Quarterly Press Briefing

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Governor

Bank of Jamaica

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Good afternoon, ladies and gentlemen.

Inflation Expectations

You may recall that at our last press conference in February, I indicated that one of the risks to future inflation was the persistence of expectations of high inflation. Then, the information from the December 2014 survey was that business expectations for annual inflation one year ahead were 10 per cent while annual inflation at the time of the survey was between 6 and 7 per cent. It seemed that people were forming their expectations of future inflation by looking back in time, perhaps a year or more, and ignoring their most recent experiences which pointed to progressively lower inflation.

This type of divergence between the current inflation rate and expectations for inflation to be higher in the future is not a good thing. Inflation expectations are a powerful force that pushes both wage inflation and cost inflation. Unless they are lowered, Jamaica will not be able to transition to a low-inflation environment.

Our challenge is to get people to be more forward-looking in forming their view of inflation. One of the things we are doing is to increase the frequency with which we communicate about inflation developments in Jamaica and what they mean.

I am therefore pleased to highlight that, based on the most recent survey conducted for Bank of Jamaica by STATIN in April of more than 250 businesses across 9 sectors, business expectations for inflation 12 months ahead have fallen to 5.1 per cent. This is much lower than the 7.7 per cent recorded in the February survey and the 10.0 per cent at the time of the December 2014 survey. These expectations are the lowest in the history of the survey. They are also lower than our forecast for inflation for the same period.

This is a very positive development. The fact that expectations have fallen is an indication that the business community is sensing that we are in a new economic environment and that fundamental economic changes are taking place in Jamaica. With perceptions now catching up with reality, it promises to make monetary policy easier, which is good news for everyone.

I am also pleased to confirm that inflation has fallen lower than we had expected at the last press conference. The inflation rate for fiscal year 2014/15 was 4.0 per cent, the lowest in 48 years. More recently, the increase in the CPI for the month of April was only 0.2 per cent, broadly in line with our forecast, and brought the annual inflation rate at April 2015 to 4.4 per cent.

Inflation Outlook

Looking ahead, we are forecasting that 12-month inflation will fall to below 3.0 per cent by September before rising moderately in the second half to end the fiscal year between 5.5 and 7.5 per cent. With a long-term target for inflation of between 2.0 and 4.0 per cent, in line with our main trading partners, we have by no means arrived at our destination but we are encouraged by the strides we have made towards our goal.

Risks to the Inflation Forecast

Bank of Jamaica's monetary policy stance is based on the outlook for inflation that I just outlined. Changes in our stance, ie, changes in the signal rate which is the rate we pay on the 30-day certificate of deposit, are also influenced by our view of the risks to the forecast. In addition to external factors, such as weather-related shocks or sharp increases in international commodity prices, the other two major areas of risk which the Bank monitors closely are the pace of exchange rate depreciation and the emergence of excess demand conditions in the economy. Closely connected with the latter is the risk that fiscal balance objectives in the near- and medium-term will not be achieved.

Taking the exchange rate first, **Bank of Jamaica does not see the exchange rate posing a major risk to inflation at this time.** This is based on a view of the fundamentals. Our assessment is that the exchange rate is currently at or close to its equilibrium. This is supported by the substantial reduction in the current account deficit of the balance of payments to an estimated 5.9 per cent of GDP in FY 2014/15 from 8.4 per cent of GDP in the previous fiscal year. We are forecasting that it will fall by a similar amount in the current fiscal year (2015/16).

Turning to the risk of excess demand emerging, **Bank of Jamaica does not see future excess demand conditions as a risk to inflation.** Growth in FY2015/16 is forecasted in the range of 1.5 to 2.5 per cent, which is a moderate pace when compared with the capacity of the economy. The government continues to demonstrate its commitment to continued fiscal restraint. If fiscal policy remains tight, inflation will remain constrained, which produces the additional benefit of lower interest rates. Conversely, if fiscal policy is loosened, it is likely that inflation expectations will rise, which would require a reaction from Bank of Jamaica to tighten monetary policy by increasing interest rates.

As it happens, the firm stance of fiscal policy so far, along with the recent trend for inflation to fall and for inflation expectations to fall, has facilitated the first easing of monetary policy since February 2013 with a reduction in Bank of Jamaica's signal rate to 5.50 per cent on 17[1] April 2015. Further adjustments to some of our interest rates in the enhanced liquidity management framework may also be warranted as conditions continue to improve and these should cause lending rates to go down.

Concluding remarks

In conclusion, much progress has been made on the economic reform programme in general and on reducing inflation in particular. Of tremendous significance to Bank of Jamaica is the recent fall in inflation expectations. The lower inflation expectations suggest that we are experiencing heightened awareness of the new economic reality, which presents opportunities as well as challenges.

We are a nation of sprinters but now, at the mid-point of the economic reform programme, we remind ourselves that this is not a sprint. We have to maintain focus, stay the course and finish the race. Much has already been achieved but there is still a lot of work to be done. As the fiscal authorities make solid headway in the difficult and long-term task of putting the fiscal house in order, this makes it easier for monetary policy to guide us to lower inflation and lower interest rates. In this market economy, private sector actors have to take us from here to where we want to go, because real growth comes from private sector investment. That expansion will come

[1] This date was first mistakenly stated as the 13th, and subsequently corrected.

largely from increased exports of goods and services and increased domestic production replacing imported items. The process of reform is not yet complete, but enough has already been done to build on, so, as I said when we met in February, the stage has been set, the foundation is being laid and it is now time for the private sector to lead the way and build.

Thank you.