management and good financial governance and the importance of the role of the board and shareholders and management in this. I spoke earlier of our various initiatives to enhance and strenghten the fit and proper criteria under the banking law. We have also at the

Central Bank issued corporate loan and standard of best practice which focus on proper control that must be in place to ensure that there are appropriate checks on balances for the various operations that take place in an institution. So for instance we have issued corporate governance standards in terms of credit, liquidity management, asset liability management, foreign exchange operation, a whole host of things which are detailed in the Fuller report. We have also issued an overall standard of governance and I think in our assessment most of these are -- the compliance to these have certainly increased over the years. The Central Bank has also taken the, took the decision several years

ago to increase the frequency of meeting that it has with the licensees and specifically with the boards of
directors and senior management of these licensee. We have always operated on the basis that certain at the end of a specific examination we would have met with senior management to go through the various issues and concerns that arose as a result of the examination and to point out the various areas of weakness in which they needed to take action. A determination was made several years ago and we have been acting on this consistently over these past few years to not only meet with senior management but also with the boards of directors, because boards do have significant responsibility, it is their responsibility to ensure the proper and prudent running of the bank and to ensure that the banks are run on the basis of policies and approved and signed off by them and so we have sought to meet with boards and this is done

very regularly, sometimes more than once a year depending on the situation that may be existing in the particular entity at the time. We have and you know I would also say Chair, that while we thought that we might have been at the end of the curve on this one our interaction with several other supervisory jurisdictions overseas has shown that this is not a common occurrence in several jurisdictions and in fact, again as a result of the financial crisis that erupted last year. We have now seen a trend where several major jurisdiction are now putting this type of thing in place. I feel that we have been a leader in some areas and it is something that we certainly intend to build on. We have been placing special emphases on improving risk management and the internal audit and control functions within these entities. In terms of training for the industry, BCJ has sought to ensure that the industry receives training as it relates to new regulatory requirement that are imposed on the institutions and their management and this has included seminars on areas such as anti-money laundering which is a newer area though not really very new and on the countering of terrorism financing as well as risk management and of course customary training in relation to any new procedures or reporting formats that we introduce for our entities. Another key challenge that would have arisen during the crisis would have been the fact that financial difficulties in several instances spanned different types of financial entities with different regulators working with differing regulatory frameworks which also had different levels of robustness and which therefore facilitated regulatory arbiters which I referred to much earlier. We saw that the issue of regulatory arbiters taking place certainly in the insurance groups and we also saw the incapacitated drain on the resources of the related banking

entities which were forced to provide liquidity and fund policy encashments of the problem insurance industry, companies. The core difficulty was that the banking supervisory as I said
earlier were unable to get a clear view of the financial conditions of the insurance arms and in a lot of instances the corporate structure of the group was so convoluted that we had to come to a determination that it was purposely done to make it opaque and not easily manoeuvred by the regulatory agencies and so we have made recommendations for significant amendments to regulations to allow us to have greater control over financial groups, conglomerate and in fact our laws currently give us some level of access, but we feel that there is -- and we do have some level of access in terms of requiring separation of banking financial entities from the real sector parts of these groups because in our government instances you had what is termed a mixed conglomerate

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here for instance you would have several financial entities in the group but you would also have groups involved in real sector activities, commercial activities, distribution whatever. And so we took a determination that the risk associated from those real sector activities were detrimental -- could very well detrimental to the financial entities and we saw instances where there was contagion between the two, from the real sector ones to the financial entities and so we now have authority to require the separation of groups so that a financial group can now only have in it, can only have financial entities in it and we now have some level of access to the parent company of that group.

MR. HYLTON: Before you leave that point Miss Anderson among the financial entities as you noted the bank doesn't regulate all financial entities.

MRS. ANDERSON: No, we don't.

MR. HYLTON: Would you want to say anything about c

oordination and information sharing between regulatory entities?

MRS. ANDERSON: Yes. In addition to the legal access that we have now including provisions in our banking statutes, we also have a much better coordination, formal coordination between the regulatory agencies and here I speak of The Financial Services Commission which is mandated to regulate and oversee the operations of security dealers, insurance companies and pension funds and what we now have is a memorandum of understanding that we signed in 2000, which was signed by BOJ, The FSC, The JDIC, which is Jamaica Deposit Insurance Corporation and the Financial Secretary of The Ministry of Finance and The Solicitor General and the MOU actually established the Financial Regulatory Council on which all of these signatories sit and the basic objective of the Financial Regulatory Council or the FRC, is to coordinate the regulatory policy for the entire financial system.

It might not be the best approach to ensuring that everyone is operating on similar bases but I think it has gone a far way in ensuring that there is formal coordination, discussion, cooperation between the regulatory agencies which didn't exist before and certainly because the groups are so composed with entities that fall under both of our jurisdiction it serves a very useful purpose in ensuring that all the regulatory agencies know exactly what is happening throughout all of the entities within the groups and that in instances where decision needs to be taken that we can at least attempt to make decisions that approach a coordinated approach to dealing with the problem. Certainly we have seen that where the Bank of Jamaica already had fairly well established standards, say for instance, in the case of our fit and proper criteria, these criteria have now been adopted by the Financial Services Commission and we have sought to assist in terms of our buildup of experience and expertise in matters *to* do with capital adequacy and all manner of things. So we meet on a very regular basis both officially and unofficially, we have communication and

information sharing and in addition to *that* Financial Regulatory Council that operates within Jamaica, we have also seen the growth over the years of regional banking conglomerate, or regional financial conglomerate which span several Caribbean jurisdiction and so we have also sought to have a similar MOU between ourselves and all of the Central Banks and monetary authorities in the Caribbean where our bank have a presence. As you know there are several large regional banking groups now. We have the Bank of Nova Scotia, we have RBTT, we have First Caribbean, we have First Global all of which have representation across the Caribbean and the operations of any of these entities can impact the operations of one in any of the jurisdiction and if there is a problem arising there could also be contagion. There is also the issue of regional supervisory arbiters because we have found that in some instances the regulatory requirement in one jurisdiction may be much stronger or much more stringent than in other jurisdictions and so we have an ongoing initiative to try to coordinate as best as possible and come to a common agreement as to requirements in terms of capital, requirements in terms of provisioning fit and proper requirements, all of the fundamental things that could significantly impact the condition of our financial entities. We are currently also working on a regional crisis prevention plan that was requested by the regional Caricom governance. This is an offshoot of the regional MOU and I should also indicate that we have a very strong Caribbean regulatory group which is a combination of the regulatory of all of these jurisdictions which undertake training p

rograms on an annual basis for our supervisory personnel to ensure that our examiners at all level are properly equipped with the technical expertize and knowledge that they need to be at the cutting edge and to discharge their functions effectively.

MR. HYLTON: Are there any statutory initiatives that you wish to have?

MRS. ANDERSON: Yes, there are some statutory initiative. We have some years ago recommended the passage of an omnibus statute, currently we oversee three main statutes, the banking financial institution and the Building Society Regulations and our recommendation was that we basically merge all of these to ensure that we have one omnibus statute and it would also, that action would also seek to remove any remaining regulatory gaps that exist between the three entities and in that regard I would have to say that in terms of our building societies, building societies do not currently operate under all of the different transaction limit that are applicable to licensees under the Banking Act or Financial Institution Act and as I said this omnibus statue would ensure everyone is operating on basically the same basis, but it would also recognize inherent differences in the types of operation.

