Bank of Ghana
Monetary Policy Report

Inflation Report

Volume 4 No.1/2016 January 2016

4.0 Summary

The Monetary Policy Committee (MPC) acknowledged heightened risks to the inflation outlook arising from both domestic and external sources throughout 2015. These risks were characterized by tight financing conditions, declining commodity prices, power supply constraints and rationalization of key sectors, including price adjustments of petroleum products and utility tariffs. Against this backdrop, monetary policy remained tight with the objective of re-anchoring inflation expectations and steering inflation towards the medium term target. During the September and November 2015 meetings, the Committee took cognizance of additional risks emerging from the possible second round effects of the expected increases in utility tariffs and tightened monetary policy by 100 basis points consecutively.

At the January 2016 meetings, the Committee highlighted risks emanating from slower growth prospects in emerging market economies, declining commodity prices, tightening external financial conditions, as well as the unanticipated upward adjustments in petroleum product prices. These risks could be transmitted to the domestic economy through the balance of payments and execution of the budget with some implications for growth and the inflation outlook. However, in assessing economic conditions, the Committee noted that the tightening of policy in September and November took into account some of these risks, hence, the forecast horizon of achieving the medium term target of 8±2 percent by early 2017 remains broadly unchanged. Consequently, the policy rate was maintained at 26 percent with the view that the earlier policy rate hikes were still filtering through the economy to deliver the medium term inflation target. In addition, continuation of the fiscal consolidation process could provide additional boost to the disinflation process by dampening aggregate demand.

4.1 Global Developments

The updated World Economic Outlook (WEO) in January 2016 indicates that global economic activity remain subdued in emerging market and developing economies while a modest recovery continued in advanced economies. Global growth was estimated at 3.1 percent in 2015 compared to 3.4 percent in 2014. For Sub-Saharan Africa, growth moderated to 3.5 percent in 2015 from 5.0 percent a year earlier due to lower commodity prices and tight global financial conditions.

In the outlook, the modest and uneven recovery in advanced economies is expected to continue while the emerging and developing economies may be confronted with difficult challenges. In particular, the slowdown and rebalancing of China's economy alongside recession in Brazil may adversely impact other economies through the trade channel and lower commodity prices as well as volatilities in financial markets will continue to weigh down growth in emerging market economies. Accordingly, global growth is projected at 3.4 percent in 2016, signaling a downward revision by 0.2 percentage points from earlier projections.

The commodity price outlook is dominated by downside risks due to continued weak global demand and rebalancing of China's economy, strong dollar and geopolitical tensions. These would adversely affect trade and heighten fiscal pressures especially in major commodity exporting countries.

4.2 Domestic Conditions

4.2.1 Headline Inflation

Annual headline inflation rose steadily in the first half year from 16.4 percent in January to 17.9 percent in July 2015. This was driven by the pass through effects of currency depreciation, upward adjustment in ex-pump prices following deregulation of petroleum prices, and increased food prices arising from the cyclical dry season. However in the second half year, the pace of price increases moderated somewhat supported by monetary policy tightening, exchange rate stability and waning effects of earlier the upwards petroleum product price adjustments. For the entire year, inflation increased by 0.7 percentage points to end at 17.7 percent in December 2015. This compares with to 3.5 percentage points increase in inflation to end 2014 at 17 percent.

Disaggregation of the consumer basket showed a faster pace of price increases in food items relative to non-food items. Prices of non-food items declined marginally as the effects of the sharp currency depreciation and petroleum price increases were offset by policy tightness. However, the unusual jump in food inflation reflected a lower food harvest outturn compared with a year earlier. Overall, food inflation rose to 8 percent in December 2015, from 6.8 percent at the end of December 2014 while non-food inflation declined marginally to 23.3 percent from 23.9 percent over the same comparative period.

Almost all the CPI components contributed somewhat to the rise in inflation during 2015. However, the housing and utilities, and transport sub-components exerted modest pressures on inflation during the last quarter on account of stable petroleum product prices and transport fares.

4.2.1a Core Inflation

Core inflation (excluding energy and utility prices) trended up for most part of 2015 despite some moderation in the last two months due to stability in the foreign exchange market. Core inflation ended at 18.6 percent in December 2015, up from 13.8 percent in December 2014, driven by items such as household goods and equipment, health expenses, education, hotels, cafes and restaurants and alcoholic beverages. Results on inflation expectations turned in mixed during the December survey round. The financial sector indicated heightened inflation expectations while consumer inflation expectations reflected some easing partly due to stability in the currency during the last quarter of 2015.

