BANK OF GHANA

Monetary Policy Report

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Overview of World and Domestic Economic Developments

The global economy is recovering faster than previously anticipated with limited impact on consumer prices. On the domestic scene while most of the key macroeconomic indicators continue to exhibit stability and improved conditions the pace of economic activity remained remaining sluggish.

Recent data on the world economy further confirm that the global economic recovery is gaining traction. A combination of cyclical inventory adjustments and unprecedented policy stimulus has boosted demand, and world trade has picked up somehow strongly. However, much of the improvement is due to temporary factors, and the world bank is signaling that economic growth will weaken once these forces fade.

Despite these reports latest data from the US economy in q1-2010 shows the recovery is under way. First signs that economic recovery is beginning to reach the place that is needed most which is the jobs market. Manufacturing data is at a 5 year high and consumer sales is up 41 percent in March 2010. Data in the United States also shows that 166,000 jobs were created in March 2010, a sign that recovery is well under way. For the first three months of the year, unemployment has remained at 9.7 percent.

Renewed optimism is sparking speculative demand for crude oil. Crude oil prices are up and trading at close to US$85 per barrel for the first week of April 2010, highest level since 2008.

On the domestic economy:

[1] The Bank of Ghana's Composite Index of Economic Activity (CIEA) which is used in gauging the pulse of the economy slowed down recording a decline in real terms of 11.7 percent during the first two months of the year.. In year-on- year, 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.

[2] 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. Businesses indicated that high lending rates continue to be a major constraint. 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.

[3] For the first three months of the year, Government's 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).

[4] The issue of three year bonds which were subscribed to mainly by non-residents during the period, to ease pressure at the domestic treasury bill auction market. The result is that interest rates have generally declined along the full spectrum of the yield curve since December 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.

[5] On prices, developments in the Consumer Price Index (CPI) indicate that the economy is still in a mode of disinflation. 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 Bank's measure of core inflation (excluding energy and utility items from the

consumer basket) which is used to monitor underlying inflation pressures in the economy declined to 12.9 per cent in March 2010 from 19.3 per cent a year earlier in March 2009.

[7] Provisional trade 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 . Total merchandise imports for the period on the other hand amounted to US$2.2 billion, 5.9 per cent higher than the level recorded in the first quarter of 2009. On balance, 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.

[8] 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).

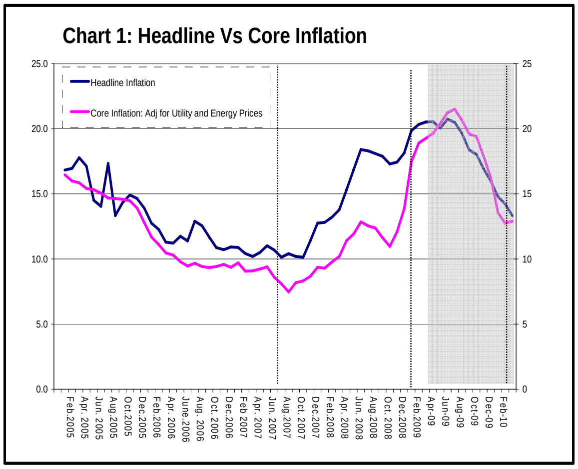
[9] Data on the movement of the exchange rate show that with the exception of the British Pound, the dollar and the Euro recorded slower rate of depreciations relative to trends a year earlier. In year-on-year terms, the Ghana Cedi as at March 2010 had recorded depreciations of 2.5 percent, 7.5 percent and 4.3 percent against the US dollar, the pound sterling and the euro respectively. The respective depreciations a year earlier were 29.5 percent, 0.8 percent and 15.5 percent

However, looking at the rates from June 2009 when they all reached their peak value,all three currencies have recorded appreciations. Against the dollar, the british pound and the euro, appreciations of 3.3 percent, 8.8 percent and 7.1 percent have been recorded.

The Outlook and Assessment of Risks to Inflation

Inflation eased significantly in the first quarter of the year. The outlook is for the disinflation process to continue till the end of the second quarter of 2010.

