



# Bank of Ghana Monetary Policy Report

## Inflation Analysis and Outlook

Vol. 6 No. 6/2020

November 2020

### 1.0 Overview of Global and Domestic Economic Developments

Global growth recovered in the third quarter of 2020, following the sharp contraction in the second quarter. This was on the back of the gradual easing of the pandemic-related restrictions and supportive fiscal and monetary policies. The latest IMF World Economic Outlook projects global economy to contract by 4.4 percent in 2020, and to rebound to 5.2 percent growth in 2021. In the near-term, the resurgence of COVID-19 infections in advanced economies has led to the re-imposition of targeted lockdown measures in several advanced economies, which is expected to moderate economic activity and moderate the recovery process.

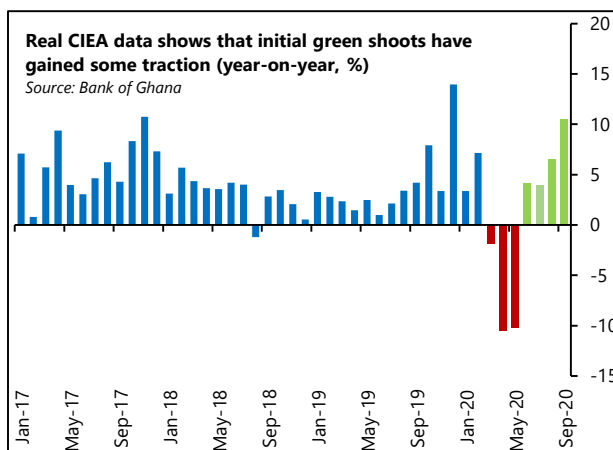
Global financial market sentiments remain positive, reflecting the large fiscal stimulus packages, the continuous supportive monetary policy, and the easing of lockdown restrictions imposed in the first half of the year. Since March 2020, equity prices have rebounded, corporate and sovereign bond spreads have narrowed, while capital and portfolio flows to emerging market and frontier economies have improved. These developments have helped ease pressures on currencies in some emerging market and frontier economies.

Global inflationary pressures remain generally muted, reflecting the lower oil price environment, weak demand, and deterioration in labour market conditions. Inflation projections have generally been revised downwards in the near-term. In Advanced Economies, inflation is expected to remain low. Exchange rate movements and COVID-related supply side constraints are likely to shape the inflation outlook in emerging market and frontier economies, going forward.

On domestic growth conditions, economic activity firmed up due to supportive fiscal and monetary policies and the easing of COVID-19 restrictions. After contracting in March, April and May, the real Composite

Index of Economic Activity (CIEA), the Bank's measure of economic activity, recorded an annual growth of 10.5 percent in September 2020 compared with 4.2 percent growth a year ago. The key drivers of economic activity during the period were construction, manufacturing, and credit to the private sector. In addition, the Purchasing Managers Index (PMI) has increased significantly since September 2020.

In the October 2020 survey round, consumer and business sentiments remained positive. In particular, consumer confidence was firmly above pre-lockdown levels supported by pick-up in economic activity following gradual relaxation of COVID-restrictions. Although business confidence was below pre-COVID 19 levels, it has shown a steady and gradual recovery supported by improved company prospects and steady demand for goods and services.



On fiscal performance, the provisional data for the first three quarters of 2020, showed an overall budget deficit of 9.0 percent of GDP against a target of 8.9 percent of GDP broadly in line with the revised mid-year budget estimates. Money supply showed significant expansion in the first ten months of 2020, reflecting the accommodative monetary policy stance and fiscal stimulus measures being implemented to mitigate the impact of the COVID-19 pandemic. In year-on-year terms, money supply (M2+) grew by 30.0 percent compared with 16.3 percent in the same period of 2019.

## 2.0 Domestic Price Developments

### Headline Inflation

Consumer price inflation declined to 10.1 percent in October 2020, from 10.5 percent in August 2020 and close to the upper band of the medium-term target band. The fall in inflation was driven largely by non-food, which eased to 8.3 percent in October 2020 from 9.9 percent in August 2020. Food inflation, on the other hand, rose from 11.4 percent in August 2020 to 12.6 percent in October 2020.

