EPOC

Economic Programme Oversight Committee

Update on the GOJ Economic Reform Programme (ERP)

December 2021 • Communiqué #38

The Jamaican economy continues on recovery path... Inflation and COVID-19 risks remain high

The EPOC met on December 3, 2021 to review the macro fiscal programme of the Government of Jamaica (GOJ) and the monetary performance of the Bank of Jamaica (BOJ) for the fiscal year 2021/22.

The following were key highlights noted by EPOC:

- **Inflationary expectations continue to increase as inflation continues to breach GOJ target range of 4% - 6%**
- **BOJ projects inflation to peak at 8-9% over the next 10 months before settling back into the GOJ target range**
- **BOJ signals strong possibility of further policy interest rate increases**
- **As at October 2021, GOJ Fiscal targets are marginally behind due to missed Tax Revenue target**
- **October 2021, Tax Revenues were noticeably behind budget primarily due to COVID-19 containment measures.**
- **Net International Reserves remain robust at US$3.90B**
- **Jamaica's Vaccination level is under 20% as Jamaica prepares for the fourth wave of the COVID-19 pandemic**

Based on the preliminary results for performance to date through to the end of September 2021, the GOJ has met the available Quantitative Performance Targets for the GOJ ERP for end September 2021, with the exception of the Inflation target.

PROGRAMME REVIEW APRIL - OCTOBER 2021

Selected GOJ Fiscal Indicators for FY2021/22 (April – October)

Selected GOJ Fiscal Indicators	Status (FY2021/22)*	Actual (Provisional) (FY2021/22)	Budget Target (FY2021/22)	Variance ($)**	Variance (%)**	Actual (Provisional) (FY2020/21)	Variance ($)***	Variance (%)***
Revenue & Grants (J$B)		375.0	377.8	-2.8	-0.7	298.7	76.4	25.6
Tax Revenues (J$B)		311.4	313.3	-2.0	-0.6	261.7	49.7	19.0
Non-Tax Revenue (J$B)		59.2	59.7	-0.5	-0.8	33.5	25.7	76.9
Total Expenditure (J$B)		393.9	393.0	0.9	0.2	370.8	23.1	6.2
Recurrent Expenditure (J$B)		364.6	363.8	0.8	0.2	343.4	21.2	6.2
Capital Expenditure (J$B)		29.3	29.2	0.1	0.3	27.4	1.9	7.0
Fiscal Balance (J$B) (Surplus + / Deficit -)		-18.9	-15.2	-3.7	-24.6	-72.1	53.2	73.8
Primary Balance (J$B) (Surplus + / Deficit -)		59.5	62.4	-2.9	-4.7	3.6	55.9	1552.8

Target Met / Exceeded Target   Target Off-Track

*Status for Actual relative to Budget for FY2021/22
**FY2021/22 actual performance relative to budget targets
***FY2021/22 actual performance relative to FY2020/21
Note: Discrepancies in the table due to rounding of figures

Selected GOJ Fiscal Indicators for FY2021/22 relative to FY2019/20 (April – October)

Selected GOJ Fiscal Indicators	Actual (Provisional) (FY2021/22)	Actual (Provisional) (FY2019/20)	Variance ($)	Variance (%)
April - October				
Revenue & Grants (J$B)	375.0	358.8	16.3	4.5
Tax Revenue (J$B)	311.4	317.6	-6.2	-2.0
Non-Tax Revenue (J$B)	59.2	37.1	22.0	59.3
Total Expenditure (J$B)	393.9	350.7	43.2	12.3
Recurrent Expenditure (J$B)	364.6	319.5	45.1	14.1
Capital Expenditure (J$B)	29.3	31.3	-1.9	-6.2
Fiscal Balance (J$B) (Surplus + / Deficit -)	-18.9	8.0	-26.9	-335.6
Primary Balance (J$B) (Surplus + / Deficit -)	59.5	85.2	-25.7	-30.2

Note: Discrepancies in the table due to rounding of figures

Jamaica's selected fiscal indicators marginally under-performed relative to budget

