BANK OF GHANA

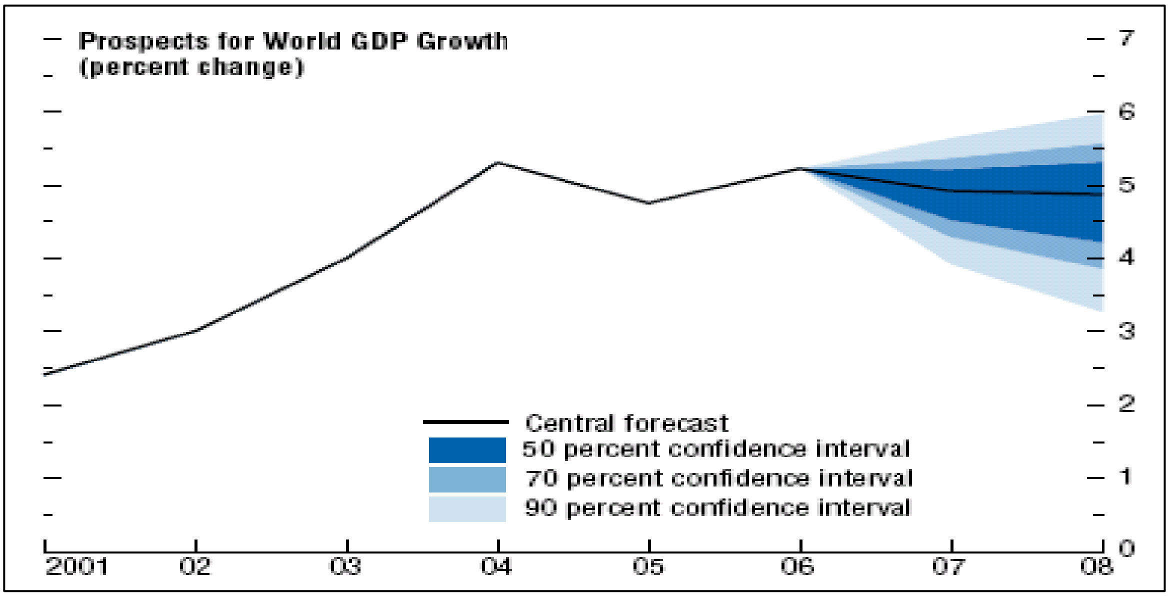
Monetary Policy Report

VOLUME 4 NO. 2/2007 MAY 2007

WORLD ECONOMIC OUTLOOK & EXTERNAL SECTOR DEVELOPMENTS

4.1 The global economy

Notwithstanding the bout of financial volatility in the first quarter of 2007 (2007:Q1), the global economy still looks well set for continued robust growth for rest of 2007 and for 2008.



While the U.S. economy has slowed more than was expected, spillovers have been limited - growth around the world looks well sustained. Global growth is expected to moderate to 4.9 percent in 2007 and 2008, some ½ percent slower than in 2006.

World Real GDP Growth (Annaual % change)				
			Current Proj*.	
	2005	2006	2007	2008
World	4.9	5.4	*4.9*	*4.9*
USA	3.2	3.3	*2.2*	*2.8*
Euro area	1.4	2.6	*2.3*	*2.3*
Japan	1.9	2.2	*2.3*	*1.9*
UK	1.9	2.7	*2.9*	*2.7*
China	10.4	10.7	*10.0*	*9.5*
India	9.2	9.2	8.4	7.8
Sub-Saharan Africa	6	5.7	*6.8*	*6.1*
Ghana	5.9	6.2	*6.3*	*6.9*

*IMF Staff projections

The short-term economic outlook for **Africa** remains positive, against the backdrop of strong global growth, continued progress in cementing macroeconomic stability, beneficial impact of debt relief, increased capital inflows, rising oil production in a number of countries, and strong demand for non-fuel commodities. Real GDP growth is expected to accelerate to 6.2 percent, from 5.5 percent in 2006, before slowing to 5.8 percent in 2008.

4.2 Survey of Monetary Policy stance

The Fed has kept the Federal funds rate on hold since June 2006, seeking to balance risks from a cooling economy and continuing concerns about inflation. Bank of Japan has raised its policy interest rate only very gradually since exiting its zero interest rate policy in July 2006.

	G7 AVG	FED	BOJ	ECB	BOE	BOC	SARB	CBT	BOG
End-2004	2.30	2.25	0.00	2.00	4.75	2.50	7.50	18.00	18.50
End-2005	2.85	4.25	"	2.25	4.50	3.25	7.00	13.50	15.50
End-2006	3.65	5.25	0.25	3.50	5.00	4.25	9.00	17.50	12.50
Jan-07	3.70	5.25	0.25	3.50	5.25	4.25	9.00	17.50	12.50
Feb-07	3.75	"	0.50	"	"	"	"	"	"
Mar-07	3.80	"	"	3.75	"	"	"	"	"
Apr-07	3.80	"	"	"		"	"	"	"
May-07	3.85	"	"	"	5.50	"	"	"	?

FED - US Federal Reserve; BOJ - Bank of Japan; ECB - European Central Bank

BOE - Bank of England; BOC - Bank of Canada; SARB - South African Reserve Bank

CBT - Central Bank of Turkey; BOG - Bank of Ghana

The European Central Bank (ECB), the Bank of England, and other central banks in Europe have continued to remove monetary accommodation in the context of economic buoyancy. Some emerging market countries — including China and India — have tightened monetary conditions in the face of concerns about over-rapid growth and overheating. But overall, inflation outcomes have continued to be favorable.

4.2.1 United States

On 09 May, the Fed kept the policy rate steady at 5.25 percent. This extension of their long pause in policy actions was seen as signaling confidence that the US economy would soon emerge from its soft patch.

