Bank of Ghana
Monetary Policy Committee
Press Release

July 27 , 2020

1. Good morning, Ladies and Gentlemen of the Media, and welcome to the 95th MPC press briefing. The MPC met last week and deliberated on the recent global and domestic economic conditions as well as reviewed the latest macroeconomic projections. I present highlights of the discussions and subsequent positioning of the Monetary Policy Rate.

2. The COVID-19 pandemic has continued to weaken global economic conditions and growth projections have worsened since the last MPC meeting. The IMF has revised downwards its initial global growth forecast from a contraction of 3.0 percent to 4.9 percent in its June release of the World Economic Outlook update. The pandemic has 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.

3. 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. Notwithstanding these signs of early bounce-back, lingering concerns of a second wave of the pandemic seem to be weighing on risk sentiments, with implications for borrowing costs, currency stability, and rising debt levels.

4. The outlook for the global economy remains uncertain despite these early encouraging signs of recovery. Signs of second wave of infections and intensification of the pandemic in other economies is sparking fears of a re-imposition of restrictions and containment measures, leading to a further slowdown in the world economy.

5. Global inflationary pressures remain subdued reflecting low energy prices and sharp drop in real GDP with significant slackness in labour market conditions. 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.

6. On the domestic scene, there has been some pressures on headline inflation. After remaining flat at 7.8 percent in the first quarter, inflation jumped to 11.2 percent in the second quarter. This sharp increase was driven in large part 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.

7. 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.

8. Latest data from the Ghana Statistical Service point to a moderation in the pace of economic growth. 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 of last year. Non-oil growth also slowed to 4.9 percent from 6.0 percent in the same comparative period. The services, agriculture, and manufacturing sectors contributed positively to the observed growth.

9. 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. Industrial consumption of electricity fell as manufacturing companies worked below capacity,

while tourist arrivals have virtually remained at a standstill due to the border closure and travel restrictions. Imports, domestic VAT, and exports have all been impacted negatively. However, port activity, DMB's credit to the private sector, and SSNIT contributions are beginning to record some modest gains—a sign of some early green shoots.

10. The business and consumer confidence surveys conducted in June 2020 showed some modest improvement in sentiments, although the level of the indices remained far below pre-pandemic levels. Low consumer demand and effects of border closure on businesses were cited as the key concerns for businesses.

11. The pace of growth in broad money supply (M2+) moderated in June 2020, consistent with the slowdown in economic activities. Annual growth in M2+ declined to 20.1 percent compared with 22.1 percent in the corresponding period of 2019. The moderation in the growth of total liquidity was driven by the significant decline in Net Foreign Assets (NFA) to 6.2 percent from 22.5 percent over the same comparative periods. In terms of components, the growth in M2+ reflected mainly in currency outside banks and domestic deposits.

12. DMBs' credit to the private sector slowed in June 2020 on account of elevated default risks and moderated demand for credit, reflecting the impact of the COVID-19 pandemic on the real sector. Annual growth in private sector credit declined to 12.4 percent in June 2020 compared with 16.8 percent growth in the same period of 2019. In real terms, private sector credit expanded marginally by 1.2 percent compared to 8.6 percent in June 2019. The three major sector beneficiaries were Services, Transport, Storage and Communication, and Agriculture, Forestry and Fishing, which together accounted for 94.1 percent of the credit flow over the 12-month period to June 2020.

13. The latest credit conditions survey for June 2020 showed a net ease in the overall credit stance on loans to enterprises following the previous tight stance reported in April. In contrast, credit stance on loans to households tightened during that same period. Banks are projecting a net ease in the credit stance on household loans along

with further easing in the credit stance on loans to enterprises in the next two months. In line with this, new advances grew by 30.4 percent year-on-year to GH¢15.8 billion by end-June 2020.

