Bank of Ghana
Monetary Policy Report

Inflation Developments and Outlook

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4.0 Global Developments

The Sovereign Debt Crisis in the eurozone continued to pose threats to the global economic outlook. While downside risks exist amidst weakened confidence and a pessimistic growth outlook, the absence of a clear roadmap and timeline of a permanent solution to the problem has heightened uncertainties in global financial markets with implications for the global recovery process. Imminent risks remain to be addressed especially among sovereigns, banks, and the real economy. In the medium to long term perspective, structural reforms should help restore some growth momentum.

The contagion effects of weak economic conditions across the eurozone is threatening growth prospects of emerging economies, especially those in Asia that rely heavily on exports to Europe. Developing countries, including Ghana, also expect a period of low demand for export commodities in Europe with implications for the country's balance of payments. This notwithstanding, downward spirals on global inflation are obvious. Global inflation has eased in recent months, partly reflecting the declining energy prices, persistent capacity underutilization as well as well anchored inflation expectations. Inflation in the OECD countries slowed to an average of around 2.4 per cent in May and remained unchanged in June. Elsewhere in Europe and Asia, inflation continued to decline with inflation in China approaching historical low levels.

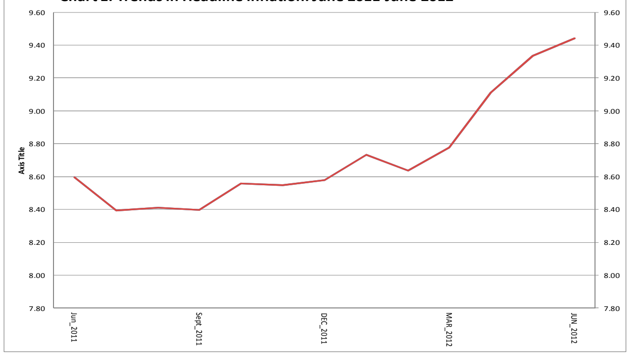
4.1 Domestic Price Conditions

Developments in Headline Inflation, Q2 2012

The rate of inflation was further elevated during the second quarter, pushing up prices and moving inflation towards the upper target of 11.5 per cent. From 9.1 per cent in the first quarter of 2012 (8.6 per cent in December 2011), inflation rose to settle at 9.4 per cent in June 2012. While non-food inflation remained stable at 11.4 per cent due to the slow pass through of recent upward volatilities in the exchange rate, food inflation rose sharply during the second quarter. Food Inflation has increased by 0.9 per centage points since the beginning of the year, rising to 4.4 per cent by March 2012 and then to 5.4 per cent by June. The rate was 4.3 per cent in December 2011.

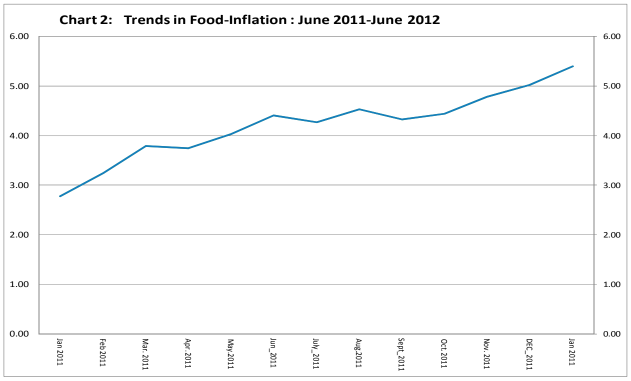
Details on the profile for non-food inflation show that it had moved within a tight range of 11.2-11.9 per cent over the six-month period. After increasing marginally from 11.2 per cent in December 2011 to 11.3 per cent by March 2012, non-food inflation surged further to 11.9 per cent in May 2012 and then eased slightly to 11.8 per cent in June.

Chart 1: Trends in Headline inflation: June 2011-June 2012



The main components of the CPI basket show that yearly price movements for the period June 2012 to June 2011 produced mixed outcomes (refer to table 1). While some components recorded surges in inflation, others recorded substantial declines. For those that increased, average inflation rose from around 6 to 9 per cent (these include food, alcoholic beverages, household goods and items, medical expenses, education and entertainment). Significant ease in inflation rates were observed in housing & utilities as well as transportation.

Chart 2: Trends in Food-Inflation : June 2011-June 2012



The prices of some of these components are administratively determined and therefore non-adjustment of prices over the past year has served to moderate inflationary pressures.

An examination of the sub-component analysis of the consumer basket show that since the beginning of the year, food prices have risen by 1.1 per cent. The sharp rise in food prices have been driven by three main factors. The first is associated with transportation costs which have risen by more than 12 per cent since the beginning of the year and the second which is more cyclical in nature is the fact that the period is associated with the lean season for food production. The third is the effect of the exchange rate depreciation which has had an impact on prices of vegetables and other such imported food crops from the sub-region.