Early-May data releases were friendly to the Fed. The core Personal Consumption Expenditure deflator - the Fed's preferred measure of core consumer prices - was flat in March, taking the year-on-year rate from 2.4 to 2.1 percent. The unemployment rate rose by a tenth to 4.5 percent.

In all, the numbers drifted in the right direction. But with the Fed's concern about tight resource use, it will have to see a substantial rise in the unemployment rate before it will be comfortable enough to lower interest rates.

Our view remains that the Fed will not cut rates before 2007:Q3 at the earliest.

4.2.2 Euro zone

The ECB held its key "refi" rate unchanged at 3.75 percent as expected on 10 May 2007, but its chief Jean-Claude Trichet sent clear signals of a further rise in eurozone borrowing costs next month (June). He added that given the favourable economic environment in the euro area, "our monetary policy continues to be on the accommodative side".

Trichet continued that the key ECB interest rates were "moderate, money and credit growth vigorous, and liquidity in the euro area ample by all plausible measures."

"Looking ahead, acting in a firm and timely manner to ensure price stability in the medium term is warranted. Over the policy-relevant medium-term horizon, the outlook for price developments remains subject to upside risks," Trichet said.

The ECB has raised eurozone borrowing costs a total of seven times, each time by 25bps, since Decmber 2005 in a bid to keep inflation in the 13-country eurozone close to 2 percent. The last move was in March and inflation in April was 1.8 percent.

4.2.3 Japan

Following BoJ's widely expected decision to keep rates on hold on in April 2007, Governor Fukui said rising land prices and currency rates were among the factors that could affect monetary policy. He added that "in guiding monetary policy in a forward-looking manner, what is important is whether the CPI would maintain its upward trend in the long run", signaling that any near-term falls in consumer prices would not directly affect monetary policy.

Analysts say that Fukui's latest reference to land prices may be a sign that BOJ will focus more on rising property prices in arguing for further rate hikes in the medium term.

BoJ seemed certain to keep its overnight rate unchanged at 0.5 percent at its 16-17 May MPC meeting. Soft economic data over the first two weeks in May did little to support the hawks within the MPC:

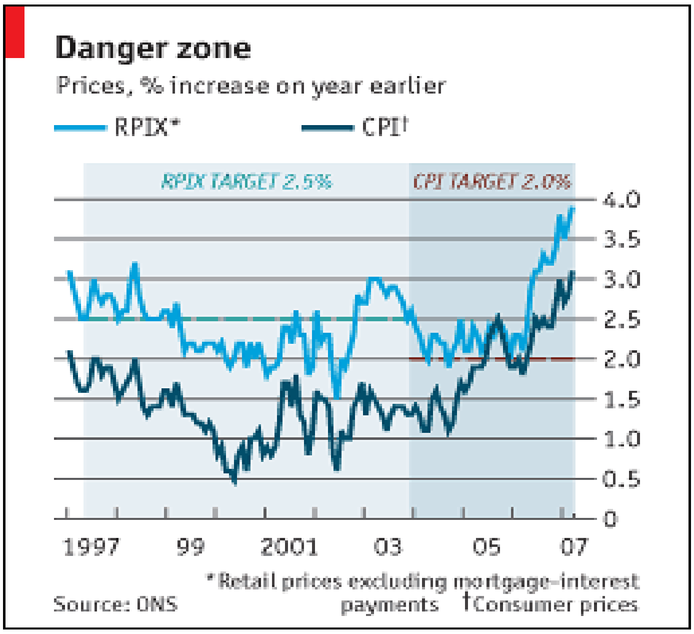
- Household spending rose by a meagre 0.1 percent year-on-year (y/y) and retail sales dropped 0.7 percent y/y in March. Industrial production also unexpectedly fell by 0.6 percent m/m.
- On the other hand, the BoJ, in its half-yearly report, revised downward its fiscal year 2007 core CPI forecasts from 0.4-0.5 to 0.0-0.2 percent, and expect it to hover around zero in coming months.

These reinforce market expectations for steady rates in the near future i.e. not before 2007:Q4.

4.2.4 United Kingdom

BoE's MPC on 10 May 2007 hiked its base rate by 25 basis points (bps) to 5.5 percent, the 4th since current hiking cycle began in August 2006.

The move had been widely expected after the Government's official measure of inflation hit 3.1 percent in March, forcing the Governor, Melvyn King, to write an explanatory letter to the Chancellor for the first time.



Mr. King acknowledged that the rise in CPI inflation to 3.1 percent was broadly based; that capacity pressures had increased, and that the "pricing climate" for businesses had become "somewhat easier".

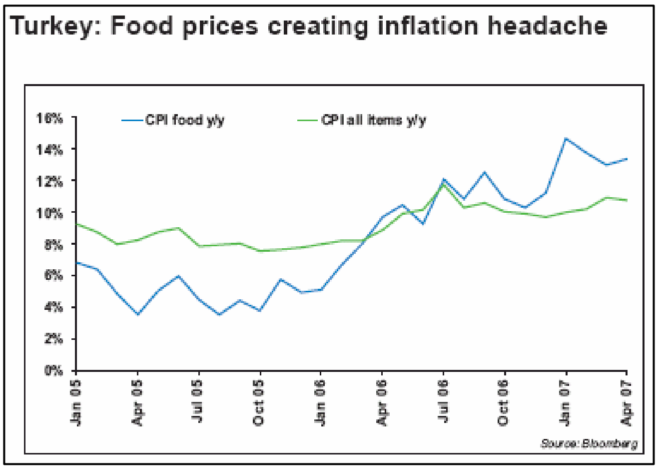
However, the Governor stated that the inflation news was "unlikely to alter the broad picture painted" in the February Inflation Report, when the Bank published its quarterly outlook. That suggests two things:

- The Bank would need to raise interest rates by a further 1/4-point before too long; and
- It remains pretty confident that consumer-price inflation was lapping close to its high-water mark and would recede to around 2 percent by end-2007.