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ovember 10, 2009

2:07 p.m.

COMMISSIONER: Ladies and gentlemen, let us resume. Mrs. Anderson, you are still on your oath. Mr. Nelson, were you able to get your questions structured and handed out?

MR. NELSON: Yes, I had words with two of my friends, Mr. Hylton and Mr. Braham, sir. And based upon the procedure which we agreed on; I didn't have my Secretary here to type but I have copied some questions which I would like to ask.

COMMISSIONER: Do I understand that she will be able to get the answers to -- I thought the idea was to allow her to go and -- I didn't know you are saying you didn't have them.

MR. NELSON: Well, I could...

COMMISSIONER: You would like to go to the office and get people to find these things?

MR. NELSON: Yes, I could through you request that...

COMMISSIONER: Well, that's what I was suggesting all the time. You get them out and I had.

asked her -- she said she would answer that.

MR. NELSON: Very well.

COMMISSIONER: So all you need to do if you could get it to her counsel. If you want to pass it through us no problem.

MR. NELSON: Yes.

COMMISSIONER: Yes, sir.

MR. NELSON: What I will do I will pass them to Mr. Hylton and he will pass them on to her and since...

COMMISSIONER: Have you got any other question you would wish to put at this time?

MR. NELSON: No sir, I will just put everything in writing and she will respond in writing.

COMMISSIONER: No, I thought perhaps you may have had another area of enquiry you wish to pursue, I don't know.

MR. NELSON: I see. Yes, sir. Well, there is another area which is different, two others.

COMMISSIONER: Perhaps you would want to pursue.

MR. NELSON: Yes. The regulatory body or a section in the Bank of Jamaica, as part of its system of monitoring and controlling the commercial banks, requires that they p

lace with the Bank of Jamaica, sufficient funds to cover large suits as one hundred million dollars in the event that money has to be paid out at a later date. Am I correct?

MRS. ANDERSON: No, you are totally incorrect.

MR. NELSON: Not correct?

MRS. ANDERSON: Not at all correct.

MR. NELSON: I see. Well, let me just ask in relation to that point. In relation to Workers Bank whether in the 1990s, you recall if they placed moneys with Bank of Jamaica to cover pending lawsuits...

COMMISSIONER: Excuse me. Will you project your voice so that the Recorder can hear what you are asking?

MR. NELSON: Whether in the 1990s Workers Bank placed moneys with the Bank of Jamaica to cover pending lawsuits in the Supreme Court?

MRS. ANDERSON: No, Workers Bank never during its lifetime placed any funds with the Central Bank to reconever any lawsuits of any kind. And in fact, it is my knowledge that no commercial bank has ever placed funds with Central Bank.

Q: I see. So any such information is erroneous?

COMMISSIONER: Well...

MR. NELSON: I am just trying to make sure, sir.

COMMISSIONER: Well, her opinion is good as anybody else's.

MR. NELSON: The rest I will put in writing. May it please you.

COMMISSIONER: The Commission as such through its Secretary would like a copy of your questions.

MR. NELSON: Sure, sir.

COMMISSIONER: So we would like to see that it gets in the hands of our Secretary so that it forms part of our proceedings' record.

MR. HYLTON: And of course sir, I also take it that my friend intends to do that today. Just for the record.

COMMISSIONER: Well, maybe I should get a specific answer. This is being done now with all deliberate speed. When are you get going to get this to the Bank, to the Governor?

MR. NELSON: I will give it to my friend Mr. Hylton. You say this was not all the questions?

MR. NELSON: No. But there are few more questions which I will add.

COMMISSIONER: I take you won't be given any installments, you know.

MR. NELSON: No, no, you will have them by tomorrow.

MR. HYLTON: That is exactly what I was concerned about sir. My friend just said I will get them by tomorrow. If I get them tomorrow he will not get the answers by tomorrow,can't. So that's the difficulty.

COMMISSIONER: What's the difficulty, Mr. Nelson?

MR. NELSON: There is no difficulty, Mr. Chairman.

COMMISSIONER: It's now just about after lunch I take it you were in a quick move to get all these things done properly, quickly, urgently?

MR. NELSON: I wrote out a number of questions, took them into the office, got copies for the panel which I also have and which I can pass to you, sir.

COMMISSIONER: The point is this. If you are going to ask questions other than the ones which you have put in writing, the responses can certainly not be given tomorrow. And we don't want to keep on putting things off and off.

MR. NELSON: Very well. I can get them to my friend by G-mail; email.

COMMISSIONER: You are living in a modern world, you have email, you don't need to carry a pigeon at this time and age.

MR. NELSON: I wonder if I could be assisted with a stapler?

COMMISSIONER: With a what?

MR. NELSON: With a stapler, sir.

COMMISSIONER: Oh heavens!

MR. NELSON: But I will pass this up to you.

COMMISSIONER: You want us to adjourn Mister, while you put your house in order; until you find a stapler? If you just reverse you will find the office of this Commission quite close and I believe we have a stapler they can lend you.

MR. NELSON: Yes. Very well, sir.

COMMISSIONER: Yes. Is that it?

MR. NELSON: Yes that is it, sir.

COMMISSIONER: For now?

MR. NELSON: For now. Thank you.

COMMISSIONER: Thank you. Any other counsel who is eager to put questions? No?

(Chairman confers with panel)

COMMISSIONER: All right, while we are here having this silent seminar. What is the way forward? I take it we will have to stand down this witness.

MR. HYLTON: One of the things sir, that I was considering depending on the questions were whether Mrs. Anderson needs to be the person to answer them because from the questions I am seeing so far it doesn't need to be Mrs. Anderson. And I certainly sir, would prefer if another witness from the Bank because -- at the present time there are a number of things that if Mrs. Anderson personally...

COMMISSIONER: It doesn't matter to the Commission who gives the evidence so long as there is somebody coming to give the evidence. We aren't insisting but I think you should wait until Mr. Nelson gets back here.

MR. HYLTON: But for the time being then sir, perhaps we could stand down then as you just said which is to return to the other witness.

COMMISSIONER: And we could have asked the other witness to come forward.

MR. HYLTON: Yes.

COMMISSIONER: What's her name, Mrs. Halsall?

(Witness sworn 2:10)

COMMISSIONER: Thank you very much for making yourself available.

(EXAMINED BY MR. HYLTON)

MR. HYLTON: Your full name?

A: Mrytle Halsall.

Q: And your position at the Bank of Jamaica?

A: Deputy Governor in charge of Research and Economic Programming and Banking and...

COMMISSIONER: Sorry, can you arrange this microphone so that it is set up for useful purpose?

(PAUSE)

MR. HYLTON: Mr. Chairman, before I continue.

COMMISSIONER: Yes.

MR. HYLTON: I just raised with Mr. Nelson an issue that I wish to draw your attention to.

COMMISSIONER: Yes.

MR. HYLTON: Yes, sir. If another person at the Bank could come to give the answers, he says he has no objection.

MR. NELSON: I have no objection, sir. But my only fear is that this witness has just told me that the Workers Bank has never lodged any money...

COMMISSIONER: You can ask that question again.