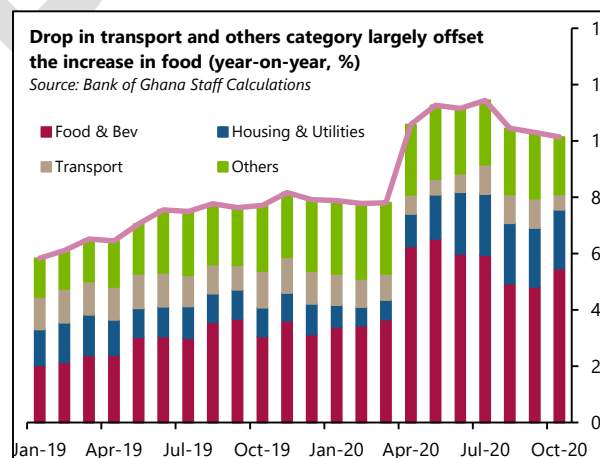
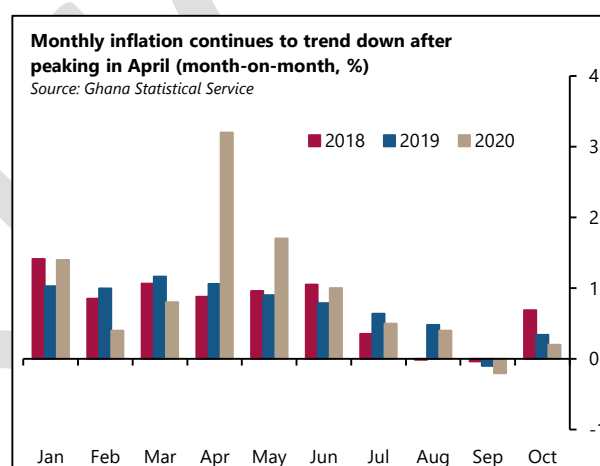
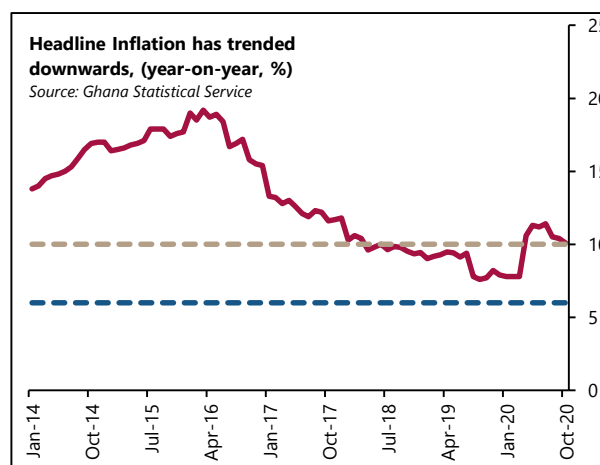
Underlying domestic inflationary pressures eased in the review period. The Bank's core inflation measure, which excludes energy and utility, declined marginally. Similarly, inflation expectations of businesses and consumers moderated, although financial sector expectations inched up marginally. The weighted inflation expectations declined marginally, indicating the easing inflationary pressures.

Month-on-month inflation rose from -0.4 percent in August 2020 to 0.2 percent in October 2020. The uptick was driven by the rise in both monthly food and non-food inflation. Monthly food inflation rose to 0.1 percent at the end of October 2020 from -1.1 percent in August 2020. Similarly, non-food prices rose marginally to 0.3 percent in October 2020 from 0.2 percent in August.

Component analysis of the consumer basket showed that the key drivers of the uptick in food inflation in October were the higher inflation rates recorded for fish, fruits and vegetables, and tubers categories. Within the non-food category, the drop in non-food inflation was largely driven by base drift in transport fares.

