Quarterly Monetary Policy Report

Press Conference

Brian Wynter

Governor

Bank of Jamaica

29 August 2018

Good morning and welcome to the Quarterly Monetary Policy Report press conference.

The Decision

Yesterday, Bank of Jamaica announced its decision to hold the policy interest rate unchanged at 2.00 per cent. The policy interest rate is the rate offered on overnight placements with Bank of Jamaica.

This policy decision reflects the Bank's updated assessment that inflation, currently below target, will rise towards the lower end of the target of 4.0 per cent to 6.0 per cent by the March 2019 quarter and approach the middle of the target range thereafter. The path for inflation continues to reflect some slack in the economy, however, which underscores the continued elevated risk of inflation falling below the baseline projection.

At the last QMPR press conference in May 2018, I signalled the possible need for more aggressive monetary policy easing given our concerns about low core inflation in the context of lower-than-potential GDP growth rates. This was followed in June 2018 by a more aggressive reduction of 50 basis points in the policy rate. More recently, in our report to the Minister of Finance on the causes of the deviation of inflation from target in April, May and June 2018, we noted that, among other things, persistent sluggishness in demand will suggest that stronger monetary policy action may be required in the near term.

The decision to maintain the policy rate, following cumulative downward adjustments of 100 basis points since the start of the year, has been made in the context of signs that have emerged of a pick-up in the rate of expansion in private sector credit.

Credit extended by deposit-taking institutions ("DTIs") to private sector businesses and individuals grew at an annual rate of 15.9 per cent at June 2018, compared to 13.9 per cent at March 2018 and 12.4 per cent at June 2017. This expansion was evenly balanced between business loans (15.8 per cent) and personal loans (16.0 per cent). Simultaneously, we have seen weighted average lending rates at commercial banks continue their decline during the June 2018 quarter.

If this acceleration in private sector credit growth continues, the resulting increase in economic activity will support inflation returning to the target of 4.0 per cent to 6.0 per cent with greater certainty. Please note, however, that Bank of Jamaica will closely monitor these credit conditions and will make further cuts to the policy rate if required.

Inflation Performance Relative to Target

Annual point-to-point inflation at June 2018 was 2.8 per cent. This represents the second successive quarter that annual inflation fell below the Bank's target of 4.0 per cent to 6.0 per cent. In the most recent data released by STATIN, annual inflation at July 2018 rose to 3.2 per cent, largely influenced by increased electricity, water and sewage costs, rising costs for some agricultural produce and higher transportation costs.

The lower-than-targeted inflation outturn at June primarily reflected the impact of stronger-than-anticipated declines in food prices since the start of 2018, which largely reflected recovery in agricultural output following production disruptions in late 2017. The lower inflation is also due to lower-than-forecasted imported inflation and a reduction in the pass-through of oil prices to inflation. In addition, weaker-than-expected demand conditions continued to prevail in the domestic economy. A detailed analysis is presented in our recently published report to the Minister. Additionally, Box 1 entitled ***Why Inflation was Lower than Target*** in the Quarterly Monetary Policy Report being released today will provide you with more detail on the factors that contributed to inflation falling below the target.

The Bank's projected path for inflation for the near to medium term incorporates recent inflation outturns, which were generally lower than anticipated. **Over the near term, the inflation forecast is mainly predicated on an expected increase in domestic agricultural prices, oil prices remaining elevated and the impact of improving economic activity supported by accommodative monetary conditions over the past year. Of note, the level of inflation expected by businesses remains anchored at the midpoint of the Bank's target (5.0 per cent).**

Risks to the Forecast

Bank of Jamaica has assessed the risks to the inflation forecast to be balanced. The main upside risks to the inflation forecast include weather conditions being worse than anticipated, domestic demand conditions being higher than projected and the exchange rate depreciating faster than is anticipated. The risks to the inflation forecast from international commodity prices, particularly crude oil, are skewed to the downside. Importantly, as I said at the beginning of these remarks, the risk to the downside arising from persistent slack in the economy remains elevated.

Developments in the Foreign Exchange Market

I wish to take this opportunity to address a narrative circulating in the public that Bank of Jamaica is manipulating the exchange rate in an effort to influence an increase in inflation back towards the Bank's target range of 4.0 per cent to 6.0 per cent.

Let me be very clear. There is absolutely no truth to this narrative. It would be to do the exact opposite of the explicitly stated objectives of the B-FXITT mechanism introduced in July 2017* and would violate the well-established commitment of the government to a flexible market-determined exchange rate. We have not been doing that, we are not doing that and we will not do that.

The channel through which Bank of Jamaica expects inflation to rise to the target is through increased economic activity. Based on the Bank's assessment, there is still some slack in the economy as actual output remains below the Bank's estimate of the economy's capacity or potential for growth. While we are now seeing some encouraging signs of the faster expansion in private sector credit that we need, we need to be sure that it is sustained so that the slack is removed as soon as possible.

I also wish to emphasize that Bank of Jamaica does not focus on nor seek to defend a particular exchange rate but seeks instead to ensure the orderly functioning of the foreign exchange market. In accordance with the rules of B-FXITT, Bank of Jamaica sold US$65

* *The original copy mistakenly had 'July 2018' and was subsequently corrected.*

million over the last two weeks. In addition, the Bank has committed to sell a further US$46.5 million over four weeks, US$16.5 million of it in today's B-FXITT sale operation. Also, the Bank has opened an offering to the market of a US dollar-indexed note as an alternative investment option for investors. These actions included a flash sale operation on Friday last week that was aimed at averting disorderly market conditions that the Bank judged to be imminent.

Macroeconomic Developments & Outlook

The Jamaican economy continues to show signs of moderate recovery, with GDP growth estimated to have accelerated in the June 2018 quarter. The economy is estimated to have expanded in the range of 1.0 to 2.0 per cent in the June 2018 quarter, above the growth of 0.1 per cent recorded in the June 2017 quarter and the 1.4 per cent expansion recorded for the March 2018 quarter. This accelerated pace of growth predominantly reflected an improvement in net external demand as well as increases in investment and some growth in private consumption.

Bank of Jamaica projects a modest acceleration in real GDP growth over the next two years but with economic activity remaining somewhat below the economy's capacity. Real GDP growth is projected to expand at an average quarterly growth rate of 1.5 per cent to 2.5 per cent, over the next eight quarters. This forecast continues to be supported by strong foreign demand, particularly from the United States. However, fiscal consolidation is expected to continue to have a restraining influence on domestic demand.

Labour market conditions also continue to reflect improvement. The unemployment rate declined to 9.7 per cent at April 2018 from 12.2 per cent a year earlier. The fall in the unemployment rate reflected annual growth of 14,700 new jobs, combined with a decline in the labour force. Bank of Jamaica expects further improvements in labour market conditions over the next two years but these improvements are not expected to present a major risk to inflation.

Ladies and gentlemen, domestic inflation is lower than targeted at this time. However, Bank of Jamaica projects that inflation will return to target in the March 2019 quarter and approach the midpoint of the target thereafter. Overall, Jamaica's macroeconomic indicators continue to reflect stability. Jamaica's net international reserves are healthy and the current account of the balance of payments, while projected to widen, will remain at sustainable levels. Market interest rates are at record lows and fiscal performance remains strong. In this environment, Bank of Jamaica is able to continue with an accommodative policy stance in support of expanded output and job creation which will return inflation to the Bank's target of 4.0 to 6.0 per cent.

Thank you.