

## OVERVIEW OF ANNUAL ECONOMIC REPORT 1998

Throughout 1998 the government maintained essentially the same economic policies that had been in place since late 1995. These policies have featured high real and nominal interest rates and an emphasis on controlling the growth of money supply and preventing a depreciation of the exchange rate. The policies have resulted in a continuing decline in the inflation rate and very little downward movement in the nominal value of the Jamaican dollar. However, the policies have taken quite a toll on some sections of the economy and the society and it is by no means clear that we have counted the full cost of them as yet.

The manufacturing and construction sectors have been hard hit by the policies and both contracted in output in 1998, the manufacturing sector having done so for the fourth consecutive year. Construction was recording its third successive year of decline. Despite the intervention of FINSAC, many locally owned financial institutions continue to experience some difficulties. While the restructuring and

closure of a number of the intervened institutions has gained speed in 1998, there remain some fundamental questions about how the FINSAC debt load will be absorbed by the government and how it will be serviced in the coming years. It is also not completely clear as to how the resuscitation of the commercial banking sector can be completed without a significant reduction in interest rates.

In this regard, it is heartening to note that the Minister of Finance, in his 1999/2000 budget speech made the reduction of nominal interest rates a key component of the fiscal programme for the coming year. The reduction of interest rates will be a key factor in the government's plan to lower its domestic debt servicing costs, even though it will be borrowing a large amount of money to finance the 1999/2000 budget. The last 6 or 7 years have seen a strong and steady build up in the domestic debt and a corresponding increase in the cost of servicing it. This has in turn put considerable and increasing strain on the fiscal accounts, which have incurred large

deficits over the last 3 years. Strong action to follow through on the planned

reductions in interest rates

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will therefore be of great help in restoring fiscal balance.

Some sectors of the economy have, however, managed to grow in 1998 and these include mining, tourism and basic services like electricity and water. However the expansion in these sectors was not enough to offset the contraction in others and the economy, as a whole, produced 0.7% less goods and services in 1998 than it did in 1997. This is the third consecutive year in which the economy has contracted and the lack of growth is beginning to have an impact on the society. The gas price demonstrations of mid-April 1999 are the most poignant evidence of these social stresses that we have had to date. Here again, the planned reductions in interest rates may help to revive investment and growth if they are implemented as programmed. The government must be congratulated for meeting its inflation targets for the calendar and fiscal years, which came at 7.9% and 6% respectively.

The major challenge facing the policymakers is to translate the lower

inflation that they have achieved into strong and sustainable economic growth. It is not clear exactly how this will be done, but it must involve bringing a halt to the deterioration in the fiscal deficit and returning to a balanced budget or a fiscal surplus. The authorities will also have to hold the confidence of the international capital market as borrowing in hard currency is going to be an ongoing part of the government's fiscal programme. A credible medium term plan for servicing and retiring the FINSAC debt which has been incurred in the rescue of companies in the financial sectors is required. These debts amount to between J\$90 and J\$100 billion and have not yet come fully into the central government's financial statements. They represent a large liability which will make a significant call on government's resources at some point in the not too distant future.

### Outlook

The course of events in 1999 will depend, to a large extent, on the government's ability to achieve its programmed reduction

in interest rates because so much seems to depend on this. The improvement in the fiscal position which is forecast for this

financial year will depend to a large extent on lower interest rates to control the servicing cost of the

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domestic debt. A recovery in private investment and hence in economic output, will also depend heavily on a reduction in the possibility that a significant reduction in interest rates may require a trade off in some other aspect of government policy, namely that with regard to the exchange rate. Lower real interest rates may require a more flexible approach to the exchange rate than the government has demonstrated in the recent past. Herein may lie the fundamental contradiction in the present policy objectives and it is very difficult to imagine how the economy will be shifted into a growth mode without this contradiction being resolved.

both nominal and real interest rates. There is

It is quite possible therefore that 1999 will be another holding year in which the economy will perform similarly to the way it did in 1998. This is even more likely to be the case if the government is successful in meeting its borrowing target in the international market and if there is no major outflow of private capital from Jamaica. Such an outcome would also assume a fairly minimal impact on tourism from the April gas price demonstrations and a fairly moderate rise in international oil prices.■

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## 1. THE WORLD ECONOMY REVIEW 1998-1999

International economic and financial conditions have deteriorated considerably over 1998 and 1999 as recessions have deepened in many Asian emerging market economies and in Japan, and as Russia's financial crisis has raised the spectre of default. Negative spillovers have been felt in world stock markets, emerging market interest spreads, acute pressures on several currencies, and further drops in already weak commodity prices. Among the industrial countries of North America and Europe, the effects of the crisis on activity have been small so far but are beginning to be felt, especially in the industrial sector (see Table 1). World growth of only 2% is now projected for 1998, a full percentage point less than expected in IMF's May 1998 World Economic Outlook and well below trend growth. Chances of any significant improvement in 1999 have also diminished, and the risks of a deeper, wider and more prolonged downturn have increased.

