Bank of Sierra Leone

MONETARY POLICY STATEMENT – 3RD OCTOBER 2022

The Monetary Policy Committee (MPC) of the Bank of Sierra Leone (BSL) met on 29th September 2022 under the Chairmanship of the Governor, Professor Kelfala M. Kallon. The Committee reviewed recent developments in the global, regional, and domestic economies and financial markets and their implications for growth and inflation in the domestic economy. Following this review, the MPC decided to raise the Monetary Policy Rate (MPR) by 100 basis points to 17.0 percent. The key considerations that informed this monetary policy stance are discussed below.

Inflation

Inflationary pressures remained elevated in the review period, although it declined marginally in August 2022. As in the previous periods since the advent of COVID-19, the observed elevated inflation during the current review period was driven mainly by disruptions in the global supply chain, increased freight charges, all of which are consequences of the COVID-19 Pandemic. The Russian-Ukraine War and the resultant sanctions imposed on Russia by some Western countries, including the United States, have induced significant increases in commodity prices (particularly food and energy prices). Furthermore, the global economic uncertainty created by the Pandemic and the Russian-Ukraine War provided incentives for economic agents to "fly to safety" by holding United States dollar (USD) denominated assets, thereby increasing the global demand for dollars relative to supply. Additionally, the tight monetary policies implemented by advanced economies, especially the United States, and the resultant increase in United States interest rates has further made USD-denominated assets even more attractive, thereby increasing the demand for USD even more.

The net result of the increased relative demand for USD has been a rapid depreciation of global currencies against the dollar. Consequently, small open developing economies like Sierra

Leone, whose debts are typically denominated in USD, must now acquire even more USD to service those debts, whose interest costs rise with the interest rate on USD-denominated assets. This has further put additional pressure on the currencies of these economies. The pass-through effect of the rapid depreciation of the currencies of these countries to prices has resulted in broad-based inflationary pressures in small-open economies like Sierra Leone.

Accordingly, headline inflation increased from 22.06 percent in March 2022 to 27.95 percent in June 2022, and further to 29.47 percent in July 2022. Thereafter, headline inflation moderated to 28.15 percent in August 2022, mainly on account of reduction in non-food inflation, following the downward revisions in domestic fuel pump prices in July and August 2022. However, food inflation continued to increase in August 2022, reflecting the rising global food prices.

The MPC noted that domestic prices remained largely driven by supply-side factors. Accordingly, it holds that policy reform measures in the productive sectors of the economy (in particularly the agriculture sector) are needed to boost domestic production and productivity in order to reduce the large supply gap.

Domestic Economic Growth

Domestic economic activity remained subdued during the review period, and it is expected to remain so in 2023. Consequently, real GDP growth is projected at 3.6 percent and 3.4 percent in 2022 and 2023, respectively. The projected subdued economic performance largely reflects the effects of the same factors that have fueled inflationary pressures, namely, Russia's war on Ukraine, rising energy and food prices, high freight charges as well as the lingering effects of the COVID-19 Pandemic. Risks to the 3.6 percent growth forecast are skewed to the downside, depending largely on the duration of the war in Ukraine and the extent of its spillovers to small open economies like Sierra Leone.

The BSL's high frequency Composite Index of Economic Activity (CIEA) shows that economic activity improved by 0.7 percent in the second quarter of 2022, after having contracted by 3.8 percent in the first quarter. The MPC encourages Government to implement policy reforms in key productive sectors in order to nudge this nascent growth.

Global Economic Growth

Based on the July 2022 *World Economic Outlook* (WEO), global economic prospects have been adversely affected by several shocks, as risks identified in the April 2022 WEO began to materialize. As such, global financial conditions are likely to be worse than anticipated. This is caused by slowdown in Chinese economic activity due to COVID-19-induced lockdowns and further negative spillovers from the war in Ukraine, including spillovers from the sanctions being imposed by some western countries on Russia for the war, have all contributed to the slowdown in global growth.

Consequently, in the July 2022 edition of the WEO, global growth for 2022 and 2023 was downgraded by 0.4 percent (from 3.6 to 3.2 percent) and by 0.7 percent (from 3.6 to 2.9 percent) respectively. Similarly, the growth forecast for Advanced Economies was revised downward by 0.8 percent to 3.6 percent in 2022 and by 1.0 percentage point to 1.4 percent in 2023. In Emerging Market and Developing Economies, the growth forecast was also revised downward by 0.2 percentage point to 3.6 percent, and by 0.5 percentage point to 3.9 percent in 2023. On the contrary, Sub-Saharan Africa’s growth forecast remained unchanged at 3.4 percent, an indication of resilience of the region in the face of the adverse effects of the Ukraine war.

Risks to the global economic outlook are heavily skewed to the downside, and these include a sudden stop of European gas imports from Russia, elevated inflation and tighter financial conditions which could induce debt distress.

In the WAMZ, growth forecasts for 2022 and 2023 remained broadly stable, with growth forecasts for most member states either revised upward or maintained at the previous levels. In Sierra Leone growth forecast was revised downward earlier this year from 6.0 percent to 3.6 percent in 2022, and by 1.0 percentage point to 3.4 percent in 2023. In Nigeria, the largest economy in the Zone, the growth forecast was maintained at 3.4 percent in 2022, but was revised upward by 0.1 percent to 3.1 percent in 2023.

External Sector

External sector performance worsened during the second quarter of 2022**.** The trade deficit widened from US$180.2 million in the first quarter of 2022 to US$254.9 million in the second quarter of 2022. This was mainly due to the increase in import bills which outweighed the increase in export receipts. The increase in import bills was largely in respect of increased payments for food and petroleum products.

