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Introduction

The last quarter of the year saw continued turmoil in international financial markets, the onset of recession in industrial countries and its effects on the global economy. The crisis has seen the collapse of major financial institutions, highly volatile stock markets, considerable re-alignment on the currency markets resulting in sharp fluctuations in exchange rates and sharp reversals in capital flows. Diminished investor appetite and lost confidence in counterparty trading countries prevail for fears of exposure to toxic assets and general contagion. Governments and Central Banks have had to embark on fiscal stimulus programmes in an effort to shore up aggregate demand and consumption, along with coordinated interest rate cuts by major central banks in the industrialized countries.

The commodities market, have seen sharp falls in the prices of most metals and commodities. From Ghana's point of view, the last quarter of the year saw the prices of gold and cocoa decline by 4 percent. The average price of gold which stood at US$889.5 per fine ounce at the end of the third quarter declined to US$857 by the end of December 2008 and then to US$835 by the end of January 2009. The average price of cocoa has also declined from US$2671 per tonne to US$2552 per tonne during the last quarter and has decreased slightly in the month of January 2009 to US$2477. Crude oil prices which reached its peak of US$147 dollars per barrel in July 2008, fell to around US$40 per barrel at the close of the year, declining by close to 60 percent. Prices have since moved up slightly to around US$45 per barrel by the end of January 2009. The decline in crude oil prices and the continued relatively firm gold and cocoa prices have shifted the terms of trade positively in Ghana's favour.

Within the context of growth, 2008 is expected to remain fairly on track with real GDP estimated at between 6-7 percent. The Ghanaian economy has been little affected to date by the turmoil. The assessment of growth potential for 2008 is derived mainly from trends derived in the Bank's Composite Index of Economic Activity (CIEA) and other macroeconomic indicators. The index showed a steady growth in economic activity into the fourth quarter of 2008 with a year on year growth of 21.1 percent. This growth is being driven by exports, expansion of credit to the private sector, industrial consumption of electricity, imports of intermediate and capital goods as well as high levels of consumption of goods and services. Also, firms' revealed intention to hire labour, derived from job vacancy advertisements placed in the Daily Graphic, recorded a strong growth for the 12-month period to December 2008. It posted a growth of 35.3 percent over the December 2007 level. However, the latest February survey point to signs of softening consumer confidence at the close of last year, and carried over into the year. Both businesses and consumers have strong and positive expectations about the prospects for the economy going into 2009.

Against the backdrop of these developments, the last quarter witnessed increased volatility in the foreign exchange market. Developments in the nominal bilateral exchange rates of the cedi to the three core currencies – US dollar, the pound sterling, and the euro – show that for the year, the cedi depreciated cumulatively against the US dollar and the euro by 22.9 and 19.1 percent respectively. The cedi however, appreciated by 7.1 percent against the pound sterling. Much of the volatility in the foreign exchange market occurred in the last quarter of the year and in January 2009.

