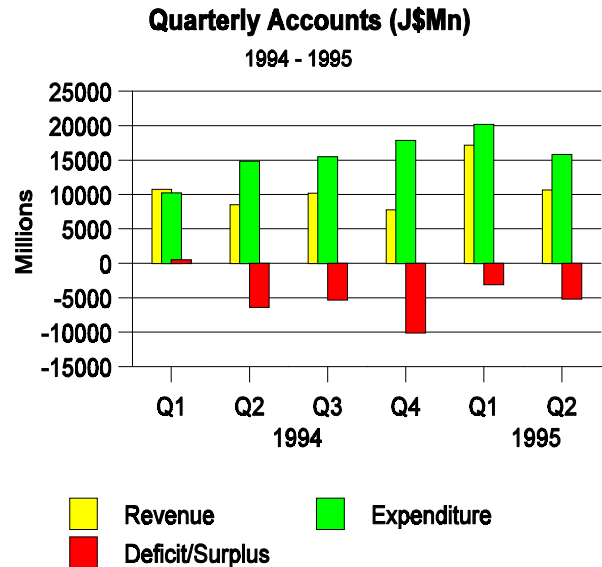
	92/93	%GDP	93/94	%GDP	94/95	%GDP	95/96 Apr-Nov	%GDP
Revenue	21029.4	27.6	34243.0	33.1	43635.7	32.1	35288.9	22.5
Expenditure	26871.1	35.2	41256.9	41.5	68383.5	50.3	36358.5	23.2
Overall Deficit/Surplus	-5841.7	7.6	-7013.9	8.4	-24747.8	18.2	-1069.6	0.7
GDP = (J\$Mn)	76249.6		102749.9		136002.1		156718.1	
Fiscal Deficit/Surplus	2145.5	2.8	3149.4	3.1	-4120.1	3.0		

## Objectives and Strategies

To achieve the macro-economic objectives it was intended that the proposed budget and the attendant fiscal policies would be supported by monetary policy to achieve these. Fiscal policy would be aimed at:

1. Achieving and sustaining a reduction in the inflation rate to 1% per month or 12% p.a.
2. Reduced inflation would encourage growth in the economy.
3. By increasing revenue collections and being prudent in expenditure - a surplus could be generated which would help to:
  - a. retire some of the internal debt and lower the debt-servicing burden.
  - b. increase capital expenditure.
4. Expenditure would focus on addressing some of the areas not

focussed on during the stabilization process eg. housing, roads, transportation, poverty alleviation



etc.

5. An attempt would be made to decrease the use of local financing instruments, while undertaking a restructuring of the maturity profile of the internal debt so as to ease the debt-servicing burden on the budget, and thereby increase funds to undertake investment activities.

## **Summary of Fiscal Operation 1995 (J\$Mn)**

	<b>Jan-May 1994/95</b>	<b>April- June 1994/95</b>	<b>Budget 94/95 Apr - Nov 1995/96</b>	<b>Preliminary (Actual) 1994/95 Apr - Nov 1995/96</b>
<b>REVENUE AND GRANTS</b>	<b>17146.0</b>	<b>10643.0</b>	<b>35174.1</b>	<b>35288.9</b>
Tax Revenue	15487.0	8594.8	31719.9	31183.8
Non-tax Revenue	746.0	311.4	978.9	1420.7
Bauxite (CDF)	-	1525.0	1528.0	1618.4
<b>Capital Revenue</b>	<b>913.0</b>	<b>211.8</b>	<b>507.0</b>	<b>400.5</b>
Grants			440.3	665.5
<b>EXPENDITURE</b>	<b>20182.2</b>	<b>15796.7</b>	<b>38004.1</b>	<b>36358.5</b>
<b>Recurrent Expenditure</b>	<b>9399.3</b>	<b>9998.3</b>	<b>31369.2</b>	<b>30306.5</b>
Interest	2969.1	4107.1	13236.5	12550.1
Traditional Obligation				
LRS				
Transfer to BOJ				
Programmes and Wages	6430.2	5891.2	18132.7	17756.4
<b>Capital Expenditure</b>	<b>10782.9</b>	<b>5798.4</b>	<b>6634.9</b>	<b>6052.0</b>
Amortization	5667.1	3768.1		
Investment	5115.8	2030.3		
<b>OVERALL DEFICIT/SURPLUS</b>	<b>(3036.2)</b>	<b>(5135.7)</b>	<b>(2830.0)</b>	<b>(1069.5)</b>

**GDP 1995/96 = 156718.1**

Fiscal Accounts and the Budget

For 1995, it appears that the Government made some effort to come to grips with the fiscal impudence which characterized its operations in previous years. During the year the returns from the :

a. Tax collection mechanism effort

improved.

b. There was some effort made at restructuring the maturity profile of the internal debt.

c. Limited inflation control was

experienced during the year.

