Bank of Ghana
Monetary Policy Report

Inflation Outlook and Analysis

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4.0 Global Economic Outlook

Global growth remains moderate, with uneven prospects across the main countries and regions. The April 2015 IMF World Economic Outlook (WEO) indicated that the outlook for advanced economies is improving, while growth in emerging market and developing economies is projected to be lower, primarily reflecting weaker prospects for some large emerging market economies and oil-exporting countries. Sub Saharan Africa is expected to register another year of strong growth, although countries with significant exposure to global markets will need to remain cautious to avert the risk of capital flow reversals that may arise from the anticipated changes in the US monetary policy stance.

Accordingly, the IMF World Economic Outlook (WEO) April 2015 update has projected global growth at 3.5 per cent, in line with January 2015 forecasts and further to 3.7 per cent in 2016. The 2015 projection is however lower than the earlier forecast of 3.8 per cent in the October 2014 WEO. The advanced economies are expected to expand at 2.4 per cent from 1.8 per cent in 2014. While Euro area (1.5% in 2015) and Japan (1.0% in 2015) are expected to pick up at a much faster pace relative to the January update, the growth in the US economy has been revised downwards to 3.1 per cent for 2015 and 2016.

In emerging and developing economies, growth forecasts remained unchanged from the January forecasts at 4.3 per cent for 2015 and 4.5 per cent for 2016. China's growth forecasts for 2015 and 2016 were in line with the January update at 6.8 per cent and 6.3 per cent respectively. The Sub-Saharan Africa (SSA) growth is expected to slow down to 4.5 per cent from the 4.9 per cent estimated in January and mainly due to falling oil prices which has subdued the outlook for Nigeria (the largest economy in SSA).

4.1 Key developments in the domestic economy since the last MPC meeting in February

[1] The Composite Index of Economic Activity (CIEA), which gauges the pace of economic activity, declined in real terms by 1.4 per cent during the first quarter of 2015 compared with an increase of

0.2 per cent a year ago. On a seasonally adjusted basis, the index picked up slightly by 0.3 per cent quarter-on-quarter, down from the 1.8 per cent recorded a year earlier. The factors contributing to the decline in index include imports, exports, and industrial consumption of electricity. In year-on-year terms, the index, registered a real growth of 5.7 per cent in the first quarter compared with a growth of 11.1 per cent in the corresponding period of 2014.

[2] The latest in the periodic surveys carried out by the Bank of Ghana indicated mixed sentiments from the businesses and consumers in March and April 2015 respectively. While consumers were measured in their optimism about the prospects of the economy, businesses were less optimistic about prospects of the economy. The consumer confidence improved marginally to 91.2 in April 2015 from 89.9 in January. However, the overall business confidence index dipped by 10.4 points to 88.8 in the latest survey in March. Businesses were concerned about the volatile exchange rate depreciation, industrial and company prospects as well as prospects for growth.

[3] The preliminary fiscal data for the first quarter showed a marked improvement in the Government's fiscal operations. The revenue and grants were above targets whiles expenditures were contained. These resulted in a provisional narrow budget deficit, on a broad coverage basis, of GH¢786.2 million (0.6% of GDP) compared with GH¢2.358 billion (2.1 % of GDP) for the first quarter of 2014. The significant improvement in the fiscal outturn was driven by over performance in the revenue and grants relative to their targets.

[4] Headline inflation remained elevated during the first quarter. The rate of inflation which stood at 16.4 per cent at the end of January 2015 rose to 16.6 per cent at the end of March 2015. The increase in inflation during the last two months was largely broad based. Food inflation which was 6.9 per cent at the end of January 2015 increased to 7.2 per cent by March. Similarly, non-food inflation also increased from 23.0 per cent to 23.1 per cent over the same period. The monthly changes in the CPI continued to grow at a pace higher than trends a year ago.

[5] In terms of the CPI components, the major contributors to the rise in inflation were broad based with the housing and utilities as well as transport exerting some downward pressures on inflation on account of the stability in the prices of petroleum products, transport fares and electricity and water tariffs in the review period.

[6] Core inflation has increased steadily since September 2014, as a result of the stability in the energy costs and rising underlying inflation. The core inflation (excluding energy and utility) rose from 10.6 per cent in September 2014 to 14.7 per cent in January and further up to 15.6 per cent by the end of March 2015.

