The Governor

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

23 February 2022

Dr The Hon 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 ("BOJ/the Bank") is required to prepare statements on the performance of the Bank in relation to monetary policy and the achievement of the inflation target. These statements 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 ("the Statement"), table a copy in the House of Representatives, following which, in keeping with the statutory provision, you shall refer it to the Standing Finance Committee of the House of Representatives.

In discharging its statutory obligations, the MPC presents the Monetary Policy Statement below, covering the second half of 2021. Also attached are copies of the Bank's Quarterly Monetary Policy Reports (QMPRs) for the September 2021 and the December 2021 quarters as additional material supporting this Statement. If the Standing Finance Committee requires, I will be pleased to attend its meeting to answer any questions related to this Statement.

Jamaica's Recent Macroeconomic Performance and Outlook

Recent Monetary Policy Developments

The coronavirus (COVID-19) pandemic continues to be a major challenge to economic activity in Jamaica and across the world. Nonetheless, the domestic economy has been showing signs of recovery, foreign reserves are robust, employment is rising and the financial system remains resilient. However, BOJ remains concerned about high domestic inflation that has remained above the upper end of the Bank's 4.0 to 6.0 per cent target since August 2021. Consequently, the Bank has taken steps to ensure that inflation returns to the target range in the shortest possible timeframe.

In the context of its inflation outlook and to meet the inflation target sustainably in the medium term, the Bank reduced the level of monetary accommodation over the six months ended December 2021 via a suite of monetary policy measures. This involved increases in the Bank's policy rate by 200 basis points (bps) to close 2021 at 2.50 per cent per annum.

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Accompanying the rate increases, the MPC maintained other measures to contain Jamaican dollar liquidity expansion and ensure that further movements in the exchange rate do not threaten the return of inflation to its target. The MPC, as a part of its forward guidance strategy, has reiterated that it would consider further increases in the Bank's policy rate and accompanying measures at subsequent policy meetings, subject to inflation, inflation expectations and other macroeconomic data evolving as projected. Effective 06 December 2021, the Bank also adjusted the limit on the foreign currency net open positions (FXNOP) of Authorised Dealers, which aimed to moderate the sharp and predictable cyclical patterns in the exchange rate.

At its latest policy decision announcement on 18 February 2022, the Bank further increased its policy rate by 150 bps to 4.00 per cent. The Bank also decided to pursue more substantial measures to contain Jamaican dollar liquidity expansion and to maintain stability in the foreign exchange market. Consistent with meeting its inflation target sustainably in the medium term, the Bank decided to consider maintaining or expanding its suite of policy measures at subsequent policy meetings. The decision to further reduce the level of monetary policy accommodation took into consideration the inflation outturn at January 2022, which accelerated and remained significantly above the upper limit of the Bank's target. The MPC's latest assessment is for inflation to continue to successively breach the upper limit of the target range over the next 10 to 12 months and to peak in the range of 9.0 to 11.0 per cent over this period.

Increases in interest rates are meant to temper potential conversion from Jamaican dollar to other foreign currencies and increase Jamaican consumers' incentive to save. Interest rate adjustments are also meant to restrain the desire for Jamaican individuals and firms to borrow. All these channels are meant to restrain the rate of price adjustments in the economy by moderating exchange rate depreciation and aggregate demand during this transitional period of elevated inflationary pressures. In the wake of its previous monetary policy adjustments, while interest rates in the money markets have increased faster than the policy rate, banks remained relatively liquid. At the same time, and for the most part, banks have not passed on the policy rate increases to their customers who hold deposits with them. In this context, banks have also only marginally increased loan rates. It is for this reason that steps to drain further liquidity from the financial system are being undertaken.

Developments over the second half of 2021

The annual point-to-point inflation rate at December 2021 was 7.3 per cent, higher than the 4.3 per cent at June 2021 and the Bank's target range of 4.0 per cent to 6.0 per cent. Inflation consecutively breached the upper end of the Bank's target range over the last five months of 2021. Most recently, on 15 February 2022, the Statistical Institute of Jamaica (STATIN) published the inflation outturn for January 2022, showing that inflation had risen further to 9.7 per cent.

The higher inflation outturn at December 2021, relative to June 2021, mainly reflected the staggered impact of increases in international commodity prices such as crude oil, grains, lumber and steel on domestic prices. Higher shipping costs have also had an impact on domestic prices. These increases were largely due to the impact of disruptions to global supply chains, new and emerging COVID-19 variants and increasing global demand as economies re-opened from government-mandated lockdowns. In the context of an accommodative monetary policy, improved domestic demand also contributed to the acceleration in inflation over the period, partly offset by improvements in local agricultural supplies.

