Bank of Ghana
Monetary Policy Report

Inflation Outlook and Analysis

Vol. 6 No. 4/2020 July 2020

1.0 Overview of Global and Domestic Economic Developments

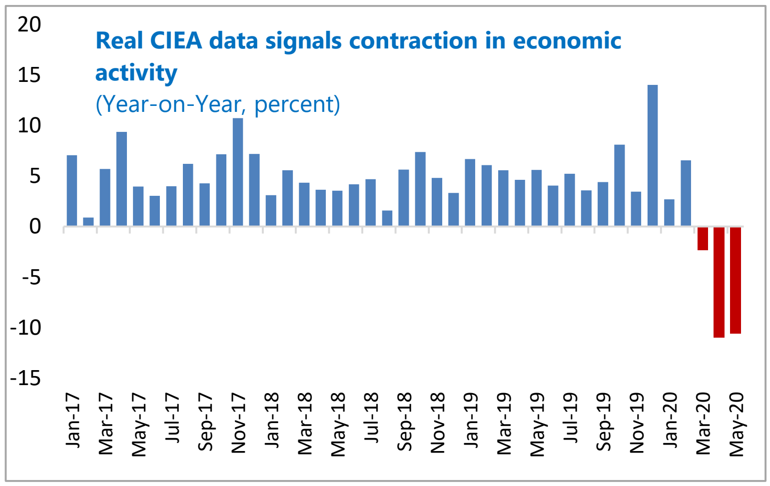
The COVID-19 pandemic has continued to weaken global economic conditions and growth projections have worsened since the last MPC meeting in May 2020. The IMF for instance, has revised downwards its initial global growth forecast from a contraction of 3.0 percent to a contraction of 4.9 percent in its June 2020 release of the World Economic Outlook update. The pandemic had a more negative impact in the first half of 2020 than anticipated and the recovery is projected to be more gradual than previously projected.

Global inflationary pressures remain subdued reflecting low energy prices and a sharp drop in real GDP with significant slackness in labor market conditions. Brent crude oil price has recovered somewhat since the collapse in the first quarter of 2020 but still below the pre-pandemic level. This reflects hopes of reversal of the collapse in oil demand associated with the pandemic, as China recovers and lockdowns in other countries are gradually eased. In the near term, inflation projections have generally been revised downwards amid lower oil prices and weaker demand. These factors more than offset any inflationary pressures from supply disruptions.

Core inflation remains low in advanced economies and inflation projections have generally been revised downwards in the near term. In emerging market and developing economies, the inflation dynamics will continue to depend on the direction of movement of the exchange rate and the impact of COVID-19 on food prices. Global financial markets have eased somewhat reflecting decisive monetary, financial, and fiscal policy actions which have helped stabilize investor sentiments. Confidence indicators are beginning to show signs of improvement although still below pre-pandemic levels, especially in countries that have successfully slowed the pace of COVID-19 infections.

The outlook for the global economy remains uncertain despite these early encouraging signs of recovery. Signs of a second wave of infections and intensification of the pandemic in other economies is sparking fears of a re-imposition of restrictions and containment measures, weighing on risk sentiments, with implications for borrowing costs, currency stability, and rising debt levels.

On domestic growth conditions, the latest real GDP outturn showed that the first quarter grew by 4.9 percent in 2020 compared with 6.7 percent in the same period in 2019. Non-oil growth also slowed to 4.9 percent from 6.0 percent in the same comparative period last year. The services, agriculture, and manufacturing sectors contributed positively to the observed growth.



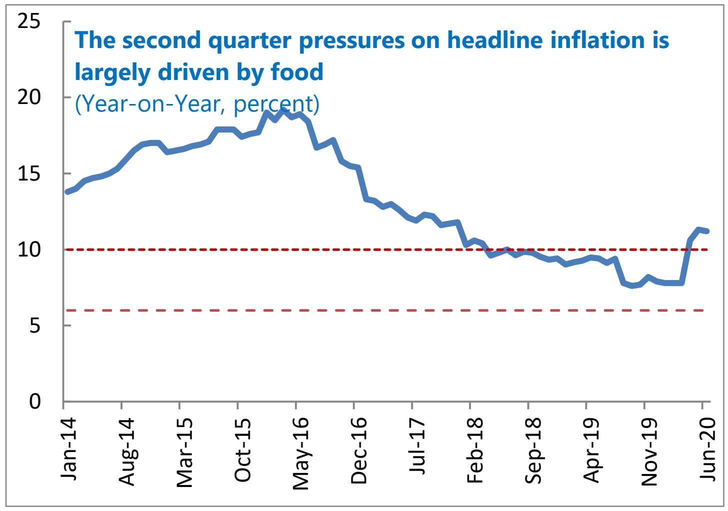
The Bank of Ghana's Composite Index of Economic Activity (CIEA) contracted sharply by 10.6 percent in May 2020 compared to 5.6 percent growth in May 2019. High frequency data shows that the contraction was broad-based and reflects the impact of the COVID-19 pandemic on the domestic economy. A modest recovery in the business and consumer confidence indices in June, which is still below the pre-COVID-19 level, suggests some optimism in the near-to-medium-term.

