GOVERNOR

BANK OF JAMAICA
NETHERSOLE PLACE
P.O. BOX 621
KINGSTON, JAMAICA, W.I.

19 May 2023

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 (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 (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 and copies of the Bank's Quarterly Monetary Policy Reports (QMPRs) for the December 2022 and March 2023 quarters as additional material in support of this Statement. I will be pleased, if required by the Standing Finance Committee, to attend its meeting to answer any questions in relation to this Statement.

Consistent with the requirements of section 34FG of the Bank of Jamaica Act, we will publish this report following the discussions of the Standing Finance Committee on the Report.

Yours sincerely,

Richard Byles

enclosures: (3)

Email: boj.gov@boj.org.jm Web: www.boj.org.jm Tel: 876 922 0858

Monetary Policy Statement

Six Months ended March 2023

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Jamaica's Recent Macroeconomic Performance and Outlook

Recent Monetary Policy Developments

The Jamaican economy continues to make appreciable progress. The key external drivers of headline inflation, such as grains, fuel and shipping prices, have continued to decline, broadly in line with the Bank's expectations. The impact of these international developments as well as tight monetary and fiscal policies have contributed to declines in domestic inflation from its peak of 11.8 per cent at April 2022. Jamaica's headline inflation rate at April 2023 of 5.8 per cent was marginally below the Bank's expectations and represented a return to the target range for the first time since July 2021. Core inflation (which excludes food and fuel prices from the Consumer Price Index) at April 2023 of 5.7 per cent was well below the outturn of 8.4 per cent at April 2022. In addition, inflation expectations continued to track downward. As expected, the pace of monetary tightening by the United States (US) Federal Reserve Board (Fed) has slowed and recent developments suggest that interest rates in the US are at or near their peak.

Notwithstanding a continued downward trend in headline inflation to 5.8 per cent at April, the Monetary Policy Committee (MPC), at its meetings on 17 and 18 May 2023, unanimously agreed to continue to hold the policy interest rate (the rate offered to deposit-taking institutions (DTIs) on overnight placements with Bank of Jamaica) at 7.0 per cent, to maintain tight Jamaican dollar liquidity and to continue fostering relative stability in the foreign exchange market.

The Bank's decisions were informed by the view that although the incoming data were generally positive, there were concerns that the inflation rate may temporarily rise again above the Bank's inflation target range over the next three to four months. The Committee was satisfied that the monetary policy actions since October 2021 have been effective in achieving their objectives but noted the need to maintain the policy stance until inflation is firmly contained within the 4.0 to 6.0 per cent corridor.

The Bank has raised its policy rate by 650 basis points since October 2021. Since October 2021 to date, the Bank, while maintaining a flexible exchange rate, has also taken strong actions in the foreign exchange market including an adjustment to the Net Open Position limits for DTIs in December 2021 and the sale of foreign exchange to the market, when necessary. The Bank's gross reserves remained comfortably above the level considered adequate, which reinforces the ability to respond to shocks and unwarranted movements in the foreign exchange market. At end-April 2023, Jamaica's gross reserves amounted to US$4.7 billion. Over the medium term, the Bank projects that the gross reserves will remain adequate based on the Assessing Reserve Adequacy (ARA) benchmark.

Overall, the Bank's policy decisions were 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. They were consequently expected to help reduce the demand for foreign currency, underpinning a more stable exchange rate and lower inflation. The measures were also intended to constrain aggregate demand and, consequently, limit the ability of businesses to pass on price increases to consumers. In reviewing the impact of previous monetary policy decisions, the Bank of Jamaica's assessment is that interest rates in the domestic money and capital markets and the term rates offered on deposits by DTIs have generally increased in line with the policy rate and the DTI sector continued to make small adjustments to rates on

saving deposits and loans. Respondents to Bank of Jamaica's Quarterly Credit Conditions Survey also indicated that credit terms were expected to tighten further for the June 2023 and September 2023 quarters. The flow of new loans to the private sector has also declined appreciably in real terms over the six months to March 2023 and generally reflects the impact of higher interest rates and the tightening in credit conditions. The MPC was of the view that the maintenance of tight liquidity in the financial system and the preservation of relative stability in the foreign exchange market have had a significant impact on limiting the pass-through of imported inflation to inflation in the Jamaican economy. In addition, in the context of the stability in the foreign exchange market, deposit dollarisation continued to trend downward.

