Bank of Ghana
Monetary Policy Report

Inflation Outlook and Analysis

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4.0 Overview of Global and Domestic Economic Developments

Global economic growth broadly remained modest although growth trends varied among major advanced economies and across the various regional groupings. Following a weaker than expected growth in the first half of 2014, growth momentum in some advanced economies firmed up in the second half year, supported by improved sentiments, stability in the financial markets and accommodative policies. In particular, growth was stronger than expected in the United States, while economic performance in other major economies fell short of expectations. The improved growth conditions in the US and UK were driven largely by strong demand. However, economic activity contracted in the Euro Area, Japan and China due to weak investments.

Looking ahead, the IMF World Economic Outlook (WEO) January 2015 update has projected global growth to pick up from 3.3 per cent in 2014 to 3.5 per cent in 2015 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 downward revision was due to gains from lower oil prices which more than offset weak non-oil and oil-related investments in major advanced economies. The advanced economies are expected to expand at 2.4 per cent from 1.8 per cent in 2014. While the US economy is projected to pick up at a much faster pace, growth in the Euro area and Japan were revised downwards. In emerging and developing economies, growth forecasts show some moderation to 4.3 per cent on the back of a slowdown in China, Brazil and Russia; while Sub-Saharan Africa (SSA) growth is expected to improve marginally to 4.9 per cent in 2015 from 4.8 per cent estimated for 2014. This was significantly lower than the earlier projection of 5.8 per cent for 2015 mainly due to falling oil prices which has subdued the outlook for Nigeria (the largest economy in SSA).

Since the last MPC meeting, the following developments have occurred in the domestic economy

(i) The increased volatilities in the foreign exchange market and sharp depreciation of the currency during the first nine months of the year stabilised in the last quarter as earlier monetary policies took effect, along with inflows from the Cocoa loan and Eurobond which offered support to the foreign exchange market. Consequently, the cedi depreciated by 0.1 per cent during the last quarter of 2014. However, the cumulative depreciation for the year was 31.2 per cent compared with 14.6 per cent a year earlier. In January 2015, the currency depreciated by 1.3 per cent.

(ii) The stable exchange rate had a positive knock on effect on business and consumer confidence in the last quarter of the year. Business and consumer sentiments improved relative to conditions that existed during the survey conducted in July 2014 (which provided the background for discussions in September). The overall assessment of economic prospects by businesses and consumers were positive.

(iii) The severe challenges in the energy sector led to an all-year round load shedding exercise with adverse effects on productive activities. The energy crisis and the sharp fall in key commodities prices culminated in a slower pace of economic expansion in 2014. As a consequence, the earlier GDP growth projection of 6.9 per cent for 2014 was revised downwards to 4.2 per cent.

(iv) On the commodities market, crude oil prices declined by 37 per cent during the last quarter. The price of Brent crude which stood at $99 per barrel at the end of September 2014 declined significantly and settled at $62 per barrel as at December 2014. The sharp drop in oil prices was attributed to improved supply, especially with increased oil production from the US, against weak demand. In addition to declining crude oil prices, the average price of gold which stood at US$1,238 per fine ounce at the end of the third quarter declined to US$1,201 by end year. Similarly, the average price of cocoa also declined from US$3,182 per tonne to US$2,853 per tonne during the same period.

(v) The softening of commodity prices on the international markets, especially crude oil prices affected the country's export earnings despite increases in production. This notwithstanding the trade balance improved significantly in 2014 as the currency depreciation constrained imports.

(vi) At the domestic level, prices of petroleum products has not responded to the downward international price trends of crude oil as expected particularly due to an introduction of a 17.5 per cent Special Petroleum Tax in November 2014. Consequently, we have seen the price of petrol at the pump increase marginally by 0.9 per cent during the last quarter to GH¢3.39 at end December 2014. For the entire year, ex-pump petrol prices increased by 54.3 per cent. However in January 2015, the domestic price of petroleum products was lowered by 10 per cent to GH¢3.05 per litre, partially reflecting developments on international markets.