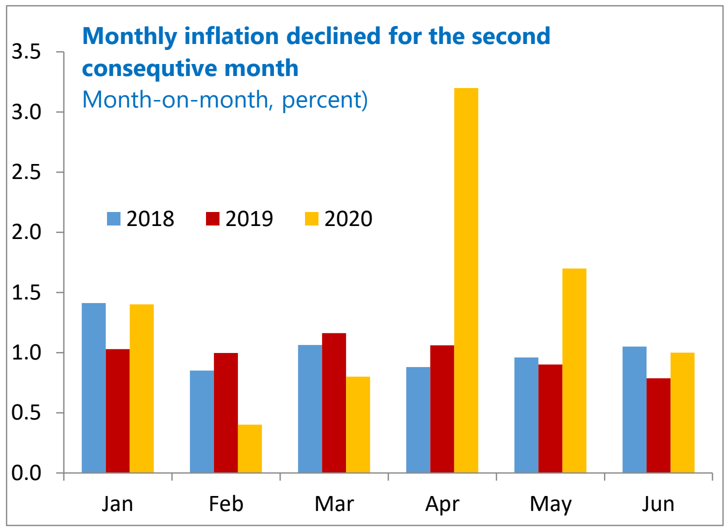
The execution of the budget for the first half of the year has been adversely affected by the COVID-19 pandemic through a combination of revenue underperformance and fast-paced spending. Half-year results indicate an overall budget deficit of 6.3 percent of GDP, against a target of 3.0 percent of GDP. The mid-year budget review has therefore revised upwards the overall budget deficit target to 11.4 percent of GDP by end year, from the earlier target of 4.7 percent of GDP, reflecting an additional 6.7 percent of GDP attributable to both direct and indirect COVID-19 impact.

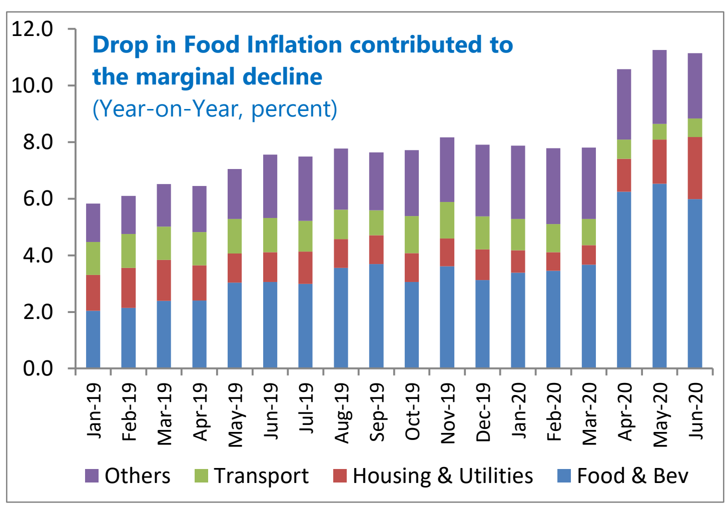
2.0 Domestic Price Developments

Headline Inflation

After remaining flat at 7.8 percent in the first quarter, inflation rose to 11.2 percent in the second quarter. This sharp increase was driven largely by food prices, which spiked in response to the panic-buying episode preceding the partial lockdown that was announced at the end of March 2020. Food prices continued to







increase from 8.4 percent at the end of the first quarter to 13.9 percent at the end of the second quarter. Non-Food inflation also rose from 7.4 percent to 9.2 percent, but this has been at a much slower pace than food prices.

