Bank of Ghana
Monetary Policy Report

Inflation Outlook and Analysis

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1.0 Overview of Global and Domestic Economic Developments

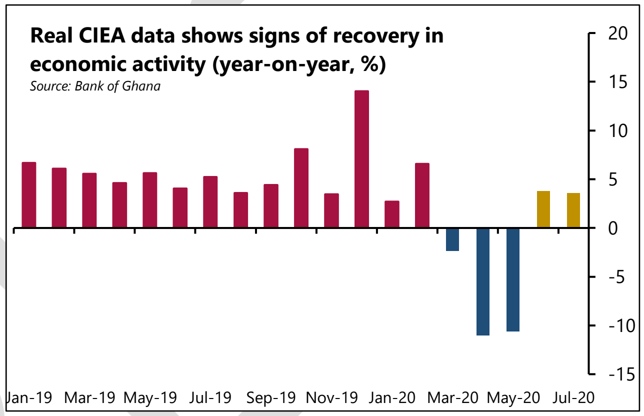
Recent survey data point to emerging signs of recovery following the sharp contraction in activity in the first half of 2020 due to the COVID-19 pandemic. The recovery has been underpinned by coordinated fiscal stimulus packages, supportive monetary policies, and general easing of restrictions, especially in countries that have made significant progress in containing the spread of the virus. The recovery is expected to continue, but at a gradual pace.

Global inflationary pressures remain broadly subdued, driven by low energy prices, the large negative output gap, and labour market slackness. Brent crude oil price has recovered somewhat since the collapse in 2020Q1 but still below the pre-pandemic levels. The partial recovery in oil prices has led to an increase in the latest headline inflation in some countries, despite downward pressure on prices from spare capacity in the global economy. Inflation is expected to remain subdued in the near-term but forecast to return to target as the COVID-related factors wane and spare capacity is eroded.

Global financial conditions have eased, reflecting a combination of rising equity prices, lower volatility and falling borrowing costs. Global confidence indicators have also shown signs of recovery, as restrictions ease, although they remain below the pre-COVID-19 levels.

The outlook for the global economy remains uncertain despite these early encouraging signs of recovery. As countries ease restrictions amidst a continuous rise in COVID-19 cases, a key downside risk that clouds the global outlook is the resurgence of a second wave of the pandemic, which is generating uncertainties and posing risks to the anticipated recovery.

On domestic growth conditions, the latest data released by the Ghana Statistical Service (GSS) confirms the full impact of the pandemic on economic activity. Real GDP contracted by 3.2 percent in the second quarter of 2020 compared with a growth of 5.7 percent over the same time last year. This was broadly in line with expectations. Non-oil growth, also, contracted by 3.4 percent, relative to the 4.3 percent growth in the same comparative period. The slowdown was due to falling output in the industry and services sectors which contracted by 5.7 and 2.6 percent respectively from a growth of 6.1 and 6.5 percent a year ago. Output in industry was particularly held back by a downturn in the manufacturing sector and a steep decline in mining and quarrying. The services sector was hit by restrictions in local and foreign travel, with the hotels and restaurants subsector suffering the most.



Notwithstanding the contraction in the second quarter, available high frequency data show some green shoots of economic activity. The Composite Index of Economic Activity grew by 3.6 percent in July 2020 compared with a contraction of 10.6 percent recorded in May. The growth observed in July was broad-based and reflects the pickup in economic activity as pandemic-related restrictions and lockdown measures are easing. In addition, results of the latest surveys conducted in August also show that consumer confidence and business confidence is bouncing back to almost pre-pandemic levels.

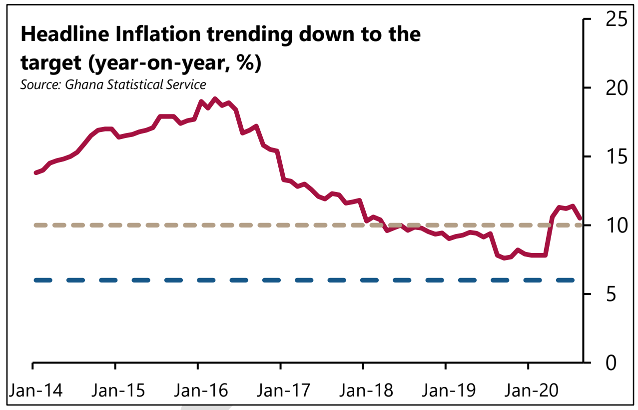
On fiscal policy, provisional data on budget execution for the first seven months, showed an overall budget deficit of 7.4 percent of GDP, against the revised target of 7.2 percent of GDP as the COVID-19 pandemic continued to impact fiscal operations.