Table 1: Consumer Price Index and Major Components : Average 2002=100

	Relative Importance [1]	June 2010	Dec 2010	June 2011	Dec 2011	Mar 2012	June 2012	Dec 2010 to June 2011	June 2010 to June 2011	Dec 2011 to March 2012	March 2012 to June 2012	Dec 2011 to June 2012	June 2011 to June 2012
		Unadjusted Series						percent change					
All Items: National	**100**	344.52	341.83	374.13	371.16	389.79	409.45	**9.4**	**8.6**	**5.0**	**5.0**	**10.3**	**9.4**
Food and beverages	44.91	305.43	288.33	313.92	300.64	313.97	330.87	**8.9**	**2.8**	**4.4**	**5.4**	**10.1**	**5.4**
Alcohol and Tobacco	2.23	341.08	354.43	383.31	394.76	418.10	445.95	**8.1**	**12.4**	**5.9**	**6.7**	**13.0**	**16.3**
Clothing and Footwear	11.29	265.87	273.80	301.07	309.68	323.81	340.72	**10.0**	**13.2**	**4.6**	**5.2**	**10.0**	**13.2**
Housing and Utilities	6.98	409.22	451.87	469.47	483.19	497.19	510.75	**3.9**	**14.7**	**2.9**	**2.7**	**5.7**	**8.8**
Household Goods, Ops & Services	7.83	297.51	305.63	333.22	345.56	360.43	379.05	**9.0**	**12.0**	**4.3**	**5.2**	**9.7**	**13.8**
Medical Care and Health Expenses	4.33	559.90	571.21	600.64	614.54	628.62	655.97	**5.2**	**7.3**	**2.3**	**4.3**	**6.7**	**9.2**
Transport	6.21	494.72	499.75	610.22	613.21	698.38	730.59	**22.1**	**23.3**	**13.9**	**4.6**	**19.1**	**19.7**
Communications	0.31	272.95	272.95	272.95	274.74	274.74	274.74	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.7**
Recreation, Ent & Cultural Services	3.04	526.71	533.51	558.19	602.88	612.95	636.19	**4.6**	**6.0**	**1.7**	**3.8**	**5.5**	**14.0**
Education	1.60	280.93	282.51	288.12	289.53	307.73	317.39	**2.0**	**2.6**	**6.3**	**3.1**	**9.6**	**10.2**
Hotels, Cafes and Restaurants	8.28	525.49	534.92	584.42	562.92	593.30	620.43	**9.3**	**11.2**	**5.4**	**4.6**	**10.2**	**6.2**
Miscellaneous Goods and Services	2.99	282.12	289.32	331.19	344.35	356.54	379.21	**14.5**	**17.4**	**3.5**	**6.4**	**10.1**	**14.5**
									6.1				9.9
Special Aggregates [2]									16.0				12.5
All items excl. energy& utility			229.349	245.607	243.469	255.58	268.31	**7.1**		**5.0**	**5.0**	**10.2**	**9.2**

Notes:

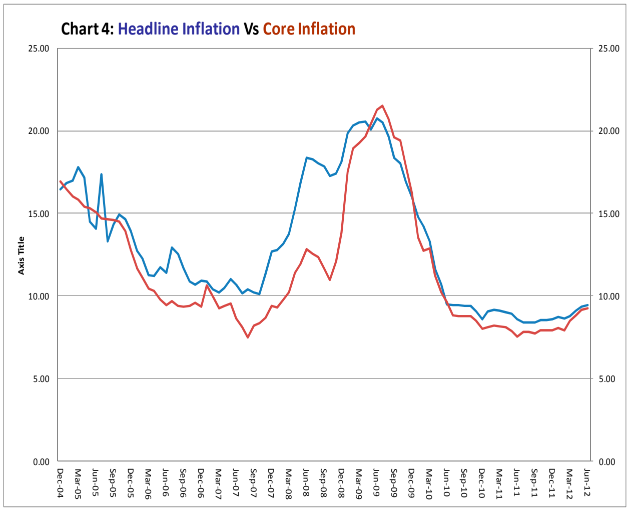
1. Relative importance reflects the weights of those items in the consumer basket

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 tarrifs.

As regards non-food prices, the detailed analysis gave a mixed picture. The main sector that exerted a push on inflation included educational costs (7.7 per cent), alcohol and tobacco (5per cent), housing and utility and household maintenance (1.9 per cent) and medical care expenses (1.6 per cent). However, on the average, transportation and miscellaneous goods recorded an average decline in the rate of inflation by some 3.8 per cent; transportation declined by 3 per cent while the miscellaneous items declined by 4.5 per cent. The decline in transportation costs reflects the non-adjustment of petroleum prices in response to rising crude oil prices during the first half of the year. These two sectors acted to moderate the increase in non-food prices.