14. Interest rates on the money market reflected downward trends at the short end, and mixed trends at the medium to long-term segments of the market. The 91-day Treasury bill rate declined to about 14.0 percent in June 2020 from 14.8 percent a year ago. Similarly, the interest rate on the 182-day instrument declined to 14.1 percent from 15.2 percent. Rates on the 2-year, 3-year and 5-year instruments decreased marginally to 18.8 percent, 18.9 percent, and 19.3 percent respectively, from 19.8 percent, 19.7 percent, and 19.8 percent. Yields on the 6-year, 7-year, 10-year, and 15-year bonds remained unchanged at 21.0 percent, 16.3 percent, 19.8 percent, and 19.8 percent, respectively. Yield on the 20-year instrument has moved up from 20.3 percent from September 2019 to 21.5 percent in June 2020.

15. The weighted average interbank lending rate, that is, the rate at which commercial banks lend to each other, declined to 13.8 percent

in June 2020 from 15.2 percent in the corresponding period of 2019, reflecting the monetary policy easing measures to inject liquidity into the banking system. In a similar direction, average lending rates of banks declined from 24.1 percent to about 22.0 percent over the same comparative periods.

16. Prices of key export commodities traded mixed in the first half of 2020. The declines in the export prices of cocoa and crude oil were partially offset by higher gold prices. From the beginning of the year to June 2020, crude oil prices contracted by 37.5 percent on the back of low demand due to the COVID-19 pandemic while gold prices increased by 17.1 percent. The surge in gold prices was attributed to global monetary policy easing, geopolitical risks, and global economic slowdown due to COVID-19. Cocoa prices contracted by 7.7 percent, occasioned by low demand for the bean due to the coronavirus pandemic.

17. These price developments, especially lower crude oil prices, impacted adversely on the external sector. In the first half of 2020, total exports contracted by 8.4 percent year-on-year to US$7.4

billion, driven mainly by the sharp decline in crude oil exports. In detail, crude oil exports sharply contracted by 37.9 percent year-on-year, while gold export receipts went up by 6.9 percent and cocoa exports were up by 8.7 percent. Similarly, total imports contracted by 4.1 percent to US$6.4 billion on account of a 26.4 percent contraction in oil and gas imports which is in line with slowing economic activity. These developments resulted in a lower trade surplus of US$952.7 million (1.4 percent of GDP), compared with US$1.4 billion (2.0 percent of GDP) for the corresponding period of 2019.

18. The current account deficit for the first half of 2020, however, improved marginally from a deficit of US$661.1 million (1.0 percent of GDP) a year ago to a deficit of US$556.3 million (0.8 percent of GDP). The current account outturn was supported by relatively stable inflows in net current transfers, especially remittances, together with significant decline in net investment income outflows, notably, profits and dividends outflows. This, together with inflows into the capital and financial account, resulted in a near-zero overall balance compared with a surplus of US$1.3 billion (2.2 percent of GDP) over the same period in 2019.

19. Gross International Reserves stood at US$9.2 billion at the end of June 2020, providing cover for 4.3 months of imports of goods and services, compared with US$8.4 billion, equivalent to 4.0 months of import cover recorded at the end of December 2019. The strong foreign exchange reserve position has helped ensure stability in the foreign exchange market, with the local currency depreciating by 2.5 percent against the US dollar in the year to 23rd July 2020. The comparative depreciation was 8.3 percent a year ago.

20. 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. Revenue sources such as, taxes on income and property, taxes on goods and services, international trade taxes and non-tax revenue all underperformed.

On the expenditure side, employee compensation, and other COVID-related expenditures have been the main sources of pressure.

21. 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. This means that total revenue and grants for the year 2020 have been revised downward to GH¢53.7 billion (13.9 percent of GDP) from the initial target of GH¢67.1 billion (16.9 percent of GDP) while expenditure and arrears clearance is projected to rise to GH¢97.7 billion (25.4 percent of GDP) from the earlier target of GH¢86.0 billion (21.6 percent of GDP). The primary balance is also projected at a deficit of 4.6 percent of GDP from the initial target of a surplus of 0.7 percent of GDP.

22. The elevated fiscal deficit path has impacted the stock of public debt which rose to 67.0 percent of GDP (GH¢258.0 billion) at the end of June 2020 compared with 62.4 percent of GDP (GH¢218.2 billion) at the end of December 2019. Of the total debt stock, domestic debt was GH¢122.1 billion (31.7 percent of GDP) while external debt was GH¢136.3 billion (35.4 percent of GDP).

