



# Bank of Ghana Monetary Policy Committee Press Release

April 16 2010

[1] Ladies and Gentlemen of the Media, welcome to the April 2010 briefing of the Monetary Policy Committee. I want to share with you the assessment of the committee on the economy and its outlook for inflation.

[2] As usual, the committee undertook a review of the macroeconomic situation against the background of developments in the global economy. The Committee also assessed developments in the pace of domestic economic activity and evaluated results of surveys on businesses and consumers, the stability of the banking system, the execution of the budget for 2010 and the external sector.

## **Global Developments**

[3] Recent data confirm the recovery of the global economy. The combination of policy stimulus and cyclical inventory adjustments has boosted demand, and world trade has picked up. The data on the world's largest economy (the United States) in the first quarter of 2010 show that the recovery is well under way, evidenced by data on manufacturing output which is at a 5 year high, consumer sales which is up significantly and new hiring by US companies.

[4] These early signs of optimism in economic activity in the advanced economies and the emerging markets is sparking demand for crude oil. Crude oil prices have increased and traded at close to US\$85 per barrel in the first week of April 2010, the highest level since 2008.

## **Inflation and Output**

[5] On the domestic front, developments in the Consumer Price Index (CPI) indicate that the process of disinflation is well on track. Headline inflation dropped from its March 2009 level of 20.5 per cent to 13.2 per cent last month. Monthly changes in the CPI continue to grow at a pace lower than trends observed in 2009. Food inflation which was 18.4 per cent in March 2009 has declined steadily to 7.4 per cent by March 2010. Similarly, non-food inflation which was 22.0 per cent in March 2009, declined to 17.6 per cent by March 2010

[6] The measure of core inflation used by the Bank of Ghana to monitor underlying inflation pressures in the economy (and which excludes energy and utility price changes from the CPI basket) declined to 12.9 per cent in March 2010 from 19.3 per cent in March 2009.

[7] Data from the Bank of Ghana's Composite Index of Economic Activity (CIEA) which is used in gauging the pulse of the economy declined during the first two months of the year, implying a slowdown in the pace of economic activity. In real terms, the index declined by 11.7 per cent in the first two months of the year. In year-on-year terms however, a growth of 0.2 per cent was recorded in the February 2010 relative to a growth of 4.0 per cent recorded for the same period in

February 2009. The factors contributing to the declining index were: imports, tourists spending, private sector transfers to social security, consumer spending (derived from VAT collections) and commercial banks' credit to the private sector.

[8] The latest in the periodic surveys carried out by the Bank of Ghana to gauge the sentiments of businesses and consumers gave mixed results. While consumers remained confident about the prospects of the economy, businesses were less confident. The overall business confidence index dropped 3.5 points in the latest survey. The survey shows that high lending rates affected business confidence. The optimism of consumers for the next six months, on the other hand, was driven by the expected improved economic situation, anticipated employment opportunities and the slowdown in consumer price growth.

### **Fiscal Developments**

[9] On a broad coverage basis, data on the 2009 budget indicate that Government fiscal operations resulted in a deficit, on a cash basis, of GH¢2.1 billion (9.9 per cent of GDP) compared with GH¢2.6 billion (14.5 per cent of GDP) for the same period in 2008.

[10] For the first three months of this year, Government fiscal operations resulted in a narrow deficit, on a cash basis, of GH¢1.1 billion (4.2 per cent of GDP) compared with GH¢100 million (0.6 per cent of GDP) for the first quarter of 2009. The fast paced growth of expenditures observed in the first quarter of 2010 was driven mainly by the clearance of road and non-road arrears and part settlement of TOR's indebtedness to GCB all totalling some GH¢700 million (2.8 per cent of GDP).

## Interest Rate Structure

[11] Interest rates have generally declined along the full spectrum of the yield curve; 8.7 percentage points on the lower end and 4 percentage points at the higher end since December 2009. The market observed shifts towards long-dated instruments, in line with easing inflation expectations. The share of the short-dated securities in the outstanding stock of Government securities fell to 53.7 per cent from 60.0 per cent at end-2009.

- Between December 2009 and mid-April 2010, the benchmark 91-day Treasury bill rate went down by 8.7 percentage points to 13.9 per cent. Similarly, the 182-day Treasury bill rate declined by 11 percentage points to 14.4 per cent.
- The rate on the 1-year note fell by 5.0 percentage points to 15.0 per cent while the 2-year fixed rate note went down by 7.3 percentage points to 16.3 per cent. The 3-year fixed rate bond also fell by 4.0 percentage points to 14.9 per cent.
- On the interbank market, the average overnight interbank interest rates fell by 1.4 percentage points to 14.9 per cent during the same period.
- After staying largely static initially, commercial banks have also begun revising their base and lending rates downwards in line with the general decline in interest rates and easing inflation expectations. However the declines were only marginal and have

not kept pace with the recent reductions in the policy and money market rates.

