BANK OF SIERRA LEONE

MONETARY POLICY REPORT

JUNE 2023

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ACRONYMS

AE	Advanced Economies
BOP	Balance of Payments
BSL	Bank of Sierra Leone
CAR	Capital Adequacy Ratio
CFC	Customers Foreign Currency
CIEA	Composite Index of Economic Activities
CPI	Consumer Price Index
CRR	Cash Reserve Requirement
dmt	Dry Metric Tons
ECB	European Central Bank
ECF	Extended Credit Facility
ECOWAS	Economic Community of West African States
EMDEs	Emerging Market and Developing Economies
FSIs	Financial Soundness Indicators
FX	Foreign Exchange
GDP	Gross Domestic Product
GoSL	Government of Sierra Leone
GST	Goods and Services Tax
IMF	International Monetary Fund
M2	Broad Money
MoF	Ministry of Finance
MPC	Monetary Policy Committee
MPR	Monetary Policy Rate
NDA	Net Domestic Assets
NEER	Nominal Effective Exchange Rate
NFA	Net Foreign Assets
NPLs	Non-Performing Loans
ODCs	Other Depository Corporations
OIN	Other Items Net
OMO	Open Market Operations
OPEC	Organization of the Petroleum Exporting Countries
Q1	First Quarter
Q2	Second Quarter
Q3	Third Quarter
Q4	Fourth Quarter
QM	Quasi Money
REER	Real Effective Exchange Rate
RM	Reserve Money
ROA	Return on Assets
ROE	Return on Equity
SDF	Standing Deposit Facility
SLF	Standing Lending Facility
Stats SL	Statistics Sierra Leone
T-bills	Treasury Bills
WB	World Bank
WEO	World Economic Outlook
WTI	West Texas Intermediate

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The Report

The June 2023 edition of the BSL Monetary Policy Report presents an assessment of global and domestic economic developments, mainly during the first quarter of 2023. The report also assesses current developments in the second quarter of 2023 for which data is available, as well as near-term prospects, with a view of implementing appropriate monetary policy consistent with the Bank's policy objectives.

BSL Monetary Policy Objectives

The primary objective of the BSL is to achieve and maintain overall price stability in the Sierra Leone economy. However, the Bank's mandate encompasses other important goals, including the stability of the financial system and financial market development, as well as supporting the general economic policy of the government to enhance overall macroeconomic stability.[1]

Monetary Policy Strategy

The BSL is the sole monetary authority in Sierra Leone with a statutory operational independence to conduct monetary policy in the country. The Bank uses appropriate policy instruments to achieve its stated objectives. They include, the Monetary Policy Rate (MPR), Open Market Operations (OMOs), Standing Lending and Deposit Facilities, Foreign Exchange Operations, and Cash Reserves Requirement.

Monetary Policy Process

The monetary policy of the Bank is formulated by the Monetary Policy Committee (MPC), which is a statutorily constituted body of seven members. The MPC includes the Governor of the Bank (who serves as the chairperson), Deputy Governor for Monetary Policy, Deputy Governor for Financial Stability, and Four other experts with relevant professional experience in monetary policy and financial market operations nominated by the Governor and approved by the Board of Directors of the BSL. The MPC meets every quarter to assess recent global and domestic economic developments, as well as near-to-medium term prospects and inflation risks. Based on these assessments, a policy decision is made, mainly using the MPR to signal the Bank's monetary policy stance. During deliberations in the MPC meeting, each member proposes a preferred MPR decision supported by underlying reasons. Final decision takes place by vote, with the chairman having the deciding vote in the occurrence of a tie. The final decision is then published in a monetary policy statement on the Bank's website, within forty-eight hours after the MPC meeting. In addition, the Governor and other authorized staff engage the public from time to time to explain the Bank's policy decisions and to clarify emerging economic issues, especially those affecting the conduct of monetary and exchange rate policies, among others.

[1] *Section 7.A of the new BSL Act 2019 states: "(1) the objective of the Bank shall be to achieve and maintain price stability. (2) Without prejudice to subsection (1) the Bank shall contribute to fostering and maintaining a stable financial system. (3) Without prejudice to the attainment of the previous two objectives, the Bank shall support the general economic policy of the Government.*

EXECUTIVE SUMMARY

The global economic outlook remains uncertain despite declining food and energy prices, re-opening of the Chinese economy, and improvements in business and consumer confidence. Factors such as the recent financial sector turbulence in the US and its associated risk of contagion, as investors exercise caution and the lingering geopolitical tensions, continue to keep uncertainty at heightened levels. In effect, downside risks remain and continue to slow rebound in economic activity. The situation is further compounded by difficulties in global trade associated with the Russian-Ukraine crisis, sovereign debt crisis and continued tightening of credit conditions. Accordingly, the IMF revised its 2023 and 2024 global growth projections downward by 0.1 percentage point each to 2.8 percent and 3.0 percent, respectively.

Global headline inflation continues to ease although at a slower pace than expected. Synchronized monetary policy tightening across most regions, relaxing supply chain conditions and retreat in energy and food prices mainly explain the receding global headline inflation. Accordingly, the IMF adjusted global inflation for 2023 and 2024 downwards by 0.4 and 0.6 percentage points to 7.0 percent and 4.9 percent, respectively.

On the domestic front, real GDP growth moderated to 3.6 percent in 2022 from the strong rebound of 4.1 percent in 2021. Growth is projected to further slowdown to 2.7 percent in 2023 from an initial estimate of 3.4 percent due to less-than expected improvement in mining output and uncertainties surrounding the other growth sectors as well as relics from the Russia-Ukraine war. Going forward, real GDP growth is expected to recover to 4.7 percent in 2024 to be driven by the anticipated increase in investment in the agriculture sector, other mining activities, expansion in manufacturing, recovery in the tourism sector, and the general improvement in the business environment as the implementation of business-friendly regulatory and financial sector reforms continue. Furthermore, the Bank's analytical high frequency indicator of economic activities (CIEA) signaled slight improvements in economic activity during 2023Q1 but forecasted to slow by end 2023Q3.

Inflation remained elevated in the first five months of 2023. Headline inflation moderated slightly from 42.96 percent in February 2023 to 41.74 percent in March 2023, but quickly rose again to 43.05 percent in April 2023 and further to 44.43 percent in May 2023. Overall, the current inflationary situation in the country could be attributed to both supply and demand factors. On the supply side, significant exchange rate depreciation continues to pass through to consumer prices, in addition to the fact that production is unable to keep pace with demand. On the demand side, expansion in monetary aggregates and fiscal operations are major factors. Inflation is expected to remain high over the remainder of 2023Q2 and may start receding towards the end of 2023Q3 and 2023Q4. In the near term, inflation is forecasted to increase slightly further but stay between 44 – 48 percent by end October 2023.

The trade deficit further narrowed to US$159.53mn in 2023Q1 from US$200.17mn in 2022Q4. This improvement reflects the combined effects of an increase in exports earnings and a decrease in imports bill. This was reinforced by the improvement in the terms of trade and the easing of global supply chain conditions, supported by the reopening of China. The gross foreign exchange reserves of the Bank of Sierra Leone decreased slightly but was still enough to cover 3.3 months of imports of goods and services.

Provisional data on the fiscal position shows that the overall fiscal deficit widened to NLe1.81bn in 2023Q1 from NLe0.85bn in 2022Q4 as total government revenues declined more than the reduction in government expenditures. The government tightened fiscal policy in 2023Q1 by cutting back on discretionary spending.

For the monetary sector, monetary aggregates were expansionary in 2023Q1. On a year-on-year basis, reserve money expanded by 33.39 percent in 2023Q1 compared to 25.55 percent in 2022Q4. Similarly, broad money expanded by 44.94 percent in 2023Q1 which was higher than the 41.05 percent growth recorded in 2022Q4. However, the growth in monetary aggregates moderated on a quarterly basis. Private sector credit also grew by 21.53 percent which was higher than the 12.05 percent in the preceding quarter. Credit was mainly directed to Commerce & Finance, construction, business and personal services.

Government securities were oversubscribed on net basis in 2023Q1 largely induced by BSL’s secondary market operations to support liquidity. The oversubscription was mainly accounted for by the 364-day T-bills with a yield hovering around 28 percent. The 91-day and 182-day T-bills were undersubscribed in 2023Q1. The interbank market rate also continued to increase during the review period, implying tight liquidity in the banking system.

Exchange rate depreciation broadly persisted in the first half of 2023, although it halted in June 2023 and the Leone even appreciated, mainly due to reduced demand pressure in the foreign exchange market, which is associated with low business sentiment as uncertainty increased during the period towards election.

On the financial sector, most of the Financial Soundness Indicators (FSIs) remained above the prudential thresholds stipulated by BSL, suggesting continued stability in the banking sector in 2023Q1. However, the NPL ratio increased slightly and remained above the statutory limit of 10 percent. Moreover, there are risks and vulnerabilities threatening stability of the system including limited intermediation, overreliance on investment in government securities as well as increase in foreign currency deposits which poses threat to the financial system.

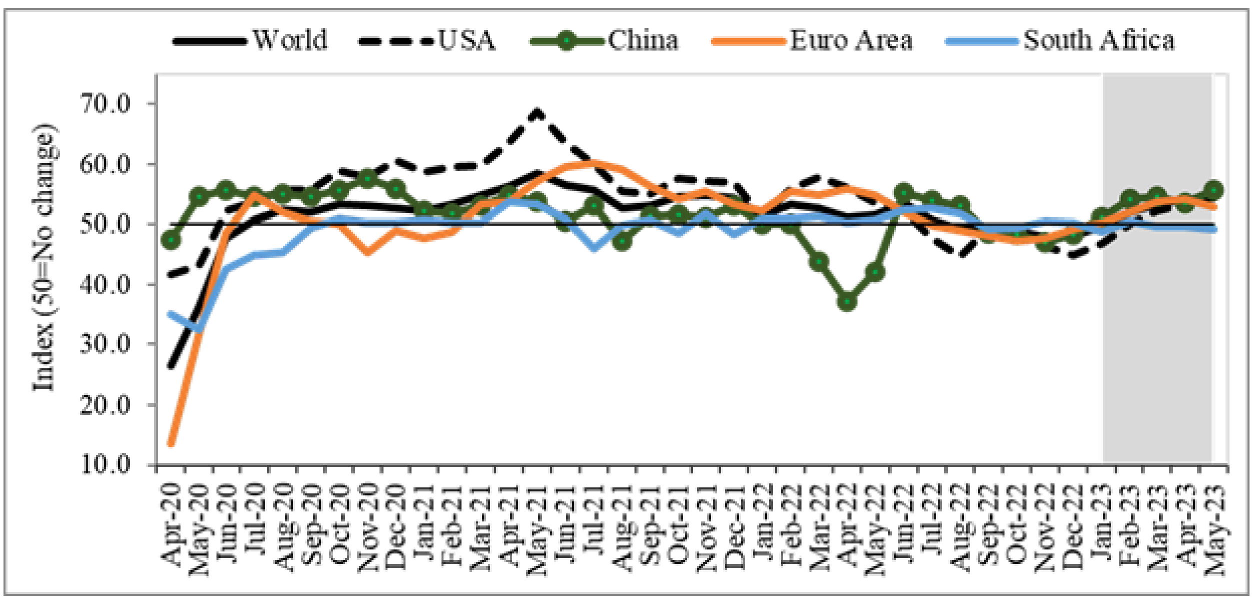
The rest of the report is structured as follows: The second section analyses the global economic developments including global growth, global inflation, commodity prices and their implications for the Sierra Leone economy. The third section reviews domestic economic developments and outlook. Finally, the fourth section covers the conclusion and decision of the MPC in the MPC meeting held in early July 2023.

1. GLOBAL ECONOMIC DEVELOPMENTS AND PROSPECTS

1.1 Global Output

The global economy remains resilient so far in 2023, though prospects are still clouded in uncertainty. Unwinding supply chains, decreasing food and energy prices and stronger recovery in China are boosting global economic activity and sentiments. Composite Purchasing Managers' Indices (PMI)[2] for the first five months in 2023 indicate a strong rebound in China followed by improving global economic momentum. Strong improvement was also observed in the United States, as the composite PMI rose through May 2023. Developments in the Euro Area also appear to beat earlier fears of recession in 2023, as the PMI continues to signal expansion in economic activity. Overall, the improvement in global composite PMI is powered to a large extent, by the services sector. Manufacturing activity remained subdued, mainly due to its greater sensitivity to rising borrowing costs (Figure 1).

Figure 1: Trends in Global and Selected Economies PMIs



Data Source: Markit Economics, through Trading Economics May 2, 2023;
Note: PMIs above 50percent signals expansion in economic activity; below 50percent signals contraction.

[2] The PMI is an index of the prevailing direction of economic trends in the manufacturing and services sectors around the world. An index below 50 indicates contraction and above 50 indicates expansion while 50 indicates no change.

Notwithstanding the positive signals suggested by the composite PMIs, further monetary policy tightening, intensification of the Russia-Ukraine war, U.S.- China tensions, financial stress risks and weak trade could weigh on global growth going forward. In addition, difficult policy trade-offs and increasing debt distress in many economies across the world could serve as major headwinds on economic outcomes going forward. Accordingly, the IMF has revised its 2023 and 2024 global growth projections downwards by 0.1 percentage point each to 2.8 percent and 3.0 percent, respectively. (See Table 1)

1.1.1 Advanced and Emerging Market Economies

Economic activity in Advanced Economies appears to be better-than-expected, mainly supported by improved consumption as well as business and consumer sentiments, as inflation appears to have reached a turning point. However, tight monetary conditions continue to weigh on manufacturing and other industrial activities. The recent banking turbulence, which indicates fragility in the financial system, is also having an adverse effect on overall economic performance. Against this backdrop, growth in advanced economies is forecasted to slow from 2.7 percent in 2022 to 1.3 percent in 2023, before improving slightly to 1.4 percent in 2024.

In emerging market and developing economies, growth is expected to remain firm, supported by the recovery in China and widespread improvement in services. However, tighter financial conditions are adversely affecting manufacturing activity, slowing down growth momentum. Therefore, growth is projected to bottom out at 3.9 percent in 2023 before rising modestly to 4.2 percent in 2024.