(vii) Due to the sharp fall in international crude oil prices and challenges in the energy sector, the Public Utility and Regulatory Commission (PURC) maintained tariffs on electricity and water during the last quarter of 2014 and first quarter of 2015.

(viii) On government fiscal operations, some gains were made in the quest to rein in government expenditures although revenue collection fell short of targets reflecting the effects of the currency depreciation, significant slowdown in economic activity as well as Government's inability to implement all the revenue mobilisation measures outlined in the 2014 Budget. As a result the narrow defined budget recorded a deficit equivalent to 6.9 per cent of GDP compared with the target of 6.5 per cent of GDP (8.8% of GDP a year earlier).

4.1 Domestic Price Conditions

Inflation remained relatively flat during the last quarter, moving from 16.5 per cent in September to 17 per cent by the end of December 2014. The increase was mainly accounted for by food inflation which moved from 5.8 per cent in September to 6.8 per cent by the end of the last quarter. Non-food inflation however slowed down during the period, moving from 24.1 per cent to 23.9 per cent as the exchange rate volatility stabilized in the last quarter.

For the year as a whole, headline inflation registered an increase of 3.5 percentage points, jumping from 13.5 per cent at the end of 2013 to 16.5 per cent in September and further up to 17 per cent in December reflecting the pass through effects of the currency depreciation, and accompanying upward adjustments in energy and transport costs.

A disaggregation of the components of the consumer basket showed that non-food prices increased at a faster pace than food prices over the 12-month period. The non-food inflation which stood at 18.1 per cent at the end of December 2013, increased consistently in the first nine months of the year to peak at 24.1 per cent by the end of the third quarter. This was mainly on account of the sharp currency depreciation which pushed up the costs of the petroleum products (31.7 – 60%), transport (40%) and utility (12.9 – 28.4%). The non-food inflation however began to decelerate during the last quarter as these effects waned.

The food inflation also moved up from 7.2 per cent at the end of 2013 to 8.2 per cent in the first quarter of 2014 mainly reflecting the costs associated with transporting food to the major centers across the country as well as increases in imported food prices. In the second to third quarters, food inflation declined to 5.8 per cent as the harvest season set in but prices picked up again during the last quarter to settle at 6.8 per cent at the end of the year.

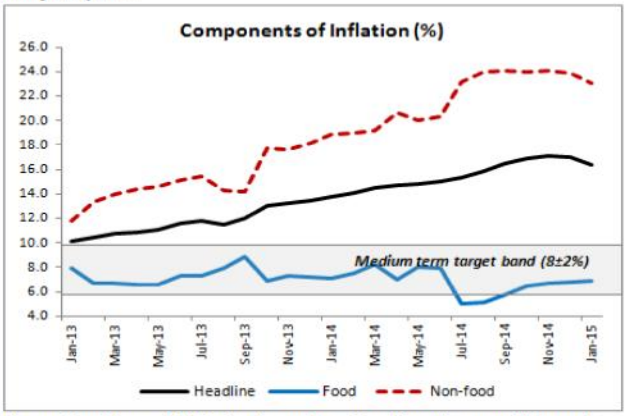
In January 2015, the headline inflation slowed down to 16.4 from 17 per cent in December 2014 as tight policy stances and base effects impacted. The slowdown reflected more in the non-food inflation category which declined to 23 per cent from 23.9 per cent at the end of December 2014. However, the food inflation moved up marginally to 6.9 per cent from 6.8 per cent.

Core inflation increased steadily in 2014 with the sharpest increase observed in January 2015, reflecting stable energy costs and rising underlying inflation. Core inflation (excluding energy and utility) was at 13 per cent in December 2014 but surged to 14.7 per cent by the end of January 2015. The observed increase in Core inflation since September 2014 was driven by all the sub components with the exception of the transport, housing and utilities.

