



BANK OF GHANA

Monetary Policy Report

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Inflation Outlook and Analysis March 2008

1. **Headline Inflation**

Developments in Headline Inflation, February 2008

For the fifth consecutive month, headline inflation went up from 12.8 percent in January 2008 to 13.2 percent in February 2008. Price increases during the first two months of the year were driven by surges in food prices and the pass through to domestic prices of rising crude oil prices.

Disaggregation of overall inflation shows that non-food prices contributed more to inflation than food prices in January and February 2008. Over the period food inflation increased from 9.5 percent to 11.2 percent while non-food prices moved from 11.1 percent to 14.2 percent. The price of cereals, meat and vegetables were some of the major contributors to food price inflation over the two months period. Transportation fares, utility charges and domestic petroleum prices at the pump were the principal driving forces behind the rise in non-food prices

Underlying inflation, measured by excluding energy and utility from the consumer basket, or core inflation, was estimated at 9.4 percent in December 2007 and 9.8 percent by the end of February 2008. However when viewed against trends a year ago in February 2007, core inflation shows a marginal decline (see table 1).

Table 1: Consumer Price Index and Major Components : Average 2002=100								
	Relative Importance ¹	Feb 2006	Feb 2007	Dec 2007	Feb 2008	Feb 2006 to Feb 2007	Dec 2007 to Feb 2008	Feb 2007 to Feb 2008
Unadjusted						percent change		
All Items: National	100	188.9	208.6	229.8	236.2	10.4	2.8	13.2
Food and beverages	44.91	181.2	198.4	211.3	220.7	9.5	4.4	11.2
Alcohol and Tobacco	2.23	157.9	182.7	195.8	201.1	15.7	2.7	10.1
Clothing and Footwear	11.29	159.2	166.7	173.2	177.7	4.7	2.6	6.6
Housing and Utilities	6.98	248.4	294.5	351.8	344.9	18.6	-1.9	17.1
Household Goods, Ops & Services	7.83	155.6	158.7	174.4	179.2	2.0	2.8	12.9
Medical Care and Health Expenses	4.33	197.8	258.5	308.8	312.4	30.7	1.2	20.8
Transport	6.21	273.1	327.8	397.3	403.8	20.0	1.6	23.2
Communications	0.31	175.1	242.3	257.0	257.0	38.4	0.0	6.1
Recreation, Ent & Cultural Services	3.04	180.9	207.7	227.3	231.2	14.8	1.7	11.3
Education	1.60	203.2	207.8	234.2	238.2	2.3	1.7	14.6
Hotels, Cafes and Restaurants	8.28	229.0	261.3	294.1	301.2	14.1	2.4	15.3
Miscellaneous Goods and Services	2.99	166.58	192.3	208.7	215.4	15.5	3.2	12.0
Special Aggregates ²								
All items excluding energy& utility	94.9	133.0	146.3	157.8	160.6	10.0	1.8	9.8
All items excluding energy&utility, volatile food items	78.2	129.7	140.7	150.9	154.1	8.5	2.1	9.5
Notes:								
1. Relative importance reflects the weights of those items in the consumer basket								
2. Special aggregates are those defined and estimated by the Bank of Ghana based on full basket information from the Ghana Statistical Service. The energy items excluded are petrol, gasoline, kerosine, gas for cooking purposes, electricity, water and telephone tariffs. The volatile food items are maize, plantain, yam, onions, tomatoes, smoked herrings, red fish, starvids								

2.0 Developments in the Food and Non-Food Indices, February 2008

Food Price Movement

The food price index rose sharply (by 2.87 percent) in February 2008 after recording an increase of 1.53 percent in January 2008. The monthly rate for February 2008 was the highest increase in the month of February in three years and shows the extent to which food prices are increasing relative to previous years trends (see table 2).

