BANK OF GHANA

Press Release

Monetary Policy Committee

May 30, 2005

1. Ladies and Gentlemen, thank you once again for honouring our invitation to this briefing. Today, I would like to share with you available data on key economic indicators and detailed information on financial policies and other developments since the last MPC meeting in March this year. And then I will communicate for the benefit of the general public the decision of the MPC on the Bank of Ghana Prime Rate.

2. The latest numbers indicate that the impact of the recent 50 percent petroleum price increase on headline consumer price Inflation has been absorbed; the underlying inflationary pressures in the economy continue to be subdued and core inflation indicators are stable and trending downwards, underpinned by strong economic fundamentals. After a jump from 11.6 percent in January 2005 to 14.0 per cent in February, and 16.7 percent in March, which interrupted the disinflation process underway, headline inflation declined marginally to 16.6 percent in April. The inflation numbers show a slow-down in food price inflation (from a monthly increase of 4.4 percent in March to 3.3 percent in April) as well as a significant decline in non-food price inflation (from monthly increases of 6.8 percent in February and 3.9 percent in March, to 0.6 percent in April. The overall Consumer Price Index rose by 2.0 percent in April compared with 4.2 percent in March and 4.8 percent in February and the increase of 2.1 percent recorded in April 2004.

3. The Bank of Ghana's measures of core inflation moved within a narrow range. Inflation adjusted for energy and volatile components in the index remain within a single digit range, with some measures tracking inflation rates of 6.6 percent, 9.0 percent and 10.4 percent in April.

4. Provisional data on the execution of the 2005 budget for the first quarter of 2005 indicates that government revenue growth has been robust. Total tax revenue amounted to ¢4,226 billion, a 30.0 percent increase over the same period in 2004. The increase in tax revenue was reflected in all the major revenue categories (CEPS, IRS, and VAT). Grant inflows for the first quarter amounted to

¢380.7 billion, 45.2 percent of the amount received for the first quarter of 2004 (¢842.7 billion). Government expenditure for the first quarter of 2005, which is provisionally estimated as ¢5,246.0 billion, was about 13.5 percent above the outturn for the same period last year. Expenditure on the government wage bill was estimated at ¢1,598 billion, equivalent to 30.4 percent of total expenditure for the quarter. While foreign financed capital expenditure was low in the first quarter, domestic financed capital expenditure increased by 16.0 percent relative to the first quarter of 2004.

- These developments resulted in an overall budget deficit of ¢378.7 billion at the end of the first quarter of 2005, compared with a deficit of ¢959.0 billion for the same period last year. Government net domestic borrowing for the first quarter amounted to ¢508.6 billion (equivalent to 2.1 percent of projected revenues) and compares to a net borrowing of ¢625.1 billion for the first quarter last year. The latest data show that government net domestic financing as a percentage of projected revenue stood at 3.0 percent in April 2005, compared to 3.3 percent in April 2004. Disbursements under the Multi-Donor Budget Support (MDBS) mechanism are expected in the second-half of the year.

5. Given these developments on the budgetary front and the stance of monetary policy, the growth of the monetary aggregates continued to slow-down from the rates observed for the corresponding period in 2004. At the end of April 2005, year-on-year growth of reserve money stood at 13.7 percent. This is a significant decline from the seasonal peak of 46.5 percent recorded in April 2004 and that was associated with the bumper cocoa harvest. Broad money M2+ growth similarly declined from 39.7 percent in March 2004 to 23.9 percent by March 2005 (the latest data available). M2 growth has also declined significantly from 39.6 percent in March 2004 to 27.6 percent by March 2005.

6. Interest rates on the money market, have continued to remain stable showing very little volatility within a narrow band.

- The benchmark 91-day Treasury bill rate edged up slightly from 17.1 percent in March to 17.3 percent by April 2005 and compares with 18.0 percent in April 2004.

- The yields on two-year and three year Government notes and bonds have also remained stable at 20.0 percent and 21.5 percent respectively since they were introduced in September 2004.

However, there was a significant lengthening of the average maturity of Treasury bills and notes from 76 days in August 2004 to 174 days in April 2005. This has reduced the turnover rate on average from 5 times to 2.1 times per year, and by implication the fiscal cost and pressure that funding the PSBR places on the money market.

7. In the foreign exchange market, the cedi exchange rate continues to be relatively stable and traded within a narrow range over the first four months of 2005 against the three major currencies. The cedi marginally depreciated against the US dollar (0.3 per cent) while it appreciated against the British Pound (1.6 percent) and the Euro (4.2 percent). For the same period in 2004, the cedi depreciated against all three currencies (1.8 percent, 6.2 percent and 0.7 percent against the dollar, the pound and euro respectively). The trade-weighted real effective exchange rate for the cedi shows a real appreciation of the cedi by 8.7 percent in the first quarter of 2005, which compares with an appreciation of 3.1 percent in the first quarter of 2004.