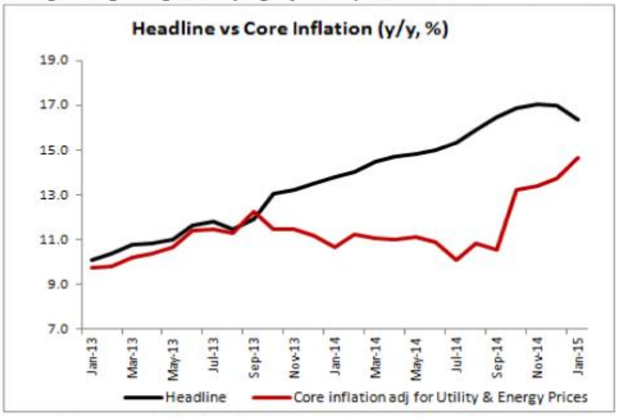
In terms of CPI components, the major contributors to the rise in inflation were broad based although contributions from the energy, transport and food were significant throughout the year. In January 2015, the housing and utilities group exerted some modest downward pressure on inflation due to the 10 per cent reduction in petroleum prices earlier in the month.

Figure 1: Recent Economic Developments

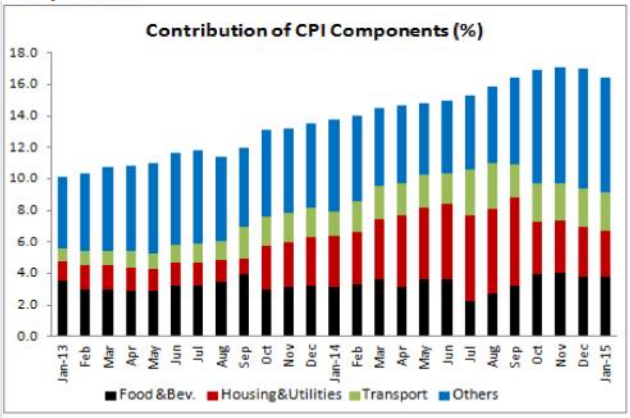
Inflation moderated slightly in January driven by marginal declines in non-food prices



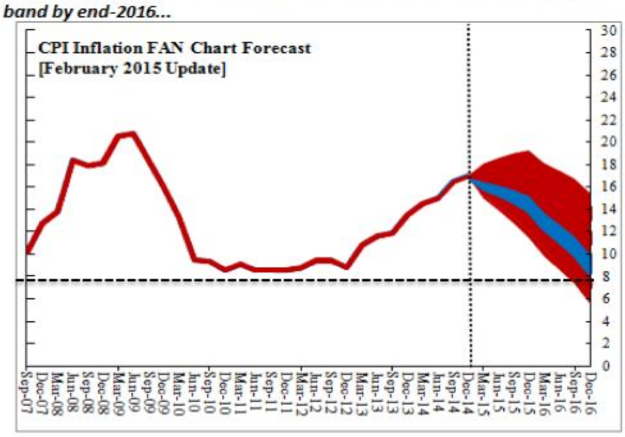
Core inflation increased steadily due to stable utility and energy costs, and signalling rising underlying inflation pressures



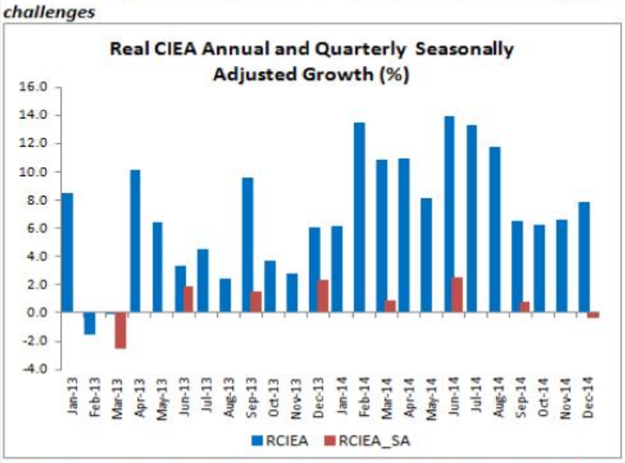
The major drivers of inflation have been food, housing & utlities and Transport costs