Credibility is one key reason why rates are set to rise again. For the MPC, credibility is critical – not as a matter of pride, but one of policy. If businesses and households do not believe that the Bank will keep inflation at its 2 percent target, labour will press for higher wages, while companies will attempt to push up prices. Expectations of higher inflation become self-fulfilling.

4.2.5 Turkey

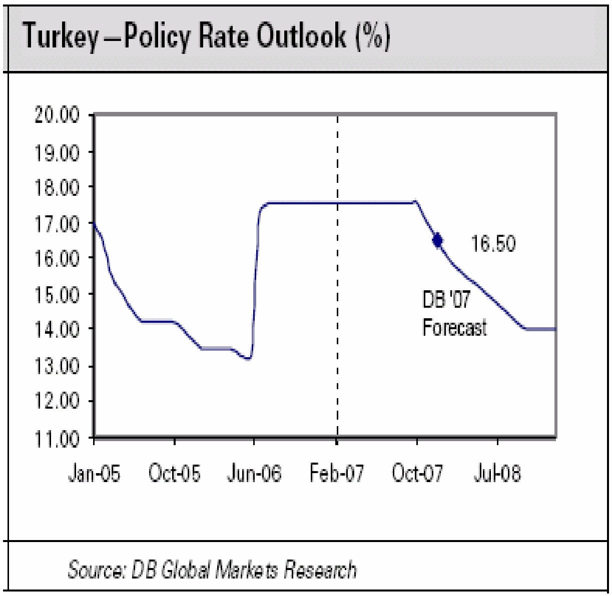
Expectations for rate easing from the Central Bank of Turkey (CBT) in 2007 have been pushed back by the upward pressure on inflation emanating from unprocessed food prices, and by another unfavorable inflation print in April. It seems ever more unlikely that the Bank's 4% +/- 2% end-2007 target will be met.



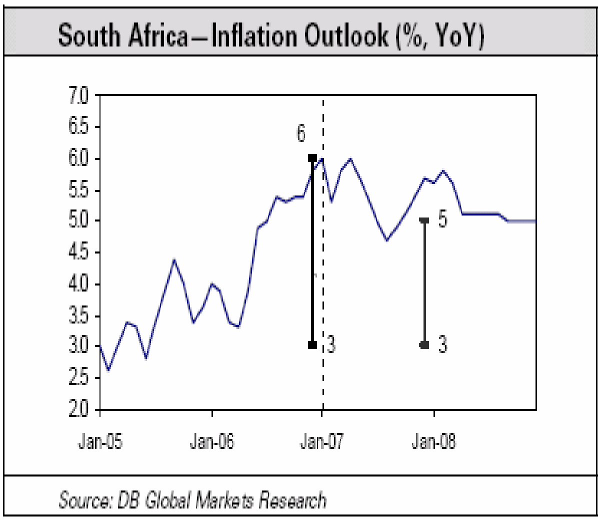
Outlook:

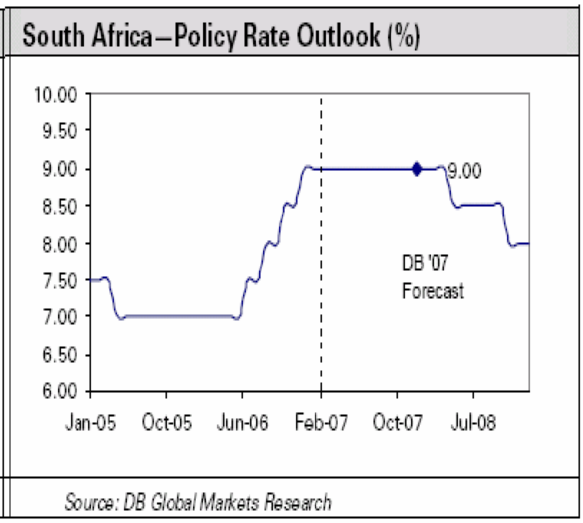
Slow pace of moderation in domestic demand, higher than anticipated salary adjustments of public workers and the double-elections constitute the main risks on the inflation front. Recent tax hikes as well as energy and weather related cost increases add more to the disinflationary challenges.

Given the large credibility gap and uncertainties lying ahead, we expect rates to be kept on hold till end-2007:Q3 and data permitting a 100bps easing by end-2007.



4.2.7 South Africa





The inflation outlook is benign, wage pressures are subdued and CPIX is expected to dip below 5 percent this year.

Trade balance pressures remain, however, though we don't expect this to lead to any policy rate reaction barring significant currency weakness.

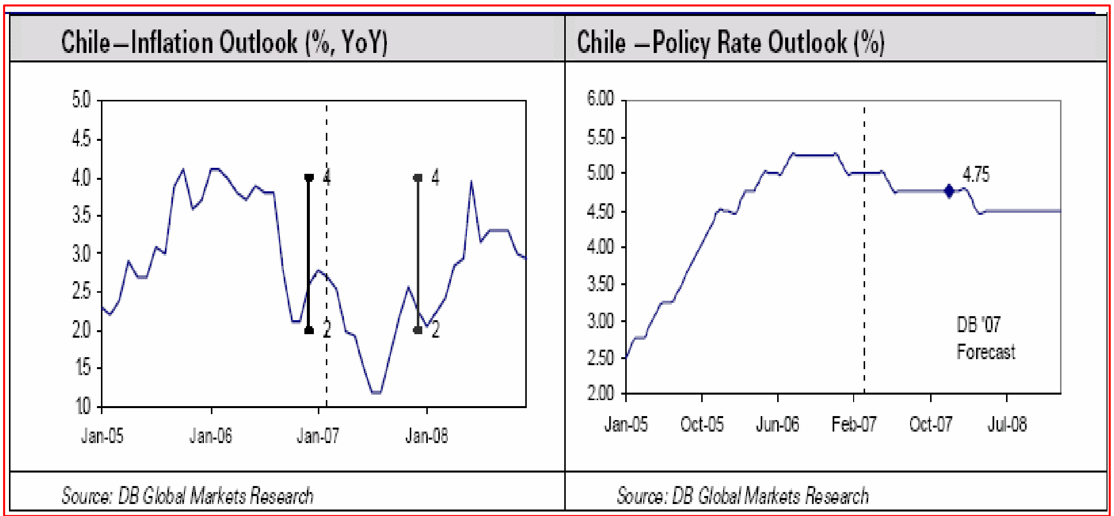
We project rates to be on hold at 9.0 percent for the remainder of this year

