Bank of Ghana
Monetary Policy Report

Inflation Analysis and Outlook

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1.0 Overview of Global and Domestic Economic Developments

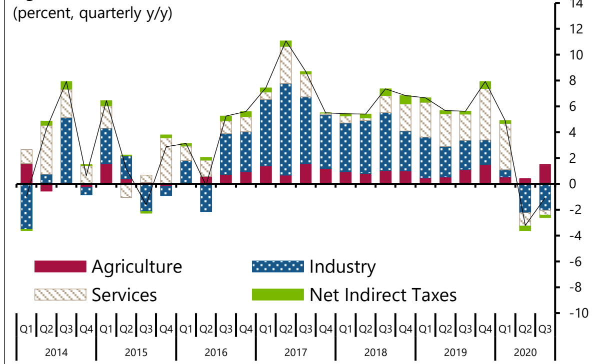
Global economic activity was projected to contract sharply in 2020 due to the adverse effects of the COVID-19 pandemic, but the outturn was better than anticipated. The second wave of the pandemic and mutation of the virus since the last quarter of 2020 has, however, resulted in the re-introduction of restrictions and partial lockdowns in some economies, and will likely weigh down on activity in the first half of 2021. Notwithstanding the anticipated softening, global growth is expected to firm in the second half of 2021, conditional on the continued policy support and progress with the vaccination efforts.

Financing conditions across the globe remained broadly accommodative throughout 2020, due to the massive policy support which reduced borrowing costs, raised stock price valuations, boosted investor risk appetite, and narrowed sovereign bond spreads across Emerging Market and Developing Economies (EMDEs). These favourable financing conditions eased pressures on emerging and frontier market currencies, while sovereign risk spreads for most Sub-Saharan African countries declined steadily in the year after rising sharply in March.

Global inflationary pressures remained muted, reflecting weak global demand and weak labour demand in 2020. Headline inflation is projected to rise to 1.3 percent in 2021 from 0.7 percent in 2020 in advanced economies, while in EMDEs, inflation is expected to soften to 4.2 percent from 5.0 percent over the same period. In emerging market and frontier economies, exchange rate movements and supply-side constraints arising from the COVIDvid-19 pandemic are expected to significantly influence price movements, going forward.

On domestic growth conditions, provisional data released by the Ghana Statistical Service showed that real GDP growth contracted by 1.1 percent in the third quarter of 2020 compared to the 3.2 percent contraction in the second quarter of 2020. (See Fig. 1). In particular, the contraction in non-oil GDP was relatively moderate at 0.4 percent in the third quarter of 2020, compared to a contraction of 3.4 percent in the second quarter. On a positive note, the Bank of Ghana's updated Composite Index of Economic Activity (CIEA) recorded an annual growth of 11.9 percent in November 2020, compared with 3.4 percent growth a year ago, indicating an improvement in growth momentum.

Fig. 1: Contribution to Real GDP Growth
(percent, quarterly y/y)



Source: GSS and Bank of Ghana Staff Calculations

The Bank's latest confidence surveys conducted in December 2020 showed improvements in both consumer and business confidence. Consumer confidence continued to remain strong at pre-lockdown levels reflecting optimism about current economic conditions following the gradual lifting of the COVID-related restrictions. Business confidence improved significantly, reaching pre-lockdown levels, for the first time, as businesses met short-term company targets and were optimistic about growth prospects in the outlook.

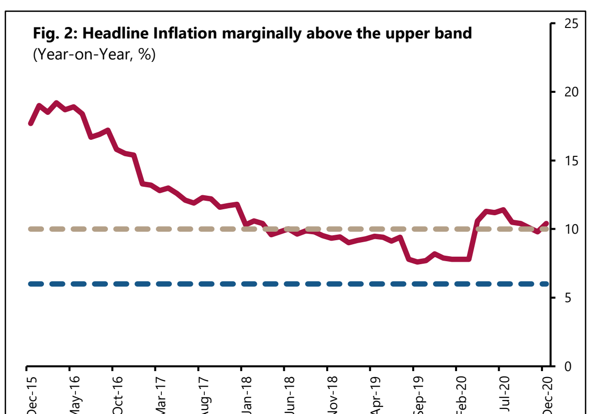
On execution of the budget, provisional data released by the Ministry of Finance as at November 2020, showed an overall broad cash budget deficit of 10.8 percent of GDP against the target of 11.4 percent of GDP for the year. The second wave of the pandemic which would necessitate additional spending to provide testing, vaccines, etc. is expected to put pressure on the fiscal position.

