



1. Macroeconomic developments through the first two months of the third quarter of the year indicate that inflationary expectations remain increasingly subdued, the exchange rate stable, and the external payments position relatively strong. This is against the background of continued fiscal consolidation underpinned by robust revenue growth and with government spending kept close to budgeted levels.

2. Developments in the Consumer Price Index through July 2005, indicate that inflation is firmly on the decline and prices are increasing at a slower pace than in the same period in 2004. Headline consumer price inflation fell for the fourth consecutive month from 16.7 percent in March 2005 to 14.9 percent in July on a year-on-year basis. The decline in inflation has been more broad-based, driven by the continued slowdown in both food and non-food price inflation. For the fifth consecutive time, the monthly increase in the food price index dropped from 1.5 percent in June 2005 to 0.4 percent in July, while that of the non-food price index declined from 0.3 percent to 0.2 percent. The Bank of Ghana's measures of core inflation continue to be stable within a narrow range remaining below the headline inflation.

3. The budgetary results for the first half of the year (January-June 2005) indicate that domestic tax revenue growth continues to be robust, and was at the equivalent of 20.2 percent of GDP (on an annualized basis). Total tax revenue amounted to ₵9,682 billion, a 24.0 percent increase over the same period in 2004. However, non-Tax revenue amounted to ₵328.0 billion, significantly short of the budget target of ₵739.6 billion.

4. Total Government expenditure for January-June 2005 is provisionally estimated as ₵12,805.2 billion (13.3 percent of GDP), some 5.2 percent above the expenditure for January-June of 2004 and 6.6 percent below the budgeted expenditure of ₵13,704 billion (14.2 percent of GDP).

5. Overall, the central government budget recorded a deficit, excluding grants, equivalent to 3.7 percent of GDP on an annual basis for the first half of the year. This continues the steady decline in the fiscal deficit since 2001 when it stood at 9.0 percent of GDP from where it has fallen to the current level of 3.7 percent, the lowest in the last five years.

6. Provisional banking data for July through early September indicates that total government receipts (including domestic revenue and grants) increased by ₵ 5,370.1 billion whereas government expenditures increased by ₵5,127 billion, generating a surplus of ₵243.0 billion, which in addition to significant donor inflow at the end of August resulted in a

net domestic financing position ø82.4 billion (0.08 percent of GDP) in early September 2005.

7. The latest numbers show that monetary conditions remain stable with continued slowdown in the growth of the monetary aggregates providing support to declining inflation. At the end of August 2005, the growth of reserve money stood at 27.8 percent, down from 33.2 percent in August 2004. Broad money (M2) growth similarly declined from 41.8 percent in June 2004 to 21.8 percent in July 2005 (the latest data available). M2+ growth has also slowed from 40.2 percent in June 2004 to 20.6 percent in July 2005. Foreign currency deposits in the banking system has increased from US\$678.9 million in June to US\$715 million in July 2005. This compares with a recorded level of US\$614.4 million in July 2004.

8. Interest rates on the money market eased downwards in the third quarter.

- The benchmark 91-day Treasury bill rate had declined further from 15.5 percent in July to 13.89 percent by early September 2005; and similarly, interbank overnight money market, rates had moved from 15.21 percent to 14.1 percent.
- Commercial bank base rates, after declining in the second quarter, have however remained sticky within a range of 21.99 percent and 23.5 since June 2005 with commonly large real interest rate spreads persisting in the industry. Lending rates were in the range of 18.0- 28.5 percent with interest on three-month time deposits averaging 10.5 percent.
- The yields on the two-year and three-year Government fixed and floating rate notes and bonds have also begun to decline. The two-year fixed rate note interest rate had declined from 20.0 percent in June 2005 to 18.5 percent by early-September, and the market share of the longer-dated instruments has continued to increase, an indication that expectations are for continued disinflation. On the basis of the provisional data, the share of the longer-dated securities has increased from 18.2 percent at the end of 2004 to 30.0 percent at the end of August 2005. Meanwhile, the share of the 91-day Treasury bill declined from 57.0 percent in June 2005 to 48.0 percent in August 2005.
- The portfolio shifts occurring in the auction market have resulted in some further lengthening of the average maturity of treasury bills and notes from 188 days in June to 210 days by August 2005. This has implied a continued lengthening of the average maturity of these securities and thus a reduction in the turnover rate from 5.0 times in August 2004 to 1,74 times per year by August 2005, which is a source of significant savings in the cost of funding the public sector borrowing requirement.

9. Bank credit to the private sector has been increasing quite rapidly relative to GDP. At the end of June 2005, credit to the private sector stood at 12.5 percent of GDP, up from 11.5 percent in June 2004, and marginally down from 12.7 percent in May. This is amongst the highest in the last five years. Credit extended to the private sector by the deposit money banks increased from ₵9,144.1 billion in June 2004 to ₵12,079.1 billion in June 2005, an annual growth of 32.1 percent. The increase in the amount of credit to the private sector over the last year was concentrated mostly in five sectors: Manufacturing, Commerce and Finance, Import Trade, Construction, and Services. Agriculture, excluding cocoa-related financing had a relatively small share of 0.3 percent.