MR. NELSON: Beg you pardon?

COMMISSIONER: You can ask that again. You can ask the question again.

MR. NELSON: Yes, but it would be of the other person not...

MR. HYLTON: And I say sure it would be a senior officer. It would be a senior officer, you are not getting a junior officer to come here.

MR. HYLTON: Yes, Mrs...

MRS. HALSALL: I am Deputy Governor in charge of Research and Economic programming as well as the Banking and Market Operations Division.

Q: And Research and Economic Programming would include?

A: Would include the design of monetary policy of the country's economic program; design of policy meaning monetary and economic development et cetera.

Q: And how long have you been with the bank?

A: Just over 30 years.

Q: That's a common figure.

COMMISSIONER: Sorry, 13?

A: 30, 3-0.

COMMISSIONER: I know.

MR. HYLTON: In the mid-1990s could you indicate what position you had in the Bank?

A: I was the Senior Director for Economic Policy and Programming Department, sub-division rather, which involves the Monetary Policy Department, the physical and economic program monitoring as well as balance of payment analysis; subsequently promoted to Division Chief with additional responsibilities for economic research as well as economic statistics.

Q: But throughout the period you were in that division?

A: Yes.

Q: At various levels?

A: Yes.
Q: Now you are familiar with the questions that this commission...

COMMISSIONER: You would be concerned, would you Mrs. Halsall, with interest rates and that sort of thing?

A: Yes.

Q: Thank you.

MR. HYLTON: You are familiar with the questions that the Commission asked of the bank?

A: Yes.

Q: Mr. Chairman I am going to take the witness to question 14.

COMMISSIONER: That's page what?

MR. GRAHAM: 32.

COMMISSIONER: 32, thank you.

COMMISSIONER: Yes, Mr. Hylton.

MR. HYLTON: The question asked.
"The view in the public domain is that the collapse of the financial institutions was due to high interest rates in the 90s". How would you respond to that?

A: I would say this. It is not true that

the collapse of the financial institutions was due to a high interest rate policies. All institutions at that time operated within the same regime facing similar interest rates and the institutions that collapsed were
affected by a confluence of factors most of which were micro-economic in nature. And these include -- we can looking at poor institutional management practices and excessive risk taking. We look at persons who took advantage of some the recently liberalised environment without putting in the relevant risk management practices. Here 1 think was mentioned this morning connective party loans without proper collaterization. We spoke of not providing for non-performing and proper non-provision for non-performing loans; managerial inadequacies and so on. The responsible investors who were noting these practices would have withdrew their savings from these institutions to proceed to stronger institutions. And I must say that during

the period we had little or no capital flight, what we had was flight to quality from the perceived weak institutions to, who had that poor practice to the strong institutions.

Q: On this issue of high interest rates could you tell us a little Mrs. Halsall, about how interest rates are determined?

A: The Bank has a Monetary Policy Report which is done every quarter and in the 2003 December issue we did a full examination of the determinants of interest rates that is -- we have provided an excerpt.

A: Mr. Chairman she is going to speak to a document on the Bank that explains interest rates; and perhaps it might be useful if I pass copies. I have five copies sir, that you can distribute as you go along. (Copies handed to heads at that table)

MR. HYLTON: May I proceed sir?

COMMISSIONER: Very well.

Q: Could you take us through, Mrs. Halsall?

A: Generally interest rates in the economy

largely reflect the bond market, that is the market that deals with securities; trading of securities and these rates vary with several factors some of which are micro-economic in nature and some are influenced by macro-economic factors. The bond market - the
influence of the bond market is condition on private sector and their demands for funds; the public sector demand as well as the Central Bank's conduct in terms of meeting its overall objective which is the price stability and how we manage the markets. So these are the main factors influenced by both public sector, private sector demand as well as Central Bank's operation. These are the main influences of aggregate demand and interest rates. If I go to the three; the private sector when the private sector demands funds in general depending on the state of liquidity in the market. If there is high liquidity in the market then they will pay low interest rate for it. If the liquidity

is low then -- I said interest rate is a price so if the liquidity is low, there is not enough funds in the system then persons who have the funds will demand the higher price for it. Similarly with government. When government enters the market to offer securities for sale because they need funds for the budget depending on the state of liquidity to market as well as the amount that they are demanding interest rates can vary. If the liquidity is high as I said before, then the interest rate will be low. If liquidity is low then the issue of -- investors of their funds will be demanding high interest rates.

With respect to the Central Bank. The Central Bank's role is to manage aggregate demand; manage the demand for funds and supply of funds in order to meet its objective which is price stability and we will get to that later. So the Central Bank tries to control the level of liquidity in the system such that the price is determined, that is how interest rate is determined. A lot of factors influence price that the Central Bank will face. One of the factors is inflation expectation. If a borrower expects that inflation in the future is going to be high then they would want to add premium to the interest rate to ensure that they are not losing in the future. So if we are in a high inflation...

The borrower?

Not the borrower, the lender, sorry. The

MR. HYLTON: lender will demand higher interest rate. So

A: inflation expectation plays a significant role in determining the interest rates. That is how the length of perceived future inflation. When there is significant demand, pressure in market say for example both the private and public sector is demanding funds at the same time and you have limited resources then they are going to have to compete for the funds and interest rates will also go up. So these are some of the domestic factors in terms of managing the liquidity system with response to liquidity in the system; that is, how much resources are in the system to go between the two institutions. Another issue relates to our balance of payments. We know that Jamaica's balance of payment -- Jamaica is running a balance of payment deficit for quite some time. When you run a balance of payment deficit it means both public sector and private sector savings or probably the savings in excess of the private sector savings or vice versa and then we end up a with a balance of payment deficit. Therefore in order to meet the demands of satisfying or financing that deficit, we either have to borrow or run down our reserve,our net-international reserves. That's the NIR, as more people know it. So in order to counter some of that the Central Bank would need to try to regulate the -- try to control the demand for funds to ensure that the demand does not exceed the supply of external resources. If the interest rate isn't on,the domestic instruments are not attractive enough, you will find that the investors would want to put their money in foreign currency probably just as a precautionary level as they see it and you will have -- in the case where we have a current account deficit you would end up with significant bouts of depreciation. In order to control that depreciation you would need to ensure that persons want to; ensure that the investors get back into Jamaican dollars and the only way to do do that again is the price which would be the interest rate. So the state of the balance of payment is also very critical to the interest rate determination.

Another thing that impacts price is country-risk, how probably external persons as well as local persons perceive the risk of the country. I mean nowadays people rely a lot on S&Ts and Moodies and Pitch and those things to sort of indicate the level of a country's risk. And persons are also going to price in that risk the rate at which they are willing to lend. So these are just some of the macro-economic factors. I say just in conclusion, there are macro-economic factors, that is, inflation expectation; the rate of say government and private sector; the demand of the economy and how the Central Bank fulfills its role in maintaining low and stable inflation. And I say interest rate is one of the two that the Central Bank uses in trying to maintain the price bringing inflation down.

MR. HYLTON: Thank you Mrs. Halsall. In a moment we will come to the specific case of the 1990s and the reasons there. But before that the next question posits another view that has been expressed and invites your comment. Another view expressed is that the monetary policy of the Bank of

Jamaica in the 1990s did not meet its objectives, instead it causes increase in interest charges and penalties which could not be met by a borrower and resulted in the collapse of the financial institutions and the various sectors. Does the Bank agree with this view and if not, what reasons can the Bank advance and disadvantages. A number of questions.