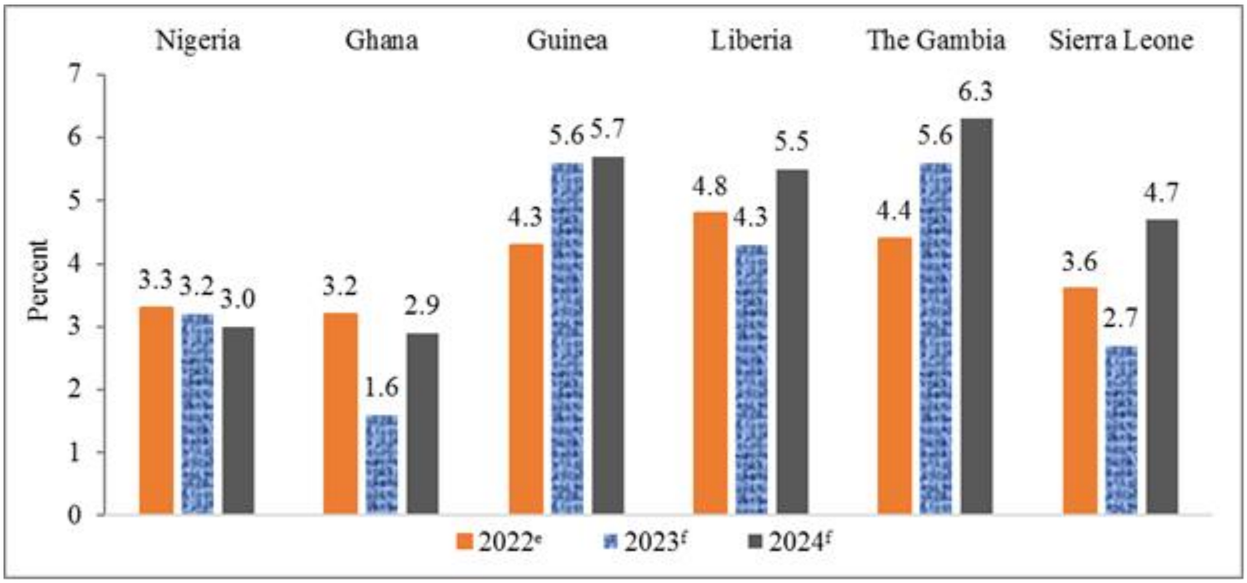
1.1.2 Sub-Saharan Africa

Growth momentum in Sub-Saharan Africa is tipped to moderate in 2023. Weak economic outturn in South Africa and Nigeria is expected to offset improvement across most of the region. However, the region is projected to remain broadly resilient with stable outlook through 2024. In this context, growth in the region is projected to drop from 3.9 percent in 2022 to 3.6 percent in 2023 before improving to 4.2 percent in 2024.

1.1.3 West African Monetary Zone (WAMZ)

Overall, economic activity in the WAMZ bloc is expected to soften in 2023, mainly driven by weak performances in Nigeria and Ghana, two of the major economies in the bloc. The Liberian and Sierra Leone economies are also tipped to further weaken in 2023. Slow foreign and domestic investments, high cost of living, elevated debt levels, and currency depreciation, amid tight financial conditions explain the expected slowdown in growth. However, growth in The Gambia and Guinea remains firm, supported by recovery in the services sector and mining sector, respectively. Looking ahead, overall performance in the bloc is expected to improve in 2024, although growth will broadly remain below historical levels in most of the economies in the bloc.

Figure 2: Trends in Real GDP Growth (percent) in the WAMZ Economies



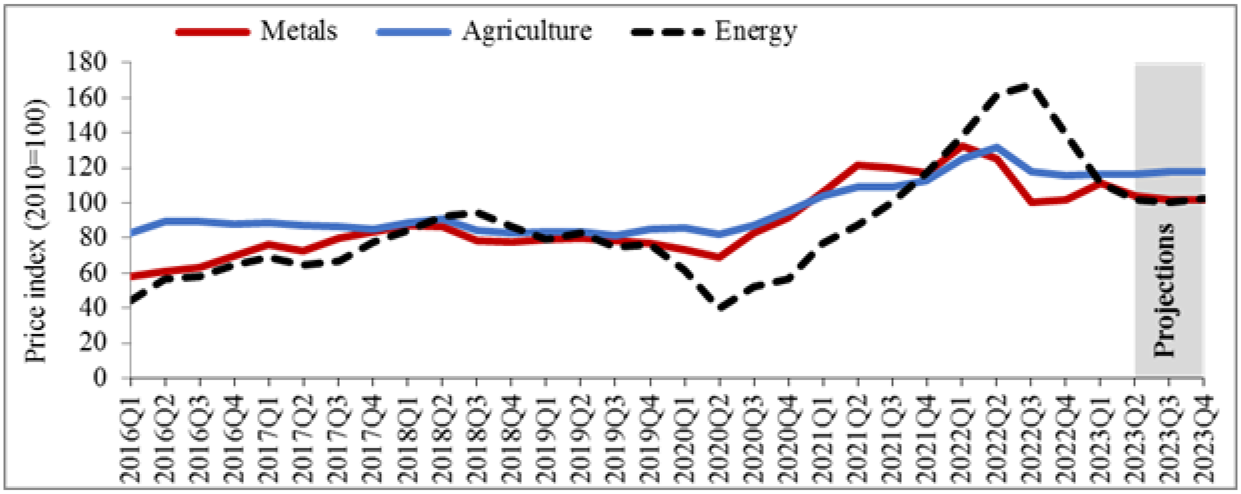
Source: IMF World Economic Outlook, April 2023, and January 2023 update;
Note: e=estimate and f =forecast

1.2 Global Commodity Prices and Inflation

1.2.1 Global Commodity Prices

Energy prices further soften by 20 percent in 2023Q1 due to high inventories and slow recovery in global manufacturing activity, which have limited crude oil demand growth. On the supply side, production cuts by OPEC+ is being significantly offset by major non-OPEC member producers including the US, Canada Mexico, and Norway. Agricultural prices remained stable in the review period as supply chain conditions continue to ease amid improving production conditions. Conversely, metal prices strengthened by 9.8 percent during the review period, buoyed by strong demand prospects in China, amid government consideration of hefty economic packages for key growth driven sectors such as real estate. Generally, commodity prices are expected to remain soft over the remainder of 2023 and into 2024 amid subdued demand and improving supply prospects.

Figure 3: Trends in Global Commodity Price Indices



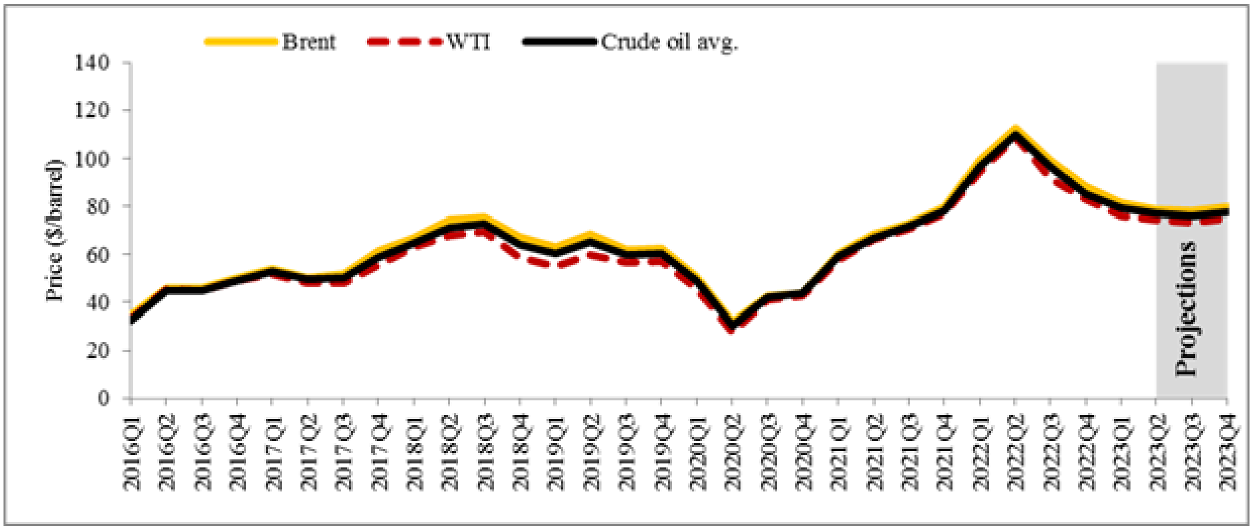
Source: World Bank Commodity Market Database June 2023

Crude Oil Prices

Average crude oil prices retreated by 28.2 percent between the peak in 2022Q2 and 2023Q1 mainly due to subdued demand amid improving supply as Russia sells its oil on major discount to non-sanctioning member countries.

At US$79.05/bbl in 2023Q1, average crude oil prices are 18.2 percent below the price level before Russia's invasion of Ukraine. Both Brent and West Texas Intermediate (WTI) crude oil prices strongly reflect the movements in the average crude oil prices. Though crude oil prices are expected to further decline slightly in 2023Q2, they are projected to stabilize afterwards and edge up slightly in 2024, as markets are expected to tighten amid budding supply pressures from OPEC+.

Figure 4: Crude Oil Prices (US$/barrel)

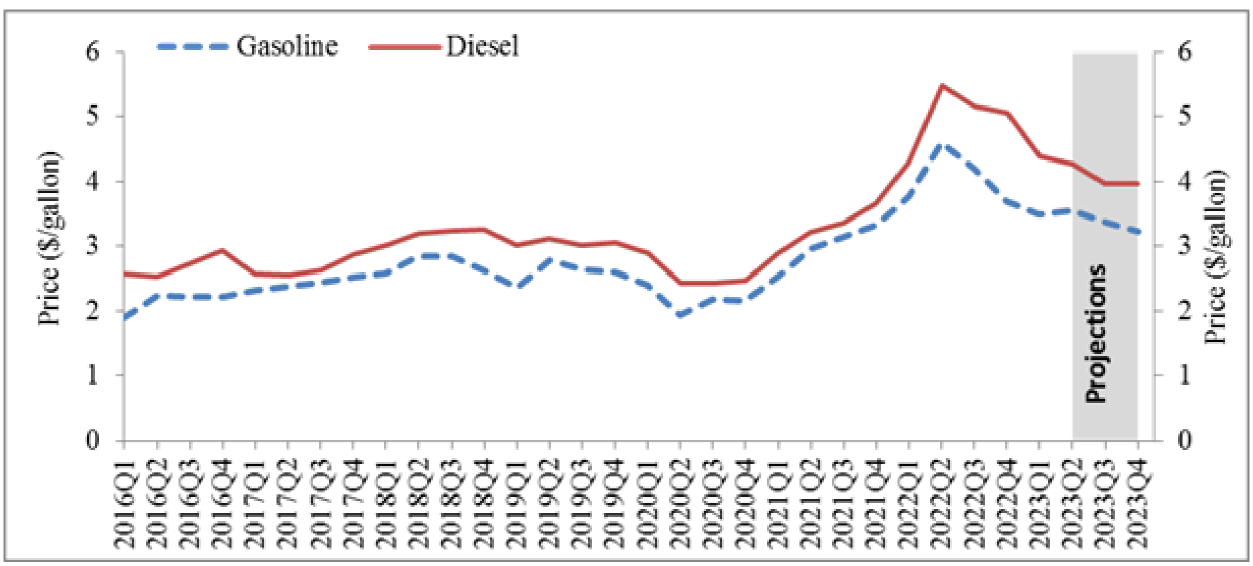


Source: World Bank Commodity Market Database June 2023

Petroleum Products (Retail Prices)

Global petroleum prices also continued to decrease during the review quarter mainly reflecting the decrease in crude oil prices, which is the main constituent in the production of petroleum products. This was further reinforced by the weakening U.S dollar.

Figure 5: Average Prices of Petroleum Products (US$/gallon)

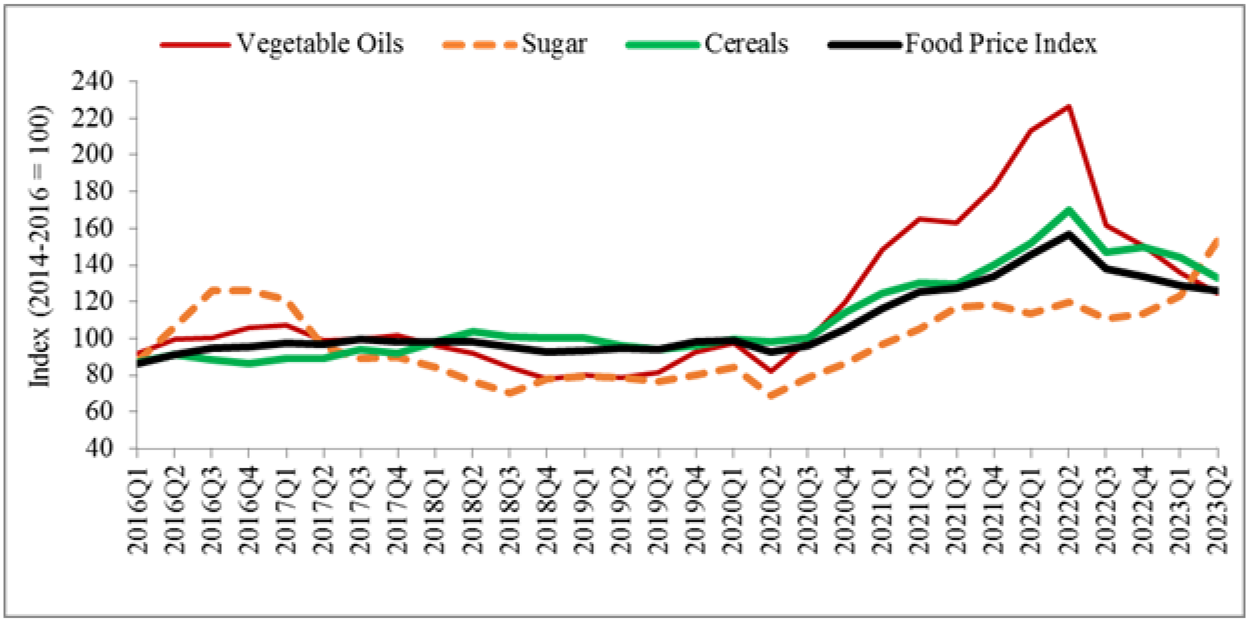


Source: U.S. Energy Information Administration, EIA (June 2023)

FAO Food Price Index

The FAO Food Price index continued to signal decreasing trend in food prices. The index decreased by 17.9 percent between its peak in 2022Q2 and 2023Q1, underpinned by significant decreases in the price indices for vegetable oils and cereals. However, sugar indices increased in 2023Q1, which continued in 2023Q2. The ease in global supply chains and redirection of trade for agriculture inputs also contribute to the observed downward trend in food prices.