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As indicated by the Producer's Price Index (PPI) produced by STATIN, the manufacturing sector has been passing on some increases related to the movements in international commodities prices. In particular, the sector's selling prices at December 2021 were higher by 19.6 per cent, relative to a year earlier. At December 2020, PPI inflation was running at a little over 1.0 per cent. There have been moderate increases in all the affected sub-sectors, but those that most directly affect the consumer have been meat and meat products, fish, packaging and utilities.

While the economy continued to be adversely affected by the COVID-19 pandemic, there have been signs of improvements in economic activity over the second half of 2021. Real GDP grew by 5.8 per cent for the September 2021 quarter, compared to a contraction of 10.6 per cent for the comparable quarter of 2020. The seasonally adjusted growth for the September 2021 quarter, relative to the June 2021 quarter, was 0.6 per cent, representing the fifth consecutive quarter of growth. Bank of Jamaica estimates that the economy grew in the range of 5.0 to 7.0 per cent for the December 2021 quarter.

The recovery in economic activity has been associated with improved external demand and the gradual easing of restrictions that the Government had implemented to contain the spread of the COVID-19 virus. All the sectors of the economy were estimated to have grown for the second half of 2021, except *Mining & Quarrying*. The contraction in the mining sector largely resulted from production disruptions due to a fire at the Jamalco plant in August 2021.

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 for the last six months of 2021 is estimated to have improved, relative to the comparable period of 2020, by approximately US$92.6 million to a surplus of US$80.6 million (or 0.5 per cent of GDP).

The improvement in the current account for the second half of the year was primarily reflected in the services sub-account and current transfers, partly offset by a deterioration in the merchandise trade balance. The estimated improvement on the services balance reflected higher visitor arrivals and average daily expenditure. Stop-over visitor arrivals and average daily expenditure increased by 208.5 per cent and 29.1 per cent over the period, respectively, relative to the corresponding period of 2020. Gross remittance inflows for the second half of 2021 were higher by 9.6 per cent, relative to the same period in 2020, related in part to the increased use of formal channels by non-resident Jamaicans. In contrast, the merchandise trade balance is estimated to have deteriorated, primarily due to increased fuel imports.

Jamaica's gross international reserves grew by US$547.5 million for the last six months of 2021 to close at US$4.8 billion at end-December 2021. These reserves were boosted by the receipt of a Special Drawing Rights (SDR) allocation from the International Monetary Fund (IMF) in August 2021, amounting to US$520.6 million. Gross reserves at end-December 2021 represented 156.9 per cent of the IMF's Assessing Reserve Adequacy (ARA 100%) metric for FY2021/22.

As it relates to developments in the foreign exchange market, the exchange rate continued to exhibit two-way movements over the second half of the year. The nominal exchange rate at end-December 2021 depreciated by 4.4 per cent ($6.57), relative to June 2021, to end the year at J$155.09 = US$1.00. This change compares to a depreciation of 1.9 per cent ($2.64) over the corresponding period of 2020. The annual average of daily exchange rates to December 2021

depreciated by 5.9 per cent, compared with the same measure at December 2020, a lower rate than the 6.6 per cent depreciation recorded a year earlier. Increased portfolio-related demand by financial institutions mainly underpinned this depreciation. To augment US dollar supplies to the market, the Bank of Jamaica sold US$265.7 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 net purchased US$563.8 million over the period, relative to US$493.6 million over the second 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 (DTIs) 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).[1]

Credit provided by deposit-taking institutions to the private sector at end-November 2021 grew by 7.9 per cent, a slower rate compared to the 9.1 per cent and 11.5 per cent recorded at end-June 2021 and end-November 2020, respectively. The growth in private sector credit reflected an increase of 6.4 per cent in lending to the productive sector at end-November 2021, below the growth of 14.7 per cent and 17.2 per cent recorded at end-November 2020 and end-November 2019, respectively. The growth in loans to the productive sector was primarily reflected in the Other Professional, Distribution and Electricity sectors. Lending to consumers expanded by 9.1 per cent at end-November 2021. Consumer lending was below the growth of 9.2 per cent and 16.4 per cent recorded at end-November 2020 and end-November 2019, respectively.

The credit quality of banks remained reasonably stable in the context of the sector's initiatives to support their clients during the crisis. The ratio of non-performing loans to gross loans increased marginally to 3.0 per cent at end-November 2021 from 2.9 per cent recorded at end-June 2021. Concurrently, the ratio of past-due loans to total loans (PDL) increased to 4.1 per cent at end-November 2021, compared to 2.9 per cent recorded at June 2021. The relative stability in the financial system was also reflected in a gradual phase-out of moratorium facilities during the year. The stock of loans remaining under moratorium facilities related to COVID-19 declined to $15.4 billion (or 1.4 per cent of gross loans) at end-November 2021, from $70.2 billion at end-2020.