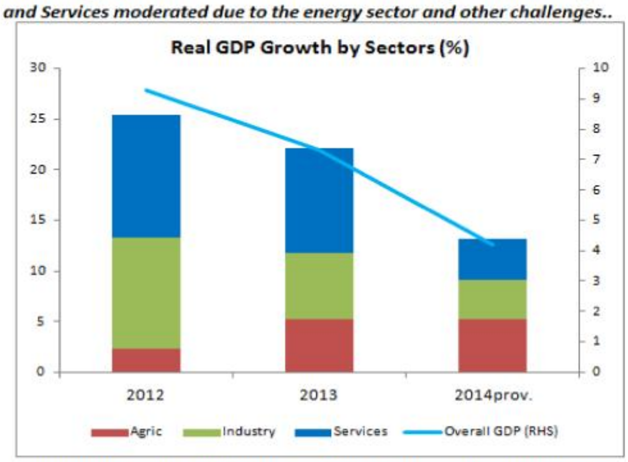
Forecast suggests inflation likely to trend towards medium term target band by end-2016...



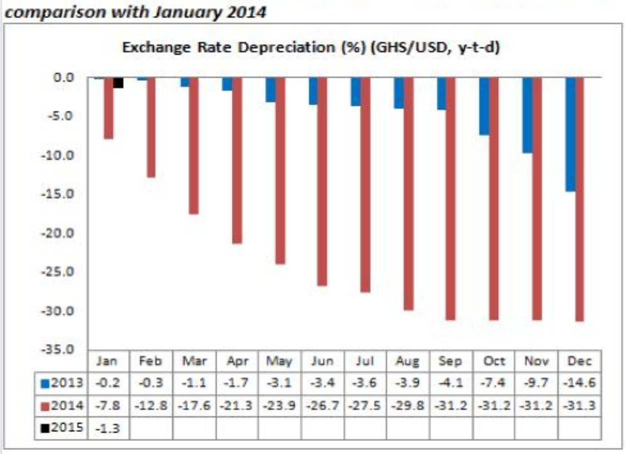
Seasonally adjusted Real CIEA contracted in Dec 2014 due to energy sector challenges



Real GDP growth was estimated at 4.2% in 2014 as growth in Industy and Services moderated due to the energy sector and other challenges..

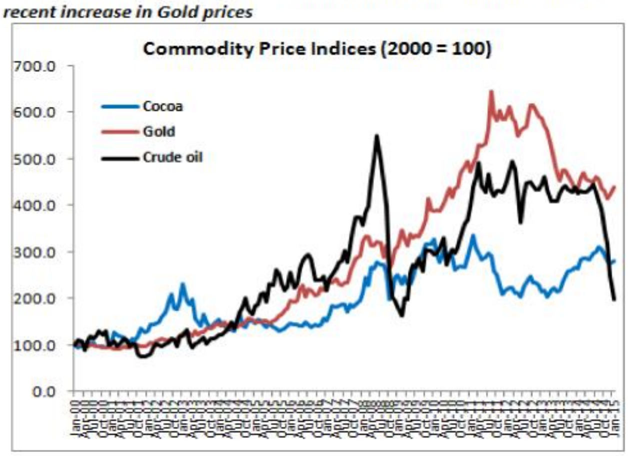


Exchange rate depreciation slowed in Q4 2014 and into January 2015, in comparison with January 2014



	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	-4.1	-7.4	-9.7	-14.6
2014	-7.8	-12.8	-17.6	-21.3	-23.9	-26.7	-27.5	-29.8	-31.2	-31.2	-31.2	-31.3
2015	-1.3											

Ghana's major commodity prices continued to trend down despite a recent increase in Gold prices



4.2 Inflation Outlook and Risks Assessments

The economy encountered challenges on several fronts in the first nine months of 2014 but conditions moderated during the last quarter as the earlier monetary policies impacted.