23. Banking sector data as at June 2020 continue to show robust performance despite the emerging risks posed by the pandemic on the sector's operations. Weaknesses in key financial performance indicators observed in the first quarter of 2020 seem to have improved somewhat in the second quarter in response to the various policy measures announced by the Bank of Ghana in March and May 2020. Although the financial soundness indicators remain strong, the industry's profitability performance has been adversely impacted by higher operational costs due to measures being put in place to limit the impact of the pandemic on bank's operations. These measures are to ensure business continuity and higher loan-loss provisions due to repayment challenges by clients who have been severely affected by COVID-19. Sectors mostly affected by the pandemic and consequently loan repayments to the banks and SDIs include the services, commerce & finance, and manufacturing. These conditions have heightened the risk of loan default in the banking sector and is pushing non-performing loans up.

24. Total asset base of the banking industry continues to remain strong, expanding by 23.2 percent in year-on-year terms to GH¢139 billion at end-June 2020. The data shows that recoveries from loans, a significant increase in deposits growth, and borrowing from parent companies have funded banks investments, while these factors, in addition to regulatory reliefs provided earlier in the year by the Bank of Ghana have supported lending to the rest of the economy. There are indications of a gradual rebound in credit growth in response to the previously announced policy measures aimed at supporting credit extension and loan restructuring in response to the pandemic's impact on local businesses.

25. Results of the latest stress tests conducted by the Bank in July 2020 are reassuring and indicate that banks are well-positioned to withstand moderate liquidity and credit shocks due to the existence of strong capital buffers. In a typical scenario of a credit default leading to the emergence of higher NPLs, the stress test results show that the necessary provisioning could be comfortably absorbed through banks, capital buffers, with no significant reduction in capital adequacy levels.

The Outlook and Policy Decision

26. The MPC noted that uncertainties in the global economy has increased, although investor uneasiness improved somewhat. The uncertainty derives from a possibility of a prolonged downturn as countries begin to experience a second wave of COVID-19 infections. Consequently, the fiscal and monetary stimulus packages will have to be continued over a much longer horizon, which could lead to a negative spill over to emerging and frontier markets with consequences for weaker growth and instability. The spill-over of weak global demand conditions on the domestic economy will negatively impact exports, foreign direct investments, remittance flows, and domestic growth conditions.

27. The most recent data on the Ghanaian economy shows that the pandemic has impacted adversely, resulting in a significant growth downturn and higher inflation. All leading indicators of economic activity, international trade, construction, and manufacturing activities declined significantly. More granular data also show that business and consumer confidence, and private sector credit growth even though declined on a year-on-year basis, is beginning to show some modest gains.

28. Policy and regulatory measures announced by the MPC in March and May have positioned the banking sector to withstand the shocks associated with the pandemic and to support businesses. These measures are working their way through the economy, and are beginning to impact positively. So far, new advances for the first half of 2020 was estimated at GH¢15.8 billion compared to GH¢12.1 billion the same period of last year. The central bank will continue to engage the banking industry to provide the necessary support in these challenging times.

29. The Committee noted that the COVID-19 pandemic has pushed public finances out of the path of fiscal consolidation. The fiscal deficit is estimated to expand to 11.4 percent of GDP by the close of the year. The huge financing gap brought about by the expanded deficit could exert pressure on public debt, with long term implications for the economy. While government stimulus package for various sectors of the economy, including micro, small and medium sized enterprises is in the right direction to boost economic activity, the Committee's view was that going forward, the 2021 budget should be focused on instituting measures to return to the fiscal consolidation path with the view to building resilience and strengthening the pillars of the economy for a return to macroeconomic stability.

30. The Bank of Ghana's 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 Bank projects a return of inflation to the medium-term target band by the second quarter of 2021, conditional on corrective fiscal measures being introduced in the near-term.

31. The Committee was of the view that 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.

Informational Note

The next Monetary Policy Committee (MPC) meeting is scheduled for September 22-25, 2020. The meeting will conclude on Monday, September 28, 2020 with the announcement of the policy decision.