EPOC

Economic Programme Oversight Committee

UPDATE ON 3-YEAR IMF PRECAUTIONARY STAND-BY ARRANGEMENT (PSBA)

JULY 2018 | COMMUNIQUÉ #19

KEEPING THE END STATE IN MIND...

What do we want to achieve by FY 2019/20, inclusive of quarter ending December 2019

- A growing economy with growth in **GDP of at least 1.9%**
- An increasingly fiscally responsible GOJ with **Debt to GDP of 93.7%** and maintaned primary surplus of 7%
- **Greater levels of (non-borrowed) NIR of about US$3.06B** <total NIR of US$3.83B> to help cushion the country from shocks

MOST RECENT RESULTS

The EPOC met on July 27, 2018 and reviewed the latest available results for the period ending May 2018. The table below shows the results of selected IMF PSBA Quantitative Performance Criteria (QPCs) and Indicative Targets (ITs). Based on the preliminary results for performance to date through the end of May 2018, Jamaica is on track to meet the targets for the QPCs and ITs for the IMF SBA for end-June 2018, with the exception of the inflation target. The 12-month inflation rate for June 2018 is 2.8%, which is below the 3.5% to 6.5% range for the June 2018 test date as set out in the Monetary Policy Consultation Clause in the PSBA. This will trigger a consultation with the IMF's Executive Board whereby the BOJ will be required to explain in writing the rationale for the deviation and planned corrective actions.

SELECTED FISCAL & MONETARY INDICATORS

Selected IMF PSBA Quantitative Performance Criteria (QPCs) and Indicative Targets (ITs)	Actual (Mar. 2018)	Indicative Target (Mar. 2018)	Actual (May 2018)	Revised Target (Jun. 2018)
Primary Balance of Central Government (J$B) *	143.9	132.0	✓ 15.8	18.0
Tax Revenues (J$B) *	496.9	473.0	✓ 78.7	110.0
Non-Borrowed Reserves (US$M) **	2,409	1,917	✓ 2,521	2,073
Inflation (%) ***	3.9	2.5-7.5	⚠ 3.1	3.5-6.5

* Provisional (Fiscal Year to Date)

** Adjusted Target (Non-Borrowed Reserves)

*** CPI point-to-point movement. The PSBA inflation target, which is given as a range, is a performance criterion linked to a monetary policy consultation clause. If inflation falls outside of this range for the review period, it triggers a formal public consultation with the IMF's Executive Board on the reasons for the deviation and the proposed policy to correct it. Noteworthy, the BOJ's medium-term inflation target range of 4.0% to 6.0% is within the PSBA inflation target range of 3.5-6.5% for end-June 2018.

JAMAICA'S INTERNATIONAL COMPETITIVENESS

Foreign Exchange Market

On 24 July 2018, the value of the Jamaica Dollar vis-à-vis the US dollar was J$134.05 = US$1.00, reflecting a depreciation of 2.81% ($3.66) for the Month to Date. This follows depreciation of 1.95% ($2.49) for June 2018.

Real Effective Exchange Rate (REER)

At June 2018, Jamaica recorded an annual point-to point gain of 0.9% in relative price competitiveness, as measured by the real effective exchange rate (REER). The increase in competitiveness stemmed from a depreciation of Jamaica's nominal exchange rate (1.1%) relative to an unchanged rate in the trade weighted exchange rate of Jamaica's trading partners against the USD.

Balance of Payments

Preliminary Data for the March 2018 quarter indicates that the Current Account deficit amounted to US$162.8 million, a deterioration of US$101.6m relative to the corresponding quarter in 2017.

The BOJ projects that this increased deficit in the current account will continue forward and contribute to a reduction in current buffer in the Net Borrowed Reserves of US$406.7m as at June 2018 to a projected buffer of US$337m in September 2018.

STRUCTURAL BENCHMARKS

- All 7 macro-fiscal structural benchmarks met through end-June 2018
- All 14 structural benchmarks for public sector transformation, public bodies and public service reform met through end-June 2018

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OUTLOOK AND CONCLUSION

INFLATION TARGET NOT MET, ALL OTHER TARGETS ON TRACK OR MET

"Fiscal and International Reserves targets are on track. However, inflation is at 3.1% as at May 2018, which dropped to 2.8% as at June 2018 and remains below the IMF SBA programme target of 3.5% - 6.5%."

FISCAL PERFORMANCE

The GOJ continued its trend in solid fiscal performance over the review period, meeting all its fiscal quantitative and indicative performance criteria as at end May 2018. Tax revenue continues to be robust at $78.7b, just ahead of the budget target of $77.7b, buoyed by strong compliance.

Total Expenditures were below budget by $1.4b. Notably, recurrent expenditure was marginally below budget by 0.9%, while capital expenditure was 9.8% below budget. We continue to urge the Government to keep in step with its capital programmes target as a critical tool to stimulate economic growth.