4.2.8 Chile

At the end of its monthly policy meeting on 10 May, the Board of Central Bank of Chile (CBC) decided to maintain the policy rate at 5 percent for the fourth consecutive time.

The Board noted, "Information available confirms stronger growth in domestic output in 2007:Q1, somewhat above earlier projections. Consumption is still robust, while both investment and exports have regained dynamism. Salaried employment continues to grow, and internal financial conditions are good.

CPI inflation is below 3 percent, although slightly above last January's projections. Most recently, it has been affected by higher-than-expected fuel prices. Core CPIX1 inflation (that excl. fuels, perishables and some regulated utilities) has also inched up especially due to an increase in food prices.
CBC's inflation target is 3 percent over the policy horizon.



Outlook:
Our view is that the CBC will cut interest rates one more time by 25bps this year, probably in June. Yet, this forecast is based on the assumption that the Fed will cut interest rates by 50 bps this year. Should the Fed stay put throughout the year, the probability of a rate cut in Chile would decline.

4.3 Commodities outlook

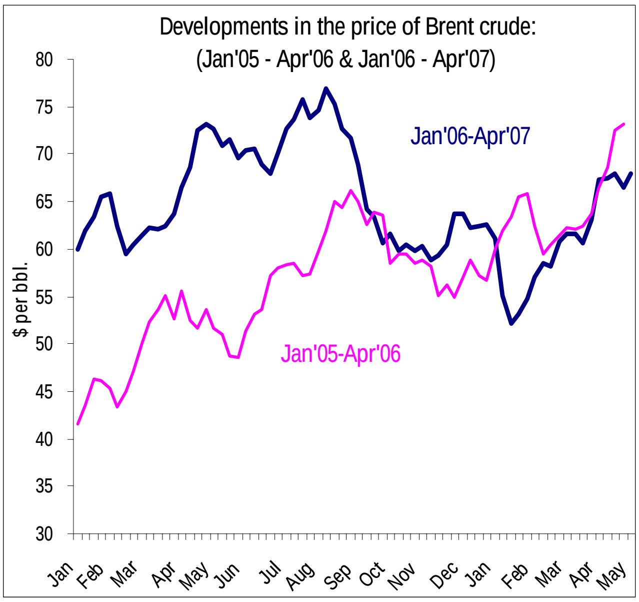
Commodities have seen a mixed performance over the last two months. Renewed strength in crude oil in March was offset by retracement in grains. A

Overview of the commodities market

		Mkt Close	Change (%)			Period Average					
						2005	2006	2007:Q1	2007:Q2	2007:Q3	2007:Q4
		(09 May)	m/m	y/y	ytd	a	a	a	f	f	f
Crude Oil											
Brent (nr future)	USD/bbl	65.20	-2.5	-9.3	8.0	55.30	66.10	59.00	67.00	63.00	60.00
Precious metals											
Gold (spot)	USD/oz	681	0.0	-4.2	6.5	445	605	650	660	620	650
Softs											
Cocoa (ICCO)	USD/tonne	1,989	-0.7	11.0	-0.7	1,539	1,581	1,806	1,980	1,900	1,600

weaker USD has supported commodities generally, and particularly gold. Overall however, the Dow Jones AIG commodity Index is still up 3.2 percent ytd (end-April). Global economic growth continues to put pressure on supplies to meet still growing demand across virtually all markets.

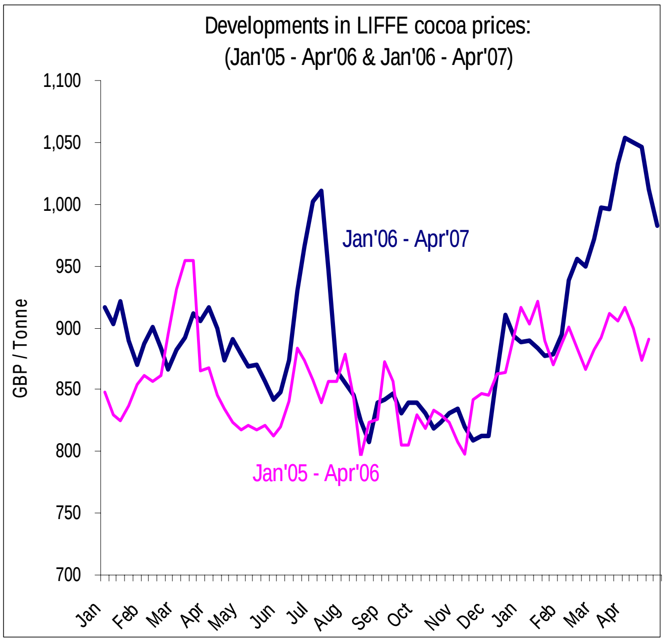
4.3.1 Oil



Prices of West Texas Intermediate (WTI) and Brent eased back in April as immediate concerns surrounding Iran receded. Inventories in the US also began to turn around. Data released by the US Energy Information Administration on 09 May showed that refinery capacity utilization was up to 89 percent.