Table 2: Trends in Food Price Index								
Monthly Price Movements (2005-2008)								
Year	Jan	Feb	Mar	Q1 Avg.	Apr	May	June	Q2 Avg.
2005	3.26	1.86	1.81	2.31	1.70	1.01	1.59	1.44
2006	0.90	0.99	1.75	1.21	1.60	1.82	0.90	1.44
2007	1.40	2.33	0.71	1.48	2.31	2.80	0.66	1.92
2008	1.53	2.87	NA	NA	NA	NA	NA	NA

Indications from the major food growing areas are that favourable climatic conditions exist for good supply of the major food staples. Reports are that early rains have started in the major food growing areas and going forward, this may boost supply in the coming months. At the same time indications on the world market show that food prices are rising and remain the main source of inflation in developed economies, a problem that could persist throughout 2008 and 2009. The uncertainty at this stage is how increases in food prices, especially cereals, on the world market will filter through to affect local food price conditions.

Non-Food Price Movement

After consumers had reacted strongly to the near 100 percent adjustment in utility tariffs in November 2007, indications are that the pass through to prices of that policy measure seems to be abating, after pushing up non-food inflation moving from 11.1 percent in November 2007 to 14.6 percent in February 2008.

Table 3: Trends in Non-Food Price Index								
Monthly Price Movements (2005-2008)								
Year	Jan	Feb	Mar	Q1 Avg.	Apr	May	June	Q2 Avg.
2005	1.34	2.31	2.80	2.15	0.93	0.64	1.13	0.90
2006	1.33	2.19	1.30	1.61	0.90	0.79	1.20	0.96
2007	0.90	0.44	1.69	1.01	0.99	1.06	0.80	0.95
2008	0.92	0.69	NA	NA	NA	NA	NA	NA

The monthly increases in non-food prices slowed down (from an average of 2.0 percent between November and December 2007 to 0.7 percent in February 2008). Uncertainty still surrounds the path of non-food prices as we move towards the first and second quarters. Crude oil prices have breached the US\$100 per barrel mark and currently trading at close to US\$120 per barrel. Analysts in the oil market have predicted that prices could reach US\$150

by the close of the second quarter to be driven mainly by the weaker US dollar, strong demand from emerging economies like China and India and unfavourable supply side factors associated with the conflicts and disruptions in Venezuela, the Middle East and Nigeria.

On the whole, while we expect food price pressures to ease ahead of the second quarter and the major harvest season, that outlook for non-food prices seem very uncertain due mainly to the high volatile nature of crude oil prices and its attendant pass through to domestic fuel prices. Going forward crude oil prices and potential higher utility tariffs for consumers and businesses will pose a challenge in the conduct of monetary policy in the coming months.

3.0 Trends in the Core Measures of Inflation

The Bank of Ghana's measure of core inflation defined to exclude price changes of energy and utility items from the consumer basket declined marginally in January 2008 and rose again in February 2008. This core measure was estimated at 9.8 percent in February 2008. The gap between this core measure of inflation and headline inflation widened further in February 2008 and continues to reflect the multiplicity of shocks hitting the economy.

	Dec-05	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Jan-08	Feb-08
Inflation Measure											
CPI	13.9	11.3	11.4	11.7	10.9	10.2	10.7	10.2	12.7	12.8	13.2
CPI excl. energy and utility	12.8	10.5	9.5	9.3	9.4	9.2	8.6	8.2	9.4	9.3	9.8
CPI ex. Energy and utility and selected volatile food items	10.8	9.7	8.0	7.9	8.1	8.5	9.1	9.2	10.3	10.2	9.5
CPI ex. Energy and utility, selected volatile food items and Transportation	9.2	9.4	10.7	10.8	8.9	9.2	9.7	7.7	9.1	8.0	9.2
CPI ex. All Food items and Energy and Utility	7.8	6.4	6.6	6.9	7.3	5.8	5.6	4.3	3.1	5.1	5.3

The highlights of movements in other core measures are as follows:

- a. INFXEUF, the measure of the core inflation, estimated by excluding price changes of energy and utility and eight selected volatile food items also declined to 9.5 percent by February 2008;
- b. INFXEUFT, CPI inflation derived by excluding Energy & Utility, 8 selected volatile food items and transportation costs also, increased by 1.2 percentage points over the

January 2008 rate to 9.2 percent. When viewed against the December 2007 rate of 9.1 percent, an almost flat profile for this core measure of inflation is observed

