

1 September 2023

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 from you, Bank of Jamaica's Monetary Policy Committee (MPC) was set a target range for annual inflation of 4.0 to 6.0 per cent over the next three years, 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). This target became operational as at April 2021 and will apply continuously, that is, for each month over the three years. The letter also stated that whenever inflation deviates from the target range, the MPC must explain the deviation within 60 days of publication of the outturn by STATIN.

In my previous correspondence to you dated 01 March 2023, I noted that inflation had been 8.1 per cent as at January 2023 and would continue to breach the Bank's target range over the ensuing months. The Bank had projected that inflation would return to the target range of 4.0 per cent to 6.0 per cent by the December 2023 quarter.

Since my letter to you, inflation continued to moderate. As published by STATIN, the annual inflation rates at February 2023 and March 2023 were 7.8 per cent and 6.2 per cent, respectively. Surprisingly, the annual point-to-point inflation rate at April 2023 was 5.8 per cent, which was below the Bank's projections and represented a return to the target range for the first time since July 2021. The subsequent annual inflation outturns for May, June and July 2023 were, however, 6.1 per cent, 6.3 per cent, and 6.6 per cent, respectively, representing breaches of the upper end of the Bank's inflation target range.

The main reasons why inflation continued to be generally above the upper limit of BOJ's target range are (i) exceptionally high agricultural price inflation due to the impact of drought and high temperatures and (ii) the first-round effect of an upward adjustment to the national minimum wage, which occurred in June 2023, and related adjustments to the price of selected goods and services. The effect of these factors was partly offset by a continued downward in trend in core inflation, reflecting the impact of the Bank's monetary policy actions and the consequent relative stability in the exchange rate. In addition, lower inflation was supported by declining international commodity prices and shipping costs, lower consumer price inflation among Jamaica's main trading partners (particularly the United States of America (US)) and a deceleration in inflation expectations.

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An increase in agricultural prices was the principal contributor to the domestic inflation rate remaining above the target range. Over the two months of June and July 2023, agricultural prices (as measured by 'Vegetables, tubers, plantains, cooking bananas and pulses') increased by 15.8 per cent, contributing 1.1 percentage points to the 2.1 per cent increase in the CPI over the same period. The significant increase in these prices reflected the lagged effect of a drought towards the latter part of 2022 and the first part of 2023, and then high temperatures that were experienced across the island towards the middle of 2023.

A 44 per cent increase in the national minimum wage in June 2023 was reflected in the *Goods And Services For Routine Household Maintenance* component of the CPI basket. It caused the inflation rate for the month to be 0.3 percentage points higher than it otherwise would have been. The adjustment also, reportedly, indirectly affected other consumer items, such as the prices of meals consumed away from home.

Declines in international commodity prices supported the continued deceleration in selected services inflation (particularly transport and electricity). As at July 2023, the average prices of crude oil and grains over the preceding 12 months were lower by 12.1 per cent and 2.9 per cent, respectively, compared to the same measure at July 2022. The same measure of liquefied natural gas (LNG) price also declined by 21.2 per cent over the period. International shipping prices in July 2023 were lower by 68.6 per cent relative to prices in July 2022. In the context of the fall in energy prices, the *Housing Water, Electricity, Gas and Other Fuels* Division of the CPI reflected an annual inflation rate at July 2023 of 1.6 per cent, much lower than the 4.9 per cent inflation rate at July 2022. Similarly, reflecting lower grains and shipping prices, processed food price inflation exhibited a lower inflation rate over the period.

Inflation expectations in Jamaica continued to fall. In the June 2023 survey of businesses' inflation expectations, the business sector's expectation for inflation 12 months ahead declined to 8.3 per cent at May 2023 from 11.5 per cent at January 2023. This was also much lower than the peak expectations of 12.8 per cent at April 2022. Survey respondents indicated that changes in the external price of imported goods continued to be the most important factor influencing inflation expectations.

In the context of the Bank's tight monetary policy stance and the fall in inflation expectations, core inflation (which excludes food and fuel prices from the Consumer Price Index (CPI)) generally trended down over the course of the past year and half. Core inflation at July 2023 of 5.2 per cent was lower than the peak rate of 9.7 per cent recorded at May 2022.

