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AGENDA

EBS/86/26

CONFIDENTIAL

February 3, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Jamaica - Review Under Stand-By Arrangement and
Proposed Understandings on the Program

Attached for consideration by the Executive Directors is the staff report for the review under the stand-by arrangement for Jamaica and proposed understandings on its program. Draft decisions appear on pages 20-22.

This subject will be brought to the agenda for discussion on a date to be announced.

Mr. Hardy (ext. 7158) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

JAMAICA

Review Under Stand-By Arrangement and Proposed
Understandings on the Program

Prepared by the Western Hemisphere and
Exchange and Trade Relations Departments

(In consultation with Fiscal Affairs,
Legal, and Treasurer's Departments)

Approved by S. T. Beza and W. Beveridge

January 31, 1986

I. Introduction

On July 27, 1985 the Executive Board approved a 22-month stand-by arrangement for Jamaica in an amount of SDR 115 million, equivalent to 79 percent of quota (EBS/85/162). Jamaica made a purchase of SDR 7.5 million following the approval of the program, and an additional purchase of SDR 7.5 million following compliance with the end-July 1985 performance criteria (Table 1). Subsequent drawings were not made because Jamaica was not in compliance with performance criteria as of end-September and end-December, and because program reviews were not completed as scheduled (Table 2).

This review paper and the attached request for a waiver of the breached performance criteria and modifications to the program are the result of several rounds of discussions between Fund staff and the Jamaican authorities, both in Kingston and at headquarters. The staff participating in all or part of these discussions included Messrs. Hardy (Head), Escobar, and Guzman (all WHD), Gandhi and Kibuka (both FAD), and Thomsen (ETR), and Ms. Coles (Secretary-WHD). Mr. Citrin, the Fund's representative in Jamaica, also participated in the discussions. The Jamaican representatives included Prime Minister Seaga, who is also Minister of Finance and Planning, Mr. Barber, Governor of the Bank of Jamaica until October 1985, his successor Mr. Brown, and other senior officials.

During the past two years, Jamaica has frequently experienced difficulty in remaining current with the Fund. The delays have usually been of brief duration, but from October 1985 through late January 1986 Jamaica accumulated arrears of almost SDR 70 million. Jamaica is at present current with the Fund.

Table 1. Jamaica: Position during Period of Stand-by Arrangement:
June 1985-April 1987

	Out- standing June 30 1985	1985			1986		1986/87
		July 1- July 31	Aug. 1- Sep. 30	Oct. 1- Dec. 31	Jan. 1- Mar. 31	Apr. 1- June 30	July 1- Apr. 30
(In millions of SDRs)							
Transactions under							
tranche policies (net) 1/		-8.6	5.4	-2.7	-19.5	-13.2	-42.0
Purchases		7.5	7.5	--	26.6	13.4	60.0
Ordinary resources		3.7	3.8	--	13.3	6.7	5.9
Borrowed resources		3.8	3.7	--	13.3	6.7	54.1
Repurchases		-16.1	-2.1	-2.7	-46.1	-26.6	-102.0
Ordinary resources		-5.1	--	-2.7	-15.6	-9.1	-26.4
Borrowed resources		-11.0	-2.1	--	-30.5	-17.5	-75.6
Transactions under special							
facilities (net) 2/		-2.6	--	-2.6	-7.4	-5.0	-7.2
Purchases		--	--	--	--	--	--
Repurchases		-2.6	--	-2.6	-7.4	-5.0	-7.2
Total Fund credit out-							
standing (end of period)	642.1	630.9	636.3	631.0	604.0	585.8	536.6
Under tranche policies 1/	539.7	531.1	536.5	533.8	514.2	501.0	459.0
Special facilities 2/	102.4	99.8	99.8	97.2	89.8	84.8	77.6
(In percent of quota)							
Total Fund credit out-							
standing (end of period)	441.3	433.6	437.3	433.7	415.1	402.6	368.8
Under tranche policies 1/	370.9	365.0	368.7	366.9	353.4	344.3	315.5
Special facilities 2/	70.4	68.6	68.6	66.8	61.7	58.3	53.3

Source: IMF.

1/ Ordinary and borrowed resources.

2/ Compensatory financing facility.

Table 2. Jamaica: Quantitative Performance Criteria, 1985-86

	1985							1986		
	Mar.	July		Sept.		Dec.		Jan.	March	
	Actual	Prog.	Actual	Prog.	Actual	Prog.	Prel.	Rev.	Prog. 1/	Rev.
<u>(End of period, in millions of U.S. dollars)</u>										
Net international reserves <u>2/</u>	-563	-567	-554.3	-545	-574.0	-527	-649.5	-575	-482	-482
Net external debt disbursements <u>3/</u>		55	15.6	110	43.7	124	58.9	128	205	205
Of which:										
1-5 years <u>3/4/</u>		(31)	(30.3)	(59)	(35.4)	(80)	(54.7)	(108)	(98)	(108)
Other public sector capital projects <u>3/</u>		68	13.6	68	15.9	68	...	68	68	68
Public sector short-term net debt disbursements <u>3/</u>		20	2.0	20	2.1	20	...	20	20	20
Arrears		--	--	--	7.1	--	112.1	52	--	--
<u>(End of period, in millions of Jamaica dollars)</u>										
Net domestic assets of the Bank of Jamaica <u>5/</u>	4,147	4,176	4,106.1	4,042	4,217.8	4,022	...	3,917	3,713	3,398
Central government net borrowing requirement <u>3/</u>		464	422.1	595	552.3	730	...	872	764	664
Net bank credit to selected public entities <u>3/</u>		27	-293.8	22	-200.2	-53	-240.4	-106	--	-30

Source: Technical Memorandum of Understanding (EBS/85/162).

1/ Indicative targets.

2/ Targets adjustable upward for net external debt disbursements over amounts specified in paragraphs 7 and 8 of the technical memorandum attached to the Letter of Intent of June 7, 1985.

3/ Cumulative change from March 31, 1985.

4/ Ceilings represent gross cumulative disbursements from March 31, 1985.

5/ Ceilings adjustable downward for net external debt disbursements over amounts specified in paragraphs 7 and 8 of the technical memorandum attached to the Letter of Intent of June 7, 1985.

II. Background and Recent Developments

Jamaica's long-standing adjustment problems have been compounded in the last few years by a large external debt that has started to mature, and the simultaneous decline of the Jamaican bauxite industry. Jamaica's medium- and long-term external public debt has risen to about 180 percent of GDP and total debt service in 1985/86 would be equivalent to almost 60 percent of exports of goods and services, with interest payments alone equivalent to 35 percent of exports of goods and services. Meanwhile, bauxite sector exports, which in 1980 amounted to 12 million tons with a gross value of US\$732 million are not expected to exceed 6 million tons in 1985/86 (fiscal year to March) with a gross value of only US\$275 million; net foreign exchange earnings from the sector have fallen from US\$380 million to an estimated US\$190 million over the same period.

The current 22-month stand-by arrangement follows a 12-month arrangement, during which the Jamaican economy underwent a significant measure of adjustment (see EBS/85/162 and SM/85/200). Particularly noteworthy was a 16 percent real effective depreciation of the Jamaica dollar, a major liberalization of imports, the elimination of external payments arrears by end-April 1985, and the reduction in the central government deficit from 15.1 percent of GDP in 1983/84 to 6.6 percent of GDP in 1984/85. However, the latter improvement was partly offset by rising Bank of Jamaica losses, which reached the equivalent of 6 percent of GDP in 1984/85 compared with 3.4 percent in 1983/84. These losses resulted mainly from increased debt service costs arising from the depreciation of the currency. Furthermore, in spite of the depreciation of the Jamaica dollar and the improvement in the central government fiscal position, the deficit in the current account of the balance of payments remained virtually unchanged at about 12 percent of GDP (Table 3). Meanwhile, economic prospects worsened at the beginning of 1985 with the closure of one of the three alumina plants in Jamaica and because of civil disturbances in January 1985, which led to a decline in tourist arrivals.

The program targets for 1985/86 (the first year of the new arrangement) were drawn up on the assumption that exports of bauxite and alumina would decline because of the above-mentioned plant closure, the operation of a second plant on a basis that would entail no net foreign exchange earnings to the country, and falling international prices. Although nontraditional exports were expected to continue performing well and earnings from tourism were projected to increase, real GDP was expected to decline by about 4 percent and nonbauxite imports by 12 percent. The current account deficit of the balance of payments was expected to be reduced from US\$267 million, or 12.3 percent of GDP, in 1984/85 to US\$209 million, or 11.5 percent of GDP, in 1985/86. The program also called for additional assistance from donor countries and rescheduling of debts to the Paris Club and commercial banks.

Table 3. Jamaica: Main Economic Indicators

	1980/81	1981/82	1982/83	1983/84	Prel. 1984/85	Prog. 1985/86	Rev. Prog. 1985/86	Prog. 1986/87
(Percentage annual change)								
Real GDP	-3.6	2.4	0.5	2.3	-0.2	-3.8	-3.8	--
Real nonbauxite GDP	-4.6	3.3	2.6	2.1	0.6	-3.3	-3.3	--
Nominal GDP	11.0	11.4	11.4	20.6	29.8	18.6	18.6	13.0
GDP deflator	15.2	8.7	10.9	17.9	30.1	23.4	23.4	13.0
Consumer price index								
Annual average	26.5	9.0	7.1	14.9	29.7	23.0	23.0	12.0
End of period	19.4	7.4	8.2	21.1	29.7	15.0	15.0	10.0
Broad money	17.6	22.5	27.7	24.7	22.3	17.5	4.6	14.0
(In percent of GDP)								
Nonfinancial public sector deficit <u>1/</u>	-13.8	-14.5	-14.9	-15.2	-6.4	-4.7	-3.8	-2.0
Of which:								
Central Government deficit	-16.5	-15.6	-14.2	-15.1	-6.6	-6.0	-5.1	-4.0
Rest of public sector	2.8	1.1	-0.7	--	0.2	1.3	1.3	1.9
Bank of Jamaica operating losses	--	--	--	-3.4	-6.3	-3.6	-3.9	-1.5
External current account deficit <u>2/</u>	-9.0	-20.2	-23.3	-12.7	-12.3	-11.5	-16.2	-7.2
Outstanding external debt	70.8	97.6	142.4	138.6	158.5	206.2	188.0	216.8
(In millions of Jamaica dollars)								
Real GDP 1974 prices	1,843	1,888	1,897	1,941	1,937	1,863	1,863	1,863
Nominal GDP	4,870	5,425	6,043	7,289	9,461	11,225	11,225	12,684
Memorandum items								
Real effective exchange rate index (1980=100) <u>3/</u>	106.3	110.6	108.1	76.1	63.6	...	59.7 <u>4/</u>	...
Average annual exchange rate J\$ per US\$								
Official	1.78	1.78	1.78	2.47	4.36	6.20	5.65	7.00
Shadow <u>5/</u>	2.32	2.51	3.06	3.27)			

Sources: Bank of Jamaica; and Fund staff estimates.

