



03 October 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:

### **Breach of Inflation Target**

By letter dated 16 April 2021, you set Bank of Jamaica's Monetary Policy Committee (MPC) a target range of 4.0 to 6.0 per cent for annual inflation, as measured by the 12-month point-to-point percentage change in the Consumer Price Index (CPI) published by the Statistical Institute of Jamaica (STATIN), over the next three years. This target became operational as at April 2021 and will apply continuously, that is, for each month over the three-year period. In that same letter, you also indicated that whenever inflation deviates from the target range, the MPC is required to explain the deviation within 60 days of publication of the outturn by STATIN.

In my previous correspondence to you dated 30 June 2022, I noted that inflation was 10.9 per cent as at May 2022 and would continue to breach the Bank's target range over the next nine months, averaging in the range of 8.0 to 9.0 per cent. Since then, inflation has shown encouraging signs of moderation. As published by STATIN, the annual inflation rates at June, July and August 2022 were 10.9 per cent, 10.2 per cent and 10.2 per cent, respectively. Although these outturns have remained above the upper limit of the Bank's target range, they have been below levels previously projected.

As I have explained in the past, inflation continued to breach the upper limit of BOJ's target range because of (i) the impact of higher international commodity prices, which the Russian-Ukraine conflict has exacerbated, (ii) improvements in domestic demand, and (iii) heightened inflation expectations.

Continued elevated international commodity and shipping prices were the principal contributors to the domestic inflation rate remaining above the target range. At August 2022, the average crude oil and grains prices for the preceding 12 months were higher by 62.3 per cent and 23.6 per cent, respectively, compared with the same measures at August 2021. The price of liquefied natural gas (LNG) also rose by 101.9 per cent over the same period, while international shipping prices rose by 165.2 per cent. The main factor contributing to the increase in crude oil prices was concerns surrounding tight global crude supplies amid the conflict between Russia and Ukraine.

Relatedly, inflation in Jamaica was supported by higher consumer price inflation among Jamaica's main trading partners (particularly the United States of America (US)). Inflation in the US accelerated to 8.3 per cent at August 2022 from 5.3 per cent a year earlier and below 9.1 per cent in June 2022, representing the highest rate in four decades.

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Domestic demand in Jamaica continued to improve. The most recent data published by STATIN indicated that economic activity expanded by 6.4 per cent for the March 2022 quarter. There are also indications that the economy expanded by 5.0 to 6.0 per cent in the June 2022 quarter.

Business expectations of inflation remain elevated. In the latest survey of business expectations of inflation in August 2022, respondents indicated that they expect inflation over the ensuing twelve months to be 12.6 per cent, significantly above the Bank's inflation target but below the previous survey of 13.1 per cent.

### **What is the Near-Term Path & the Attendant Risks for Inflation to Return to the Target?**

BOJ's most recent projections indicate that inflation will average 7.0 to 8.0 per cent over the next 24 months (September 2022 to June 2024) and will remain above the target range for some time. The Bank's inflation forecast anticipates the continued lagged impact of elevated imported inflation due to high international commodity prices and improvements in domestic demand. The recovery in domestic demand is forecasted to be driven mainly by external demand.

Consistent with consensus forecasts, international commodity prices - energy (crude oil and LNG) and grains - are projected to remain elevated but fall over the next two years. In particular, WTI crude oil prices are projected to average US\$93.56 per barrel for the next eight quarters (September 2022 to June 2024), implying an average quarter-over-quarter decline of 3.5 per cent. As international commodity prices decline, inflation expectations should also moderate in the second half of the year.

In relation to selected risks, while there are headwinds to agriculture price inflation from lower fertilizer prices, adverse weather and increased demand pose upside risks to agricultural prices over the near term. Grains and crude oil prices have trended below the forecast but liquefied natural gas (LNG) prices have evolved higher than anticipated.

Inflation in the US also remains high, which prompted a larger than anticipated monetary adjustment by the Federal Reserve (Fed) in September 2022. The Fed also changed its forward guidance to signal that its target for interest rates could rise to 4.4 per cent by end-2022 and to 4.6 per cent by end-2023. This more aggressive stance could result in US dollar assets becoming more attractive relative to those denominated in Jamaican dollars, which could cause capital outflows, prompting a faster pace of exchange rate depreciation and, consequently, a derailment of the Bank's efforts to manage inflation.

### **Bank of Jamaica's Policy Actions to Return Inflation to Target**

The MPC unanimously agreed to further increase the policy rate by 50 basis points (bps) to 6.50 per cent at its meetings on 27 and 28 September 2022. The MPC also decided to continue pursuing other measures to contain the Jamaican dollar liquidity expansion and to maintain relative stability in the foreign exchange market. To ensure that individual depositors are encouraged to continue to save Jamaican dollars, the MPC is also considering further measures to support upward movements in DTIs' deposit rates.

The MPC noted that its current decision has resulted in a cumulative increase in the policy rate of 600 bps since October 2021.

These interest rate adjustments, in conjunction with the Bank's decisive actions in the foreign exchange market over the period to date, have contributed to maintaining stability in the foreign exchange market. The average exchange rate (JMD/USD) over the year to August 2022 depreciated by 3.6 per cent, relative to the same measure for August 2021. This change represents a slower pace of depreciation compared with the 6.1 per cent depreciation in the same measure for the previous year.

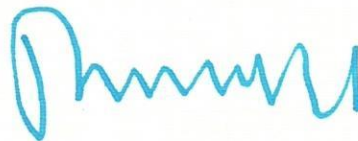
Without these actions, imported inflation and hence the final prices faced by Jamaican consumers would have been higher.

The Bank's gross reserves have remained comfortably above the level considered adequate, reinforcing its ability to support the foreign exchange market as needed. At 27 September 2022, Jamaica's gross reserves amounted to US\$4.3 billion, constituting approximately 125.6 per cent of the projected IMF's Assessing Reserve Adequacy (ARA) measure for FY2022/23.

The Bank will closely monitor the global and domestic economic environment and is prepared to act as necessary to ensure a downward track for inflation.

Minister, we stand prepared to provide any clarification that may be needed on the enclosed submission.

Yours sincerely,



Richard Byles