Revenue & Grants

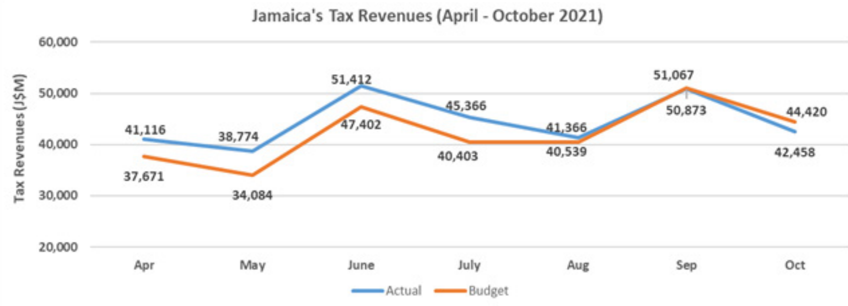
Revenue & Grants for April to October 2021 performed lower than the First Supplementary target, with total receipts of $375.0B falling short of budget by $2.8B (0.7%). Tax Revenue was the main contributor to the under-performance. Non-Tax Revenue and Grants also under-performed.

Tax collections for the review period amounted to $311.4B reflecting a shortfall of $2.0B (0.6%) relative to the First Supplementary target. This outturn, however, was $49.7B (19.0%) above the receipts for the similar period of FY 2020/21, but below the receipts for the comparable period of FY 2019/20 by $6.2B (2.0%). The lower-than-target collection was due to below-budget performance of all tax categories: Income and Profits, Production and Consumption as well as International Trade.

Non-Tax Revenue

Non-Tax Revenue of $59.2B fell marginally behind budget by $496.2M but was significantly above the $33.5B for the same period in 2020/21 and $22.0B over the same period in 2019/20. This differential was driven primarily by the BOJ dividend paid in April 2021 of $32B.

Tax Revenues marginally off against budget in September and October 2021 driven by COVID-19 restrictions



As indicated in the graph above, total monthly tax revenues were higher than budget for the April to August 2021 period but fell below budget during September and October 2021 by $0.2B and $2.0B, respectively. The falloff relative to budget continues to be impacted by the GOJ's COVID-19 containment measures.

Total Expenditure (Recurrent & Capital) of $393.9B was $0.9B (0.2%) ahead of budget

Expenditure

Expenditure (above-the-line) which totaled $393.9B was $929.1M (0.2%) above budget. Total Expenditure, for the April to October 2021 period, was $23.1B (6.2%) higher than the same period for 2020/21 and $43.2B (12.3%) higher than the same period for 2019/20 due mainly to higher recurrent spending which was significantly driven by the GOJ response to the COVID-19 pandemic.

Capital spending for the review period was $29.3B, reflecting an excess of $96.7M (0.3%) relative to the revised budget. The expenditure on capital projects was $1.9B (7.0%) higher than for the corresponding period of FY 2020/21, but $1.9B (6.2%) below the capital spending for the comparable period of FY 2019/20.

Interest Costs above budget and set to increase in rising interest rate environment

Interest payments amount to $78.4B, which was above budget by $802.0M, and higher than last year's payments by $2.7B (3.5%). As the BOJ seeks to tighten monetary policy and with the BOJ increasing its policy interest rates, we see the rates on GOJ Treasury Bills steadily increasing with the benchmark 180 day Treasury Bill increasing from 1.66% at the end of September 2021 to 3.92% in November 2021.

Lower than projected revenues drive missed Fiscal and Primary Balance targets

For April to October 2021, the lower than budgeted Revenues and Grants, and above-the-line expenditure being broadly in line with budget generated a **Fiscal Deficit of $18.9B**, which exceeded the budgeted deficit of $15.2B. This compares to the $72.1B fiscal deficit recorded for the similar period in FY2020/21 and the fiscal surplus of $8B generated for April to October 2019.

The Central Government operations also led to a **Primary Surplus of $59.5B**, which was $2.9B below the surplus target of $62.4B. This performance was also lower than the surplus of $85.2B recorded for April to October 2019 but significantly outperformed the primary surplus of $3.6B noted for the similar period in 2020 by $55.9B.