4.2.2 Exchange Rate Developments

The foreign exchange market experienced increased volatility in the first half year, resulting in a faster depreciation of the currency by 26.2 percent against the US dollar. The trend however moderated in the last quarter as foreign exchange inflows improved amid policy tightness. Foreign inflows from the Cocoa loan and Eurobond issue summing up to about US$2.8 billion provided a strong buffer to the foreign exchange market. Consequently, the cedi appreciated by 14.5 percent during the second half of 2015. Cumulatively, however, the cedi depreciated by 15.7 percent on a year-to date basis in 2015, a much slower pace than 31.3 percent depreciation in 2014.

4.2.3 Real Sector

The pace of expansion in economic activity moderated during the last quarter on account of the energy sector challenges, lower commodity prices and policy tightness. An update of the Banks' lead indicator, the Composite Indicator of Economic Activity (CIEA), indicated a year-on-year real growth of 4.9 percent in December 2015, compared with 7.7 percent in the same period of 2014. On a quarter-on-quarter basis, the seasonally adjusted CIEA increased by 0.8 percent in the fourth quarter, from a negative growth of 1.5 percent in the third quarter. The main factors that contributed to the positive growth in the RCIEA were construction activities and domestic VAT collections.

The latest Ghana Statistical Service (GSS) provisional estimate puts real GDP growth at 3.6 percent (year-on-year) for the third quarter of 2015 compared to 12.2 percent in the same period of 2014. The slowdown in economic activity reflects tight credit conditions and continued energy supply constraints over the period. By sectors, Services recorded the highest growth of 4.9 percent in the quarter, followed by Industry (3.6%) and Agriculture (3.2%). The sub-sectors which contributed significantly to overall growth were water and sewerage (14.2%), information and communication (12.6%), and construction (9.1%). However, hotels and restaurants, and mining and quarrying sub-sectors contributed negatively to overall growth by 5.6 and 2.2 percent respectively largely reflecting the energy sector challenges.

The Bank's survey of consumer confidence in December 2015 suggested that consumers were less optimistic about general economic conditions. This was reflected in the responses to questions relating to current macroeconomic situation, welfare issues as well as overall expectations on key economic indicators. The survey results suggest that consumer's welfare situation worsened due to increases in utility tariffs, rising consumer prices coupled with worsening household financial situation. Consequently, the overall Consumer Confidence Index slowed to 87.5 from 91.7 recorded in October 2015. Consumers however lowered their inflation expectations in the last quarter, compared to the previous surveys. The turnaround in consumer sentiments on inflation was attributed to the relative stability in the exchange rate during the fourth quarter of 2015 which is expected to impact positively on the macroeconomic situation.

4.2.4 Fiscal Developments

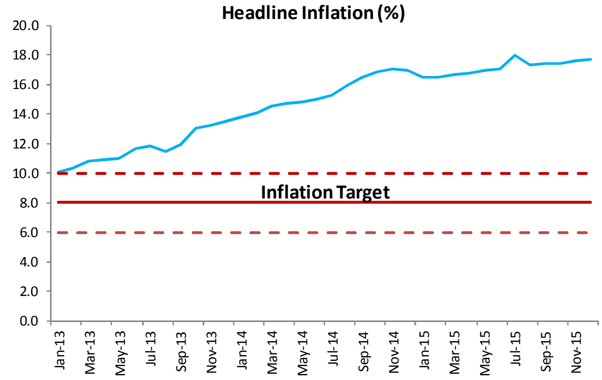
On government fiscal operations, the expected fiscal consolidation progressed well in the year. Significant gains were made in reining in government expenditures alongside improving revenue collections in spite of a significant slowdown in economic activity. This resulted in a cash fiscal deficit of 5.6 percent of GDP, compared with a projected 6.8 percent of GDP, and 8.1 percent of GDP deficit in the same period of 2014.

4.2.5 External Sector Developments

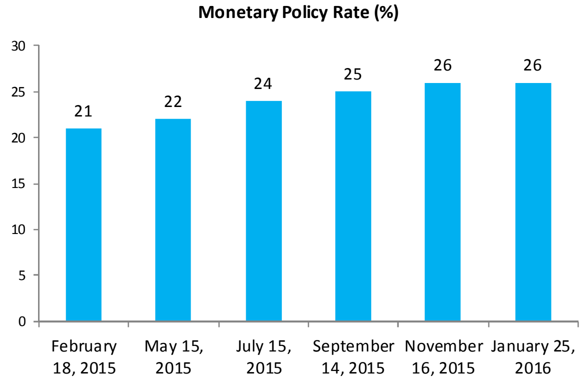
Prices of the country's major commodity exports declined sharply on the international markets as global demand slowed. In the year, prices of gold and crude oil fell by 10.9 and 37.6 percent respectively while cocoa prices gained 15.7 percent on a year-on-year basis. The lower prices for gold and crude oil together with lower production volumes for gold and cocoa resulted in a 22.8 percent year-on-year decline in total export earnings. Similarly, total imports also declined by 4.8 percent on the back of lower oil and gas imports. Consequently, the trade deficit widened to US$3.7 billion in 2015, compared with a deficit of US$1.4 billion in 2014. In spite of this, the current account balance was estimated to have narrowed within the 9 percent earmarked for 2015 on account of significant improvement in the services account.