This outturn of Tax Revenues and Expenditures contributed to a Primary Balance Surplus of $15.8b which exceeded the GOJ target of $14.2b. It is likely that the IMF SBA programme fiscal targets will be met for end June 2018.

MONETARY PERFORMANCE – 'Monetary Policy Consultation Clause triggered.'

Monetary quantitative performance continued to show mixed results at end June 2018, which is the date for which the IMF will complete the next review of the Programme targets. The most recent results at end of June show inflation at 2.8%, which is a deepening out-of-target performance, below the BOJ's target of 4.0% to 6.0%.

The BOJ has indicated that inflation fell outside the target range due to a stronger than anticipated recovery in agricultural supplies in the March 2018 quarter, as well as lower than forecasted imported inflation associated with a strengthening currency and a reduction of the pass through of oil prices to inflation. The BOJ further indicated that the low inflation outturn was influenced by weak domestic demand conditions.

Most importantly, the first quarter IMF SBA Quantitative Performance Criteria (QPC) for inflation has been breached, and will trigger the Monetary Policy Consultation Clause (MPCC) which requires the BOJ to consult with the IMF's Executive Board on the reasons for the deviation and the proposed policy response.

On a positive note, Non-Borrowed Reserves at US$2.484b has exceeded the SBA target of $2.073b at end June 2018.

BOJ Lower Interest rates – 'Push Aggregate Demand'

On June 28, 2018, the Bank of Jamaica aggressively lowered its policy rate by 50 basis points to 2.00 per cent. As indicated in the last EPOC communique, this was done in response to their projections that inflation will remain below its targeted 4-6 percent up to end December 2018. The BOJ has indicated that the decision to loosen the policy stance is aimed at fostering greater credit expansion, stimulating aggregate demand, and increasing the growth rate of GDP, which will support inflation returning to the target of 4.0 percent to 6.0 percent.

EPOC continues to support the decision to lower policy rates and believes over the medium term it should stimulate credit expansion and economic growth.

Trends in the Exchange Rate

EPOC has taken note of the recent trend in the depreciation of the Jamaican dollar by 6.4% for the financial year to date. On July 24, 2018 the dollar depreciated to a record low of $134.05 to US$1.00, reflecting a depreciation of 2.81% or $3.66 for the month to date. According to the BOJ, the devaluation was influenced by strong end-user and portfolio related demand as well as a tightening of US dollar liquidity.

While EPOC understands and expects there to be inevitable movements in the exchange rate under a floating exchange rate regime, many have linked exchange rate stability to macro-economic stability, and, therefore, we believe the transition from a managed float to a free float should be managed to preserve the confidence in the macro-economic stability that stakeholders have gained over the past 5 years.

Independence of the BOJ

The Minister of Finance and the Public Service, Hon. Dr. Nigel Clarke, has indicated that he will be tabling in Parliament by October 2018, amendments to the Bank of Jamaica Act, the Banking Services Act, and the Public Bodies Management and Accountability Act, which will strengthen the operations of the BOJ.

These amendments will enhance BOJ's governance structure and independence, which are crucial to pursuing an effective inflation rate targeting policy. This involves establishment of a clear and prioritized mandate of price stability as the goal of monetary policy.

Inflation Targeting

EPOC notes the benefits of inflation targeting in creating an environment of price stability that preserves the value of money leading to improved business planning, stronger social protection, and better predictability in pricing long term assets.

However, as the GOJ and the BOJ move towards a focus on inflation targeting and away from the movements in the value of the Jamaican dollar in relation to the US dollar, EPOC believes it is important that through education, credibility be built in the inflation measurement as there exists scepticism around the inflation numbers relative to the price movements that Jamaicans feel they experience.

We welcome the movement towards an Independent Central Bank and inflation targeting as the primary monetary policy focus as an important foundation for financial and economic stability.

However, we caution the GOJ that the transition should be carefully managed and supported by appropriate and effective sensitization, communication and education to the financial markets and the general Jamaican population to minimize uncertainty and anxiety.

PROGRAMME RISKS & MITIGATING STRATEGIES

Public Sector Wage Negotiations and the 9 percent Wage to GDP Fiscal Rule (2018/19)

The wage negotiations between the GOJ and the Public Sector workers continue quietly and remain an outstanding item in the new Financial Year 2018-19. EPOC continues to be hopeful that an agreement will be concluded with all the remaining stakeholders, including the Police and Nurses, in keeping with Jamaica's legislated 9 percent wage to GDP Fiscal Rule for 2018-19.

Inflation below targets – 'Fiscal targets at Risk'

EPOC reiterates that a low inflation out-turn can be received as positive, but it does have implications for Programme targets, specifically fiscal targets, including Tax Revenues and those linked to Nominal GDP - such as the Debt to GDP targets and 9 percent Wage to GDP Fiscal Rule (2018/19).

Increasing Current Account Deficit

With the continued increase in Oil and Natural Gas Prices, the Current Account deficit could possibly widen further and, therefore, EPOC will be paying close attention to the Movement in the Non-Borrowed Reserves Quantitative Performance Criteria.