- d. The divestment programme continued but at a slow pace.
- e. Efforts were made at keeping expenditure in line with revenues, and when the adverse impact of budget over-runs were evident, some expenditures were deferred.

Although these efforts were not major, there is the impression that some attempts were made at fiscal adjustments.

For the first quarter of 1995, total revenue collected was J\$17,146.0 million - representing increases of 120.5% and 59.7% respectively over the previous quarter September to December 1994 and similar quarter January to March 1994. The significant increase in revenue for this quarter maintains the established trend, as effort is as made during this quarter to make returns for the end of fiscal year taxes. Contributing to this also, was increased inflows from customs, betting, gaming and lotteries and from stamp duties.

Total expenditure for the quarter rose to J\$20,182.2 million, almost double that of the

January to March quarter of 1994 and J\$2.3 billion less than the previous October to December 1994 quarter. Overall, expenditure for this quarter does not follow the usual trend of being less than revenue collected in order to facilitate having an overall quarterly surplus, instead, a fiscal deficit of J\$2.63 billion was realized. For the fiscal year, which ended in March 1995, the overall budget deficit was J\$24.7 billion and the fiscal deficit J\$4.1 billion.

For the quarter April to June 1995, total revenue reached J\$10.6 billion which was J\$6.5 billion less than previous quarter.

These returns maintain the usual declining trend of first fiscal quarter revenues.

Contributing to this out turn were declines in the revenues inflows in almost all categories. However, bauxite revenue of J\$1.5 billion paid in this quarter gave a boost to the level of overall inflows. Expenditure for this quarter amounted to J\$15.8 billion and was 48.4% greater than total revenues. This resulted in an overall and fiscal deficit of J\$5.1 and J\$1.5 billion respectively.

Data is unavailable for budgetary activities pertaining to the other two quarters of the 1995/96 fiscal year, however, budgetary activities for eight months April to November

1995 are in table ( ). They constitute, budgeted and preliminary-actual expenditures for the period. The only positive aspect of these activities was that actual revenues and grants collected were J\$114.8 million more than that the level budgeted. Contributing to this is a 51.2% increase in grants as well as a 45.1% increase in non-tax revenue and 59% in bauxite levy inflows.

For the same period, total actual expenditure was less than budgeted by 4.3%. Actual expenditure on all items over the period were less, except for that on interest payments on foreign obligations which rose consequent on the devaluation of the local currency. The April to November expenditure also shows actual capital expenditure being less than budgeted. During the late months of 1995, following an increased demand for expenditure to offset emergency needs as well as Government's awareness of the deterioration on the balance of payments it indicated a re-phasing and postponement of some planned expenditure on its fiscal operations.

Despite these efforts, there is need for Government to address the following aspects of its operations as they impact on budget financing, the macro-economic climate of the

economy and eventually on GDP and its growth.

1. Government increasingly relies on borrowing as well as open market operations to finance its expenditure and it has now become trapped in an increasing debt spiral, to the extent that for fiscal year 1995/96 it utilized 53% of its expenditure budget on debt-servicing. This situation serves not only to crowd out the private sector, but it robs the country of investment funds and discourages the accumulation of savings which are all vital inputs to economic growth. Since Government's expenditure is skewed to increasing recurrent expenditure which is swamped with the debt-servicing obligations, any expenditure over runs lead to cuts in the capital budget eg. the recently tabled Supplementary Estimates saw a J\$2.5 billion cut in capital expenditure.
2. To the extent that there continues to be declines in the level of capital expenditure it implies that investments in development and physical infrastructural projects also decline.