As expected CPI Inflation continue to decline. In March 2010 inflation declined to 13.3 percent.



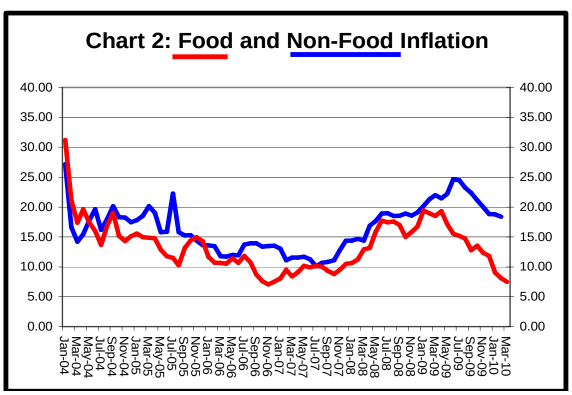
The decline marks represents the 8th consecutive months of decline since it peaked at 20.7 percent in March 2009. The decline brings the total ease in the first quarter of 2010 to 2.7 percent. The transportation and communication sectors continue to be the main sources of inflationary pressures in the economy. With the exception of the communication and transportation sectors of the economy, all the other sub-groups of the CPI recorded declines in its year-on-year measure of inflation (see table 1). Core inflation also continues to trend downwards and estimated at 12.9 for March 2010. The current trends in core inflation is indicative of the fact that underlying inflationary pressures may be subdued (see chart1).

Table 1: Contribution of Sub-Groups to Consumer Price Changes

	Relative Importance	Dec-08	Mar-09	Dec-09	Mar-10	Absolute Change Dec-09 to Mar 2010	Absolute Change Mar-09 to Mar2010
Overall Inflation	**100.0**	**18.1**	**20.5**	**16.0**	**13.3**	**-2.70**	**-7.20**
Food & Non-Alcoholic Beverages	44.9	16.7	18.5	11.8	7.3	-4.5	-11.2
Alc. Beverages and Tobacco	2.2	23.0	31.5	22.2	16.1	-6.1	-15.5
Clothing & Footwear	11.3	16.9	17.9	18.5	19.8	1.3	1.8
Housing and Utilities	7.0	9.8	10.1	1.7	4.5	2.8	-5.6
Household Goods and Equipment	7.8	22.2	28.4	29.0	22.2	-6.8	-6.2
Health	4.3	25.0	51.3	33.2	13.3	-19.9	-38.1
Transport	6.2	11.0	0.0	10.5	19.4	8.9	19.4
Communications	0.3	1.6	1.6	4.5	4.5	0.0	2.9
Entertainment	3.0	17.2	52.2	87.0	41.0	-45.9	-11.1
Education	1.6	16.0	15.6	3.0	0.9	-2.1	-14.7
Hotels, Cafes and Restaurant	8.3	34.5	37.4	17.7	20.4	2.8	-16.9
Miscellaneous	3.0	17.1	16.0	6.7	6.3	-0.3	-9.7

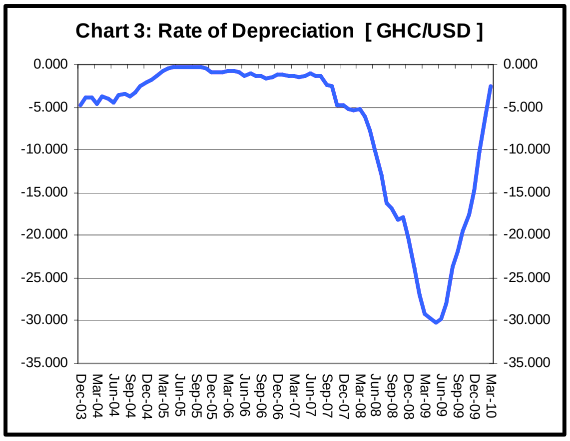
Food inflation has trended down nicely and this should provide support to the whole disinflation process. At 7.5 percent for March 2010, food inflation is one of the lowest observed over the past 4 years. Over the horizon, the expectation is that food inflation will continue to remain stable.