- Average base rates of the banks were revised downward in the range of 24.7 – 32.0 per cent with an industry average of 29.9 per cent. Similarly, average lending rates were revised downward by 0.61 percentage points to 32.1 per cent in the range 23.6 – 39.9 per cent.

## **Banking Sector Developments**

[12] Developments in the Banking sector through February 2010 show continued strong asset growth on account of significant increases in deposits and shareholder funds. However, as a result of the slow pace of growth of loans and advances, the growth in total assets was lower than the February 2009 position.

[13] The banking system continued to be well capitalised and liquid. Capital Adequacy Ratio (which measures the banking system capacity to withstand unexpected losses) increased from 14.8 per cent in February 2009 to 19.7 per cent in February 2010. Let me clarify this point. In the last MPC Press briefing, we reported that the ratio of non-performing loans to gross loans for December 2009 was 14.9 per cent. This figure has had to be revised to 16.2 per cent for December 2009 on account of additional provisions the Bank Supervision Department requested a few Banks to make for loan impairment. Therefore the correct rate should have been 16.2 per cent in December 2009, rather than 14.9 per cent. Since then the non-performing loans ratio has

increased to 20 per cent in February 2010 due to energy sector loans (amounting to 3.7 per cent) which were re-classified.

[14] The survey of credit conditions conducted by the Bank of Ghana in March 2010 continue to show a general net tightening of credit to enterprises and households for mortgages in the first quarter of 2010. There are additional declines in net demand for long term credit. The cost of funds and increases in adversely classified loans contributed to the net tightening of credit.

[15]. Non-price terms and conditions such as shortening of the maturity of loans or credit lines, and the requirement of additional loan covenants and collaterals were employed to tighten the credit stance in the first quarter of 2010.

[16] As a source of funding, external borrowings by banks continued to be less than 5 per cent of total bank funding requirements. This confirms the reduced reliance on external borrowings as a source of funding.

[17] Commercial Banks credit to the private sector and public institutions over the 12-month period to February 2010 increased by GH¢0.8 billion (13.2 per cent) compared with GH¢1.9 billion (46.9 per cent) recorded for the same period in 2009. The private sector's share of the credit flow was GH¢0.7 billion (85.5 per cent), which translates to a 13.9 per cent growth and compares with 47.4 per cent over the corresponding period in 2009.

[18] There has been a shift in the distribution of the annual flow of credit to the private sector. For the first time the agricultural sector

absorbed most of the credit extended in the year to February 2010. The agricultural sector received 20.2 per cent of the flow of credit to the private sector while electricity, gas & water absorbed 18.8 per cent. Other major recipients include the manufacturing sector (16.9 per cent), import trade (16.5 per cent) and construction (15.4 per cent).

[19] Real credit extended by the commercial banks to the private sector declined by 0.3 per cent at end-February 2010 compared with a growth of 22.5 per cent at end-February 2009. Outstanding commercial bank credit to the private sector in February 2010 was GH¢5.7 billion (26.6 per cent of GDP) compared with GH¢5.1 billion (23.4 per cent of GDP) at end- February 2009.

## **External Sector Developments**

[20] Provisional data on the external sector indicate that total merchandise exports for the first quarter of 2010 amounted to US\$1.7 billion, a growth of 20.9 per cent on year–on-year basis. Cocoa beans and products earned US\$704.1 million, an increase of 28.5 per cent and gold earned US\$678.2 million, an increase of 16.5 per cent. These compare with 35.9 per cent in the export of cocoa beans and products in 2009 and a decline of 4.4 per cent in gold exports. However, concerns exist over the attainment of the 2009/2010 major season target of 650,000 tonnes of cocoa purchases. By the first week of April 2010, only 518,304 tonnes had been purchased compared with 562,538 tonnes at the same time during the 2008/2009 crop season. The crop size at the close of the 2008/2009 season was 634,256 tonnes.

[21] Other exports improved by 17.6 per cent from US\$280.9 million to US\$330.2 million in the first quarter of 2010, compared with 20.4 per cent growth recorded in a similar period of 2009.

[22] Total merchandise imports in the first quarter of 2010 amounted to US\$2.2 billion, 5.9 per cent higher than the level recorded in the first quarter of 2009. Oil imports for the three-month period amounted to US\$399.1 million or 43.9 per cent above the US\$277.4 million recorded a year ago. The increase is mainly due to a price effect, as the average realized price recorded for crude oil imports was 64.1 per cent above the US\$47.9 per barrel realized a year ago.

