Kingston, November 22, 2016

In its editorial of November 21, The Gleaner asked for more clarity on prospects for the Jamaican dollar. It is, of course, the government's prerogative to define its policies on this and other economic issues. The IMF is here to support those efforts and to provide the best policy advice we can.

However, we believe we can contribute to the domestic debate and dispel some incorrect notions that have been floated in recent days, particularly as they relate to the new IMF-supported Stand-By Arrangement with Jamaica.

Q. Is the Jamaican currency overvalued?

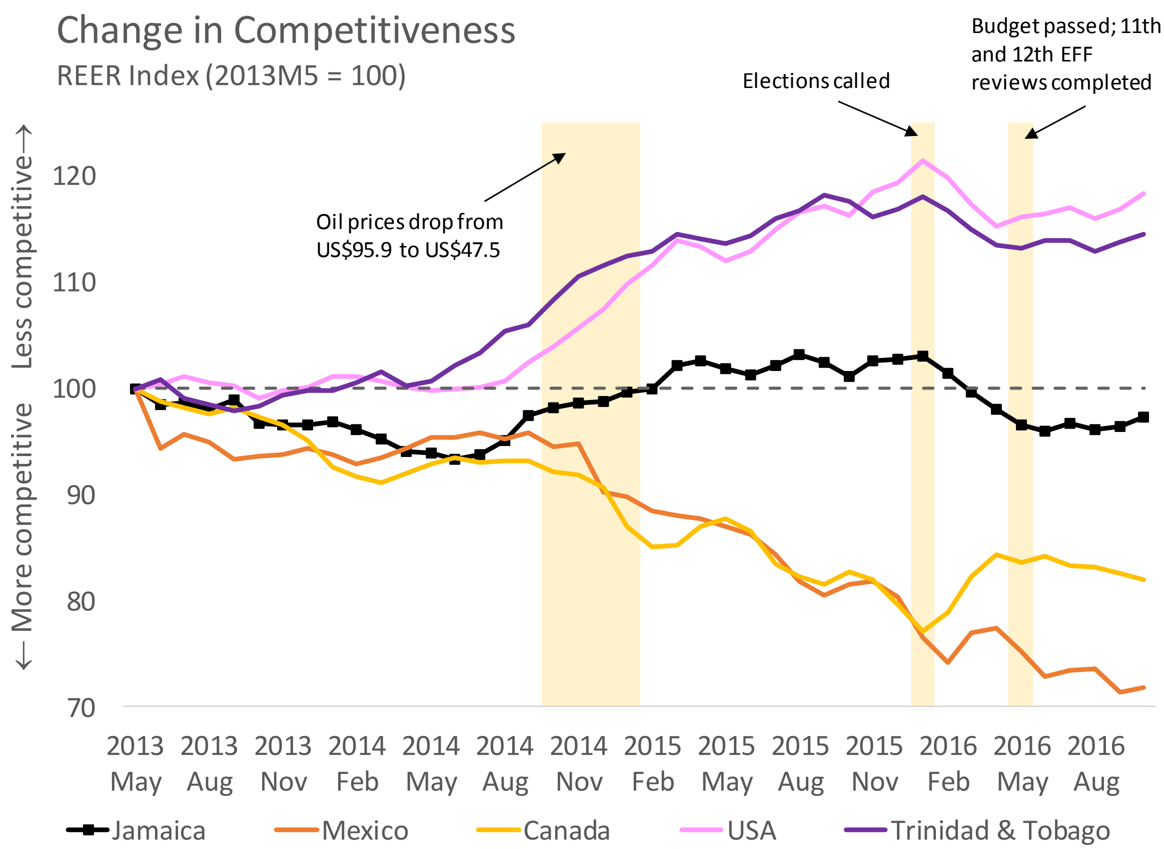
A. **No.** The evidence shows that the Jamaican currency is broadly in line with the existing economic fundamentals. We fully agree with the Bank of Jamaica on that point. There are, as you may imagine, a lot of moving parts and risks to any such assessment. If we are asked to describe the risks around our assessment, our best judgment is that there is a risk that the Jamaican dollar is more likely to be modestly overvalued. However, such risks are linked to the speed at which the country intends to liquidate its external liability position: if Jamaica wants to liquidate its external liabilities faster, then the currency is at the risk of being modestly overvalued. We have outlined more details on how we undertake our exchange rate assessment in our recent staff report http://www.imf.org/external/pubs/cat/longres.aspx?sk=44394.0.

Q. What is the IMF-supported program's objective for the exchange rate?

A. **Our goal, which we have shared with the Jamaican government over the past 4 years, is that the Jamaican dollar should be flexible and market determined**. We have also supported the government's goals to build foreign exchange reserves. Exchange rate flexibility – which works as an economic shock absorber – implies that the currency can freely move in either direction, and there is no notional target range for the exchange rate. Of course, if there are abrupt movements in the exchange rate due to extraordinary circumstances, then the Bank of Jamaica should use FX intervention to smooth out the volatility, as it has been doing. But, outside of those unusual movements, it is in Jamaica's best interest to allow market forces to determine the level of the exchange rate and for the Bank of Jamaica to focus on its inflation objective and to steadily build its international reserves.

Q. Has the Jamaican dollar depreciated too much?

A. **No.** We know there are sensitivities on the level of the Jamaican dollar with respect to the U.S. dollar. We recognize also that there has been anxiety as the currency has moved from 119 to 129 over the past 12 months. But we believe it is important to look at the exchange rate in a broader way—not just relative to the U.S. dollar but relative to *all* of Jamaica's trading partners (including Canada, Europe, and Caribbean neighbors) and to adjust for differences in inflation across countries. On this basis, as the picture shows, the Jamaican dollar today is roughly at the *same place* it was 3 years ago. We know that sounds counter-intuitive. But remember from September 2014-September 2015 the U.S. dollar itself was rising by more than 1 percent per month against its trading partners. Taking such a broader perspective is likely to become increasingly important in the months ahead. With the change of administration in the U.S., one cannot discount that the U.S. dollar could strengthen further against international and regional currencies. Indeed, the U.S. dollar has already risen around 2 percent over the past 2 weeks against a global basket of currencies. It would be a mistake for Jamaica to hitch itself to a rising U.S. currency.



Q. Is the IMF going to dismantle the existing institutional arrangements in the currency markets?

A. **No.** We are working, however, to support the Bank of Jamaica in improving the ways in which it interacts in the currency markets to make those interactions more efficient and more market based. The current system has worked well to build reserves, but it is rudimentary and results in a relatively shallow FX market. This, in turn, leads to increased day-to-day volatility in the exchange rate. The idea is for the Bank of Jamaica to gradually phase out its surrender requirements, which is a blunt tool to buy foreign exchange. Instead, if the Bank of Jamaica wishes to buy or sell reserves, it would have to do so like everyone directly in the FX market. To ensure those transactions are transparent and market-based, a new FX auction mechanism for freely buying and selling FX would be introduced. The end goal would be for the Bank of Jamaica to be one of many market participants in the interbank FX market. If successful, market participants would be able to trade with each other without the Bank of Jamaica sitting in the middle of the market. Supply and demand would be determining the day-to-day movements in the exchange rate. We would emphasize, such a shift in institutional arrangements will be gradually phased in and should have no added effect on the level of the exchange rate. These changes are entirely technical and aim to modernize the operational toolkit of the Bank of Jamaica in line with those of other central banks.

Authors: Constant Lonkeng (IMF Resident Representative in Jamaica) and Uma Ramakrishnan (IMF Mission Chief for Jamaica)