- As these projects are needed to contribute to the development process, then its pace will be that much retarded.
3. Servicing the heavy national debt has lessened available funds for expenditure on vital areas, education and training health and transportation which are essential for maintaining a healthy economy and achieving sustainable development. Steps therefore need to be taken to drastically retire the bulk of the nation's internal debts.
    - a. The size of Government needs to be reduced and its operations become more efficient.
    - b. The tax policies need to be reviewed so as to enhance compliance.
  4. In order to achieve prudence and efficiency in the operation of Government the following needs to be done:
    - a. The size of Government needs to be reduced and its operations become more efficient.
    - b. The tax policies need to be reviewed so as to enhance compliance.
    - c. The revenue collection machinery needs to be consolidated and its efficiency and performance levels significantly improved.
    - d. Government's policies need to be predictable and supportive of growth and investment and its operational rules more transparent.
    - e. Inter-quarter finances need to be managed to prevent serious over runs and to this end - expenditure needs to be prioritized and rationalized. Increased accountability with checks and balances need to be enforced.
    - f. Revenue inflows need to be structured to prevent the quarterly fluctuations currently being experienced.
    - g. Money creation and the containment of public debt need focused attention.



## **INFLATION**

Continuing from 1994 and into 1995, one of the main focus of Government's policies was towards the control of inflation. It's stated objective was to achieve a 1% monthly inflation rate for 1995. As a result it continued to maintain in 1995, restrictive monetary policies aimed at fostering stability in the exchange rate. These policies led to a lowering of inflation which continued from the latter half of 1994 into mid 1995.

The year 1995, saw a six-month period of lower monthly inflation rates January to June (0.9% to 1.3%) followed by a six-months of higher monthly rates (1.7% to 4.3%). This trend has been characterising the monthly rates of the years 1992-1995.

Inflation for the first four months of 1995 cumulated to 4.5% or 1.12% averaged monthly. This was influenced by relative stability in the exchange rate, moderate growth in the Net International Reserves and improved fiscal balances. However, towards the end of the first quarter of 1995, with a relaxation of policies and a lack of implementation of corrective initiatives, the macro-economic climate deteriorated, destabilizing the economy and the exchange rate. The effects of the depreciating exchange rates reflected in rising prices so an increasing inflation rate trend set in by July and continued through the rest of the year. It does appear that the conditions favouring lower inflation rates can be created in the economy but there is a lack of consistency and continuity of policy to maintain the trend.

The rate of inflation for 1995, as measured by the Consumer Price Index(CPI) was 25.5%. This rate reflects declines of 1.2% and 4.6% over the 26.7% and 30.12% for 1994 and 1993 respectively and far exceeds

the targetted 12% p.a. rate set by the Government. It is also significantly greater than the average 3-3.6% of our international trading partners and the even lower rates of some Caribbean neighbours.

### **Factors influencing inflation during 1995** **Internal**

- (1) The CPI which measures the inflation rate, uses a basket of goods and a level of income which is extremely price sensitive. So that fluctuations in the exchange rate is translated readily into movements in the index. During 1995, the exchange rate began deteriorating in March, was full blown between June and September and then showed some stability from then to the end of the year. By December, there was a 19.6% devaluation of the Jamaican dollar. The trend movements in the inflation rates mimicked with a lag, the effect of the depreciating exchange rate on prices.

### Monthly Rates of Inflation 1993 - 1995

	Jan	Feb	Mar	Apr	May	June	July	Aug	Sept.	Oct.	Nov	Dec
<b>Year to Date</b>												
1993	0.9	1.4	2.7	3.8	5.5	6.7	11.1	14.8	19.7	22.6	26.6	30.1
1994	2.4	5.8	8.2	10.2	12.8	15.3	19.1	22.1	23.3	25.0	25.8	26.7
1995	1.3	2.5	3.4	4.5	6.0	7.0	8.8	10.7	14.0	17.1	20.3	24.6
<b>Actual CPI Mvmt.</b>												
1993	423.2	425.2	430.7	435.5	442.8	447.8	466.0	481.9	502.3	514.6	531.2	546.0
1994	558.9	587.0	590.7	601.6	616.1	629.8	650.5	666.4	673.5	682.5	687.3	692.0
1995	701.1	709.2	715.8	723.5	734.5	741.8	753.5	766.4	789.4	810.3	832.8	868.7
<b>Mthly Infl. Rates %</b>												
1993												
1994	0.9	0.5	1.3	1.1	1.7	1.1	4.1	3.4	4.2	2.4	3.2	2.8
1995	2.4	3.4	2.2	1.9	2.4	2.2	3.3	2.4	1.1	1.3	0.7	0.7
	1.3	1.2	0.9	1.1	1.5	1.0	1.7	1.7	3.0	2.7	2.8	4.3

