



BANK OF GHANA

Monetary Policy Report

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Inflation Outlook and Analysis

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Overview of World and Domestic Economic Developments

The global economy is recovering but at a slower pace while on the domestic scene inflation which dropped to 8.6 per cent in December 2010 increased to 9.1 percent in January 2011 on account of higher international crude oil prices which were passed on through domestic petroleum price increases. The domestic economy continues to record increased tempo in economic activity relative to the pace observed a year ago.

Global GDP is expected to slow down in 2011 from a growth rate of 3.9 percent recorded in 2010, to 3.3 percent. In the industrialized economies growth is expected to remain weak and not enough to bring down the high rates of unemployment; it is expected to fall marginally from 2.8 percent observed in 2010 to 2.4 percent in 2011.

In Asia and emerging market economies, challenges of how to avoid overheating and issues associated with strong capital inflows were at the heart of most policy debates. Inflationary pressures were beginning to mount in these economies and there were signs of overheating, driven in part by strong capital inflows. The projection by international forecast institutions is that the upward pressure on global prices is expected to persist in 2011, due to continued robust demand and a sluggish supply response to tightening market conditions.

Also, within the West African Sub-region, the countries of the West African Monetary Zone (WAMZ) economies recorded fairly robust growth rates and improved economic outcomes during 2010. Economic performance remained robust within the WAMZ countries and output turned out stronger at 7.2 percent in 2010 compared to the 4.5 percent recorded for Africa as a whole. Inflation pressures dampened and was projected at 11.3 percent at the end of 2010, down from 12.3 percent at the end of 2009.

With respect to commodity prices the global stage witnessed strong commodity price appreciation with record high crude oil prices, on the back of strong demand and weak dollar. Demand effects from severe winter conditions on Europe, US and Asia and geo political

tensions in the Middle East are expected to further deliver stronger commodity prices. Food inflation, which has been on the upsurge in many economies, is posing a threat of resurgence of global inflation with inflation rising above targets in most economies. As a result, crude oil prices have surged to as high as over US\$100 per barrel and with continued re-alignment of major currencies in the world international market.

On the domestic economy the following conditions have existed since the last Monetary Policy Committee Meeting:

- [1] Efforts on the part of government to implement some of the details of the revenue measures outlined in the 2011 Budget Statement that was read in November 2010
- [2] In January 2011, the National Petroleum Authority (NPA) announced an average price increase of 30 percent on petroleum products and this was in line with increasing price trends of crude oil on the international market. Also the NPA in February, at a press conference, indicated that domestic petroleum prices could go up further by the end of the first quarter if the geo-political tensions in the Middle East continued to exert upward pressures on crude oil prices
- [3] The Public Utilities and Regulatory Commission (PURC) also indicated the introduction of its automatic tariff adjustment formula for water and electricity. The formula saw some marginal declines in the tariffs charged for certain sectors of the economy.
- [4] Compared with trends a year ago, the economy witnessed a relatively faster pace in the depreciation of the currency attributed to unusually large demand for foreign exchange. Since the last meeting in November 2010 to January 2011, the Ghana Cedi depreciated in value by almost 6 percent compared with a depreciation of 0.02 percent for the similar period in 2010.
- [5] The Ghana Statistical Service (GSS) has released two readings of CPI inflation since the last Monetary Policy Committee meeting in December 2010. Inflation, which stood at 9.1 per cent in November 2010, eased considerably to 8.6 percent in December 2010 but reverted to 9.1 percent in January 2011, mainly on account of the 30 percent increase in the prices of petroleum products announced in the first week of January which has been

passed through to transportation costs. Food inflation which stood at 5.3 percent in November 2010 also dropped to 4.5 percent in December 2010 and then picked up to 4.8 percent in January 2011. Non-Food inflation followed a similar pattern, falling from 11.5 per cent to 11.2 percent in December and then moved to 11.8 percent in January 2011.