1/ Consists of central government budget and selected entities. The latter includes the Capital Development Fund, the National Insurance Fund (NIF), the National Housing Trust (NHT), the Human Resource and Employment Trust (HEART).

2/ Until 1983/84 calculated on the basis of the shadow exchange rate.

3/ End of period.

4/ End November 1985.

5/ Defined as the nominal exchange rate necessary to maintain the real effective exchange rate constant at the 1978 level.

The program was designed to strengthen the adjustment of the Jamaican economy by reducing the nonfinancial public sector deficit, from 6.4 percent of GDP in 1984/85 to 2 percent of GDP by fiscal year 1986/87, and by pursuing a flexible exchange rate policy. The central government deficit was projected to decline from 6.6 percent of GDP in 1984/85 to 6 percent during 1985/86 and to 4 percent in 1986/87 in spite of significantly smaller revenues from bauxite taxes, and increased interest payments abroad. The financial performance of the selected public entities also was expected to improve.

The monetary program for 1985/86 was set to achieve the balance of payments targets and be consistent with a reduction in inflation from 30 percent in 1984/85 to 15-18 percent in 1985/86 and with an average exchange rate of J\$6.2 per U.S. dollar over the program period. The latter assumed a depreciation of the Jamaica dollar from J\$5.5 per U.S. dollar at the beginning of the program year to around J\$6.9 per U.S. dollar by March 1986, involving a moderate depreciation in real effective terms. Under these assumptions, banking system liabilities to the private sector were expected to grow by about 17 1/2 percent and banking system credit to the private sector was programmed to increase by 9 percent, in relation to liabilities to the private sector at the beginning of the period.

In the period April-September, the Central Government's overall deficit was J\$542 million, just within the program target (Table 4). However, the composition of budgetary financing was very different from that programmed, as a shortfall of about J\$100 million in external financing together with an equivalent shortfall in domestic nonbank financing was met by higher than programmed borrowing from the Central Bank. In September the Bank of Jamaica exceeded the limit on its net domestic assets by J\$176 million, reflecting the larger than programmed lending to the Central Government and larger than projected losses, which were only partly offset by higher than programmed deposits of the selected public entities and an accumulation of excess reserves by the commercial banks at the Bank as their loans to the private sector were lower than expected (Table 5).

The buildup of liquidity in the banks resulted in a substantial increase in the demand for treasury bills. As the supply of treasury bills was not increased, the discount rate on these bills dropped from 20 percent during April and May to below 18 percent in August. Interest paid on time deposits by banking institutions also declined below the minimum savings rate, which remained fixed at 20 percent, while lending rates for new loans ranged from 27 to 30 percent.

In October the ceilings on private sector credit were removed and private credit picked up rapidly. During October/November credit to the private sector increased by J\$190 million, or by over 8 percent compared with its end-September level. Although the Bank of Jamaica began to sell Certificates of Deposits (CDs) in November, its overall operations

Table 4. Jamaica: Summary Operations of the Central Government

	1981/82	1982/83	1983/84	Prel. 1984/85	1985/86		Rev. Est.	Prog. 1986/87
					Prog. Apr. - Sept.	Prel. Apr. - Sept.		
(In millions of Jamaica dollars)								
Revenue	1,512	1,659	1,798	2,709	1,412	1,374	3,340	3,440
Tax revenue	1,160	1,407	1,535	2,021	1,237	1,194	2,860	2,982
Nontax revenue	52	54	69	182	59	85	132	127
Bauxite levy	300	198	194	481	66	27	345	170
Of which: advance levy 1/	--	16	34	61	...	...	81	44
Grants	...	...	...	25	50	68	142	160
New revenue measures 2/	--	--	--	--	--	--	100	...
Expenditure	2,358	2,518	2,902	3,332	1,963	1,916	4,163	4,559
Current	1,715	1,861	2,394	2,818	1,722	1,662	3,393	3,595 3/4/
Capital and net lending	643	657	508	447	241	254	770	964
Float and unrelated items 5/	--	--	--	66	...	...	...	...
Overall balance	-846	-859	-1,104	-623	-551	-542	-684	-507
Adjustment gap	--	--	--	--	--	--	--	612
Financing	846	859	1,104	623	551	542	684	507
Net external 1/	504	419	411	1,047	379	275	955	1,187 6/
Net domestic	342	440	693	-424	172	267	-688	-615
Banking system	189	644	790	-654	72	295	-850	-761
Other (including residual) 5/	153	-204	-97	230	100	-28	162	146
Financing gap/exceptional financing	--	--	--	--	--	--	417	-- 7/
(In percent of GDP)								
Revenue	27.9	27.5	24.7	28.6		31.0	29.8	27.1
Tax revenue	21.4	23.3	21.1	21.3		25.5	23.9	23.5
Nontax revenue	1.0	0.9	1.0	1.9		1.2	1.2	1.0
Bauxite levy	5.5	3.3	2.6	5.1		3.1	2.6	1.3
Grants	...	...	...	0.3		1.2	1.2	1.3
New revenue measures	--	--	--	--		--	0.9	...
Expenditure	43.5	41.7	39.8	35.2		37.0	34.9	36.0
Current	31.6	30.8	32.8	30.5 8/		29.5	29.5	28.4
Capital	11.9	10.9	7.0	4.7		6.9	5.4	7.6
Adjustment gap	--	--	--	--		--	--	4.9
Overall balance	-15.6	-14.2	-15.1	-6.6		-6.0	-5.1	-4.0
Financing	15.6	14.2	15.1	6.6		6.0	5.1	4.0
Net external	9.3	6.9	5.6	11.1		8.5	10.6	7.7
Net domestic	6.3	7.3	9.5	-4.5		-6.1	-5.5	-9.0
Banking system	3.5	10.7	10.8	-6.9		-7.5	-6.8	-10.5
Other (including residual)	2.8	-3.4	-1.3	2.4		1.4	1.3	1.5
Financing gap/exceptional financing	--	--	--	--		3.6	--	5.3
Memorandum item								
Fiscal year GDP (millions of Jamaica dollars)	5,425	6,043	7,289	9,461		11,225	11,225	12,684

Sources: Ministry of Finance; and Fund staff estimates.

1/ Corresponding to an advance of the bauxite levy in 1982/83, being repaid out of yearly bauxite production, and included also in net external financing.

2/ Implemented January-March 1986.

3/ External interest is on a commitment basis.

4/ Incorporates additional expenditure reduction measures estimated at 1 percent of GDP implemented in 1985/86.

5/ Through 1983/84, float and unrecorded items are treated as part of financing residual items. Since 1984/85, such items are treated as part of expenditures.

6/ Before rescheduling of external principal obligations.

7/ Part of the financing gap for 1986/87 is expected to be closed through rescheduling.

8/ Includes float and unrecorded items.

Table 5. Jamaica: Summary Monetary Accounts

	April - Prog.	July Actual	April - Prog.	Sept. Actual	April-Dec. Prog.	April 85-Mar. 86 Prog.	Rev. Prog. 1/
(Cumulative flows in millions of Jamaica dollars)							
I. Banking System							
Net international reserves 2/	-25	29	111	-159	226	504	399
Net domestic assets	196	251	136	-450	351	212	-209
Net claims on Central Government	45	298	-85	278	-310	-850	-761
Net claims on selected public entities	27	-282	22	-199	-53	--	-30
Credit to private sector and other public sector	20	-1	69	-35	262	372	36
Net credit to other financial institutions	-41	26	-61	14	-106	-139	4
Medium- and long-term foreign liabilities	62	67	35	34	225	355	51
Valuation adjustment, exchange losses, and other (net)	83	143	156	508	333	474	491
Liabilities to private sector	229	339	305	349	635	774	248
Special deposits	-58	-58	-58	-58	-58	-58	-58
II. Bank of Jamaica							
Net international reserves 3/	-25	51	111	-71	226	504	455
Net domestic assets	29	-41	-105	71	-125	-434	-417
Net claims on Central Government	-67	172	-192	31	-466	-1,007	-676
Net claims on selected public entities	-21	-161	-56	-91	-90	-95	-4
Net claims on other public sector	2	78	8	10	17	20	
Net credit to banks	-19	-176	-29	-242	-86	-107	-282
Medium- and long-term foreign liabilities	62	67	35	34	225	355	65
Valuation adjustment, exchange losses, and other (net)	72	-21	129	329	275	400	480
Currency in circulation	4	11	6	--	101	70	38
III. Commercial Banks							
Net foreign assets	--	-22	--	-88	--	--	-56
Net domestic assets	167	292	241	379	476	646	208
Net claims on Central Government	112	126	107	247	156	157	-85
Net claims on selected public entities	48	-121	78	-108	37	95	-26
Net credit to other financial institutions	-41	26	-61	14	-106	-139	4
Credit to private sector and other public sector	18	-79	61	-45	245	352	-4
Claims on Bank of Jamaica	23	213	40	294	104	132	336
Other (net)	7	127	16	-23	40	49	-17
Liabilities to private sector	225	328	299	349	534	704	210
Special deposits	-58	-58	-58	-58	-58	-58	-58
(Changes in percent)							
Banking system 3/							
Net domestic assets	4.8	6.2	3.3	11.0	8.6	5.2	-5.1
Net credit to Central Government	1.1	7.3	2.1	6.9	-7.6	-20.8	-18.5
Credit to private sector and other public sector	0.5	--	1.7	-0.9	6.4	9.1	0.9
Liabilities to private sector	4.2	8.3	6.1	7.1	14.1	17.5	4.6

Sources: Bank of Jamaica; and Fund staff estimates.

