



# Bank of Ghana Monetary Policy Committee Press Release

February 15, 2012

1. The Committee has assessed developments in the economy for 2011 and I am happy to present highlights of recent economic developments and their implications for macroeconomic stability and growth, leading to the positioning of the Monetary Policy Rate.

## **Global Developments**

2. Recent policy discussions have centred on the Euro zone crisis and the challenges it poses for global economic recovery, a crisis that has pushed the global economy into a difficult phase of significant downside risks. The situation has further been compounded by widespread downgrades of banks and sovereigns, and we noted the lack of a comprehensive and definitive approach to its resolution.
3. In response to these developments, the IMF World Economic Outlook update for January 2012 has significantly revised growth forecasts downwards. World output is now projected to expand by 3.3 per cent in 2012, from the 4 per cent forecast in September 2011. In emerging and developing economies, growth is projected to be moderate, on account of the worsening external environment and slowdown in domestic demand.
4. Global inflation is anticipated to ease as demand softens and commodity prices stabilize. In advanced economies, inflation pressures are expected to remain subdued on account of slower growth and high levels of unemployment. Similarly, inflationary pressures are generally expected to reduce in emerging and developing economies, driven by declining food prices.

### **Domestic Inflation and Growth**

5. Inflation ended 2011 at 8.6 per cent, lower than the projected target of 9 per cent and remained within single digits throughout the year. The low inflation environment was driven by relative stability in both food and non-food components of the consumer basket. Non-food inflation which was at 11.2 per cent at the beginning of the year increased to 12.4 per cent by June 2011 but eased to 11.2 percent by the end of the year. Food inflation, on the other hand, fell from 4.5 percent at the beginning of the year to a historical low of 2.8 per cent in June. Subsequently it rose to 4.3 percent by December 2011.
6. Bank of Ghana's Composite Index of Economic Activity (CIEA) indicates that the pace of economic activity increased in the last quarter of 2011. From 305.3 in September, the index rose to 314.7 in December 2011. In real terms, the CIEA grew by 3.1 per cent during this period. In year-on- year terms, the CIEA recorded a growth of 15.2 per cent compared to 10.4 per cent in December 2010.
7. Real GDP data, released by the Ghana Statistical Service (GSS) for the third quarter of 2011, showed that the economy expanded by 12 per cent (year-on-year), compared to 17.6 per cent in the second quarter. Industry recorded the highest growth of 37.2 per cent, driven by the oil and mining subsectors. The services sector grew by 5.8 per cent while agriculture recorded a 5.2 per cent growth. Real GDP growth in 2011 is projected at 13.6 per cent.
8. The Consumer Confidence Index for January 2012 showed an increase of just under 1 per cent compared to November 2011. The Business Confidence Index however declined by a similar margin between September and December 2011.

### **Government Fiscal Operations (Narrow Coverage)**

9. Total revenue and grants in 2011 amounted to GH¢10.7 billion compared to GH¢7.5 billion in 2010. Import duties, import VAT, petroleum taxes and NHIL receipts accounted for GH¢3.5 billion. Income and property taxes were GH¢3.8 billion while domestic VAT, excise duty and NHIL amounted to GH¢1.3 billion. Programmed grants of GH¢340.6 million also accrued.

10. Total expenditure was GH¢12.7 billion in 2011, compared to GH¢9.2 billion in 2010. Wages, salaries and related expenditures totalled GH¢5.2 billion.
11. Fiscal operations in 2011, therefore, resulted in a narrow budget deficit of GH¢2.1 billion, and was financed mainly through the issuance of domestic bonds. The Net Domestic Financing (NDF) of GH¢2.1 billion was within the programmed target of GH¢2.4 billion.
12. In January 2012, total revenue and grants amounted to GH¢649.3 million, while expenditures were GH¢1.4 billion. This resulted in a narrow fiscal deficit of GH¢756.4 million compared to a surplus of GH¢107.7 million recorded for January 2011. The deficit was financed mainly from the domestic sector of GH¢679.9 million, and net foreign inflows of GH¢76.6 million. The NDF for January of GH¢679.9 million represents 80.6 per cent of the first quarter target of GH¢844 million.
13. The stock of domestic debt increased by 43 per cent year-on-year to GH¢11.84 billion in 2011, from GH¢8.3 billion in 2010. The external debt stock also increased by 20.1 per cent over the end of December 2010 position to US\$7.6 billion (GH¢11.77 billion). Cumulatively, the total public debt was GH¢23.6 billion, equivalent to 44.2 per cent of GDP at end 2011, compared to GH¢17.6 billion (38.1 per cent of GDP) in 2010.