A: Yes.

COMMISSIONER: Start at the top.

A: Monetary Policy did not meet the objective. I will tell you why this is not true in terms of -- first of all you need to define what the objective is. The objective of monetary policy is to engender in the 1990s and is now -- to engender price stability. That is the objective for monetary policy. In the 1990s the specific objective was to engender a sharp dissileration in inflation. At the end of 1991 inflation was 80 percent and as Mrs. Anderson said peaked at one time to 102 in April 1992.

So the monetary policy of the Bank was geared at bringing that inflation down from the high of 102 two in April 1992 where it reached by the end of the '90s -- and it would have been indicated in Table six; by 1998 it would have reached about 8 percent. So we started... Just hold a second.

Mr. chairman could I refer you to page 41 of

Q: the full Report? It's there in Table 5 on to table 6. Could you take us through; indicate what row or column you are referring to?

Row number 2: "Inflation point to point".

And point to point means?

A: For the full year. The full calendar. year. Inflation for the full calendar year. So in

Q: 1990 it was 29.8 to 80.2 in 1991 to 40.2 at

A: the end of 1992 but as I tell you before it reached 102 in April of that year and so on. 30.1 in '93 until it reached 7.9 in 1998. So our monetary policy was geared at bringing the, -- taming the inflation animal, bringing it down from those high numbers in single digits.

Q: Would you say that was successful?

A: Well, I would say it was. Bringing inflation from a high level is not something that can be done *over* night. If you do it in a drastic way then interest rates would have had to be higher, we would have had to do several more things. And one of the constraints that we had at the time was, the limited tools that we had to use. The tools that we had in monetary policy was moral suasion. The reserve requirement; that's cash reserves and liquid assets and interest rates. There are not many tools that we have in trying to bring inflation under control. Those were the ones that were used at the time. subsequently now that we have higher levels of reserves we are able to sell foreign exchange in the market and so on. But at that time we had negative reserves; negative net international reserves. So the only three tools that we had at the time were as I said, interest rate; cash reserve and liquid assets. So virement and moral suasion. And with the liquid assets and cash reserves requirement I think we used that to its maximum. At one point liquid asset was as high as 50 percent; the liquid asset was as high as 50%. So the Central Bank had to then go to it's only other two and that is interest rate. With little or no reserves and the demand for foreign exchange being very strong and that point we had the liberalisation of the foreign exchange market. So it's not that you had price exchange control so everybody could buy, go and take foreign exchange out of the country et cetera, invest abroad. And at that time as I said before the balance of payment we had a deficit. So it's not like the country was earning a lot of money so whatever you demanded you could get. So in order to control -- try to create the demand for the foreign exchange with the supply of foreign exchange again, it's a price. And so, we tried to ensure that persons rather than trying to invest abroad invest locally where you could use your Jamaican dollars. And therefore in order for that to happen again,it's a price and it would be the price demanded by the private sector which would be in the making. As I mentioned the liberalisation -- the Bank was very challenged in the period. As I said, just after the liberalisation, with no reserves, the demand for foreign exchange, interest rates were high. The cash reserves were also high but the only other -- as I said the only tools that we have were the interest rates. The Banks had to ensure that...

COMMISSIONER: Sorry, cash reserves were?

A: The cash reserves?

COMMISSIONER: Yes.

A: It reached as high as 25 percent.

COMMISSIONER: I see. When was that?

A: I don't remember the exact date. I could look that up. I know the...

MR. HYLTON: The cash reserves reached 25 percent?

A: Yes, it had reached as high as 25 percent. I could get that information. I think it probably could have been the time that...

COMMISSIONER: So when the Bank had to deposit 25 percent they had -- three-quarters was left to do everything else?

A: Right.

Q: Run the bank; lend money; whatenever?

A: I didn't...

Q: What was left is what the bank used to manage its affairs?

A: Yes. As I said the purpose of it was to control the level of demand in the economy to be able to match it with the supply of the funds that were available in the economy. Because if you have too much demand with too little resources it can cause high inflation and depreciation in the exchange rate, et cetera.

A: So I said after we had applied all the moral suasion...

COMMISSIONER: Moral suasion is poetry?

A: Yes, I mean it's just trying to...

COMMISSIONER: Sorry. You read some poetry to the Bank? Because I mean what you are doing you are preaching a sermon.

COMMISSIONER: It worked?.

A: Not then. I mean we have seen -- yeah, it does work sometimes. I mean the credibility of the Central Bank has been built up overtime and I suppose then they may not have believed you so you have to build your credibility to such an extent that when you speak people will respond and believe you. So at that time with all of what was going on in the economy; very little growth, depreciation taking place; inflation high, the institutions are not going to be as confident in you as they do now.

COMMISSIONER: I always wonder about the moral suasion thing. The Central Bank has morning breakfast and things like that?

A: No. We have regular meetings with the bankers. We have regular meetings with the institutions.

COMMISSIONER: They agree with you and go do the same thing?

A: No, they always...

COMMISSIONER: The reason why I am saying so is because having read all this mass of stuff we have here, I can't see where I must confess I can't see the impact.

A: That is why we can't rely on it. I mean it is there as a tool and in that country where there is very strong confidence it will work.

MR. HYLTON: And of course, Mr. Chairman the question relates to the failed institutions.

COMMISSIONER: Yes.

MR. HYLTON: Not to those stuff.

COMMISSIONER: It's quite a few that didn't succeed.

MR. ROSS: Could I just ask regarding that same table, what in fact is behind the high rate of growth of M2 during that period and what was done to restrain that?

A: I would have to look at -- well I think it would be a result of credit growth. If you look at the 7th line; Private Sector Credit, you will see significant growth in private sector credit which would be the main driver of the growth in money.

Tuesday, November 10, 2009

2:37 p.m.

MISS HALSALL: Well I think it would be a result of credit note, to look at the 7th line, private sector credit. You will see a significant growth in private sector credit which would be the main driver of the growth in money.

MR. HYLTON: I wonder through you Mr. Chairman, could you explain what M2 growth means?

A It is the total demand savings and time deposits and currency in circulation in the Commercial Banks, in the banking system.

Q And what is M l ?

A M' is just demand deposits and currency.

MR. ROSS: I must say looking at the numbers here that in fact M2 was really what might be driving the growth in credit it is just the numbers on the table here in the early part of the `90's.

A But money growth is a result of, not a cause, so I

I am not saying that credit is the only thing, but one of the major thing driving money at that time was increase credit.

Q: Could it also be a national reserve?

A The reserves?

Q Provision of reserves for the Central Bank.

A If you look at the NIR at that time we moved from negative 47.8 to negative 44.2 we are looking at the 1991.

Q Negative 43 to negative 67?

A But that is 91 to 92 .

MR. HYLTON: The table there doesn't have 91 to 92.

A Oh sorry.

COMMISSIONER: I have the chart from 1990.

MR. HYLTON Yes. And it is identical to the previous chart?

A Except for the 1990 and it is also as the rate of exchange movement, we had just the actual exchange rate, the second to last line is added which shows the rate of change, rate of depreciation in the second to last line.