1/ March 1986 revised projections are flows from April 1985 through March 1986.

2/ Valued at J\$6.20 per U.S. dollar in the original program; for the revised March 1986 targets valued at J\$5.65 per U.S. dollar.

3/ Changes in relation to the stock of private sector liabilities at the beginning of the period.

resulted in a liquidity expansion from end-September through mid-December. Data for end-December are not yet available.

By September it was clear that the current account deficit in the balance of payments would be much larger than envisaged in the program. It is now estimated at US\$323 million (16 percent of GDP), or some US\$114 million above program, reflecting a sharp drop in alumina prices, a modest performance of nontraditional exports and tourism, and higher than programmed imports. The decline in net foreign exchange receipts from exports of bauxite and alumina is estimated at about US\$80 million, some US\$40 million more than programmed; tourist receipts could be some US\$30 million less than originally projected, and imports are now projected to be US\$30 million above program (Table 6).

During the period April-September, the adverse trends in the current account of the balance of payments were compounded by shortfalls in official capital inflows resulting from slow execution of projects and a late disbursement of certain economic assistance. However, private capital inflows amounted to US\$120 million in the period, which was well above program levels and largely offset the deterioration in the current and official capital accounts. These inflows seem to have been mainly in response to the interest rates and tight monetary conditions prevailing from March to September. They also may reflect other factors which encouraged the use of foreign credit, such as denial of access of importers and banks to the auction market to obtain foreign exchange to be used as escrow for the opening of letters of credit or as payment for imports on the basis of shipping documents. The net international reserves target of the Bank of Jamaica for September was missed by US\$29 million, of which US\$15 million could be ascribed to delays in disbursements.

As had been foreseen in the program, the Jamaica dollar depreciated gradually, averaging J\$5.5 per U.S. dollar in the period April-June, and J\$5.8 per U.S. dollar in July-September. In early October, however, the the Jamaica dollar came under pressure, depreciating to J\$6.4 per U.S. dollar on October 24. The authorities considered that the exchange rate depreciation and its price consequences could lead to a recurrence of civil unrest and might undermine business confidence. Moreover, they felt that most sectors of the Jamaican economy were internationally competitive at an exchange rate of J\$5.5 per U.S. dollar. They increased the supply of foreign exchange in the auction market to cause an appreciation of the Jamaica dollar to J\$5.5 per U.S. dollar and maintain it at that level (Charts 1 and 2). In this endeavor, the authorities used some resources which had not been foreseen in the program (including proceeds from the sale of an office building in New York), and in addition accumulated significant external arrears. The latter also partly reflected their inability to make further purchases under the stand-by arrangement and delays in disbursements of programmed aid flows. According to preliminary data, by the end of December 1985 arrears amounted to US\$112 million, including SDR 27.7 million to the

Table 6. Jamaica: Balance of Payments

(In millions of U.S. dollars)

	1980/81	1981/82	1982/83	1983/84	Prel. 1984/85	1985/86		April-Sept. 1985/86	
						Prog.	Rev.	Prog.	Prel.
<u>Current account deficit</u>	-189	-438	-461	-282	-267	-209	-323	-135	-193
<u>Trade account</u>	-192	-599	-658	-529	-513	-467	-599	-230	-286
Exports, f.o.b.	1,010	889	734	722	723	632	530	317	289
Bauxite/alumina	785	669	473	477	436	326	275	148	151
Nontraditional (excluding CARICOM)	80	84	105	96	151	177	160	94	80
Other	145	136	156	149	136	129	95	75	58
Imports, c.i.f.	-1,202	-1,488	-1,392	-1,251	-1,236	-1,099	-1,129	-547	-575
Bauxite related	-284	-300	-230	-216	-207	-190	-190	-87	-84
Nonbauxite related	-918	-1,188	-1,162	-1,035	-1,029	-909	-939	-460	-491
<u>Service and transfer account</u>	3	161	197	247	246	258	276	95	93
Travel (net)	230	301	317	361	368	394	365	192	164
Interest payments (net)	-176	-219	-250	-252	-279	-324	-314	-171	-152
Other services (net)	-146	-45	-20	-15	10	33	70	13	17
Transfers (net)	95	124	150	153	147	155	155	61	64
<u>Capital account</u>	37	481	241	-166	764	208	419	167	196
<u>Public (net)</u>	211	427	314	65	567	168	275	105	73
Inflow	314	649	639	450	974	606	702	297	269
Bilateral	66	188	293	273	583	228	347	...	...
Multilateral	25	66	51	51	65	97	82	...	...
Commercial banks	52	119	44	--	164	97	94	...	...
Other	171	276	251	126	162	184	179	...	...
Outflow	-103	-222	-325	-385	-407	-438	-427	-192	-196
<u>Private capital (net) 1/</u>	-174	54	-73	-231	197	40	144	62	123
<u>Overall balance of payments</u>	-152	43	-220	-448	497	-1	96	32	3
<u>Financing</u>	152	-43	220	448	-497	-96	-96	-32	-3
<u>Change in net international reserves (increase -)</u>	152	-43	122	306	-266	-81	-81	-17	12
Gross reserves	11	-57	44	27	-127	34	11	48	52
Net use of IMF resources	-36	168	134	39	39	-19	-20	16	13
Arrears 2/	65	-106	--	190	-118	-72	-72	-72	-65
Other	112	-48	-56	50	-60	-24	--	-9	12
<u>Other arrears 3/</u>	--	--	98	142	-231	-15	-15	-15	-15
<u>Memorandum items</u>									
<u>Bauxite equivalent (millions of metric tons)</u>	12.4	11.0	7.8	8.5	7.6	6.2	5.9	...	...
<u>Current account deficit (in percent of GDP)</u>	-9.0	-20.2	-23.3	-12.7	-12.3	-11.6	-16.2	...	...
<u>Rescheduled debt (millions of U.S. dollars)</u>	52	87	153	111	535	206	206	...	...
<u>Outstanding debt (millions of U.S. dollars)</u>	...	...	2,812	3,090	3,440	3,730	3,741	...	...
<u>Debt service (in percent of goods and services) 4/</u>	...	...	36.5	41.5	48.6	57.0	59.8	...	...

Sources: Bank of Jamaica; and Fund staff estimates.