The inflows from Cocoa loan, Eurobond, and progress in the IMF talks calmed expectations and somewhat restored confidence in the economy as both businesses and consumer sentiments improved. These contributed to the stability in the currency during the last quarter of 2014 and the first month of 2015, easing off inflation pressures. The gains made from the foreign exchange market are expected to be further cemented by tight fiscal and monetary policy stance under the imminent IMF 3-year program.

The developments in the global economy point to subdued growth conditions in 2015 relative to earlier projections. The expected weak demand together with improved supply has resulted in a sharp fall in crude oil prices since mid-2014. The oil prices are expected to remain volatile throughout the first half of 2015. This development has implications on the domestic economy through the external sector, the execution of the budget and on inflation dynamics. On a more positive note, falling oil prices is expected to support the disinflation process in 2015 given the significant contributions of energy and transport costs to overall inflation in the past two years. Although the full pass through from the falling oil prices in the international scene has not yet occurred, prices of petroleum products were reduced by 10 – 12 per cent across all petroleum products in January 2015 which reflected in the January CPI numbers. However, the disinflation process will to a large extent depend on the moderating effects from the introduction of the special petroleum tax; extent of the pass through to pump prices and developments in the exchange rate.

The implementation of the fiscal consolidation measures as outlined in the 2015 Government Budget Statement has begun. On the revenue side, the imposition of the special petroleum tax of 17 per cent; the extension of national fiscal stabilization levy of 5 per cent and special import levy of 1 – 2 per cent to 2017 have been implemented. On the expenditure side, the wage settlement agreement has been completed, while the structural reforms regarding the payroll are being fashioned out. In the outlook, the major fiscal risks remain the likely effect of the falling commodity prices particularly the fall in oil revenue as well as the likely revenue shortfalls from the energy challenges and associated dampened growth outlook.

On the real sector, the pace of expansion in economic activity further dampened during the last quarter as evidenced by the quarterly real GDP and CIEA numbers. The provisional real GDP growth for 2014 was revised downwards to 4.2 per cent compared with earlier estimated figure of 6.9 per cent. Growth conditions are expected to further moderate in the outlook as energy crisis deepens, international commodity prices fall, and the tight policy stance for 2015 which seeks to unwind the large macroeconomic imbalances impact.

These developments are expected to dampen inflation expectations and exert some downward pressures on prices in the economy. Inflation stabilized in the last quarter of 2014 and in January 2015, dropped 600 basis points to 16.4 percent as the exchange rate pass through effects gradually tapered off. Although the decline was initiated by non-food components, the observed increase in food inflation since

December and also the rising core inflation remain a source of concern to the inflation outlook and needs to be monitored as the lean season approaches.

The central path of the Fan Chart forecast shows that inflation is likely to moderate in 2015 and head towards the target band of 8 ± 2 percent by the end of 2016. This is under a key assumption of tight monetary policy stance supported by stringent fiscal consolidation programme under an IMF programme.

The uncertainties surrounding these inflation projections are however varied. The upside risks include the behavior of crude oil prices which has shown greater volatility in recent times and its implications on the budget; ability to contain emerging pressures in the foreign exchange market; and resolution of the energy crisis to eliminate cost-push effects. On the downside, the tight monetary stance, ongoing fiscal consolidation, falling crude oil prices, an IMF programme and subdued growth conditions are likely to support the disinflation process in 2015 and beyond.

4.0 Conclusion

The economy was confronted with many challenges in 2014. As a result, the policy stance for 2015 is meant to unwind the macroeconomic imbalances to restore investor confidence and regaining the macroeconomic stability. This is expected to be driven by full implementation of all the fiscal consolidation measures outlined in the 2015 budget, maintaining tight monetary policy stance as well as keeping the foreign exchange market stable.