<u>Monetary Performance – Inflation looms large</u>

Bank of Jamaica remains vigilant as inflationary expectations increase

- **BOJ's survey of Business Inflation Expectations indicate business expect higher annual inflation rate of 8.2%** The survey conducted in October 2021 indicated that businesses expectations for inflation are trending upwards from 7.4% in survey conducted in August 2021.
- **12-month point-to-point Inflation has breached BOJ's 4% - 6% target range since August 2021**
  - The 12-month point-to-point inflation rate (October 2020 – October 2021) accelerated to 8.5% in October 2021, compared to 8.2% in September 2021 and 5.0% in October 2020.
- **Core Inflation remains elevated**
  - Core inflation, measured as the change in prices excluding agricultural commodities and fuels prices, measured 7.7% at October 2021 which was slightly lower relative to the previous month, which peaked at 7.8% but was well above the 3.6% for October 2020.
- **The Bank of Jamaica (BOJ)** indicated that the elevated inflation rate has been largely influenced by international commodity and shipping prices, which continue to adversely impact domestic transport-related costs and processed food prices and utility costs. The Central Bank further noted that, while it has no control over these external prices, it has some control over the second-round effects of these increases, and has taken strong monetary policy actions.

The BOJ has increased its policy interest rate in an effort to steer inflation back to the target range for the second half of 2022

Following the 100 basis points increase to the policy rate (the rate offered on its overnight balances) to 1.50% per annum effective October 1, 2021, the BOJ announced its decision on November 16, 2021 to further increase the policy rate by 50 basis points to 2.00% per annum.

BOJ continues to reduce monetary accommodation

- The BOJ continues to maintain measures to contain Jamaican dollar liquidity expansion.
- While not targeting any specific level of the exchange rate, the BOJ indicated that it will continue to ensure that movements in the exchange rate do not threaten the inflation target.
- The BOJ has sold US$675M to the market for the calendar year to end October 2021.
- Effective December 6, 2021, the Bank of Jamaica adjusted the limits on foreign currency net open positions of Authorized Dealers.

BOJ's Monetary Policy Committee to consider further increases in the policy rate

The BOJ noted that the decision to tighten monetary accommodation is intended to:

- Raise market-based interest rates, which will make the returns on Jamaican dollar assets more attractive relative to foreign currency assets.
- Make saving in Jamaican dollars more attractive and borrowing in Jamaican dollars more expensive.
- Temper the demand for foreign currency and hence moderate the pace of depreciation in the exchange rate.
- Reduce demand in the economy.

The Monetary Policy Committee (MPC) agreed to consider further increases in the Bank's policy rate and to maintain or intensify the accompanying measures at subsequent policy meetings until inflation expectations are reduced and, consequently, the inflation outlook is solidly within the Bank's target range.

Jamaica's International Reserves remain healthy

At November 30, 2021, Jamaica's Gross International Reserves of $4.75B remain above the 100% Reserve Adequacy at 151.8% while the Net International Reserves stood at US$3.90B. Jamaica's foreign reserves were boosted by continued buoyant remittances, which increased by US$286M year over year for the fiscal year to October 2021, and increased visitor arrivals, which increased by 489.3% to 864,166 persons up to October 31, 2021 (62% of visitor arrivals for the comparable period in 2019).

Foreign Exchange Market

On December 10, 2021, the value of the Jamaican dollar vis-à-vis the US dollar was J$155.20 = US$1.00, reflecting a depreciation of 5.4% ($7.95) for the quarter to date. This follows an appreciation of 1.3% ($0.86) for the September 2021 quarter relative to the June 2021 quarter.

Growth in Private Sector Financing has slowed

The annual growth in total loans and advances extended by Deposit-Taking Institutions (DTIs) to the private sector at end-September 2021 was 7.0%, which was lower than the growth of 12.2% at end-September 2020 and 16.5% at end-February 2020, immediately prior to the start of the pandemic.