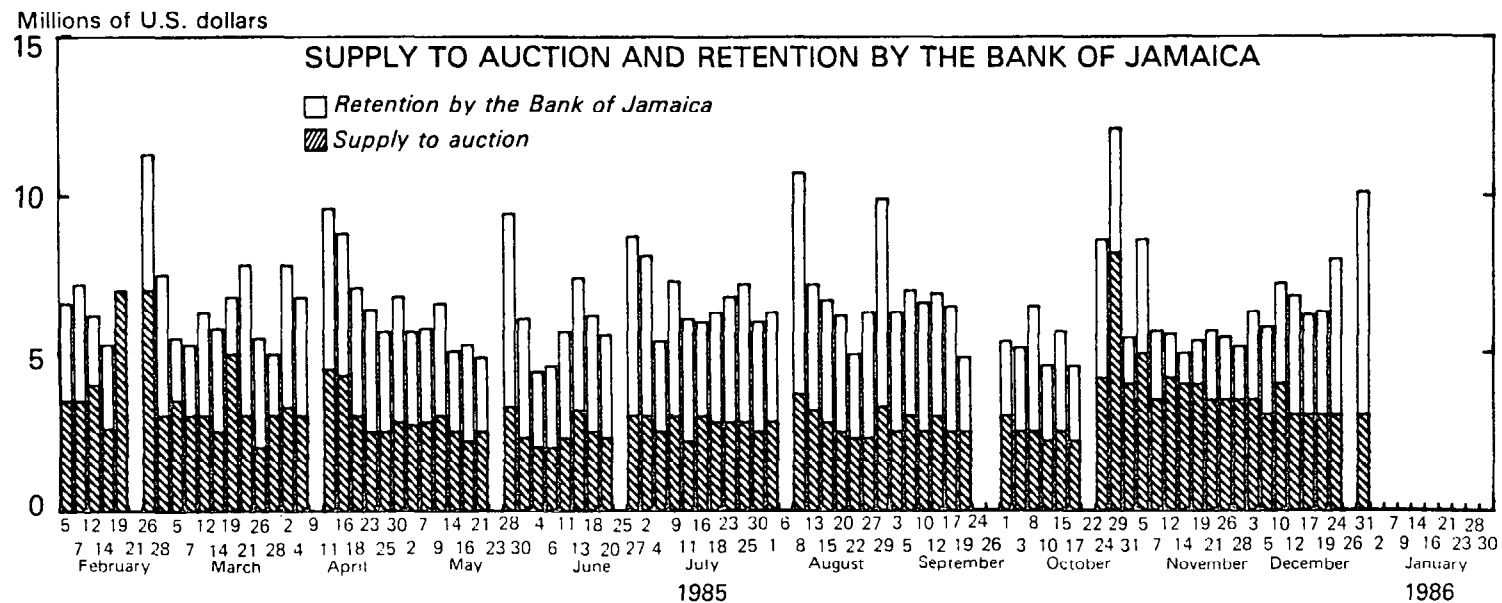
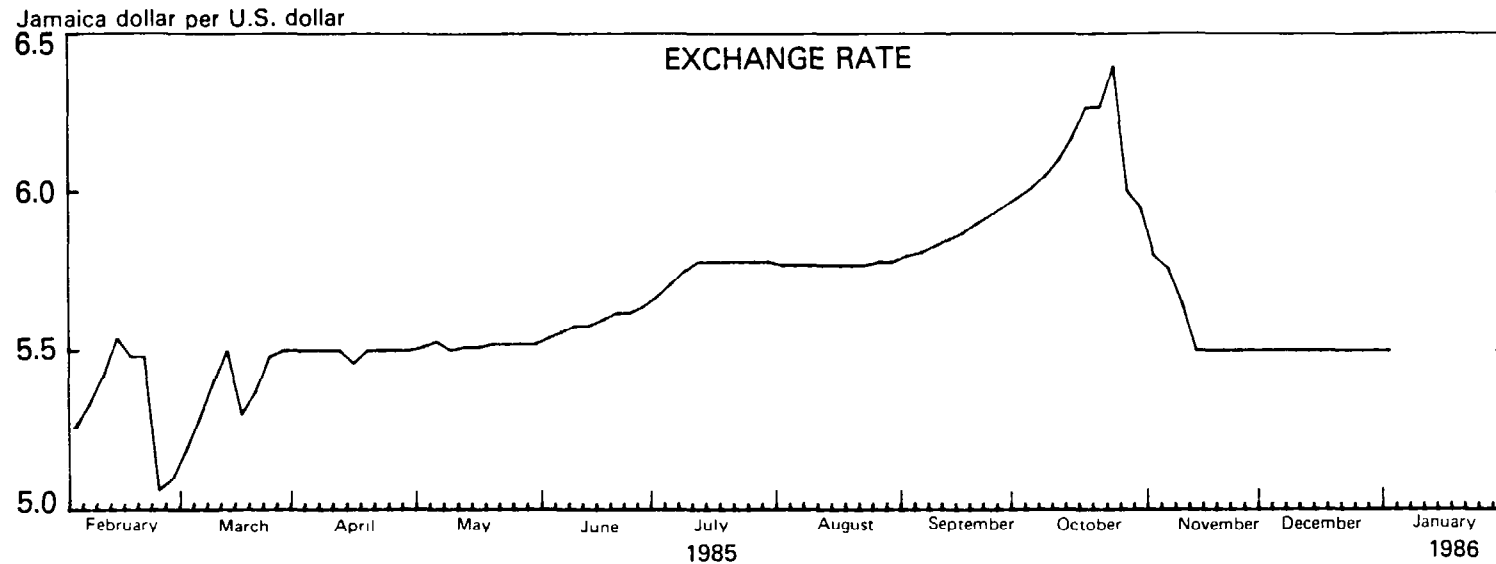
1/ Includes errors and omissions.

2/ Overdue payments treated as reserve liabilities for program purposes.

3/ Includes private sector overdue payments and overdue official debt payments in the process of being refinanced.

4/ Before rescheduling.

CHART 1
JAMAICA
FOREIGN EXCHANGE AUCTION

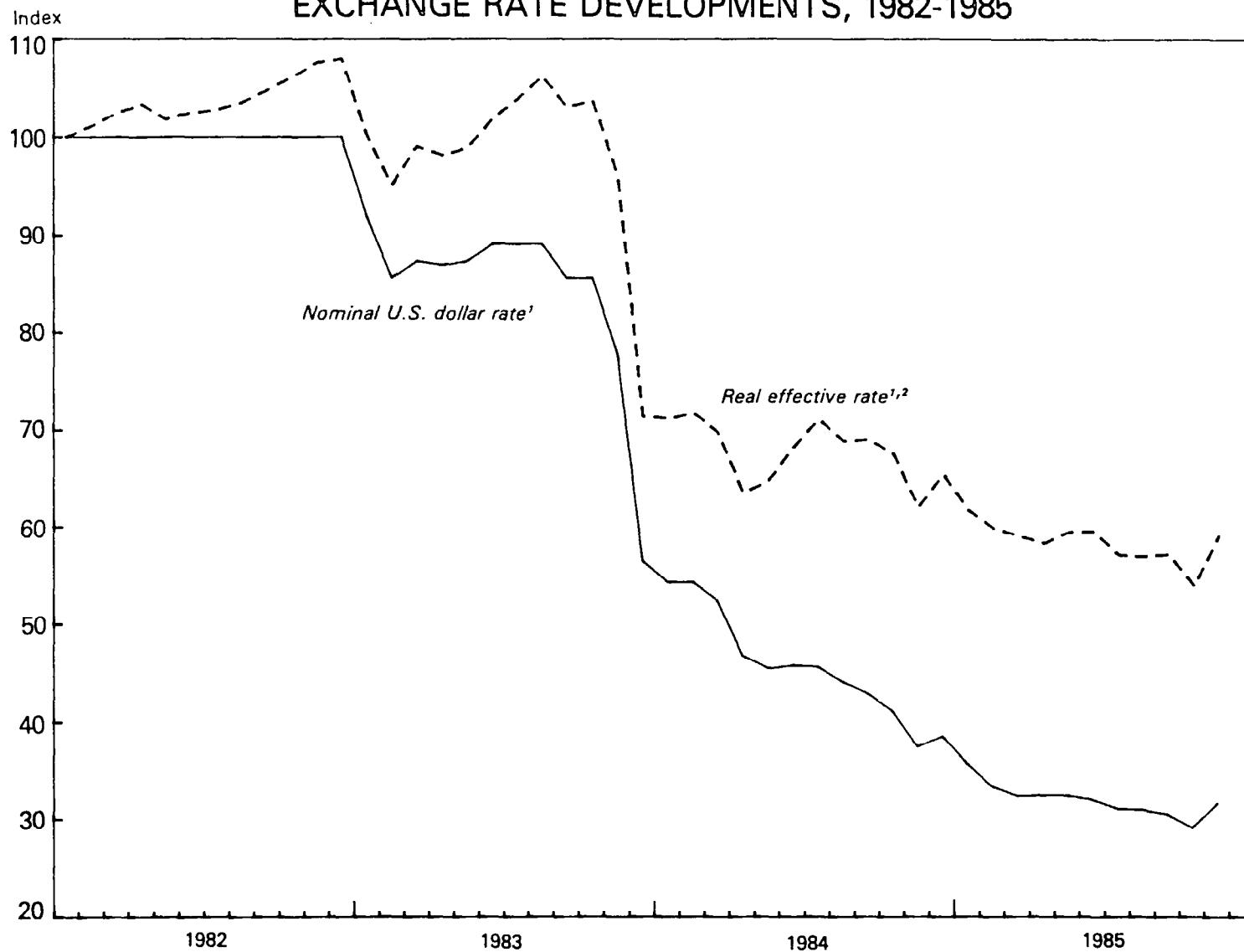


Source: Bank of Jamaica.



CHART 2
JAMAICA

EXCHANGE RATE DEVELOPMENTS, 1982-1985



¹January 1982=100.

²Trade weighted 1980 average value of partner countries currencies in terms of Jamaica dollars, adjusted for movements in relative consumer prices (increase in index denotes appreciation); incorporates officially-sanctioned dual market transactions and, for 1979 and beyond, transactions in the black market.

Fund. The net foreign assets target for that date was missed by US\$122.5 million, about half of which could be ascribed to delayed aid disbursements.

Concurrently with the decision to change the exchange rate policy, the Jamaican authorities requested that the Fund, the IBRD, and U.S. AID carry out a joint mission to review economic policies in Jamaica, and initiated discussions with the Fund staff on policy adaptations that would be consistent with maintenance of a J\$5.5 exchange rate through the remainder of 1985/86 while achieving the balance of payments objectives of the program. These discussions and the policy modifications that have been adopted are summarized below.

III. Policy Modifications

The Jamaican authorities were convinced that a depreciation of the Jamaica dollar at this stage would be counterproductive, as it would trigger increases in prices of gasoline and basic foods that would result in civil disturbances and undermine confidence. The authorities ascribed the poor performance of the export sector to factors other than competitiveness, again emphasizing the lack of confidence. They therefore favored concentrating on measures in the fiscal and monetary areas. It was agreed that, consistent with no change in the exchange rate over the period April 1985-March 1986 (i.e., maintenance of the rate of J\$5.5 per U.S. dollar) net domestic assets of the banking system would need to contract by 5 percent over the fiscal year ending March 1986 (in relation to private sector liabilities outstanding at the beginning of the period), compared with a planned expansion of 5 percent. In order to limit the credit contraction in the private sector, policy measures were agreed that would reduce the fiscal deficit by around J\$100 million below the original program level by end-March, and the selected entities also were targeted to reduce their domestic borrowing by J\$30 million compared to program. Even so, a reduction of outstanding commercial bank credit to the private sector of almost 6 percent from its end-November level would be necessary to achieve the new targets, implying no growth in private credit for the year as a whole and a reduction in real terms of 15-18 percent.

a. Central government finances

In the original program, the central government deficit was projected to be reduced from 6.6 percent of GDP in 1984/85 to 6 percent of GDP in 1985/86. In order to address the fiscal gap for the second year of the program, the authorities also undertook to implement two rounds of recurrent expenditure reductions each equivalent to 1 percent of GDP on an annual basis. The first round was implemented in July-September and a second round by early January 1986.

