Richard Byles: Update and outlook for the Jamaican economy

Monetary Policy Press Statement by Mr Richard Byles, Governor of the Bank of Jamaica, at the Quarterly Monetary Policy Report press conference, Kingston, 21 May 2024.

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Introduction

Good morning and welcome to our Quarterly Monetary Policy Report press conference.

Before I speak on the recent monetary policy decision, I would like to make some brief remarks on the Bank's inflation target. In April 2024, Bank of Jamaica received written confirmation from the Minister of Finance and the Public Service that the inflation target for Jamaica will be maintained at 4.0 to 6.0 per cent for the next three years.

This inflation target is a major policy instrument for the Government of Jamaica and it is an important guidance tool for the entire economy. The target is the anchor that underpins how individuals and businesses should view current and future changes in the general level of prices in the economy. The determination of the target by the Minister followed consultation with the central bank.

The Bank's recommendation to maintain the inflation target at 4.0 to 6.0 per cent reflects our view that this target is generally consistent with the country's economic structure and stage of economic development. Clearly, Jamaica would not wish to have higher inflation. Lower inflation is desirable but is difficult to achieve in the near term for a number of reasons. The first is that Jamaica has a weak monetary transmission mechanism. Among the primary constraints to the transmission mechanism in Jamaica, particularly via the credit channel, is limited competition in the banking sector. The dominant players hold high levels of low-cost saving deposits, which makes their funding cost less sensitive to the central bank's policy actions. This limits the ability of the central bank to target a lower inflation without significant economic and social costs. By way of example, our assessment is that, with the existing system, the central bank would have to raise interest rates to double digits to contain inflation below 4.0 per cent, which would dramatically increase financing costs and reduce financing opportunities. These actions would also reduce the Government's ability to achieve the targeted reduction in the debt to GDP ratio by pushing up interest costs on GOJ debt. It is also of primary importance that the targeted rate of inflation enables nominal GDP to grow at a rate that is consistent with the country's debt reduction strategy.

Targeting a lower inflation rate is also hampered by low factor productivity. A highly productive economy produces goods and services at lower unit costs, which dampens inflation. On the flip side, lower productivity means that goods and services will become relatively more expensive over time, which makes it more difficult to reduce inflation. Finally, a significant part of the Consumer Price Index (CPI) – the 'basket' of goods and services that people buy, includes goods and services for which the prices are regulated by the government. These include PPV fares and utilities. In this regard, large and unpredictable regulated price adjustments complicate the job of the central bank in containing inflation.

Bank of Jamaica remains committed to pursuing measures to improve the transmission mechanism to facilitate greater and quicker pass-through of policy rate adjustments in the banking system.

The correspondence between the Minister and the central bank on the inflation target has been published on the Bank's website.

I will now speak on the MPC's recent decision.

Monetary Policy Decision

The Bank's Monetary Policy Committee (MPC) met on the 16th and the 17 th of May and announced the decision yesterday, to maintain: (i) the policy interest rate at 7.0 per cent; (ii) relative stability in the foreign exchange market; and (iii) tight Jamaican dollar liquidity conditions.

This decision reflects the Committee's view that while inflation is continuing its downward trend, it is still not yet firmly anchored within the target range and the risks to future inflation are skewed to the upside.

STATIN reported on Wednesday last week that Jamaica's annual headline inflation rate at April 2024 was 5.3 per cent, which is within the Bank's target range and lower than the rate recorded at March 2024. The Bank is encouraged by this outturn which represented the third consecutive month of lower inflation and the second consecutive month in which annual inflation was within the target range. The April 2024 outturn was also lower than the Bank's most recent forecast, mainly due to a faster than projected deceleration in agricultural food inflation. Core inflation, which excludes food and fuel prices from the Consumer Price Index, was 5.7 per cent and although elevated, it was marginally lower than the outturn recorded in March 2024.

Some of the key drivers of headline inflation, such as international grain prices and inflation expectations continued to decline. Inflation in the economies of Jamaica's main trading partners has also continued to moderate. However, international oil prices have been volatile.