The stock of gross international reserves of the Bank of Sierra Leone (excluding swaps) decreased from US$860.4 million in the first quarter of 2022 to US$729.8 million in the second quarter of 2022, which is adequate to cover 3.5 months of imports of goods and services. The MPC also noted that the inflow of remittances remained relatively high at US$129.0 million in the second quarter of 2022Q2. As such, it remains a significant source of the foreign exchange needed for trade finance.

Exchange rate pressures remained elevated in the second quarter of 2022, and continued into the third quarter, due to a structural imbalance between the demand for, and supply of, foreign exchange. While the MPC welcomed the commencement of the BSL foreign exchange auction on 21st September 2022 aimed at numbing speculative pressures on the Leone, it does not see it as a panacea for the current depreciation pressure on the Leone. Because a very huge proportion of the nation's import bill goes to the importation of essential commodities (food and fuel, specifically) and for making debt-service payments, the MPC holds the view that increasing domestic food production, thereby reducing food imports, and the demand for foreign currency to finance it, is one of the low-hanging fruits that can yield a lasting impact on exchange rate stability. Secondly, joining other fragile economies to seek debt forbearance and/or the postponement of debt-service payments until the world economy returns to its pre-pandemic state can also significantly reduce the demand for foreign exchange, and thereby dampen the rate of depreciation of the Leone.

On the supply side, increasing the volume of exports and, more importantly, ensuring that exporters repatriate the resultant export revenues back into the country, is the most immediate first step to increasing the supply of foreign exchange. Cash-crop exports, which demand little or no imported inputs, should be prioritized in this strategy. Creating avenues for increasing remittance inflows, through diaspora bonds, for example, should also be explored. Finally, tourism should be promoted as a means for shoring up the supply of foreign currency.

The above notwithstanding, the MPC hopes that the expected improvement in the domestic food supply in the harvest season, the continuation of the current moderation in global energy prices and the usual injection of foreign currency by visiting diasporans could help to reduce exchange rate pressures in the immediate future.

Fiscal Policy

The overall fiscal balance deteriorated in the second quarter of 2022, as the fiscal deficit widened from NLe1.33 billion in the first quarter of 2022 to NLe1.84 billion in the second quarter of 2022. The deterioration was mainly due to higher increase in government expenditures relative to the increase in government revenues. The primary balance also worsened, as the deficit increased from NLe1.17 billion in the first quarter of 2022 to NLe1.42 billion in the second quarter of 2022.

The MPC noted that domestic revenue mobilization remained subdued as the growth in total revenue was mainly in respect of foreign grants received in the second quarter of 2022. Going forward, the MPC recommends further fiscal consolidation efforts in order to counterbalance the expected election-related expenditure increase for the 2023 general elections.

Money and Banking

Developments in monetary aggregates were mixed in the review period, as broad money (M2) expended, while reserve money contracted in the second quarter of 2022. However, Credit to private sector increased by 5.6 percent in the second quarter of 2022, up from 1.6 percent in the first quarter of 2022. Despite its increase, the MPC noted that credit to private sector was lower than expected, and that the prevailing high bank lending rates pose challenges for private sector investment and growth.

In the money market, the yields on government securities continued to rise in the second quarter of 2022 and in August 2022 due mainly to increased demand for the 364-day Treasury bills. The MPC noted that the persistent increase in the yields on government securities could have adverse implications for debt sustainability and could limit the fiscal space for essential government programs. Also, the interbank rate continued to trend upward, but remained within the Policy corridor, indicating improvement in the monetary transmission in the wholesale market and tight liquidity conditions.

Financial System Stability

The Banking sector remained relatively stable, well capitalized, liquid and profitable as most of the key financial soundness indicators (FSIs) were above their minimum thresholds in the review period. However, although the Non-Performing Loans ratio (NPLs) decreased from 15.1 percent in the first quarter of 2022 to 14.3 percent in the second quarter of 2022Q2, it still remains above the prudential limit of 10.0 percent. The MPC also noted that the spread between banks' lending rates and deposit rates remained very high. The high NPL ratio and the wide interest-rate spread pose challenges for financial intermediation and could stifle private sector growth and development.

Conclusion

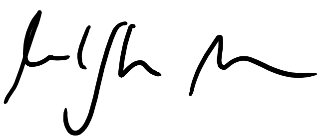
Inflationary pressures remained elevated, and it is expected to remain high throughout the remaining months of 2022. This is due mainly to supply-side factors including rising global commodity prices, higher freight charges, disruption in the global supply chain, uncertainty surrounding COVID-19 pandemic and the Ukraine war.

The MPC noted with concern the high domestic prices and the likely effects on the welfare of particularly the poor. The Committee also noted that the economy remains in an environment of stagflation, and that policy reform measures in the productive sectors of the economy particularly the agriculture sector to support aggregate supply remain vital to support growth and development.

Consequently, mindful of the BSL's responsibility for safeguarding price and financial-system stability, while supporting economic growth, the MPC decided to raise the Monetary Policy Rate (MPR) by 100 basis points to 17.0 percent and adjust the Standing Lending Facility Rate and the Standing Deposit Facility rate upward by the same margin. Hence, effective 3rd October, 2022, the following rates are published for the information of the public:

Monetary Policy Rate is 17.0 percent
Standing Lending Facility Rate is 20.0 percent
Standing Deposit Facility Rate is 11.0 percent

The MPC will continue to monitor developments in the global and domestic macroeconomic and financial environment and stands ready to take appropriate actions should they adversely impact price and financial-system stability.



Professor Kelfala M Kallon
Governor