



The Governor

Bank of Jamaica
Nethersole Place
Kingston, Jamaica, W.I.

01 September 2021

Hon Dr 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,

Under section 34FG of the Bank of Jamaica Act, the Monetary Policy Committee (“the Committee/MPC”) of the Bank of Jamaica is required to prepare statements on the performance of the Bank with respect to monetary policy and the achievement of the inflation target, which are to be submitted to you every six months, at minimum, or as may be directed by Parliament. The law also guides that you shall, upon receipt of the Monetary Policy Statement, table a copy in the House of Representatives, following which, in keeping with the statutory provision, you shall refer to the Standing Finance Committee of the House of Representatives.

In discharging its statutory obligations, the MPC will submit to you, through the Chairman of the Committee, two sets of the Quarterly Monetary Policy Report (QMPR) in February and August of each year, immediately following the decision meetings in these months. The attached copies of the QMPR for the March 2021 and the June 2021 quarters, and a summary below of these reports, aim to satisfy the first of such a requirement. I will be pleased, if required by the Standing Finance Committee, to attend its meeting to answer any questions in relation to this Statement.

Jamaica’s Recent Macroeconomic Performance and Outlook

The ongoing coronavirus (COVID-19) crisis continues to be a major challenge for the Jamaican economy. While there has been increased optimism stemming from the deployment of COVID-19 vaccines globally, domestic economic activity, while improving, continues to be impacted by the measures to control the spread of the virus.

There have nonetheless been many signs of improvements in the Jamaican economy. GDP is recovering, employment has risen, the balance of payments is in a sustainable position, inflows into the foreign exchange market have been buoyant, reserves are growing and are more than adequate and, importantly, inflation has been contained within the Bank’s target range of 4.0 per cent to 6.0 per cent.

Based on these developments, the MPC maintained the policy interest rate (the rate offered to deposit-taking institutions on overnight placements with BOJ) unchanged at the record low of 0.50 per cent per annum, over the first half 2021.

Going forward, there are heightened concerns about the outlook for domestic inflation. In particular, recent significant increases in international commodity prices and higher imported inflation in general will cause inflation in Jamaica to temporarily breach the upper limit of the Bank's target range from as early as the September 2021 quarter. This situation is not unique to Jamaica as other economies such as the US are experiencing higher than normal inflation.

At its August 2021 meeting, while the MPC decided to maintain the policy rate at 0.50 per cent, the Committee agreed to consider commencing a tightening of monetary policy at its next meeting in September 2021. The MPC also decided to implement other measures aimed at moderating inflation expectations, including the containment of Jamaican dollar liquidity expansion. The MPC reiterated that, while the Bank does not target any specific level of the exchange rate, Bank of Jamaica will seek to ensure that movements in the exchange rate do not threaten the inflation target.

Increases in interest rates are meant to temper potential conversions from Jamaican dollars to other foreign currencies and to increase the incentive for Jamaican consumers to save. Interest rate adjustments are also meant to restrain the desire of Jamaican individuals and firms to borrow. All of these channels are meant to restrain the rate of price adjustments in the economy by moderating aggregate demand. Low, stable and predictable inflation is considered more important and more conducive to long run, sustainable GDP growth, wealth creation and the amelioration of poverty than the temporary fillip to economic activity that may be provided in the short run by loose monetary policy.

Developments over the first half of 2021

The annual point-to-point inflation rate at June 2021 was 4.3 per cent, lower than the 5.2 per cent at December 2020 and within the Bank's target range of 4.0 per cent to 6.0 per cent. The lower inflation outturn at June 2021, relative to December 2020, mainly reflected the moderating impact on food price inflation of a recovery in agricultural supplies, partly offset by the impact of increased international commodity prices, continued accommodative monetary conditions and improved, albeit still weak, aggregate demand.

Over the first six months of calendar year 2021, inflation fell below the lower end of the target range on two occasions, representing a success rate of 66.7 per cent. Inflation in February and April 2021 were both 3.8 per cent, representing breaches of the target and which primarily emanated from continued weak domestic demand conditions and a strong recovery in agricultural food supply. There was also a transient reduction in energy prices in April 2021.