- [6] Details of the consumer price basket revealed that out of the 12 different subcomponents, the Housing & Utilities and the Transportation sectors recorded significant jumps in inflation. Within the Housing & Utilities sub-sector for instance, inflation which stood at 3.8 percent in January 2009 jumped up to 14.8 per cent by January 2011. Similarly, the transportation sector's inflation which stood at 18.4 percent in January 2009 and which had dropped to 2.6 percent by the end of December 2010, increased significantly to 19.4 percent. With the exception of the alcoholic beverage & tobacco sector which attained an inflation rate of 19.3 percent, the remaining 9 sub-sectors recorded moderate inflation rates, ranging between 4.8 – 11.2 percent.
- [7] Underlying inflation also known as core inflation (and defined to exclude energy and utility) however increased marginally by 10 basis points, moving from 8.0 percent at the end of December 2010 to 8.1 percent in January 2011.
- [8] Observed some increased momentum in the pace of economic activity. In year-on-year terms, the Bank of Ghana's Composite Index of Economic Activity (CIEA) registered a growth of 10.5 per cent in 2010 compared to 9.6 per cent in 2009. Credit to the private sector, Industrial activity, construction sector activity, and sales of key manufacturing establishments were some of the sectors that contributed to the increase in the index relative to the pace observed a year ago.
- [9] Consumer and Business sentiments moved in opposing directions at the latest survey round conducted in January 2011. While that for consumers softened, confidence went up in the case of businesses. The latest survey suggest that uncertainty about developments in crude oil prices, volatility in the foreign exchange market and the first round effects of the recently announced petroleum price hikes contributed to the softening of consumer sentiments. However, optimism about general economic prospects, realization of

expectations and company's prospects contributed significantly to the positive assessment of businesses.

- [10] Latest credit conditions survey conducted by the Bank of Ghana in January 2011 shows that access to credit continued to improve. Commercial Banks eased credit conditions for both small and medium sized and large enterprises through reductions in margins on average loans and increased size of credit. The survey points to an overall improvement in credit conditions for both households and enterprises. However, the survey also revealed that credit conditions for mortgages continued to be tightened through additional collateral requirements.
- [11] The merchandise trade deficit for 2010 increased to US\$ 2.8 billion from the US\$ 2.2 billion deficit recorded in 2009. The developments in the trade account resulted in a deficit of US\$2.6 billion in the current account compared to the deficit of US\$1.6 billion recorded in 2009. With a surplus of US\$4.2 billion registered in the Capital and Financial Account an overall Balance of Payments surplus of \$1.5 billion was recorded in 2010 compared with a surplus of US\$1.2 billion in 2009.
- [12] As a result of the improvements in the external sector for 2010, the Gross International Reserves of the Bank of Ghana grew from US\$3.2 billion at the end of 2009 to \$4.7 billion. The reserve level at the end of 2009 represented approximately three (3.0) months of imports cover compared to 3.7 months of import cover achieved at the end of 2010.

Outlook for Inflation

During the last quarter of 2010 CPI inflation declined by 1.5 percentage points and bumped up in January 2011 on account of a 30 percent rise in the price of petroleum products. The outlook is for slight inflationary pressures but not enough to significantly shift inflation out of the target band of 7-11 percent by the end of 2011.

Inflation performed better than target turning in at 8.6 percent at December 2010 compared with the target of 9.2 percent set at the beginning of the year. The thirty percent petroleum price increase and an average of fifteen percent increase in transportation costs affected the disinflation process in January 2011, resulting in a rise in inflation of 50 basis points. Similarly, the core measure of inflation registered an increase of 10 basis points. Detailed subcomponent inflation analysis suggests that food and transportation costs were the main factors that exerted upward pressure on inflation in January 2011. Second round effects of the petroleum price hike

is expected to filter through the basket in the next two to three months with moderate inflationary pressures. The expectation is that inflation will stay below 10 percent by the end of June 2011, before the onset of the food bumper season.