Figure 6: FAO Food Price Indices

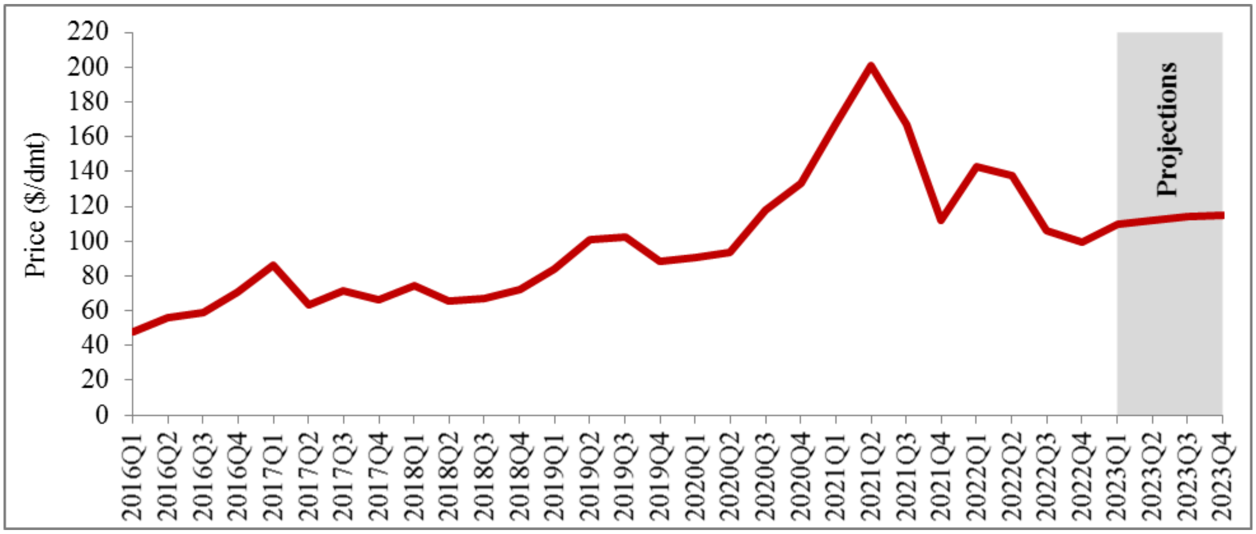


Source: FAO food price index database, June 2023

Iron Ore Price

After decreasing sharply for the past three consecutive quarters, iron ore prices surprised with an increase of 27 percent in 2023Q1 mainly spurred by a seasonal rise in China's steel output, which raised steel prices and the demand for iron ore. This effect is expected to subside over the remainder of 2023 in addition to expected improvement in supply. Accordingly, iron ore prices are tipped to remain subdued through 2024.

Figure 7: Trend in the Price of Iron Ore (US$/dmt)

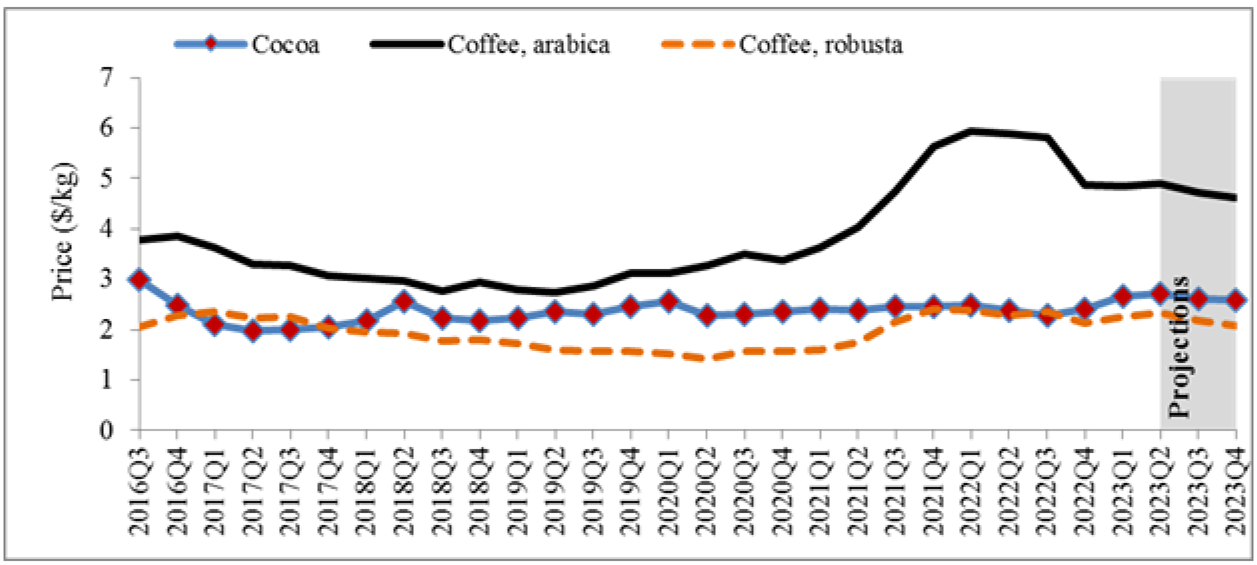


Source: World Bank Commodity Market Database June 2023

Cocoa and Coffee Prices

Cocoa prices edged up by 10.9 percent selling at US$2.68/kg in 2023Q1, supported by strong demand and supply concerns.

Figure 8: Cocoa and Coffee Prices (US$/kg)



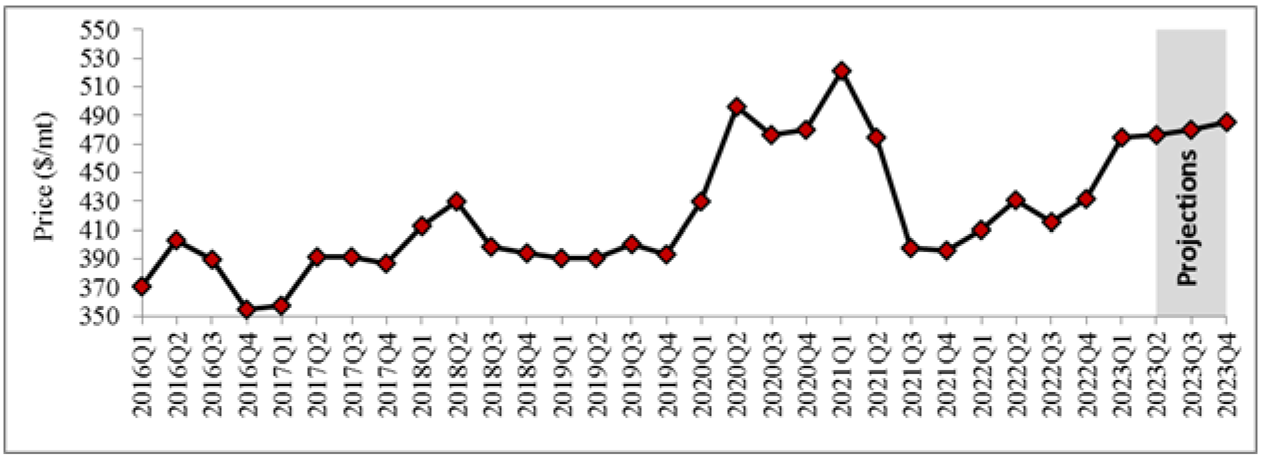
Source: World Bank Commodity Market Database June 2023

Similarly, robusta coffee prices recorded gains by 6.2 percent, selling at US$2.25/kg in 2023Q1 due to tighter global stocks, rains in Brazil, and supply concerns over the El Nino weather pattern. Meanwhile, Arabica coffee prices were broadly unchanged during 2023Q1, but remained significantly higher than pre-pandemic prices. Cocoa and coffee prices are expected to revolve around current levels over the remainder of 2023, as supply conditions gradually align with demand.

Rice Prices

Despite the decrease in general food prices, the price for rice climbed further by 9.8 percent averaging US$474.17/mt in 2023Q1. The increase in the price of rice reflects tight supply conditions due to unfavorable weather in major rice producing economies including China and Pakistan. Global rice prices are expected to remain high through the remainder of 2023, underscored by weak production levels and dwindling stocks.

Figure 9: Trend in the Average Price Rice (US$/mt)

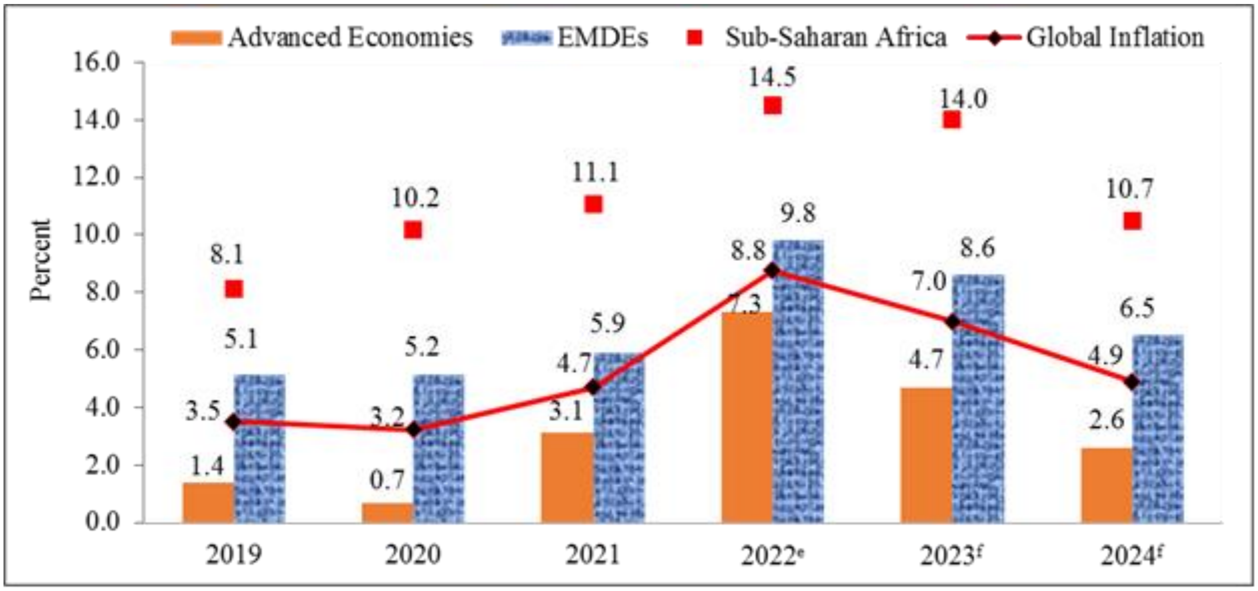


Source: World Bank Commodity Market Database June 2023

1.2.2 Global Inflation

Global inflationary pressures have started to ease, though at a slower pace-than-expected. Synchronized monetary policy tightening across most regions, easing supply chain bottlenecks and retreat in energy and food prices mainly explain the receding global inflation.

Figure 10: Trends in Global and Regional inflation



Source: IMF World Economic Outlook (WEO) April 2023 and January 2023 update.

However, core inflation remained elevated in most economies amid high financial stress risks. Accordingly, the IMF has revised global inflation for 2023 and 2024 upwards by 0.4 and 0.6 percentage points to 7.0 percent and 4.9 percent, respectively, compared to its January 2023 WEO update. Consumer price inflation projections for advanced economies were unchanged at 4.7 percent and 2.6 percent in 2023 and 2024, respectively. Consumer price inflation in EMDEs was revised upwards by 0.5 and 1.0 percentage points to 8.6 percent and 6.5 percent, respectively.

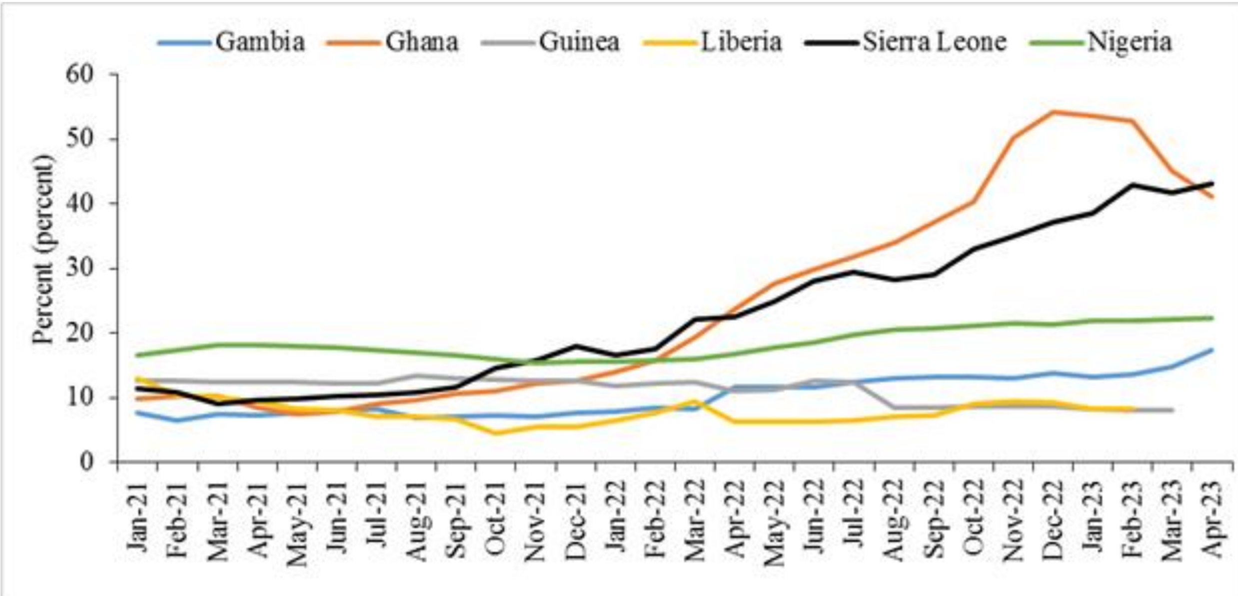
Sub-Saharan Africa (SSA) Inflation

Inflation pressures in SSA are expected to ebb amid slowing activity and tight monetary policy across most economies in the region. However, inflation rates are expected to remain elevated in the short-to-medium term. While inflation is projected to decline over 2023 and 2024, there have been upward revisions of 2.1 and 1.9 percentage points respectively to projections, compared to January 2023 WEO update due to persistent underlying inflationary forces.

