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Quarterly Monetary Policy Report

Press Conference

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Governor

Bank of Jamaica

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Ladies and gentlemen,

Good morning and welcome to Bank of Jamaica's quarterly monetary policy press conference and the presentation of the Quarterly Monetary Policy Report (QMPR) for the June 2019 quarter.

I trust you will indulge me to say a few things on a personal note before I get to the monetary policy statement.

Firstly, I would like to take this opportunity to thank the staff here at the Bank for all the work they have done to bring me up to speed on the critical workings of the complex machinery called Bank of Jamaica.

I start this journey at a time when Jamaica's economy looks better in a long time but also at a time when the global economy faces clouds of uncertainty. If I never knew before, now I know why economists are so addicted to the phrase, "on the other hand!"

I start this journey with a confidence because I am a Jamaican who believes in the potential of Jamaica and the economy. I am proud of the hard work we have done across political administrations to move the economy forward. We have a great foundation to build on and I am inspired to take the baton from Governor Wynter and play my part in the process.

I am happy that one of my first tasks as Governor is to face you in a press conference because communication is as critical to monetary policy as journalism is to a sound democracy, We all want an informed and educated public on economic matters. This is therefore one of the most important parts of my job and I'm glad to get started so early.

Now on to today's statement.

Monetary Policy Decision

On Tuesday, we announced the decision to lower the policy rate (the rate offered on overnight placements with Bank of Jamaica) by 25 basis points to 0.50 per cent per annum, effective yesterday, 28 August 2019.

Bank of Jamaica's decision to cut rates further reflects our assessment that, in the absence of additional monetary policy action, inflation is expected to fall below the lower limit of the inflation target of 4.0 per cent to 6.0 per cent at various points over the next eight quarters. In addition, notwithstanding the recent uptick in annual inflation, core (or underlying) inflation is projected to remain at relatively low levels. In the period that follows the next eight quarters, headline inflation is forecasted to gradually approach the midpoint of the target, although at a slower pace than we had expected at the last assessment in May 2019.

As had been indicated to you in the past, Bank of Jamaica's medium-term inflation target of 4.0 per cent to 6.0 per cent was determined by the Minister of Finance on the basis of Jamaica's *current* and *prospective* economic circumstances. This inflation target is also consistent with the Government's objectives of GDP growth and debt reduction. If Jamaica were to pursue a lower inflation target, this would require a reversal of the Bank's current accommodative monetary policy posture to one that is more conservative or restrictive. This would result in a slowing of the pace of economic expansion and job creation, and it could also have an adverse impact on the fiscal accounts.

Bank of Jamaica's decision to lower the policy rate is therefore solely intended, as usual, to stimulate a faster pace of expansion in private sector credit, which will fuel increased economic activity on the part of businesses and households. This increased economic activity by businesses and households will be accompanied by price pressures and, in that way, the rate cut will support inflation returning to the centre of the target more quickly.

Ladies and gentlemen, the decision on Tuesday to reduce the policy rate follows a series of rate reductions by the Bank between June 2017 and June 2019. Cumulatively, the Bank over this period has reduced the policy rate by 300 basis points (bps). The response of the system to our policy signals has been significant as we have seen reductions in commercial banks' local currency lending rates. At the same time, we have observed a marked uptick in the growth in financing provided by deposit-taking institutions (that is, commercial banks, merchant banks and building societies) (or DTIs for short) to the private sector. This demonstrates that the transmission of policy rates to market rates has been working, albeit not as efficiently as we would have liked.

We continue to observe that private sector credit expansion has accelerated in recent months, consistent with our previous accommodative policy actions. **Credit extended by DTIs to private sector businesses and households grew by 16.8 per cent over the 12 months to June 2019, which was above the 12.3 per cent growth experienced a year earlier at June 2018. While this faster pace of private sector credit growth is a positive signal, we are of the view that this expansion in credit is still not fast enough, particularly in the context where domestic activity remains below the economy's potential or capacity. This suggests that an even faster pace of credit growth is possible without causing inflation to rise above the inflation target.**

Inflation Outlook

I will now provide more details on the outlook for inflation that informed Bank of Jamaica's decision that was announced on Tuesday.