2.0 Domestic Price Developments

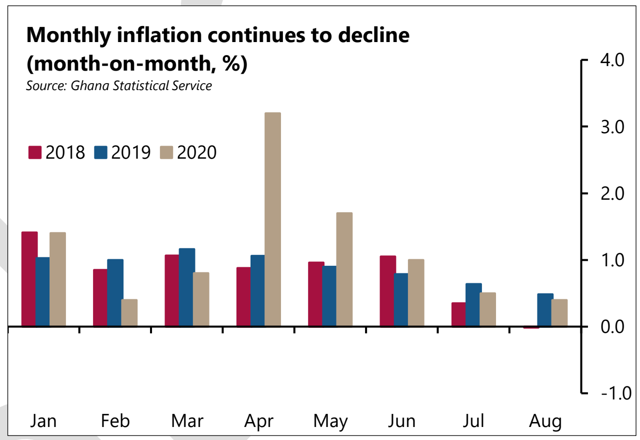
Headline Inflation

Consumer price inflation fell from 11.2 percent in June 2020 to 10.5 percent in August 2020, approaching the upper band of the medium-term target band. The decline in inflation was driven largely by easing pressures on food prices, following the sharp rise in food prices on account of the panic-buying episodes preceding the partial lockdown that was announced at the end of March 2020. Food inflation slowed down to 11.4 percent in August 2020 from 13.8 percent in June. Non-food inflation on the other hand continued its steady rise increasing from 9.2 percent in June to 9.9 percent in August, partly driven by an increase in clothing and footwear and the housing and utilities sub-categories.

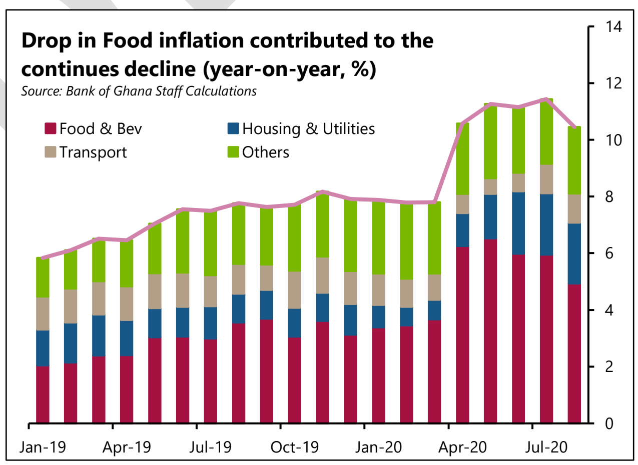
The measures of underlying inflation pressures all point to an easing of inflationary pressures in August. Core inflation (as measured by inflation excluding energy and utility) fell from 11.9 percent in June 2020 to 11.1 percent in August 2020. Also, the weighted inflation expectations index trended downwards in the August survey round, driven by easing inflation expectations of businesses and consumers.



Monthly inflation increased at a more measured pace of 0.4 percent in August 2020 relative to the 1.0 percent rise recorded in June 2020. The decline was driven by the significant drop in both monthly food and non-food inflation. Monthly food inflation fell from 0.1 percent at the end of June 2020 to -1.1 percent in August 2020. Similarly, non-food prices rose by 0.2 percent in August compared to 1.8 percent in June 2020.

