Richard Byles: Lessons from a small, open, developing, inflation targeter

Speech by Mr Richard Byles, Governor of the Bank of Jamaica, at the Macroeconometric Caribbean Conference "Managing the post-COVID inflation shock", Kingston, 20 March 2025.

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Presentation accompanying the speech

Introduction

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Good [afternoon]. Thank you for inviting me to participate in this forum. I will speak on Jamaica's experience in managing the post-COVID-19/Russia-Ukraine inflation shocks. This experience may be a useful case study among Latin America and Caribbean (LAC) economies and could offer some insights for our ongoing enquiry into appropriate macroeconomic policy making.

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My basic conclusion is that, in response to the twin shocks, Jamaica performed well relative to other LAC countries. In the context of appropriate fiscal and monetary policy responses, Jamaica's GDP rebounded to its pre-pandemic level at a speed consistent with the recovery of its peers. Inflation spiked but returned to target in short order while inflation expectations, although rising temporarily, returned fairly quickly to normal levels. The exchange rate remained relatively stable and our foreign reserves increased.

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Against this background, my presentation will briefly describe the main impacts of the global shocks on the Jamaican economy and our policy responses. I will then outline the evolution of Jamaica's macroeconomic data after the shocks and in the context of our policy responses, before briefly outlining the key lessons learnt.

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Jamaica's Economic Context

Let me start by providing you with a brief tour of the Jamaican economy. While large relative to other Caribbean states, Jamaica is a geographically small country. We also have a very small population of 2.8 million with a per-capita GDP of approximately US$6,800.

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While Jamaica boasts a somewhat diversified economy comprising tourism, agriculture and light manufacturing, the Island is very open and is heavily reliant on tourism. The contribution of tourism to Jamaica's economic activity is somewhat less than that for other service-based states in the Caribbean, but the sector is a major source of income for the economy when compared with the LAC bloc as a whole.

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Remittances require a special note as these flows play an outsized role in the Jamaican economy. As a share of GDP, remittances to Jamaica is the 3rd highest in the LAC region and, by the same measure, is the 10th largest of 236 countries. You can therefore appreciate any shocks to the global economy that affects remittances is expected to have a large impact on consumption and welfare, Jamaica's balance of payments, growth, fiscal dynamics and inflation.

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A survey of the economy prior to the pandemic, highlights that macroeconomic conditions in Jamaica were strong. In 2019, the International Monetary Fund (IMF) assessed the country as having "entrenched" stability-". The central government's debt-to-GDP ratio at end FY2019/20 was close to 95 per cent, coming from a peak of 146 per cent in FY2012/13. To achieve this deleveraging, the fiscal authorities had maintained primary surpluses above 7.0 per cent for 7 consecutive years.

By 2019, inflation had also trended downward towards the lower end of the central bank's 4 to 6 per cent target range. Gross reserves were healthy and above the ARA metric. Jamaica's external accounts had also improved significantly, with an average current account-to-GDP deficit of -1.9 per cent between 2015 and 2019 relative to an average of -9.6 per cent between 2010 and 2014.

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The Twin Shocks: The Pandemic/War

In March 2020, Jamaica confirmed its first case of COVID-19. Like many other countries, our initial reactions included closing our borders and enforcing work-from-home orders, which effectively halted tourism and reshaped workplace practices for almost two years. These measures, however, proved to be effective in controlling outbreaks.

With the phased easing of containment measures, a global recovery gained momentum in late 2021. This led to a combination of resurging demand and constrained supply conditions, triggering inflation pressures.

As we all know, the Russia-Ukrainian conflict, which began in February 2022, further exacerbated supply chains disruptions, resulting in yet higher international commodity prices and further inflationary pressures.

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The curtailment in economic activity during the pandemic resulted in a contraction in GDP for Jamaica of 10.0 per cent for 2020. This was somewhat lower than our Caribbean counterparts, and broadly consistent with the average contraction recorded for the LAC. Not surprisingly, the significant fall in Jamaica's output was led by a considerable fallout in the Tourism sector and its related industries. A significant decline of 65.0 per cent tourism-related foreign exchange earnings also adversely affected the stability of Jamaica's foreign exchange market.

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It is in this context that depreciation in the exchange rate accelerated in 2020. Nevertheless, of the countries that have floating exchange rate regimes in the LAC, only Costa Rica and Peru fared better than Jamaica by this metric for that year. As we will recall, the Brazilian currency, an outlier benchmark, lost more than 30% of its value during the year. The relative performance of the Jamaican currency reflected the impact of our policy response, but I will return to this issue later.

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Turning to the CPI, for the first time in several years, inflation in 2021 reached double-digit levels in the context of the twin shocks. The combination of sharper exchange rate depreciation, rising commodity prices and increases in inflation expectations, among other things, contributed to accelerated inflationary pressures. Inflation initially remained within BOJ's target range in 2020 but exceeded it between March 2021 and March 2024.