The sharp rise in inflation in the second quarter has somehow disrupted the disinflation process with a potential of prolonging the time horizon for reaching steady state inflation. Inflation expectations of the financial sector, businesses, and consumers have all trended upwards.

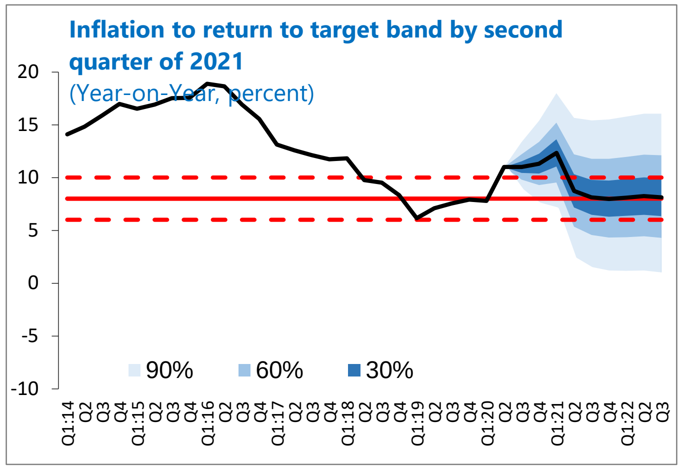
On a monthly basis, consumer prices increased by 1.0 percent in June 2020 lower than the 1.7 percent rise recorded in May 2020. The decline comes on the back of a significant drop in monthly food inflation from 2.3 percent at the end of May 2020 to 0.1 percent in June 2020. The decline in monthly food inflation was moderated by a rise in non-food inflation on a month-on-month basis. Non-food prices rose by 1.8 percent in June from 1.3 percent in May 2020.

Component analysis of the consumer basket showed that the key drivers of the decline in food inflation in June were the significant drop in price of Vegetables and, Fruits and Nuts, which recorded inflation rates of 28.8 and 17.4 percent in June from 34.9 and 21.5 percent in May respectively. Within the non-food category, the uptick was driven by the rise in rents in the Housing and

Utilities sub-category, which pushed up inflation for the category to 21.3 percent in June 2020 from 15.1 percent in May 2020 in year-on-year terms.

3.0 Inflation outlook

Headline inflation averaged 11.0 percent in the second quarter of 2020 from an average of 7.8 percent in the first quarter, above the upper band of the medium-term target of 8±2 percent. The decomposition of inflation into factors driving it shows that the rise in inflation was mainly driven by relatively higher inflation expectations and supply shocks emanating from higher food prices.



Adjusting for the unusual noise in the food inflation, the indications are that underlying inflationary pressures are stable. Despite the sharp uptick in inflation in the second quarter, inflation is expected to gradually return to the medium-term target by the second quarter of 2021. In the outlook, the dynamics in headline inflation are anticipated to be driven by somewhat higher expectations and the persistence of supply shocks.

Output gap (the measure of the level of capacity utilization) is projected to remain negative in the medium-term, driven by real sector expectations of weak economic activity, persistence of the current negative demand shocks, and relatively tight monetary conditions in the forecast horizon. This 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 above trend with the real exchange rate remaining broadly close to 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 on the upside in the forecast horizon. The key risks as assessed at this MPC round include:

- ***Global economic conditions***

The weak global growth conditions are expected to soften global demand thereby easing pressures on prices. Consequently, headline and core inflation across the globe are expected to remain low in the medium-term.

- ***Oil prices and Transport fares***

Rising ex-pump prices in the domestic market in recent months alongside agitation for upward review in fares by commercial transport owners due to social distancing measures impacting on margins led to an upward adjustment in transport fares by 15 percent in July 2020. The direct impact on the CPI basket as well as the second-round effects of higher transport fares on overall pricing of goods and services are expected to put upward pressures on prices in the outlook. This is however expected to be muted somewhat with the expected drop in in transport fares of some 10 percent following the recent easing of social distancing requirements for commercial transport.

- ***Domestic economic activity***

Latest data on the Ghanaian economy shows that the pandemic has impacted adversely, resulting in a significant growth downturn. Leading indicators of economic activity for the second quarter suggest significant deterioration of most real sector indicators, albeit with incipient signs of recovery. This, in addition to baseline projection of economic activity remaining below capacity, suggests low domestic demand pressures on inflation in the outlook.