### **World Trade**

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The prospects for world trade and output in

1998 have been clouded, to some degree, by

the Asian financial crisis. Projections for economic growth have been scaled down markedly in Asia. The five countries, Indonesia, Korea, Malaysia, the Philippines and Thailand which are at the core of the crisis, are expected to record average GDP growth of 3% or less in 1998. As intra-Asian trade and investment links have developed dynamically over the last decades, more than half of Asia's trade was intra-regional in 1996; the repercussions of the crisis are foremost within the region. Intra-regional trade, which has more than tripled since 1990, could even decrease.

World trade volume in goods and services, as supplied from the preliminary indicators of the International Monetary Fund, was projected to grow at 3.7% in 1998 (6 percentage points below 1997's outcome) as compared with 4.6% in 1999 (2.2 percentage points below the growth rate in 1996). The moderate projected recovery in 1999 is premised on the sustained overall growth in the advanced economies of North America and Europe.

## THE WORLD ECONOMY REVIEW 1998-1999

### **Oil**

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Successive agreements among oil-producing countries in the Spring of 1998 to cut production led to only temporary increases in oil prices, with market skepticism persisting about the effectiveness of the cuts. Prices fell to a 1998 low in the middle of June in real terms, the lowest level since 1973. Prices rebounded somewhat following fresh pledges of production cut-backs by oil-exporting countries in late June, but declined again in August. On the basis of future market quotations for the rest of the year oil prices in 1998 as a whole are projected to be 30% lower, on average, than in 1997, with only a partial recovery projected for 1999.

### **Inflation and Commodity Prices**

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The prices of many non-fuel commodities weakened further between May and August 1998 by about 9% on average, following some stabilization in early 1998, as the situation in Asia and other emerging markets deteriorated. They are now projected

to be about 12% lower

on average in 1998 than in 1997, and to show little upward movement in 1999.

With the weakness of primary commodity prices adding to the downward pressures on the broader price level arising from enhanced competition from Asia, most of the advanced economies have moved closer to price stability. This has led to a projected inflation rate for advanced economies at 1.7% in 1998 and 1999.

Inflation in developing countries continue to be subdued, with inflation for 1998 and 1999 projected at 10.3% and 8.3% respectively. However, activity in the transition countries as a group is now expected to stagnate in both 1998 and 1999 mainly as a consequence of the Russian crisis. This has therefore led to a projected inflation rate of 29.5% in 1998 and 34.6% in 1999.

### **Trade Development**

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In terms of world trade agreements there have

not been many in 1998. However the United States has been challenging the European

Union to comply with a World Trade Organisation

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(WTO) ruling to reform its banana import regime, which the United States contends violates the European Union's WTO obligations.

This approach would provide the EU with an opportunity to prove its contention that its new measures, scheduled to be implemented on January 1, 1999, are consistent with the WTO. At the same time, this approach will preserve the right of the United States to suspend concessions within the WTO prescribed time frames. In preparation for exercising these rights, the United States has readily begun to receive public comments on the November 10, 1998 proposal to impose prohibitive duties on selected products that the United States imports from the EU.

### **World Economic Outlook 1999**

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Growth has continued to be well sustained overall in the advanced economies of the North America and Europe, but with significant changes in the relative growth

performance. In the United States, growth eased to below its potential rate in the second quarter of 1998

after registering its highest rate for almost two years in the first quarter, but final domestic demand remained robust. Growth has also slowed in the United Kingdom and Canada. In continental Europe the recovery has gained momentum since early 1997, underpinned by strengthening domestic demand. Recent IMF indicators, including strong business and consumer confidence and improvements in labour market conditions, suggest that the near-term growth prospects in the European Union remain favourable.