The average weekly price per barrel of the benchmark Brent crude closed 2007:Q1 at $63.09. In April, it climbed to $68.00 before easing slightly to $67.88 at end-April, which represented a softening of 6.7 percent in y/y terms and a firming of 11 percent from the end 2006 level.

4.3.2 Cocoa



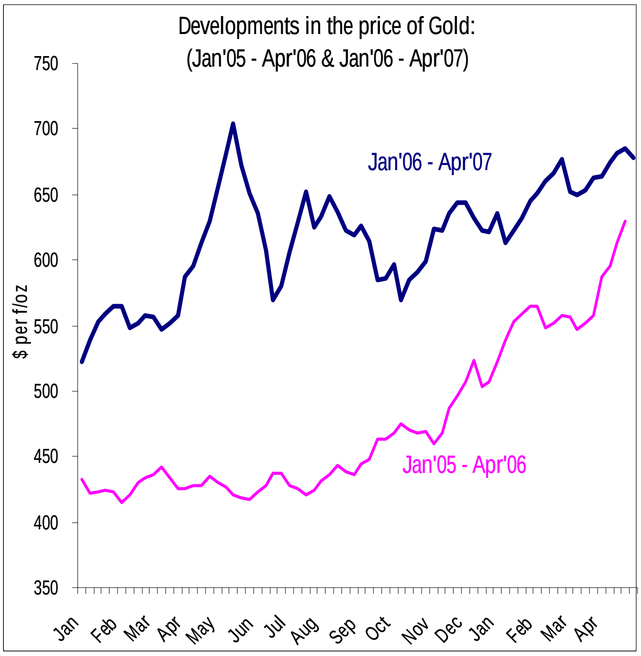
Cocoa prices rallied in March and April as reports of a delay to Indonesia's main harvest added to concerns over W/African mid-crops. The International Cocoa Organisation (ICCO) has forecast a deficit of 103,000 metric tones (m/t) for 2006/07 crop year (ending September), adding to the market consensus for a sizeable deficit.

High levels of fund interest (i.e. Doubts over the West African mid-crops drew investors towards cocoa) has left the market vulnerable to correction, but near term shortages will provide support ahead of the Indonesian harvest.

Price at end April was £983.00 per m/t and represented a 10.7 and 11.8 percent increase ytd and y/y respectively.

4.3.3 Gold

The fundamentals for gold appear to be price supportive in the near to medium term:

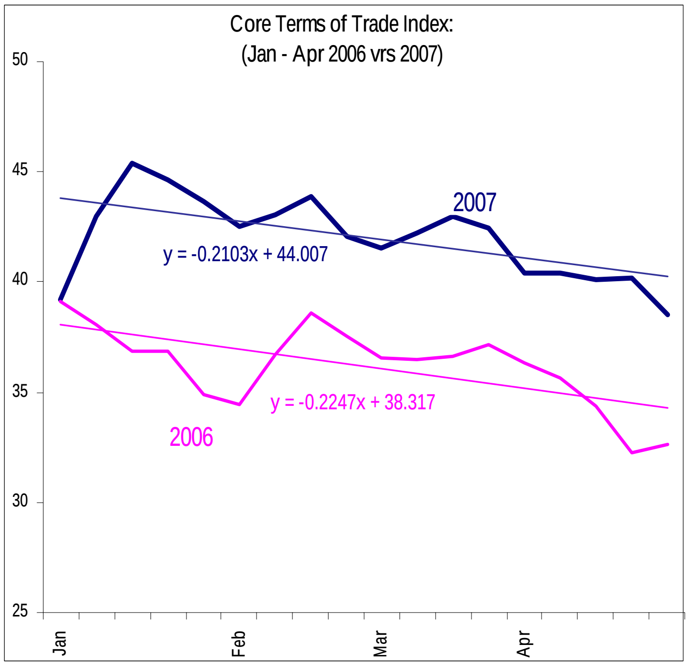


- Germany's Bundesbank has confirmed that it does not plan to sell its allotted gold under the Central Bank Gold Agreement in 2007, and had made no firm decision on sales in 2008.
- The USD, which is expected to continue weakening through 2007:H1, remains price supportive.

Year-to-end-April, gold has rallied 6.6 percent to $677.74 per ounce, which represents a y/y increase of 3.3 percent.

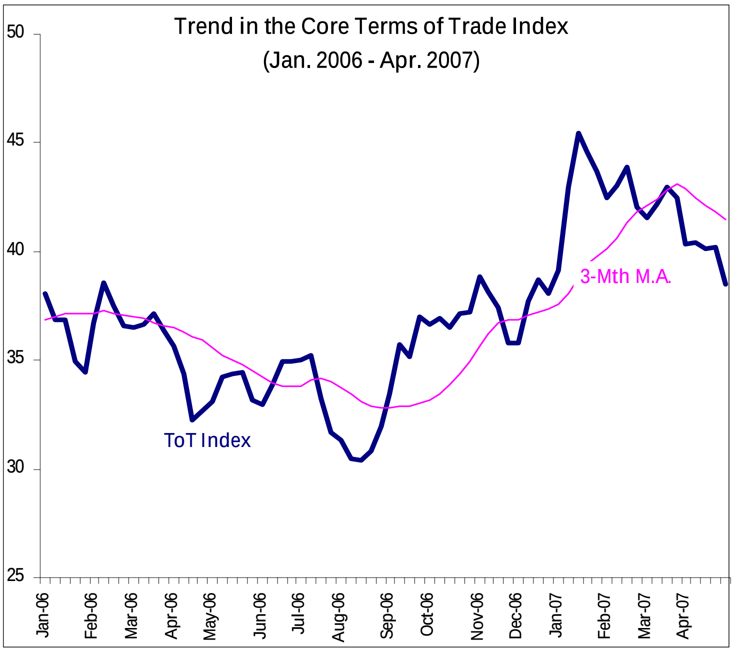
4.3.4 Core terms of trade index – benchmark prices

A core weekly terms of trade index (2002: wk1=100) is constructed for Ghana based on the developments in the prices of the three core items that represent Ghana's merchandise trade. Imports are represented by crude oil, while gold and cocoa represent exports. But gold and cocoa are weighted to reflect the proportions of foreign exchange inflows attributable to the two commodities.