The major part of the expenditure reductions involved the elimination of some duplication of functions within the Central

Government and between the central and local government levels, affecting a total of 14,000 personnel positions, including temporary workers and vacancies. Because some of these personnel have been transferred to other agencies, the net effect in terms of personnel reduction is not known. The measures are expected to reduce direct government wage payments by around J\$150 million on an annual basis, but their effect in 1985/1986 is reduced by redundancy payments estimated at J\$89 million. Among the services that are being reorganized is water distribution for areas outside metropolitan Kingston, which was previously the responsibility of the local governments. The National Water Commission (NWC) has now taken over this function, and the costs will be covered by a rate increase of 88 percent on all users of the system, thereby eliminating budgetary transfers that used to be given to both the local governments and the NWC. Also, fees for tertiary level education will be introduced as from September 1986 to cover part of the costs of the university and thereby reduce budgetary transfers.

In early January the authorities adopted measures designed to raise revenues by a further J\$100 million (or almost 1 percent of GDP) during the period January-March 1986. The measures included the removal of exemptions from import stamp duties for a selected group of imported goods; elimination of exemptions of certain public enterprises from payment of indirect taxes and income taxes; increases in specific excise taxes on alcohol, cigarettes and aerated water and other beverages; new user taxes on telephone calls, telecommunications and microwave antennas; and increases in travel taxes and stamp duty on airline tickets. In addition, the authorities imposed a nonrecurring conversion fee on motor vehicle registration plates, reached agreement with insurance companies to pay income tax arrears at a reduced rate, and finalized arrangements to collect a construction levy that had been introduced 18 months previously. The latter group of measures are expected to yield about half of the anticipated incremental revenues in the first quarter of 1986. To offset the cash-flow impact of the tax package on the public entities as a group, the Government increased Port Authority wharfage charges on some imports.

b. Operations of the public entities

The selected entities as a group complied with the program ceilings on use of net domestic bank credit in July, September and December with a substantial margin. However, their performance was not as favorable as might appear because of an accumulation of external arrears of the Jamaica Commodity Trading Corporation (JCTC), a drawdown of inventories by the publicly owned petroleum refinery, and a temporary buildup of bank deposits by entities that were expected to invest surplus funds in government papers. In addition, the financial outcome of the entities as a group benefited from the sale of an office building in New York by the National Investment Bank of Jamaica, a transaction which had not been foreseen in the program. Because of the recent appreciation of the Jamaica dollar, the selected entities are now expected to reduce their credit requirements compared with the original program, without any price adjustments.

c. Monetary and credit policies

Under the revised monetary program outlined above, since early January 1986 the Bank of Jamaica has sold large amounts of treasury bills and CDs in order to tighten liquidity conditions. These open market operations have been designed to limit the growth of base money at end-January and end-March to the levels specified in the attached letter of intent. The authorities have agreed that if base money at the end of January were above the stipulated target, additional sales of CDs would be made in early February. Further open market operations also would be undertaken during the rest of the first quarter to assure compliance with the end-March target for base money.

The authorities felt that the credit squeeze on the private sector resulting from the tightening of liquidity would be mitigated by increased use of external credit lines through the World Bank's Export Development Fund, the IDB's Rehabilitation Fund, and Eximbank facilities. Procedures for making use of these loans have been modified to allow the Jamaican Export Credit Insurance Corporation (JECIC), a subsidiary of the Bank of Jamaica, to provide guarantees for up to 80 percent of the loans, instead of the local commercial banks. As a result, they estimated that drawdowns under these facilities could reach some US\$25 million in the first quarter of 1986, offsetting the reduction in domestic bank credit to the private sector. They also pointed out that the attainment of the March 1986 balance of payments targets depended on securing large private capital inflows, which would be stimulated by these policies.

The authorities felt that the interest rate effects of these monetary policies might be mitigated if the minimum savings rate, which is presently set at 20 percent, were abolished. They agreed with the staff, however, that there was some merit in retaining the minimum savings rate as a floor until other distortions in the interest rate structure had been reduced. In particular they were aware of the large spread between bank deposit and loan rates resulting from the liquid assets requirement of 48 percent dischargeable in cash and government securities, and the nonremunerated cash reserve requirement of 20 percent. Also it was noted that, with prices rising by 23 percent in the year ended December, savings rates have been negative in real terms. Moreover, real interest rates would be effectively lowered by the imposition of a withholding tax in the near future.

The authorities added that these issues were about to be tackled in the context of a forthcoming World Bank financial sector loan, which contemplates the removal of the minimum savings rate after the liquid assets ratio has been reduced significantly, and after interest was being paid to banks on the cash reserve requirement above 10 percent.

As a result of the open market sales by the Bank of Jamaica, in early January the discount rate on treasury bills rose from less than 18 percent to 22 percent, and rates on Bank of Jamaica CDs which

initially were under 22 percent have been ranging up to 27 percent on an annual basis.

d. Balance of payments financing

Significant shortfalls are expected in bilateral and multilateral loan disbursements resulting from slow execution of projects and cutbacks in the availability of certain credits. To offset these shortfalls, the Jamaican authorities have undertaken additional refinancing and borrowing operations that were not contemplated in the original program. These include refinancing of US\$27.7 million by Trinidad and Tobago and of other obligations falling due by Venezuela. In addition, Libya is being approached to refinance some US\$14 million that has fallen due. Furthermore an 18-month loan from a commodities broker, linked to future sales of alumina, is being concluded in an amount of US\$27 million (last year Jamaica had a similar arrangement). Under the program these operations would have led to an adjustment of the net foreign assets target or a breach in the ceiling on one- to five-year borrowing. However, since they are expected to cover shortfalls on bilateral and multilateral loans, thereby keeping the program level of net official capital flows on target, it is proposed to increase the program subceiling on refinancing by US\$ 25 million, and to raise the ceiling on gross disbursements of debts with a maturity range of one to five years by US\$10 million.

Jamaica is making good progress in completing the bilateral agreements under the Paris Club rescheduling and has also initiated discussions with other official bilateral creditors that did not participate in the Paris Club meeting. The commercial banks have agreed in principle to a rescheduling of 100 percent of principal payments falling due in 1985/86 and 1986/87; this agreement is expected to be signed shortly. The commercial bank agreement would be in line with the assumptions built into the original program.

IV. Medium-term Outlook

When the 22-month program was drawn up and quantitative performance criteria were agreed for 1985/86, the medium-term balance of payments projections indicated large financing gaps through the end of the projection period, in spite of the assumptions that a continued high level of balance of payments support would be forthcoming from donor countries and that nontraditional exports and tourism would perform strongly. The medium-term financing gaps have now widened because of the virtual stagnation of nontraditional exports and the reduction in tourism earnings that have occurred during 1985/86. Closing these gaps would require a substantial compression of imports and even larger exceptional balance of payments support, including continued debt rescheduling (Table 7). The policy framework needed to address this

Table 7. Jamaica: Medium-Term Balance of Payments Outlook

	Prel.	Prog.	Rev.	Proj.			
	1984/85	1985/86	1985/86	1986/87	1987/88	1988/89	1989/90
(In millions of U.S. dollars)							
Current account	-267	-209	-323	-256	-241	-245	-254
Trade account	-513	-467	-599	-505	-523	-543	-561
Exports, f.o.b.	723	632	530	533	548	601	662
Bauxite/alumina	436	326	275	242	220	231	242
Nontraditional (excluding CARICOM)	151	177	160	182	210	243	281
Other	136	129	95	109	118	127	139
Imports, c.i.f.	-1,236	-1,099	-1,129	-1,038	-1,071	-1,144	-1,223
Bauxite related	-207	-190	-190	-152	-141	-148	-155
Nonbauxite related	-1,029	-909	-939	-886	-930	-996	-1,068
Service and transfer account	246	258	276	249	282	298	307
Travel (net)	368	394	365	399	435	474	516
Interest payments (net)	-279	-324	-314	-339	-333	-349	-375
Other services (net)	10	-33	70	20	14	2	-11
Transfers (net)	147	155	155	160	166	171	177
Capital account	764	208	419	103	79	128	107
Public (net)	567	168	275	53	79	128	107
Inflow	974	606	702	543	457	445	426
Bilateral	583	228	347	228	200	200	200
Multilateral	64	97	82	70	45	45	45
Commercial banks	164	97	94	99	91	67	36
Other	162	184	179	146	121	133	145
Outflow	-407	-438	-427	-490	-378	-317	-319
Private capital (net) 1/	197	40	144	50	--	--	--
Overall balance of payments	497	-1	96	-153	-162	-117	-147
Financing	-497	-96	-96	-90	-165	-178	-132
Change in net international reserves							
increase -)	-266	-81	-81	-90	-165	-178	-132
Gross reserves	-127	34	11	-11	-20	-20	-20
Net use of IMF resources	39	-19	-20	-65	-131	-158	-112
Arrears	-113	-72	-72	--	--	--	--
Other	-65	-24	--	-14	-14	--	--
Other liabilities 2/	-231	-15	-15	--	--	--	--
Financing gap/exceptional financing	--	97 3/	--	244 4/	327	295	279
Memorandum items							
Exports of bauxite and alumina in bauxite equivalent (millions of metric tonnes)	7.6	6.2	5.9	4.8	4.8	4.8	4.8
Current account deficit (in percent of GDP)	-12.3	-11.6	-16.2	-14.1	-13.1	-13.0	-12.9
Outstanding medium- and long-term public and publicly guaranteed debt 5/ (in millions of US\$)	3,440	3,730	3,741	3,779	3,727	3,697	3,697
(in percent of GDP)	159	206	206	217	223	225	222
Debt service (in percent of exports of goods and services)	48.6	57.0	59.8	66.9	57.5	51.4	46.7

Sources: Bank of Jamaica; and Fund staff estimates.

1/ Includes net errors and omissions.

2/ Arrears that were excluded from reserves for program purposes.

3/ The original program was drawn upon the assumption that the financing gap would be closed through rescheduling of debt falling due to official bilateral creditors. The outcome of the reschedulings was in line with the working assumption on which the program had been based.

4/ Before rescheduling of debt falling due to official bilateral creditors. Preliminary staff estimates show that US\$125 million to US\$150 million of debt service payments to official creditors will be eligible for rescheduling in 1986/87.