2.0 Domestic Price Developments

Headline Inflation

Price developments in 2020 were broadly driven by COVID-related factors, especially after the spike in inflation observed during the second quarter on the back of events preceding the partial lockdown. (See Fig. 2). Headline inflation rose from 10.1 percent in October 2020 to 10.4 percent in December 2020, above

Fig. 2: Headline Inflation marginally above the upper band
(Year-on-Year, %)



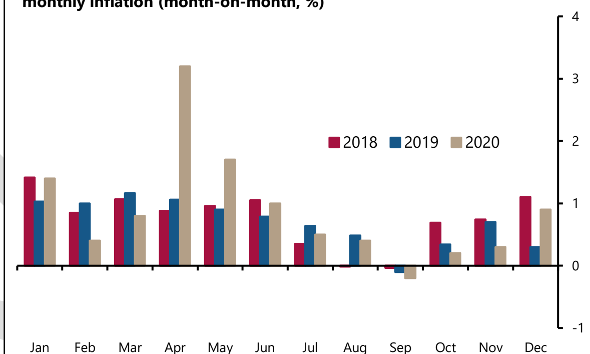
Source: Ghana Statistical Service

the upper band of the medium target band. The pickup in inflation was driven largely by food inflation. Food inflation rose to 14.1 percent in December 2020 significantly above the 12.6 percent recorded in October 2020. Non-food inflation continued to ease from 8.3 percent in October 2020 to 7.7 percent in December 2020.

Underlying inflationary pressures edged up marginally alongside the uptick in headline inflation. The Bank's core inflation measure, which excludes energy and utility, rose marginally from 10.7 percent in October to 10.9 percent in December 2020. Survey based measure of inflation expectations pointed to a moderation in inflation expectations of businesses and consumers although financial sector inflation expectations inched up marginally.

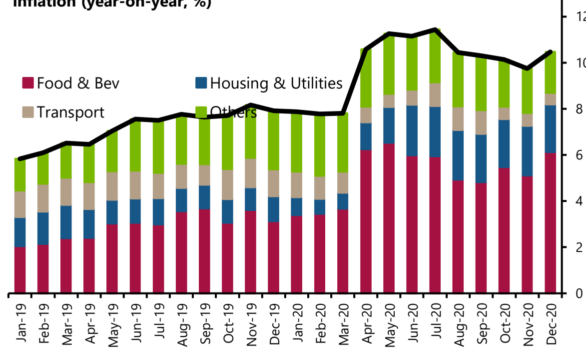
Month-on-month inflation rose significantly to 0.9 percent in December 2020 from 0.2 percent in October 2020 reflecting the rise in both monthly food and non-food inflation. Monthly food inflation rose sharply to 1.5 percent in December 2020 from 0.1 percent at the end of October 2020. (See Fig. 3). In the same vein, non-food prices rose marginally to 0.4 percent from 0.3 percent in October over the same comparative period.

Fig. 3: Monthly food inflation drove the rise in overall monthly inflation (month-on-month, %)



Source: Ghana Statistical Service (GSS)

Fig. 4: Food prices contributed more than half of overall inflation (year-on-year, %)



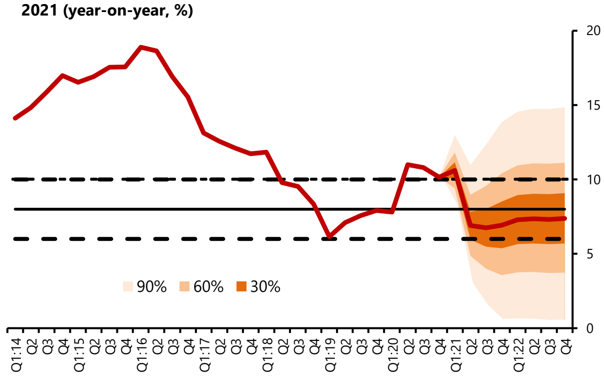
Source: Bank of Ghana Staff Calculations

Similar to October, the component analysis of the consumer basket revealed that the key drivers of the uptick in food inflation in December were the higher inflation rates recorded for fish, cereals, fruits & vegetables, and tubers categories. Within the non-food category, the drop in non-food inflation was largely driven by base drift in transport fares as well as sharp declines in education and recreation and culture sub-categories in response to Covid-related restrictions.

3.0 Inflation outlook

Headline inflation is currently just above the upper band of the medium-term target of 8±2 percent given the decline in average inflation for the quarter under review. The model decomposition of inflation into factors driving it shows that the decline in inflation from an average of 10.8 percent in the third quarter of 2020 to an average of 10.1 percent in the fourth quarter was mainly driven by the dissipation of non-food supply shocks reflecting the pick-up in production and trade associated with the easing of Covid-induced restrictions.

Fig. 5: Inflation to return to target band by second quarter of 2021 (year-on-year, %)



Source: Bank of Ghana Staff Forecast

Similar to the outlook presented in the November Inflation Report, inflation is expected to gradually return to the medium-term target by the second quarter of 2021. Inflation is projected to slightly rise in the first quarter of 2021 driven by base-drift effects. (See Fig. 5). However, inflation is expected to ease in the subsequent quarters towards the central target of the medium-term band driven by lower inflation expectations and real marginal costs barring any unforeseen shocks.

Output gap (the measure of the level of economic activity) continued to narrow but remained negative in the fourth quarter, after rebounding in the third quarter from the steep decline in the second quarter. The narrowing of the output gap was driven by fiscal impulses, accommodative monetary policy stance, and positive demand shocks attributed to the easing of restrictions that were imposed to curb the transmission of the virus. In the outlook, the output gap is projected to remain negative but closing in the medium term, driven by real sector expectations and the anticipated recovery in foreign demand. The negative output gap is expected to keep real marginal costs low in the forecast horizon in the near-term, although real marginal costs are expected to pick up in the medium-term due to the lowering of inflation differentials with the country's foreign partners. The real interest rate is expected to remain marginally above trend in the near-term due to well-anchored inflation expectations before returning to trend levels in the forecast horizon. The real exchange rate is forecast to be broadly close to fundamentals as inflation differentials narrow in the outlook.

3.1 Risks to the Inflation outlook

Assessment of risks to the inflation outlook from global economic conditions, domestic economic activity, expected stability of the cedi, and government's fiscal policy implementation amid the pandemic suggests that the balance of 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 second wave of the pandemic has led to the re-introduction of lockdown restrictions in several countries. This is anticipated to moderate the growth momentum thereby easing pressures on prices in the near-term. However, progress on the vaccine front despite the emergence of new variants of the coronavirus is expected to boost activity in the medium-term. In addition, the subdued headline and core inflation across the globe are expected to mute imported inflationary pressures in the medium-term.

- ***Oil prices***

Ex-pump prices have started edging upwards in line with rising international crude oil prices. Crude oil prices have continued to recover since the November MPC Meeting and has led to an upward movement in ex-pump prices. Should this trend persist, the upward adjustment in ex-pump prices could likely result in the higher transport fares with its consequential effects on the overall CPI basket.

- ***Domestic economic activity***

The Ghanaian economy is projected to rebound in 2021, after the COVID-induced slowdown in 2020. The Bank's updated Composite Index of Economic Activity increased significantly by 11.9 percent in November 2020 compared to 3.4 percent a year ago, indicating improved momentum in economic activity. Furthermore, results from the Bank's latest confidence surveys showed improvements in both consumer and business confidence. The broad-based rise in the indicators of economic activity is expected to be supportive of growth conditions in the outlook. However, given the existence of spare capacity as well as the re-introduction of some COVID-restrictions in January 2021 following the increase in cases, the projected rebound in activity is not likely to pose inflationary pressures in the outlook.

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

The recent upsurge in COVID-19 cases could further increase government's health-related expenditure on vaccines, tracing and testing, etc., thereby slowing down the return to the path to fiscal consolidation in the outlook. Given that economic activity was below potential, fiscal developments are more likely to pose an upside risk to the inflation profile in the medium-term than in the near-term. It remains imperative to return to the path of fiscal consolidation to contain fiscal risks and debt sustainability concerns over the medium-term.