[7] Crude oil prices remained volatile on the international commodity market. After dropping to around US$50 per barrel in January 2015, prices rose to around US$57.0 per barrel by March 2015. However, the sharp turnaround is expected to be modest with analysts predicting an average price of US$59 per barrel in 2015. On the domestic side, after the 10 per cent reduction in petroleum prices earlier in January, the prices at the pumps have remained broadly stable through to March. With the pick-up in the crude oil prices and rapid depreciation of the local currency, the stability in pump prices is not likely to be sustained in the immediate outlook.

[8] Gold and Cocoa price have also remained volatile in the first quarter of the year. The average price of gold which stood at US$1,249.9 per fine ounce at the end of January 2015 declined to US$1,181.2 per fine ounce by March. Gold prices are expected to come under some pressure in the immediate outlook as financial markets continue to anticipate the Federal Reserve rate hikes. The price of cocoa also declined from US$2,919 to US$2,797 per tonne over the same period. However, analysts have projected cocoa prices to peak in 2015 as supply weaknesses push up prices.

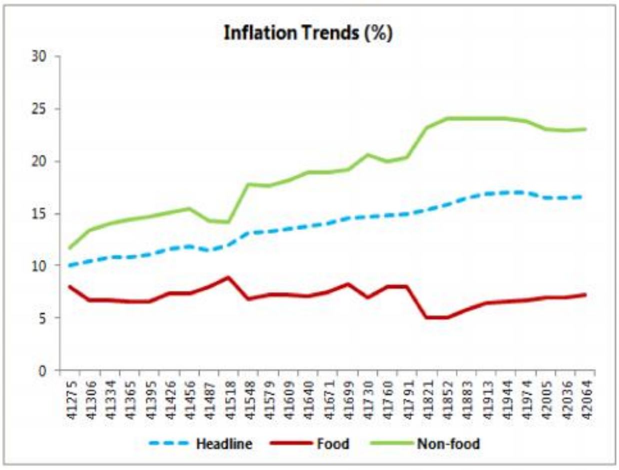
[9] Continued volatilities in commodity prices partly accounted for the worsened trade balance in the first quarter of 2015 to US$446.2 million from US$215.2 million in the corresponding period a year ago. The current account balance however, narrowed to US$549.3 million from US$1.1 billion as improvements in the Services, Income and Transfer account offset the deterioration in the trade balance. With a relatively lower Capital and Financial Account surplus of US$54.8 million compared with US$499.5 a year earlier, the overall Balance of Payments registered a deficit of US$849.4 million.

[10] These developments accounted for the decline in the Gross Foreign Asset from US$ 5.46 billion (3.8 months of import cover) in December 2014 to US$4.96 billion at the end of March 2015, representing 3.3 months of imports cover.

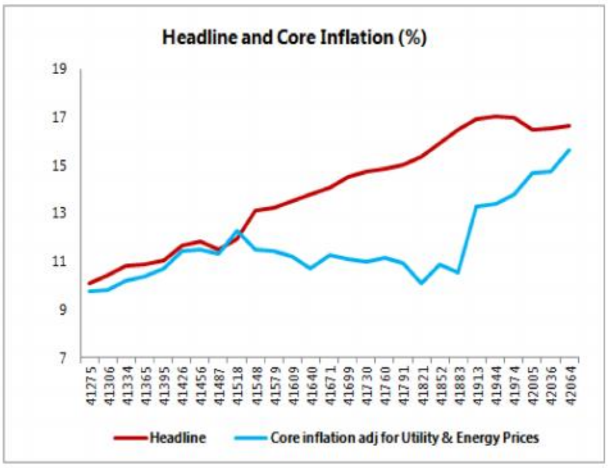
[11] The effects of the adverse external sector developments together with speculative activities of the foreign exchange traders and other market participants seeking to hedge against further depreciation put pressure on the local currency for the first four months of the year. In the first three months of 2015, the local currency depreciated by 15 per cent against the US dollar. However, the pace of depreciation slowed down in April with a monthly depreciation of about 2 per cent, bringing the cumulative depreciation to 16.9 per cent by the end of April. Although this level of depreciation is lower than the 21.3 per cent depreciation recorded a year ago, it presents a significant risk to the inflation outlook.