On the real sector, the pace of economic activity in the economy has moderated and this is expected to be compounded by the impact of the energy sector challenges, falling commodity prices and tight policy stances from the fiscal and monetary fronts. The improvements in the business and consumer sentiments in the last two survey rounds as well as strong real credit are expected to sustain the growth conditions.

In 2015, overall inflation is expected to ease. However, risks in the short-term outlook are on the downside given the relative stability in the foreign exchange market, improved inflation expectations from consumers and businesses, subdued growth conditions and a tight policy stance. On the exchange rate front, early conclusion of IMF discussions and the associated balance of payments support is expected to provide an added boost to the country's reserve levels and ease off the cyclical exchange rate pressures during the first half year.

Table 1: Overall Inflation, food and Non-food Inflation (%)

	2015	2014						2013	2012	2011
	Jan	Mar	Jun	Sep	Oct	Nov	Dec	Dec.	Dec.	Dec.
Headline Inflation	16.4	14.5	15	16.5	16.9	17.0	17.0	13.5	8.8	8.6
Food Inflation	6.9	8.2	7.9	5.8	6.5	6.6	6.8	7.2	3.9	4.3
Non-Food Inflation	23	19.2	20.3	24.1	24.0	24.1	23.9	18.1	11.6	11.2

Source: GSS

Table 2: CPI Components

	Relative Importance (%)	Jan-13	Dec-13	Jan-13	Sep-14	Dec-14	Jan-15	Absolute Change in Inflation Jan-13 Dec-13	Absolute Change in Inflation Jan-14 Dec-14
Overall	**100.0**	10.1	13.5	13.8	16.5	17.0	16.4	3.4	3.2
Food and Beverages	**43.9**	8.0	7.2	7.1	5.8	6.8	6.9	-0.7	-0.3
Non-food	**56.1**	11.8	18.1	18.9	24.1	23.9	23.0	6.3	4.9
Housing, Water, Elect, Gas & Fuels	**8.6**	13.9	35.0	37.9	63.5	35.2	32.3	21.1	-2.7
Transport	**7.3**	9.7	25.6	21.4	27.1	30.8	31.1	15.9	9.4
Communications	**2.7**	-0.1	4.4	5.0	8.6	12.8	11.6	4.5	7.8
Alcoholic Beverages, Tobacco	**1.7**	11.2	13.2	13.1	15.3	17.3	16.4	2.0	4.2
Health	**2.4**	8.5	10.7	12.3	15.1	19.4	14.5	2.2	7.1
Recreation & Culture	**2.6**	10.8	11.2	14.6	12.6	22.8	20.4	0.4	8.2
Hotels, Cafes & Restaurants	**6.1**	10.7	8.8	9.3	13.0	13.6	13.9	-1.9	4.3
Clothing and footwear	**9.0**	16.6	16.6	20.2	14.9	20.8	18.9	-0.1	0.6
Miscellaneous gds & Serv.	**7.1**	11.0	17.5	19.3	13.7	16.0	14.3	6.5	-3.3
Furnish, H/H Equip. etc	**4.7**	13.5	15.7	15.2	12.0	16.5	17.7	2.3	1.3
Education	**3.9**	6.2	8.9	9.1	3.5	14.2	20.2	2.7	5.1

Source: GSS

Table 3: Measures of Core Inflation

	Relative Importance	2013 Dec	2014 Mar	2014 Jun	2014 Sep	2014 Dec	2015 Jan
Headline Inflation	**100.0**	13.5	14.5	15.0	16.5	17.0	16.4
Core 1: Inflation excl Energy and Utility	**94.9**	11.2	11.1	10.9	10.6	13.8	14.7
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
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
Core 4: Inflation excl All Food Items, Energy & Utility	**51.0**	14.8	13.3	13.1	13.3	19.0	20.6

Source: BOG and GSS