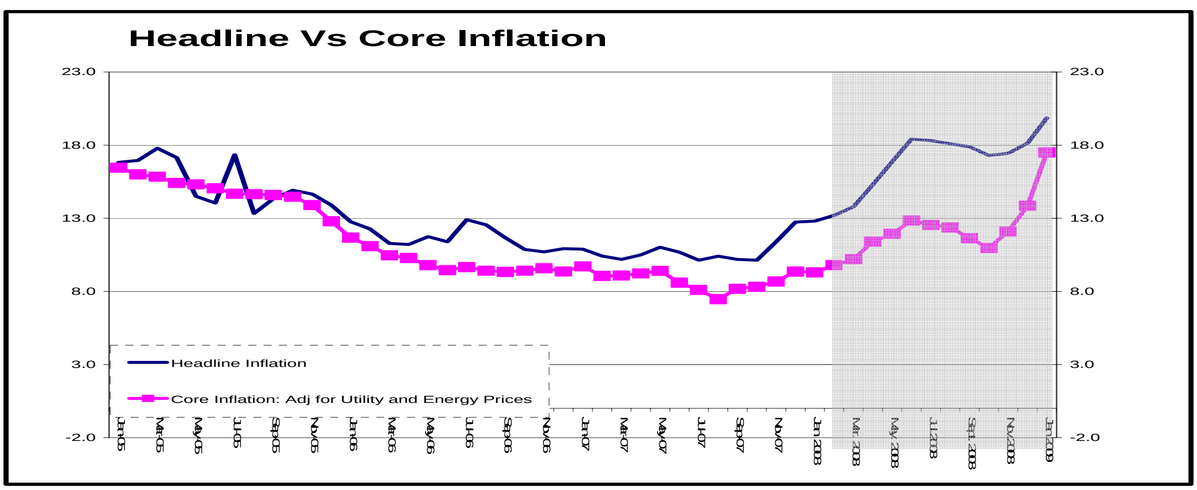
Domestic Price Conditions

Inflation remained relatively flat during the last quarter of the year. It moved marginally from 17.9 percent to 18.1 percent. The slight increase in inflation was driven by movement in non-food prices. Non-Food inflation which stood at 16.5 percent at the end of the third quarter, moved to 17.1 percent by the end of December 2008. The growth in food prices however slowed down during the period, moving from 17 percent to 16.7 percent (table 1).

Table 1: Overall Inflation, Food Inflation and Non-Food Inflation										
	Dec-05	Dec-06	Dec-07	Mar-08	Jun-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09
Overall Inflation Rates	**14.2**	**10.9**	**12.7**	**13.8**	**18.4**	**17.9**	**17.3**	**17.4**	**18.1**	**19.9**
Food Inflation	**14.3**	**7.5**	**10.5**	**13.0**	**17.7**	**17.0**	**15.0**	**15.8**	**16.7**	**19.4**
Non-Food Inflation	**13.6**	**13.5**	**14.4**	**14.4**	**18.9**	**18.5**	**18.9**	**18.6**	**19.1**	**20.2**

For the year as a whole inflation registered an increase of 5.4 percentage points. The rate of inflation which was reported at 12.7 percent at the beginning of the year, surged significantly to 18.4 percent by June 2008, eased slightly to settle within a narrow range around 18 percent through the third quarter, ending the year at 18.1 percent. A disaggregation of the components of the consumer basket showed that food prices increased at a faster pace than non-food prices. Food inflation which stood at 10.5 percent at the end of December 2007 jumped up to 16.7 percent mainly on account of the world food and energy crises and the pass through to domestic prices. Domestic fuel price increases during the first half of 2008 added to costs associated with distributing food to the major food centres across the country. Non-food inflation increased from 14.4 percent to 19.1 percent.

In January 2009 inflation moved up further to 19.8 percent on account of both food and non-food prices. Sharp increases were observed in some of the non-food category of the inflation basket. The increased inflation was the combination of an increase in food inflation to 19.4 percent and an increase in non-food inflation to 20.2 percent.



Core inflation increased steadily during the past three months with the sharpest increase observed in January 2009. This measure of inflation (which excludes energy and utility), stood at 13.9 percent by the end December 2008 and surged to 17.5 percent by the end of January 2009. The reading in October was 13.5 percent. The increase in the core since September 2008 has been driven by items like household goods and equipment, health expenses, hotels cafes and restaurants and alcoholic beverages

Sectoral Inflation Rates

Profile of the annual rates of inflation up to January 2009 is shown in table 2. Sectors including the alcoholic beverages and tobacco, clothing and footwear, imported household goods and equipment, entertainment and hotel charges contributed significantly to the rise in inflation.

Table 2: Sectoral inflation Rates (percent)