The chart (right) tracks and compares the developments in the index for January – April 2006 and 2007. The fitted trend lines show that on the average the terms of trade deteriorated less in trend in January-April 2007. But comparison of the standard deviations (1.83 and 1.89 for 2006 and 2007 respectively) indicates that the index shows greater volatility in the first four months of 2007 than over the same period in 2006.

In the chart (below), the index is plotted from January 2006 to April 2007 against its 12-week (or quarterly) moving average. From October 2006, the index rose above its quarterly trend to reflect improvement in the terms of trade that resulted from the pullback in crude oil prices.



In January-April 2007, the terms of trade deteriorated on the average by 0.65 points on the index. The value of the index at the end of April was 38.52, which represents an improvement of 5.41 points in year-on-year terms.

4.4 Currency markets

The USD's slide against most of the world's major currencies gained pace recently, with the pound sterling and euro leading the charge against the embattled dollar, as interest rates are still expected to head higher in both Europe and the UK. Sterling hit the magic rate of USD2.00 in recent trading.

In our view, the recent weakness of the dollar has not been driven by the traditional structural forces that drove its weakness during 2002-04—the current account deficit and capital flows. This weakness has been driven instead (i) by the rotation of growth away from the US towards Europe, Japan and the emerging markets; and (ii) by central bank reserve diversification flows out of dollars by emerging market central banks.

MOVEMENTS IN SELECTED INTERNATIONAL CURRENCIES (%)						
	EUR/USD	GBP/USD	YEN/USD	ZAR/USD	CLP/USD	GHC/USD
2001	0.9	1.5	13.2	51.6	15.5	3.7
2002	-15.8	-9.4	-4.0	-22.9	5.7	14.5
2003	-15.4	-9.6	-12.1	-27.1	-15.3	4.8
2004	-8.3	-9.3	-3.4	-11.8	-4.0	2.2
2005	12.3	10.1	13.4	10.6	-11.0	0.9
2006	-10.6	-11.4	-0.9	11.4	2.8	1.1
Monthly Changes						
2006						
Jan	-2.2	-1.2	-2.6	-4.4	2.4	-0.0
Feb	1.6	1.2	2.1	0.6	-0.1	0.0
Mar	-0.7	0.2	-0.5	2.2	0.8	0.2
Apr	-2.1	-1.4	-0.3	-2.6	-2.4	0.0
Cum. Chg (%)	-3.4	-1.2	-1.3	-4.2	0.6	0.2
2007						
Jan	1.7	0.2	2.8	2.2	2.6	0.1
Feb	-0.7	0.0	0.0	-0.2	0.2	0.1
Mar	-1.2	0.6	-2.7	2.4	-0.7	0.2
Apr	-2.0	-2.1	1.4	-3.4	-1.3	0.0
Cum. Chg (%)	-2.3	-1.3	1.5	1.0	0.8	0.5

4.5 Local foreign exchange market

4.5.1 Nominal performance of the cedi – Bilateral and Effective

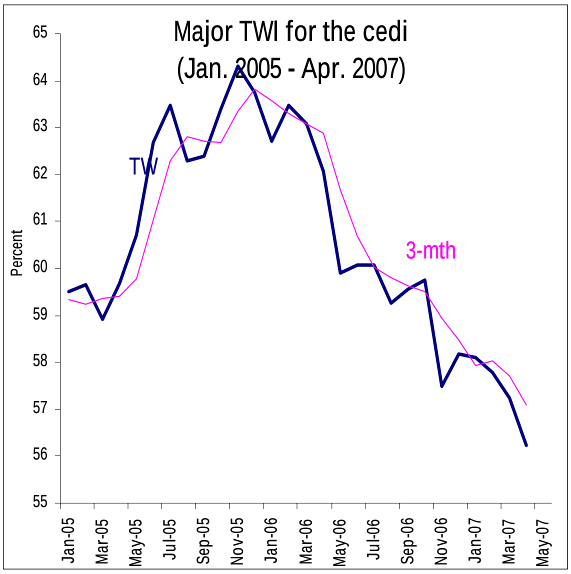
Bilateral movements

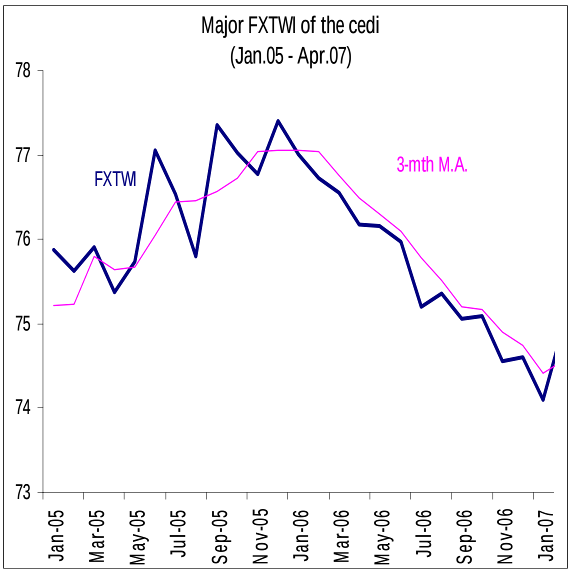
Developments in the nominal bilateral exchange rates of the cedi against the three core currencies – the US dollar, the pound sterling and the euro – show that in January-April 2007, the cedi depreciated, cumulatively, against all three core currencies by 0.5, 3.7 and 4.0 percent respectively. This compares with a cumulative appreciation of 0.2, 4.1 and 7.8 percent against the dollar, the pound sterling and the euro respectively over the same period in 2006.