#### **Banking Sector Developments**

14. The banking system recorded steady growth in assets and profitability in 2011. Total assets increased by 26.8 per cent year-on-year to end 2011 at GH¢22.6 billion, compared with GH¢17.4 billion in 2010. The growth in assets was funded mainly by deposits, which grew by 35.3 per cent on a year-on-year basis to GH¢16 billion in 2011, compared to a growth of 31.7 per cent in 2010. Growth in capital and reserves amounting to GH¢739 million also supported banking sector balance sheet expansion.
15. The Capital Adequacy Ratio (CAR) of the industry declined to 17.4 per cent in 2011 from 19.1 per cent in 2010, although it remained well above the statutory level of 10 per cent. The overall liquidity position also increased due to higher funding (deposits and capital) as against a slow growth in the credit portfolio.

16. In terms of earnings, all the indicators (Return on Equity, Return on Assets and Return on Earnings Assets) improved in 2011 compared to the 2010 levels. The Non-Performing Loan ratio declined from 16.1 per cent in 2010 to 14.2 per cent at the end of 2011.
17. The Credit Conditions Survey, conducted by the Bank of Ghana in January 2012, points to a tightening of credit stance by banks for both households and enterprises. The tightening of credit stance was more pronounced for small and medium enterprises on account of inadequate cashflow to support repayment, weak financial performance and inadequate security.
18. The Bank of Ghana has also, this month, conducted stress tests of the banking system. The tests confirm that the banking system is resilient to interest and exchange rate shocks. However, credit and deposit concentration risks remain.
19. Private sector credit increased in 2011 compared to the decline in 2010. By December 2011, private sector credit had reached GH¢8.6 billion from GH¢6.8 billion in 2010, representing a year-on-year growth of 26.3 per cent. Services and Commerce and Finance sectors accounted for 74.3 per cent of the total DMB credit allocated in 2011.
20. Broad money (M2+) growth eased from 33.8 per cent in 2010 to 33.2 percent in 2011. This is attributed to the slower accumulation of Net Foreign Asset (NFA).

#### **Interest rates trends**

21. Interest rates generally trended down in 2011. On the money market, the 91-day Treasury bill rate fell from 12.3 per cent to 10.3 per cent while the 182-day rate also fell from 12.7 per cent to 11.1 per cent. However, in January 2012, the 91-day Treasury bill rate increased to 10.9 per cent while the 182 day rate increased marginally to 11.2 percent.
22. Similarly, the interest rate on the 1-year note declined from 12.7 per cent to 11.3 per cent and the 2-year note fell from 12.7 per cent to 12.4 per cent. The 1-year note has since moved up to 11.4 percent while the 2-year note has dropped to 12.3 percent.
23. Average base rates of banks went down from 25.8 per cent to 22.5 per cent in 2011 with quotations within the range of 16.8 – 25.9 per cent. Average lending rates also declined

from 27.6 per cent to 25.9 per cent in 2011, with Annual Percentage Rates for enterprises ranging between 17.4 – 30.8 per cent.

