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IMF Concludes 2004 Article IV Consultation with Jamaica

On August 2, 2004, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Jamaica.¹

Background

Following the near crisis in the first half of 2003, the authorities have succeeded over the past year in stabilizing the economy and restoring market confidence. The foreign exchange market stabilized in mid-2003, inflation has decelerated, domestic interest rates have declined, and growth improved, while Jamaica has returned to the international capital market. Although the external environment was favorable, a key contributor to this outcome was the government's renewed fiscal adjustment effort in FY 2003/04. In particular, the increase in the primary fiscal surplus, reflecting both expenditure savings and revenue measures, allowed the budget deficit target to be met despite higher-than-budgeted interest payments.

After more than a decade of virtual stagnation, real GDP growth reached 2 percent in FY 2003/04. The improvement was led by strong performance in the key tourism and mining sectors. The agricultural sector rebounded from the effects of widespread flooding in the previous year, and utility, communication, and financial sectors also turned in good performances. Reflecting the significant exchange rate depreciation in late 2002 and early 2003, as well as the impact of tax measures introduced with the FY 2003/04 budget, 12-month

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

(as well as year-on year) inflation increased to double digits. However, annualized monthly inflation has declined to single digits in recent months.

In FY 2003/04, the government contained the budget deficit in relation to GDP slightly below the preceding year's outturn, despite a much higher interest bill. The primary surplus (excluding privatization-related receipts) increased by 4 percentage points of GDP, to 11 percent of GDP, compared to 7 percent of GDP in FY 2002/03. Revenue increased by about 2 percentage points of GDP, to 30 percent of GDP, reflecting higher receipts from the general consumption tax, personal income tax, and taxes on interest as a result of measures introduced in the FY 2003/04 budget, as well as the imposition of an import surcharge. Primary expenditure declined by 2 percentage points, to 19 percent of GDP, as cuts in nonwage current spending and capital outlays were implemented. While the deficit was initially financed largely from domestic sources, the government was able to secure, towards the end of the fiscal year, foreign currency financing of around US\$450 million. The public debt ratio declined slightly, to 145 percent of GDP.

Monetary policy has continued to rely on open market operations guided by inflation and NIR objectives. Following the sharp increase in interest rates on its open market instruments at the end of FY 2002/03, the Bank of Jamaica (BOJ) has substantially reduced its interest rates to 14–17 percent by June 2004—less than half the March 2003 peak. Nonetheless, given improved confidence, the BOJ succeeded not only in rolling over maturing CDs but also in mopping up additional liquidity, associated mainly with government external borrowing. The resulting contraction in the central bank's NDA contained base money growth at about 11½ percent while providing room for a partial recovery in NIR during FY 2003/04.

Developments in the banking system have reflected improved confidence. Broad money growth exceeded that of nominal GDP, with a significant buildup in foreign assets. Private sector credit, mainly to the tourism and telecommunications sectors, showed strong recovery after a prolonged post-financial crisis slowdown. Bank soundness indicators continued to improve: the percentage of past due loans stands at 3 percent, while provisioning for loan losses, capital adequacy, and profitability remain well above minimum international standards. While deposit dollarization increased somewhat, banks have maintained a roughly balanced foreign exchange position.

The external current account deficit narrowed by 4 percentage points of GDP to 11 percent of GDP in FY 2003/04. Tourism completed its recovery and alumina exports rose in the context of capacity expansion, increased international demand, and better export prices. Agricultural exports experienced a weather-related improvement while reported remittances also rose. Imports declined reflecting currency depreciation and the winding down of investments in the telecommunication sector.

The exchange rate of the Jamaican dollar has continued to be determined in an interbank market that is free of restrictions on current payments, and in the context of an open capital account. The exchange rate has remained around J\$60 per U.S. dollar over the past year, in the context of declining domestic interest rates and broadly unchanged official international reserves. The real effective exchange rate has risen somewhat following the steep depreciation in late 2002/early 2003, but remains well below its range in the six-year period through 2002.

Executive Board Assessment

Executive Directors welcomed the authorities' progress in stabilizing the economy after a near-crisis in the first half of 2003, noting that in the past year, growth has resumed after years of virtual stagnation, inflation has slowed, and interest rates have declined significantly. While the favorable external environment has played a role, the authorities are to be commended for their policy efforts, which reflected their strong commitment to reform and their efforts to secure a broad consensus. These policy efforts included a substantial fiscal adjustment and active use of monetary and exchange rate policies. However, Directors emphasized that formidable challenges still remain because of the very high level of public debt, and the associated vulnerabilities of the economy, exacerbated by the high degree of indexation of the debt to exchange rates and short-term interest rates. Going forward, Directors urged the authorities to continue to secure consensus on the reforms.

Directors supported the priority placed by the authorities on bringing down the public debt-to-GDP ratio. They stressed that prospects for achieving this goal will hinge on steadfast fiscal discipline in conjunction with structural reforms to promote growth. Some Directors cautioned that, even if successfully implemented, the authorities' strategy will still leave the public debt ratio at a level over the medium term that will continue to constitute an important vulnerability to the Jamaican economy.

Directors welcomed the government's efforts to strengthen tax collection and expenditure management, which they viewed as essential for achieving the ambitious deficit reduction target for FY 2004/05. Moreover, achieving the balanced budget target for FY 2005/06 is likely to require additional measures to compensate for the discontinuation of one-off revenue items, as well as possible higher-than-projected interest payments. Directors were encouraged by the authorities' intention to keep the fiscal outlook under review, and urged early identification and prompt implementation of any necessary additional measures to deal with unforeseen contingencies.