Fig. 1 Recent Economic Developments

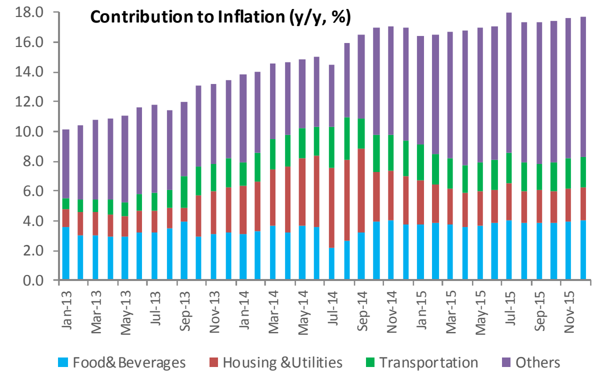
Headline inflation moderates slightly in the last quarter of 2015…



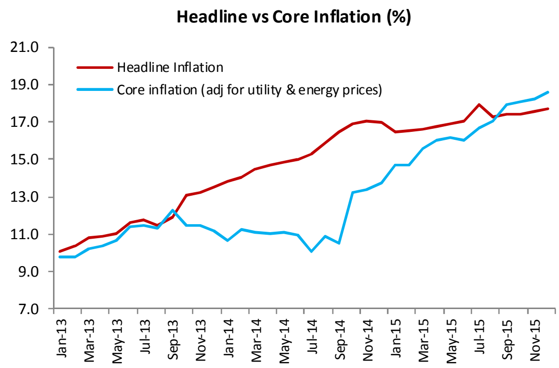
Monetary Policy Rate hiked by 500 bps in 2015….



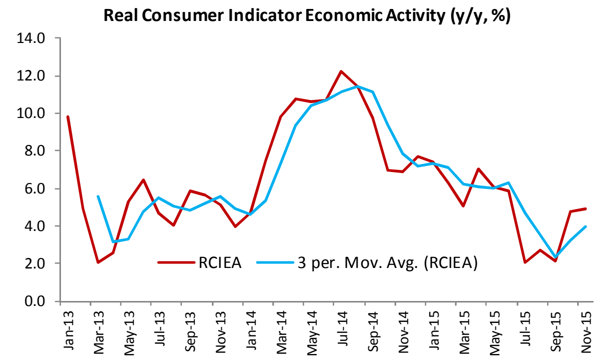
Components driving inflation include education, hh gds, hotels, restuarants…



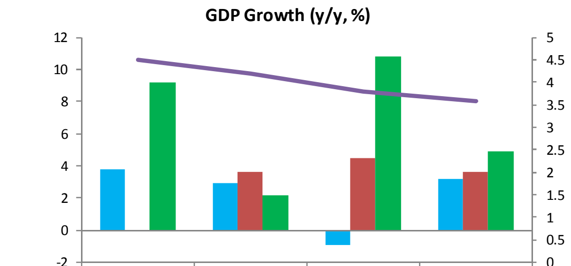
Core inflation trended upwards for most part of the year ….



Economic activity moderated somewhat in the last quarter of 2015….

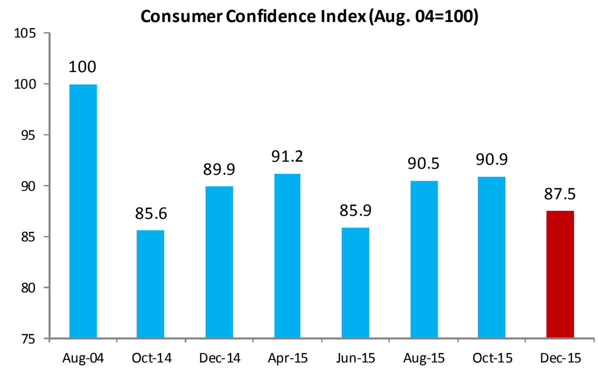


Provisional estimates of GDP growth show some moderation….