	Relative Importance	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Jan-09	Absolute Change in Inflation: Sep-08 to Dec 2008	Dec-07 to Dec 2008	Dec-08 to Jan 2009
Overall Inflation	100.0	12.8	13.8	18.4	17.9	18.1	19.9	0.2	5.4	1.7
Food & Non-Alcoholic Beverages	44.9	10.5	11.23	17.7	17.0	16.7	19.4	-0.3	6.2	2.7
Alc. Beverages and Tobacco	2.2	8.4	10.09	14.4	16.3	23.0	32.0	6.7	14.6	9.0
Clothing & Footwear	11.3	5.9	6.65	12.8	13.5	16.9	17.6	3.4	11.0	0.7
Housing and Utilities	7.0	22.6	17.11	19.1	21.4	9.8	7.3	-11.6	-12.8	-2.5
Household Goods and Equipment	7.8	10.1	12.91	18.2	17.0	22.2	27.6	5.2	12.1	5.4
Health	4.3	26.0	20.84	21.5	13.7	25.0	39.5	11.2	-1.1	14.6
Transport	6.2	21.5	23.19	29.1	22.4	11.0	2.1	-11.4	-10.4	-8.9
Communications	0.3	6.2	6.08	0.0	0.0	1.6	1.6	1.6	-4.6	0.0
Entertainment	3.0	9.9	11.32	11.8	16.1	17.2	37.4	1.2	7.3	20.1
Education	1.6	13.3	14.59	19.6	19.3	16.0	17.0	-3.3	2.7	1.0
Hotels, Cafes and Restaurant	8.3	14.6	15.27	22.2	21.3	34.5	36.7	13.1	19.8	2.3
Miscellaneous	3.0	10.4	11.99	11.9	12.1	17.1	14.5	5.0	-5.4	-2.6

These sectors again in addition to price increases in the health sector dominated the headlines in January 2009 as they pushed up inflation further to 19.8 percent.

Core Measures of Inflation

Summary of movements in all the core measures of inflation estimated by the Bank of Ghana is reported in table 3:

Table 3: Measures of Core Inflation

Inflation Measures	Dec-06	Dec-07	Mar-08	Apr-08	May-08	Jun-08	Sep-08	Dec-08	Jan-09
CPI	10.9	12.7	13.8	15.3	16.9	18.4	17.9	18.1	19.9
CPI excl. energy and utility	9.4	9.4	10.2	11.4	11.9	12.8	11.6	13.9	17.5
CPI ex. Energy and utility and selected volatile food items	8.1	10.3	9.8	10.9	11.8	12.2	11.2	12.9	15.8
CPI ex. Energy and utility, selected volatile food items and Transportation	8.9	9.1	8.8	9.8	10.7	11.1	10.5	13.3	17.3
CPI ex. All Food items and Energy and Utility	7.3	3.1	4.1	4.6	4.8	4.6	4.2	5.8	8.1

The highlights of movements are as follows:

a. CPIXEUF, the measure of the core inflation, estimated by excluding price changes of energy and utility and selected volatile food items was estimated at 15.8 percent by January 2008. It closed the year at 13 percent.

b. CPIXEUFT, CPI inflation derived by excluding Energy &Utility, selected volatile food items and transportation costs was at 13.3 percent by the end of the year 2008. It accelerated to 17.3 percent by the end of January 2008.

c. CPIXF (The all items CPI excluding price change effects of all food items in addition to energy & utility): This measure of core inflation went up from 4.2 percent at the end of the third quarter to 5.8 percent by the end of December 2008. It accelerated further by 2.3 percentage points to 8.1 by January 2009.

