Quarterly Monetary Policy Report

Press Conference

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Bank of Jamaica

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Ladies and gentlemen,

Good afternoon, and welcome to Bank of Jamaica's quarterly monetary policy press conference and the presentation of the Quarterly Monetary Policy Report for the first quarter of 2019.

Monetary Policy Decision

Last Friday, we announced the decision to lower the policy rate (the interest rate offered on overnight placements with Bank of Jamaica) by 50 basis points to 0.75 per cent per annum effective 20 May 2019.

This decision reflects the Bank's forecast that, even though headline inflation will increase to average 4.5 per over the next two years, there will be months when inflation will fall below the lower limit of the inflation target of 4.0 per cent to 6.0 per cent. In addition, notwithstanding the uptick in annual inflation, core, or underlying, inflation is projected to remain low. In the period that follows, headline inflation is forecasted to approach the midpoint of the target gradually but, and this is the important point, at a slower pace than we had expected at the last assessment in February 2019.

This rate cut is aimed at increasing the pace of expansion in private sector credit, which will stimulate increased economic activity on the part of businesses and households. We have made this point many times in the past and I want to emphasise it today as it is very important that the public fully appreciates that this is the sole purpose of our action. The increased economic activity by businesses and households will bring with it a bit more inflation and, in that way, the rate cut will support inflation returning to the centre of the target more quickly.

We note that, consistent with our previous policy actions, the pace of credit expansion has accelerated since our last press briefing in February 2019 and this is indeed encouraging. But it is still not fast enough. Based on our estimates of the capacity of the economy, faster growth is possible without causing inflation to rise above the inflation target. Credit extended by banks, merchant banks and building societies to private sector businesses and households grew by 15.2 per cent over the 12 months to March 2019, somewhat higher than the 13.4 per cent observed at the end of December 2018 and the 13.8 per cent experienced a year earlier at March 2018.

Other Actions

Bank of Jamaica continues to make changes to the monetary policy framework to improve the effectiveness of monetary policy. In addition to the decision to lower the policy rate, Bank of Jamaica last week announced a reduction in the cash reserve requirement by two percentage points to seven per cent, effective 03 June 2019. This is the second reduction in the cash reserve requirement this year, following the reduction by three percentage points that took place in March. This second reduction in the cash reserve requirement will increase liquidity in the financial system by $12.3 billion, thereby supporting the provision of more credit to businesses and households at lower rates and on better terms.

These cash reserve reductions are possible because of macroeconomic stability in Jamaica.

Yesterday, we also reduced the width of the interest rate corridor from 300 basis points to 200 basis points. Narrowing the width of the corridor is aimed at strengthening the effect of changes in the policy rate on the interest rates the public pays when they borrow from banks and other financial institutions and the interest rates the public receives on their bank deposits and other investments.

The interest rate corridor is the difference between the policy rate and the standard interest rate on the overnight Standing Liquidity Facility (SLF). The SLF is a Bank of Jamaica facility that provides overnight advances on demand to banks, merchant banks and building societies. The reduction in the width of the interest rate corridor will result in a reduction in the standard interest rate on the SLF to 2.75 per cent per annum (that is, the policy rate (0.75 per cent per annum) plus 200 basis points).

Bank of Jamaica also last week made an announcement about some additional liquidity operations aimed at encouraging faster expansion in credit and increasing the availability of assets that qualify as liquid assets for banks, merchant banks and building societies. These operations, in combination with the Bank's regular liquidity operations, will also assist in smoothing the impact on system liquidity of the government repaying $40.5 billion to investors on the maturity date of a government bond in July 2019.

Inflation Outlook

I will now share with you the outlook for inflation that informed the Bank's decision that was announced on Friday.

In STATIN's latest release, annual inflation at April 2019 was 3.9 per cent, up from 3.4 per cent at March 2019 and 3.2 per cent at April 2018. As we can see, inflation has been picking up. This mainly reflected the impact of some normalization (in other words, an increase back to normal levels) in the prices of agricultural food items, particularly vegetables and some processed foods, partly offset by a decline in electricity rates. At the same time, we can see that inflation remained below the target for the fifth month in a row and also that underlying inflation remained low.

The Bank's main measure of underlying, or core, inflation is headline inflation with the immediate influence of agriculture and energy prices excluded; we call this measure of core inflation CPIAF. Core inflation remained low (below 2.5 percent) from January to April 2019. Low core inflation is symptomatic of domestic demand conditions running below the economy's capacity over the preceding four quarters. Also, the second-round effects of lower oil prices are contributing to keeping core inflation so low.

Looking ahead, Bank of Jamaica anticipates that headline inflation will rise towards 5.0 per cent, the mid-point of the target, by the March 2020 quarter as domestic agriculture prices increase from the low levels of recent months to more normal levels and domestic economic activity increases in response to the lowering of the policy rate over the last eight quarters. But, and as I said earlier, this is the important point, we do not expect inflation to stay at the mid-point of the target. Rather, we expect that inflation will decline towards the bottom of the target in the period after the March 2020 quarter and only return to the mid-point slowly over the ensuing three years. In this forecast, the return to the middle of the target will take quite a bit longer than what we were seeing at the time of our last forecast presented at the last press briefing. This outlook also carries a meaningful risk that inflation will fall below the target again during that period in the absence of a policy response.

You can see more details in the QMPR about the forecast path for inflation.

Risks to the Forecast

The risks to the inflation forecast over the next two years are generally balanced.

The main upside risk that would cause inflation to be higher than our forecast is the possibility of higher-than-anticipated international commodity prices, particularly for crude oil. Downside risks to inflation that could cause inflation to be lower than expected include the possibility of more-than-anticipated production in the agriculture sector that would lead to smaller increases in food prices. Additionally, demand for Jamaican exports and therefore domestic economic activity could be lower than projected if global trade tensions escalate.

Conclusion

Our view is that the prospects for the Jamaican economy are positive, as economic growth continues with rising employment. Foreign reserves are adequate and we have a sustainable position in the current account of the balance of payments. Fiscal performance is strong and Jamaica is shedding its burdensome debt load at an admirable rate. Inflation is low, stable and predictable. However, the economy continues to operate below its potential in that there exists spare capacity for the production of goods and services that can be used but is not being used. This is why we believe that there is room to accommodate more growth without compromising our ability to meet the inflation target. Bank of Jamaica is therefore maintaining an accommodative monetary stance to support a faster return of inflation to the centre of the target in the period after March 2020.

Thank you.