Bilateral movements of the cedi against selected currencies									
	EXCHANGE RATE			MONTHLY CHANGE (%)			CUMULATIVE (%)		
Month	USD	GBP	EUR	USD	GBP	EUR	USD	GBP	EUR
2006									
Dec-05	9,133.40	15,672.30	10,792.26						
Jan-06	9,131.70	16,120.15	11,037.05	-0.0	2.9	2.3			
Feb-06	9,132.55	15,805.18	10,866.75	0.0	-2.0	-1.5			
Mar-06	9,147.81	15,810.15	11,045.91	0.2	0.0	1.6	0.2	0.9	2.4
Apr-06	9,148.94	16,316.05	11,641.13	0.0	3.2	5.4	0.2	4.1	7.8
2007									
Dec-06	9,233.40	18,069.12	12,131.51						
Jan-07	9,244.34	18,126.69	12,028.55	0.1	0.3	-0.8			
Feb-07	9,255.68	18,150.95	12,201.68	0.1	0.1	1.4			
Mar-07	9,276.83	18,175.98	12,356.72	0.2	0.1	1.3	0.5	0.6	1.9
Apr-07	9,280.69	18,746.54	12,625.64	0.0	3.1	2.2	0.5	3.7	4.0

Nominal Effective Exchange Rate (NEER)

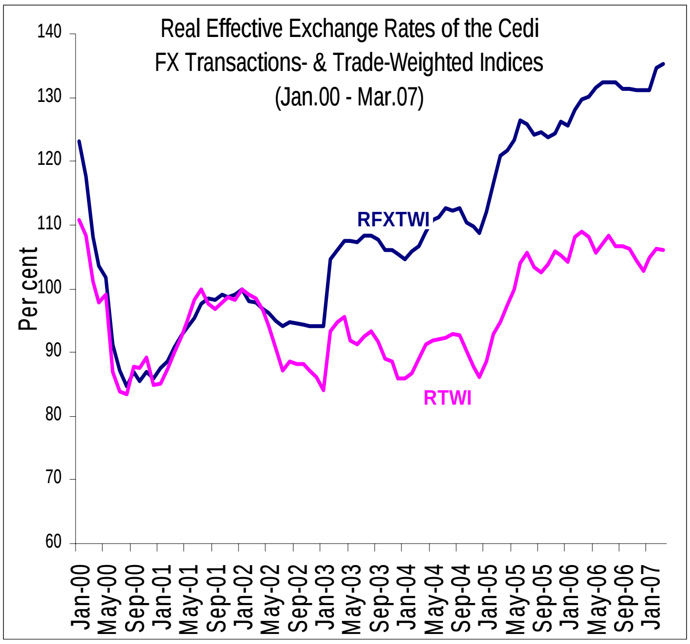
The major (or core) Trade Weighted Index (TWI) is an index measure of the value (January 2002=100) of the cedi relative to the currencies of Ghana's top three trading currencies – the euro, the pound and the dollar. It is thus an effective index.





Over the January-April 2007 period, the cedi depreciated by 1.9 percentage points in trade-weighted terms. This compares with a depreciation of 1.7 percentage points over the same period in 2006. The April 2007 value of the index was 56.24 and was 84 basis points below its quarterly trend represented by the 3-month moving average.

4.5.2 Real exchange rate developments



The Real Trade Weighted Index (RTWI), which is a total trade (i.e. import plus export) weighted, and the Real Foreign Exchange Transactions Weighted Index (FXTWI), which is a total foreign exchange transactions (i.e. purchases plus sales) weighted, are both real effective exchange rate indices, (January 2002=100) and monitor the real exchange rate developments of the cedi. They track the (geometric) average of the exchange rate changes (in real terms) of the cedi against the three major trading currencies: the USD, GBP and EUR.

In trade-weighted terms, the real exchange rate of the cedi appreciated, cumulatively, by 3.5 percentage points in 2007:Q1, as compared with 3.8 over the same period in 2006.

The foreign exchange transactions weighted index shows that the real exchange rate of the cedi appreciated cumulatively by 4.3 percentage points in 2007:Q1 compared with 3.7 percentage points in 2006:Q1.

4.5.3 Inward remittances

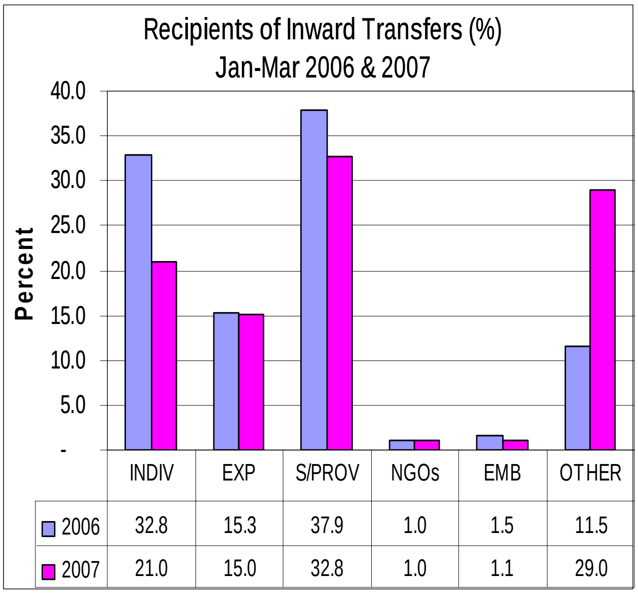
Inward Transfers, Jan - Mar 2006 & 2007 ($'million)				
	Jan	**Feb**	**Mar**	**Total**
2006				
Banks	416.85	342.85	514.58	1,274.28
Finance Companies	8.16	7.70	5.52	21.38
Total	**425.01**	**350.55**	**520.10**	**1,295.66**
2007				
Banks	486.85	441.08	555.68	1,483.62
Finance Companies	13.89	9.66	9.66	33.20
Total	**500.75**	**450.74**	**565.34**	**1,516.82**
Memorandum				
Change ($'million)	*75.74*	*100.19*	*45.24*	*221.16*
Change (%)	*17.8*	*28.6*	*8.7*	*17.1*
Share of Banks (2007)	*97.2*	*97.9*	*98.3*	*97.8*
Share of Banks (2006)	*98.1*	*97.8*	*98.9*	*98.3*