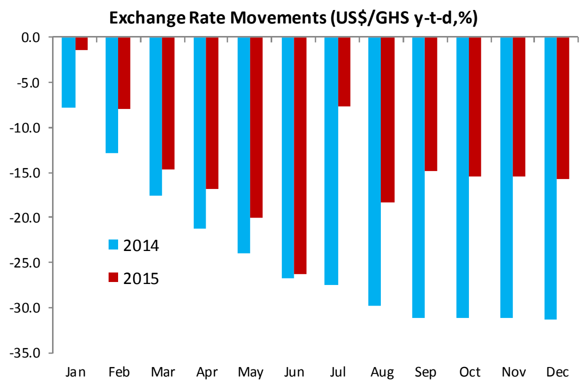


	Q414	Q115	Q215	Q315
Agriculture	3.8	2.9	-0.9	3.2
Industry	-0.1	3.6	4.5	3.6
Services	9.2	2.2	10.8	4.9
GDP	4.5	4.2	3.8	3.6

Consumer confidence wanes in December 2015….



Exchange rate depreciates at a slower pace in 2015….



4.3 Inflation Risk Assessments

The MPC taking cognizance of the increased risks, from the second round effects of the expected increases in utility tariffs and tight global financial conditions, tightened monetary policy by 100 basis points each at the September and November meetings to rein in inflation expectations and steer inflation down to the medium term inflation target of 8±2 percent early 2017. In January 2016, the MPC assessed the following risks to the inflation outlook:

- ***Global economic conditions***

The Committee noted heightened risks from the global economy driven by slower growth prospects in China, declining commodity prices and Fed's monetary policy tightening. These have the potential to transmit to the domestic economy through the trade and financing channels with implications for the balance of payments outlook and execution of the budget.

- ***Petroleum product price adjustments***

The domestic economy witnessed some significant upward adjustments in petroleum product prices. This was mainly due to increases in petroleum taxes (as part of the rationalization and restructuring of the existing Energy Act) which more than offset the consistent declines in international crude oil prices. Going forward, further oil price declines in the international markets is expected to support the disinflation process in 2016 given the enormous impact of petroleum and transport costs to inflation dynamics over the past three years. This however, may be dependent on continued stability in the exchange rate, which is a key factor in the determination of petroleum product prices in the country.

- ***Exchange rate movements***

The first half year volatility in the foreign exchange market reduced significantly in the second half of 2015 as well as in January 2016. The sharp contrast was influenced by tightness in both monetary and fiscal policies supported by inflows from donors, the cocoa syndicated loan and the Eurobond. The cyclical exchange rate pressures in first half year and its knock on effects on consumer prices has been a major concern over the past few years. To break the cycle, the Bank is instituting policy measures geared towards stability in the exchange rate market to support the disinflation process, at least in the first half year. First, monetary policy is expected to remain tight. This will be complemented by the enforcement of repatriation of export proceeds into the banking system to boost supply of foreign exchange. These are expected to reduce foreign exchange demand and ease off the cyclical currency depreciation in the first half year.

- ***Fiscal consolidation***

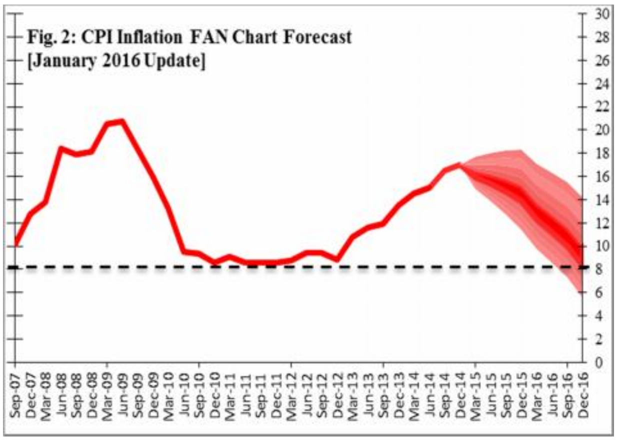
The pace of fiscal consolidation in 2015 progressed faster than programmed. With revenues on track and expenditures contained, the fiscal deficit for the first eleven months of 2015 turned in lower than targeted. In spite of the increased commitment to fiscal consolidation, some pressure points are emerging particularly with increased uncertainty in the global financial conditions, revenue implications from declining crude oil prices, pressure from the labour front and rising debt levels. Even with these difficult emerging risks, the fiscal consolidation process is expected to continue over the medium term under the IMF ECF arrangement.