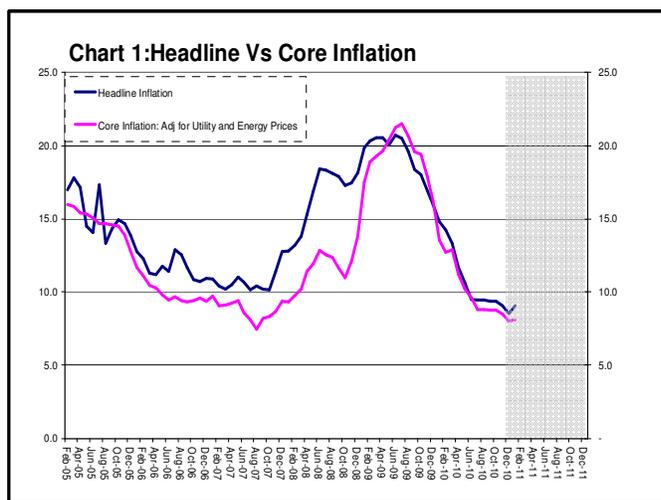
Table 1: Contribution of Sub-Groups to Consumer Price Inflation

	weights	Inflation Rates					Absolute Change		
		Dec-09	Jan-10	Sep-10	Dec-10	Jan-11	Dec-09 to Jan 2010	Sep-10 to Dec 2010	Dec-10 to Jan-11
Overall Inflation	100.0	16.0	19.9	9.4	8.6	9.1	3.9	-0.8	0.5
Food & Non-Alcoholic Beverages	44.9	11.8	9.1	5.7	4.5	4.8	-2.8	-1.2	0.3
Alc. Beverages and Tobacco	2.2	22.2	14.5	19.4	20.4	19.3	-7.8	1.0	-1.1
Clothing & Footwear	11.3	18.5	20.2	14.8	14.1	11.2	1.7	-0.6	-3.0
Housing and Utilities	7.0	1.7	3.8	15.6	15.1	14.8	2.1	-0.5	-0.3
Household Goods and Equipment	7.8	29.0	24.6	10.5	11.1	9.9	-4.5	0.6	-1.2
Health	4.3	33.2	21.3	11.0	11.1	9.2	-11.9	0.1	-1.9
Transport	6.2	10.5	18.0	2.8	2.6	19.4	7.5	-0.2	16.8
Communications	0.3	4.5	4.5	0.0	0.0	0.0	0.0	0.0	0.0
Entertainment	3.0	87.0	59.9	8.8	7.1	6.8	-27.1	-1.8	-0.2
Education	1.6	3.0	2.0	1.1	1.0	0.9	-1.0	-0.2	-0.1
Hotels, Cafes and Restaurant	8.3	17.7	20.1	15.7	15.0	10.3	2.4	-0.8	-4.6
Miscellaneous	3.0	6.7	9.5	10.7	11.0	10.9	2.8	0.3	-0.1

Along the declining path of headline inflation in the last quarter of 2010, the core measure of inflation, which excludes energy and utility price changes, also eased. Between the end of the third quarter and the fourth quarter of 2010, core inflation went down by 80 basis points moving from 8.8 percent at the end of September 2009 to 8.0

percent by the end of December 2010. Headline inflation over the same period declined by 50 basis points (see chart1).

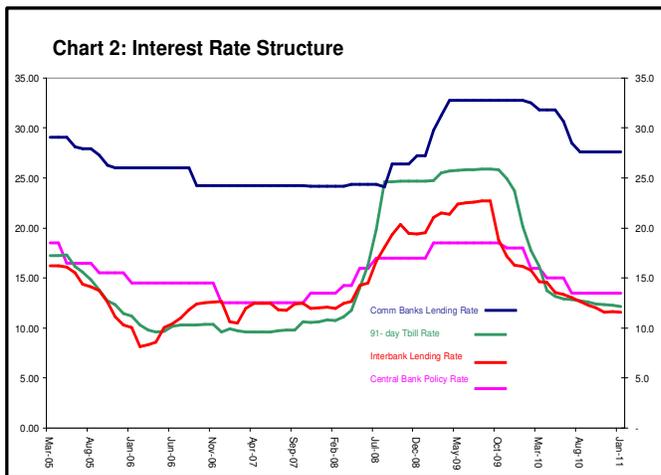
At the December 2010 meeting, the Monetary Policy Committee maintained the policy rate