Private inward transfers **–** received by **NGOs, embassies, service providers, individuals etc. –** through the banks and finance companies for January–March 2007 amounted to $1.52 billion, which represents 17.1 percent increase over those for the corresponding period in 2006, which were in turn 33.7 percent increase over those in 2005.

Of the total transfers in 2007:Q1, $119.86 million (22.8 percent) accrued to individuals, compared with 32.8 percent in 2006:Q1.

Of the transfers through banks over the period, the share of service providers was highest at 32.8 percent in 2007 compared with 37.9 percent in 2006.

The top five recipient banks accounted for 68.4 percent of total transfers through banks in 2007:Q1, compared with 73.3 in 2006:Q1. The shares from 2002 to 2006 show a decline in trend, which suggests stiffer competition among the banks in the transfer business.



4.5.4 Foreign exchange purchases and sales

Foreign exchange transactions (i.e. purchases plus sales) by banks and forex bureaux in 2007:Q1 amounted to $1.90 billion, which was 15.9 percent increase over purchases and sales for 2006:Q1. In April 2007, total transactions came to $646.17 million. For the January – April period in 2007, total fx transactions grew by 16.9 percent over those for the corresponding period in 2006.

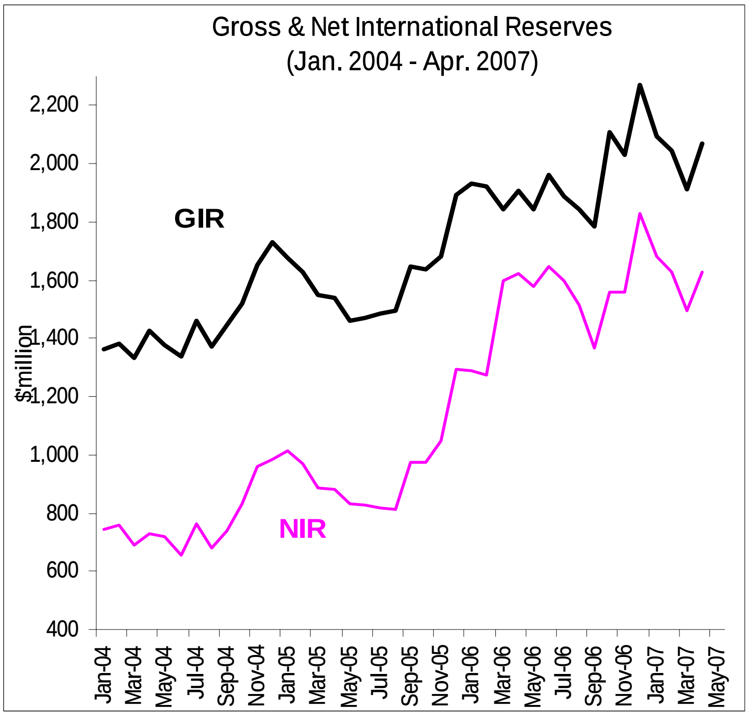
FX PURCHASES AND SALES ($'million)			
	Q1	Apr	Total
2006			
DMBs	1,499.87	489.18	1,989.05
F/Bureaux	141.64	48.46	190.10
Total	1,641.51	537.64	2,179.15
2007			
DMBs	1,765.18	595.37	2,360.55
F/Bureaux	136.98	50.80	187.78
Total	1,902.16	646.17	2,548.33
Memorandum			
Change in Total ($'m)	*260.65*	*108.53*	*369.18*
Change in Total (%)	*15.88*	*20.19*	*16.9*
Banks' share (%) - 2006	*91.37*	*90.99*	*91.3*
Banks' share (%) - 2007	*92.80*	*92.14*	*92.6*

*F/Bureaux numbers for Jan-Apr 07 are provisional

Using the share of forex bureaux and banks' transactions to represent their relative shares of the foreign exchange market, the forex bureaux' market share increased from 91.3 percent in 2006 to 92.6 in 2007 for the same period.

4.6 Gross International Reserves

Over the first three quarters of 2006, the GIR oscillated between a narrow band of $1.84 and $1.96 billion. In October, it broke out of this band and exceeded $2 billion for the first time. In November, it declined marginally by 3.8 percent but still stayed above the $2 billion mark. December 2006 saw a further growth in the GIR by 11.8 percent to $2.3 billion, which represented an increase of 27.3 percent on the quarter (the highest quarterly growth since December 2003) and 19.8 percent increase in year-on-year terms.



The GIR position of the Bank declined steadily throughout 2007:Q1. The March 2007 level of $2,070.66 million represented a 15.7 percent decline from the December 2006 level but a 3.7 percent increase in year-on-year terms. In April, the GIR registered an increase of 8.2 percent to $2.07 billion.

Developments in the Net International Reserves (NIR) virtually followed the same pattern. From its peak of $1,649.3 million in June 2006, it declined rather sharply to $1,366.3 in September. Like the GIR, it shot up in October, declined marginally in November but shot up by 17.2 percent in December 2006 to the all-time high of $1.83 billion. The level of NIR in April 2007 was $1.63 billion.

In terms of the 2007 Programme estimates, the April 2007 GIR position of $2.07 billion translates, on the average, into goods and services import cover of 2.5 months.

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