- ***Expected stability of the cedi***

Recent pressures on the local currency have eased somewhat, on the back of inflows from the mining sector, positive sentiments of the early issuance of the Eurobond and US$1billion Rapid Credit Facility from the IMF, and forward auctions sales. Furthermore, the US$1 billion Repurchase Agreement (Repo) facility with the U.S. Federal Reserve under its Repo facility for Foreign and International Monetary Authorities (FIMA Repo Facility) will further boost the exchange rate in the outlook. In addition, the slowdown in capital outflows from emerging market economies is expected to support the current stability of the cedi.

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

As part of the relief measures to ease the impact of the COVID-19 pandemic, Government announced in the mid-year budget review that it would extend the relief packages on utilities for consumers from June to September 2020. The direct effect of this is a reduction in prices of the utilities sub-component in the non-food basket, which could generate some downward pressures on headline inflation. On the other hand, the

COVID-19 pandemic has derailed the earlier fiscal consolidation as financing requirements surged. The huge financing gap due to unexpected health related expenditure to contain the pandemic and the stimulus package for real sector recovery is expected to exert some fiscal pressures on inflation in the medium term. In addition, election-year fiscal uncertainties may pose additional upside risks to inflation. 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.

4.0 Conclusion

Latest forecast shows that inflation is currently above its upper limit, driven mostly by food prices. Adjusting for the unusual noise in the food inflation, the indications are that underlying inflationary pressures are stable. The projections show a return of inflation to the medium-term target band by the second quarter of 2021, partly conditional on corrective fiscal measures being introduced in the near-term. The MPC noted among others that, under the current extraordinary circumstances, with a widened budget deficit and a residual financing gap, would require some monetary restraint to preserve the anchors of macroeconomic stability. In the circumstances, the Committee decided to maintain the policy rate at 14.5 percent.

Appendix Table 1: CPI Components

CPI Components (%)														
		2018	2019						2020					
	Weghts (%)	Dec	Jan	Mar	Apr	May	Jun	Jul	Jan	Feb	Mar	Apr	May	Jun
Overall	100.0	9.4	9.0	9.3	9.5	9.4	9.1	9.4	7.8	7.8	7.8	10.6	11.3	11.2
Food and Beverages	43.9	8.7	8.0	8.4	7.3	6.7	6.5	6.6	7.8	7.9	8.4	14.4	15.1	13.8
Non-food	56.1	9.8	9.5	9.7	10.4	10.6	10.3	10.7	7.9	7.7	7.4	7.7	8.4	9.2
Alcoholic Beverages, Tobacco	1.7	8.4	8.3	8.4	8.7	9.5	9.9	10.3	11.1	11.6	11.4	9.7	10.1	8.6
Clothing and footwear	9.0	13.0	12.8	13.3	14.3	15.0	15.2	14.9	7.2	8.5	8.4	8.3	7.9	7.3
Housing and Utilities	8.6	3.4	2.9	2.1	6.0	6.5	6.8	9.8	7.6	6.3	6.7	11.2	15.1	21.3
Furnish, H/H Equipt. Etc	4.7	11.6	11.2	12.2	12.8	14.5	14.6	14.6	4.3	4.3	4.3	4.6	4.5	4.9
Health	2.4	6.4	5.3	5.0	5.9	7.1	7.5	7.9	6.3	6.4	6.2	6.5	5.6	7.8
Transport	7.3	13.6	13.4	13.7	13.2	12.5	6.9	6.9	10.5	9.9	9.2	6.7	5.4	6.3
Communications	2.7	5.1	5.2	5.8	6.7	6.1	6.9	7.6	3.1	2.9	3.0	4.0	6.2	6.3
Recreation & Culture	2.6	13.2	12.7	14.1	14.1	15.0	15.0	14.8	9.0	9.0	9.0	8.6	9.4	5.8
Education	3.9	8.2	8.1	8.4	7.8	6.2	6.2	6.4	6.8	6.7	6.8	6.9	7.1	4.1
Hotels, Cafes & Restaurants	6.1	6.3	6.7	7.5	8.1	7.2	9.5	9.9	7.5	6.8	3.5	3.6	4.3	5.8
Insurance and Finacial services									0.6	0.4	0.1	0.1	0.2	3.5
Miscellaneous goods & services	7.1	10.0	9.6	9.4	10.0	9.5	11.3	11.2	7.3	7.4	7.3	6.4	5.9	5.4

Source: Ghana Statistical Service

Appendix Table 2: Headline Inflation

	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

Source: Ghana Statistical Service