MR. ROSS: So it has one column 1990 and it has one row?

A In 1992 we did have a significant private capital inflows right, which would have helped to increase the NIR from minus 443 to minus 67 and that in itself would also - those that came from the private sector would also influence the amount of domestic savings, deposit so it would have a impact on money supply in that area. And you would also be looking at three tools that you were using, you have the interest rate, you have the liquid asset requirement as well?

Yes.

MR. BOGLE: And also the deposit reserve. So the liquid asset requirement...

A Liquid Asset and cash reserve, cash reserve is a subset of the liquid asset.

Q So therefore this we are looking at 50% that at one point the banks had to adhere to 50%.

A Well 25% is in cash but the other 25 percentage points would be held in mainly in short term

Q

A

securities, mainly government securities, cash in their vaults and other securities that were short term and less than 9 months to maturity . So you had the investment securities that could qualify as liquid asset.

Q But would be subject to quite a bit of smaller interest rate than what was in the market?

A No, it would be market instrument, most of which were government securities so it would be market instrument.

COMMISSIONER: This doesn't show the cash reserve.

A No, it is not there.

COMMISSIONER: Where would one find that?

A It is in the narrative, not on a table, page 42 somewhere in the middle, first paragraph fourth line, liquid assets requirement at the time 50% that was 1994. It was increased prior to that that information I will have to - I can get that information in terms of the series from 1990.

MR. HYLTON: What period?

MR. HENRIQUES: It is the same year right across.

MR. HYLTON: The question you were addressing Mrs Halsall is the question 15 as to whether the policy met its objective and so on. Is there anything else you wanted to say on that?

A No, I mean I pointed out that the objective was price related and gradually between 1991 to 1998 that objective was achieved, it moved from 80% in 1991 to 7.9 % in 1998 which I think was quite successful given the macro-economic conditions we were working under. The start of the period, we had negative, large negative reserves, we had very little growth. We had high inflation, high inflationary expectation which is one of the hardest thing to get people, to change people's outlook. Because inflation expectation is not something that you can dictate, persons have to believe in your policies and have confidence in you that you will deliver down the road a lower level of inflation. So this is one of the things that we had to ensure and through the limited tools that we had we did our best and I think we were, we can say I think we were successful. Half, I mean not everybody will -- in trying to bring inflationary limited expectation without doing that one would have to look at the all alternative of what would happen. In a liberalised environment if you allow people just to demand foreign exchange there might significantly more demand than were available. The dollar would depreciate and what would happen people would demand higher interest rate to compensate for the devaluation of the currency et cetera. So the bank had to take the decision to, at that point increase the interest rate to try and subsequently bring it down as indicated in the information that we had, the bank rate, the banks interest rate came down gradually.

Could you give us some idea of the other tools that you would have liked to add or would

MR. ROSS:

normally be available in the macro economy to deal with inflation in particular?

A Well another - if in a, as I said before one of the determinants is the level of demand and I would say if government were running significant surpluses then that would also assist in - depending on the interest rate or balancing, but if you are running significantly strong surpluses and we are talking about 5 to 10% surpluses then that would assist. But the tools that we had were just those. Now we had foreign exchange, then instead of trying to curb the demand for foreign exchange by reducing interest rates you could do as usual to sell foreign exchange in the market. So the tools of monetary policy are not very many.

COMMISSIONER: Having regard to a terms of reference I am wondering whether it is appropriate at this stage to ask questions along these lines. When other countries let's take our Caribbean neighbours

contrast to the Jamaican situation with our

Caribbean neighbours I don't know if they had a Commission of Enquiry I don't know, I don't know if they had a meltdown or what, I never heard of it, but what made Jamaica in that sense unique in the Caribbean? Because the terms of reference say we must compare ourselves with what happen in other jurisdiction. So what is the contrast? Was there a contrast? Was there a difference? I want to presume the answer.

MR. HYLTON: I suspect sir that to the extent that Mrs. Anderson had indicated to the various factors that led to our situation .

COMMISSIONER: Mrs Anderson can....

MR. HYLTON: Yes, I think I can summarise what has been said so far. That to the extent that those factors were not present in our neighbours that might be part of the answer but....

COMMISSIONER: I don't recall our trying to see what is the comparison with our jurisdiction was, I can't recall that, that is why I was asking Mrs. Halsall since she is the expert in this kind of thing.

A I would have to just go from memory because I did not come prepared to answer a comparative question.

COMMISSIONER: I should warn the persons who are coming from the bank that although we ask specific questions there are going to be questions arise out of those.

A In relation to Jamaica but I didn't think I had to go outside of Jamaica.

COMMISSIONER: But I was hoping that you would have got the terms of reference and see how expansive we are, or rather not how we are, how we are required to be. We are to go the world we are suppose to not just looking around Jamaica. We are going to in the context of Jamaica's economic circumstances and in comparison to the intervention by the states in other countries which have had similar experiences, and that is only one little subset.

MR. HYLTON: Your question was a little wider than ....

COMMISSIONER: It may be but I don't think it is out of context.

MR. HYLTON: Can I say sir that to the extent that we will need to return tomorrow could I answer that question tomorrow.

COMMISSIONER: Certainly. All that we need is to get the answers. When we get it it is not as important to us so long as we get it. Thank you.

MR. HYLTON: If I may proceed let's go to question 16 which raises another view to which your comment directed. Still another view is that the increase in fiscal expenditure nullifies any impact that the BOJ's monetary policy may have had. Does the BOJ agree with this view, and if not, what reason can BOJ advance for disagreeing with same?

A Well up to the period of the collapse of the financial institution the published data by the Ministry of Finance shows that the revenue inflows out performed expenditure so that they were running a surplus. Not massive surplus but surpluses and they would have instituted new taxes, at the time they introduced the GCT so that their revenues were significantly moved by that.

COMMISSIONER: During the time we had surpluses?

A Yes.

COMMISSIONER: In Jamaica?

A Yes. As I said we go by the published information from the Ministry of Finance.

MR. HYLTON: Perhaps we should go ahead and add though what appears to cause that.

A As I said at the time the 1991, 91192 they introduced a new tax that is the General Consumption Tax and the compliance rate for General Consumption Tax at the time was very high I think it was about probably about 80%.

MR. BOGLE: When was G CT?

A `91. In the 91/92 fiscal year. And as I said compliance was very high probably almost up to 80% at that time. So their revenue was boosted significantly so they were able to meet their objectives. And I think there was also some social contract I think introduced at the time and therefore the fiscal policy was nothing that could be worked together in terms of in tandem with the monetary policy at the time. Fiscal was not a - complemented I would say, the monetary policy stance during the period.

MR. ROSS: Looking at the numbers that certainly was the case up until 95/96 but they went into significant deficit after that?

A Yes,

Q And the fact that is the period in which the actual collapse of the institutions took place.

A Well the collapse really don't happen in one year that is when it was manifested it would have been building up. So it is not that it is just, 1995 comes and it happens. The genesis started earlier in the year and the building up on all the policies, on all the issues that we had described so far coming from 1991.

COMMISSIONER: Like a Tsunami?

MR. ROSS: It also coincided with a period of very high building spate in the latter part of the 90's.

