BANK OF NOVA SCOTIA JAMAICA LIMITED

THE ECONOMY

For the Jamaican economy, the year 1995 was influenced by macro economic management focussed on economic stability. Highlights were the growth in the level of official net international reserves, and the containment of inflation. Inflation for the year to September was 14%, compared with 20% for the similar period in 1994. Despite this lower level of inflation, at the end of September the U.S. Dollar exchanged at J$37.35 indicating an 11.9% depreciation since the start of the year.

In the first half of 1995, the growth of the economy remained negligible, despite lower inflation and an upturn in the tourism sector. Output was low in many sectors of the economy leading to an overall slowing in gross domestic product relative to the first half of 1994. High interest rates led to a contraction in investment. Also significant increases in consumption contributed to an adverse trade balance during the year.

Factors which influenced economic activity during 1995 were:

- High interest rates.
- Continued growth in money supply
- Continued depreciation of the dollar
- Open market operations of the Central Bank

In October, the Government strengthened its monetary policies to tighten liquidity and stem the demand for foreign exchange in order to stabilize the exchange rate. During the first part of the year, commercial banks operated in

an environment in which interest rates although high throughout the financial system, fell below 1994 levels, influenced by treasury bill rates. This has already begun to change in response to the new measures.

For the first eight months of the year, total loans for commercial banks grew by 52% over 1994. Deposits also increased 37%. Savings as a percentage of deposits increased over 1994, moving from 30.9% to 34.2%. Foreign currency as a percentage of total deposits declined, moving from 23% to 19%. However, there still appears to be a preference to keep funds in US Dollars to hedge against inflation and ensure availability when needed. As a result, less is made available for spot sales. Activity levels in foreign currency accounts intensified over the year. As well, foreign currency loans outstanding in the banking system at the end of the fourth quarter were 47% higher than the fourth quarter of 1994.

Growth in money supply continued to be influenced by expansion in the Net International Reserves (NIR), creating problems for monetary and Fiscal policy management. The NIR, which grew rapidly in 1994, experienced a significant decline in its rate of growth in 1995, as the Central Bank reduced its purchase of foreign exchange from authorised dealers and Cambios. The expansion of the NIR was also constrained by sizeable debt repayments, as well as reduced foreign exchange market activity. Although the growth in the NIR was not as strong as in 1994, it accounted for about 30% of the gross increase in money supply over the first 10 months of the fiscal year.

The tourism sector showed a 5.9% increase in arrivals for the first six months of 1995, compared to the same period last year. Estimated earnings for the same period showed an increase of 2.3%. The export sector continued to record increased earnings in 1995. The most significant growth in non-traditional exports was in the apparel sector (37%), food exports (22%) and in the traditional sector - mining, alumina (8.5%) sugar (22.4%), coffee (56%) and bananas (8.9%).

As well, all categories of imports showed dollar increases, January to June versus the same period prior year. Imports, which have a base nearly twice as large as exports, rose significantly in the first half of the year. Consumer goods rose by 48.9%, fuelled by a 69% rise in food imports, a 28.4% growth in motor car imports and 55.5% increase in imports of non-durable consumer items.

The major challenge for policy makers remains the issue of growth. The heavy reliance on monetary policy has led to pressures on the budget and a massive increase in the local debt serving cost. The monetary policy has also increased pressures on the productive sector of the economy through the high real interest rates that must be paid on borrowed funds.

The year 1996 will be a challenging one, particularly in reversing the current trend in inflation. Economic growth and development will hinge on such traditional areas of strength as tourism, bauxite and greater restraint on the importation of consumer goods.