With regard to the international commodity price shock, there have been rapid increases since the start of 2021 in the prices of fuel, wheat, corn, soy, steel, lumber and shipping costs. These increases have been due largely to the impact of disruptions to global supply chains, unfavourable weather conditions and increasing global demand as economies re-opened from lockdowns.¹

¹ At end-June 2021, WTI crude oil and LNG prices were higher by 86 per cent and 92 per cent, respectively, relative to June 2020. Over the same period, corn, soybean and wheat prices rose by 97 per cent, 67 per cent, and 19 per cent, respectively. These increases mainly reflected the impact of supply shortfalls and strong demand from China. Lumber and steel prices have also increased on an annual basis, by 161 per cent and 229 per cent, respectively, amid tight global supplies and a surge in demand associated with increasing housing demand in the North America. Freight charges at June 2021 were higher by an estimated 294 per cent, relative to a year earlier, driven by the impact of improved global demand and pandemic-related restrictions in the industry.

Commodity prices appear to have started to reverse. The prices for grains declined in June 2021 given expectations of a large boost to supply which coincided with reductions in China's demand for agricultural feedstock. Lumber prices also declined in June 2021 as some homebuilders temporarily delayed their projects in the context of the high input costs as well as signs of revival in lumber supply.

Although there has been a recent decline in some of commodity prices, their overall rise has affected domestic prices for transportation services and processed foods. As indicated by the producer's price index (PPI) produced by the Statistical Institute of Jamaica (STATIN), the manufacturing sector has been passing on some of the increases related to the movements in international commodities prices. In particular, the sector's selling prices at June 2021 were higher by close to 15.0 per cent, relative to a year earlier. At December 2020, PPI inflation was running at a little over 1.0 per cent. We have seen strong increases in all the affected sub-sectors, but those that most directly affect the consumer have been meat and meat products, grains and petroleum products. STATIN on 16 August 2021 published the inflation outturn for July 2021 which showed that inflation had risen to 5.3 per cent, higher than the June 2021 outturn of 4.3 per cent.

While the economy continued to be adversely affected by the COVID-19 pandemic, there have been signs of improvements in economic activity over the first half of 2021. Following the contraction in the June 2020 quarter, the seasonally adjusted, quarter-over-preceding-quarter performance of real GDP for the September 2020, December 2020 and March 2021 quarters reflected growth of 8.5 per cent, 0.9 per cent and 0.6 per cent, respectively. Bank of Jamaica estimates that, using the same measure, the economy grew in the range 1.0 per cent to 2.0 per cent for the June 2021 quarter.

This recovery in economic activity has been associated with the gradual easing of restrictions that had been implemented to contain the spread of the COVID-19 virus. All the sectors of the economy were estimated to have grown for the first half of 2021, with the exception of Mining & Quarrying.

Jamaica's current account deficit of the balance of payments (BOP) is estimated to have remained at a sustainable level over the review period. The current account balance deteriorated by approximately US\$81.0 million for the first six months of 2021 to a small deficit, equivalent to 0.6 per cent of GDP, relative to a balanced account for the first six months of 2020. The worsening of the current account deficit (CAD) for the 6-month period reflected a deterioration for the March 2021 quarter, partly offset by an improvement in the June 2021 quarter.

The deterioration in the current account balance for the first half of the year was reflected in the merchandise trade balance, the income and services sub-accounts, partially offset by improvements in current transfers. The estimated deterioration in the merchandise trade balance was due to an increase in fuel imports while the deterioration in the income sub-account was due to higher investment outflows associated with dividend payments. The deterioration in the services sub-account was underpinned primarily by the fall-out in the tourism sector in the context of the impact of the COVID-19 pandemic. Tourist arrivals and earnings fell by 10.6 per cent and 14.2 per cent over the period, respectively, relative to the first half of 2020. The estimated improvement in remittance inflows may have reflected the increased use of formal channels by non-resident Jamaicans as well as the impact of fiscal stimulus measures in source market countries.²

² Remittance inflows are estimated to have increased by 32.4 per cent for the first six months of 2021 relative to the corresponding period of 2020.