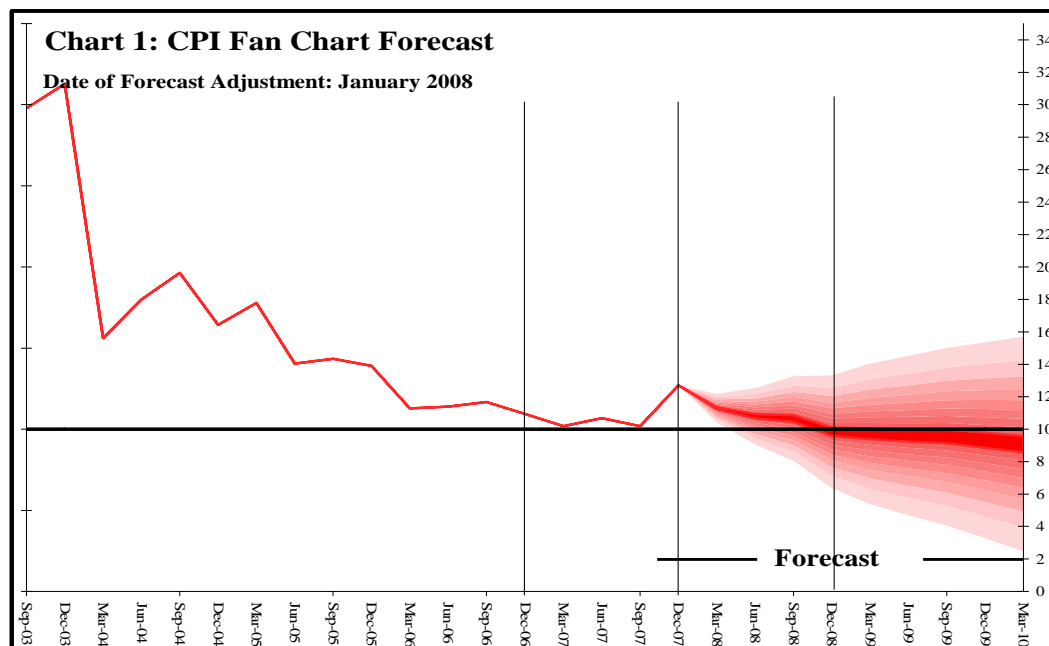
- c. INFXAFE (The all items CPI excluding price change effects of all food items in addition to energy & utility): This measure of inflation was up in February 2008 and estimated at 5.3 percent .

Generally, trends in the core measures of inflation show that inflationary pressures still remained in the economy as at February 2008. At this stage it is clear that the second round effects of the shocks that hit the economy in the third and fourth quarters of the year are taking hold. Businesses are revising their cost-price expectations and this is affecting underlying inflation in the economy. The next few readings up to the end of the second quarter should confirm the extent to which prices have been fully absorbed in the economy.

4.0 Assessment of Risks to the Inflation Outlook

Chart 1 shows the outlook for CPI inflation through 2008 and beyond. The central projection, which is driven by the Bank's average forecast and assumptions about economic fundamentals (ie interest rates, energy prices and crude oil assumptions) shows inflation at likely to remain around 10 percent by the end of the year, some 2.0 percentage points above the Central Banks target range of 8-6 percent. Over the longer term horizon to 2009 the central path of inflation shifts to around 8.5 percent

On the external front, the effect of volatile crude oil prices still remains a major upside risk to the inflation outlook. Crude oil is currently trading at over a \$100 per barrel mark. For so long as the United States economy slows down, investors will continue to hedge in crude oil. Crude oil prices will go up and its attendant pass through to domestic petroleum prices could add on to inflationary pressures.



Additional uncertainties around the central path are rising food prices on the world market and their potential pass through to domestic food prices, strong fiscal stimulus in an election year and its impact on general economic activity and aggregate demand pressures and potential wage-price inertial expectations in the economy. The extent to which these uncertainties materialise will largely determine the path of CPI inflation, complicating the task of monetary policy.

5.0 Concluding Remarks

Our assessment of the current situation shows that some form of tightening would be needed to contain inflationary pressures and ensure a faster move towards the desired target ranges. The uncertainties in the crude oil market may affect inflation expectations moving forward. Government should also strive to maintain a healthy spending posture to better align fiscal and monetary policy.