5/ Does not include debt contracted to close the financing gap.

prospect is being analyzed by the tripartite mission that is reviewing Jamaica's medium-term adjustment strategy.

The fiscal outlook over the medium term also indicates a need for substantial further adjustment to bring the scope of public sector activities in line with the declining availability of bauxite sector resources and a sustainable level of foreign borrowing. The success of this effort would depend heavily on improved allocative efficiency of the tax and budget system. In this regard, the Jamaican authorities have completed a three-year study of the tax system with assistance from U.S. AID and are about to implement major reforms. The tax reform encompasses reductions in individual income tax rates, together with a widening of the income tax base in early 1986, and reductions in corporate income tax rates in 1987. In addition, the authorities plan to introduce a general consumption tax in late 1986 that would rationalize and simplify existing indirect taxes. Changes in the import tax regime would include modifications to the tariff structure, following recommendations from an IBRD-sponsored study on comparative advantage. Steps are being taken to improve customs administration, including the use of an international valuation service for import declarations. Property valuation has been updated and will serve as a basis for the revised property taxation to be introduced in 1986.

The comprehensive tax reform will be implemented over a number of years and is likely to have an adverse revenue impact in the early stages. This prospect adds to the need for a comprehensive review of all budgetary and extrabudgetary expenditures in Jamaica to establish priorities and to facilitate the needed reduction in the fiscal deficit.

V. Modifications to the Program

The modifications to the original program targets for March 1986, which are detailed in the technical memorandum annexed to the attached letter, involve a reduction in the borrowing requirement of the Central Government, consistent with the adoption of the fiscal measures described above; a reduction in the use of domestic credit by the selected entities; a reduction of the net domestic assets target for the Bank of Jamaica, consistent with the new credit and exchange rate policy; an increase in the ceiling on debt disbursements with a maturity of one to five years, and an increase in the ceiling on rescheduling to allow the refinancing of certain obligations to offset shortfalls in new disbursements. There is no change proposed in the original program targets relating to the net international reserves of the Bank of Jamaica, and arrears, which have accumulated in recent months, are to be eliminated by end-March.

As a guideline in the attainment of the March targets, the authorities and the staff have developed a set of indicative targets for end-January 1986. The end-January targets, which are detailed in the second annex to the attached letter, include ceilings on the borrowing requirement of the Central Government, on domestic credit to the selected

entities, on net domestic assets of the Bank of Jamaica, on medium- and long-term external debt of the public sector, and on debt rescheduling or refinancing. In addition, there is a target for the net international reserves of the Bank of Jamaica and a targeted reduction in arrears to a level not exceeding US\$52 million.

The discussions that form the basis of the present program review and the modifications to the quantitative performance criteria cover the period through March 1986. Quantitative performance criteria for the remaining 12 months of the program will be negotiated in the next few months in light of the findings of the tripartite mission and the degree of international assistance available to support Jamaica's adjustment effort.

VI. Staff Appraisal

During the first nine months of FY 1985/86, exports, tourism receipts and official capital inflows fell short of projections while imports, although lower than in the previous year, were higher than had been programmed. Despite large private capital inflows that partly offset the adverse developments in the current account and in official flows, Jamaica did not comply with the net foreign assets targets in September and December and accumulated external arrears amounting to US\$112 million by end-December 1985. Although these negative developments in part reflected delays in disbursements of official balance of payments support funds, they also reflected Bank of Jamaica intervention in the foreign exchange auction market since late October that caused the Jamaica dollar to appreciate from J\$6.4 per U.S. dollar to J\$5.5 per U.S. dollar by mid-November.

The Central Government through September observed the overall borrowing requirement ceilings under the program, but its performance was weaker than programmed as lower than budgeted revenues have been offset by delays in project implementation. The shortfall in foreign financing led to a larger than programmed use of domestic bank credit by the Central Government which, after September, was accompanied by a rapid expansion of bank credit to the private sector. As a result, the Bank of Jamaica failed to comply with its net domestic assets and reserve targets for September and December.

The authorities have decided to adopt a policy package for the rest of the current fiscal year that seeks to maintain the exchange rate of J\$5.5 per U.S. dollar, because of the likely social and political repercussions from price increases that would be triggered by a depreciation of the exchange rate at this time. The staff recognizes these constraints, but would underscore that the heavy reliance on demand management policy that is involved in the approach adopted by the authorities may have significant costs in terms of output and employment, and may be protecting consumption at the expense of investment.

Pegging the exchange rate at the level reached in March 1985, even temporarily, while domestic prices have been rising by 15-18 percent a year involves a real appreciation which will weaken the process of export diversification and structural change. Thus, the pegging of the rate would seem feasible only on a temporary basis; beyond the short run, it is the staff's view that a flexible exchange rate policy is needed to maintain the competitiveness of the economy, encourage growth and structural change, and prevent capital outflows.

The decision to maintain the exchange rate requires that monetary and fiscal policies have to be adjusted to reduce absorption. In addition to fiscal measures, open market operations will need to be pursued aggressively to attain the revised net domestic assets target of the Bank of Jamaica. These operations may result in significant increases in interest rates, with consequences for economic activity and investment.

Although fiscal policies have been tightened recently, the staff is concerned that about half of the expected revenue increases are one-time measures and thus will not improve the budget on a permanent basis. Considerable fiscal action will be needed to close the large gaps that are expected for 1986/87 and beyond.

The staff welcomes the proposed tax reforms, which should make an important contribution to the restructuring of the economy, and urges their prompt implementation. However, care will need to be taken to avoid a significant net revenue loss. At the same time, major attention needs to be given to public expenditure. Up to now expenditure reduction measures have been mainly of an ad hoc nature. In view of the fiscal constraints, a major comprehensive review of the priorities and controls on all central government outlays needs to be undertaken without delay.

The group of selected public entities continues to be a problem area, and a major strengthening of their finances is required. The necessary improvements involve rationalization of administrative practices, restructuring and consolidating enterprises, and the adoption of pricing policies that reflect opportunity costs.

Jamaica's medium-term outlook remains extremely difficult and substantial financing gaps are envisaged. Demand management policies and structural adjustment efforts need to be strengthened, and supported by a cautious incomes policy and a flexible exchange rate policy. The report of the tripartite mission (composed of the IBRD, U.S. AID, and the Fund) is expected to provide an important input in the design of the policy framework that addresses the medium-term difficulties faced by Jamaica and that can mobilize the needed domestic support and external assistance.

The staff would prefer that the authorities opt soon for a more market-oriented exchange system and for financial policies that provide

greater room for private sector investment. The present combination of policies, if continued beyond the short run, is likely to impede growth and the needed structural changes.

In the circumstances the staff proposes that the Fund reaches the understandings set out in the proposed decision and described in the attached letter and annexes, and completes the program review.

VII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1. Jamaica has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Jamaica (EBS/85/162, Sup. 2) in order to reach understandings on the circumstances in which purchases can be resumed under the arrangement.
2. The letter from the Prime Minister and Minister of Finance and Planning and the Governor of the Bank of Jamaica dated January 31, 1986, the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985 and the Understanding on Targets for January 31, 1986 shall be annexed to the stand-by arrangement for Jamaica and the letter of June 7, 1985 and the Technical Memorandum of Understanding attached thereto shall be read as modified and supplemented by these documents.
3. Accordingly, the quantitative limits and target of the stand-by arrangement through March 31, 1986 shall be as follows:
 - (i) The limit on the central government borrowing requirement referred to in paragraph 4(a)(i) of the arrangement shall be as stated in paragraph 2 of the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985;
 - (ii) The limit on net domestic credit to the selected public entities referred to in paragraph 4(a)(ii) of the arrangement shall be as stated in paragraph 3 of

the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985;

- (iii) The limit on net domestic assets of the Bank of Jamaica referred to in paragraph 4(a)(iii) of the arrangement shall be as stated in paragraph 4 of the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985;
- (iv) The limit on external payments arrears referred to in paragraph 4(b) of the arrangement shall be as stated in paragraph 7 of the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985;
- (v) The limit on net disbursements of new public and publicly guaranteed foreign indebtedness referred to in paragraph 4(d) of the arrangement shall be as stated in paragraph 5 of the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985;
- (vi) The limit on external public debt rescheduling or refinancing referred to in paragraph 4(e) of the arrangement shall be as stated in paragraph 6 of the Amendment to the Technical Memorandum of Understanding attached to the letter of June 7, 1985.

4. The Fund finds that the review contemplated in paragraph 4 of the stand-by arrangement has been completed, and that Jamaica may proceed to make purchases under the arrangement.

Exchange System

Jamaica retains a multiple currency practice resulting from the auction system as described in EBS/85/162. The Fund grants approval for the retention of this practice until May 31, 1986 or the completion of the next Article IV Consultation, whichever is earlier.

Jamaica - Fund Relations

I. Membership status

- (a) Date of membership February 21, 1963.
(b) Status: Article VIII.

