Quarterly Press Briefing

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Unprecedented Resilience

Good morning, and welcome to our third economic review briefing for this calendar year.

Today I wish to highlight the fact that the Jamaican economy is becoming more *resilient to inflationary shocks*, because of the transformation taking place under the economic reform programme.

Despite significant economic shocks over the past two years, inflation remains in single-digit territory, and has trended down between September last year and the end of the review quarter. Headline inflation stood at **8.0 per cent** at the end of June 2014, down from **8.8 per cent** at the same point last year, and down from **8.3 per cent** at the end of March 2014. Not the least of these shocks has been the **13.3 per cent** and **10.8 per cent** depreciation in the exchange rate in the last two fiscal years, respectively. Additionally, there was the 25.0 per cent increase in bus and taxi fares last year.

Historically, such a combination of shocks would have been enough to send inflation spiralling into double-digit territory, but that did not happen this time. Instead, the environment for inflation has demonstrated an unprecedented resilience.

What are the factors accounting for this resilience?

First, the strong fiscal conditions created by the reform programme have restrained the ability of producers and retailers to pass on to consumers the impact of some shocks, particularly the exchange rate depreciation. Second, in the productive sector, especially in agriculture, which has a significant impact on inflation, there were significant improvements in efficiency and output, with the advent of supply-side initiatives such as the agro parks.

How do we maintain and build on these gains, especially when the environment changes and domestic demand is no longer weak?

Firstly, maintaining the current stance of fiscal discipline will continue to temper the emergence of excess domestic demand, and thereby deepen the economy's resilience. Secondly, the preservation of economic stability, together with the maintenance of recent gains in external price competitiveness, will allow the productive sector to grow faster, led by exports and competitive import substitution. Finally, the public's expectation is a critical factor in managing inflation in a market economy, and, if we are going to achieve these objectives, we must pay careful attention to it. Therefore, transparency and the availability of timely information, which enable the public to draw reasoned conclusions, are important to monetary policy. This is the reason for these press conferences, and why the quarterly and other reports are made public.

Revamped Quarterly Monetary Policy Report (QMPR):

To enhance this process, we have created a new look for the QMPR and streamlined its content. To explain and illustrate some of the issues discussed, the report employs more diagrams, charts, and tables. This should make the material more digestible, and facilitate analysis and discussion by expert and layman alike. The new-look report also focuses more attention on inflation management, placed in the context of the relevant economic variables and the medium-term inflation objective. In addition, the report will provide the Bank's outlook for the next four quarters, as monetary policy is always forward looking. We believe that the new-look QMPR will be of greater value to the public and, once you have had a chance to read it, I very much look forward to being able to incorporate your feedback into further evolutions of this important report.

I will now highlight some of the macroeconomic issues covered in the report.

Inflation Outlook

The resilience I described earlier allows us to be optimistic about the inflation path, in spite of a few near term challenges. We are projecting that inflation will end the fiscal year within the target range. Looking further ahead, we are aiming to keep inflation in the **6.0 per cent** to **8.0 per cent** range over the next two years, while our longer term objective is an inflation environment in line with our main trading partners, which is in the region of **2.0 per cent** to **4.0 per cent**.

Turning to the review quarter, June 2014, there was a deceleration in inflation, largely reflecting a slower pace of increase in agricultural commodity prices. However, the impact of the current drought has already become evident in the data for July, when prices went up by **1.4 per cent** for the month, and brought the annual inflation rate to **9.0 per cent**.

Despite this uptick, twelve-month inflation is expected to remain within the target range of **7.0 per cent** to **9.0 per cent** for the September 2014 quarter, possibly approaching the upper end of the range in August. Notably, we are projecting that most of the impact from the drought will be seen in the September quarter, and will be reversed by year-end. This view is underpinned by the assessment that most of the crops that were affected by the drought were short-term, and as replanting resumes when the weather normalises, agricultural prices will go back down. In that context, **the Bank's inflation outlook for the full fiscal year remains in the target range of 7.0 per cent to 9.0 per cent**.

Our inflation forecast is also underpinned by assumptions of higher oil prices in light of geopolitical tensions, and some pass-through of exchange rate depreciation. On the other hand, continued declines in international grains prices, due to favourable weather conditions in producing countries, as well as continued weakness in domestic demand, are expected to have a downward effect on inflation.

However, there are important upside risks to our projection. The recently announced increase in bus fares could push inflation towards the upper bound of our target range, although the impact would be temporary. Additionally, an increase in the tariff rate for electricity as requested by the Jamaica Public Service Company would add a further inflationary impulse.

Other Economic Indicators

The other economic indicators that establish the context for our estimates of inflation have continued to evolve favourably. Economic recovery continued in the June quarter. Real economic activity is estimated to have expanded in the range of **1.0 per cent** to **2.0 per cent** during the quarter, the fourth consecutive quarter of growth. The recovery is projected to continue over the next four quarters, despite some slowing in the September quarter due to the impact of the drought on agricultural production. The outlook for growth in the full 2014/15 fiscal year remains within the original projections of **1.0 per cent** to **2.0 per cent**.

The current account of the balance of payments continues to improve, due in part to the impact of fiscal consolidation and exchange rate depreciation over the past two years. Concurrently, our holdings of foreign reserves continue to improve. The NIR, which currently stands at just over **US$2.0 billion**, also reflects US$800 million received from the Government's highly successful return to the international bond market last month.

Monetary Policy

On monetary policy, the Bank continued to ensure that appropriate levels of liquidity were maintained in the financial system during the review period. Guided by monetary policy, market interest rates have remained in a relatively low range, in part because of our view of future inflation relative to our target. The central bank's current generally accommodative stance is in keeping with prevailing conditions. We can be expected to maintain this stance until the upside risks to inflation have dissipated, and inflation expectations have moderated.

Thank you.