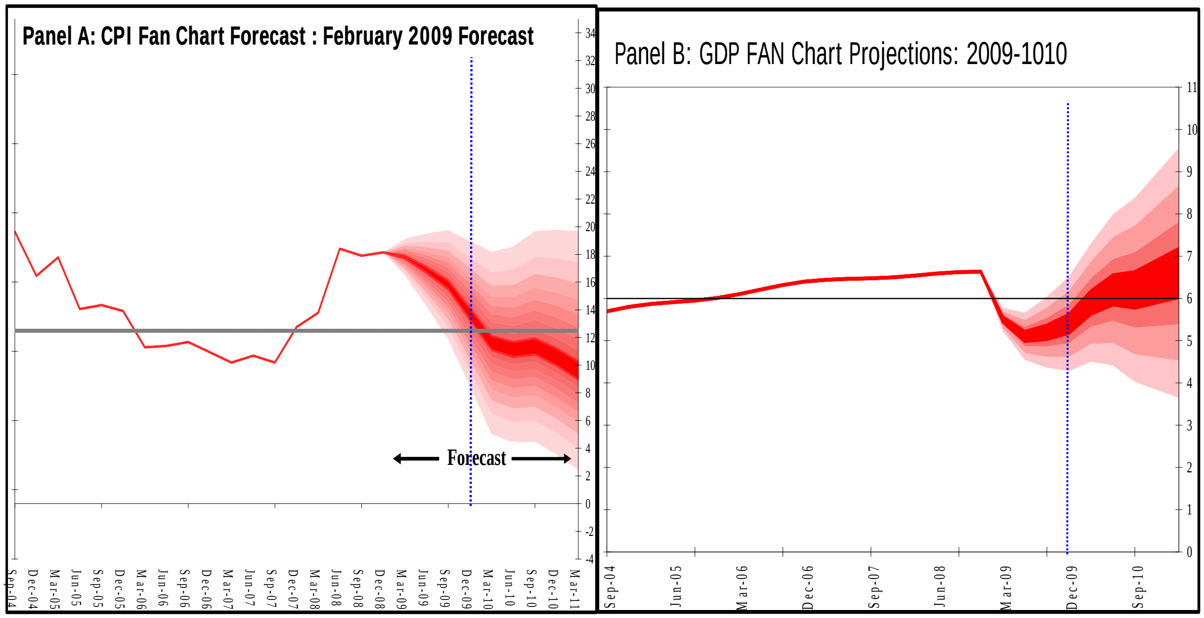
Inflation Outlook

Inflation remained relatively stable during the last quarter of 2008 within a tight range of 17.9-18.1 percent. Interest rates also remained stable during the last quarter following a steep rise in the third quarter. At the same time crude oil prices retreated sharply and traded within the range of US$40-45 per barrel. The significant drop occurred in the midst of a weakened demand associated with the weakened global economy. At the last policy meeting in October 2008 uncertainty surrounded the depth and duration of the recession and its impact on the global economy. This has since turned into a deep recession in advanced and emerging market economies, with possible impact on developing countries including Ghana.

Different countries have responded differently to these crises. Countries with enough fiscal space are resorting to stimulus packages to counter output and employment losses while other countries are using a combination of macroeconomic and structural policy tools to contain the downturn. In Ghana, a combination of expansionary fiscal policies underlined by sharp increases in capital expenditure, fiscal cost of energy subsidies, rising wages and salary bill and rapid demand and GDP growth has resulted in wider fiscal and external current account deficits. The effects of these fiscal stimuli are still working through the system. In the event, inflationary pressures have remained elevated, core inflation has risen steadily since October 2008 (estimated at 17.5% in January 2009) and the local currency has fallen at a much faster pace relative to trends observed over the past five years.

Tight monetary policy alongside fiscal contraction will be needed to break this incipient dynamics of price inflation and exchange rate expectations, and as well withdraw some stimulus from the economy and to reinforce the anchor for inflation expectation and stability.

The outlook for 2009 is for an unwinding of the fiscal and external current account imbalances. Projected oil price developments should be a stabilizing factor. The terms of trade (driven by cocoa and gold prices) remain relatively firm, with the risk on the downside given uncertainty about the depth and duration of the global recession and the speed of transmission of its effects on to the domestic economy. GDP is likely slowdown a bit in 2009 on account of slowdowns in export proceeds, remittances as well as imports of intermediate and capital goods. These factors are some of the downside risks and threats to output generation in the Ghanaian economy. Given the appropriate mix of policies output growth could be in the range of 5-6 per cent in 2009 (see panel B). 2009 is likely to witness some pass through of the slow down in the world economy to the domestic economy.



Against this background and revised assumptions about the world economy and the subsequent pass through of the relatively rapid exchange rate depreciation, headline inflation is expected to rise and peak early in the second quarter of 2009. Thereafter, inflation is expected to steadily decline during the second half of the year to between 10-13 percent by the end of the year (see Panel A). Over the horizon to 2011 (panel A), inflation is expected to move towards 10 percent in the fourth quarter of 2010 and in the single digit range in early 2011.

As always, there are uncertainties surrounding these projections and these are varied including: the behaviour of crude oil prices which has shown greater volatility in recent months, global inflation and its impact on import prices, the extent of the impact of the recession on commodity terms of trade, and the developments in the central government budgetary operations.