### **The External Sector**

24. The overall balance of payments recorded a surplus of US\$546.5 million in 2011, significantly down from the GH¢1.5 billion surplus recorded in 2010. The decline was due to the widening of the current account deficit. The current account balance worsened in 2011 as a result of increased net outflows in the Services and Income Account, which rose to US\$3.1 billion in 2011 from US\$2.1 billion in 2010.
25. Total merchandise exports grew by 60.6 per cent in 2011 to US\$12.7 billion, supported by oil exports and favourable commodity prices. The exports of gold amounted to US\$4.9 billion while cocoa beans totalled US\$2 billion. The value of crude oil exports was US\$2.7 billion over the same period.
26. Total merchandise imports grew by 46.2 per cent in 2011 to US\$15.9 billion. Of the total, oil imports were US\$3.3 billion compared with US\$2.2 billion recorded in 2010. Crude oil imports amounted to US\$1.4 billion while imports of refined oil products were US\$1.7 billion. Gas imports were estimated at US\$172.8 million.
27. Total non-oil imports amounted to US\$12.7 billion. By end-use, capital imports were US\$2.7 billion, intermediate imports amounted to US\$6.1 billion, consumption goods, US\$3.0 billion and others constituted US\$900 million.
28. The Capital and Financial Account surplus improved to US\$4.5 billion in 2011 from a surplus of US\$4.3 billion in 2010, driven by net inflows of private capital investments mainly into the oil sector.
29. The Gross International Reserves of the Bank of Ghana improved to US\$5.4 billion in 2011 from US\$4.7 billion in 2010. However, it declined to GH¢4.6 billion as at January 2012 due to the increased demand for foreign exchange resulting from the higher than normal surge in seasonal demand to support trade. We also experienced premature redemptions by some foreign investors.

30. Total inward transfers received by individuals through the banking system grew by 72.7 per cent to US\$1.9 billion in 2011 from US\$1.1 billion in 2010.
31. The cedi depreciated by 4.9 per cent against the US dollar in 2011, compared to 3.1 per cent in 2010. In trade-weighted terms, a real effective depreciation of 1.7 per cent was recorded, compared to 1.5 per cent in 2010.
32. In January 2012 however, the cedi depreciated at a much faster pace of 5.9 per cent compared to 1.9 per cent in January 2011, mainly on account of strong demand for foreign exchange and some speculative activities.

### **Summary and Outlook**

33. In assessing the outlook for inflation, the Committee identified three main sources of upside risks to prevailing macro-economic stability. These are possible contagion from the Eurozone debt crisis, fiscal pressures and the unusual upward volatility in the foreign exchange market observed last month.
34. With respect to developments in the Euro zone, the Committee was of the view that the potential impact of the crisis on the domestic economy could be transmitted through four possible channels. These are: a reduction in trade finance to domestic banks, diminished portfolio inflows, worsening terms of trade due to reduced global demand for primary commodities, and reduction in remittances and donor flows.
35. While Government's fiscal targets were met in 2011, potential sources of pressures exist in the outlook for this year. Specifically, the pace of executing the budget in terms of arrears clearance, including those relating to the migration to the SSSS, and the recently announced increase in the minimum wage may impose additional demand pressures.
36. The rapid growth in imports in 2011 and the unusual surge in demand for foreign exchange during the last quarter of the year created a misalignment in Bank of Ghana's foreign exchange cash flow. Initially, this led to a marginal depreciation in the interbank rate as banks searched for resources to meet their customers' requirements. Further pressure was placed on the exchange rate when foreign investors sought early redemption of their investments on the domestic bond market. The situation was further aggravated in January

2012 by speculative activities of dealers and traders. The pass-through to inflation expectations of developments in the foreign exchange market is obvious. The Bank therefore intervened to calm the market and restore stability. Going forward, the situation will be monitored closely and the Bank is ready to take appropriate measures to stem potential threats to achieving the inflation target.

37. The Committee concluded that the balance of risks to inflation is elevated. To contain future inflation pressures and realign interest rates in favour of domestic assets, it is necessary that monetary policy continues to be fine tuned to ensure that inflation expectations remain anchored to keep inflation within the target band.

38. Therefore, the Monetary Policy Committee has decided to increase the Monetary Policy Rate by 100 basis points to 13.5 per cent.