(A) Financial Relations (as of December 31, 1985)

II. General Department

- (a) Quota: SDR 145.5 million
(b) Total Fund holdings of Jamaica dollars:
SDR 776.67 million or 533.8 percent of quota
(c) Fund credit (i.e., Fund holdings of Jamaica dollars
subject to repurchase and charges):

	Millions of SDRs	As Percent of Quota
Total Fund credit	631.10	433.8
Of which: Under tranche policy	533.90	367.0
Credit tranches	76.96	52.9
Extended facility	456.94	314.1
Ordinary resources	(132.18)	(90.9)
Supplementary financing	(150.86)	(103.7)
Enlarged access resources	(173.90)	(119.5)
Under CFF	97.20	66.8
(d) Reserve tranche position: --		

III. Current stand-by or extended arrangement and special facilities

- (a) Current stand-by arrangement:
 (i) Duration: July 17, 1985 to May 31, 1987
 (ii) Amount: SDR 115 million
 (iii) Utilization: SDR 15 million
 (iv) Undrawn balance: SDR 100 million
(b) Stand-by and extended arrangements during the last ten years:

Type	Date	Duration	Amount	(millions of SDRs)	(In percent of then quota)
Stand-by	6/01/73	1 year	26.5	26.5	50.0
Stand-by	8/11/77	2 years	64.0	19.2	25.9
EFF	6/09/78	3 years	200.0		
(augmented)	6/11/79		259.7	155.0	209.5
EFF	4/13/81	3 years	477.7	402.8	362.9
Stand-by	6/22/85	1 year	64.0	64.0	44.0

(c) Special facilities during the last 5 years:

CFF	4/13/81	SDR 37.0 million
CFF	8/25/82	SDR 19.4 million
CFF	6/26/84	SDR 72.6 million

IV. SDR Department

- (a) Net cumulative allocation: SDR 40.61 million
- (b) Holdings: SDR -- million (0.00 percent of net cumulative allocation)

V. Administered Accounts

- (a) Trust Fund loans: --
- (b) SFF Subsidy Accounts: Payments by Fund
 - August 10, 1982 SDR 4.67 million
 - September 29, 1983 SDR 3.33 million
 - July 20, 1984 SDR 3.07 million
 - Total SR 11.07 million

VI. Overdue Obligations to Fund

Jamaica has frequently experienced difficulty in remaining current with the Fund within the past two years and has been overdue on payments for periods ranging from a few days to eight weeks. Jamaica is at present current with the Fund.

(B) Nonfinancial Relations

VII. Exchange Rate Arrangement

In November 1983, Jamaica adopted a unified floating rate within an adjustable exchange rate band. An auction mechanism to determine rates was instituted in December 1983, modified in March and November 1984.

VIII. Last Article IV Consultation

March 1985, completed by the Executive Board on July 17, 1985 (standard 12-month cycle).

IX. Technical Assistance

CBD: Two CDB advisors were assigned to the Bank of Jamaica from April 1983 to November 1984.

X. Resident Representative

Mr. Daniel Citrin, since December 1, 1984.

Jamaica--Basic Data

Area and population

Area	4,411 sq. miles (11,424 sq. kilometers)
Population (1984)	2.2 million
Annual rate of population increase (1978-84)	1.1 percent
Unemployment rate (October 1984)	25.4 percent

GDP (1984) 1/

SDR 2,319 million
US\$2,376 million
J\$9,368 million

GDP per capita (1984)

SDR 1,054

Origin of GDP (1984)

(percent)

Agriculture and fishing	9.3
Mining	4.2
Manufacturing	15.9
Construction	5.4
Government	19.6
Other	45.6

Ratios to GDP (1984)

Exports of goods and nonfactor services	60.6
Imports of goods and nonfactor services	65.6
Central government revenues (fiscal year from April 1)	28.6
Central government expenditures (fiscal year from April 1)	35.2
External government and government-guaranteed debt (fiscal year from April 1)	158.5
Gross national savings	8.1
Gross domestic investment	21.0
Money and quasi-money (end of year)	38.2

<u>Annual percentage changes in selected economic indicators</u>	<u>1982/83</u>	<u>1983/84</u>	<u>Prel. 1984/85</u>	<u>1985/86</u>	
				<u>Prog.</u>	<u>Rev.</u>
Real GDP per capita	-1.5	0.6	-1.5	-6.3	-6.3
Real GDP	0.5	1.1	-0.2	-3.8	-3.8
GDP at current prices	11.4	20.2	29.8	18.6	18.6
Domestic expenditure (at current prices)	10.0	14.5	23.6	16.5	24.4
Investment	3.8	18.9	27.2	10.4	2.3
Consumption	11.5	13.5	22.8	18.1	30.0
GDP deflator	10.4	19.0	29.8	23.4	23.4
Consumer prices (period average)	7.1	14.9	29.9	23.0	23.0
Money and quasi-money	26.8	26.3	18.3	17.5	4.6
Money	2.3	21.3	22.1	...	...
Quasi-money	35.5	26.5	17.1	...	...
Net domestic bank assets 2/	33.1	57.6	-12.2	5.2	-5.1
Credit to public sector (net)	30.6	17.3	-19.2	-20.8	-18.5
Credit to private sector	20.5	17.6	4.3	9.1	0.9
Central government revenues	9.9	9.9	50.7	28.4	23.2
Central government expenditures	9.7	14.1	14.8	24.9	17.4
Merchandise exports (f.o.b., in U.S. dollars)	-17.4	-1.7	0.1	-12.6	-26.7
Merchandise imports (c.i.f., in U.S. dollars)	-6.5	-10.1	-1.2	-11.1	-8.7
Travel receipts (net, in U.S. dollars)	5.6	13.7	1.9	7.1	-0.8

<u>Central government finances</u>	<u>1982/83</u>	<u>1983/84</u>	<u>Prel. 1984/85</u>	<u>Prog. 1985/86</u>	<u>Rev. Prog.</u>
	<u>(millions of Jamaica dollars)</u>				
Revenues	1,659.0	1,798.0	2,708.9	3,479.0	3,340.0
Expenditures	2,518.0	2,902.0	3,332.0	4,163.0	3,912.0
Current account deficit (-)	-292.4	-596.0	-109.0	86.0	33.0
Overall deficit (-)	-859.0	-1,104.0	-623.1	-684.0	-572.0
External financing (net)	419.0	411.0	1,047.1	1,372.0	1,187.0
Domestic financing (net) and residual	440.0	693.0	-424.0	-688.0	-615.0
<u>Balance of payments</u>	<u>(millions of U.S. dollars)</u>				
Merchandise exports (f.o.b.)	734.2	721.8	722.7	632.0	530.0
Merchandise imports (c.i.f.)	-1,391.6	-1,250.7	-1,235.8	-1,099.0	-1,129.0
Travel (net)	317.3	360.9	367.7	394.0	365.0
Investment income (net)	-214.6	-215.6	-296.0	-324.0	-314.0
Other services and transfers (net)	94.2	101.2	157.0	188.0	225.0
Balance on current and transfers accounts	-460.5	-282.4	-267.4	-209.0	-323.0
Official capital (net)	314.4	65.4	567.2	168.0	275.0
Private capital (net) and errors and omissions	-73.3	-231.2	197.4	40.0	144.0
SDR allocation	--	--	--	--	--
Overall balance	-220.0	-448.2	497.2	-1.0	96.0
<u>International reserve position</u>	<u>(end of period, millions of U.S. dollars)</u>				
Central Bank (gross)	188.1	65.0	191.6	158	181
Central Bank (net)	-619.2	-859.3	-555.2	-474	-474

1/ Based on the average exchange rate for the Jamaica dollar.

2/ In relation to the stock of bank liabilities to the private sector at the beginning of the period.

January 31, 1986
Kingston, Jamaica

Mr. Jacques de Larosiere
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosiere:

On July 17, 1985, the Fund's Executive Board approved a 22-month stand-by arrangement in support of a financial program for the balance of 1985/86 and 1986/87, as described in our letter to the Managing Director dated June 7, 1985. The Government of Jamaica hereby requests from the International Monetary Fund waivers from the performance criteria on Bank of Jamaica net foreign assets, Bank of Jamaica net domestic assets, on external arrears and on restrictions on current payments due to the incurring of arrears. The Government also requests approval of modifications to certain performance criteria for March 1986 on the basis of the policies and measures described below.

Our program for 1985/86 anticipated that net foreign exchange earnings from exports of bauxite and alumina would decline very substantially. However, over the last few months it became clear that the decline in earnings from exports of bauxite and alumina would prove to be even larger than expected, and that the growth in nontraditional exports and tourism would be significantly below what was programmed. Furthermore, although imports were down significantly compared to last year, the decline would fall short of what had been programmed. Thus, by September it was apparent that the balance of payments current account deficit, on an annual basis, would be some US\$100 million above program.

Through September, the higher than programmed current account deficit was exacerbated by a shortfall on the official capital account of about US\$40 million, reflecting a slower than expected disbursement of project-related loans and a delay in the disbursement of US\$15 million from the United States' Economic Support Fund (ESF). Nevertheless, the combined shortfall on the current and official capital accounts was largely offset by a much higher than programmed private capital inflow. As a result, the net foreign asset ceiling for end-September was missed by only US\$29 million, of which US\$15 million was due to the delayed disbursement from the ESF facility. These figures included US\$7 million of new external arrears.

The shortfalls on the current and official capital accounts were associated with increasing pressure on the exchange rate, which began to depreciate rapidly, moving from J\$5.9 per US\$1 at the beginning of October to J\$6.4 per US\$1 three weeks later. In these circumstances of mounting speculative pressure, the Government reviewed its policies and

decided that it could not allow the rapid depreciation of the Jamaican dollar to continue, because of the impact on prices (particularly those of the principal consumption items of the lower income groups), and the impact on domestic business confidence. Therefore, in order to counter speculative pressures, the Bank of Jamaica increased the supply to the foreign exchange auction pending the adoption of tighter demand management measures, and the exchange rate appreciated to J\$5.5 per US\$1 by the middle of November. In addition, the Government decided to request the Fund, the World Bank and U.S. AID to undertake a joint review of adjustment policies and programmes.

Discussions were then initiated with the Fund on a revised strategy that would achieve a less depreciated exchange rate for 1985/86 than originally envisaged in the program. The balance of payments objectives of the program, however, remain unchanged as regards total net official foreign borrowing, the targeted increase in net foreign assets of the Bank of Jamaica and the commitment to eliminate all arrears by March 1986.

Achievement of the balance of payments targets with a lower than programmed depreciation requires a significantly tighter stance on domestic credit than originally planned. In order to curtail the Central Government's use of domestic credit, the new policy package incorporates additional fiscal measures which will reduce the budget deficit by a further J\$100 million (net) compared with the original program before the end of March; these measures are equivalent to about 2 percent of GDP on an annual basis. This forms part of a set of measures designed to reduce the net domestic assets of the banking system by almost 3 percent for the year as a whole, equivalent to a reduction in real terms of about 20 percent.