Non-food inflation, although trending down as well has remained quite sticky and at 18.4 percent by March 2010. The non-food category which has a high import content is beginning to benefit from from the stability in the exchange rate in the coming months the biggest gains in the non-food category has been from the health and educational sectors.

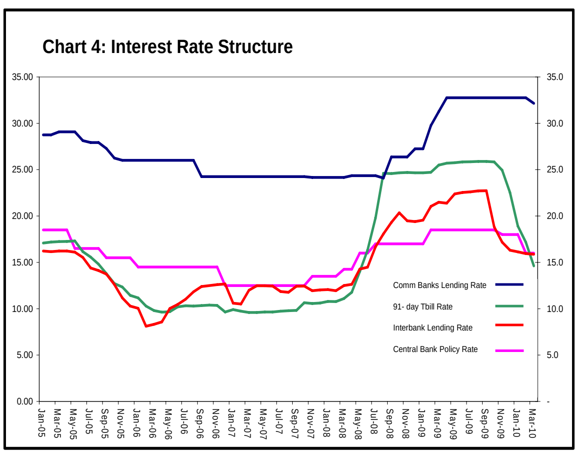


Exchange Rate depreciation has slowed down significantly and infusions to import prices should be minimal over the forecast horizon. The stable conditions in the foreign exchange market is driven by three main factors; the policy framework, portfolio inflows into the money market and strong export performance.

In nominal terms, the 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 (chart 3). 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. The stable conditions in the exchange market are gradually shaping expectations. Results from the latest surveys also show that inflation and exchange rate expectations are gradually stabilizing as economic agents expects the process of disinflation and exchange rate stability to continue.

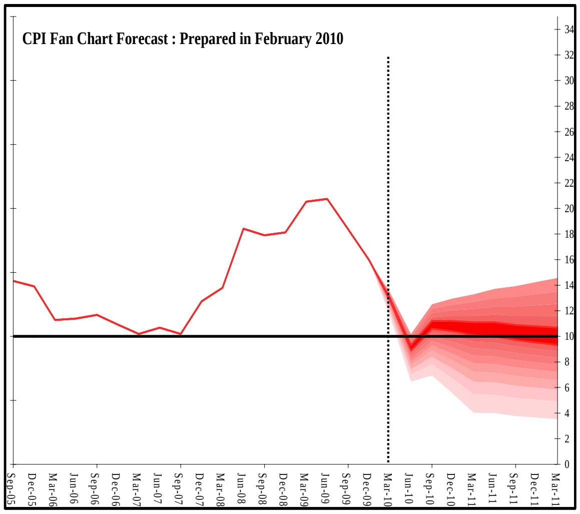


At its meeting in April 2010, the Monetary Policy Committee reduced the policy rate by 100 basis points citing weaknesses in the real sector of the economy as one of the reasons for the rate reduction. Earlier on in February 2010, the committee reduced the key policy rate by 200 basis points, bringing the total reduction in the key policy rate for the year to 300 basis points. The committee in its April 2010 statement indicated that it was also concerned about the transmission of the reductions to other rates in the economy especially commercial banks average lending rates. Although most of the key rates in the economy have converged around the key policy rate **(see chart 4),** the average lending rates of the commercial banks have not kept pace with reductions in the other rates. The average lending rates, since the beginning of the year have been revised downward by 0.61 percentage points to 32.1 per cent and in the range 23.6 – 39.9 per cent.



Generally, interest rates declined along the full spectrum of the yield curve of the treasury bill market. 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 3-year fixed rate bond also fell by 4.0 percentage points to 14.9 per cent.

The forecasts at the last MPC meeting in February 2010 showed a centre of 12.9 percent for



Q1-2010. At 13.3 percent there was a deviation of 0.4 percentage points from the central point and well within the target range of 11- 15 percent that was envisaged for the first quarter of 2010. The bank staff projects that the second quarter will see inflation within 9 – 11 percent. With expected continued disinflation, inflation should be well within target by June 2010.. The baseline forecasts shows a small rise in inflation thereafter but overall inflation is likely to stay within the target range for the year. Under the program for the year inflation is projected to be within 7-11 percent by the end of the year. Policies would have to be reinforced to keep inflation within target.

