BANK OF JAMAICA

Challenges for Monetary Policy in Latin America and the Caribbean

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It is a pleasure for me to participate in this conference and to share some reflections with you on the topic "*Challenges for Monetary Policy in Latin America and the Caribbean*". I wish to thank CEMLA for the invitation to speak here and to congratulate the Centre on its efforts at maintaining and enhancing itself as a "Hub of Knowledge on Central Bank and Monetary Policy Topics".

I would like to focus my remarks on the policy challenges faced by Jamaica in the post-crisis period as an interesting case study within the Latin America and the Caribbean region. It helps to first briefly review our collective experience over the past five or so years as a background for my discussion of Jamaica.

The global financial crisis brought significant challenges for practically all central banks and certainly for those in the region. Some economies experienced capital outflows with the attendant impact, depending on the prevailing exchange rate regime in the country. Others saw declines in real GDP or sharp slowdowns in growth.

The crisis necessitated prompt and substantial policy responses in a bid to induce growth. For the advanced economies, we witnessed the use of extraordinarily accommodative monetary policy, including very low interest rates and massive expansion of central bank balance sheets.

For developing economies, our challenges have not all been similar. For commodity exporters, the post-crisis macroeconomic challenges stemmed from capital inflows in search of higher returns together with high commodity prices and the related boost in current account earnings. For commodity importers with high public debt (which is typical of countries within the Caribbean) the challenge was how best to manage debt and fiscal issues in a context of capital outflows and lower growth. Caribbean central banks in these countries were therefore challenged to maintain reserves in the context of vulnerabilities brought on by small size, openness and unsustainable fiscal positions.

As a final note, we are all aware that the post-crisis policy focus has been to repair the damage to financial infrastructure and quickly stimulate economic recovery. The more immediate challenge for the LAC region is the potential impact of the expected normalization of monetary policy in the USA.

As a net commodity importer, Jamaica in the aftermath of the crisis was adversely affected by higher oil prices as well as private capital outflows. Our main foreign exchange earning sectors also experienced downturns, specifically tourism and bauxite and alumina. The financial markets experienced instability and, as everywhere else, were characterised by heightened uncertainties in the context of the credit squeeze. Our foreign exchange reserves fell dramatically. The ratio of government debt to GDP, already one of the highest in the world, increased.

Owing mainly to the reform and recapitalisation of the financial sector that took place over the previous decade, Jamaica did not experience a collapse of financial firms during and in the aftermath of the crisis. However, given unsustainable fiscal, debt and external positions, we had little fiscal space to mitigate the impact of the shocks. Reliance on the international capital market was not feasible as funding would have been at a significant premium given the country's economic condition and the unsettled state of the international financial market. Jamaica faced the prospect of a slow, uncertain path to economic recovery due to its macroeconomic imbalances and structural rigidities.

The response to the global crisis and the new normal was therefore the implementation of a set of policies and reforms to address the macroeconomic imbalances and strengthen the resilience of the economy - preconditions for sustained growth. In this regard, Jamaica commenced fiscal and structural reforms, including debt restructuring, aimed at increasing competitiveness and strengthening economic resilience. This has been supported by multilateral financial institutions including an Extended Fund Facility arrangement with the International Monetary Fund.

The central bank, as a part of this strategy, has had to manage the potential for a rapid correction in the real exchange rate in the context of an unsustainable current account deficit and reduced capital inflows. Depreciation in the nominal exchange rate has also, at times, been exacerbated by our own efforts to rebuild reserves. The challenge for us has been to manage this adjustment without igniting a depreciation/inflation spiral and hence the need for a sharp rise in nominal interest rates.

Perhaps the most important support for our monetary policy objectives has been the significant steps taken towards a reduction in fiscal dominance. Continuing a trend improvement, the fiscal accounts for the fiscal year just ended (April 2013 to March 2014) were brought into overall balance with a primary surplus of 7.5% of GDP. The debt to GDP ratio, which was previously on an upward trajectory, has begun a sharp decline. Not surprisingly, though, fiscal consolidation has imposed a drag on the pace of recovery and the economy remains weak and fragile.

In this context, the central bank has maintained an accommodative monetary policy stance to support credit expansion and economic recovery while simultaneously seeking to contain inflationary expectations, manage inflation downwards and build foreign reserves. This required the introduction of a series of innovations in open market operations in the Jamaican context to ensure adequate liquidity. It has involved a difficult balancing act, one whose precariousness also contributes its own dose of uncertainty even as the central bank attempts to steer a course towards a more stable growth-enhancing equilibrium.

A key result of our efforts is that Jamaica's external competitive position has improved. Inflation has continued to fall even while the nominal exchange rate depreciated at a faster pace relative to historical norms. The current account deficit is improving and economic growth has resumed. There has been notable progress in other areas of our economic programme and international rating agencies, investors and our multilateral development partners are showing signs of renewed confidence in Jamaica.

The global financial crisis and the slow post-crisis recovery process have certainly created challenges to policy management for the region. But in Jamaica it is fair to say that a principal consequence was to expose and exacerbate deep structural imbalances which were long overdue for sustained attention and reform. Even as we now tackle these problems, the main lesson that we have drawn from the experience is that countries with strong banking systems and sound economic fundamentals were better able to manage the crisis and the challenges of the recovery. These underpinnings are essential for effective monetary policy management, particularly in small open economies such as Jamaica's.

Thank you.