(2) Government continues to be imprudent in the management of the fiscal aspects of the country's affairs. These accounts continue to show deficit expenditure funded by advances from BOJ and proceeds of open market operations. These instruments of credit to the Government are sources of money creation. As the Government spends these funds the demand for goods and services increases, if production is not rising then the effect is to fuel inflation in the economy. During 1995, the obligations of the government to BOJ moved from J\$4.6 billion in January to J\$14.8 billion in September of which

open market operations accounted for J\$14.6 billion.

(3) During 1995, there was an increase in the income tax threshold which allowed more disposable income to many. In addition, significant wage increases were granted in both the public and private sectors. These increases granted against no comparable rise in productivity gave rise to excess demand and fuelled a demand-pull inflation which contributed to:

(a) the increase in demand for imported commodities and a merchandise trade deficit.

- (b) an increased demand for foreign exchange which against a background of declining supply contributed to the depreciation of the exchange rate and increases in the costs prices of products and services.
- (4) The interest rate levels in 1995 could have impacted on inflation in the following ways:
- (a) As the rates trended down in the earlier part of the year , combined with increased disposable incomes, it could have encouraged expenditure and discouraged saving. As well, lower interest rates encourage borrowing for consumption as was evident for the expenditure on motor-car imports. Where output (supply) is low or flat this forces prices up which is inflationary, and also fosters increased importation of goods.
  - (b) As interest rates trended up in the latter part of the year, it discouraged investment and made credit expensive for businesses. These increased costs were passed on as price increases to consumers and was evident as the increase cost of foreign exchange was passed on in the rise in prices of imports and in inflation in the latter part of 1995
- (5) While the General Consumption Tax was increased from 12.5% to 15% in April, this brought with it general levels of price increases. However, as there was a basic basket of goods which remained zero-rated and these constitute a fair selection from the CPI's basket of goods, the full impact of the increases in GCT on prices was not captured in the CPI movements.

**GRAPH FROM BOJ BULLETIN**

External Factors

- (1) As trade liberalization took a firmer grip on Jamaica's trading activities, 'cheaper imports' found their way on

to the local market and this served to moderate prices to the consuming public with a similar impact on inflation. In a similar vein, as the inflation rates in most of Jamaica's trading partners is significantly less, this was reflected in the costs of some imports to the Jamaican market.

- (2) Oil and its by-products are essential to all aspects of the country's operations. The costs of imported crude is a major component of domestic costs. During the year, the prices of domestic oil imports rose by 10.0% from US\$16.97 to US\$18.67 per barrel and, coupled with devaluations of the Jamaican dollar, resulted in significant increases in the prices of petroleum products as well as in the cost of goods and services dependent on oil consumption - transportation, water, electricity etc. These increases contributed significantly to inflation during the year.

#### The Consumer Price Index

The Consumer Price Index (CPI) is comprised of the following categories:

1. Food and Drink.
2. Fuels and other household supplies.
3. Housing and other housing expenses.
4. Household furnishing and furniture.
5. Health care and personal expenditure
6. Personal clothing, footwear and accessories.
7. Transportation
8. Miscellaneous expenses

It should be noted that the 'food and drink' category carries the highest weighing of all the groups (55.63%) so that price movement in this category significantly influence movements in the overall index. During the year each month saw upward movements in the prices of food items, therefore this group had a constant impact on the inflation rate. This was so as prices for sugar, flour, starchy foods and vegetables, poultry and fish as well as meals away from home rose during the year. This positive impact of this group on inflation was particularly felt in April, August, November and December.

However, for the year 1995, it is the increase in prices for items in the subgroup 'Fuels and Other Household Supplies' which impacted most (37.1%) on overall annual inflation. The removal of the subsidiary on kerosene oil and the resulting

price increase for this product not only pushed the December inflation rate to 4.3% but also affected the overall annual rate. Price movements in other sub groups which had a significant impact on inflation were 'Household Furnishing and Furniture' 30.5%; 'Food and Drink' 27.6%; Personal

Clothing, Footwear and Accessories 23.7%.