Future monetary policy decisions to maintain inflation within the Bank's target range will depend on incoming data. The Bank will also continue to pursue strategies to strengthen the monetary transmission mechanism to ensure that monetary policy achieves the desired impact on inflation.

As stipulated by the Bank of Jamaica (Amendment) Act, 2020, the Bank is dedicated to achieving its primary mandate of preserving price stability.

Developments over the October 2022 to March 2023 period

The annual point-to-point inflation rate at March 2023 was 6.2 per cent, lower than the 9.3 per cent at September 2022 but was above the Bank's target range of 4.0 to 6.0 per cent. Inflation consecutively breached the upper end of the Bank's target range from October 2022 to March 2023 and was expected to continue to breach the target up to September 2023. The inflation outturn, which was the lowest increase since August 2021, reflected the continuation of a generally favourable downward trend since April 2022, when inflation peaked at 11.8 per cent.

The lower inflation outturn at March 2023 relative to September 2022, mainly reflected the impact of the general decline in the prices of international commodities such as crude oil and grains, as well as shipping costs. In addition, tight fiscal and monetary policy (inclusive of a relatively stable exchange rate) also continued to limit the second-round impact of imported inflation and lower inflation expectations.

The Jamaican economy continues to grow strongly. Real GDP grew by 3.8 per cent for the December 2022 quarter and is estimated to grow within the range of 4.0 to 5.0 for the March 2023 quarter. The increase in domestic activity for the December 2022 and March 2023 quarters is estimated to have been largely supported by continued growth in *Tourism* and its allied services. All the sectors of the economy are estimated to have grown for the review period, with the exception of *Construction.* These outturns, however, were lower than the growth in the September 2022 quarter (5.9 per cent).

Jamaica's current account balance of the balance of payments (BOP) for the period October 2022 to March 2023 is estimated to have improved, relative to the same period last year. The surplus for this period is estimated at US$114.4 million (or 0.7 per cent of GDP), approximately US$518.4 million lower (better) than the balance for the same period in FY2022/2023. The estimated improvement in the current account was primarily reflected in the services sub-account, partly offset by a deterioration in the merchandise trade balance. The higher surplus on the services sub-account reflected increases in stopover visitor arrivals and average daily expenditure of 36.3 per cent and 1.2 per cent, respectively, relative to the corresponding period of the previous years. The higher deficit on the merchandise trade balance primarily reflected higher imports, partially offset by an improvement in exports.

Net remittance inflows for October 2022 to March 2023 were lower by 0.6 per cent, relative to the same period in 2021/2022. However, remittance flows were stronger-than-expected and remained above pre-pandemic levels.

Jamaica's gross international reserves increased by US$335.1 million to US$4.7 billion at 31 March 2023 relative to end-September 2022. This was primarily due to an increase in net market purchases and was partly offset by net GOJ outflows. Gross reserves at 31 March 2023 represented approximately 111.4 per cent of the IMF's Assessing Reserve Adequacy (ARA 100%) metric for FY2022/23.

The foreign exchange market has also remained relatively stable over the review period reflecting, in part, improvements in foreign currency flows and the actions taken by the Bank in the market to engender stability. The exchange rate appreciated over the six-month ended March 2023 by 1.2 per cent (or $1.91) to J$150.91 = US$1.00. This compared to a depreciation of 4.4 per cent (or $6.54) over the corresponding period of FY2021/2022. Also, the average of the daily exchange rate for the twelve months to 31 March 2023 depreciated by just 0.2 per cent, compared with the same measure at end-March 2022, a significantly lower rate than the 5.4 per cent depreciation recorded a year earlier. Demand pressures for the review period mainly stemmed from portfolio-related transactions by financial institutions and from imports in the context of rising import prices. To augment US dollar supplies to the market, Bank of Jamaica sold US$350.0 million via its B-FXITT facility over the period, while US$39.0 million was sold directly to the energy sector.