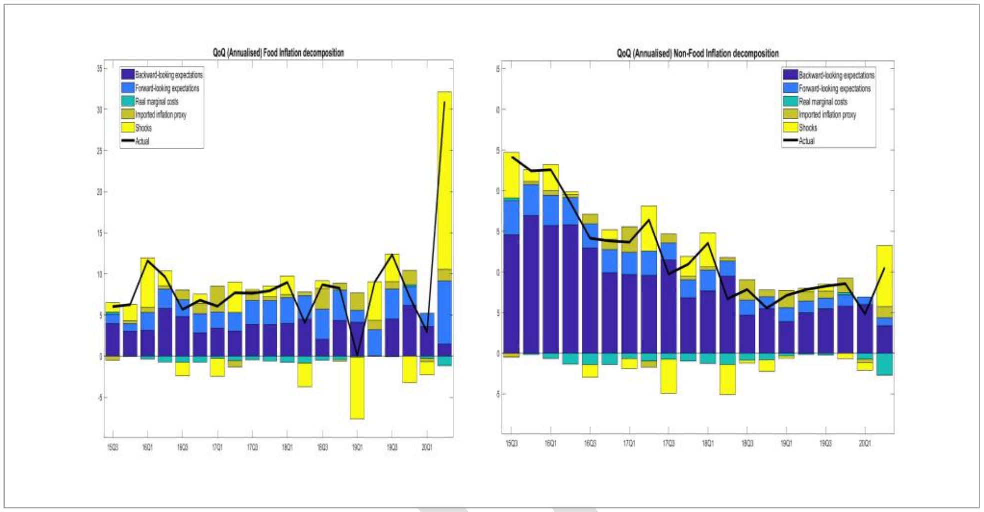


Component analysis of the consumer basket showed that the key drivers of the decline in food inflation in August were the continued drop in price of vegetables and, fruits and nuts, which recorded inflation rates of 21.4 and 4.2 percent in August compared to 28.8 and 17.4 percent in June respectively. Within the non-food category, the uptick was driven by the rise in the alcoholic beverages sub-category, which recorded inflation rates of 9.4 percent in August 2020 from 8.6 percent in June 2020, and the still high inflation of the Housing and Utilities sub-category at 20.8 percent.

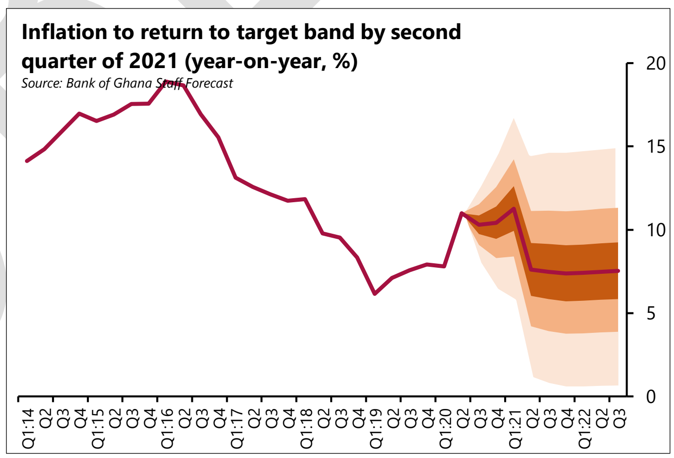


3.0 Inflation outlook

Headline inflation is currently above the upper band of the medium-term target of 8±2 percent. A decomposition of the inflation shows that the sharp rise in inflation averaging 11.0 percent in the second quarter of 2020 from the average of 7.8 percent in the first quarter, was driven mainly by supply shocks emanating from higher food prices and elevated inflation expectations. Inflation dynamics in the third quarter is expected to be driven by receding food supply shocks and the impact of expectations.



In the outlook, inflation is expected to gradually return to the medium-term target by the second quarter of 2021. Over the next three quarters, the dynamics in headline inflation are expected to be driven by the persistence of supply shocks and some base-drift effects. However, in quarters further ahead, inflation will be driven to the central target of the medium-term band by both lower inflation expectations and real marginal costs.



Output gap (the measure of the level of capacity utilization) is projected to narrow in the third quarter albeit still negative in the medium-term. The recovery in the output gap in the third quarter is expected to be driven by improved buoyancy from increased fiscal spending and positive demand shocks to economic activity from the easing of restrictions that were imposed to contain the spread of COVID-19. The residual negative output gap is expected to keep real marginal costs low in the forecast horizon which should, in turn, support the disinflation process. The real interest rate is expected to remain marginally below trend in the near term before returning to trend levels in the forecast horizon. The real exchange rate is forecasted to be broadly aligned to the fundamentals, supported by a broadly stable nominal exchange rate, and narrowing price differentials.

3.1 Risks to the Inflation outlook

Assessment of risks to the inflation outlook from global economic conditions, domestic economic activity, exchange rate dynamics, and government's fiscal policy implementation amid the pandemic suggests that the risks to the inflation outlook are broadly balanced in the forecast horizon. The key risks as assessed at this MPC round, include:

- ***Global economic conditions***

The muted global growth conditions are anticipated to dampen global demand thereby easing pressures on prices. In addition, the subdued headline and core inflation across the globe are expected to dampen price pressures from imported products in the medium-term.

- ***Crude Oil prices***

Crude oil prices are projected to recover due to the easing of restrictions on movement and the full compliance of agreed global crude oil production cut by OPEC+. As a result, ex-pump prices may rise in the outlook to reflect the projected increase in international crude oil prices.

- ***Administrative measures and Reduction in CST***

The reduction in the Communication Services Tax (CST) from 9.0 percent to 5.0 percent alongside the extension of "free water" supply to December 2020 is expected to further bring inflation down in the outlook. The direct effect of this is a reduction in prices of the utilities and communication sub-components in the non-food basket, which could generate some downward pressures on headline inflation.

- ***Domestic economic activity***

The economy is gradually recovering from the sharp downturn in economic activity in the second quarter. Leading indicators of economic activity for the third quarter point to a gradual recovery in most real sector indicators. A sustained level in consumer and business confidence, broad-based growth in the indicators of the CIEA are all supportive of growth in the outlook. However, given that the level of activity was currently below potential, the emerging recovery is not expected to exert any significant price pressures from aggregate demand, thus should not pose risks to the disinflation process.

