



30 June 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 23 February 2022, I noted that inflation was 9.7 per cent as at January 2022 and would continue to breach the Bank's target range over the next 10 to 12 months, peaking in the range of 9.0 to 11.0 per cent. Since then, inflation has generally increased. As published by STATIN, the annual inflation rates at February, March, April and May 2022 were 10.7 per cent, 11.3 per cent, 11.8 per cent and 10.9 per cent, respectively. These outturns have not only remained above the upper limit of the Bank's target range but have also exceeded the peak range I previously indicated.

There was a deceleration in inflation at May 2022, relative to April 2022, which primarily reflected the temporary effects of lower inflation for agricultural commodities, particularly vegetables, due to an improvement in supplies. In addition, *Housing, Water, Electricity, Gas and Other Fuels* fell, primarily due to the Government of Jamaica's subsidy on electricity bills for customers who use 200 kilowatts per hour or less. Notwithstanding these events, the annual point-to-point core inflation rate at May 2022 (measured as inflation less fuel and food prices (CPI-FF)) of 9.7 per cent was slightly above the Bank's most recent forecast and higher than the April 2022 outturn.

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 domestic inflation rate remaining above the target range. At April 2022, the average of crude oil and grains prices for the preceding 12 months were higher by 74.4 per cent and 36.2 per cent, respectively, when compared with the same measures at April 2021. The price of liquefied natural gas (LNG) also rose by 86.3 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.

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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 8.6 per cent at May 2022 from 5.0 per cent a year earlier, which represented the highest rate in four decades.

Domestic demand in Jamaica has improved, aided partly by the relaxation of measures to control the spread of the COVID-19 virus. The most recent data published by STATIN indicated that economic activity expanded by 6.7 per cent for the December 2021 quarter. There are also indications that the economy expanded by 4.5 to 6.5 per cent in the March 2022 quarter.

Business expectations of inflation remain elevated and have increased further. In the latest survey of business expectations of inflation in April 2022, respondents indicated that they expect inflation over the ensuing twelve months to be 12.8 per cent, significantly above the Bank's inflation target and the previous survey of 12.1 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 8.0 to 9.0 per cent over the next 24 months (June 2022 to March 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. Past increases in regulated transportation fares, utility rates and the minimum wage will support higher annual inflation for a further nine months (June 2022 to May 2023).

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\$100.20 per barrel for the next eight quarters (June 2022 to March 2024), implying an average quarter-over-quarter decline for the period of 1.0 per cent. As international commodity prices decline, inflation expectations should also moderate in the second half of the year.

The Government's electricity subsidy will help temper inflation for May to August 2022, relative to the Bank's most recent forecast. While agricultural prices remain volatile, there are indications that the supply of vegetables and tubers to the domestic market in June and July 2022 will be adequate; their prices may continue to fall if weather conditions remain favourable. While grains and crude oil prices have generally trended in line with the Bank's forecast, liquefied natural gas (LNG) prices have evolved at higher levels than anticipated.

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

The MPC unanimously agreed to increase the policy rate by 50 bps to 5.50 per cent at its meetings on 27 and 28 June 2022. The MPC also decided to continue pursuing other measures to contain Jamaican dollar liquidity expansion and maintain relative stability in the foreign exchange market. The MPC noted that the Bank's robust reservoir of international reserves reinforces its ability to support the foreign exchange market as needed.

The MPC's most recent decision reflects a cumulative increase in the policy rate of 500 bps since October 2021, which has taken the policy rate closer to the level that the Committee

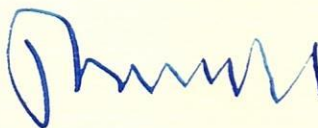
considers appropriate. The Bank, over this period, also sold foreign exchange to the market, when necessary, including via the public sector enterprise facility, while continuing to ensure that the gross reserves remained comfortably above the level considered adequate. At 27 June 2022, Jamaica's gross reserves amounted to US\$4.4 billion, representing approximately 129 per cent of the projected IMF's Assessing Reserve Adequacy (ARA) measure for FY2022/23. In addition, the Bank increased its stock of certificates of deposit by J\$35 billion over the period and adjusted the Net Open Position limits for deposit-taking institutions (DTIs).

In the context of these actions, the average exchange rate (JMD/USD) between end-September 2021 and end-May 2022 depreciated by 4.8 per cent, relative to the same measure for 2020/2021. This represents a slower pace of depreciation compared with the 7.0 per cent depreciation in the same measure recorded at end-May 2021. Without these measures, inflation in Jamaica would have been higher.

The MPC remains steadfast in monitoring the highly uncertain economic environment closely and making its future policy decisions based on incoming data.

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

Yours sincerely,



Richard Byles