Recent Economic Developments

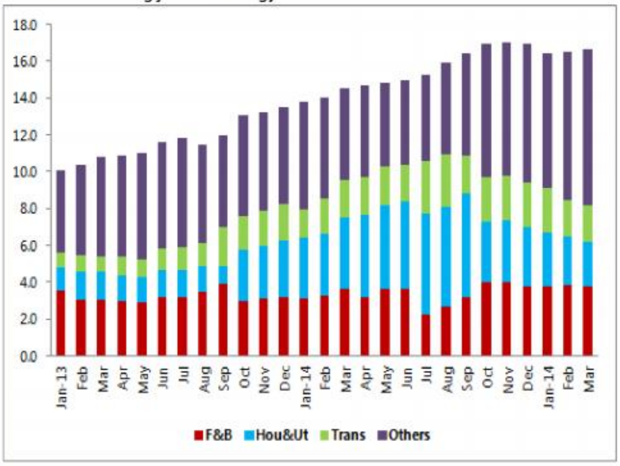
Inflation continued on an upward trajectory, after declining slightly in January...



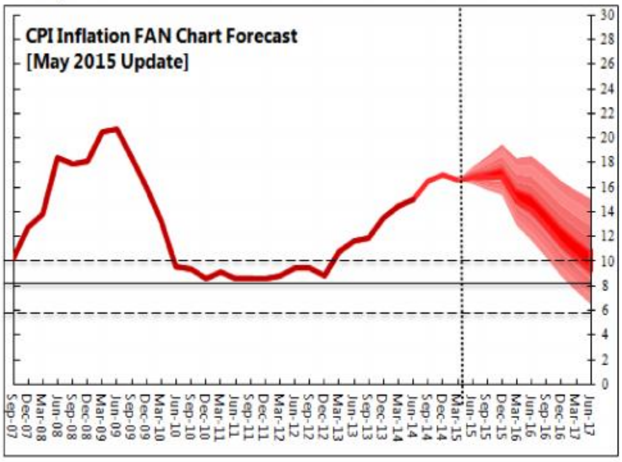
Core inflation continued to rise.......



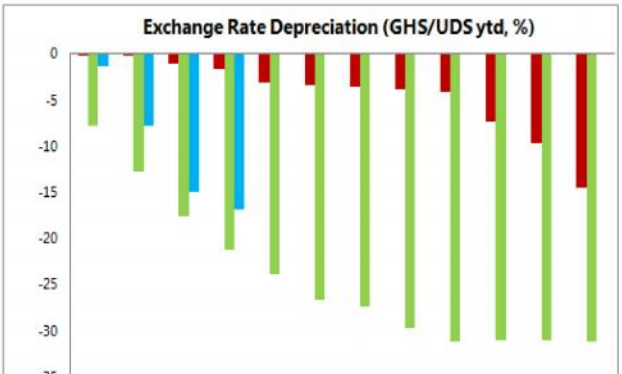
Broad based contribution to inflation in the first quarter indicating cost push pressures emanating from the energy crisis.....



Fan chart forecast suggests inflation likely to trend towards medium term target band in 2017.....

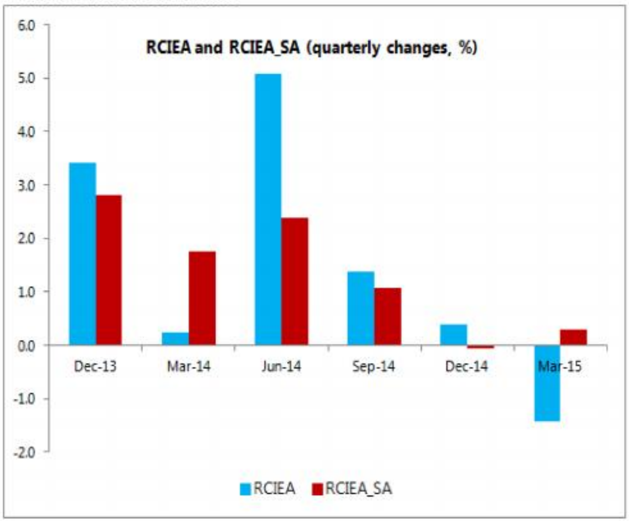


Cedi depreciation continued though at a slower pace than 2014....