There are the four main factors that inform our inflation outlook: (i) low, although improving, domestic demand, which translates into low underlying (or core) inflation; (ii) slower growth and lower inflation among Jamaica's main trading partners; (iii) declines in crude oil prices; and (iv) the impact of an imminent change in the fuel mix used in generating electricity.

In STATIN's latest release, annual headline inflation at July 2019 was 4.3 per cent, up from 4.2 per cent at June 2019 and 3.2 per cent at July 2018. This mainly reflected the impact of increases in the prices of agricultural food items, particularly vegetables, as well as an increase in electricity rates. With this outturn, inflation remained within Bank of Jamaica's target of 4.0 per cent to 6.0 per cent for the third month in a row.

Notwithstanding this slight uptick in headline inflation, underlying inflation within the domestic economy remains low. Core inflation, which is headline inflation excluding the immediate influence of agriculture and energy prices, remains low below 3.0 per cent, despite a marginal improvement over the past two months. As we indicated at our previous press briefing in May 2019, low core inflation is symptomatic of domestic demand conditions running below the economy's capacity. Second-round effects of lower oil prices would have also contributed to keeping core inflation at current low levels.

Looking ahead, Bank of Jamaica anticipates that headline inflation will average approximately 4.3 per cent over the next eight quarters and, in the absence of a further monetary policy accommodation, will in all likelihood fall below the lower limit of Bank of Jamaica's target at various points during this period. The near-term (eight quarters ahead) outlook for inflation is based on the expected impact of continued low domestic demand conditions relative to the economy's capacity as well as expectations for slow growth among Jamaica's main trading partners and declines in international commodity prices. In addition, we expect that a change in the fuel mix in Jamaica's electricity generation by the Jamaica Public Service in favour of liquefied natural gas (LNG) in the December 2019 quarter will translate into relatively lower electricity rates. We have provided a box in this issue of the QMPR which presents a discussion on the impact that Jamaica's transition to LNG will have on electricity rates, and by extension, domestic inflation. I'm sure you will find this very interesting.

Over the medium-term (that is, three to five years ahead), inflation is expected to gradually increase towards the centre of the target, although at a slower pace than we had previously anticipated. This forecast path for inflation continues to carry some risk of a breach of the lower limit of the target given continued heightened volatility in domestic agricultural food prices. I invite you to read the QMPR for more details 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 risks that would cause inflation to be lower than our forecast is the possibility of stronger-than-anticipated production in the agricultural sector which would lead to lower rates of increases in food prices. In addition, domestic demand could be lower than anticipated, particularly in light of escalating global trade tensions.

A risk that could cause inflation to be higher than expected is the possibility that the impact of the planned diversification of Jamaica’s fuel mix on electricity costs may not be as significant as projected.

Macroeconomic Developments & Outlook

With respect to the macroeconomic outlook, the prospects for the Jamaican economy remain positive. We however note the headwinds arising from the global economy.

Domestic economic activity continues to show signs of recovery, although at a slower pace than earlier observed. The near-term outlook is for real GDP to expand at an average quarterly rate of 1.0 to 2.0 per cent, which is below the previous projection for a quarterly expansion of 1.5 per cent to 2.5 per cent. Consequently, we expect that the output gap, that is Jamaica’s GDP growth relative to the economy’s capacity, will be wider than previously expected, suggesting that inflationary pressures will largely remain contained over the next eight quarters.

Notwithstanding the expectation for a slower pace of GDP growth, labour market conditions continue to improve. Jamaica’s unemployment rate fell to a record low of 7.8 per cent in April 2019, down from 9.8 per cent a year earlier. We expect to see even further improvements in labour market conditions over the next two years with more jobs anticipated in Tourism, Manufacturing, Finance & Insurance and Business Process Outsourcing.

Conclusion

Ladies and gentlemen, Bank of Jamaica's view is that the prospects for the Jamaican economy remain positive, even though headwinds are on the horizon. Foreign reserves are at adequate levels and we have a sustainable position in the current account of the balance of payments. The fiscal performance is strong and public sector debt continues to decline at a steady pace. Market interest rates remain generally low. **However, the domestic economy continues to operate below its potential. In this context, we believe that there is room to accommodate a faster pace of growth in economic activity without compromising the inflation target**. In this context, Bank of Jamaica will maintain an accommodative monetary stance to support a faster return of inflation to the centre of the target.

Thank you.