

GOVERNOR



BANK OF JAMAICA
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KINGSTON, JAMAICA, W.I.

29 November 2024

The Hon Fayval Williams, MP
Minister of Finance and the Public Service
Ministry of Finance and the Public Service
30 National Heroes Circle
Kingston 4

Dear Minister Williams:

Breach of Inflation Target

By letter dated 29 April 2024 from the Minister of Finance and the Public Service, Bank of Jamaica's (BOJ'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 2024 and applies 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 the Minister on this matter, dated 25 April 2024, I noted that inflation had been 6.2 per cent as at February 2024 and would continue to breach the Bank's target range from April 2024 to June 2025. The primary reason for this projection was the view that the continued impact of the increase in public passenger vehicle (PPV) fares, coupled with the effect of higher wage adjustments in the context of a tight labour market, would cause inflation to remain elevated.

Since my letter, there has been a moderation in inflation due primarily to a sharp deceleration in the pace of increases in agricultural food prices (in the context of better-than-anticipated supplies). The annual inflation rates at March, April, May, June, and July 2024 were 5.6 per cent, 5.3 per cent, 5.2 per cent, 5.4 per cent and 5.1 per cent, respectively. However, inflation for August 2024 was 6.5 per cent, representing a breach of the upper end of the Bank's inflation target range. Subsequently, for September 2024, inflation moderated to 5.7 per cent - within the 4.0 to 6.0 per cent target range.

Inflation breached the upper limit of BOJ's target range in August 2024, primarily due to a temporary rise in agricultural prices associated with the negative impact of Hurricane Beryl on agricultural supplies. Inflation for the month was also supported by a sharp increase in electricity rates in the context of disruptions to operations caused by the hurricane. These inflationary pressures were partly offset by the lagged impact of the Bank's relatively tight monetary policy posture on inflation expectations, the exchange rate, and, consequently, imported inflation. In this context, core inflation averaged 4.8 per cent over the period March to September 2024, which was lower than the average of 5.7 per cent over the previous seven months (August 2023 to February 2024) and the average of 6.3 per cent recorded for the corresponding period in the previous year (March to September 2023).

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For August and September 2024, the annual change in agricultural prices (as measured by 'Vegetables, tubers, plantains, cooking bananas and pulses') increased to 10.8 per cent and 13.6 per cent, respectively, relative to a decline of 0.2 per cent recorded in July 2024. These significant increases reflected the lagged impact of Hurricane Beryl on agricultural supplies.

The Jamaican economy is estimated to have contracted in the September 2024 quarter due primarily to a decline in domestic crop production associated with the passage of Hurricane Beryl. This estimated decline is therefore underpinned by contractions in Agriculture, Forestry & Fishing, Construction, Hotels & Restaurants and Electricity & Water Supply. However, a rebound in economic activity is projected to begin in the March 2025 quarter.

While anecdotal information suggests that private sector wage increases have stabilised at their pre-COVID rate, reports of labour market pressures in selected sectors have emerged. The unemployment rate at April 2024 of 4.2 per cent indicates that the domestic labour market remains tight.

Inflation expectations have also moderated. In the September 2024 Survey of Businesses' Inflation Expectations, respondents lowered their expectations for inflation 12 months ahead to 7.6 per cent from 8.2 per cent in July 2024.

Declines in international commodity prices (grains and energy) supported the trend deceleration in inflation. At September 2024, the average prices of crude oil and grains (wheat, corn and soybean) over the preceding 12 months were lower by 2.0 per cent and 23.3 per cent, respectively, compared to the same measure at September 2023. The price of liquefied natural gas (LNG) in the United States (US) commodity markets also declined by 23.4 per cent over the same period. In the context of the fall in energy prices, the Housing, Water, Electricity, Gas and Other Fuels division of the CPI decelerated to an annual inflation rate at September 2024 of 3.6 per cent, lower than the 8.0 per cent inflation rate at August 2024.

Inflation in the US was 2.5 per cent at August 2024, a deceleration relative to the July 2024 outturn of 2.9 per cent. Inflation in the US is projected to continue to moderate as the economy slows but remains above the US Federal Reserve's (Fed) target of 2.0 per cent for the remainder of 2024.

In the context of the Bank's tight monetary policy stance and the fall in inflation expectations, core inflation (which excludes agriculture and fuel prices from the CPI) generally trended down over the past two years. Core inflation was 4.5 per cent at September 2024, below the 5.7 per cent outturn at September 2023.

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

Inflation is projected to remain broadly within the Bank's target range over the next two years. The key drivers of headline inflation, such as international grains prices and inflation in the economies of Jamaica's main trading partners, continue to decline. In addition, the private sector's expectations about the level of future inflation are gradually trending down. Despite an uptick in the exchange rate over recent months, the foreign exchange market remains relatively stable, supported by the Bank's use of its buoyant foreign reserves to augment flows in the market.

Overall, fuel prices are projected to increase gradually over the next two years, while grains prices are projected to continue declining. West Texas Intermediate (WTI) crude oil prices are projected to average US\$77.74 per barrel between December 2024 and September 2026, implying an average quarter-over-quarter increase of 0.8 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 1.0 per cent over the same period. US LNG prices, on average, are projected to increase gradually. Inflation expectations should continue to ease as global inflation moderates.

However, the risks to the inflation forecast are skewed to the upside. Uncertainty related to potential economic policy changes among Jamaica's main trading partners could have adverse implications for investment and remittance inflows, as well as inflation expectations. Higher inflation could also result from escalating geopolitical tensions, which could negatively impact international supply chains. Worse-than-anticipated weather conditions in Jamaica could also put upward pressure on inflation. While anecdotal information suggests that private sector wage increases have stabilised at their pre-COVID rate, reports of labour market pressures in selected sectors have emerged. On the downside, lower inflation could result from weaker-than-projected demand.

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

At its most recent policy meeting on 19 and 20 November 2024, the MPC assessed that the prevailing economic environment was conducive to a further easing of its monetary policy stance and unanimously agreed to: (i) reduce the policy rate by 25 basis points (bps) to 6.25 per cent per annum, effective Friday, 22 November 2024; and (ii) preserve relative stability in the foreign exchange market. The decision of the MPC to ease monetary policy further was based on an improvement in the inflation outlook.

The MPC noted that following Hurricane Beryl's temporary impact on prices, inflation is becoming more anchored in the Bank's target range. As reported by STATIN, annual headline inflation at October 2024 was 4.9 per cent, lower than the 5.7 per cent at September 2024. This outturn was also lower than the most recent forecast and was within the Bank's target range of 4.0 to 6.0 per cent. Core inflation (which excludes the prices of agricultural food products and fuel from the CPI) was 4.5 per cent at October 2024, representing the sixteenth consecutive month that core inflation was below 6.0 per cent.

Foreign exchange market stability is a significant contributor to price stability and the MPC reaffirmed its commitment to ensuring continued stability in the market. It also stated that, based on available information, future interest rate adjustments will, of necessity, be gradual and will continue to depend on the incoming data.

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

Yours sincerely,



Richard Byles

Enclosure