Although the acceleration in inflation was substantial, Jamaica fared better than our regional counterparts, regardless of whether or not they practised inflation-targeting.

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Despite the adverse impacts on key macro-economic variables, Jamaica's external accounts were, surprisingly, not severely impacted. For 2020, the current account recorded a deficit of - 1.1 per cent of GDP, an improvement from the -1.9 per cent deficit the previous year. This was due mainly to a fall in imports (given the decline in economic activity) and a stronger than expected rise in remittance inflows that offset the fall in tourism receipts. Remittance inflows defied expectations and increased by almost 30.0 per cent for the year. This phenomenon has not been fully explained but, to the extent that it was also evident in other countries such Mexico, Guatemala and El Salvador, it points to the impact the stimulus packages in the USA and other advanced economies, and less to factors such as changes in the behaviour of the remitters to Jamaica.

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Finally, although the financial sector faced challenges in 2020, the system remained sound and liquid. Admittedly, there was some deterioration in the sector's profitability and asset quality as a result of the pandemic. Credit to households also declined sharply. Despite this, the capital adequacy ratios of the system remained well above regulatory requirements throughout the period, reflecting the sector's resilience and the impact of solid macro-prudential oversight and intervention.

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Let me turn to discussing our policy interventions.

Policy Response

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Fiscal Policy

While demonstrating a strong commitment to fiscal discipline, Jamaica's fiscal response was measured, temporary and targeted towards supporting the most affected segments of the population. Stimulus packages were introduced by the Government throughout the pandemic years, which cumulatively amounted to 1.3 per cent of GDP. [These included one-off monetary transfers to households and firms, one-off salary compensation to workers, targeted household subsidies and reduction or deferral of selected taxes.]

Notably, Jamaica's stimulus package was more restrained than those of its Caribbean peers and below the regional average.

It also important to note that the country's public debt reduction path, which, before the crises, aimed to lower debt to 60.0 per cent of GDP or less by the end of FY2025/26, was temporarily disturbed by them. To navigate the challenges, the government sought a temporary suspension and amendment of Jamaica's fiscal rules.

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Monetary Policy Response and Inflation Control

In relation to monetary policy, the Bank responded differently during the Covid-19 shock relative to the second shock brought on by the war.

During the first phase of the shock, that is between 2020 and early 2021, the policy rate was held at a historic low of 0.50 per cent to support economic recovery. In real terms, this was a very negative rate. The central bank also provided USD liquidity of over 7 per cent of GDP and JMD liquidity amounting to 4 per cent of GDP to the financial sector during the shock, while implementing other macro-prudential measures to ensure banking sector stability.

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At the start of the second phase of the shock, BOJ was granted the formal status of inflation targeter. However, the staff of the Bank had been practising inflation targeting for years before this formal designation and had developed several worst-case scenarios on the impact of the outbreak by this time. The staff was therefore able to quickly identify the tidal wave of food-price inflation coming through to us and advised the newly-formed MPC of the need to tighten monetary policy so as to anchor inflation expectations and stem any second-round effects that would have arisen from the shock.

The BOJ therefore employed a three-pronged approach by:

- Deploying open market operations more aggressively to maintain tight Jamaica liquidity conditions,
- Gradually increasing the policy interest rate by 650 basis points (bps) between October 2021 and November 2022; and
- Engendering greater stability in the foreign exchange market through foreign exchange intervention and adjustments to the Net Open Position limits.

This policy stance influenced the conduct of the Bank's open-market operations between 2022 and 2024. The Bank's 30-Day certificates of deposit and special longer dated instruments were used to tighten liquidity. During the 2022, a net absorption equivalent to 1.6 per cent of GDP (JMD$41.6 billion) via this medium was done, much higher than the 0.1 per cent of GDP (or JMD$2.1 billion) net absorbed in 2021. Continuing this stance in 2023, the Bank net absorbed the equivalent of 1.5 per cent (JMD$46.3 billion).

A major issue for Jamaica during the tightening cycle was the weakness in the credit channel of the monetary transmission mechanism. During this period, the Bank observed a low pass-through of its policy actions to DTIs lending and deposit rates. This weakness primarily resulted from a lack of competition in the banking sector, given the domination of the system by a few financial institutions. The three-pronged approach was therefore deemed critical to taming inflation.

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With, perhaps, the exception of Mexico, Brazil and New Zealand, to name a few, this change in monetary policy stance had not yet been contemplated by some of the major central banks. Brazil stands out as the most proactive in the region, tightening as early as four quarters before March 2020. The key issue for Bank of Jamaica at the time was to get ahead of inflation expectations and the second-round effects of the shock.

The start of Jamaica's tightening phase was therefore sooner than many inflation-targeting countries within the Latin American and Caribbean region.