Inflation in the WAMZ

Consumer price inflation remains elevated in the WAMZ economies, except for Guinea and Liberia whose inflation rates have been relatively unaffected by the global shocks. However, there has been a sharp turn-around in Ghana's inflation since February 2023, which is associated with a combination of factors, including monetary policy tightening, ease in currency depreciation and decrease in domestic fuel pump prices.

Figure 11: Inflation Trends in the WAMZ



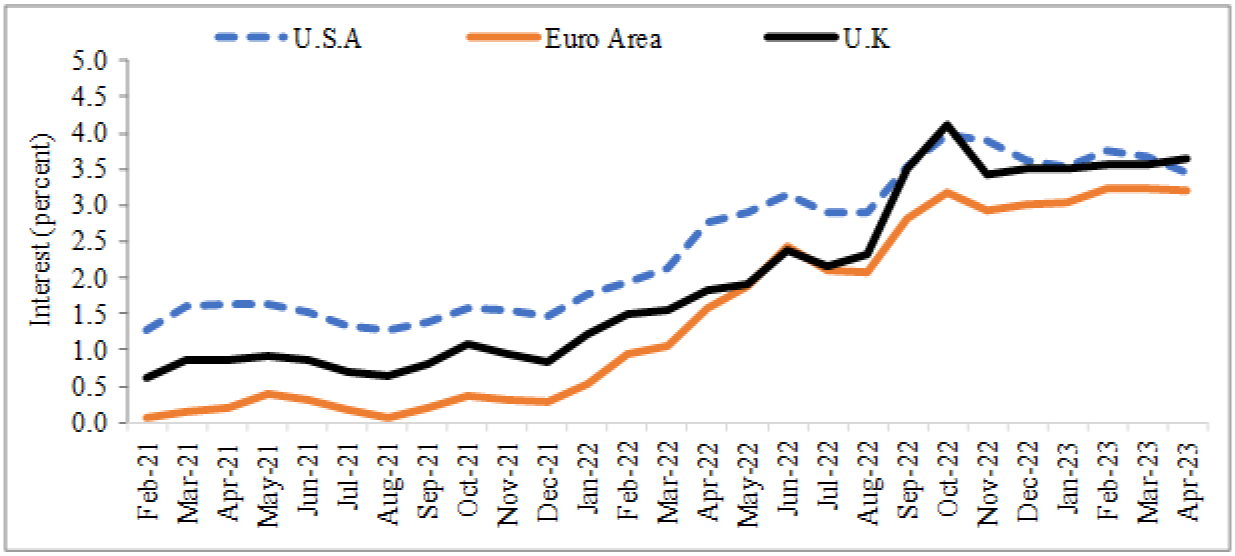
Data Source: Country Central Banks through Trading Economics

1.3 Monetary Policy and Financial Market Developments

The unexpected financial sector turbulence in the U.S. and collapse of confidence in Credit Suisse (a globally significant bank) in 2023Q1 has raised global financial stress risks. This situation has also worsened the challenges faced by monetary policy authorities. The balancing act to quickly bring down inflation near targets while preserving financial stability has become more delicate. However, many central banks continue to raise policy rates, though at a relatively slow pace. Consequently, global financial conditions remain tight. (See table 2)

Further interest rates hikes in major economies and the ensuing tight financial conditions will continue to weigh on investment and worsen public finances particularly in emerging markets and developing economies, where fiscal policy has limited space to respond to shocks. The interest rate on the 10-year government bonds in the United States, Euro Area and United Kingdom (proxy for global borrowing cost) remained elevated in the first five months of 2023.

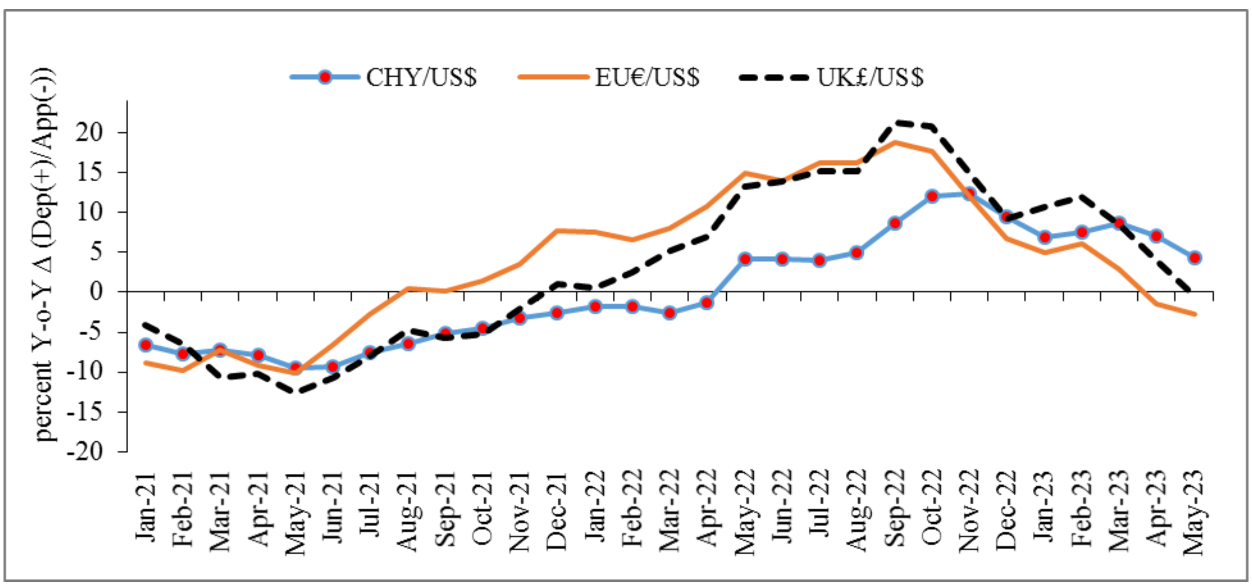
Figure 12: Selected Sovereign Bond Yields



Source: Federal Reserve Economic Data (FRED) June 2023

On the international currency market, the expected slowdown in the pace of interest rates hikes in the U.S has weakened the U.S dollar during the review period. This situation could help to ease depreciation pressures in EMDEs, as well as small open economies such as Sierra Leone.

Figure 13: Exchange rates of Selected Major Global Currencies to the U.S. Dollar

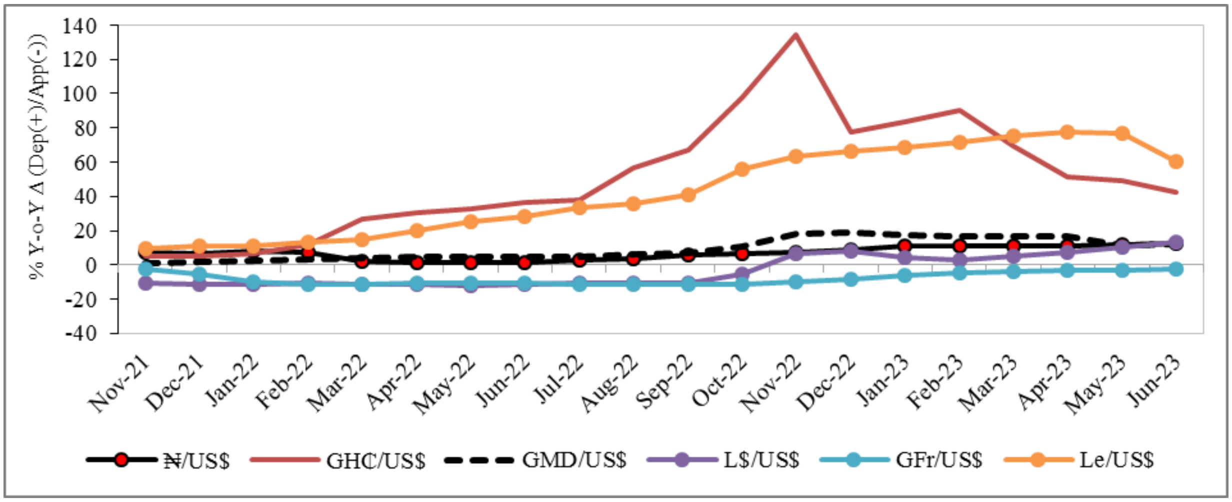


Data Source: FRED (June 2022) Note: a positive change indicate depreciation against the U.S. dollar and a negative change indicates an appreciation against the U.S. dollar.

1.4 WAMZ Exchange Rates

Exchange rate depreciation pressures in Ghana and Sierra Leone have started to recede reflecting varying factors. The depreciation rate of the Ghana Cedi slowed significantly between November 2022 and June 2023, supported by fiscal consolidation efforts, domestic debt exchange program, external debt restructuring and strong remittance & mining inflows. Muted demand in the FX market and weakness in the U.S dollar also provided further support for the Cedi. In Sierra Leone, the depreciation rate of the Leone slowed in June, mainly underpinned by reduction in demand for foreign exchange as business agents pause importation due to elections-related uncertainty. Meanwhile, the currencies of the other four economies in the WAMZ bloc remain relatively stable.

Figure 14: Year-on-Year Movements in the WAMZ currencies against the US dollar



Source: Trading Economics

1.5 Implications for the outlook of the Sierra Leone economy

Overall, the global environment became more benign for Sierra Leone. The strong rebound in China and improvement in global economic activity could boost demand for Sierra Leone's export and enhance GDP growth. The observed decrease in global food and energy prices coupled with the easing global supply chain bottlenecks could significantly reduce Sierra Leone's import prices, while the strong iron ore and cocoa prices may boost export receipts. The ensuing improvement in the terms-of-trade may eventually improve the current account and ease depreciation pressures in the domestic FX market. The receding global inflation may also translate to lower imported inflation for Sierra Leone going forward. The relative global weakening of the U.S. dollar may also dampen pressures in the domestic foreign exchange market. However, persistent tightness in global financial conditions and the continuing focus on Ukraine could dampen potential FDI and ODA flows into the country. Moreover, high global uncertainty may significantly weigh on domestic economic activity in the short-to-medium term.

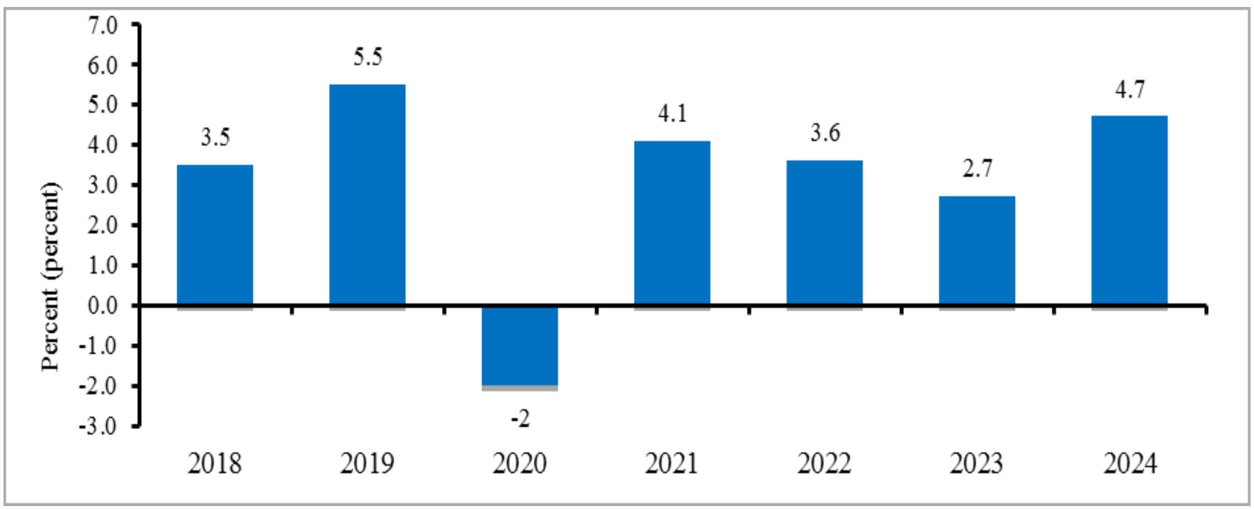
2 DOMESTIC ECONOMIC DEVELOPMENTS

2.1 Real Sector Developments

2.1.1 Real GDP Growth

Economic growth slowed to 3.6 percent in 2022, compared to 4.1 percent in 2021, driven mainly by spillovers from the Russian-Ukraine crisis and associated global economic uncertainty, coupled with high global food and energy prices. Notwithstanding, there were improvement in the performance of the agricultural and services sectors on account of government diversification strategy. The economy is projected to slow down to 2.7 percent in 2023, largely due to less-than-expected improvement in mining output and uncertainties surrounding the other growth sectors as well as higher food and fuel prices, exchange rate depreciation, weak purchasing power and tight fiscal stance. Going forward, the real GDP growth is expected to recover to 4.7 percent in 2024 driven by the anticipated increase in investment in agriculture sector; other mining activities, expansion in manufacturing, recovery in the tourism sector, and the general improvement in the business environment as investment in agriculture and the implementation of business regulatory and financial sector reforms. (see Figure 15)