at 13.5 percent explaining that, the recovery in economic activity and the counterbalancing effects of the risks in the outlook for inflation were the main influence in its decision. Since that meeting, inflation has gone up slightly and the exchange rate has depreciated relatively faster. However, interest rates along the spectrum of the yield curve continue to decline, though

marginally. Between November 2010 and January 2011, the 91-day Treasury bill rate declined from 12.32 percent to 12.15 percent while the 2-year fixed rate note also dropped from 12.75 percent to 12.55 per cent. While all the other rates have converged -within the range of 11.5-13.5 percent, the average lending rate remained virtually unchanged at 27.6 percent by December 2010 (chart 2).

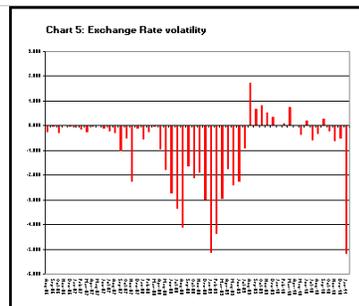
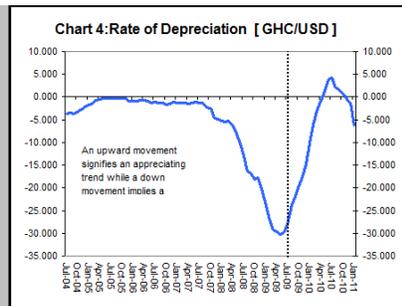
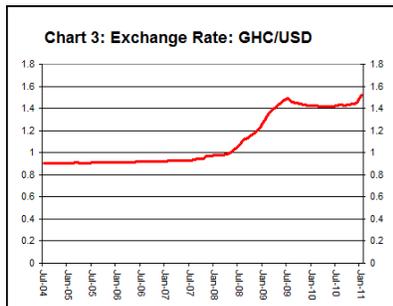
Information on the latest credit conditions survey conducted by the Bank of Ghana in January 2011 shows that access to credit continued to improve. Commercial Banks eased credit



conditions for both small and medium sized and large enterprises through reductions in margins on average loans and increased size of credit. The survey points to an overall improvement in credit conditions for both households and enterprises. However, the survey also revealed that credit conditions for mortgages

continued to be tightened through additional collateral requirements. It is the broad expectation that further easing in the lending rates would result in increased momentum in overall economic activity and foster a steady growth in output.

Between November 2010 and January 2011, the movement of the Ghana cedi against the other major currencies was characterised by some excessive volatility, reflecting unusual higher seasonal demand for foreign exchange. This volatility has since subsided. Over the horizon portfolio investments flows into the economy, relatively higher interest rates and expected flows accruing to petroleum revenues should help ease pressure on the cedi considerably.

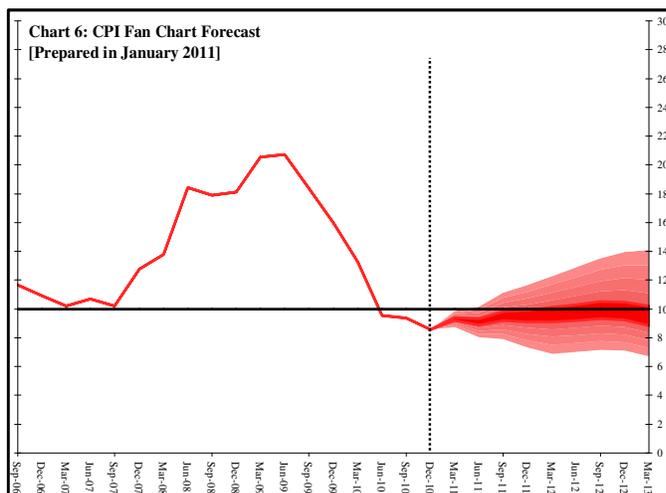


Against the backdrop of these developments, the rate of depreciation of the dollar which stood at 0.3 percent by the end of November 2010, depreciated further by 3.1 percent by end December with a further of 5.1 percent in January 2011.