Despite the encouraging outturns at March and April, the declining inflation is expected to be interrupted temporarily, with inflation projected to breach the upper end of the target range towards the end of the June 2024 quarter. This is expected to reflect mainly seasonally higher agricultural food prices, a normalisation in electricity rates following significant declines in the same quarter of 2023, and higher transport-related inflation, due to the uptick in oil prices. Thereafter, inflation is projected to return to the target range and generally remain there over the next eight quarters, with the exception of a few months in 2025.

The current outlook for inflation is lower than the previous forecast that was shared with you in February 2024. The improved outlook is mainly due to the removal from the forecast of the second increase in public passenger vehicles (PPV) fares, which was scheduled for April 2024. This is consequent on the Government's recent announcement to postpone the second increase. Processed food prices and the cost of meals away from home were also revised downward due to lower international grains prices. This is partly offset by the incorporation in the forecast of the announced increase in the national minimum wage and higher energy and transport-related inflation, due to higher international oil prices.

Notwithstanding the improved outlook, the MPC considered that the risks around the forecast were skewed to the upside over the next eight quarters. In particular, while core inflation has moderated, it remains close to the upper end of the target range. Additionally, both measured and survey-based indicators of businesses' inflation expectations, although lower, have remained above the inflation target. Larger-than-projected regulated price adjustments could also influence higher inflation.

There are also some upside risks that are external to Jamaica that could influence higher inflation. These include higher-than-projected international oil prices and worse-than-anticipated weather conditions due to the emerging La Niña weather phenomenon that could result in a more active 2024 hurricane season.

On the flip side, the factors that could result in lower-than-projected inflation include weaker-than-projected global growth, which could reduce domestic demand and imported inflation.

The MPC noted that a decision to reduce interest rates will depend on incoming data related to the risks to inflation noted above. In particular, the evolution of wage adjustments, inflation expectations and core inflation are important factors that will guide the MPC's decisions on policy rate adjustments and other monetary policy actions in the future. The Bank will maintain heightened surveillance of the risks to inflation.

Let me now provide brief updates on the foreign exchange market and Jamaican dollar liquidity.

Foreign Exchange Market

Over the 12 months to end-April 2024, on average, the Jamaican dollar depreciated against the US dollar by 1.4 per cent, continuing the fairly stable trend over the last two years. There was, however, an uptick in the pace of depreciation in April which primarily resulted from a seasonal increase in demand following the ending of the March tax season. To prevent undue volatility in the foreign exchange market, BOJ has sold approximately US$983 million via its B-FXITT facility over the 12 months to end-April 2024.

When these sales are set against BOJ purchases, the result is that the Bank net purchased approximately US$1.3 billion over the period, resulting in NIR of US$5.1 billion as at end April 2024. The pace of depreciation slowed over the first two weeks of May and the Bank will continue to act to ensure orderly movements in the exchange rate.

Consistent with these developments and reflecting continued confidence in the Jamaican dollar, DTI deposit dollarisation (which is measured by the proportion of DTIs' United States (US) dollar deposits to total deposits) has moderated.

Jamaican Dollar Liquidity

To support the stability in the exchange rate, Bank of Jamaica continues to maintain tight Jamaican dollar liquidity. This stance is reflected in higher yields on the Bank's 30-day CD and increases in private money market rates. The average yield on BOJ's 30 Day CD, for example, has fluctuated between 10 to 11 per cent over the past 6 months.

Update and Outlook for the Jamaican Economy

The Jamaican economy continues to grow but at a more moderate rate. Real GDP for FY2023/24 is estimated to have grown within the range of 1.5 to 2.5 per cent and the economy is expected to grow in the June 2024 quarter albeit at a slower pace.

Looking ahead, the Bank projects that real GDP will increase by 1.0 to 2.0 per cent for FY2024/25. This growth is projected to be broad-based with modest increases in Hotels & Restaurants and its allied industries, Mining & Quarrying, Agriculture, Forestry & Fishing, Manufacture and Electricity & Water Supply.

Concluding Statement

Ladies and gentlemen, the primary mandate of Bank of Jamaica is to see inflation firmly anchored between 4.0 and 6.0 per cent and we remain resolute in this commitment.

Thank you. I will now take questions.