	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2013	-0.2	-0.3	-1.1	-1.7	-3.1	-3.4	-3.6	-3.9	-4.12	-7.35	-9.71	-14.55
2014	-7.811	-12.85	-17.62	-21.29	-23.93	-26.71	-27.48	-29.79	-31.19	-31.15	-31.15	-31.25
2015	-1.341	-7.874	-15.02	-16.9								

Seasonally adjusted Real CIEA picked up slightly in March 2015, following a contraction in Dec 2014 due.....



4.2 Inflation Outlook and Risk Assessments

At the May 2015 MPC meeting, the Committee identified some underlying risks dominated by exchange rate pressures, cost push inflation arising from persisting energy sector challenges, imminent upward adjustment in energy and utility prices as well as a possible transmission of external vulnerabilities to the domestic economy. These factors had affected inflation expectations which prompted an increase in the policy rate to dampen threats to inflation outlook. Although, the growth prospects were noted to be less optimistic, this was considered as an inevitable short–term outcome of the frontloaded fiscal consolidation efforts alongside a tight monetary policy stance.

Inflation has remained significantly high since the last MPC meeting in February. The elevated levels of inflation were sustained partly by high costs of food, cost-push effects from energy sector challenges and rising inflation expectations. All the measures of core inflation have also increased steadily since October 2014 through to March 2015. Over the six month period, the core inflation (defined as inflation excluding utilities and energy) has moved up by 5.1 per cent to 15.6 per cent by March. The current trends in core inflation are indicative of the fact that underlying inflation pressures are heightened and likely to drive up the headline inflation over the forecast horizon.

Similarly, inflation expectations are building up and currently above the medium-term inflation target. The rapid exchange rate depreciation together with ongoing energy challenges has largely accounted for the rising inflation expectations across consumers, businesses and the financial sector. The extent to which retailers adjust their mark-ups in the face of anticipated rising costs pressures will be crucial in the immediate outlook. In particular, manufacturing input prices are likely to rise on the back of these pressures as evidenced by recent Ghana Statistical Service (GSS) release of the Producer Price Index. The index picked up in April (the first since September 2014) on the back of currency depreciation and effects of energy supply constraints. This is likely to provide a leading indication of how consumer prices may evolve in the near future.

Food inflation has continued to trend up since August 2014, from 5.1 per cent to 7.2 per cent by March 2015. In the first quarter of 2015, food inflation has moved up by about 0.3 per cent, largely driven by the cyclical lean season associated with food harvests in the first half year. The expectation over the horizon is that food inflation is likely to remain broadly at current levels to the end of the second quarter and begin to slowdown during the third quarter but the extent of reduction will depend on the behaviour of imported food inflation.

Non-food inflation remains elevated and has hovered within a tight band of 19 – 23 per cent since 2014. There is the need to break the elevated trend in non-food prices without which, it will be difficult to bring inflation down to the desired levels over the medium term. The outlook for the non-food category is dependent on the degree of exchange rate pass-through to domestic inflation in the coming months as this category has high import content. The local currency has depreciated by 16.9 per cent against the US dollar in the year to April 2015 but this is yet to reflect in the CPI numbers. Given the transmission lags and how agents perceive the nature of the depreciation (temporary or permanent), the expectation is that when businesses fully adjust to the cost impact, the pass-through to domestic prices would ensue.

The external sector development remains vulnerable with volatile international financial markets and commodity prices alongside expected lower than anticipated cocoa production. These are likely to pose additional risks to both inflation and growth in the outlook. In particular, the fragile global financial conditions and continued commodity price volatility could adversely impact on reserve accumulation. Also, the anticipated increase in US interest rates could lead to capital flow reversals.

The fiscal posture was constrained in the first quarter of 2015 as the deficit and the central bank financing were well within the target levels. The progress made so far would have to be sustained through the electoral cycle to support the efforts by monetary policy to restore the macroeconomic stability. However, there are underlying concerns that would have to be managed to ensure that all the fiscal targets set for the medium term are achieved. These include the

- revenue implications of the energy sector challenges,
- sharp cedi depreciation,
- dampening real sector activity evidenced by the CIEA,
- softened consumer and business sentiments, and
- the management of the rising debt and public sector wages.

Real GDP growth is projected to remain subdued in 2015 on account of the expected fiscal constraint and tight monetary policy, ongoing energy challenges, rising cost of doing business and adverse external sector conditions. These factors together with weak consumer and business sentiments constitute the major downside risks to output growth in the economy but at the same time these factors may also dampen inflation pressures. The real GDP growth is expected to be in the range of 3-4 per cent in 2015 but projected to pick up in 2016 and 2017 to 6.4 and 9.2 percent respectively. The turnaround in the 2016 – 17 is expected to be driven largely by the coming on stream of the TEN oil project as well as expected improvement in the macroeconomic environment.

