Economic Update: Jamaica
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Real GDP advanced 0.6% for 2012Q1 while economic performance remains below potential level
Recent estimates from the Planning Institute of Jamaica (PIOJ) showed that the economy continues to advance albeit at a slower pace with 2012Q1 real GDP increasing 0.6%. The goods producing sector led the way with 1.4%, while the services sector grew marginally by 0.2%. However, the domestic economy is currently performing below its potential level or the maximum sustainable level of real GDP that can be produced when the economy is most efficient or at full capacity. This has resulted in a negative output gap as the economy at present, operates at an inefficient rate. This has protracted from the past year when the economy grew 1.5%, producing a negative output gap of 1.1% of potential GDP (Figure 2). Though this represents 98.9% of full capacity level production, the economy fell short of its 2011 potential GDP growth rate of 2.7%.

The global economic slowdown and the resultant external demand contraction have contributed to Jamaica undershooting its potential output level. Also, the contraction in real government spending coupled with slow credit growth (Figure 3) has depressed domestic demand below economic potential, resulting in significant spare capacity as evidenced by the high unemployment rate (14.1%) and the number of businesses that remained closed. Nonetheless, the ability of the economy to regain momentum for the remainder of the calendar year depends both on external conditions as well as improvements on the domestic front. Nonetheless, the ongoing Euro zone debt crisis and a US economy which is showing signs of slowing poses near term downside risks to growth.

On the domestic side, the recently tabled J$19.4 billion tax package and its ensuing inflationary effect may constrain the economic upswing. Also, we expect credit growth to continue advancing at a slow pace, as a weaker economy will likely compress corporate earnings, which would affect the growth in loans. However, given that oil prices have plunged 25% since the past month (Figure 4), local households and businesses could get some reprieve from the lagged effect. Despite the current economic weakness, we don't anticipate any economic contraction and we maintain our forecast for the economy to expand though at a relatively slower rate of at most 1% for full year 2012.

Sustained higher economic growth pace needed for the medium term
Given the fiscal realities, the government may need to generate and sustain growth rates of at least 2% to put the fiscal trajectory on a sustainable path and reduce the debt burden to its FY2015/16 target of at most 100% of GDP. This would serve to prevent the economic deterioration that is likely to occur from severe fiscal adjustments through increased taxation and continued cuts to public expenditure. The question then is, how can this be achieved?

A number of projects have been scheduled for the medium term which includes; Harmony Cove development, the North South Link of Highway 2000, the Gordon Key Container Transshipment Port and the Port Augusta Terminal. If the government forges public-private partnerships in a way to ensure that these projects utilize a greater portion of domestic labour and raw materials where possible, this could boost local production and close the output gap. Nonetheless, though these projects would provide some impetus for growth, it's fundamentally important that the government implement with urgency, the necessary reform measures. This would serve to improve the business climate, thereby attracting foreign direct investments which could lead to greater competition and innovation. This would also enhance total factor productivity growth, increasing economic potential and providing for greater and sustainable economic growth pace over the medium term.
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