

01 March 2023

Dr the Honourable Nigel Clarke, MP  
Minister of Finance and the Public Service  
Ministry of Finance and the Public Service  
30 National Heroes Circle  
Kingston 4

Dear Minister Clarke:

### **Breach of Inflation Target**

By letter dated 16 April 2021 from you, Bank of Jamaica's Monetary Policy Committee (MPC) was set a target range for annual inflation, as measured by the 12-month point-to-point percentage change in the Consumer Price Index (CPI) published by the Statistical Institute of Jamaica (STATIN), of 4.0 to 6.0 per cent over the next three years. This target became operational as at April 2021 and will apply continuously, that is, for each month over the three-year period. Your letter also stated that whenever inflation deviates from the target range, the MPC is required to explain the deviation within 60 days of publication of the outturn by STATIN.

In my previous correspondence to you dated 03 October 2022, I noted that inflation was 10.2 per cent as at August 2022 and would continue to breach the Bank's target range over the next nine months, averaging in the range of 8.0 to 9.0 per cent. Since then, inflation has continued to show moderation. As published by STATIN, the annual inflation rates at September, October, November, December 2022 and January 2023 were 9.3 per cent, 9.9 per cent, 10.3 per cent, 9.4 per cent and 8.1 per cent, respectively. Although these outturns have remained above the upper limit of the Bank's target range, they have generally been below the levels projected by the Bank.

As I have explained in the past, inflation continued to breach the upper limit of BOJ's target range because of (i) the lagged impact of elevated international commodity prices, which has been exacerbated by the Russia-Ukraine conflict, (ii) recovery in domestic demand, and (iii) heightened inflation expectations.

Elevated international commodity and shipping prices continued to be the principal contributors to the domestic inflation rate remaining above the target range. At January 2023, the average of crude oil and grains prices for the preceding 12 months were higher by 33.2 per cent and 20.7 per cent, respectively, when compared to the same measure at January 2022. The same measure of liquefied natural gas (LNG) price also rose by 67.5 per cent. In contrast, international shipping prices declined by 25.5 per cent for the period due to an easing in supply constraints. The main factors contributing to the increase in crude oil prices were concerns about tight global crude supplies amid the decision of OPEC and its allies to restrict crude production, and the disruptions caused by the war in Ukraine.

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However, these price increases have decelerated and were below those outturns quoted in my previous letter as a result of (i) an expected slowdown in global growth which signals lower demand, (ii) an acceleration in new coronavirus cases in China and (iii) the appreciation of the US dollar, which reduced investors' appetite for dollar denominated commodities.

Inflation in Jamaica has been supported by elevated, albeit decelerating, consumer price inflation among Jamaica's main trading partners (particularly the United States of America (US)). Inflation in the US was 6.4 per cent at January 2023, lower than the outturn of 6.5 per cent at December 2022.

Domestic demand in Jamaica has continued to increase. The most recent data published by STATIN indicated that real GDP expanded by 5.9 per cent for the September 2022 quarter. There are also indications that economic growth could range between 3.0 per cent and 5.0 per cent for the December 2022 and March 2023 quarters. In this context, real GDP is expected in the range of 4.0 to 5.5 per cent for FY2022/23.

Business expectations of inflation remain elevated, albeit declining. In the latest survey of business expectations of inflation in November 2022, respondents indicated that they expect inflation over the ensuing twelve months to be 11.5 per cent, significantly above the Bank's inflation target but below the previous survey of 11.6 per cent.

#### **What is the Near-Term Path & the Attendant Risks for Inflation to Return to the Target?**

BOJ's most recent projections indicate that inflation will continue to decelerate to average 5.5 to 6.5 per cent over the next eight quarters (March 2023 to December 2024) and continue to breach the upper limit of the Bank's target range until the December 2023 quarter. The projected fall in inflation over the period reflects the continued slowdown in international commodity and shipping prices, tight monetary conditions and moderating inflation expectations. The impact of these downward pressures is likely to be partly offset by increases in selected regulated prices and domestic wage inflation.