A: Well if you just take the inflation and the interest rate then remember persons also look at the expectation for depreciation and persons would also factor in that in their interest rate, in interest demand. So it is not just looking at the interest rate and just looking at the fiscal deficit, what happened there and the inflation. Remember persons had risk premium because of a confluence of other macro-economic factors including sovereign risk and so on, how the statement of the balance of payment is.

MR. ROSS: I would just like to ask one more question. You mentioned that exchange rate pressures and clear part in Bank of Jamaica decisions, am I right to understanding that when BOJ sets their Repo rate, open market rate they set it at a level that they estimate that the market will accept given the current exchange rate that is prevailing at the time?

A A future, it is not just at the time, you have to look forward, what is the, what do we, our estimate of inflation expectation. Remember where we started setting into our open market rate, the Bank of Jamaica was trying to as we say control higher powered money that is the monetary base, that is the Bank of Jamaica's, the currency, reserves and so on would impact the money supply . So in order to do that and to restrict the liquidity in the system build on itself and increase money supply we started offering our own open market instruments and at that time we set a rate and the rate at which we set is a rate at which the market would accept and buy the instrument. Because what I said what we were trying to do is control the level of liquidity in the system . Controlling the liquidity, offset liquidity as I mentioned before, what you use to control it is a price. The market, if you put a rate a lower rate, let us say the Bank of Jamaica set a rate of 9% the market expectation is that inflation is going up to 20. There is nobody going to come in and buy new security so the Bank of Jamaica would not be able to monitor the liquidity in the system effectively. So the rate as I did before at the origin at the start of question 15 was to lay the conditions under which people will accept a certain interest rate. And you have to look at all the macro-economic factors that are there, it is not just a wish.

MR. ROSS:

I am still trying to understand how the BOJ determines what those expectations are, because it seem once in the past where we have gone to bed one day and if we are making sense we wake up the next morning we are at 25, how does that come about?

A

Well it is through our daily open market operations. The Bank of Jamaica is being market on a daily rate and we assess the impact as I said we are trying to control high powered money that is the impact on the Bank of Jamaica Balance

Sheet and the Bank of Jamaica is not suppose to inject any liquidity in the system so we are trying to control our monetary base. So *each day,* every morning we have *a* look at the - we assess our balance sheet and see the impact of our operations *the* day before and the Bank of Jamaica does not change interest rate after a day, it is weeks or probably months of assessment of every single factor that is why we have a large research division assessing all the factors. It may seem to you as if today is 18 and tomorrow it is 20 or 22, but the decision to change is not something that occurs on the spur of the moment it is after weeks of research, deliberation, trial moral suasion trying everything and it is usually it is when it is the only thing the only other tool that we can use. And as I say we test it everyday by offering our open market instruments and the market is not taking it and they will just say sorry, no, and the bank at that point you would have had the open market operations maturing on the day and persons would say I am sorry I am not putting it back in the bank give me my money. And the only way the Bank of Jamaica would be able to control the liquidity is to offer those reserves. And as I said we have several economic modules that we look at. We look at other countries, we have significant training in this area, so it is not a one day spur of the moment decision, it is something that is after intensive research, weeks and weeks of intensive research and monitoring. As well as market feedback , market feedback is very important. We have a system of primary dealers and one of the requirements of the primary dealers is information feedback. So it is a confluence of factors that we examine at any point in time that we are going to adjust interest rates. We will also have knowledge of the fiscal, what is happening on the fiscal side, if there is excessive demand there and so on. So there are several factors that we look at.

MR. ROSS: Just one final question. If that is the case why are increases done more gradually why is it that we have these very large sudden movements from time to time?

A Well on the normal circumstances it is done gradually but sometimes an event occurs which pushes , which you have to act precipitously. For example in October the impact of the financial meltdown overseas and the

in the beginning it

wasn't as significant but the manifestation of the impact on the system in Jamaica where credit lines were suddenly withdrawn and so on. So an event can occur. I can't remember the events that would have occurred, other events that would have occurred in the 1990, but some of them are external in nature but sometimes when a shock occurs you have to act precipitously or else you could have significant runaway depreciation in the exchange rate and that is a more long term, long lasting effect. Inflated interest rates can be brought down. But as we have seen and in our history exchange rate is sticky downward, so we have to make sure that we use the tools that tend to impact and more long lasting.

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3:05 p.m.

MR. BOGLE: Looking in comparatively, do you see Jamaica anywhere in the near future having interest rates like the other Caribbean islands?

A: I mean, that is our intention, that is our target that interest rates will be in single digit in the near medium term, that is what we are working towards, but as I said all the other factors have to work in tandem. You know as the fiscal improves go towards fiscal surpluses, then that is one of the things that would have been tamed the demand from the public sector would have been tamed, so you have one less thing to worry about. So, yes our medium target is for single digit interest rate and we have been very dose until the financial system, the overseas financial system meltdown in recent time. We were just at 12% the other day.

MR. HYLTON: Turning finally, Mrs. Halsall, to the interest rate regime in the 1990's, question 18 asks, "What reason does The Bank of Jamaica have for the maintenance of the high interest rates during the 1990's and for what purpose was such interest rates prescribed moreover in relation to what aspects of monetary policy?"

A: I think really all the issues that I would have raised in order to bring aggregate spending in line with aggregate supplied, that is one of the reasons why we had to use the interest rate to ensure that we try to bring aggregate demand in line with aggregate supplies. I think in the early 90's, the firms with, the liberalization firms that increased their demand for foreign exchange and in order to, and the supply of the foreign currency was not sufficient to meet the demand so we therefore tried to encourage investors back into Jamaica dollars such as not to put pressure on the exchange rate and on the reserves because I said we started off with negative net International Reserves in the 90's before we had increase in capital close. So the bank had to adopt a tight monetary policy stance, it had no choice. How we see it, the alternatives would be significantly worse.

MR. BOGLE: Would you say Then that the liberalization was ill conceived or was it a matter that there was not enough consultation between The Bank of Jamaica and the Ministry of Finance?

A: Well, there was consultation, there was significant consultation but...

Q: Independence not withstanding.

A. Yes, yes, there was consultation. We have written on it and there was however, IMF, World Bank program and some of the conditionality of the program was liberalization. It is not the Bank's view that the macro-economic conditions were right for full liberalization at the time, so probably not the fact of liberalization but the timing, but when you don't have resources and the lender of the resources are the ones who I say, put the conditions.. .

COMMISSIONER: Imposed.

A: Imposed the conditions.

COMMISSIONER: IMF.

A: It is not only IMF. It was IMF, World Bank, IDB, it was a tripartite mission I would call it, those times that that insisted that we should have liberalization. The private sector was pushing for it as well so not to forget them. They all wanted it. But we recognize, we at The Bank of

Jamaica recognize the resources of the country was just not sufficient to facilitate the liberalization at that time, but the fact of liberalization is not a bad one but the timing may have been a little off.

MR. BOGLE: So we should in a sense blame the high interest rate on the liberalization in part?

A: Well, that was a factor.

Q: Big factor?

A: It was a factor.

MR. ROSS: I'm a little bit confused. In the early 90's, we had fiscal surpluses which would have made it easier to conduct monetary policy. We had huge inflows of capital as a result of liberalization which meant our supply of hard currency was increasing so that should have made it easier to maintain exchange rate stability, but instead we had the opposite and it seems to me that the massive growth of money supply, whatever were the factors behind that, must have been a major contributory factor to the instability that we had. I'm still not clear as to what really was causing the problem there.

