



The Governor



Bank of Jamaica

Nethersole Place

Kingston, Jamaica, W.I.

07 August 2018

The 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,

Breach of Inflation Target

By letter dated 14 September 2017, the Minister of Finance set Bank of Jamaica a target for 12-month CPI inflation for FY2018/19 of 5.0 per cent with an allowable deviation of plus or minus 1.0 per cent. This target of 4.0-6.0 per cent would also apply (continuously) to the medium term, subject to periodic review.

The inflation target set by the Minister was consistent with a target range for inflation of 3.5-6.5 per cent that formed part of the agreement with the International Monetary Fund as a performance criterion under the precautionary Stand-by Arrangement. Specifically, a Monetary Policy Consultation Clause ("MPCC") in the agreement provides that if inflation were to fall outside the target range as at any of the review dates under the arrangement, the Jamaican authorities would be obliged to provide an explanation to the IMF Executive Board of the circumstances that led to that outcome and the policy responses that were being implemented.

In April, May and June of 2018, 12-month CPI inflation was measured at 3.2, 3.1 and 2.8 per cent, respectively, all falling below the 4.0 per cent floor set by Government and below the MPCC threshold for June 2018. A full report to the Minister on this performance relative to the objective set by the Government is therefore appropriate in order to inform wider macroeconomic policy and to facilitate Ministerial review of the target. The content of the report would also form the basis for the required consultation with the IMF Executive Board.

A comprehensive report that includes an analysis of the outturn at June 2018 and a forward-looking assessment of the monetary policy options for returning to the target is enclosed. In brief, the lower outturn for inflation at June 2018 relative to the target primarily reflected the impact of a stronger-than-anticipated reversal in agricultural prices in the March

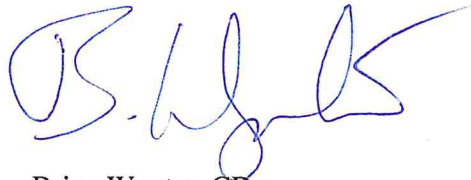
2018 quarter, lower-than-forecasted imported inflation and a reduction in the pass-through of oil prices to inflation. Domestic demand conditions were also assessed to be weaker than originally anticipated.

Bank of Jamaica projects that during the September 2018 and December 2018 quarters inflation will remain close to 3.5 per cent (ie, below the lower limit of the inflation target and below the lower limit of the inflation target band of the MPCC) but will rise to the midpoint of the target by June 2019 and remain broadly at that level over the medium term. This view is informed by an expected normalization in agricultural prices, higher oil prices and higher domestic GDP growth, the latter driven in part by the accommodative monetary conditions induced by the central bank over the past year.

Bank of Jamaica is consequently of the view that the economic programme remains on track. However, persistent sluggishness in demand notwithstanding the strong pace of job creation, specific constraints in the monetary policy transmission and the possibility of additional negative inflationary shocks suggest that stronger monetary policy action may be required in the near term.

Minister, we propose to supplement the analysis contained in this report with a technical appendix that examines the efficacy of the monetary transmission mechanism. This will be completed later this week. We stand prepared to provide any clarification that may be needed on the enclosed submission and await your confirmation of the appropriateness of the medium-term inflation target.

Yours sincerely,



Brian Wynter, CD

enclosure: