Bank of Ghana
Monetary Policy Report

Inflation Outlook and Analysis

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1.0 Overview of Global and Domestic Economic Developments

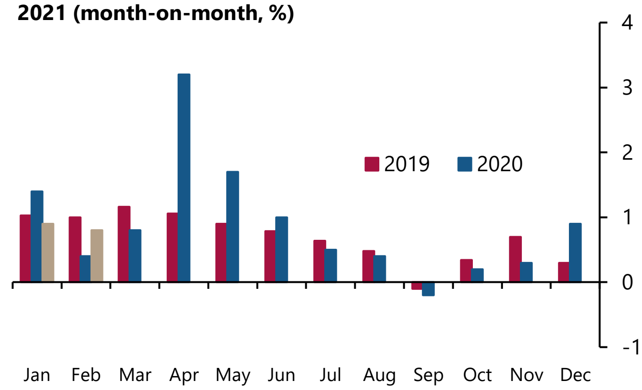
Global economic growth is picking up amid the emergence of new variants of the coronavirus, which dampened activity in the last quarter of 2020. The continued policy support and vaccination rollout have worked in concert to spur optimism and investor confidence for a stronger rebound in economic activity for 2021. Updated IMF projections released in January 2021 show global growth at 5.5 percent in 2021, 0.4 percentage points higher than the October 2020 projection.

Global financing conditions remained benign as major central banks continued with the asset purchase programmes and policy support. Despite a marginal pick-up in long-term bond yields in some advanced countries and the ongoing recovery in equity valuations, borrowing costs remained generally low. Emerging Market and Developing Economies (EMDEs) faced improved financing conditions with robust debt issuance in the first two months of the year which helped ease currency pressures. In the medium-term, global financing conditions would remain favourable, underpinned by the accommodative monetary policies, which are expected to persist until global growth firms.

Global headline inflation has begun picking up, particularly in some advanced and emerging market economies, reflecting the sharp rise in commodity prices and past currency depreciation. However, underlying inflationary pressures remain subdued in advanced economies, weighed down by the still sizeable spare capacity and the significant slack in labour and product markets. In emerging market and frontier economies, currency movements and COVID-related supply-side constraints are expected to drive price movements.

The Ghanaian economy experienced an upturn in economic activity, evidenced by the Bank's updated Composite Index of Economic Activity (CIEA). The CIEA recorded an annual growth of 13.9 percent in January 2021, the highest since December 2019, compared to 3.4 percent in the corresponding period of 2020. The key drivers of economic activity during the period were construction, imports, industrial consumption of electricity, domestic VAT, passenger arrivals at the airport, and port activity.

Fig. 1: Monthly inflation edged down in February 2021 (month-on-month, %)



Source: Ghana Statistical Service

Results from the Bank's latest confidence surveys conducted in February 2021 showed some softening of both consumer and business sentiments. The softening of consumer confidence reflected heightened concerns about the potential re-imposition of restrictions following the upsurge in COVID-19 cases in the first two months of the year. Similarly, business sentiments about the general economic situation also deteriorated on concerns that re-imposition of restrictions would be detrimental to the attainment of their short-term goals. However, with the commencement of the vaccine roll out and gradual lifting of remaining restrictions, the expectation is for both business and consumer confidence to rebound.

On budget execution, provisional data from the Ministry of Finance indicated that 2020 recorded an overall broad cash budget deficit of 11.7 percent of GDP against the revised target of 11.4 percent of GDP. The primary balance also recorded a deficit of 5.3 percent of GDP compared to the revised target deficit of 4.6 percent of GDP. Over the review period, total revenue and grants amounted to GH¢55.1 billion (14.3 percent of GDP), marginally higher than the revised target of GH¢53.7 billion (13.9 percent of GDP). Total expenditures and arrears clearance amounted to GH¢100.1 billion (26.1 percent of GDP) against the revised target of GH¢97.7 billion (25.4 percent of GDP).

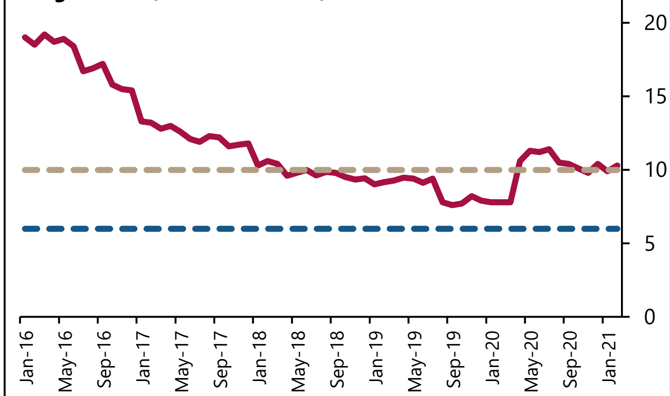
2.0 Domestic Price Developments

Headline Inflation

Headline inflation remained above pre-pandemic levels with price developments in the first two months of 2021 broadly mixed. The two readings in the first two months showed that headline inflation eased from 10.4 percent in December 2020 to 9.9 percent in January 2021, and subsequently rose to 10.3 percent in

February, marginally outside the medium-term target band of 8±2 percent. The uptick in inflation in February was mainly driven by non-food inflation, which rose to 8.8 percent from 7.7 percent in January. Food inflation, on the other hand, eased to 12.3 percent from 12.8 percent over the same comparative period.

Fig. 2: Headline Inflation Marginally Above the Target Band (Year-on-Year, %)

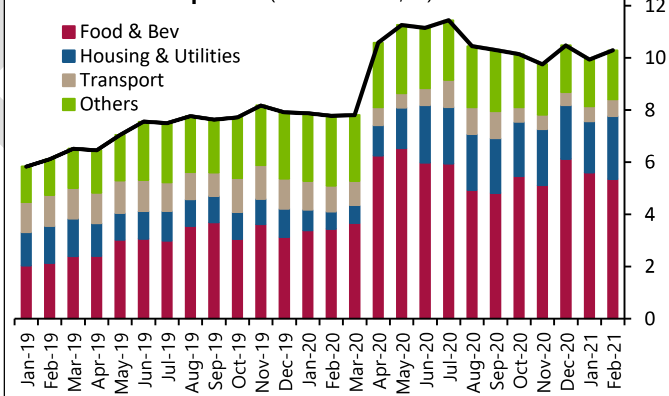


Source: Ghana Statistical Service

Underlying inflation exhibited similar trends as the headline inflation. The Bank's core inflation measure, which excludes energy and utilities prices, fell from 10.9 percent in December 2020 to 10.1 percent in January and moved up marginally to 10.4 percent in February 2021. Inflation expectations of businesses inched up in February, while both consumer and financial sector inflation expectations declined.

Month-on-month inflation edged down to 0.8 percent in February 2021 from 0.9 percent recorded in January 2021 and December 2020, respectively. Monthly food inflation dropped sharply to 0.0 percent in February 2021 from 1.5 percent at the end of December 2020 (See Fig. 3). The gains from the drop in food prices were partly offset by an increase in monthly non-food inflation from 0.4 percent to 1.4 percent over the same period.

Fig. 3: Upward pressures mainly driven by Housing and Utilities component (Year-on-Year, %)



Source: Bank of Ghana Staff Calculations

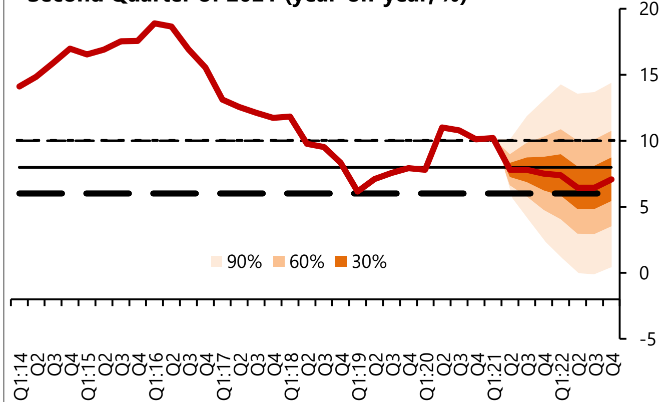
In terms of drivers, the fall in food inflation was occasioned by the lower contribution from fruit-bearing vegetables, fish, and others categories. Within the non-food category, the pick-up was driven by rent in the Housing and Utilities subgroup.

3.0 Inflation outlook

Both food and non-food inflation are projected to decline to the central path of 8 percent and remain around the central path, driven by low input costs through weak demand conditions and a strong exchange rate.

Imported inflation is expected to exert some upward pressures as inflation recovers in our trading-partner countries.

Fig. 4: Inflation to Return to Target Band by Second Quarter of 2021 (year-on-year, %)



Source: Bank of Ghana Staff Forecast

The low input cost projections in both food and non-food sectors are due to low domestic input costs as the economy is projected to operate below full capacity, and the fact that the exchange rate is expected to remain strong in the medium-term. The economy is projected to operate below full capacity on the back of subdued fiscal impulse coming from the projected fiscal consolidation in the medium term, together with tight monetary conditions, real sector expectations and weak foreign demand conditions.

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***

COVID vaccination programmes have led to a gradual easing of lockdown restrictions in several countries. This is expected to give a boost to the emerging growth momentum, gradually eroding existing spare capacity across the globe and adding moderate pressures on prices in the near term. Furthermore, rising headline and inflation expectations across the globe are expected to lift imported price inflation in the medium term.

- ***Oil prices***

Ex-pump prices rose in the first two months of the year in tandem with rising international crude oil prices. Crude oil prices have firmed up by about 12 percent in February from the January MPC Meeting. Besides the direct effect of rising ex-pump prices on the CPI basket, rising ex-pump prices pose an indirect effect on headline inflation as it could lead to an upward review of transport fares.

- ***Domestic economic activity***

The Ghanaian economy is projected to rebound by 5 percent in 2021, from the sharp decline in the country's growth trajectory that occurred in 2020 induced by the pandemic. In addition, the Bank's updated Composite Index of Economic Activity (CIEA) recorded an annual growth of 13.9 percent in January 2021, the highest since December 2019, compared to 3.4 percent in the corresponding period of 2020. These developments are expected to increase growth momentum in the near term and strengthen aggregate demand pressures. However, the existing spare capacity is expected to ease gradually and mute the impact of increase in aggregate demand pressures on inflation. Furthermore, stability on the exchange rate front would help anchor prices and support disinflation in the outlook.

- ***Fiscal operations and budget measures***

The adjustment measures announced in the budget for 2021 focus more on measures to improve revenue mobilization than expenditure rationalization. This is due to the need to sustain the stimulus programmes introduced to ameliorate the impact of the pandemic on businesses and individuals. To this end, new revenue measures were announced in the budget to boost revenue. However, these measures are expected to be inflationary when implemented. In particular, the proposed increase in VAT, NHIL, road tolls, energy sector and sanitation levies are likely to impact on prices, especially in the non-food category. This might be marginally moderated by the reduction in income taxes for the hospitality industry and suspension of the vehicle income tax and tax stamps for small businesses. Overall, the revenue measures are assessed to be inflationary when implemented.

4.0 Conclusion

Headline inflation stood at 10.3 percent in February 2021, 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 in the second quarter of 2021, supported by easing food price pressures, stable exchange rate, and well-anchored inflation expectations. Key upside risks to the outlook include the new tax measures announced in the 2021 budget and rising international crude oil prices.

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**
Dec-19	**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
2021						
Jan	9.9	12.8	7.7	0.9	1.2	0.7
Feb	10.3	12.3	8.8	0.8	0.0	1.4
Source: Ghana Statistical Service						

Appendix Table 2: Headline Inflation

CPI Components (%)									
		2020						2021	
	Weghts (%)	Jan	Feb	Mar	Jun	Sept	Dec	Jan	Feb
Overall	100.0	7.8	7.8	7.8	11.2	10.4	10.4	9.9	10.3
Food and Beverages	43.1	7.8	7.9	8.4	13.8	11.2	14.1	12.8	12.3
Non-food	56.9	7.9	7.7	7.4	9.2	9.8	7.7	7.7	8.8
Alcoholic Beverages, Tobacco	3.7	11.1	11.6	11.4	8.6	9.0	6.0	7.4	7.2
Clothing and footwear	8.1	7.2	8.5	8.4	7.3	8.0	7.9	7.2	6.2
Housing and Utilities	10.2	7.6	6.3	6.7	21.3	20.3	20.1	19.0	23.4
Furnish, H/H Equipt. Etc	3.2	4.3	4.3	4.3	4.9	4.9	4.7	4.5	5.0
Health	0.7	6.3	6.4	6.2	7.8	8.9	6.0	6.9	6.9
Transport	10.1	10.5	9.9	9.2	6.3	10.1	4.8	5.4	6.2
Communications	3.6	3.1	2.9	3.0	6.3	6.8	7.0	6.7	8.4
Recreation & Culture	3.5	9.0	9.0	9.0	5.8	3.4	1.8	3.0	3.9
Education	6.5	6.8	6.7	6.8	4.1	4.2	0.2	0.3	0.4
Hotels, Cafes & Restaurants	4.6	7.5	6.8	3.5	5.8	7.0	5.4	4.8	5.4
Insurance and Finacial services	0.2	0.6	0.4	0.1	3.5	2.0	3.3	3.3	7.4
Miscellaneous goods & services	2.4	7.3	7.4	7.3	5.4	4.6	3.8	5.1	4.3
Source: Ghana Statistical Service									