10. The Bank of Ghana Survey of business confidence indicates that business sentiments about their own prospects and those of the economy in 2005 remain generally optimistic. In June, the Bank's Composite Indicator of Economic Activity (CIEA) registered a year-on-year growth of 17.30 percent, an easing from the 22.3 percent for the same period in 2004. This indicates a continued increase in the level of economic activity and in line with the trend growth rate of 21.0 percent since 2001. Business sector confidence has also increased after some softening recorded in the second quarter. Consumer confidence has also increased for the sixth consecutive month since February 2005.

11. Detailed industry-wide data show that the banking system as a whole continues to be well capitalized, profitable, fairly liquid and resilient and adapting to the declining inflation environment. Non-Performing loans (NPLs) continued on a downward trend, with the share in banks portfolio of assets declining from 18.5 percent in June 2004 to 13.3 percent in June 2005. NPLs net of provisions to capital declined from 9.4 percent at the end of the first quarter to 2.1 percent by the end of the second quarter of 2005, a marked contrast to the high of 16.8 percent recorded in June 2001. Non-Bank Financial Intermediaries sector registered strong asset growth of 33.2 percent for the year ended June 2005 with an improvement in their liquidity position.

12. Developments in international commodity prices for the year through July indicate a weakening terms of trade. Cocoa prices at the end of August 2005 stood at US\$1,414 per tonne, down from US\$1,580 per tonne at the end of 2004 and below the 2005 year to date average of US\$1,580. The price of Gold at the end of August 2005 was US\$435 per ounce, up from US\$410 per ounce at the end of 2004 and above the year-to-date average of US\$428 per ounce. Crude oil prices have also increased significantly from \$36.0 at the end of 2004 to between \$65-\$70 currently.

13. The latest data available on the external trade position show that for the first seven months of the year earnings from cocoa exports amounted to US\$551.5 million, compared with US\$669.5 million for the same period in 2004. Cumulative earnings from gold exports in the first seven months of the year amounted to US\$516.7 million, and was higher

than the value of US\$488.3 million earned for the same period in 2004. Cumulative earnings from timber and timber products for the year through July 2005 is estimated at US\$134.2 million, compared with US\$119.4 million for the same period in 2004, representing a growth of 12.4 percent. Imports of crude oil and finished oil products for the year to July 2005 amounted to US\$507.5 million, 31.0 percent above the oil bill 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 US\$2.35 billion for January-July 2005 compared to US\$1.51 billion for the same period in 2004. This is a 55.6 percent increase above last year's level. Of the total remittances received, 28.5 percent (i.e. \$666.2 million) was from individuals.
- In the foreign exchange market, total purchases and sales of foreign exchange by deposit money banks amounted US\$3.9 billion by August 2005 and this compares with US\$2.6 billion for the same period in 2004. This represents an increase of some 48.0 percent in the depth of the market.
- Gross International Reserves, reached a level of US\$1.64 billion at beginning of September 2005, significantly above the level of US\$1.35 billion recorded for the same period in 2004. The Gross international reserves position at the beginning of September 2005 is equivalent to some 3.2 months of imports of goods and services, with significant cocoa proceeds still in prospect in the fourth quarter.

14. The cedi exchange rate has continued its recent nominal and real appreciation against the British Pound and Euro while remaining stable against the US dollar. Between January and August this year, the cedi appreciated in nominal terms against the Euro (10.3 per cent) and British Pound (6.6 percent) while it traded within a tight range, and ending virtually unchanged against the US dollar at the end of the period. For the same period (January-August) in 2004 the cedi depreciated by 2.2 percent against the US dollar and 5.5 percent against the British Pound, and ended virtually unchanged against the euro. The trade-weighted real effective exchange rate for the cedi shows a real appreciation of the cedi by 17.0 percent in the first seven months of 2005, restoring the index, and the competitiveness of the economy close to its level in January 2002.

15. Developments on key economic indicators over the three quarters ending in September, show the consolidation of the macroeconomic stability, with downward pressure on inflation and interest rates, and the exchange rate has been stable in a relatively liquid foreign exchange market. The preliminary results on the execution of the budget indicate continued reduction in the fiscal deficit and the debt/GDP ratio, easing the pressures on the domestic money market. While the stock market remains bearish, economic activity remains on trend, business

confidence generally optimistic, firming up after some softening in the first quarter of the year.

16. The major downside risk continues to be associated with volatility of crude oil prices on the international market. These are now in the range of US\$60 – 70 per barrel and are not expected to decline given world demand conditions but the direction of price movement remains uncertain. A sustained surge in prices would be a significant source of pressure on the external payments position and domestic price inflation and a withdrawal of stimulus to growth. The outlook nonetheless continues to be for macroeconomic consolidation providing a basis for achieving the inflation and GDP growth targets for 2005 given the prudent implementation of the fiscal and monetary framework and the supporting policies.

17. Overall, given the balance of risks, the Monetary Policy Committee has decided to reduce the Bank of Ghana Prime Rate from 16.5 percent to 15.5 percent. .