The fiscal policy measures that have been implemented involve an expansion of the tax base by removing exemptions from various taxes, especially stamp duty on imports and income tax on public enterprises. This is estimated to yield J\$30 million through March. In addition, taxes have been levied on telephone and telecommunications services and television satellite antennas (J\$13 million). We have also increased taxes on tobacco, alcoholic products, aerated waters, airline tickets, and airport departures. Finally, nontransferrable motor vehicle registration plates will be issued before end-March, estimated to yield J\$30 million. Since some of these measures affect the public enterprises as a group, wharfage charges levied by the Port Authority have been imposed to provide an offsetting improvement in the combined financial position of those entities. To ensure that the increased taxation on imports will not place Jamaica's exports at a disadvantage, we will institute a simple and effective duty drawback scheme before mid-March 1986. Furthermore, in accordance with the commitments made in our letter of June 7, 1985 we have raised water tariffs by 88 percent, will announce by February 20, 1986 the introduction of tertiary education fees with effect from September 1, 1986 with a projected yield of J\$23 million by end of fiscal year 1986/87, and have reduced other

current payments and transfers so as to yield a net savings of 1 percent of GDP in 1986/87.

In the area of monetary policy, liquidity will be reduced mainly through the issue of Certificates of Deposit (CDs) by the Bank of Jamaica, which will be the primary tool to ensure attainment of the program objectives for the level of base money at end-January and end-March. This is expected to hold the growth in banking system liabilities to the private sector to about 4 1/2 percent for the year as a whole. Consistent with these targets, banking system credit to the private sector is expected to decline marginally during the fiscal year ending March 1986. However, at the same time steps have been taken to further encourage the private sector to use external credit lines such as the EDF, the IDB/Rehabilitation Fund, and the Eximbank Credit Facility. The Bank of Jamaica will reduce the liquid assets ratio applying to the banks by 4 percentage points during February 1986. This is designed to reduce the captive nature of the market for Treasury Bills. At the same time, the Bank of Jamaica has moved to discourage secondary market sales of Treasury Bills by setting a substantial penalty on the discount of such bills.

All external arrears will be eliminated by the end of March 1986 in accordance with the original program, and the Government will maintain the foreign exchange auction system and a flexible exchange rate policy.

The Government of Jamaica believes that the tightening of demand management policies that has been undertaken constitutes a strong adjustment effort and that these policies will ensure attainment of the balance of payments objectives of the program. The Government will periodically consult with the Fund in regard to the progress being made in the implementation of the program and about any policy adaptations judged to be necessary to achieve the program targets.

Yours sincerely,

/s/
Headley Brown
Governor
Bank of Jamaica

/s/
Edward P.G. Seaga
Prime Minister and
Minister of Finance and Planning

Amendment to the Technical Memorandum
of Understanding, attached to the
Letter of June 7, 1985

1. This amendment specifies the changes to the Technical Memorandum of Understanding which formed a part of the Letter of Intent from the Prime Minister and the Governor of the Bank of Jamaica dated June 7, 1985.

2. For the fiscal year 1985/86, the financing requirement of the Central Government will not be more than J\$664 million through March 31, 1986. For the purpose of this paragraph, the financing requirement of the Central Government is as defined in paragraph 2 of the Technical Memorandum of Understanding dated June 7, 1985.

3. The stock of net domestic banking system credit to the selected public entities will not decrease by less than J\$30 million over the period March 31, 1985 through March 31, 1986. Further, during the remainder of this fiscal year, the selected entities will eliminate any outstanding payments arrears, will not incur any new payments arrears, or increase their stock of net domestic nonbank credit over the stock outstanding on March 31, 1985. For the purpose of this paragraph, the public entities remain as defined in Table 3 attached to the Technical Memorandum of Understanding dated June 7, 1985.

4. The stock of the net domestic assets of the Bank of Jamaica will be no higher than J\$3,398 million from September 30, 1985 through March 31, 1986. This ceiling will be subject to a downward adjustment, for any excess over (a) the projected net external debt disbursements and (b) the projected total external debt rescheduling or refinancing described in paragraphs 5 and 6 below. For the purpose of this paragraph, the stock of net domestic assets of the Bank of Jamaica are as defined in paragraph 4 of the Technical Memorandum of Understanding dated June 7, 1985. For the purpose of this paragraph, all foreign assets and liabilities including those denominated in special drawing rights (SDRs) will be converted into Jamaica dollars at the accounting rate of US\$1.00=J\$5.65, for the period September-March 1985/86. In seeking to achieve these targets, the Bank of Jamaica open market operations will aim to achieve a level of base money of J\$1,421 million at end-March 1986. Base money is defined as currency in circulation plus commercial bank reserve holdings at the Bank of Jamaica.

5. The change in the stock of medium- and long-term external debt of the public sector (as defined in paragraph 7 of the Technical Memorandum of Understanding dated June 7, 1985), will not exceed US\$205 million between March 31, 1985 and March 31, 1986. Furthermore, any change in this stock in excess of US\$185 million will lead to adjustments in the net domestic assets and net international reserves of the Bank of Jamaica as described in paragraph 4 above, and paragraph 5 of the Technical Memorandum of Understanding dated June 7, 1985. Gross

disbursements of external debt of the public sector with an original maturity range of between one to five years will not exceed US\$108 million between March 31, 1985 and March 31, 1986.

6. External debt rescheduling or refinancing in excess of US\$227 million between March 31, 1985 and March 31, 1986, will lead to adjustments in the net domestic assets and net international reserves of the Bank of Jamaica as described in paragraph 4 above, and paragraph 5 of the Technical Memorandum of Understanding dated June 7, 1985. For the purpose of this paragraph, external debt rescheduling or refinancing will be as defined in paragraph 8 of the Technical Memorandum of Understanding dated June 7, 1985, and any such rescheduling or refinancing with a maturity range of one to five years will be excluded from the ceiling on the gross disbursement of external debt of the public sector of such maturity as set out in paragraph 5 above.

7. External payments arrears on public sector obligations (as defined in paragraph 5 of the Technical Memorandum of Understanding dated June 7, 1985) will be eliminated by March 31, 1986.

Understanding on Targets
for January 31, 1986

1. It is understood that for the review of the 1985/86 stand-by arrangement to be completed, the following targets and ceilings for January 31, 1986 must be observed.
2. For the fiscal year 1985/86, the financing requirement of the Central Government will not be more than J\$872 million through January 31, 1986. For the purpose of this paragraph, the financing requirement of the Central Government is as defined in paragraph 2 of the Technical Memorandum of Understanding dated June 7, 1985.
3. The stock of net domestic banking system credit to the selected public entities will not decrease by less than J\$106 million over the period March 31, 1985 through January 31, 1986. Further, through January 31, 1986, the selected entities will not increase their stock of net domestic nonbank credit over the stock outstanding on March 31, 1985. For the purpose of this paragraph, the public entities remain as defined in Table 3 attached to the Technical Memorandum of Understanding dated June 7, 1985.
4. The stock of the net domestic assets of the Bank of Jamaica will be no higher than J\$3,917 million from September 30, 1985 through January 31, 1986. This ceiling will be subject to a downward adjustment, for any excess over (a) the projected net external debt disbursements; and (b) the projected total external debt rescheduling or refinancing described in paragraphs 6 and 7 below. For the purpose of this paragraph, the stock of net domestic assets of the Bank of Jamaica are as defined in paragraph 4 of the Technical Memorandum of Understanding dated June 7, 1985. For the purpose of this paragraph, all foreign assets and liabilities including those denominated in special drawing rights (SDRs) will be converted into Jamaica dollars at the accounting rate of US\$1.00=J\$5.65, for the period September 1985 to March 1986. The Bank of Jamaica will issue CDs consistent with the achievement of a level of base money of J\$1,434 million as of end-January 1986. Net sales of CDs may be required in early February depending on the end-January base money outcome.
5. The net international reserves of the Bank of Jamaica, which were negative US\$574 million on September 30, 1985, will not be less than negative US\$575 million on January 31, 1986. The net international reserve target will be subject to an upward adjustment for any cumulative excess over (a) the projected net external debt disbursements; and (b) the projected total external debt rescheduling or refinancing described in paragraphs 6 and 7 below. For the purpose of this paragraph, foreign assets and liabilities of the Bank of Jamaica and the accounting rates for all assets and liabilities are as defined in paragraph 5 of the Technical Memorandum of Understanding dated June 7, 1985.

6. The change in the stock of medium- and long-term external debt of the public sector (as defined in paragraph 7 of the Technical Memorandum of Understanding dated June 7, 1985), will not exceed US\$128 million between March 31, 1985 and January 31, 1986. Furthermore, any change in this stock in excess of US\$98 million between March 31, 1985 and January 31, 1986, will lead to adjustments in the net domestic assets and net international reserves of the Bank of Jamaica as described in paragraphs 4 and 5 above. Gross disbursements of external debt of the public sector with an original maturity range of between one to five years will not exceed US\$108 million between March 31, 1985 and January 31, 1986.

7. External debt rescheduling or refinancing in excess of US\$198 million between March 31, 1985 and January 31, 1986 will lead to adjustments in the net domestic assets and net international reserves of the Bank of Jamaica as described in paragraph 4 and 5 above. For the purpose of this paragraph, external debt rescheduling or refinancing will be as defined in paragraph 8 of the Technical Memorandum of Understanding dated June 7, 1985, and any such rescheduling or refinancing with a maturity range of one-five years will be excluded from the ceiling on the gross disbursement of external debt of the public sector of such maturity as set out in paragraph 6 above.

8. External payments arrears on public sector obligations (as defined in paragraph 5 of the Technical Memorandum of Understanding dated June 7, 1985) will not exceed US\$52 million on January 31, 1986.