- ***Economic Activity***

On the real sector, the pace of expansion in economic activity further dampened during the last quarter as evidenced by the updated CIEA. The slowdown reflects the tight fiscal and monetary policy stance, energy supply constraints, slowdown in global demand and lower commodity prices. Again, consumer sentiments on the general economic conditions remain subdued, while private sector credit growth moderated below trend in both nominal and real terms. In spite of these downside factors, growth conditions are expected to pick up in the medium term as the economy rebalances supported by sustained improvement in the energy situation and anticipated increased production of oil and gas.

4.4 Inflation Outlook

The unanticipated upward adjustment in petroleum prices by 18 to 27 percent will impact on consumer prices by the end of January 2016. In addition, the increment has the potential of pushing up transport costs and its associated second round effects. Given these price shocks, headline inflation is projected to rise during the first quarter of 2016, peak early in the second quarter and thereafter, inflation is expected to decline steadily towards the target band of 8 -10 percent early 2017.



There are however, uncertainties surrounding these inflation projections. The upside risks include ability to contain pressures in the foreign exchange market in the first half of 2016, the extent of the second round effects of the petroleum price adjustment and higher transport costs, as well as price effects of the on-going tax reforms. On the downside, the tight monetary stance and continued fiscal consolidation, falling crude oil prices, subdued growth conditions and improved energy challenges (possible elimination of cost-push effects) may help dampen inflation pressures.

4.5 Conclusion

In conclusion and taking into account all the factors discussed above, the Committee viewed risks to inflation and growth as fairly balanced and maintained the MPR at 26 percent at its January 2016 meeting. Nevertheless, monetary policy would have to remain vigilant, especially in the first half of the year, to manage any build-up of inflationary pressures.

Table 1: Overall Inflation, food and Non-food Inflation

	2015						2014	2013	2012
	Mar	Jun	Sep	Oct	Nov	Dec	Dec	Dec.	Dec.
Headline Inflation	16.6	17.1	17.4	17.4	17.6	17.7	17.0	13.5	8.8
Food Inflation	7.2	7.4	7.8	7.8	7.9	8.0	6.8	7.2	3.9
Non-Food Inflation	23.1	23.6	23.2	23.0	23.2	23.3	23.9	18.1	11.6

Table 2: Monthly price movements (2012 - 2015) : Food

				Q1				Q2				Q3				Q4
Year	Jan	Feb	Mar	**Avg.**	Apr	May	Jun	**Avg.**	Jul	Aug	Sep	**Avg.**	Oct	Nov	Dec	**Avg.**
2012	1.90	1.17	0.00	**1.02**	2.80	0.00	0.75	**1.18**	1.71	-1.92	-4.46	**-1.56**	1.25	0.37	0.68	**0.77**
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**	-0.61	0.74	0.64	**0.26**
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**	0.10	0.86	0.75	**0.57**
2015	5.67	0.50	0.79	**2.32**	1.49	1.12	1.45	**1.36**	-0.85	-1.21		**-1.03**	0.06	0.96	0.83	**0.62**

Table 3: Monthly price movements (2012 - 2015) : Non - Food

				Q1				Q2				Q3				Q4
Year	Jan	Feb	Mar	**Avg.**	Apr	May	Jun	**Avg.**	Jul	Aug	Sep	**Avg.**	Oct	Nov	Dec	**Avg.**
2012	2.16	1.62	0.87	**1.55**	0.76	1.27	1.53	**1.19**	0.62	0.82	1.54	**0.99**	1.22	0.87	0.88	**0.99**
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**	4.30	0.80	1.31	**2.14**
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**	4.20	0.88	1.13	**2.07**
2015	2.16	1.59	1.20	**1.65**	2.02	0.91	1.97	**1.63**	4.14	-0.49		**1.82**	4.08	1.08	1.22	**2.13**

Table 4: Monthly Price Movements (2012 - 2015) : All Items

				Q1				Q2				Q3				Q4
Year	Jan	Feb	Mar	**Avg.**	Apr	May	Jun	**Avg.**	Jul	Aug	Sep	**Avg.**	Oct	Nov	Dec	**Avg.**
2012	2.20	0.64	0.15	**0.99**	1.49	0.58	0.95	**1.01**	1.11	-0.41	-1.12	**-0.14**	1.23	0.66	0.80	**0.89**
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**	2.26	0.78	1.04	**1.36**
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**	2.70	0.87	0.99	**1.52**
2015	3.45	1.18	1.05	**1.89**	1.82	0.99	1.78	**1.53**	2.30	-0.75		**0.77**	2.69	1.04	1.09	**1.60**

Source: GSS and BOG computations