Directors noted that the magnitude and duration of the fiscal adjustment envisaged by the authorities is unprecedented, and subject to considerable risks, and emphasized that reform measures to underpin the adjustment will be critical. They urged the authorities to elaborate promptly a comprehensive fiscal reform agenda to strengthen the budgetary outlook, including policies to contain the wage bill and rationalize government employment. In this context, Directors welcomed the recent understandings in these areas reached with the trade unions. At the same time, the social safety net should be strengthened to mitigate the potential impact of adjustment measures on the disadvantaged. Directors welcomed the substantial progress made in modernizing the tax administration in recent years, and encouraged the government to design the forthcoming tax reform in a manner that would help to achieve the balanced budget target, and provide for a stable ratio of tax revenue to GDP over the medium term. In this context, Directors saw the need to reduce exemptions that narrow the consumption tax base, and to eliminate reduced rates and other features that complicate the tax system.

Directors observed that the current level of the exchange rate reflects market forces, and that the exchange rate has remained stable, despite a substantial decline in domestic interest rates. They encouraged the authorities to continue to minimize intervention in the foreign exchange market and to make flexible use of monetary and exchange policies in the period ahead. A few Directors encouraged the authorities to eliminate the multiple currency practice associated with the foreign exchange surrender requirement.

Directors stressed the mutually reinforcing links between achieving greater debt sustainability and higher growth. They noted that while Jamaica has undertaken several important reforms, structural and social weaknesses still discourage private investment and hamper external competitiveness. In this regard, the planned structural reforms in the fiscal area will go a long way in creating an enabling environment for private sector development.

Directors considered that in the financial sector, prudential regulation needs to be reviewed and strengthened, given the system's large exposure to public debt. In particular, the envisaged introduction of prudential requirements for securities dealers would help cushion the large interest rate and liquidity risks in this subsector. Directors welcomed the ongoing preparatory work on legislation to combat money laundering and the financing of terrorism, and the plan to undertake a FSAP in 2005. Directors urged the authorities to develop options for reducing rigidities in the labor market, particularly high redundancy costs, and they supported the government's planned initiatives to improve the education system, and ongoing efforts to fight crime.

Directors endorsed the authorities' request for intensified surveillance of the Jamaican economy and of progress in implementing their economic strategy. In this regard, they looked forward to the semi-annual interim reports for information of the Executive Board between Article IV consultations. Directors considered that the usefulness of intensified surveillance would be enhanced by the authorities' firm commitment to and ownership of the economic program, supported by full communication of the program and its objectives to the public, aimed at building consensus.

Directors noted that while the statistical information provided by Jamaica is broadly adequate for surveillance purposes, there remains scope for further strengthening the statistical system. They encouraged the government to commit to a plan to subscribe to the SDDS within a defined timeframe.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The Staff Report for the 2004 Article IV Consultation with Jamaica is also available.

Jamaica: Selected Economic Indicators 1/

	1998/99	1999/00	2000/01	2001/02	2002/03	Prel. 2003/04
	(Annual percentage changes)					
GDP, prices, and employment						
Real GDP	-0.6	1.1	0.8	1.0	1.9	2.0
Nominal GDP	7.5	8.1	11.6	9.5	10.0	16.6
Consumer price index (end of period)	6.0	8.4	6.4	7.6	6.2	16.8
Consumer price index (average)	8.1	6.3	7.7	8.0	6.5	12.9
Exchange rate (end of period, in J\$/US\$)	4.9	10.6	8.3	4.0	18.2	8.1
End-of-period REER (percent change, depreciation +)	-1.6	4.0	0.2	-3.9	14.3	-4.2
Unemployment rate (in percent)	15.5	15.7	15.5	14.8	15.4	12.8
	(In percent of GDP, unless otherwise indicated)					
Government operations						
Budgetary revenue	25.8	29.1	29.1	27.0	28.1	29.9
Budgetary expenditure	37.7	37.1	33.6	32.6	35.7	36.9
<i>Of which:</i> interest payments	17.3	17.5	16.0	13.4	14.9	18.1
Budget balance	-11.9	-8.1	-4.5	-5.6	-7.6	-7.0
<i>Of which:</i> primary fiscal balance	5.4	9.4	11.5	7.8	7.3	11.1
Off-budget expenditure	...	0.5	0.3	0.5	3.2	1.9
Overall fiscal balance	-11.9	-8.6	-4.8	-6.1	-10.8	-8.9
Public debt	116.5	132.5	132.0	132.1	146.4	144.8
External sector						
Current account balance	-2.0	-3.3	-4.8	-9.6	-14.9	-10.6
<i>Of which:</i> exports of goods, f.o.b.	20.0	19.9	20.5	17.8	15.6	17.3
<i>Of which:</i> imports of goods, f.o.b.	34.3	35.3	38.2	37.6	39.8	40.3
Net international reserves (in millions of US\$)	582	704	1,286	1,942	1,340	1,569
	(Changes in percent of beginning of period broad money)					
Money and credit						
Net foreign assets	2.6	12.5	23.0	24.3	-8.1	9.0
Net domestic assets	8.2	6.8	3.4	-14.3	15.6	11.3
<i>Of which:</i> credit to the central government	-0.2	-9.5	26.6	71.2	8.2	9.0
Broad money	10.8	19.3	9.2	10.0	7.5	20.2
Interest rate (180 day BoJ CD rate, end of period, in percent per annum)	22.0	18.6	16.9	13.8	33.5	16.0
Velocity (ratio of GDP to broad money)	2.7	2.4	2.4	2.6	2.7	2.6
Memorandum items:						
Nominal GDP (in billions of Jamaica dollars)	287.4	310.8	346.8	379.8	417.7	486.9
Exchange rate (end of period, J\$/US\$)	38.1	42.2	45.7	47.6	56.2	60.8

Sources: Jamaican authorities; and IMF staff estimates.

1/ Fiscal years run from April 1 to March 31.