**Quarterly Press Briefing**

***Monetary Policy in Transition***

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**Governor**

Bank of Jamaica

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Good morning.

Ladies and Gentlemen, I am pleased to release Bank of Jamaica's Quarterly Monetary Policy Report ("QMPR") for the October to December 2017 quarter.

Last week, Bank of Jamaica published a schedule setting out the dates when we will announce monetary policy decisions during 2018. This is a public commitment to an announcement schedule that is an important outcome of the Bank's plan to improve the transparency of the monetary policy framework.

**Decision**

Yesterday, the Bank announced the first monetary policy decision under the new schedule. **The decision was to lower the policy rate by 25 basis points to 2.75 per cent (the policy rate is the interest rate paid by Bank of Jamaica on overnight deposits).**

This adjustment reflects the Bank's assessment that inflation for the next eight quarters will remain within the inflation target of 4.0 per cent to 6.0 per cent, with the risks slightly skewed to the downside.

The most recent information from STATIN indicates that headline inflation at January 2018 was 4.8 per cent. This was lower than the 5.2 per cent at December 2017 but broadly in line with inflation at September 2017. The trajectory for inflation reflected the rise and then the fall in agricultural food prices as the impact of flood rains late in the year started to dissipate and agricultural supplies improved. Over the course of the next year, the Bank expects inflation to continue to track around the lower half of the 4.0 per cent to 6.0 per cent target before rising to around 5.0 per cent.

Recovery in the Jamaican economy has been sluggish, though, and the Bank expects that GDP will remain below the economy’s capacity in the near term. The Bank believes that this, together with continued fiscal consolidation and low inflation expectations anchored around the Bank’s target, calls for a more accommodative monetary policy stance.

**FPAS**

Ladies and gentlemen, over the past two years the Bank has worked hard at improving how it formulates monetary policy. The improvements in the process, referred to as the forecasting and policy assessment system ("FPAS"), has culminated in this commitment to fixing the dates in the decision-making calendar for the full year ahead and disclosing to the public each decision promptly, along with the rationale for the decision, even when the decision is to leave the policy rate unchanged. Monetary policy decisions will be made eight times each year.

The schedule of announcement dates can be found on the Bank's website and we would like to encourage the public to check there to be reminded of upcoming dates. With the increased transparency, we also want to encourage stakeholders to improve their understanding of what we are doing and to be in a position to question and analyse our messages with confidence so that they can make full use of them in forming their own decisions.

As an example of this, I will begin with an explanation of FPAS and its outcomes. Under FPAS, the Bank undertakes a comprehensive assessment of current and projected economic conditions, including, most importantly, the outlook for inflation. **The end result of each assessment is a monetary policy decision that normally will be to (i) increase the policy rate, (ii) maintain the policy rate unchanged or (iii) reduce the policy rate.**

These decisions are intended to guide the interest rates set by commercial banks and other financial institutions that affect the spending, investment and saving decisions of households, firms and farms that, in turn, influence the rate of inflation. The impact of monetary policy changes is usually first seen in money market rates before spreading outwards to other interest rates such as those on bank loans and deposits.

These influences exert their effect over periods that are both long and variable, however. For the Bank to meet the inflation target, therefore, it has to act on the basis of how it sees inflation evolving in the future and not in reaction to the current inflation rate. **A decision to reduce the policy rate is consistent with a view that there is a relatively low risk of future**

**inflation rising above the target. In some circumstances, it may imply that underlying conditions in the economy or in the labour market are weak. A decision to increase the policy rate most likely means that the Bank is acting to reduce future inflation pressures. A decision to keep rates unchanged signals a general comfort by the Bank that interest rates are consistent with future inflation remaining within the target.** There are other tools that may be used from time to time but changes to the policy rate will be the principal tool for the conduct of monetary policy.

**Foreign Exchange**

As a final note, I wish to highlight that the foreign exchange market continues to perform as we had expected. Jamaica's transition to a modern competitive foreign exchange market is in train. The recent behaviour of the market highlights that it is experiencing more two-way movements and we expect this behaviour to continue. The exchange rate appreciated by 3.8 per cent during the review quarter, a trend that continued into the first week of January. Since then, the market entered a new phase with a reversal of the previous appreciating trend.

We invite stakeholders to take careful note of some of the effects of the new reality of two-way movements in the exchange rate. Participants who before had built long positions in foreign exchange have begun to learn that these positions, seen by many as an obvious way to retain value, can actually cause them to lose money. The new reality favours investors and savers who take a more balanced approach to the acquisition of foreign exchange and foreign currency-denominated investments. Another example of what can happen to the unwary is the loss realised by investors in a US Dollar-indexed bond issued by Bank of Jamaica early last year. When the bond was fully repaid in accordance with its terms at maturity last month, on 30 January 2018, investors found that, instead of earning a moderate interest rate together with a sizable capital gain based on the anticipated depreciation of the Jamaican dollar, they in fact lost money with a negative return of 1.15 per cent. Effectively, they paid Bank of Jamaica to keep their money for a year.

The new reality means that banks and other financial institutions are in a better position to offer reasonably priced insurance or hedging tools to customers who do not want to or cannot bear the short-term risks presented by the two-way movements in the exchange rate. Removing the assurance that you cannot lose by simply buying and holding foreign exchange means that investors have more incentives to put their money into Jamaican dollar-denominated, growth-oriented investments. Two-way movements in the exchange rate also mean that the pass-through from depreciation to prices is more and more muted.

As we continue to implement our strategy to deepen the foreign exchange market, Bank of Jamaica reduced the foreign exchange surrender requirements on 07 February 2018 by 5.0 percentage points. This added about US$30 million to the monthly flow of foreign exchange available to authorised dealers and cambios for sale to their customers. This follows the same-sized reduction in October last year. Sale operations under B-FXITT remain in place with the current four-week ahead schedule, grounded on the market intelligence received by the Bank, including a total of US$40 million to be sold to the market next month. We are required to believe that market participants have learned the lessons of the recent past and are giving due weight to this signal.

Plans for the Bank to introduce buying operations under B-FXITT are in train and we expect that we will be in a position to announce their inclusion in the options available for standard operations.

Ladies and gentlemen, Bank of Jamaica continues to implement policies and procedures to improve the operations of the financial markets and to improve the way in which it interacts with these markets. The goal is to improve macroeconomic stability and resilience in Jamaica as our contribution to sustainable growth and job creation.

Thank you.