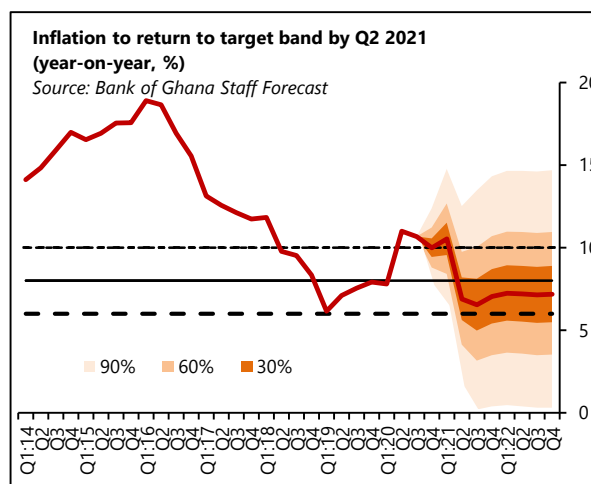
### 3.0 Inflation outlook

Headline inflation is currently edging closer to the upper band of the medium-term target of  $8 \pm 2$  percent. The model decomposition of inflation into factors driving it shows that the decline in inflation from an average of 11.0 percent in the second quarter of 2020 to an average of 10.8 percent in the third quarter was mainly driven by the dissipation of food supply shocks which occurred at the height of the pandemic in the second quarter 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. More specifically, inflation is expected to rise a little in the first quarter of 2020 driven by base-drift effects. In the quarters further ahead, inflation is expected to be driven to the central target of the medium-term band by lower inflation expectations and real marginal costs.

Output gap (the measure of the level of economic activity) recovered in the third quarter from its steep decline in the second quarter although it was still negative in the third quarter. The recovery in the output gap could be attributed to the favorable fiscal impulses and positive demand shocks attributed to the lifting of restrictions that were imposed to curb the transmission of the virus. The output gap is projected to remain negative 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 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 forecast to be broadly close to the fundamentals since the nominal exchange rate is projected to remain broadly stable.



### 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 recovery in global growth conditions is expected to slow down somewhat in the fourth quarter as COVID-related restrictions are tightened in Europe and other major advanced economies due to rising COVID-19 cases. This is anticipated to moderate the growth momentum thereby easing pressures on prices in the near-term. Over the medium-term, however, global activity is expected to receive a major boost from the significant progress made on developing a COVID-vaccine.

- **Oil prices**

Crude oil prices are expected to remain low in the near term due to the reintroduction of restrictions in most countries and subdued global economic activity. Consequently, ex-pump prices are expected to remain stable as oil prices remain low.

- ***Domestic economic activity***

The Ghanaian economy appeared to be gradually recovering from the sharp downturn in economic activity in the second quarter. The real composite indicators of economic activity grew significantly in September alongside a steady rise in the Ghana's Purchasing Managers Index. The broad-based rise in the indicators of economic activity is expected to be supportive of growth conditions in the outlook. However, given that the economy was currently operating below its potential, the rebound in activity is not expected to pose inflationary pressures in the outlook.

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

The substantial fiscal stimulus measures put in place to ameliorate the impact of the COVID-19 pandemic has moved the economy off the fiscal consolidation path. Increased spending on the health sector to contain the pandemic and the stimulus package for real sector recovery has however not translated into inflationary pressures due to the negative output gap (subdued real sector activity). A return to fiscal consolidation would be required to contain fiscal risks in the medium-term.

#### **4.0 Conclusion**

At 10.1 percent, headline inflation is currently close to the upper band of the medium-term target of  $8 \pm 2$  percent. The latest forecast projects a return of inflation to the medium-term target band by the second quarter of 2021, supported mainly by easing food price pressures and well-anchored inflation expectations. The Monetary Policy Committee viewed risks to the immediate outlook for inflation and growth as broadly balanced and maintained the policy rate unchanged at 14.5 percent in November 2020.