The pace of increase in core inflation, which is defined to exclude price changes of energy and utility, accelerated during the second quarter. After rising by 0.57 per centage points in the first quarter, it went up further by 0.74 per centage points during the second quarter.

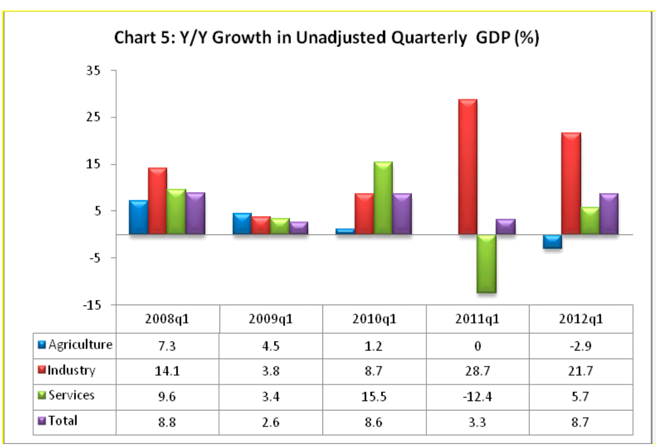


Cumulatively for the first half of the year, the core measure of inflation increased by 1.31 per centage points compared with an increase of 0.86 per centage points observed in the headline rate of inflation. The upward pressure in core inflation has been driven by sharp food prices increases over the year. Food prices have doubled from the levels recorded a year ago.

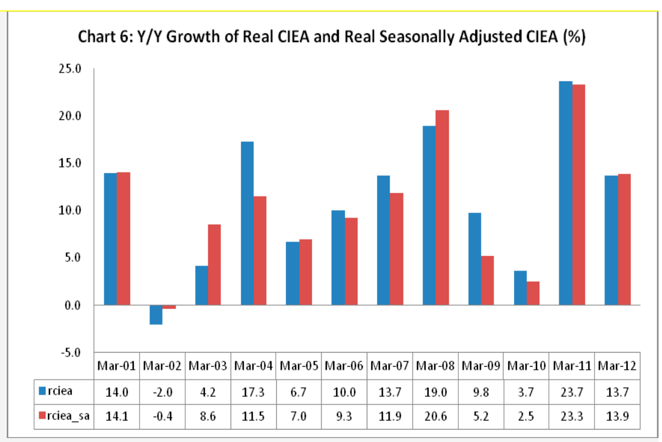
On measures of inflation expectations, the Bank of Ghana's June 2012 round of survey suggested that uncertainty about developments in crude oil prices, rising exchange rate trends and food prices during the past six-months have led to heightened inflation expectations. Businesses expectations about future inflation rose for the third consecutive survey. From the perspective of businesses, these are likely impact on operational costs over the coming months.

4.2 Real Sector Indications

Data from the Ghana Statistical service show that in line with seasonal trends real GDP grew at a slower pace during the first quarter of 2012. This was influenced largely by a contraction in the agricultural sector. During the quarter, real GDP declined by 22.2 percent. However, services and industry registered strong growth. In year-on-year terms real GDP recorded a growth of 8.7 percent.



	2008q1	2009q1	2010q1	2011q1	2012q1
Agriculture	7.3	4.5	1.2	0	-2.9
Industry	14.1	3.8	8.7	28.7	21.7
Services	9.6	3.4	15.5	-12.4	5.7
Total	8.8	2.6	8.6	3.3	8.7



	Mar-01	Mar-02	Mar-03	Mar-04	Mar-05	Mar-06	Mar-07	Mar-08	Mar-09	Mar-10	Mar-11	Mar-12
rciea	14.0	-2.0	4.2	17.3	6.7	10.0	13.7	19.0	9.8	3.7	23.7	13.7
rciea_sa	14.1	-0.4	8.6	11.5	7.0	9.3	11.9	20.6	5.2	2.5	23.3	13.9