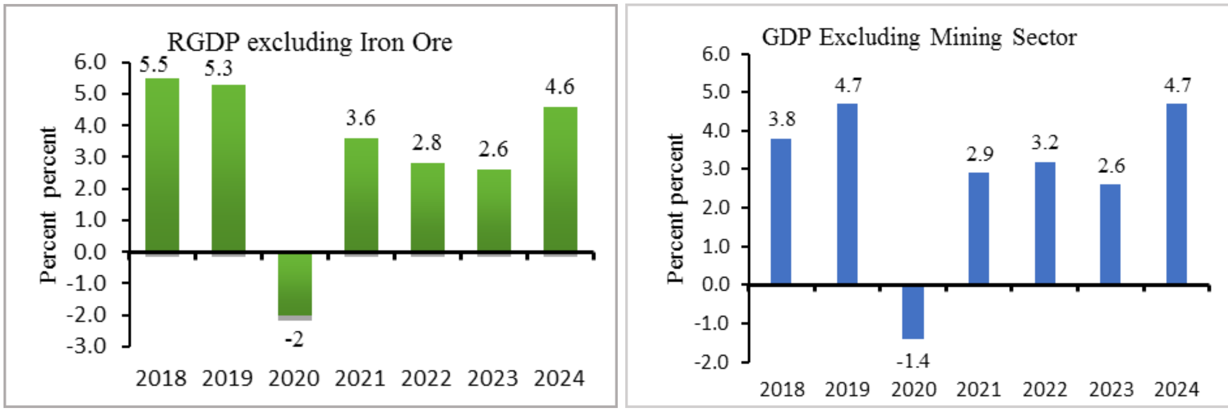
Figure 15: Real GDP growth



Source: Statistics Sierra Leone & IMF

Real GDP growth, excluding the mining sector, is estimated at 3.2 percent in 2022 compared to 2.9 percent in 2021. Excluding iron ore, real GDP growth is estimated to decline to 2.8 percent in 2022 from 3.6 percent growth in 2021. In 2023, real GDP growth, excluding the mining sector and iron ore are projected to grow at a flat rate of 2.6 percent. (see Figure 16)

Figure 16: Real GDP growth Rates Excluding Iron ore and Mining Sectors

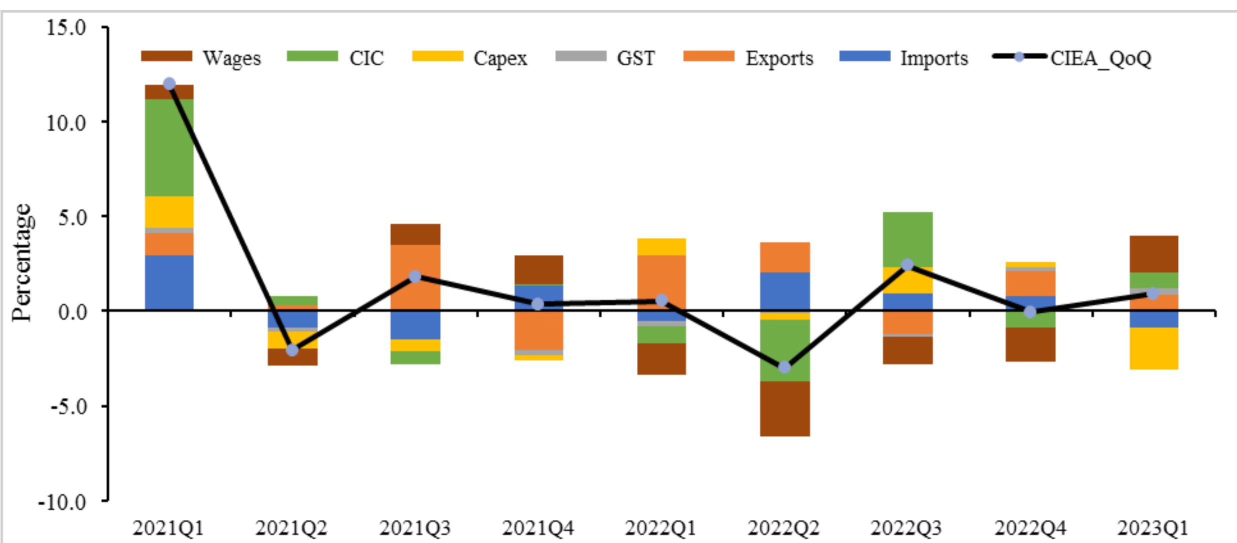


Source: Statistics Sierra Leone & IMF

2.1.2 Composite Index of Economic Activity (CIEA)

The Bank's analytical high frequency indicator of economic activities recorded a positive growth in 2023Q1, compared to a negative growth in 2022Q4. The Composite Index of Economic Activities (CIEA) rose by 0.90 percent in 2023Q1, from a contraction of 0.05 percent in 2022Q4. Based on its input variables, the improvement in economic activities was due to an expansions in currency-in-circulation, wages & salaries, GST, and exports. (see Figure 17)

Figure 17: Contributions to CIEA

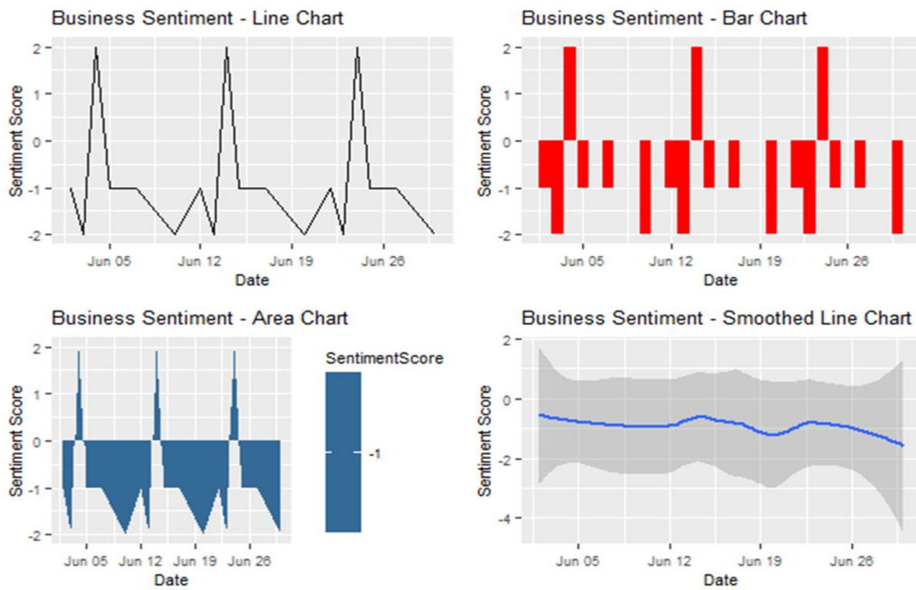


Source: BSL

Box 1: Business Confidence

Business sentiment analysis plays a crucial role in understanding the prevailing attitudes and emotions within the business community. Staff at the BSL assessed business sentiment in Sierra Leone during the month of June 2023 using the AFINN Lexicon Methodology[3]. The sentiment score ranges between -5 to 5, with a score of -5 indicating the most pessimistic (worst) sentiment score. The figure below displays a business sentiment score of -1, suggesting a negative outlook or pessimism among businesses.

Figure 18: Business Sentiment Chart Grid



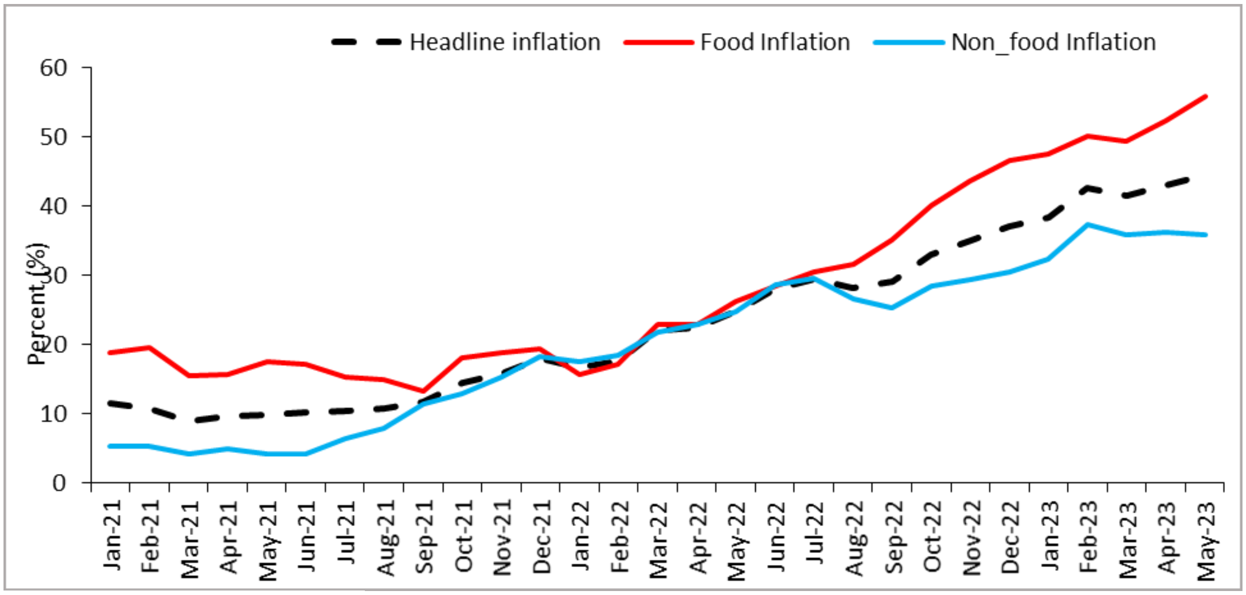
Source: BSL, staff calculation

2.1.3 Price Developments

Inflationary pressures persisted in 2023Q1 through May 2023 with headline inflation increasing from 37.09 percent in December 2022 to 41.74 percent in March 2023. It increased further to 43.05 percent and 44.43 percent in April and May 2023 respectively. The elevation in headline inflation was partly driven by the combined effect of the continuous depreciation of the domestic currency and increased fiscal deficit financing. Headline inflation mirrors both increases in food and non-food inflation. Food inflation rose from 46.70 percent in December 2022.to 50.05 percent in March 2023 and further to 52.33 percent in April 2023. Non-food inflation increased from 30.60 percent in December 2022 to 35.84 percent in March 2023 before reaching 36. 24 percent in April 2023.

[3] The AFINN Lexicon Methodology provides a natural language processing approach to sentiment analysis. It involves creating a lexicon, or word list, where each word is assigned a sentiment score.

Figure 19: Trend in Headline, Food and Non-food Inflation

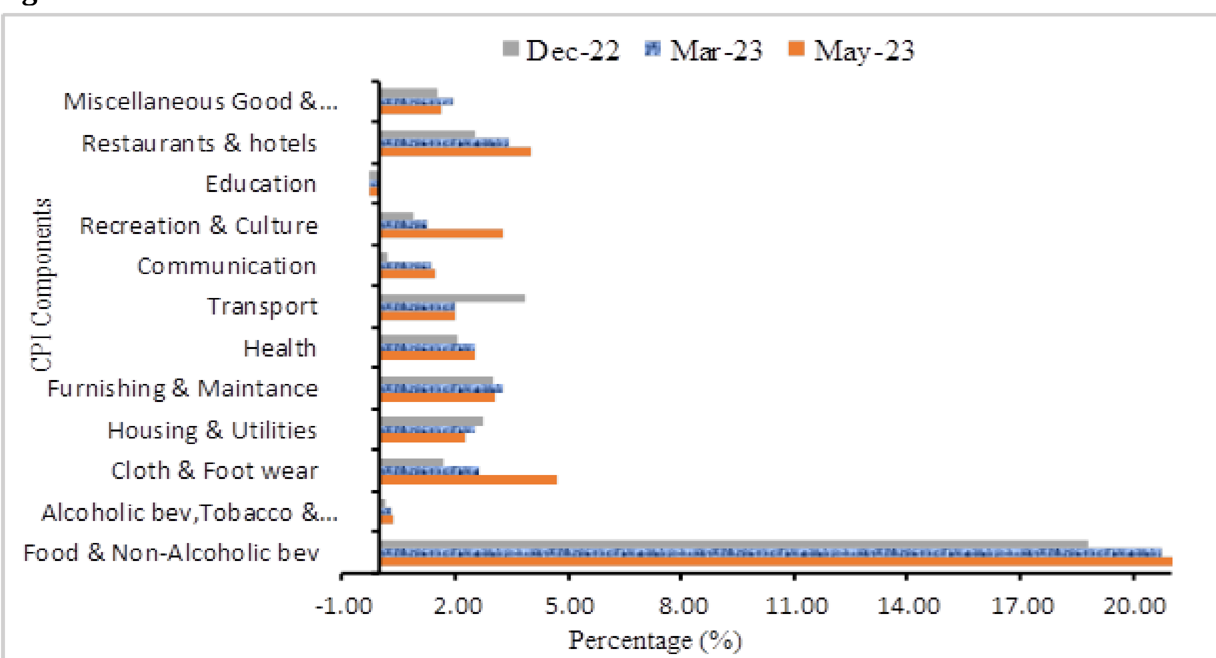


Source: Statistics Sierra Leone

Contributions to headline inflation

The increase in annual headline inflation in May 2023 reflected mainly the increases in food & non-alcoholic beverages, clothing & footwear, recreation & culture, and restaurants & hotels.