Against the Pounds Sterling and the Euro the respective appreciations recorded in November 2010 was 18.6 and 13.5 percent while appreciations of 2.0 and 5.7 percent were recorded for December 2010. In January 2011, depreciations of 1.6 percent and 3.2 percent were recorded

against the Pounds Sterling and the Euro. For the same period in January 2010, the comparative depreciation of the Ghana Cedi against the pound sterling and the euro were 20.7 and 15.6 per cent respectively.

The observed shifts in the movement of the Ghana cedi against the three core currencies resulted in a nominal effective appreciation of 1.5 percent in trade-weighted terms over the December 2009 – December 2010. This compares with a nominal effective depreciation of 9.2 per cent over the corresponding period in 2009.



The inflation outturn for December 2010 was within the target range of 7.2 – 11.2 percent. At 8.6 percent, the December 2010 inflation was slightly below centre of the target of 9.2 percent. The central path of the FAN CHART expected inflation shows a fall by 2.4 percentage points to bring the end 2010 inflation within the 7.2-11.2 percent target band. At 9.1 percent for

January 2011, inflation is currently 60 basis points above the end 2011 target of 8.5 percent. The Fan Chart forecast shows that under baseline conditions, a small rise in inflation during the first half of the year will be experienced. This will however not be enough to shift the path significantly above target. Inflation is thus expected to be within the range of 9-11 percent by the end of 2011.

Assessment of Risks to CPI Inflation

The risks to inflation are tilted slightly on the upside at this stage and this is being exerted mostly by external influences. A variety of factors account for the tilt in the risks and these are:

First, developments in key macroeconomic indicators point to stability; short term money market rates though stable in nature continue to decline marginally, observed continued investor interest in the economy, strong build-up in gross reserves and continued measures aimed at

consolidation in the governments' fiscal balances are all supportive of a general macroeconomic stability.

Secondly, monetary and fiscal policies have worked in concert throughout 2010 and delivered an inflation rate at the end of 2010 close to the target of 8.5 percent. While some elements of continued disinflation is still at play, the first quarter of 2011 is likely to witness some fair amount of inflationary pressures coming mainly from the first and second round effects of the petroleum price adjustments that were announced in January 2011.

Real sector activity is beginning to pick up strongly relative to conditions that existed in 2010. Indicators like credit to the private sector, sales of some key manufacturing concerns, construction activity, imports and exports have all picked up modestly. Though significant, VAT (which captures consumer demand for goods and services) is still below trend, indicating that aggregate demand pressures to inflation may not be that severe at this stage.

However, there are uncertainties in the outlook which have a potential to affect the disinflation process and impact - inflation on the upside:

- The extent of the impact of the second round effects of the petroleum price is uncertain at this stage. The first effect seem to have filtered through consumer prices and the next impact will be determined to a large extent by how business will factor the impact in their pricing
- The evolving geopolitical tensions in North Africa and the Middle East and crude oil price implications. The National Petroleum Authority has given indication of further price adjustments if prices of crude oil on the international market continue to rise.
- The recent fast paced exchange rate depreciation should also be a concern in the outlook. Its impact on Non-Food Inflation will have to be watched in the next few months.
- Also, preliminary indication is that 2010 ended with a somewhat broad budget deficit of around 11.5 percent of GDP. The Monetary and Exchange rate implications of this excess deficit may have to be also factored in the outlook.