**Appendix Table 1: CPI Components**

| CPI Components (%)               |            |      |      |      |      |      |      |      |      |      |      |      |
|----------------------------------|------------|------|------|------|------|------|------|------|------|------|------|------|
|                                  | Weghts (%) | 2019 | 2020 |      |      |      |      |      |      |      |      |      |
|                                  |            | Oct  | Jan  | Feb  | Mar  | Apr  | May  | Jun  | Jul  | Aug  | Sept | Oct  |
| <b>Overall</b>                   | 100.0      | 7.7  | 7.8  | 7.8  | 7.8  | 10.6 | 11.3 | 11.2 | 11.4 | 10.5 | 10.4 | 10.1 |
| <b>Food and Beverages</b>        | 43.9       | 7.0  | 7.8  | 7.9  | 8.4  | 14.4 | 15.1 | 13.8 | 13.7 | 11.4 | 11.2 | 12.6 |
| <b>Non-food</b>                  | 56.1       | 8.2  | 7.9  | 7.7  | 7.4  | 7.7  | 8.4  | 9.2  | 9.7  | 9.9  | 9.8  | 8.3  |
| Alcoholic Beverages, Tobacco     | 1.7        | 13.2 | 11.1 | 11.6 | 11.4 | 9.7  | 10.1 | 8.6  | 7.6  | 9.4  | 9.0  | 6.7  |
| Clothing and footwear            | 9.0        | 7.4  | 7.2  | 8.5  | 8.4  | 8.3  | 7.9  | 7.3  | 7.6  | 7.9  | 8.0  | 7.0  |
| Housing and Utilities            | 8.6        | 9.9  | 7.6  | 6.3  | 6.7  | 11.2 | 15.1 | 21.3 | 20.3 | 20.8 | 20.3 | 20.2 |
| Furnish, H/H Equipt. Etc         | 4.7        | 5.9  | 4.3  | 4.3  | 4.3  | 4.6  | 4.5  | 4.9  | 4.4  | 4.7  | 4.9  | 4.4  |
| Health                           | 2.4        | 8.5  | 6.3  | 6.4  | 6.2  | 6.5  | 5.6  | 7.8  | 6.8  | 7.2  | 8.9  | 5.7  |
| Transport                        | 7.3        | 12.9 | 10.5 | 9.9  | 9.2  | 6.7  | 5.4  | 6.3  | 10.0 | 9.9  | 10.1 | 5.3  |
| Communications                   | 2.7        | 3.0  | 3.1  | 2.9  | 3.0  | 4.0  | 6.2  | 6.3  | 6.1  | 6.0  | 6.8  | 6.7  |
| Recreation & Culture             | 2.6        | 7.9  | 9.0  | 9.0  | 9.0  | 8.6  | 9.4  | 5.8  | 5.3  | 3.8  | 3.4  | 2.5  |
| Education                        | 3.9        | 3.3  | 6.8  | 6.7  | 6.8  | 6.9  | 7.1  | 4.1  | 5.0  | 4.9  | 4.2  | 3.8  |
| Hotels, Cafes & Restaurants      | 6.1        | 4.1  | 7.5  | 6.8  | 3.5  | 3.6  | 4.3  | 5.8  | 5.3  | 6.2  | 7.0  | 7.1  |
| Insurance and Financial services |            | 0.9  | 0.6  | 0.4  | 0.1  | 0.1  | 0.2  | 3.5  | 2.7  | 2.7  | 2.0  | 2.1  |
| Miscellaneous goods & services   | 7.1        | 8.2  | 7.3  | 7.4  | 7.3  | 6.4  | 5.9  | 5.4  | 5.2  | 5.3  | 4.6  | 3.4  |

*Source: Ghana Statistical Service*

**Appendix Table 2: Headline Inflation**

|               | Headline Inflation (%) |            |            | Monthly Changes in CPI (%) |            |            |
|---------------|------------------------|------------|------------|----------------------------|------------|------------|
|               | Combined               | Food       | Non-food   | Combined                   | Food       | Non-food   |
| <b>Dec-18</b> | <b>9.4</b>             | <b>8.7</b> | <b>9.8</b> | <b>1.1</b>                 | <b>1.3</b> | <b>1.0</b> |
| <b>2019</b>   |                        |            |            |                            |            |            |
| 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        |
| <b>2020</b>   |                        |            |            |                            |            |            |
| 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        |

*Source: Ghana Statistical Service*