Figure 20: Contribution to Headline Annual Inflation



Source: Statistics Sierra Leone

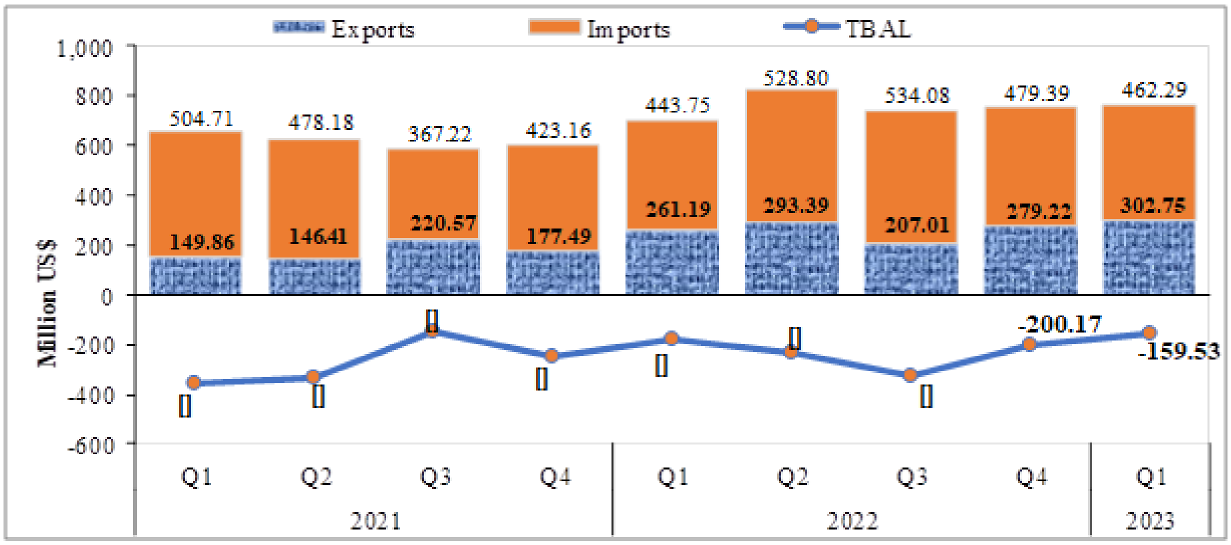
On the other hand, decreases were recorded for housing, health, furnishing & maintenance, and miscellaneous goods and services, while education remained unchanged during the review period.

2.2 External Sector Developments

2.2.1 Merchandise Trade

The trade deficit further narrowed in 2023Q1 to US$159.5mn from US$200.2mn in 2022Q4. This improvement reflects the combined effects of an increase in exports earnings and a decrease in the imports bill. The increase in total exports was primarily occasioned by increase in iron ore exports, whiles the fall in total imports was mainly due to a reduction in food imports.

Figure 21: Merchandise Trade

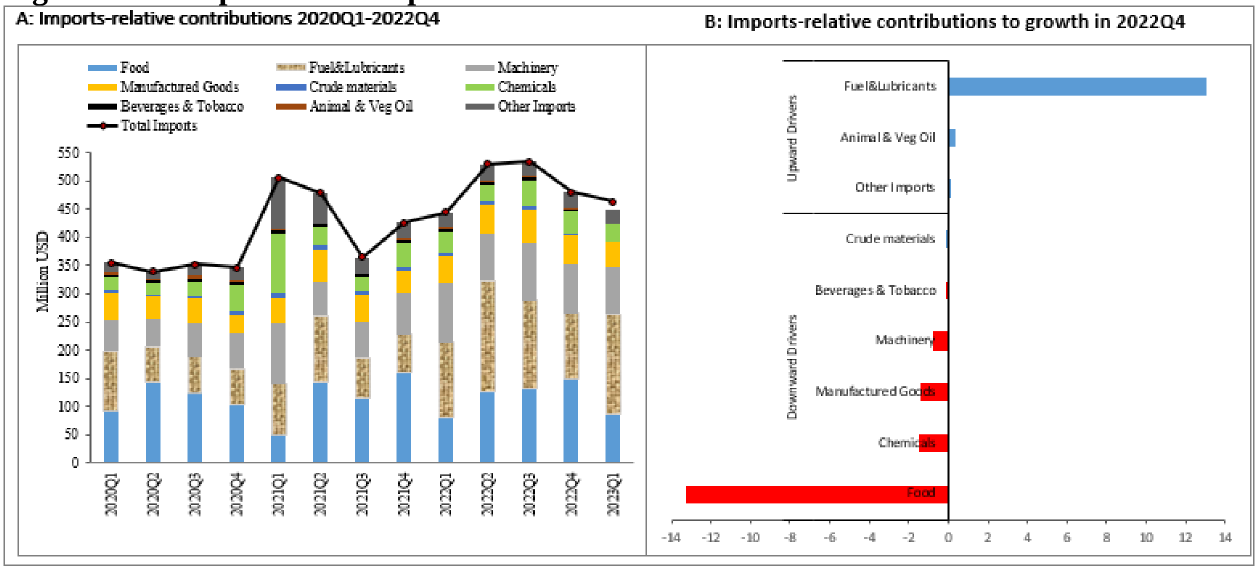


Source: NRA/Customs & BSL

Components of Import

The import bill decreased in 2023Q1, largely on account of decreases in the import bill for food, chemicals, and manufactured goods, which outweigh the increase in the impot bills for petroleum and vegetable oil products. The total merchandize import was US$462.3mn in 2023Q1, down by 3.6 percent compared to US$479.4mn in 2022Q2. This was mainly driven by lower aggregate demand as inflation reduced the purchasing power of household income.

Figure 22: Components of Import

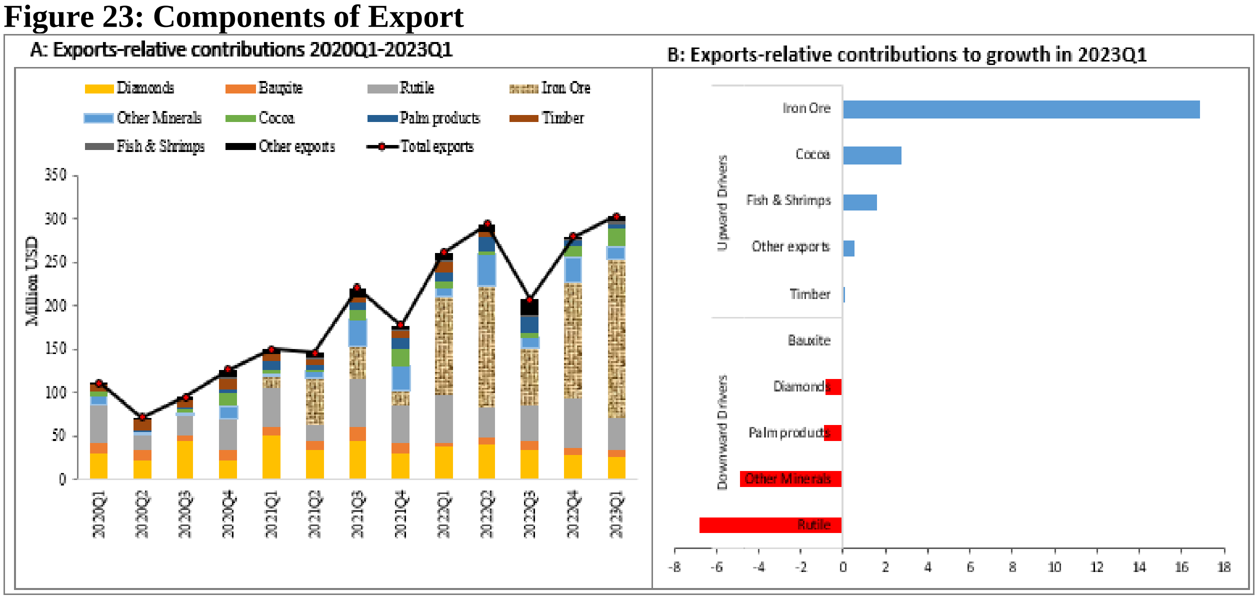


Source: NRA/Customs & BSL

Components of Export

Merchandise export was boosted by iron ore, cocoa, and fish & shrimps exports, which more than offset the decrease in receipts from palm products, diamonds, rutile, and other mineral exports. Total value of merchandise exports increased by 8.4 percent to US$302.7mn in 2023Q1 from US$279.2mn in 2022Q4.

Figure 23: Components of Export

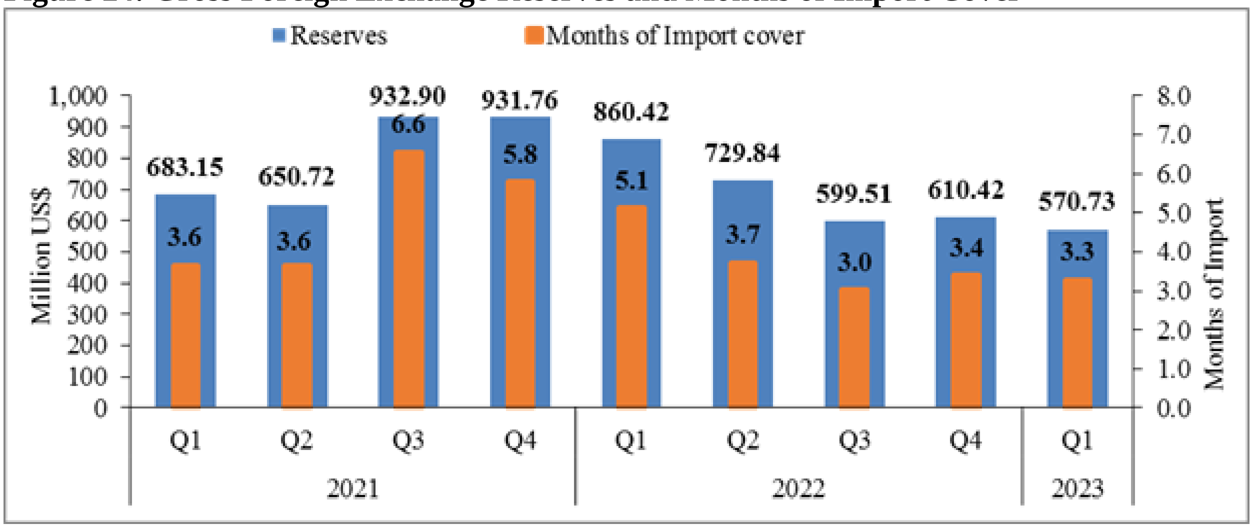


Source: NRA/Customs & BSL

2.2.2 Gross Foreign Exchange Reserves

Gross Foreign Exchange Reserves (excluding swaps) of the Bank of Sierra Leone decreased to US$570.73mn in 2023Q1 relative to US$610.42 in 2022Q4, mainly on account of excess outflows over inflows during the quarter. Consequently, the import cover deteriorated to 3.3 months in 2023Q1, from 3.4 months in 2022Q4. Gross Foreign Exchange Reserves (excluding swaps) declined from US$558.37mn in April 2023 to US$552.42mn in May 2023.

Figure 24: Gross Foreign Exchange Reserves and Months of Import Cover

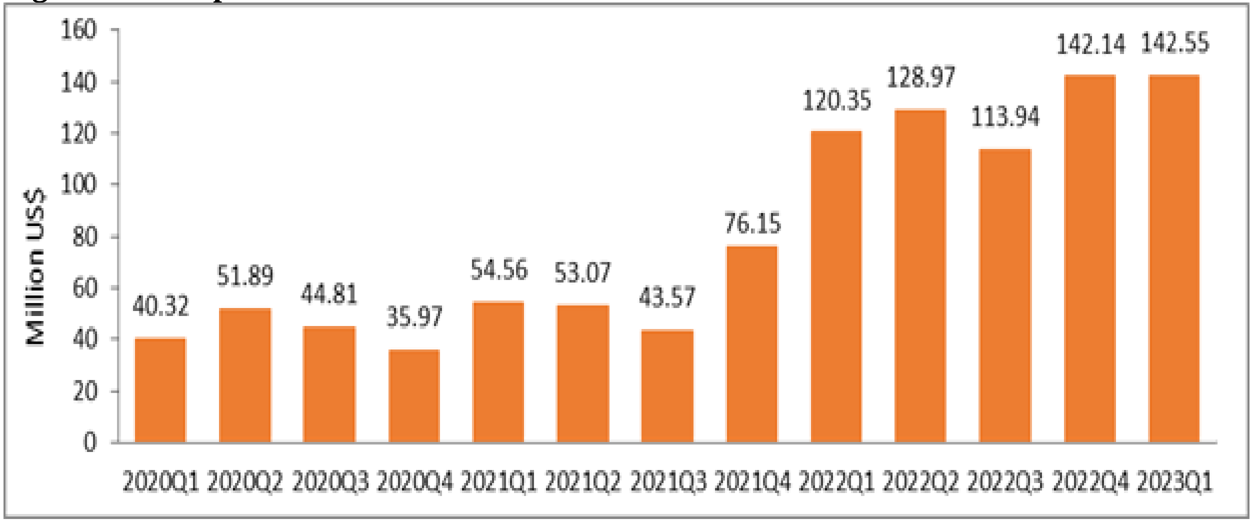


Source: BSL

2.2.3 Diaspora Remittances

Diaspora remittance inflows increased marginally to US$142.55mn 2023Q1 from US$142.14mn in 2022Q4. Remittances are expected to continue to flow in support of households' incomes amid the rising cost of living. This will help to reduce pressures in the foreign exchange market and support stability in the exchange rate.