Jamaica's gross international reserves grew by US\$204.8 million for the first six months of 2021 to US\$4.3 billion at end-June 2021. Gross reserves at end-June 2021 represented 130.6 per cent of the IMF's Assessing Reserve Adequacy (ARA) metric for FY2021/22. Additionally, the net international reserves (NIR) at end-June 2021 amounted to US\$3.4 billion, which was US\$262.6 million above the stock at end-December 2020.

As it relates to developments in the foreign exchange market, the exchange rate continued to exhibit two-way movements over the first half of the year but there is evidence that the pace of depreciation is slowing down. The nominal exchange rate at end-June 2021 depreciated by 4.1 per cent (\$5.87), relative to December 2020, to end the first half of the year at J\$148.52 = US\$1.00. This compares to a depreciation of 5.6 per cent (\$7.44) over the corresponding period of 2020. The depreciation of the exchange rate for the first half of 2021 was mainly underpinned by increased portfolio-related demand by financial institutions. In an effort to augment US dollar supplies to the market, Bank of Jamaica sold US\$198.7 million via its BOJ Foreign Exchange Intervention and Trading Tool (B-FXITT) facility over the period. However, due to buoyant foreign exchange availability, Bank of Jamaica's net purchases over the period amounted to US\$453.8 million, relative to US\$274.0 million over the first half of 2020.

The financial sector was adversely affected by the COVID-19 pandemic but managed the crisis well. In this context, deposit taking institutions have remained well capitalised and retained adequate liquidity to allow them to withstand shocks. Further, banks have remained profitable as measured by their return on assets (ROA).³

Credit provided by deposit-taking institutions (DTIs) to the private sector for the calendar year to June 2021 (CYTD) grew by 3.5 per cent, a slower rate when compared to the growth rate of 4.5 per cent recorded for the same period in 2020. The CYTD growth for 2021 in private sector credit reflected an increase of 2.8 per cent in lending to the productive sector, below the growth of 5.9 per cent and 9.0 per cent recorded for the corresponding periods of 2020 and 2019, respectively. The growth in loans to the productive sector was primarily reflected in the Other Professional, Tourism, Distribution and Transport sectors. Lending to consumers expanded by 4.0 per cent for the first six months to June 2021. This reflected a mild acceleration relative to the growth of 3.4 per cent recorded for the corresponding period of 2020 but remained below the growth of 8.8 per cent for the similar period of 2019.

The credit quality of banks remained fairly stable in the context of the initiatives of the sector to support their clients during the crisis. The ratio of non-performing loans to gross loans increased marginally to 2.9 per cent at end-June 2021 from 2.8 per cent at end-December 2020. The ratio at June 2020 was 2.9 per cent. Similarly, the ratio of past due loans to total loans (PDL) was 3.7 per cent at end-June 2021, compared to 3.0 per cent at end-December 2020 and 3.6 per cent at end-June 2020. This relative stability occurred in the context of moratoria (or payment accommodations) provided by financial institutions to their clients. Since the onset of the crisis, these payment accommodations amounted to approximately \$210.3 billion. At end-May 2021, the outstanding stock of loans under moratorium stood at \$48.7 billion (or 4.5 per cent of gross loans), as payment holidays progressively expired.

Bank of Jamaica supported the sector throughout this process by relaxing its regulatory treatment of restructured and modified loans, which allowed licensees to not deem these exposures as being credit-impaired. The Bank, in the early phase of the crisis, had also requested and received the commitment of Financial Holding Companies (FHCs) and DTIs to make only limited dividend distributions in an effort to preserve DTI's capital. In the context of the fall in

³ At end-June 2021 the ROA of the DTIs stood at 2.12 per cent, compared to 1.32 per cent at end-December 2020 but still below the ROA of 2.29 per cent at end-June 2020.

the stock of loans under moratorium, the improving economic environment as well as the strong capacity of the financial system to absorb unexpected losses, Bank of Jamaica in April 2021 reached an agreement with Finance Holding Companies (FHC) and DTIs for the resumption of the distribution of dividends to large shareholders.