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Strategic market interventions ensured that the exchange rate remained stable during both phases of the crises. By end-2023, the annual depreciation in the exchange rate was contained at 0.5 per cent, a large improvement compared to the spike in 2020. Jamaica therefore recorded a moderate nominal depreciation of its currency of just 17 per cent over the 5-year period from 2019 to 2024, substantially lower than the experience of Chile and Brazil. Also, compared to its LAC counterparts with floating exchange rate regimes, Jamaica exhibited one of the lowest levels of exchange rate volatility between 2020 and 2024. This stability was underpinned by the BOJ's approach to liquidity management and foreign exchange intervention, which ultimately reinforced the credibility of Jamaica's monetary policy framework to meet the inflation targeting objectives. It also highlights the effectiveness of the BOJ's strategic interventions in containing depreciation pressures, relative to other regional economies.

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I will now briefly summarise the impact on the economy of the monetary and fiscal responses.

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The reopening of the ports and the cessation of lock-down activities drove a recovery in GDP to pre-pandemic levels in just under two years. This pace of recovery was generally consistent with that of the LAC countries.

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Given the lower revenue flows caused by the contraction in GDP, along with increased expenditure for Covid-19 related activities, the central government's fiscal balance fell from a surplus of 1.4 per cent of GDP in 2019 to a deficit of 3.8 per cent of GDP in 2020. This was the first deficit since 2016 and the largest since 2012. The country's debt-to-GDP ratio increased to 108.7 per cent in 2020 from 94.7 per cent in 2019, largely the consequence of the fall in nominal GDP for the year. Although this change in debt-to-GDP was broadly in line with the LAC average, the fiscal deficit was significantly below the regional average and one of the lowest in the region.

The effects of the pandemic on the debt stock were, however, temporary. Jamaica reduced its debt-to-GDP ratio by 40 percentage points, from 108.7 per cent in 2020 to approximately 69 per cent by 2024. Prudent fiscal management, along with the rebound in nominal GDP, caused the debt ratio to revert sharply and with one exception, faster than our peers.

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Inflation also returned to BOJ's target range by early 2024, a faster pace than some in the LAC. This was driven in large part by the fall in commodity prices and the lagged impact of the Bank's relatively tight monetary policy stance (including its foreign exchange market interventions).

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Jamaica's current account also improved noticeably to a surplus of 3.1 per cent of GDP for FY2023/24, due in large part to a sharp rebound in tourism and continued high levels of remittances. This surplus, in addition to inflows from the IMF and Government's inflows contributed to the steady accumulation of reserves. Foreign exchange reserves consequently increased by 34 per cent between 2019 and 2023, outperforming some regional counterparts.

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Lessons Learned and Policy Takeaways

I will now conclude by offering some key lessons and policy takeaways.

The overarching lessons from Jamaica's experience are that

1. Buffers are crucial in our ability to respond to shocks;
2. Institutions matter;
3. Strong and early monetary policy action are important, particularly for new inflation targeters;

4. Credible and transparent FXI frameworks are necessary if the MTM is weak and there is a large shock and, finally
5. Remittances are clearly countercyclical.

Jamaica's ability to respond to shocks through fiscal expenditure and foreign exchange market intervention emphasised the importance of maintaining buffers.

On the point of strong policy institutions, Jamaica over a number of years have made steady progress in building them out. By granting the central bank policy autonomy, the government allowed it to take swift, decisive, potentially painful and thus politically unsavoury policy measures, just when the economy needed them. More recently, the GOJ has established a fiscal commission to act as a watch dog over fiscal policy determination and implementation. Institutions mattered for Jamaica during the crises and they will work towards continued stability in the future.

The strong and resolute policy interventions of the BOJ, as a new inflation targeting central bank, served to improve the credibility of Jamaica's the monetary regime and will help in the future to better anchor inflation expectations. Resolute upward adjustments in the policy rate along with aggressive liquidity tightening played a major complementary role in this strategy.

Looking in the rear-view mirror, BOJ's FX interventions strategy became the anchor for monetary policy in a context where the exchange rate channel of the monetary transmission mechanism is strong, but the credit channel is weak. The Bank, however, has committed significant resources and time to improving its tools and the credit channel of the MTM, with a view to arming itself for future inflation battles. What we are doing in this area may be the topic for an entirely different presentation.

A final lesson was seen in the resilience of remittances, underscoring their counter-cyclical nature.

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Closing

Notwithstanding all the accomplishments of the central bank as well as the fiscal authorities, challenges still abound. We recognise the necessity to tackle the weaknesses in the monetary transmission mechanism. We also recognise that Jamaica's high level of openness will continue to expose us to external shocks and that, along with our exposure to climate change risk, imply the need for us to maintain our buffers and to build resilience.

The next challenge for the country therefore is to transition from the entrenched macroeconomic stability that it now enjoys to a path of sustainable higher economic growth.

Thank you.