- ***Exchange rate pass-through***

The strong performance of the cedi in 2020 reflects improvements in global financial market sentiments, inflows from the mining sector, and improved remittance flows despite COVID-19. The anticipated Cocoa

Syndicated Loans should further boost international reserves to cushion against potential external vulnerabilities.

- ***Fiscal operations and government response to the pandemic***

The COVID-19 pandemic has derailed the fiscal consolidation path observed over the past three years with increased spending and revenue shortfalls. The significant financing shortfall due to unexpected health related expenditures to contain the pandemic and the stimulus packages to boost growth may exert pressures on inflation in the medium term. Although, fiscal developments are more likely to pose an upside risk to the inflation profile in the medium term, the existing wide negative output gap is likely to mute this risk. Nonetheless, there is an urgent need to define a feasible fiscal adjustment necessary for a return to the path of fiscal consolidation to and to ensure public debt remains at sustainable levels.

4.0 Conclusion

Inflation is currently above its upper limit, driven mostly by food prices. The baseline forecast shows a return of inflation to the medium-term target band by the second quarter of 2021, driven by easing COVID-19 related food price pressures and well-anchored inflation expectations. However, the widening budget deficit and its associated financing gap could pose risks to debt sustainability if decisive measures are not implemented to return to the path of fiscal consolidation.

Appendix Table 1: CPI Components

CPI Components (%)										
		2019	2020							
	Weghts (%)	Aug	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug
Overall	100.0	7.8	7.8	7.8	7.8	10.6	11.3	11.2	11.4	10.5
Food and Beverages	43.9	8.2	7.8	7.9	8.4	14.4	15.1	13.8	13.7	11.4
Non-food	56.1	7.4	7.9	7.7	7.4	7.7	8.4	9.2	9.7	9.9
Alcoholic Beverages, Tobacco	1.7	12.9	11.1	11.6	11.4	9.7	10.1	8.6	7.6	9.4
Clothing and footwear	9.0	6.6	7.2	8.5	8.4	8.3	7.9	7.3	7.6	7.9
Housing and Utilities	8.6	9.9	7.6	6.3	6.7	11.2	15.1	21.3	20.3	20.8
Furnish, H/H Equipt. Etc	4.7	6.1	4.3	4.3	4.3	4.6	4.5	4.9	4.4	4.7
Health	2.4	5.4	6.3	6.4	6.2	6.5	5.6	7.8	6.8	7.2
Transport	7.3	10.2	10.5	9.9	9.2	6.7	5.4	6.3	10.0	9.9
Communications	2.7	2.0	3.1	2.9	3.0	4.0	6.2	6.3	6.1	6.0
Recreation & Culture	2.6	7.4	9.0	9.0	9.0	8.6	9.4	5.8	5.3	3.8
Education	3.9	2.7	6.8	6.7	6.8	6.9	7.1	4.1	5.0	4.9
Hotels, Cafes & Restaurants	6.1	4.8	7.5	6.8	3.5	3.6	4.3	5.8	5.3	6.2
Insurance and Finacial services		0.3	0.6	0.4	0.1	0.1	0.2	3.5	2.7	2.7
Miscellaneous goods & services	7.1	7.1	7.3	7.4	7.3	6.4	5.9	5.4	5.2	5.3
Source: Ghana Statistical Service										

Appendix Table 2: Headline Inflation

	Headline Inflation (%)			Monthly Changes in CPI (%)		
	Combined	Food	Non-food	Combined	Food	Non-food
Dec-18	**9.4**	**8.7**	**9.8**	**1.1**	**1.3**	**1.0**
2019						
Aug	7.8	8.2	7.4	0.5	1.0	0.1
Sep	7.6	8.5	7.0	-0.1	-0.3	0.2
Oct	7.7	7.0	8.2	0.3	-1.3	1.6
Nov	8.2	8.4	8.0	0.7	1.1	0.4
Dec	7.9	7.2	8.5	0.3	-0.6	1.0
2020						
Jan	7.8	7.8	7.9	1.4	2.3	0.8
Feb	7.8	7.9	7.7	0.4	0.5	0.4
Mar	7.8	8.4	7.4	0.8	1.6	0.3
Apr	10.6	14.4	7.7	3.2	6.4	0.8
May	11.3	15.1	8.4	1.7	2.3	1.3
Jun	11.2	13.8	9.2	1.0	0.1	1.8
Jul	11.4	13.7	9.7	0.5	0.0	0.9
Aug	10.5	11.4	9.9	0.4	-1.1	0.2
Source: Ghana Statistical Service						