Despite the recent turmoil in the banking sector abroad which has resulted in the failures of three US banks, the domestic financial system has remained stable over the review period. Deposit-taking institutions have been 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] The credit quality of banks remained stable over the period. The ratio of non-performing loans to gross loans increased marginally to 2.7 per cent at end-February 2023 from 2.5 per cent at end-September 2022. In addition, the ratio of past-due loans to total loans (PDL) was 3.0 per cent at end-February 2023, in line with the 3.0 per cent recorded at end-September 2022.

The stock of credit provided by DTIs to the private sector at end-March 2023 was higher by 11.1 per cent, relative to a year earlier, a marginally slower rate of increase compared to the 11.2 per cent at end-September 2022 but stronger than the 8.7 per cent recorded at end-March 2022. The growth in private sector credit reflected an increase of 12.0 per cent in lending to the productive sector at end-March 2023, above the growth of 8.6 per cent at end-September 2022. The growth in loans to the productive sector was primarily reflected in the Professional & Other Services, Tourism, Construction and Distribution industries. The annual growth in lending to consumers slowed to 12.3 per cent at March 2023, relative to the increase of 14.0 per cent at end-September 2022.

Outlook

Jamaica's macroeconomic outlook remains generally positive. Consistent with global consensus forecasts for a further fall in certain commodity prices, the Bank's overall monetary policy stance and in the absence of new shocks, inflation is projected to continue to decelerate to the

[1] At end February, the capital adequacy ratio of deposit taking institutions was 14.3 per cent, an improvement relative to the 13.8 per cent recordeded at end October 2022. The ROA of the DTIs at end-February 2023 stood at 1.7 per cent, slightly below the ROA of 1.9 per cent at end-October 2022.

Bank's inflation target range of 4.0 to 6.0 per cent by the December 2023 quarter. The Bank projects, however, that there will be temporary upticks during the June and September 2023 quarter, affected by recent increases in the cost of communication services, the national minimum wage, seasonally higher agricultural prices as well as pending increases in other regulated prices such as transport costs.

The risks to the inflation outlook are balanced. Higher-than-projected wage adjustments, a stronger-than-anticipated impact of climate change on domestic agricultural prices and a worsening in supply chain conditions could put upward pressure on inflation. Further, higher-than-projected interest rates among major developed economies could worsen the interest differential and hence the pace of depreciation in the exchange rate. Among the factors that could lead to lower-than-projected inflation, weaker-than-expected global growth could negatively affect domestic demand and some projected adjustments to regulated prices may not materialise.

Gross domestic product (GDP) for fiscal year 2022/23 is projected in the range 4.0 to 5.5 per cent, in line with the range previously anticipated by the Bank. There are signs that the economy continued to expand for the June 2023 quarter and GDP growth for FY2023/24 is projected to moderate between 1.0 and 3.0 per cent. The projected growth for FY2023/24 largely reflects expansions for Mining & Quarrying, Agriculture, Forestry & Fishing and Manufacturing. The projected growth over the near term (June 2023 – March 2025) is broadly in line with the Bank's previous forecast, primarily reflecting an upward revision to the growth for Hotels & Restaurants, partly offset by downward revisions to the growth for Mining & Quarrying and Agriculture, Forestry & Fishing.

The risks to the domestic GDP forecast are skewed to the downside, which means that actual GDP growth could be lower than the forecast. Growth in tourist arrivals and related activities could be adversely affected by headwinds to global growth. There is also a risk that domestic consumer spending could be adversely affected by domestic inflation.

The current account deficit (CAD) of the BOP for FY2023/24 is projected to deteriorate to the range of 0.5 to 1.5 per cent of GDP from the estimate of 0.2 per cent of GDP for FY2022/23. This deterioration largely reflects a fall in the surplus on the current transfers sub-account, partially offset by a higher surplus on the services sub-account. The gross international reserves are projected to remain above the ARA 100 per cent benchmark over the medium term.

The risks to the projections for the CAD are skewed to the upside (higher deficit). The main upside risks (higher deficit) to the CAD relate to lower travel inflows associated with weaker-than-expected growth in source markets. The main downside risks (lower deficit) relate to lower imports associated with weaker-than-expected domestic demand.

Bank of Jamaica reaffirms its commitment to achieving its primary mandate of maintaining price stability for the benefit of the entire population. The Bank will continue to closely monitor the global and domestic economic environments for potential risks to Jamaica's inflation rate.