A. Causing which problem?

Q. The high inflation and the excessive monetary growth which fueled it.

A. Well, look at what happened in 1991 and your exchange rate. Your exchange rate depreciated by 60.9% in 1991.

Q: How does that affect money growth, could you explain that for me, please?

A. Well, going into - when you have the impact -- one of the things that we did was to use the interest rate which I said the following year would have brought in the private capital flows because if the interest rate is high here and the Government policy, announced policy at the time were to bring inflation under control and so on and we started to see the movement then you will have the private capital inflows come in and impact on money supply. The NIR would increase and the money goes to the private sector. If the Government brings in the money for their use then they would go ahead and spend it so the money supply would also increase. The capital store is not only private sector but also Government. So we did have strong private capital inflows in 1992.

Q: Inflation was coming down at that time.

A: Well, inflation will be coming down, but you remember inflation expectation sometimes lag the actual. So persons will remember the last inflation and factor then at what is coming into the future and even now in recent times -last year we would have a spike in inflation. We do an inflation expectation survey now and in the early part of the year persons were saying inflation is going to be 30% this year, because that is their expectation of it. Is not that they factor that the actual is going to be down it is going to take time for them to adjust their inflation expectations to be in line with the actual. So, it doesn't run concurrently, so inflation may be coming down, private investors will say, well I'll have to see what happens in a year before I make my adjustment in my interest rate demand. It is not concurrent.

COMMISSIONER: This is hardly scientific.

A: I try and explain it as simply as possible.

MR. HYLTON: Justice is a good witness.

COMMISSIONER: It's an art. It must be art form.

A: Science and art with a lot of judgment in it.

COMMISSIONER: I thought you had some formula and you multiply X by Y, so and so.

A. No, no. We would need to employ in short economist at the bank.

MR. HYLTON: Mrs. Halsall, is there anything else you want to add to that in answer to those questions?

A. No, I think I have said everything that was asked.

COMMISSIONER: What is the impact of Government expenditure looking at your table, because there are dramatic jumps in the expenditure of the Government?

MR. BOGLE: Looks like we have a large deficit from '96/97, onward.

A: Well, the Government in the mid 1990's started not only to rely on the limited lending from multilateral institutions and the reliance on the domestic market but it also started relying on the international capital market. So they would be borrowing to finance from overseas as well. So the Government's borrowing in the market, in the local market would not be as much as it would have been when it was relying quite significantly on the -- but the Government -- can't answer to why the Government expenditure is increasing.

COMMISSIONER: The Minister is coming, Ex-Minister, I mean.

Maybe he can tell us.

A: I know that in terms, I mentioned the introduction to GCT in 1991 and the compliance rate was very high in the beginning. I know after subsequent increases in the GCT rate compliance dropped. So they were not getting the sort of revenue that they probably would have expected with the same type of compliance. When they set their budget the out turn would have been lower.

COMMISSIONER: The rate remained the same, the GCT rate remain the same.

A. No, it was 10%, then I think it went to 12%, it is now 16 '/2. It went from 10, I think it was 10 for about two years and then it went to 12 '/2 and then it went to 15 and then 16 '/2.

COMMISSIONER: So it fell at what point?

A: The compliance rate started to decline from the first increase.

COMMISSIONER: Oh, I see.

A: The second increase wasn't as bad but by the time it reached 15, the compliance rate had started to decline.

COMMISSIONER: It had started to lessen?

MR. ROSS: My understanding from what you say was that the interest rate placed a very large blow in the Bank of Jamaica interest rates - I just wonder whether the cost of those interventions, the cost of the sharp rises in interest rates whether an evaluation was made at the cost of that versus the cost of the exchange rate adjustment and how that evaluation is made given the massive impact I would say on Government debt and on private investors that is?

A. Yes, I say we have a research department who continuously research these issues. The Bank of Jamaica has to remain focus on its objective, price stability. The high depreciation feeds almost instantaneously into prices. The higher the rate of depreciation the faster the translation into prices and if you leave that alone without doing something about controlling the rate of exchange rate movement then inflation will go up. When the depreciation is sharp the prices pass through. Our research have shown prices pass through within three months, fully passed through, inflation is fully passed through within three months and so we have to try to curtail the rate of depreciation in the exchange rate because the impact, and we have done several research both inside the Bank in conjunction with, we did a joint paper with the IMF and so on. We have done significant research because as I said this is our focus and we spend a lot of time and resources and examining the impact of these movements, but we have to remain focused on the price stability issue because if that gets out of control then our real sector activity is going to be even worse . I mean one may look at interest rate movement and say, why did you have to move it? But the question is that most people never asked is why. If you did not do it what would have happened? And we have done the research both looking at other research from other researchers overseas and looking at different studies doing empirical work ourselves on the impact on the Jamaican market. We are definitely conscious of the impact on the real sector and so on, but we, our opinion and the research has shown that in a stable environment it provides the platform for everything else. If the environment is unstable then the investors cannot plan. I recall an institution, I think it was probably six, seven years ago came in to us to give us their projection and they had the exchange rate at a hundred and that was like five, six years ago. So you see and they were planning in that environment because that is where they expected the exchange rate to go. People will come to us and say we can't plan because we don't know what the exchange rate is going to be today, tomorrow and so you have to ensure - the Central Bank's role in the whole growth and development is to ensure that we have a stable environment and I said the tools are not many.

Q: I was a little bit confused by the assertion that the exchange rate leads right through to inflation and if you look at last year we had 25%, a peak of 25% on inflation last year and we didn't have an exchange rate movement until the last quarter finished, it was coming down.

A. The impact on inflation was not due to exchange rate. It was due to commodity prices. Remember our inflation is not only impacted by domestic conditions but international conditions as well.

Q The point I am trying to make is that during the period over which we had the exchange rate move, appreciation there was very little inflation and in fact inflation this year is much lower than it was last year even at 25% exchange rate increase.

A. You must recall we are in a recession and therefore demand has contracted significantly. Remember I spoke about controlling the demand to equate supply. Right now it is happening by itself because of the contraction of the economy and the state of the world economy and its impact on Jamaica. Demand has contracted significantly. So the demand for foreign exchange is not there as it was in the past and last year we would have the impact of oil and so on.

MR. BOGLE: It's a good time to bring down interest rates then since the demand on the foreign exchange is so weak. Then why keep interest rate that high?

A. Remember I said there are a confluence of factors, no one factor dictates the movement in interest rate, you have to examine everything and if you recall interest in today's environment, just looking at what is happening today. Interest rate is coming down. We were at 24% in June, I think and we are now down to 17 and on the way down.

COMMISSIONER: May I ask you, I have before me an IMF report to your Governor for sometime ago. And I am talking about sustainability and they made this observation. **"Experience in other countries is the case that no financial system would remain sound in an environment where interest rates are very high in real terms."**

That might be a nice question for - but since we are very concerned about high interest rates what comment would you have in regard to this?

A: Well that would be true if it is sustained.

COMMISSIONER: It was sustained.

A. At a high ...

COMMISSIONER: Why, it wasn't sustained, I thought it was. Interest rate didn't last for five seconds. It should decline.