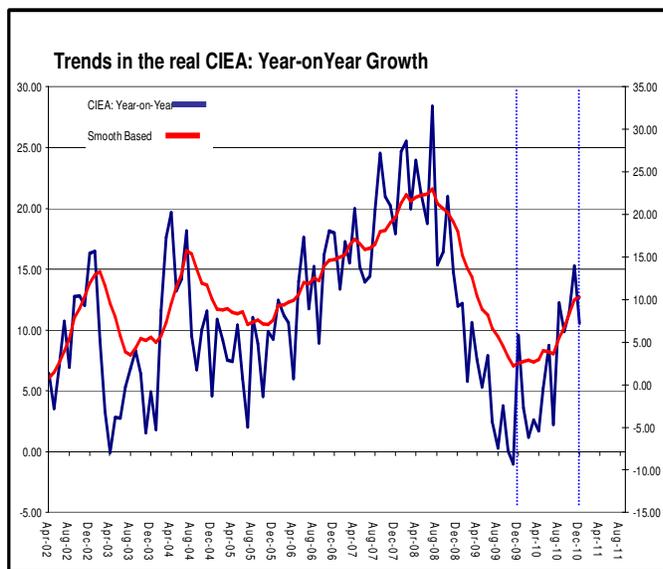
- Then, there is also an emerging world food price rise. The pass-through to domestic food inflation could pose some risk to the inflation profile in the outlook and this would have to be factored in.

The Monetary Policy Committee judges that the upside risks are more than the downside factors and that the counterbalancing effects could result in a slightly elevated inflation profile, but with inflation being within target by the end of the year.

The Outlook for GDP Growth

The risks to growth are on the downside even though output has rebounded judging from information derived from the Composite Index of Economic Activity (CIEA). Current data suggests that economic activity recovered somewhat in the last quarter of 2009 as most of the indicators rebounded.

Data on the CIEA for the last quarter of 2010 show a significant rebound in economic activity. In the fourth quarter the CIEA grew by 9.1 percent compared to a growth of 3.4 percent in the third quarter. In year-on-year terms, however, the Bank of Ghana's Composite Index of Economic Activity (CIEA) registered a growth of 10.5 per cent in 2010 compared to 9.6 per cent in 2009. Commercial banks' credit to the private sector, industrial activity, level of imports, construction sector activity, tourist arrivals, social security contribution, sales of key manufacturing establishments and port and harbour activity are some of the sectors that contributed to the increase in the index relative to the pace observed a year ago.



Mixed signals were received from the consumer and business survey conducted in January 2011. Sentiments from the two groups of economic agents moved in opposite directions. While that for consumers softened, confidence went up in the case of businesses. The latest survey suggest that uncertainty about developments in crude oil prices, volatility in the foreign exchange market and the first round

effects of the recently announced petroleum price hikes contributed in the softening of consumer sentiments. However, optimism about general economic prospects, realization of

expectations and company's prospects contributed significantly to the positive assessment of businesses.

Other real sector enhancing activities like exports and imports of intermediate and capital goods grew at a healthy pace in 2010, all suggesting fairly brisk economic activity. Combined with the pace of economic activity measured by the tempo in the CIEA, the indication is that the negative output gap that existed in the most part of 2009 may have closed with GDP growth almost close to trend.

Conclusions

The macroeconomic policy mix in 2010 delivered an inflation rate consistent with the country's economic fundamentals and ensured that inflation was on target. Although elements of disinflation is still at play in the economy, there are some emerging risks in the outlook, especially with respect to crude oil price developments that could potentially have an impact on governments fiscal stance and inflation in the short to medium term. These will put some form of pressure on prices in the course of the year. As regards the real sector of the economy, the indication is that real GDP growth may have moved close to trend, with further upward push in 2011. On balance, while growth is expected to pick up significantly in 2011 (on account of oil) a slightly elevated inflation profile could be observed on account of the risks enumerated in the outlook.