However, growth prospects have been marked down significantly for Asia, Russia, and to a lesser extent for many emerging market countries in other regions, including oil and other commodity exporters, as a direct consequence of the reduction in oil and non-fuel commodity prices. Growth in the world economy is now projected at 2% in 1998, 2.3 percentage points lower than projected in

1997. In 1999 global growth is projected to pick up moderately to 2.2%; a modest turnaround of growth in Asia, including Japan,

is projected to be offset by a slowing of expansions in North America and, to a lesser extent, in Europe, with

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the developing countries outside of Asia, and the transition countries, showing little or no improvement. The impact of the emerging market crisis is the main factor contributing to the projected slowdown in world trade growth

exceptionally high 1997 growth rate, with only a moderate pick-up predicted in 1999. The trade growth now projected for 1998 and 1999 is similar to that experienced during 1992-93.

to 3: in 1998, markedly lower than the

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## THE WORLD ECONOMY REVIEW 1998-1999

<b>Overview of the World Economy</b> (Annual percent change unless otherwise noted)	<b>1996</b>	<b>1997</b>	<b>Current Projections</b>	
			<b>1998</b>	<b>1999</b>
<b>WORLD OUTPUT</b>	<b>4.2</b>	<b>4.1</b>	<b>2.0</b>	<b>2.5</b>
Advanced economies	3.0	3.1	2.0	1.9
Major industrial countries	2.8	2.9	2.1	1.9
United States	3.4	3.9	3.5	2.0
Japan	3.9	0.8	-2.5	0.5
Germany	1.3	2.2	2.6	2.5
France	1.6	2.3	3.1	2.8
Italy	0.7	1.5	2.1	2.5
United Kingdom	2.2	3.4	2.3	1.2
Canada	1.2	3.7	3.0	2.5
<b>OTHER ADVANCED ECONOMIES</b>	<b>3.8</b>	<b>4.2</b>	<b>1.4</b>	<b>2.3</b>
Industrial countries	2.8	2.9	2.3	2.0
European Union	1.7	2.7	2.9	2.5
Euro Area	1.6	2.5	3.0	2.8
Newly industrialized Asian economies	6.3	6.0	-2.9	0.7
<b>DEVELOPING COUNTRIES</b>	<b>6.6</b>	<b>5.8</b>	<b>2.3</b>	<b>3.6</b>
Africa	5.8	3.2	3.7	4.7
Asia	8.2	6.6	1.8	3.9
ASEAN-4 <sup>1</sup>	7.1	3.7	-10.4	-0.1
Middle East and Europe	4.7	4.7	2.3	2.7
Western Hemisphere	3.5	5.1	2.8	2.7
<b>COUNTRIES IN TRANSITION</b>	<b>-1.0</b>	<b>2.0</b>	<b>-0.2</b>	<b>-0.2</b>
Central and Eastern Europe	1.6	2.8	3.4	3.6
Excluding Belarus and Ukraine	3.7	3.2	3.7	4.1
Russia	-5.0	0.9	-6.0	-6.0
Transcaucasus and Central Asia	1.6	2.1	4.1	3.8
<b>WORLD TRADE VOLUME (GOODS AND SERVICES)</b>	<b>6.8</b>	<b>9.7</b>	<b>3.7</b>	<b>4.6</b>
<b>IMPORTS</b>				
Advanced economies	6.4	9.0	4.5	4.7
Developing countries	9.3	9.8	1.0	4.6
Countries in transition	10.0	8.2	3.5	3.5
<b>EXPORTS</b>				
Advanced economies	6.0	10.3	3.6	4.2
Developing countries	8.8	10.9	3.9	5.5
Countries in transition	7.0	6.9	5.3	5.9
<b>COMMODITY PRICES</b>				
Oil <sup>1</sup>				
In SDRs	23.7	-0.2	-29.2	10.4
In U.S. dollars	18.4	-5.4	-31.1	9.3
Nonfuel <sup>2</sup>				
In SDRs	3.3	2.0	-11.6	1.4
In U.S. dollars	-1.2	-3.3	-13.9	0.4
<b>CONSUMER PRICES</b>				
Advanced economies	2.4	2.1	1.7	1.7
Developing countries	14.1	9.1	10.3	8.3
Countries in transition	41.4	27.9	29.5	34.6
<b>SIX-MONTH LIBOR (IN PERCENT)<sup>3</sup></b>				
On U.S. dollar deposits	5.6	5.9	5.7	5.7
On Japanese yen deposits	0.7	0.7	0.7	0.6
On deutsche mark deposits	3.3	3.4	3.7	...
On Euro deposits	...	...	...	3.7

**Note:**

Real effective exchange rates are assumed to remain constant at the levels prevailing during July 27 - August 24, 1998,

except for the bilateral rates among ERM currencies, which are assumed to remain constant in nominal terms.

<sup>1</sup> Simple average of spot prices of U.K. Brent, Dubai, and West Texas Intermediate crude oil. The average price of oil in U.S. dollars a barrel was \$19.27 in 1997; the assumed price is \$13.28 in 1998 and \$14.51 in 1999.

<sup>2</sup> Average, based on world commodity export weights.

<sup>3</sup>London interbank offered rate.