8. The foreign exchange market recorded significant increases in liquidity and activity.

- Total purchases and sales of foreign exchange by deposit money banks amounted $1.78 billion for the four-month period through April 2005 and this compares with $1.18 billion and represents an increase of some 50.0 percent for the same period in 2004.

- Private inward remittances – transfers received from NGOs, religious groups, individuals etc. – channelled through the banks and finance companies amounted to $969 million for the first quarter of 2005 compared to $611.5 million in the same period last year. This is a 58.5 percent increase above last year's level. Of the total remittances received in the first quarter, $305 million (31.5 percent) was from individuals.

9. The Bank of Ghana Business Confidence Survey indicates that while there was some softening in business confidence during the first quarter, business remains generally optimistic about their own prospects and those of the economy for the year 2005. The Bank's Composite Index of Economic Activity (CIEA) rose by 26.0 points (13.4 percent) over the March 2004 level indicating a sustained increase in the level of economic activity in the first quarter of 2005. This is reflected in port activity, industrial electricity consumption, tourist arrivals, and the additional number of employees (53,117) for which the private sector makes contributions to SSNIT.

10. Credit extended to the private sector by the deposit money banks continues to show a rising trend. Between March 2004 and March 2005, an additional amount of ¢2,584 billion of credit was extended to the private and public institutions (an annual growth of 24.4 percent).

- The private sector accounted for 96.0 percent of the credit.
- Credit to the private sector as a percentage of GDP increased from 10.3 percent in March 2004 to 11.2 percent by March 2005.
- The distribution of the increased credit to the private sector over the period was very broad-based, but more significant in the manufacturing, personal and mortgage loans, commerce and finance as well as the services sub-sector. These sectors together accounted for 65.4 percent of the increase in credit to the private sector.
- Agriculture, forestry and fishing recorded marginal declines.

11. The banking system as a whole continues to remain well capitalized, profitable, fairly liquid and sound, and the quality of their loan portfolio has improved. Non-performing loans of banking system declined further from 18.8 percent of total assets in March 2004 to 15.7 percent at the end of March 2005. Moreover, when full account is taken of long-outstanding loans, which have been fully provided for but have remained on bank books the non-performing loan ratio drops to 8.0 percent in March 2005.

12. In the external sector, provisional estimates of the current account of the balance of payments showed a deficit of US$123.9 million, an improvement from a deficit of US$288.7 million recorded over the preceding quarter and compared with a surplus of $35.4 million in the first quarter of 2004.

- Quarterly export earnings increased by 5.5 percent to $701.5 million, compared with $664.5 million in the preceding quarter. Cocoa beans and products accounted for $214.6 million, slightly exceeding the contribution of other exports (including non-traditional exports) which amounted to $208.6 million compared with $121.6 million in the first quarter of 2004.

- Merchandise imports (excluding oil), which reached $1,005.9 million for the last quarter of 2004 eased back to $880.9 million for the first quarter of 2005. The oil import bill amounted to $177.4 million for the quarter compared with $142.1 million for the first quarter of 2004.

- A large deficit on the trade account ($336.8 million) offset the surplus of $212.9 million on the services, income and transfers account. As the capital account was broadly in balance, the overall balance of payments is estimated to have recorded a deficit of $165.3 million for the first quarter of 2005, similar to the $152.3 million recorded in the first quarter of 2004. This deficit was financed mostly by the draw-down of reserves. Gross international reserves stood at $1.5 billion at the end of April 2005.

13. Looking ahead, given continued prudent implementation of the fiscal monetary framework and supporting policies for 2005, the prospects are for continued progress along the path toward low and stable inflation and increased levels of economic activity, with relative exchange rate stability. The economic fundamentals continue to be relatively strong; monetary aggregates are on a low growth path, with an improved fiscal and domestic debt position exercising downward pressure on inflationary expectations that would keep the economy on the trend disinflation path. Prospective disbursements under the Multi-Donor Budget Support (MDBS) mechanism would be an added stabilizing influence.

14. The pass-through effects of the corrective domestic petroleum products price increases under the deregulation and

market-based pricing system, have worked through domestic cost and price setting, and the scope for further price mark-ups appears diminished by its effect on aggregate demand. International crude oil prices have also declined somewhat from the $55 per barrel levels a few months ago into the range of $48-50 per barrel. This somewhat attenuates the downside risks in the outlook, including on the side of the terms of trade. On the inflation horizon, implementation of the new petroleum pricing mechanism would avoid the bouts of inflation jumps from large petroleum price adjustments, allowing macroeconomic policies to work to achieve the desired single digit inflation target.

15. Overall, given the stance of policies, and the current state of economic fundamentals, the balance of risk is in favour of continued progress towards low and stable inflation and relative exchange rate stability, with a liquid money and foreign exchange market providing the underpinnings for growth.

16. The Monetary Policy Committee has therefore decided to reduce the Bank of Ghana Prime Rate from 18.5 percent to 16.5 percent.