Figure 25: Diaspora Remittances into Sierra Leone

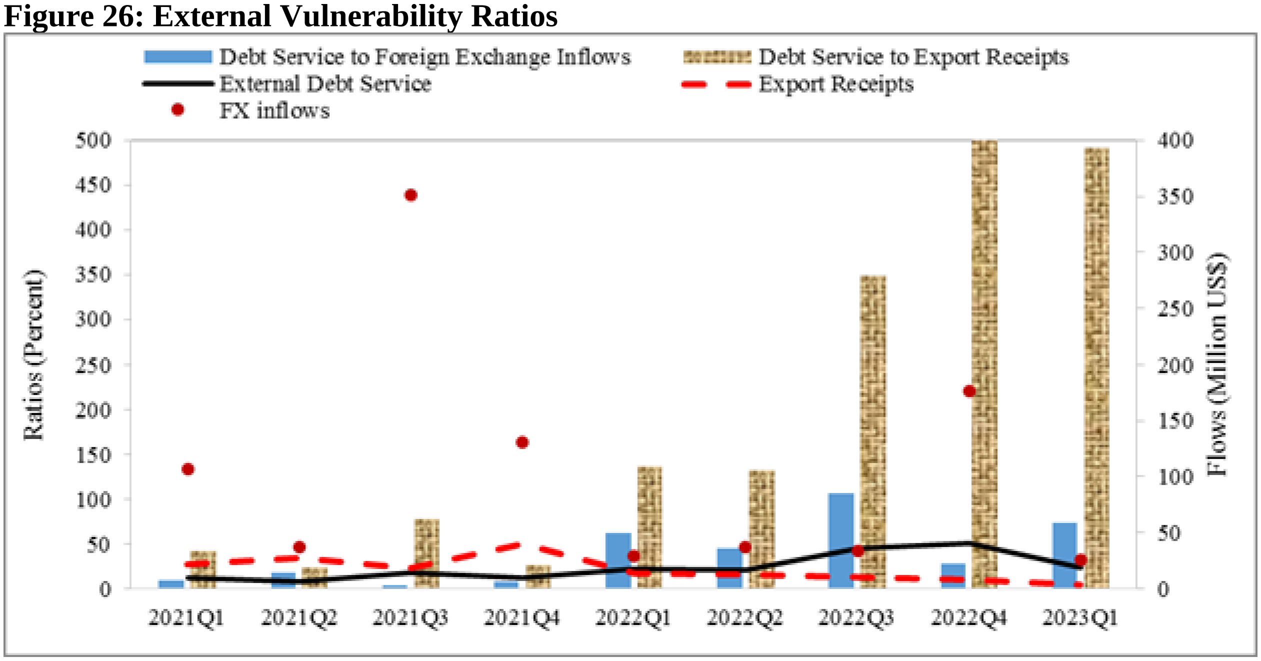


Source: BSL

2.2.4 External Vulnerability Ratios

External debt service payments decreased significantly to US$19.04mn in 2023Q1, from US$40.14mn in 2022Q4. Similarly, forex inflows decreased to US$25.86mn in 2023Q1 from US$144.50mn in 2022Q4; while export receipts increased marginally to US3.87mn in 2023Q1 from US$2.95mn in 2022Q4. Accordingly, the ratio of debt service payment to export receipts decreased, whiles the ratio of debt service payment to FX inflows increased.

Figure 26: External Vulnerability Ratios



Source: BSL

2.2.5 Outlook of the foreign exchange rate market

Liquidity constraints in the FX market are expected to persist and the demand for foreign exchange remain worryingly high, reflecting the high cost of imported goods, particularly food and oil. Additionally, there is increase foreign currency substitution by market participants, as evidenced by the increased level and share of foreign currency deposits in commercial banks, thereby exerting more pressure on the already depreciating exchange rate. Consequently, the stability of the exchange rates will continue to be challenged given as we enter the lean period when there is reduced production activities and export of minerals, with a resultant drop in the supply of FX in the market.

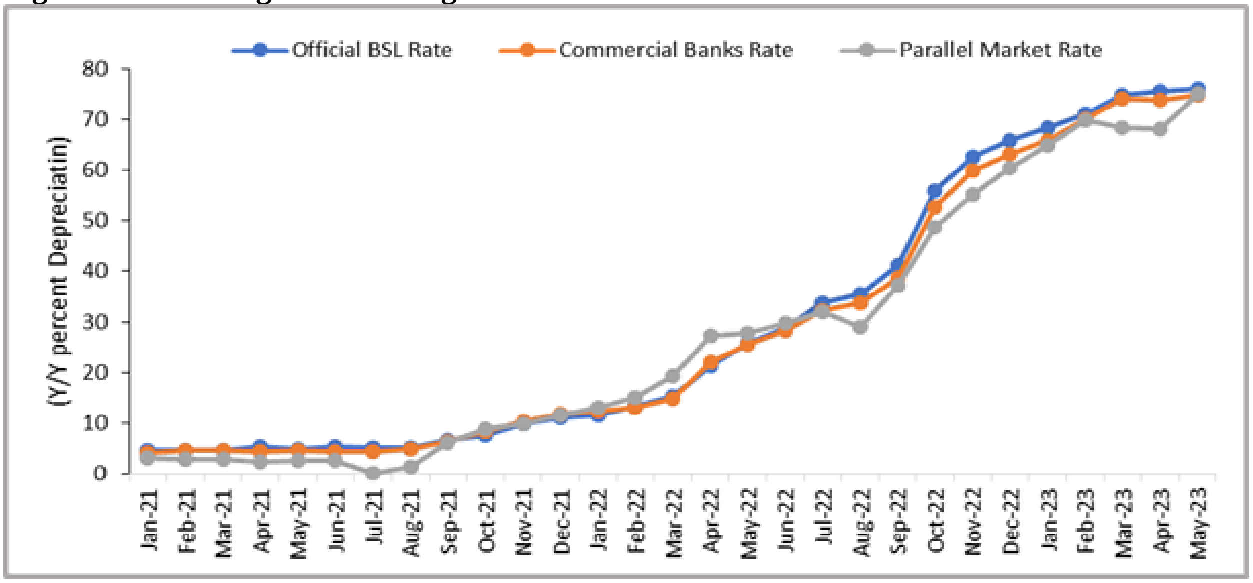
However, the recent loan disbursement of 20.65 million from the IMF will help in building the reserves and enable BSL to intervene in the foreign exchange market to help smoothen excess volatility.

2.3 Exchange Rates and Foreign Exchange Market Developments

2.3.1 Exchange Rate Movements

The Leone continued depreciating in the first half of 2023. The BSL official mid exchange rate against the US dollar depreciated by close to 12 percent in Q1 bringing the year-on-year depreciation to 78.5 percent by the end of March 2023. The pace of weakening has since subsided, and the Leone even appreciated in early June mainly due to reduced demand pressure associated with low import demand as uncertainty increased during the period before the general elections.

Figure 27: Exchange Rate Change vis-à-vis the US Dollar

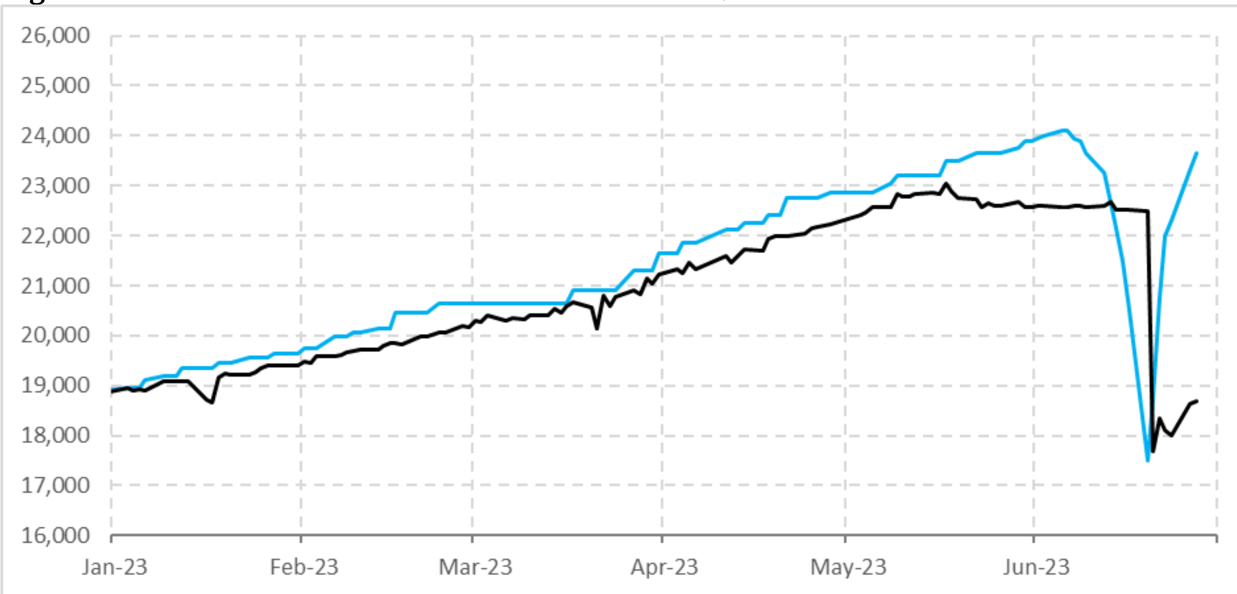


Source: BSL

Initially, parallel market rates weakened further in early June, which led to a widening of the spread to official rates. However, parallel market rates soon collapsed, strengthening by almost 15 percent on a single day and almost 27 percent between the end of May and the 19th of June. It is possible that the break of the previous depreciation trend has led to some panic sales from parties who expected the depreciation to continue. The daily volatility remained high, as the parallel market rate rebounded in a similarly rapid fashion than its collapse a few days earlier. It stabilized slightly lower than its end-of-May value, representing around 70 percent depreciation on year-on-year terms, ahead of the Q2 MPC-meeting.

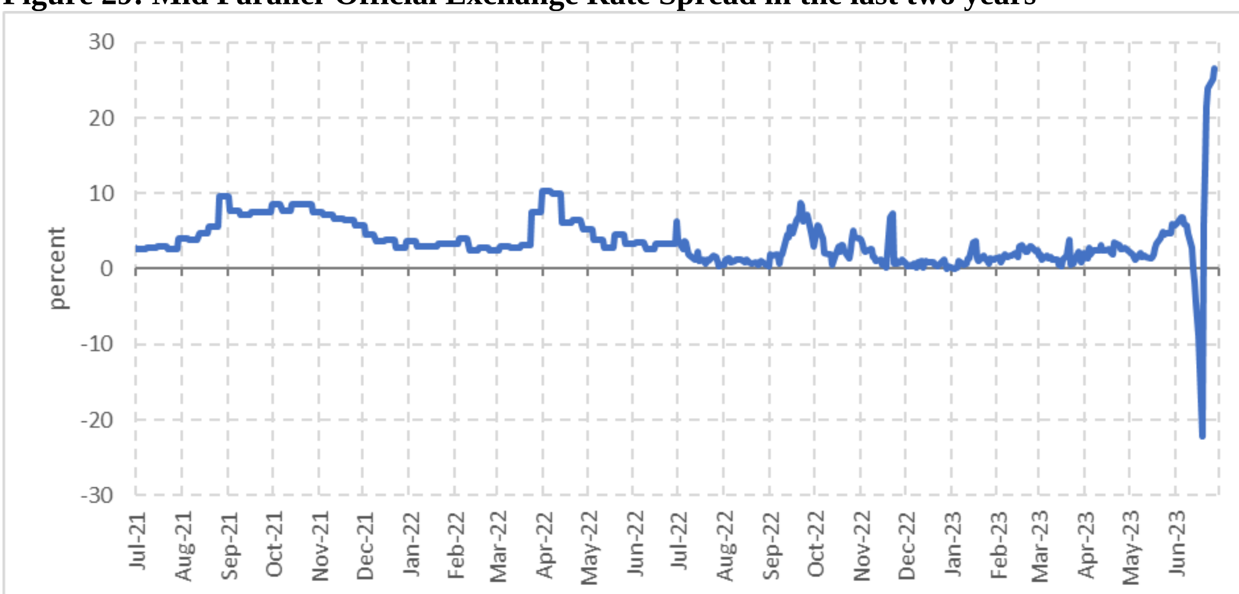
The fall of parallel market rates pulled down official rates even more in the middle of June. However, while the parallel market quickly rebounded, the official rates started to depreciate much more slowly, leading to very wide parallel-official market spread.

Figure 28: The Official and Parallel Market NLe/US$ Mid Rates in 2023



Source: BSL

Figure 29: Mid Parallel-Official Exchange Rate Spread in the last two years



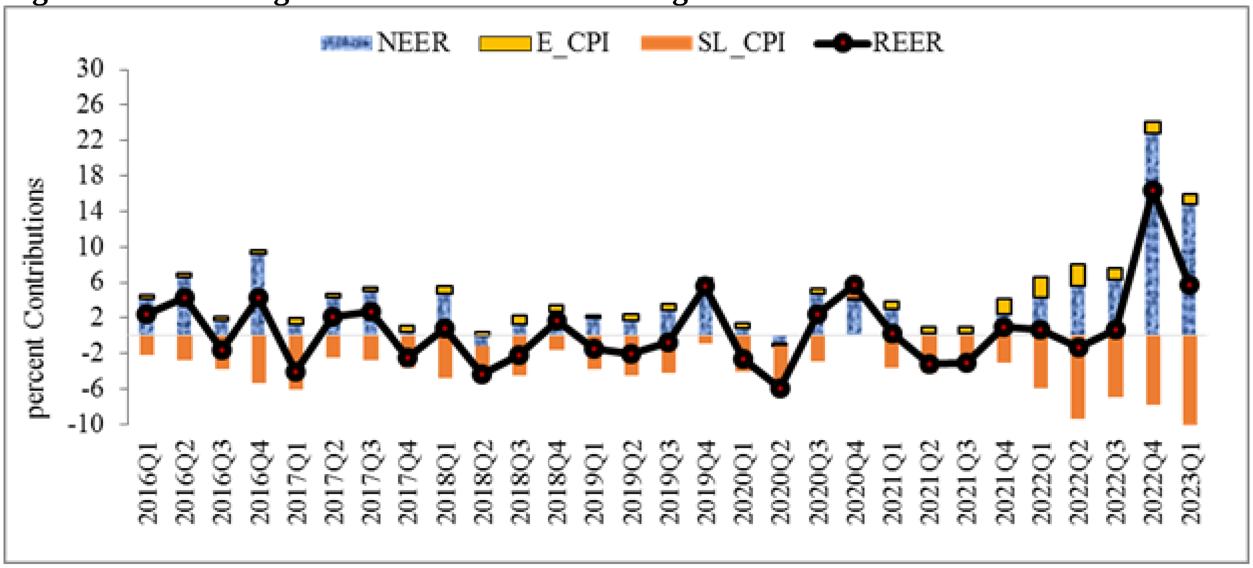
Source:BSL

2.3.2 Effective Exchange Rates

The Nominal Effective Exchange Rate (NEER), which measures the relative strength of the Leone against the currencies of Sierra Leone's trading partners depreciated by 16.0 percent in 2023Q1, bringing the year-on-year depreciation of the NEER to 69 percent by the end of March 2023.