Outlook

The macroeconomic outlook is generally positive but inflation will be adversely impacted by the lagged impact of recent increases in commodity prices and imported inflation. Inflation is projected to average between 5.5 per cent and 6.5 per cent over the next two years (September 2021 to June 2023), breaching the target range of 4.0 per cent to 6.0 per cent. This projection is being driven by one-off adjustments to regulated prices, the lagged impact of higher international commodity and shipping prices, a recovery in domestic demand and a temporary jump in inflation expectations as a result of the commodity price shock.

Inflation is likely to temporarily rise above the upper limit of the Bank's inflation target over the next year, then gradually decelerate towards the midpoint of the target range as the transitory effects of the pandemic fade. Conditional on the gradual tightening of monetary conditions, inflation is projected to remain at 5.0 per cent over the medium term.

While there is a high level of uncertainty surrounding the inflation forecast, especially given the emergence of new variants of the coronavirus in some countries, the risks to the near-term forecast for inflation are skewed to the upside. Upside risks (which means that inflation could track above the forecast) include higher than expected inflation expectations and the impact of an adverse hurricane season on the supply of agricultural foods and prices. On the downside, demand conditions could be weaker than anticipated because of lower global growth and tighter stringency measures, while there could be a stronger than expected fall in commodity prices, all stemming from the emergence of the delta variant of the coronavirus.

GDP growth for FY2021/22 is projected to rebound within the range of 7.0 per cent to 10.0 per cent, before moderating to the range of 2.0 per cent to 4.0 per cent for FY2022/23. The improvement in economic activity over the next two years is estimated to reflect the impact of improvements in the economies of Jamaica's major trading partners. In this context, growth in the services industry, particularly tourism, is expected to be robust.

The economy is expected to return to pre-COVID levels by end-2022. Over the medium term (FY2023/24 – FY2027/28), GDP growth is projected to average 1.5 per cent.

The risks to the domestic GDP forecast are balanced. Growth in tourist arrivals and related activities could rebound even faster than envisaged in the current projections due to the pace of vaccination in Jamaica's main source markets and the pent-up demand that exists. However, a key downside risk relates to the continued domestic spread of the COVID-19 virus, the emergence of new variants, especially in source markets but also in Jamaica, and the efforts to control it. If Jamaica's stringency measures are tightened over a protracted period, retrenchment in travel and disruptions in the production and distribution of goods could occur.

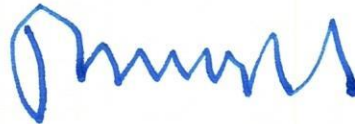
Jamaica's balance of payments position is projected to remain at sustainable levels. The CAD of the BOP for FY2021/22 is projected to deteriorate to 3.6 per cent of GDP from 1.1 per cent of GDP in FY2020/21, mainly due to an increase in imports, higher investment income outflows and lower remittances inflows. The impact of these factors is expected to be partly offset by an increase in stop-over visitor arrivals and earnings for the fiscal year. For FY2022/23, the CAD is projected to deteriorate to 3.9 per cent of GDP before improving to an average of 0.9 per cent of GDP over the medium term.

The outlook for Jamaica's gross reserves is also positive, with the reserves having been strengthened by the receipt of an IMF general SDR allocation amounting to approximately US\$521 million in August 2021. Reserves are projected to remain above the IMF's ARA 100 per cent benchmark over the next five years.

The risks to the projections for the CAD are skewed to the downside (an improved position) due to the possibility of visitor arrivals being higher than currently projected in the context of faster than expected vaccination deployment, and a reopening of economies, in source market countries. A slower than anticipated pace of normalization for remittance inflows is also a possibility. However, the impact from the spread of the delta variant of the coronavirus could cause the current account to be worse than anticipated. The risks to the outlook for the reserves are skewed to the upside (higher reserves) due to risk associated with the current account.

The Bank remains committed to achieving its primary mandate, as stipulated by the Bank of Jamaica Act as amended by the Bank of Jamaica (Amendment) Act, 2020, of maintaining price stability. The Bank will continue to closely monitor the economic environment and will take whatever action, as needed, to achieve this objective.

Yours sincerely,



Richard Byles

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