Outlook

Jamaica's macroeconomic outlook is generally positive. However, inflation remains a concern. The Bank believes that the future path of inflation will be influenced by the continued lagged impact of international commodity and shipping prices, continued recovery in domestic demand and seasonal agricultural price pressures, the influence of which will be partly offset by some moderation in inflation expectations. The recovery in domestic demand is forecasted to be driven mainly by external demand. Without further policy action, inflation is projected to average between 6.0 and 7.0 per cent over the next two years, which is higher when compared to the average inflation rate of 5.7 per cent recorded over the past two years. Specifically, inflation is projected to continue to successively breach its target over the next 10 to 12 months, peaking in the range of 9.0 to 11.0 per cent over this period. Conditional on the Bank's monetary policy adjustments, inflation is projected to revert to the Bank's target range of 4.0 per cent to 6.0 per cent by end-2022.

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[1] At end-December 2021, the ROA of the DTIs stood at 1.2 per cent, albeit below the ROA of 2.1 per cent at end-June 2021 and 1.6 per cent at end-December 2020.

There remains some uncertainty around the inflation forecast. Nevertheless, the risks to the forecast are assessed to be balanced (which means that actual inflation should track in line with the forecast). The factors that could cause the inflation rate to be higher than forecasted include a higher than anticipated pass-through of imported inflation to domestic inflation and heightened inflation expectations. The prospects of earlier and stronger monetary tightening among Jamaica's major trading partners may also precipitate capital outflows and exert pressure on the exchange rate, if domestic monetary policy is not appropriately aligned. Further, underlying demand pressures may begin to threaten the stability of the foreign exchange market and, with it, diminish the prospects of inflation returning to the target range.

On the downside, weaker global growth from the possibility of geopolitical tensions as well as more persistent supply constraints could impact domestic economic activity and, consequently, demand. Business expectations of inflation remain elevated and have increased further. In the latest survey in December 2021, respondents indicated that they expect inflation over the ensuing twelve months to be 9.8 per cent, significantly above the Bank's inflation target and the previous survey of 8.9 per cent. This increase in expectations contrasts with the Bank's objective of returning inflation to the target range by the second half of 2022. Indicative yields on Government of Jamaica (GOJ) long-term domestic currency bonds also increased during the December 2021 quarter in the context of an upward shift in expectations.

GDP growth for FY2021/22 is projected to partially rebound within the range of 7.0 to 10.0 per cent, before moderating to the range of 2.0 to 4.0 per cent for FY2022/23. Domestic economic activity is projected to reflect the impact of continued growth in the economies of Jamaica's major trading partners. In this context, growth is anticipated in most of the sectors of the economy, particularly Hotels & Restaurants, Other Services, Transport, Storage & Communication, Manufacture and Construction, notwithstanding setbacks from the Omicron variant of the coronavirus. The GDP forecast also assumes that the temporary disruption to production at one of Jamaica's main alumina plants will be resolved by June 2022. The Jamaican economy is expected to return to pre-COVID-19 levels by FY2022/23. 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 skewed to the downside (that is, slower growth). Growth in tourist arrivals and related activities could be lower than currently projected, given the emergence of new variants of the coronavirus and the impact of efforts to control it. Further, constraints posed by the shortage of critical raw materials and the impact of higher inflation on real incomes could harm GDP growth. More severe climate change also poses a downside risk to GDP growth.

Jamaica's balance of payments position is projected to remain at sustainable levels. The current account deficit (CAD) of the BOP for FY2021/22 is projected to improve to a surplus in the range of 2.0 to 3.0 per cent of GDP from a deficit of 1.0 per cent of GDP in FY2020/21. This projection is mainly based on increases in travel-related and remittances inflows, partly offset by higher imports and higher transportation outflows, the latter related to increases in freight charges. However, the current account for FY2022/23 is projected to deteriorate to a deficit, in the range of 3.0 to 4.0 per cent of GDP, before improving over the medium term.

The risks to the projections for the CAD are assessed to be balanced. The main downside risk (lower deficit) relates to a slower than anticipated pace of normalisation for remittance inflows. The main upside risk (higher deficit) relates to the impact of recurring waves of COVID-19 infections.

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The outlook for Jamaica's gross reserves also remains positive. Gross reserves are projected to be positively impacted by the improved outlook for the current account and are forecasted to be above the ARA 100% benchmark over the medium term.

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

Yours sincerely,

Richard Byles

Enclosures: (2)