Consistent with consensus forecasts, the rate of increase in international commodity prices – energy (crude oil and LNG) and grains – are projected to continue slowing over the next two years. WTI crude oil prices are projected to average US\$80.80 per barrel for the next eight quarters (March 2023 to December 2024), implying an average quarter-over-quarter increase for the period of 0.3 per cent. This forecast is lower than the 8-quarter forecast outlined in my previous letter. The average price of grains is projected to decline at an average quarter-over-quarter rate over the next eight quarters of 2.0 per cent. As international commodity prices trend downward, inflation expectations should continue to ease over the near term.

Inflation in the US is projected to continue to fall from its peak of 9.1 per cent in June 2022 but remain above the Fed's target of 2.0 per cent for the remainder of 2023.

The near-term risks to inflation are skewed to the upside and elevated.



### **Bank of Jamaica's Policy Actions to Return Inflation to Target**

At its most recent policy meeting on 16 and 17 February 2023, the MPC unanimously decided to increase the domestic currency cash reserve requirement (CRR) for deposit-taking institutions (DTIs) by one (1) percentage point to 6.0 per cent, and the foreign currency cash reserve requirement by one (1) percentage point to 14.0 per cent, effective 01 April 2023. This adjustment is aimed at further reducing liquidity in the financial system. The MPC also decided to maintain the policy interest rate (the rate offered to DTIs on overnight placements with Bank of Jamaica) at 7.00 per cent, to maintain its posture in the money market and to maintain relative stability in the foreign exchange market.

Bank of Jamaica's policy signals are expected to cause interest rates on deposits and loans to rise further, making savings in Jamaican dollars more attractive relative to foreign currency assets and borrowing in Jamaican dollars more expensive. The MPC noted that while interest rates in the money and capital markets have generally increased in line with the policy rate, some DTIs have only effected marginal adjustments to their deposit and lending rates. Between October 2021 and December 2022, the weighted average deposit rate offered by commercial banks to the public increased by 59 basis points (bps). The MPC also noted preliminary data which indicate that these rates will be adjusted upward by marginal amounts in the near future. In addition, the overall weighted average lending rate to the private sector on local currency loans was 11.7 per cent at December 2022, 7 bps below the rate at September 2021. In this context, local currency deposits grew by 12.6 per cent at December 2022, remaining unchanged relative to a year earlier. Growth in loans and advances at December 2022, however, accelerated to 12.6 per cent from 7.6 per cent a year earlier. This is concerning given that domestic demand continues to recover at a stronger-than-anticipated pace with implications for potentially higher prices. Further, labour market shortages carry the potential for future wage adjustments that can put stronger than anticipated upward pressure on inflation.

In the context of previous policy actions, the average exchange rate (JMD/USD) between end-September 2021 and 15 February 2023 depreciated by 2.2 per cent, relative to the corresponding period in 2020/2022. This represents a slower pace of depreciation compared with the 6.1 per cent depreciation in the same time period to 15 February 2022. Without this exchange rate stability, Jamaica's inflation would have been higher.

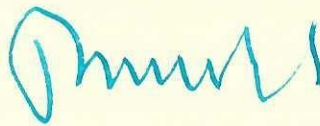
The MPC further noted that the reserves were sufficient and continued to exceed the 100 per cent of the IMF's Assessing Reserve Adequacy (ARA) benchmark. At 15 February 2023, Jamaica's gross reserves amounted to US\$4.4 billion, which represented 109.7 per cent of the projected IMF's ARA measure for FY2022/23.

The MPC stated that, in the absence of new shocks, its future monetary policy decisions aimed at returning inflation to the Bank's target range, including further adjustments to the cash reserve requirement, will depend on the state of liquidity in the financial system and the continued pass-through effect of past policy rate changes on deposit and loan rates. The decisions will also depend on the MPC seeing more pass-through of international commodity price reductions to domestic prices and on the Fed continuing to slow its policy rate increases.

The MPC also reiterated its continued commitment to pursuing initiatives to address structural impediments to the monetary transmission mechanism. The Bank will continue to closely monitor the global and domestic environment and is prepared to act as necessary to ensure a continued downward track for inflation.

Minister, we stand prepared to provide any clarification that may be required in relation to this submission.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'R. Byles', is positioned above the printed name.

Richard Byles