Inflation in the US at June 2023 was 3.0 per cent, lower than the outturn of 6.4 per cent at January 2023.

The Jamaican economy continues to expand, which supports increases in aggregate demand for goods and services. The most recent data published by STATIN indicated that real GDP expanded by 4.2 per cent for the March 2023 quarter. The Planning Institute of Jamaica estimated that the economy grew by 1.5 per cent for the June 2023 quarter. There are signs that the economy continued to expand in the September 2023 quarter. GDP growth for FY2023/24 is projected to moderate between 1.0 to 3.0 per cent from 4.7 per cent for FY2022/23.



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

The uptick in inflation between May and July 2023 is projected to continue for the remainder of the September 2023 quarter, driven by higher agricultural prices, higher education costs and wage pressures. Notwithstanding the uptick, inflation is projected to decelerate to the Bank's target range of 4.0 to 6.0 per cent by the December 2023 quarter and remain there except for a few months in 2024. This projection is consistent with global consensus forecasts for the path of specific commodity prices and the Bank's continued tight monetary policy stance.

Overall, fuel prices are projected to increase over the next two years, while grains prices are projected to decline. WTI crude oil prices are projected to average US\$81.94 per barrel between September 2023 and June 2025, implying an average quarter-over-quarter increase of 1.4 per cent. This forecast is lower than the 8-quarter forecast outlined in my previous letter. The average price of grains is projected to decline at an average quarter-over-quarter rate of 1.4 per cent over the same period. As international commodity prices trend downward, inflation expectations should continue to ease. The forecast, however, assumes that international grain prices will increase in the September 2023 quarter, given a recent rise in geopolitical tensions.

Headline inflation in the US is projected to moderate over the next two years, but generally remain above the Fed's target of 2.0 per cent.

Domestic inflation could, however, rise above the projected path. Higher-than-projected future wage adjustments in the context of the tight domestic labour market, second-round effects from the agricultural price inflation, deteriorating supply chain conditions and an elevation of world oil prices could put further upward pressure on inflation. Downside risks to this outlook include weaker-than-expected global growth, which could reduce domestic demand, and the non-materialisation of some projected adjustments to regulated prices.

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

At its most recent policy meeting on 16 and 17 August 2023, the MPC unanimously decided to maintain: (i) the policy interest rate at 7.0 per cent, (ii) tight Jamaican dollar liquidity conditions and (iii) relative stability in the foreign exchange market. The maintenance of the Bank's monetary policy stance is consistent with the view that, aided by the Bank's management of the exchange rate and liquidity, there has been material success in controlling core inflation.

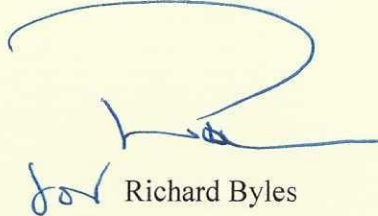
The MPC continues to see a relatively strong, lagged pass-through of its policy rate to interest rates in the domestic money and capital markets, and in the term rates offered on deposits by DTIs. However, the upward adjustment in these rates has slowed, consistent with the MPC's pause in interest rates. The DTI sector also continued to make small changes to their rates on saving deposits and new loans. In the context of the tight monetary conditions, the flow of new loans to the private sector declined in real terms by 6.2 per cent over the year to May 2023. In addition, in the context of the stability in the foreign exchange market, deposit dollarisation continued to trend downward.

The MPC also noted that the reserves are sufficient and continued to exceed the 100 per cent of IMF's Assessing Reserve Adequacy (ARA) benchmark. At end-July 2023, Jamaica's gross reserves amounted to US\$4.6 billion, representing 114.5 per cent of the projected IMF's ARA measure for FY2023/24.

Future monetary policy decisions will depend on the incoming data related to the indicators associated with the abovementioned headwinds to inflation. The MPC will continue to closely monitor the global and domestic economic environments for potential risks to Jamaica's inflation rate and act accordingly.

Minister, we stand prepared to provide any clarification that may be required in relation to this submission.

Yours sincerely,

A handwritten signature in blue ink, consisting of a large, stylized 'R' followed by a horizontal line and a small flourish.

Richard Byles