[23] Volumes of crude and oil products imported in the economy declined by 9.5 per cent to 622,417 metric tonnes from 687,497 metric tonnes a year ago. Capital and intermediate goods together accounted for 75.1 per cent of total non-oil imports at the end of the first quarter of 2010, compared with 69.5 per cent recorded in a similar period of 2009.

[24] The trade balance recorded a reduced deficit of US\$487 million in the first quarter of 2010, which compares favourably with a deficit of US\$665.5 million recorded in the corresponding period of 2009.

[25] The Gross International Reserves (GIR) position of the Bank of Ghana which had increased to \$3.2 billion in December 2009 grew further by 4.4 per cent in the first quarter of 2010 to US\$3.3 billion, translating into three months cover of imports of goods and services. This compares to gross reserves of US\$1.8 billion in March 2009 (or 1.8 months of import cover).

[26] The foreign exchange market continued to gain in depth, with relative stability. Total foreign exchange transactions (i.e. purchases plus sales) by banks and forex bureaux amounted to US\$3.6 billion for the three month period to March 2010, or 58.7 per cent above the level recorded over the same period in 2009.

[27] Private inward transfers – received by NGOs, embassies, service providers, individuals etc. - through the banks amounted to US\$1.6 billion in the first two months of 2010, representing 27 per cent increase over the amount of US\$1.3 billion for the corresponding period in 2009. Of the total transfers, US\$239.7 million (15.1 per cent) accrued to individuals, compared with US\$223.1 million (17.8 per cent) recorded for the same period in 2009.

[28] The favourable external environment continues to support the stability in the foreign exchange market. The nominal exchange rate of the cedi against the US dollar, show that in the cedi depreciated on year-on-year terms by only 2.5 per cent compared with 29.2 per cent a year earlier. For the period January - March 2010 however, the cedi appreciated against by 0.7 per cent against the United States dollar. This compares with a depreciation of 11.9 per cent over the same period in 2009.

## **Summary and Outlook**

[29] To summarise, developments through the last quarter of 2009 and the first two months of 2010 suggest that the global economy appears to be gaining some traction, but with limited pressures on consumer prices, reflecting the substantial economic slack in the major economies. In the

emerging market economies the stronger recovery is helping to keep commodity prices up.

[30] On prices, developments in the first quarter of the year indicate that the process of disinflation is well on track with inflation easing to 13.3 per cent in March 2010. The impact of the appreciating currency on import prices and stable monetary aggregate conditions should work together to reinforce the process of disinflation over the year. Inflation expectations from the Bank of Ghana's recent surveys appear to be well anchored. At the same time, banks continue to tighten overall credit market conditions with overall access to financing remaining tight, which is supportive of constrained aggregate demand conditions and should help weigh down inflation. The outlook for inflation is for continued decline towards the target range of 7.2 -11.2 per cent for 2010. The forecast suggests that inflation will continue to ease steadily in the second quarter of the year beyond which it will stabilize.

[31] However, there are some risks to the baseline profile. Firstly, the Committee recognises that as the global economic recovery takes hold crude oil prices may rise faster than currently projected on the international market. Secondly, there is the concern that postponement of adjustments in administered price (especially with respect to petroleum and electricity tariffs) when finally passed through could exert undue shocks on the economy through cost push effects.

[32] As far as the execution of the budget framework for 2010 is concerned, certain early pressure points have been identified. There appears to be some revenue shortfalls related to Import duties, import VAT, petroleum tax and communications service tax. On expenditures,

higher than programmed payments on road and non-road arrears, interest on domestic debt and part-settlement of TOR's debt owed to the Ghana Commercial Bank have affected the fiscal outcome for the first quarter of the year. Consequently, close monitoring of the fiscal situation is required to underpin macro-economic stability and anchor inflation expectations.

[33] On the real sector of the economy, developments have not been encouraging. The Committee was concerned about the slow pace of economic activity, as evidenced by the declining trend as captured in the CIEA. Retail sales and import VAT collections (which are partial indicators of consumer spending) were below expectation. Also, real credit to the private sector declined during the first two months of the year. However the Committee recognises that the partial repayment of TOR's debt to Ghana Commercial Bank would improve overall liquidity in the banking system and help crowd-in the private sector. The growth in the stock of Non-Performing Loans remains a source of concern.

[34] The response of Commercial Banks to the earlier rate reductions has not been encouraging. The MPC would want to see these rate cuts passed through to lending rates, to reduce the cost of credit and restore economic growth.

[35] In the circumstances, having assessed the risks to inflation and inherent weaknesses in the real sector of the economy, the Monetary Policy Committee has decided to reduce its Policy Rate by 100 basis points from 16 per cent to 15 per cent.

Thank you.