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IMF Concludes Article IV Consultation with Jamaica

The IMF Executive Board on September 8, 1997 concluded the Article IV consultation[1] with Jamaica.

Background

In FY 1996, which began April 1, inflation declined to 9.5 percent from 31 percent in the previous fiscal year, supported by a very tight monetary policy. However, the public finances shifted from a significant surplus in FY 1995 to a substantial deficit. In addition, following the interruption of talks on a social pact, the authorities were unable to hold wages in the public sector to levels originally envisaged, although the rate of wage increase was substantially reduced. The mix of policies led to very high real interest rates, a substantial real appreciation of the currency, and a decline in output of 1.4 percent. The financial situation of the banks and insurance companies also deteriorated.

To some extent, the weakening in the public finances in FY 1996 reflected the increase in interest rates and the postponement of interest payments from FY 1995. However, the primary central government surplus (overall balance excluding interest payments) also declined by over 5 percentage points of GDP to about 5.5 percent of GDP, owing to an increase in the wage bill (including back pay), a rise in capital spending, and a decline in central government revenue. In addition, the rest of the public sector shifted from a small surplus to a small deficit. At the end of FY 1996, public sector debt stood at the equivalent of 90 percent of GDP with external debt of 52 percent of GDP. Domestic debt increased by almost 50 percent during the year, including debt issued to cover Bank of Jamaica open market operations.

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[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 directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

In the face of increasing problems in the financial sector, evidenced by the intervention of a medium-sized bank in July 1996, in early 1997 the government took a number of steps to shore up the system. In January 1997 the government presented a supplementary budget allocating about 5 percent of GDP to support restructuring of problem institutions. The government also created the Financial Sector Adjustment Company (FINSAC) to strengthen the financial system through mergers, capitalization, and reorganization of financial institutions. In addition, in February and March 1997 the Bank of Jamaica provided liquidity to banks in the face of deposit withdrawals from two financial institutions.

Notwithstanding the real appreciation of the currency and a deterioration in the terms of trade, the external current account deficit declined to US$240 million (about 4 percent of GDP) in FY 1996. There was a significant decline in the volume of nonbauxite imports, especially raw materials and capital equipment, reflecting the weakness of economic activity. At the same time, merchandise export earnings fell mostly reflecting a drop in the price of alumina, and a decline in the volume of nonbauxite exports. After strong growth in the first half of the fiscal year, tourism was also subdued for the year as a whole. The current account deficit was more than fully financed by private capital inflows estimated at US$350 million (5.6 percent of GDP). Net international reserves of the central bank rose by US$150 million in FY 1996.

For FY 1997, the government's priority is to reduce inflation further to 8–9 percent while raising output growth to 2–3 percent; net international reserves are targeted to increase by about US$100 million. To support monetary and exchange rate stability, the government is aiming to reduce the overall public sector deficit to 1.7 percent of GDP, or to 1.5 percent of GDP for the central government. Public sector wage increases for workers who have not yet negotiated in the current round would be limited to the raises already agreed with the police and teachers.

Executive Board Assessment

Executive Directors noted that economic reforms over the past several years had helped to expand the role of market forces while macroeconomic policies had given increased emphasis to improving internal and external balances. As a result, the authorities had achieved significant progress in reducing inflation and rebuilding international reserves, and Jamaica's external debt had reached manageable levels. However, Directors expressed concern that per capita income continued to fall and that fiscal policy had shifted from a surplus in fiscal year 1995 to a sizable deficit. This policy mix had led to high real interest rates, which in turn had contributed to large capital inflows and a substantial real appreciation of the currency, while problems in the financial sector had worsened.

Directors expressed concerns that the present policy mix risked undermining the achievements of the past several years. Accordingly, Directors urged the authorities to tighten fiscal policy and intensify structural reforms, particularly with regard to the labor market and the financial sector.