Assessment of Risks to CPI Inflation

Although uncertainties exists, the risks to inflation are on the downside at this stage. Support to the disinflation process should come from stable food prices, stable import prices stemming from an appreciated currency and stable monetary aggregates.

First, developments in key macroeconomic indicators show some stability. Inflation has stabilised, exchange rate volatility has reduced sharply, short–term interest rates are trending down and consolidation in the fiscal balances is still on-going , all supportive of a disinflation process.

Second, monetary and fiscal policies are still working together to constrain aggregate demand pressures in the economy. Indicators like credit to the private sector, household consumption (measured through VAT collections) and the earlier sharp depreciations of the currency have all played out to constrain aggregate demand and should help exert downward pressures on prices.

However, there are uncertainties surrounding the projections in the FAN CHART.. Some of the potential upside factors are :

- Electricity tariff Increases and its impact on consumer prices poses a risk in the outlook. This has been tentatively put on hold but its implementation is imminent

- Uncertainties have been heightened about the direction of crude oil prices on renewed optimism in the US economy which is fuelling demand for crude, thus pushing prices upwards. In the first week of April 2010 prices have jumped close to US$85 per barrel (12 percent increase since the beginning of the year). The world economy is still not sure at this stage whether the recovery is broad-based.

- First round impact of the increases in road tolls announced in the first quarter of the year have gone through the CPI numbers. Transportation costs increased in the event somewhat. The second round effects may be working its way through the system but this can't be gauged accurately at this stage.

- There is also potential wage pressures in 2010. There have been some initial signs of organized labour demanding pay increases. The implementation of the single-spine salary structure poses a risk as it has a lot of budgetary implications. This will have to be managed.

- Also on the fiscal, arrears relating to outstanding commitments by governments will have to be managed so as to minimize its impact on the financial program

The upside risks to inflation are mainly from two main sources; impact of crude oil prices as a result of the recovery in global economy and fiscal concerns. The downside risks on the other hand is coming from low aggregate demand pressures, appreciating exchange rate, well anchored inflation expectations, slowdown in the world economy and its implications for lower crude oil prices and government's intervention policies.The overall risks to inflation will depend on how these opposing factors will play out in the near-to-medium term.

The Outlook for GDP Growth

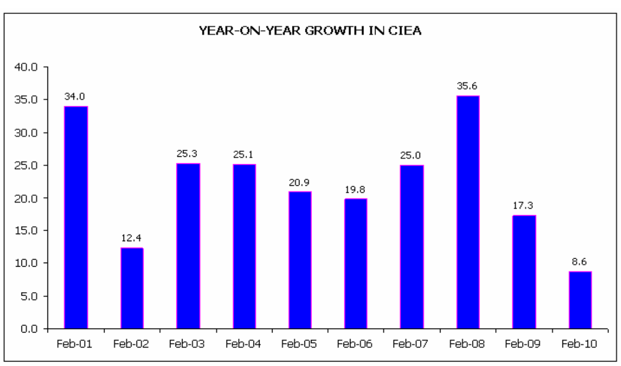
The risks to growth are still on the downside. The observed rebound in economic activity in the last quarter of the year lost steam in the first two months of 2010 with the index declining in real terms by 11.3 percent..

New information on the CIEA for the first two months of the year indicate that the rebound in economic activity observed during the last quarter of 2009 may have been associated with the christmas festivities which is normally characterised by brisk economic activity. After recording an increase in the Composite Index of Economic Indicator (CIEA) in the last quarter of 2009, the CIEA declined in nominal terms. The index level which stood at 563.1 as at vthe end of December 2009 declined to 507.7 by the end of February 2010, representing a decline of 9.7 percent.