In 1994, the subgroups, which impacted most on annual inflation included 'Transportation' 36.4%; Housing 32.6% and Food and Drinks 27.3%.

		Point		-to-	Point			
	Weights	1989	1990	1991	1992	1993	1994	1995
<b>ALL GROUPS</b>	<b>100.00</b>	<b>17.2</b>	<b>29.8</b>	<b>80.2</b>	<b>40.2</b>	<b>30.1</b>	<b>26.9</b>	<b>25.5</b>
<b>FOOD AND DRINK</b>	<b>55.63</b>	<b>20.9</b>	<b>29.0</b>	<b>84.3</b>	<b>40.4</b>	<b>31.8</b>	<b>27.3</b>	<b>27.6</b>
Meals away from home		20.7	28.1	65.9	51.1	39.8	26.3	
Meat, Poultry and Fish		22.3	38.4	92.2	38.4	29.4	16.1	
Diary Products, Oil & Fats		26.3	33.0	159.6	38.1	26.4	28.4	
Baked Products, Cereal, Breakfast, Drink		26.4	29.1	96.7	48.1	18.2	32.8	
Starchy Food		16.4	8.3	49.8	39.4	36.5	40.0	
Vegetables, Fruits		9.0	34.9	40.6	35.9	63.7	18.8	
Other Foods and Beverages		21.4	15.0	68.3	22.8	25.0	65.5	
<b>FUELS &amp; OTHER HOUSEHOLD SUPPLIES</b>	<b>7.35</b>	<b>11.6</b>	<b>42.9</b>	<b>94.0</b>	<b>30.8</b>	<b>18.6</b>	<b>18.7</b>	<b>37.1</b>
Fuels		14.2	64.5	45.7	33.3	29.7	22.3	
Housing Supplies		7.2	31.3	126.1	25.3	14.0	17.1	
<b>HOUSING</b>	<b>7.86</b>	<b>7.7</b>	<b>38.5</b>	<b>64.7</b>	<b>27.7</b>	<b>20.9</b>	<b>32.6</b>	<b>17.4</b>
Rent		3.0	13.5	12.2	20.6	8.7	31.0	
Other Housing Expenses		9.5	45.7	77.1	32.0	22.9	32.8	
<b>HOUSEHOLD FURNISH. &amp; FURNITURE</b>	<b>2.38</b>	<b>10.0</b>	<b>19.6</b>	<b>70.9</b>	<b>34.8</b>	<b>30.3</b>	<b>13.8</b>	<b>30.5</b>
Furniture		13.7	22.8	68.1	38.1	26.9	12.7	
Furnishings		8.7	18.3	73.2	32.6	31.7	14.4	
<b>HEALTH CARE &amp; PERSONAL EXPENSES</b>	<b>6.97</b>	<b>9.4</b>	<b>29.4</b>	<b>87.3</b>	<b>41.9</b>	<b>32.0</b>	<b>21.2</b>	<b>18.0</b>
<b>PERSONAL CLOTHING &amp; ACCESSORIES</b>	<b>5.07</b>	<b>13.9</b>	<b>23.1</b>	<b>75.6</b>	<b>73.1</b>	<b>25.0</b>	<b>16.5</b>	<b>23.7</b>
Clothing Material		9.3	12.2	86.6	57.2	21.0	4.4	
Make-up, Clothing & Accessories		11.0	26.4	85.2	77.2	23.7	13.6	
Footwear		18.8	20.6	34.8	67.8	31.5	20.4	
Making Repairs		18.3	20.6	34.8	67.8	31.5	36.8	
<b>TRANSPORTATION</b>	<b>6.44</b>	<b>26.7</b>	<b>28.0</b>	<b>59.9</b>	<b>20.6</b>	<b>34.0</b>	<b>36.4</b>	<b>15.0</b>
<b>MISC. EXPENSES</b>	<b>7.85</b>	<b>11.2</b>	<b>27.5</b>	<b>74.4</b>	<b>50.1</b>	<b>36.8</b>	<b>35.6</b>	<b>21.8</b>