Directors agreed with the authorities on the need for a low inflation environment to ensure a sustained recovery of output and employment, and welcomed the authorities' continued commitment to low inflation. Directors emphasized that a stronger fiscal position would be a crucial element in improving the policy mix in the anti-inflation effort. Directors expressed concern that the authorities' fiscal projections for fiscal year 1997 might be overly optimistic, given developments in the first quarter of the year and possible support to the financial sector that had not been included in the budget. Directors urged the authorities to continue their efforts to contain public expenditure and improve tax administration, and to adopt revenue measures to assure that the government's fiscal target is met.

Directors noted that the strategy of targeting base money had been useful in reducing inflationary expectations and in containing inflation, and should be maintained. However, monetary restraint needed to be supported by a strengthening of policies in other areas, particularly fiscal policy and wage policy.

Some Directors agreed with the staff that a more flexible approach to exchange rate policy would be desirable, emphasizing that such a policy needed to be combined with strengthened fiscal policy, as well as wage restraint, to assure that any movement in the exchange rate would be reflected in an improvement in competitiveness.

Some other Directors, however, understood the authorities' preference for a stable exchange rate, but they too underscored that such a policy required tighter fiscal and wage policies, combined with continued monetary restraint, to be sustainable and credible. Directors urged the authorities to accelerate structural reforms aimed at improving competitiveness, including measures to increase the flexibility of labor markets.

With respect to the problems of the financial sector, Directors noted that the authorities had so far been successful in keeping financial markets calm and that progress had been made in advancing legislation that would increase the government's powers for dealing with problem financial institutions in the future. They were concerned, however, that the government's approach had resulted in very high fiscal costs. Directors urged the authorities to deal with remaining problems as quickly as possible, paying due regard to moral hazard considerations, and to ensure that no payments are made to shareholders of institutions that have lost their net worth.

Directors called on the authorities to reduce government intervention in the economy and to refrain from supporting troubled private enterprises through subsidies, equity participation, and loans. Directors also urged the authorities to accelerate the privatization program and to focus public sector resources on improving education, health, and infrastructure in areas where private sector investment may not be feasible.

Directors urged the staff to maintain a close dialogue with the authorities.

Press Information Notices (PINs) are a new series of IMF press notices (see Press Release 97/21). PINs will be issued, at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the view of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies.

Jamaica: Selected Economic Indicators 1/

	1992	1993	1994	1995	Prel. 1996
Real economy (change in percent)					
Real GDP	1.5	1.3	1.0	0.0	-1.4
Real GDP per capita	0.5	0.4	-0.1	-1.2	-2.4
Consumer prices (end of period)	21.1	37.1	21.2	30.8	9.5
Public finances (percent of GDP)					
Central government balance	3.8	3.2	3.3	1.0	-6.7
Primary balance	12.0	11.8	13.3	11.0	6.4
Public sector balance	2.2	1.6	3.9	3.0	-5.8
Public debt	121.2	135.5	115.5	98.1	90.3
Money and interest rates (end of year, in percent)					
Base money (12-month change)	56.0	32.5	42.5	22.3	15.2
M3 (12-month change)	86.2	32.5	39.3	23.2	25.8
Treasury bill interest rate 2/	20.5	50.3	20.4	43.2	18.1
Balance of payments (millions of U.S. dollars)					
Current account	-5.0	-56.0	15.0	-257.0	-236.0
(percent of GDP)	-0.1	-1.4	0.3	-5.0	-3.8
Capital account	175.0	192.0	379.0	304.0	388.0
Gross official reserves	295.0	429.0	783.0	732.0	826.0
(in months of nonbauxite imports and nonfactor services)	1.6	1.9	3.2	2.5	2.8
Exchange rates (end of period)					
Nominal exchange rate (Jamaica dollar per U.S. dollar)	22.2	33.1	32.3	38.9	35.1
Real effective exchange rate (1990 = 100)	89.9	80.9	91.5	96.5	119.9

Sources: Jamaican authorities; and IMF staff estimates.

1/ For fiscal years, which begin April 1.

2/ On six-month treasury bills or three-month when not available.