Nominal Trends in the CIEA

Data up to the end of the February, 2010, point to a fairly weak real sector performance from the levels recorded in the first two months of the previous year, 2009. The data shows that the first two months of 2010 saw a CIEA decline in nominal terms by 9.7 percent compared with a decline of 0.7 percent observed for the first two months of 2009. The contraction in the CIEA relative to the same period in 2009 was exerted by the following sectors which continued to witness significant slowdown; weak consumer demand (proxied by benchmark retail sales), employment prospects, income from tourist arrivals and VAT collections (a proxy for consumer consumption) are some of the indicators that exerted a downward influence on the index in the first two months of the year.

In year-on-year terms, the growth in the level of economic activity was about half the tempo



observed for the corresponding period of 2009. While the year-on-year growth of economic activity increased by 17.3 percent in 2009, a decelerated in the growth was observed, dropping significantly to 8.6 percent for the review year of 2010. This decline marks two consecutive period od decline since February 2008 when the index was recorded to be growing at 35.6 percent.

Other Indicators of Economic Activity

Other indicators of economic activity monitored by the Bank of Ghana, which provides an indication to future economic activity were however encouraging. Motor Vehicle Registration for example, rose by 24.9 per cent (26,226 vehicles) during the first two months of the year 2010 , compared with the 8.8 per cent fall in vehicles registration recorded over the same period of 2009.

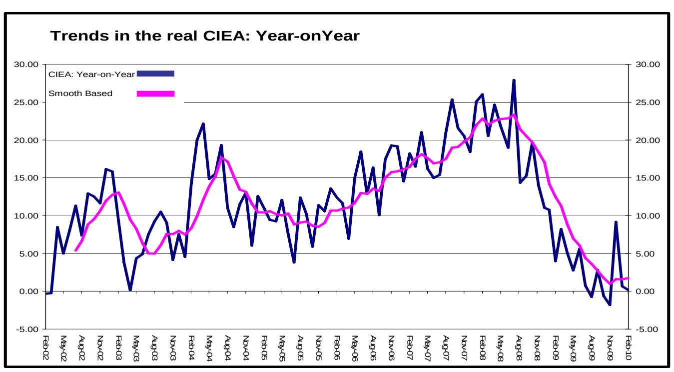
Advertised Job vacancies, a leading indicator of future economic activity and an indication of firm's intention to hire employees, for the first two months of the year was significantly higher than trends observed a year earlier in 2009. Cumulatively, for the period January to February 2010, a total of 5,986 jobs were advertised, compared with 3,912 for the same period in 2009, representing an increase of 53 per cent in year-on-year terms.

Imports of Capital and Intermediate Goods

Capital and intermediate goods are important indicators are indicators of future economic activity and output growth in the economy. Capital and intermediate goods (adjusted for oil imports) increased marginally by 0.9 percent in the last quarter of 2009. However when viewed over the same period in 2009, imports of capital and intermediate goods declined by as much as 27 percent.. The decline came mainly from 4 categories; primary inputs for the food and beverage industry, general supplies to heavy industrial concerns, parts and accessories necessary for the transportation sector as well as intermediate inputs for the processing industry.

Real Trends in the CIEA

In real terms, the index, which is also 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.

Business and Consumer Confidence

The latest in the periodic surveys carried out by the Bank of Ghana to gauge sentiments of businesses and consumers produced 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.

Conclusions

In sum, prices developments in the first quarter of the year indicate that inflation continues to decline and at 13.3 percent, inflation is 2.1 percentage points above the target range of 7.2 -11.2 per cent for 2010. The impact of the appreciating currency on import prices, stable monetary aggregate conditions and constrained aggregate demand posture should work together to reinforce the process of disinflation over the year. The outlook for inflation is for continued decline towards the target range. The forecast suggests that inflation will continue to ease steadily in the second quarter of the year beyond which it will stabilize.

The risks to growth are currently on the downside. Most indicators of real sector activity have not been encouraging. The pace of economic activity, as captured by the CIEA has slowed down drastically. Retail sales and import VAT collections (which are partial indicators of consumer spending) were below expectation and real credit to the private sector has also declined significantly.