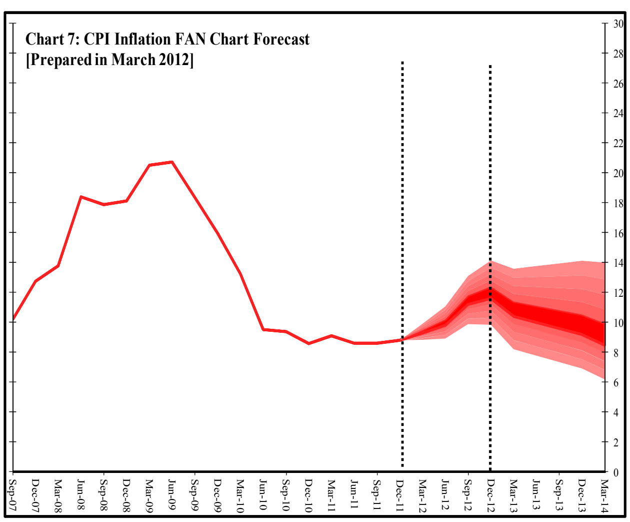
Similarly, trends in the Banks' Composite Indicator of Economic Activity (CIEA) continued to record strong growth, although at a reduced momentum compared to a year ago. The first quarter of the year saw a year-on-year growth of 13.7 per cent in the CIEA against 23.7 per cent in the corresponding period of 2011.

Overall consumer confidence went down by 4.3 points between the March and June 2012 surveys. Consumers' expectations about higher energy prices as crude oil prices continue to soar and rising cost of household consumables weighed down heavily on overall consumer sentiments. Similarly, the Business Confidence Index decreased by 6.3 points between the March 2012 and December 2011 surveys, influenced by rising inflation expectations and exchange rate depreciation.

4.3 The Inflation Outlook

Since the last Monetary Policy Committee (MPC) in June 2012, economic conditions have not changed significantly. The MPC raised the key policy rate by 50 basis points to support additional measures taken during the second quarter of the year to contain liquidity and stabilize the foreign exchange market. It may be recalled that in April 2012, the central bank announced series of monetary policy measures which include shifts in the composition of mandatory reserve holdings in favour of the cedi, and reduction in banks' net open positions. The Central bank did indicate, at the time that it would not hesitate to adjust interest rates further, if warranted, to defend the inflation target band of 5.7 to 11.7 per cent. Since then, some stability has been observed in the foreign exchange market and the pace of liquidity growth has slowed down somewhat. In the best collective judgment of the staff, although inflation has risen in recent times, the path has been below expectations given the scale of exchange rate depreciation.

The Fan Chart forecast (chart 7) shows that the current assessment of the inflation outlook remains unchanged from the March 2012 forecast round. The assumptions underlying key macroeconomic fundamentals, crude oil prices, pass-through of exchange rate movement, the assumptions about world growth, the inertia on domestic inflation and interest rate path have not deviated significantly from the March 2012 assessment. In the projections and based on earlier assumptions, inflation may rise to around 11.5 per cent by end year before easing in the first quarter of 2013. Given that crude oil prices have retreated on the international markets, the possibility of upward adjustment in domestic petroleum prices by the National Petroleum Authority is unlikely till the end of the year. Hence, inflation may not breach the projected elevated profile. Analysts in the crude oil sector are predicting that prices could fluctuate within the range of US$90-95 per barrel to the end of the year.



4.4 Assessment of Risks to Inflation

The risks to the outlook for inflation are varied and may act in different directions:

- The risks from the unsettled global economic conditions remain and their impact on commodity prices, as well as from domestic factors, including the effects of the depreciation of the cedi will have to be carefully weighed.

- At the same time, the external sector conditions also show that inflation in advanced economies is slowing down. In China, United States and Europe, inflation has eased considerably. The potential therefore to import low inflation from the rest of the world therefore exists. The net effect of this on domestic prices is contingent on movements in the exchange rate.

- The fiscal risks were judged as elevated at the June 2012 monetary policy meeting. The underlying pressures in government expenditures were identified as outstanding payments, energy subsidies, higher than budgeted spending on wages and related expenses, and rising interest costs. The government's decision to clear all outstanding arrears within the second half of the year while laudable, may exert further pressures on inflation.

- Developments in food prices during the harvest season will determine the extent to which food prices will evolve in the third quarter. A good bumper harvest season would dampen food prices and exert less pressure on inflation. Otherwise, food prices will continue to rise.

- The role of inflation expectations will matter in the months ahead. While current surveys point to rising inflation expectations, improved macroeconomic conditions should help abate these expectations.

- It is not yet clear at this stage the extent to which exchange rate fluctuations have passed through to import prices and there is some uncertainty regarding how earlier depreciation of the local currency would transmit to prices of imports.

4.5 Conclusions

The economy has come under strain in the first half of the year, risks have risen and monetary policy has been tightened to stabilize exchange rate volatilities and contain inflationary pressures. The measures taken by the Central Bank has helped bring about some stability in the foreign exchange rate market, albeit with the drawback of reducing the Central Banks Gross International Reserves. Re-establishing reserve buffers in the next half of the year will be essential. On fiscal policy, a clear commitment to fiscal discipline will enhance the macroeconomic outlook.