A. Well, the economist view of timing is probably a little bit different from yours.

COMMISSIONER: If I were Shakespeare I would agree with you, timing is very relative. It's an axiom?

A: Yes.

COMMISSIONER: I take it that somebody had in mind a sound financial system. Some people must have thought that that was the idea of the exercise, to get a sound financial system. But how you going maintain that when you have, I thought that would have been compatible.

MR BOGLE: There are some people who said that the argument put forward very strongly is that the banks really collapsed in a sense because of bad management and there are other persons who feel that a lot of the collapse of the banks, some of the banks was due to the fact that so many of their borrowers could not pay because they borrowed at, let us for argument say, 15% but after about six months to a year the interest rates went up to 60 or 70%, which means that they would not be able to service their debts although at the time when they borrowed the banks, commercial banks and the managers might have looked at everything that obtained at that time and felt that the loan, the risks were checked, analyzed.

However no one could have foreseen what took place, let's say a year down the road. So a lot of the factors in the bank at that time were partly due to the fact that so many of the borrowers, some of them were paying their loans quite good and suddenly they find that regardless of how much they pay they were not able to pay the interest rates on loan. As such the banks were ending up with a lot of loans that were not being serviced. What do you say about that in terms of the interest rates on the borrowers of the commercial banks?

A. Well, we do not dictate the interest rate of the commercial banks, notwithstanding. Not withstanding, the banks assess.

COMMISSIONER: You don't dictate it directly but indirectly. Go ahead.

A. Notwithstanding the impact of the high interest rate on the borrowers is something that is real, is not something that just happens in Jamaica, it is something that is real and if they faced, I don't know to the extent that the Bank would have decided to increase the interest rate to the borrower to that extent, but that is something that most of the times the rates were probably not necessarily in line with the banks, the rates in the market, but probably to cover-up some of their inefficiencies.

COMMISSIONER: But you can't collect. What's the point of having it?

A. As I said the decision is the individual financial institution's, and yes it would impact negatively on the borrower, but the rates that the banks charge is not necessarily in relation to the rate that is the monetary policy rates, the benchmark rates that the BOJ have on their instruments. They would also have -- because of their other inefficiencies and probably their profit motive would have put on additional and blame it on the Central Bank. We have seen quite a bit of that and we have seen in the past...

COMMISSIONER: But is it factual that all these banks were so inefficient, because that presupposes that a great many banks were.

A: Well we can look. The number of banks were - eleven at the time.

COMMISSIONER: And eleven failed?

A: It came down to about five, right, so about six of them failed.

COMMISSIONER: I don't know if that is a logical conclusion.

A: I said it is not any one factor to pin it on. You have to look at the confluence of factors that impacted each of the institutions and each of them are different.

COMMISSIONER: Yes. Though I understand you, inefficiency certainly played a significant role?

A: Yes.

COMMISSIONER: And 1 just can't -- it is beyond my comprehension that we had so many inefficient banks in this small country.

MR. HYLTON: Chairman, when one considers the evidence earlier of the growth of the banking sector in the years before and a point Mrs. Anderson made about you would have a limited number of persons with the expertise then being offered positions in a much better group not necessarily the result.

COMMISSIONER: Since she was giving the evidence there I was asking her so that I can get it from her on my record.

You are not by any means minimizing the impact of high interest rates?

A: No, I'm not.

COMMISSIONER: And given the axiom of IMF experts that we can't sustain a sound financial system in a high interest rate environment.

A: You did have some financial institution in the high interest rate environment.

COMMISSIONER: We had a sound system?

A: You did have some institutions which were sound.

COMMISSIONER: Well 1 suppose so. After all, two survived the Tsunami.

A: More than two.

COMMISSIONER: BNS and Citibank.

A: You had Trafalgar, JNBS.

COMMISSIONER: They were not planting papaw.

A: Again it's practices, bank practices. Unfortunately most of them were foreign banks.

MR. ROSS: Because they were regulated by foreigners, regulated by their parent company and so they had to conform.

COMMISSIONER: They had experience, but the policy was to -- you are the expert to answer this question.

A: Remember, there is one other issue, you know, we are looking at those foreign banks, where there is a culture of compliance which sadly was not the same here.

COMMISSIONER: These cultures did not make up last night, these banks were just overnight, a great many of what Mr. Hylton is telling us about. All of a sudden there were banks, they were just growing up like Woolworth at street corners. Yes

Mr. Hylton.

MR. HYLTON: I have nothing more, sir.

MR.HENRIQUEZ: Miss Halsall, fiscal policy is for the Ministry of Finance and monetary policy for the Bank of Jamaica?

A: Yes, it is.

Q: That would entail financial stability, price control, exchange rates and inflation?

A: Yes, sir.

Q: Now, in carrying out this monetary policy, the main tool that a Central bank has is its exchange rate mechanism, isn't that so, the main tool?

A: The main tool is interest rates.

Q: Yes, that is what I said.

A: I thought you said exchange rate.

Q: I am sorry, my mistake, sorry, interest rate mechanism, that is the main tool?

A: Yes.

Q: And in this case, if we look at your table here, it shows that there was a great concentration on bringing down the inflation rate to 7.9 in 1998?

A: Yes.

From 80% in 1991?

A: Yes.

Q: Now you use the interest rate mechanism to do that, isn't that so?

A: Yes, that is one of the tools, yes. But

it is your main tool?

Q:

Yes, main tool.

A:

Q: What about the exchange rate now, you noticed it jump up 60% in 1991 and it seemed to be controlled thereafter? Well,

A: in....

Q: It moved from 60% depreciation in 1991 to 5.9 in 1993/1992, a vast difference? That was due

A: to the -- if you look at the time line before, the NIR, which moved from negative 443 to negative 67, so we had significant inflows of foreign exchange, so the supply of foreign exchange had increased.

Are you saying then that the interest rate

Q: mechanism did not assist in that regard, the exchange rate?

Yes, it did, it would have because as I

A:

said the higher interest rate would have attracted some foreign capital inflows.

Q: That is what I am saying, that you used the main tool that you had to deal with inflation and at the same time assist in the exchange rate?

A: Yes.

Q: Thank you.

COMMISSIONER: Mr. Nelson is back.

MR. NELSON: I don't think I have any questions for this witness.

COMMISSIONER: Don't think.

MR. NELSON: I don't have any questions for this witness, I reserve my questions for the previous witness or her replacement.

COMMISSIONER: Is there any other counsel who think they should trouble -- No? Very well. Mrs. Halsall, thank you very much for coming. All I can say is sort of put you on notice that it maybe, you may have to be re-called because we are operating in a very peculiar environment where everybody who should be here isn't here and may or may not turn up so I can't even give you a definitive answer. Okay, thank you for coming and you have been very helpful.

MR. HYLTON: Yes Mr. Chairman, subject to returning tomorrow, sir, to respond to the question you raised and to the questions that Mr. Nelson raised, that would be the evidence from the Bank, I have nothing more.

COMMISSIONER: Mr. Braham, you have anybody?

MR. BRAHAM: No, sir, regretably.

COMMISSIONER: Very well. We will adjourn until tomorrow morning at 9:30. Thank you very much for coming everybody.

A D J 0 U R N M E N T