4.0 Conclusion

Headline inflation ended the year at 10.4 percent in December 2020, marginally above the upper band of the medium-term target of 8±2 percent. The baseline forecast indicates a return of inflation to the medium-term target band by the second quarter of 2021, supported by easing food price pressures, stable exchange rate, and well-anchored inflation expectations.

Appendix Table 1: CPI Components

	Headline Inflation (%)			Monthly Changes in CPI (%)		
	Combined	Food	Non-food	Combined	Food	Non-food
Dec-17	**11.8**	**8.0**	**13.6**	**1.0**	**1.3**	**0.9**
Dec-18	**9.4**	**8.7**	**9.8**	**1.1**	**1.3**	**1.0**
2019						
Jan	9.0	8.0	9.5	1.0	1.5	0.8
Feb	9.2	8.1	9.7	1.0	1.2	0.9
Mar	9.3	8.4	9.7	1.2	1.3	1.1
Apr	9.5	7.3	10.4	1.1	0.1	1.5
May	9.4	6.7	10.6	0.9	0.6	1.0
Jun	9.1	6.5	10.3	0.8	0.8	0.8
Jul	9.4	6.6	10.7	0.6	0.4	0.7
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
Sept	10.4	11.2	9.8	-0.2	-0.5	0.1
Oct	10.1	12.6	8.3	0.2	0.1	0.3
Nov	9.8	11.7	8.3	0.3	0.3	0.3
Dec	10.4	14.1	7.7	0.9	1.5	0.4

Source: Ghana Statistical Service

Appendix Table 2: Headline Inflation

CPI Components (%)														
		2019	**2020**											
	Weghts (%)	**Dec**	**Jan**	**Feb**	**Mar**	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sept**	**Oct**	**Nov**	**Dec**
Overall	100.0	7.9	7.8	7.8	7.8	10.6	11.3	11.2	11.4	10.5	10.4	10.1	9.8	10.5
Food and Beverages	43.1	7.2	7.8	7.9	8.4	14.4	15.1	13.8	13.7	11.4	11.2	12.6	11.7	14.1
Non-food	56.9	8.5	7.9	7.7	7.4	7.7	8.4	9.2	9.7	9.9	9.8	8.3	8.3	7.7
Alcoholic Beverages, Tobacco	3.7	13.5	11.1	11.6	11.4	9.7	10.1	8.6	7.6	9.4	9.0	6.7	5.9	6.0
Clothing and footwear	8.1	6.7	7.2	8.5	8.4	8.3	7.9	7.3	7.6	7.9	8.0	7.0	7.4	7.9
Housing and Utilities	10.2	10.5	7.6	6.3	6.7	11.2	15.1	21.3	20.3	20.8	20.3	20.2	21.0	20.1
Furnish, H/H Equipt. Etc	3.2	4.7	4.3	4.3	4.3	4.6	4.5	4.9	4.4	4.7	4.9	4.4	4.4	4.7
Health	0.7	6.7	6.3	6.4	6.2	6.5	5.6	7.8	6.8	7.2	8.9	5.7	3.7	6.0
Transport	10.1	11.0	10.5	9.9	9.2	6.7	5.4	6.3	10.0	9.9	10.1	5.3	5.3	4.8
Communications	3.6	2.8	3.1	2.9	3.0	4.0	6.2	6.3	6.1	6.0	6.8	6.7	6.5	7.0
Recreation & Culture	3.5	9.3	9.0	9.0	9.0	8.6	9.4	5.8	5.3	3.8	3.4	2.5	2.8	1.8
Education	6.5	6.6	6.8	6.7	6.8	6.9	7.1	4.1	5.0	4.9	4.2	3.8	2.3	0.2
Hotels, Cafes & Restaurants	4.6	5.5	7.5	6.8	3.5	3.6	4.3	5.8	5.3	6.2	7.0	7.1	7.2	5.4
Insurance and Finacial services	0.2	0.6	0.6	0.4	0.1	0.1	0.2	3.5	2.7	2.7	2.0	2.1	2.1	3.3
Miscellaneous goods & services	2.4	7.4	7.3	7.4	7.3	6.4	5.9	5.4	5.2	5.3	4.6	3.4	3.4	3.8

Source: Ghana Statistical Service