<u>Jamaican economy demonstrates solid recovery</u>

<u>GDP Projections</u>

The Planning Institute of Jamaica (PIOJ) estimated that real Gross Domestic Product (GDP) growth for the July to September 2021 quarter compared with the corresponding quarter of 2020 was 6.3%. This performance continues to be championed by the Hotels and Restaurants industry, which grew by 114.7% and reflected a 293.3% increase in stopover visitors and an estimated $463.4M in expenditure for the two first months in the quarter. The industry benefitted from initiatives such as the establishment of a resilient corridor and the drive by tourism stakeholders to get their workers vaccinated.

PIOJ also projects growth within a range of 5.0% to 8.0% for October to December 2021, as preliminary indicators estimate 141.5% increase in airport arrivals for October 2021.

For FY2021/22, the projection is for growth within the range of 6.0% to 9.0%. The BOJ also indicates that it expects real GDP to fall within a similar range (7% - 10%) in FY2021/22 and 2-4% in 2022/23 resulting from an anticipated increase in tourism and related sectors activities, driven largely by the pace of vaccination in source markets and pent-up demand for travel. **The economy is expected to return to pre-COVID levels by FY2022/2023.** The International Monetary Fund (IMF) supports this outlook, as they anticipate growth of 8.25% in FY2021/22 and 3.5% in FY2022/23.

<u>Unemployment Rate signals continued improvement in the labour market</u>

Jamaica's unemployment rate of 8.5% at July 2021 represents an improvement relative to the 12.6% and the 9.0% recorded at July 2020 and April 2021, respectively. This indicates that approximately 93,400 persons have gained employment since July 2020. **The PIOJ expects employment to return to pre-COVID levels in FY2022/23.**

EPOC's OUTLOOK – Inflation and the COVID-19 pandemic are major risks to Jamaica's continued recovery

Jamaica has done more than a credible job in managing the macro-fiscal conditions and balancing the opening of the economy with the risks of the COVID-19 virus. This effective management has seen Jamaica experiencing fairly robust recovery in growth levels year over year and quarter over quarter.

However, the COVID-19 pandemic and the rising inflation and inflationary expectations globally and locally, create uncertainty and risks to the continued pace of recovery into the medium term.

While Jamaica is experiencing relatively low new cases of the COVID-19 virus and positivity rates are in single digits, Jamaica has low vaccination rates. With the inevitable arrival of the Omicron variant of the virus, along with increased travel by Jamaicans and tourists and increased movement with the Christmas festivities, we could see the anticipated fourth wave of COVID-19 impact. Efforts to contain the spread locally and internationally could see restrictions on economic activities in the domestic and international markets, which could lead to a slowdown in travel and disruptions in production and distribution.

The Bank of Jamaica has been very proactive in their pre-emptive strategies in moderating inflationary expectations and taking measures aimed at bringing inflation within the target range of 4%-6%. However, globally and locally, inflation continues to trend upwards and the BOJ has signaled that it will continue to tighten monetary policy and continue to increase the policy rate, if necessary, to contain inflation. The BOJ clearly states that their intention is to reduce domestic demand in the economy in order to reduce the ability of businesses to pass on price increases to the consumer.

Increasing interest rates locally and globally will have fiscal implications, as it will increase the cost of servicing Jamaica's debt as we have new issuances or rollover debt. Secondly, reducing domestic demand will temper growth levels, business activity and tax revenues. This however will be offset by higher nominal growth, which should see increased tax revenues.

Jamaica now faces a complex set of macro-fiscal scenarios in the delicate balancing of living with COVID-19 along with the knock-on effects of inflation over the next year. This will require astute management from the BOJ and the MOFPS as Jamaica seeks to continue on its growth trajectory.

Gratitude

EPOC would like to express its gratitude to all frontline workers in the public and private sectors who have sacrificed and given it their all to see Jamaica through a challenging year.

We continue to implore our Jamaican brothers and sisters to protect themselves, get vaccinated and observe the protocols as we seek to get back to a greater level of normalcy.