4.3 Inflation forecasts

Against this background and revised assumptions about energy and utility charges (due to the pickup in crude oil prices and rapid cedi depreciation), and their anticipated pass through effects, the May 2015 forecast round has shown a further lengthening of the inflation target horizon into 2017. The headline inflation is now expected to rise and peak later in 2015 and thereafter decline steadily during 2016, ending the year in a range of 12-13 per cent. Over the horizon to 2017, inflation is expected to move towards the target band in the first half of 2017 and single digit range by the end of 2017. These forecasts are however, contingent on achieving all the fiscal targets along with tight monetary policy stance.

Upside risks to the inflation projections are varied and include, the behaviour of the exchange rate and crude oil price volatilities in recent months, implications of international commodity prices and US interest rate hikes on the external sector developments and associated central bank's ability to re-build reserves, as well as the behaviour of fiscal operations of government. The ***downside risks*** include, the tepid growth conditions, sustenance of fiscal constraint and tight monetary stance which are critical for achieving macroeconomic stability in the medium term.

Appendix

Overall Inflation, food and Non-food Inflation	2015			2014				2013
	Jan	Feb	Mar	Mar	Jun	Sep	Dec	Dec.
Headline Inflation	16.4	6.9	23.0	14.5	15	16.5	17.0	13.5
Food Inflation	16.5	7.0	23.0	8.2	7.9	5.8	6.8	7.2
Non-Food Inflation	16.6	7.2	23.1	19.2	20.3	24.1	23.9	18.1

Monthly Price Movements (2012 - 2015) : All Items

Year	Jan	Feb	Mar	Q1 Avg.	Apr	May	Jun	Q2 Avg.	Jul	Aug	Sep	Q2 Avg.
2013	3.66	0.91	0.50	**1.69**	1.57	0.72	1.50	**1.27**	1.26	-0.72	-0.68	**-0.05**
2014	3.93	1.13	0.93	**1.99**	1.72	0.86	1.63	**1.40**	1.60	-0.20	-0.20	**0.40**
2015	3.45	1.18	1.05	**1.89**								

Monthly Price Movements (2012 - 2015) : Food

Year	Jan	Feb	Mar	Q1 Avg.	Apr	May	Jun	Q2 Avg.	Jul	Aug	Sep	Q2 Avg.
2013	5.67	0.00	0.00	**1.89**	2.66	0.00	1.47	**1.38**	1.71	-1.37	-3.62	**-1.09**
2014	5.53	0.39	0.65	**2.19**	1.48	0.98	1.39	**1.28**	-1.00	-1.30	-3.01	**-1.77**
2015	5.67	0.50	0.79	**2.32**								

Monthly Price Movements (2012 - 2015) : Non - Food

Year	Jan	Feb	Mar	Q1 Avg.	Apr	May	Jun	Q2 Avg.	Jul	Aug	Sep	Q3 Avg.
2013	2.40	0.21	0.26	**0.96**	0.45	1.06	1.12	**0.87**	0.92	-0.22	1.52	**0.74**
2014	2.86	1.63	1.11	**1.87**	1.89	0.77	1.80	**1.49**	3.30	0.50	1.58	**1.79**
2015	2.16	1.59	1.20	**1.65**								

Measures of Core Inflation

	Relative Importance	2013	2014				2015		
		Dec	Mar	Jun	Sep	Dec	Jan	Feb	Mar
Headline Inflation	100.0	13.5	14.5	15.0	16.5	17.0	16.4	16.5	16.6
Core 1: Inflation excl Energy and Utility	94.9	11.2	11.1	10.9	10.6	13.8	14.7	14.7	15.6
Core 2: Inflation excl Energy and Utility and Volatile Food Items	77.3	12.1	11.7	11.7	12.5	16.4	17.2	17.2	18.3
Core 3: Inflation excl Energy and Utility Volatile Food Items & Transportation	73.1	10.5	9.9	10.3	11.4	12.5	13.5	14.1	15.0
Core 4: Inflation excl All Food Items, Energy & Utility	51.0	14.8	13.3	13.1	13.3	19.0	20.6	20.6	22.2