Similarly, the Real Effective Exchange Rate (REER) index, which measures the competitiveness of Sierra Leone's traded goods relative to those of its trading partners depreciated by 6.0 percent in 2023Q1 and by 26 percent compared to 2022Q1.

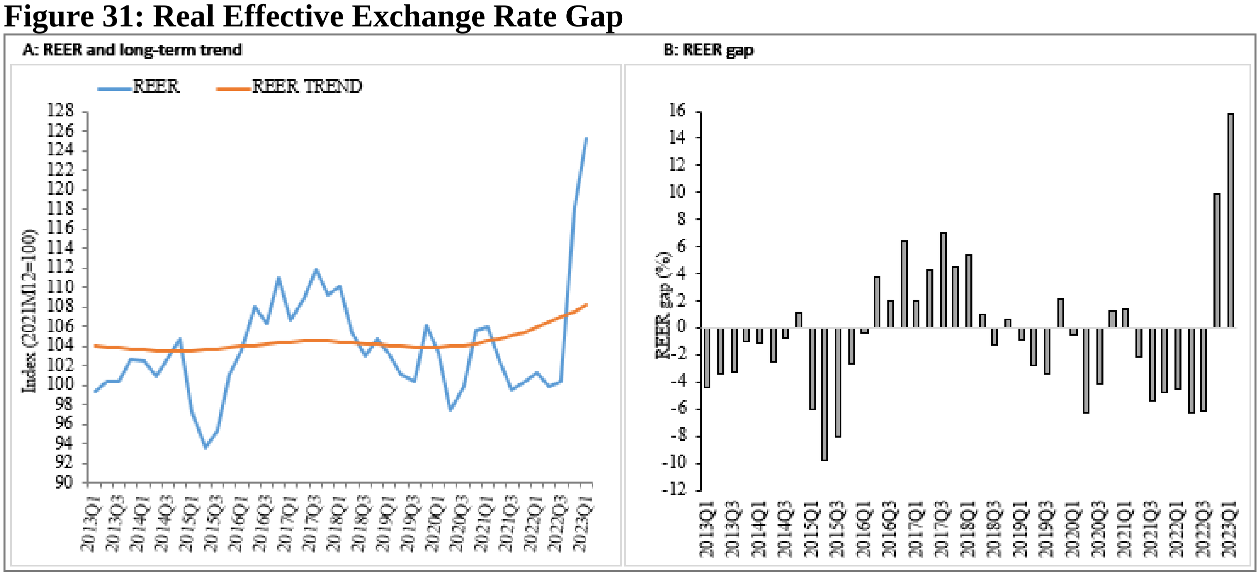
Figure 30: Percentage Contributions to the Change in REER



Source: BSL, staff estimation. Note: positive NEER and REER denote depreciation and negative means appreciation

The REER depreciation continues to largely reflect nominal depreciation, which far outweighs the inflation differential with trading partners.

Figure 31: Real Effective Exchange Rate Gap



Source: BSL, staff estimation

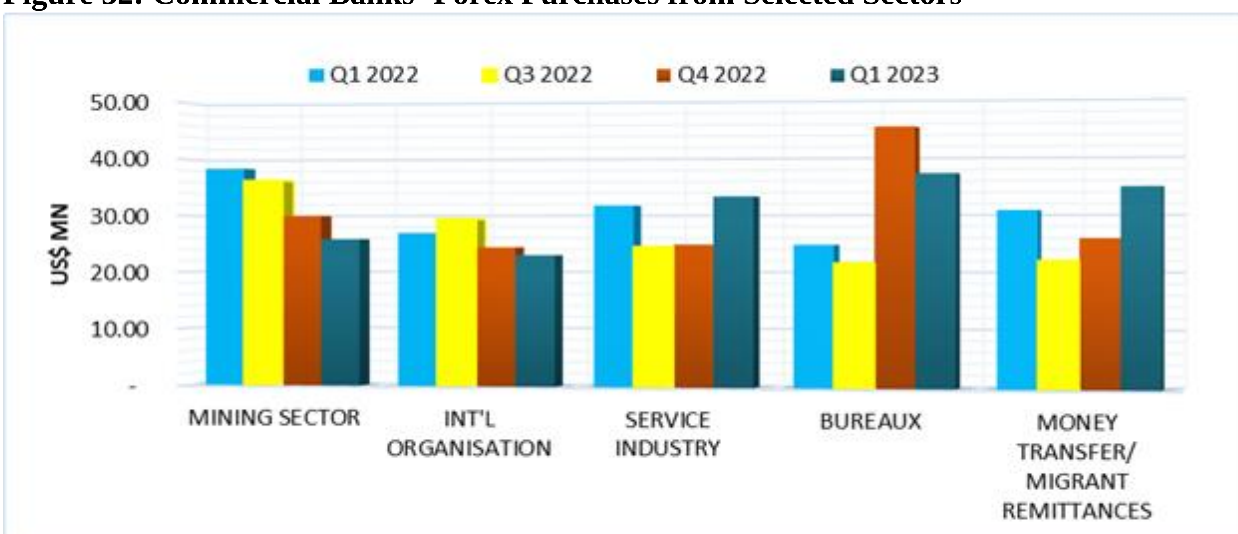
2.3.3 Foreign Exchange Market Turnover

The foreign exchange market comprises the official market, including banks and FX-bureaus, and the parallel market, which also includes some of the official institutions, notably the FX-bureaus. Even though its prices are observable, there is no data on parallel market turnover, but anecdotal evidence indicates that it is deeper and more liquid than the official one.

Total amount traded in the official foreign exchange market (purchases and sales) during 2023Q1 was US$370.21mn, a 7.8 percent decline relative to the corresponding quarter of 2022 and a 6.6 percent decline from 2022Q4. Banks purchased US$211mn and sold US$a160mn worth of FX in Q1. This compares to an average quarterly remittance inflow of cc US$125mn.

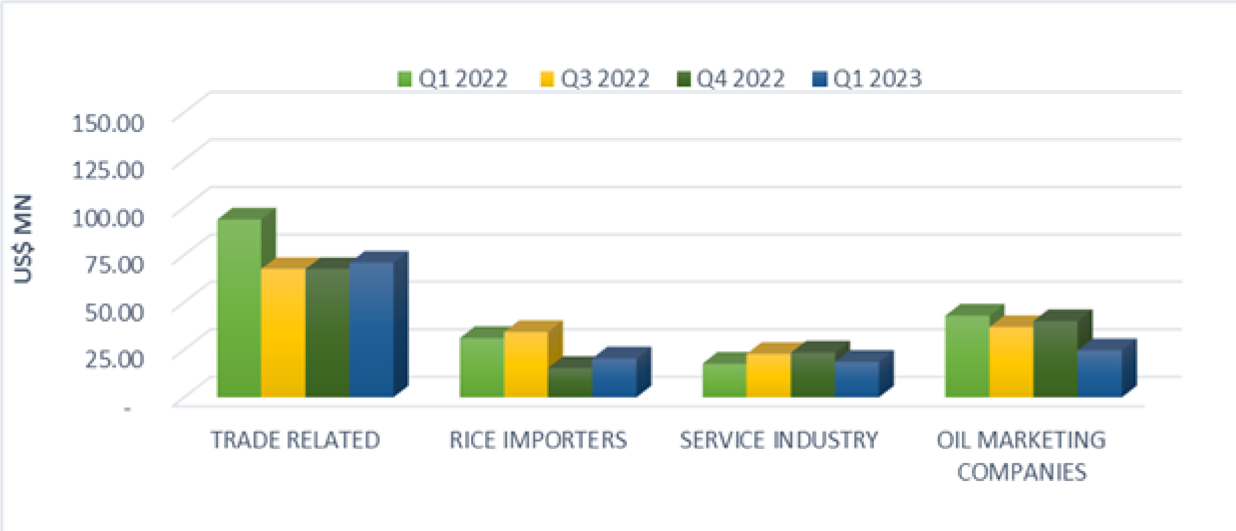
Banks typically purchase FX from the mining sector, the service industry, the FX-bureaus, and international organisations (mostly NGO's). Foreign exchange from remittances is typically purchased either directly from remittance companies or indirectly from FX-bureaus. Banks typically sell FX to importers, including rice importers, oil marketing companies, and the service industry.

Figure 32: Commercial Banks' Forex Purchases from Selected Sectors



Source: BSL

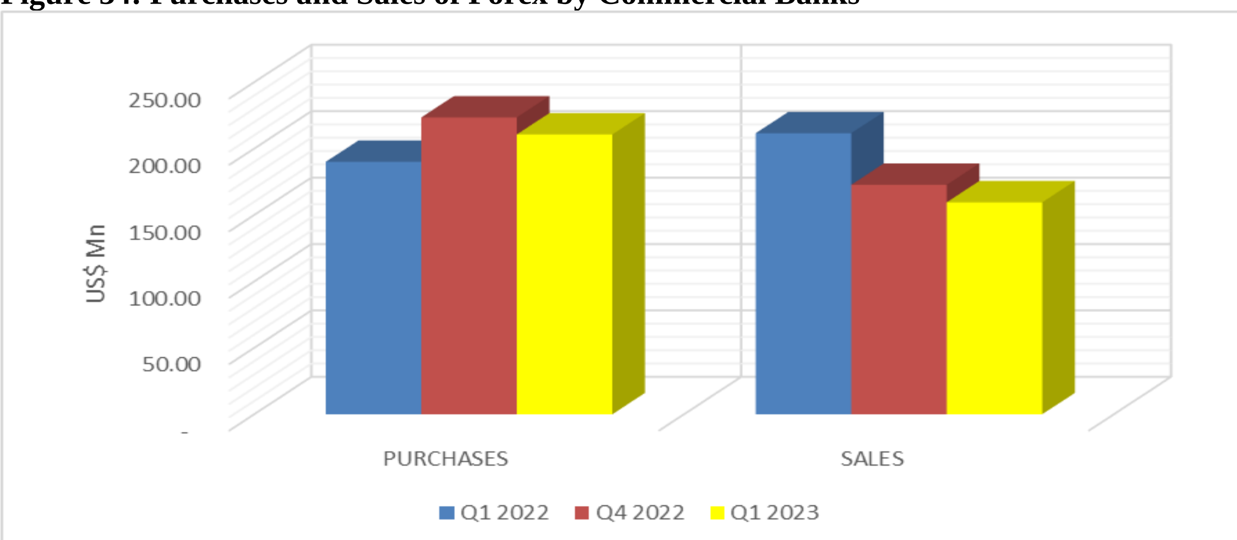
Figure 33: Sales of Forex by Commercial Banks to Selected Sectors



Source: BSL

Receipts into customer FX accounts reached US$576.69mn, while payments from customer FX accounts amounted to US$346.53mn in 2023Q1, resulting in a net increase in FX balances of roughly US$230mn. Receipts and payments increased by 37.3 percent and 30.9 percent, respectively, compared to the same period in 2022

Figure 34: Purchases and Sales of Forex by Commercial Banks



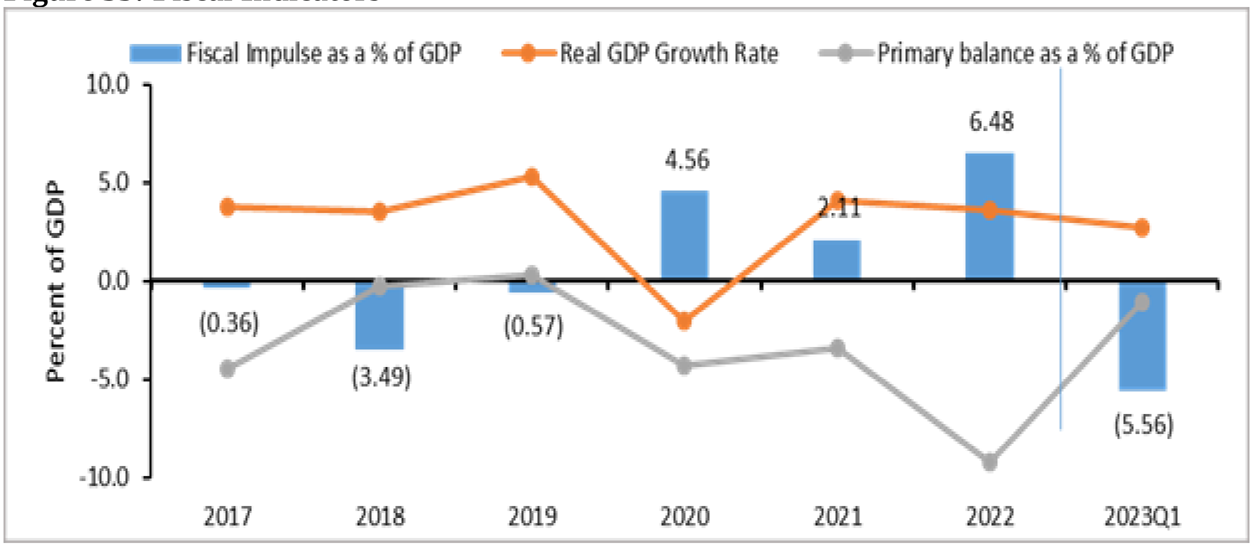
Source: BSL

2.4 Fiscal Developments

2.4.1 Fiscal Policy Stance

In 2023Q1, the fiscal authorities focused on improving domestic revenue collection and expenditure rationalization to lower the deficit after its large increase in 2022Q4 and, at the same time, create room for priority programmes in the uncertain economic environment.

Figure 35: Fiscal Indicators



Sources: MoF & BSL

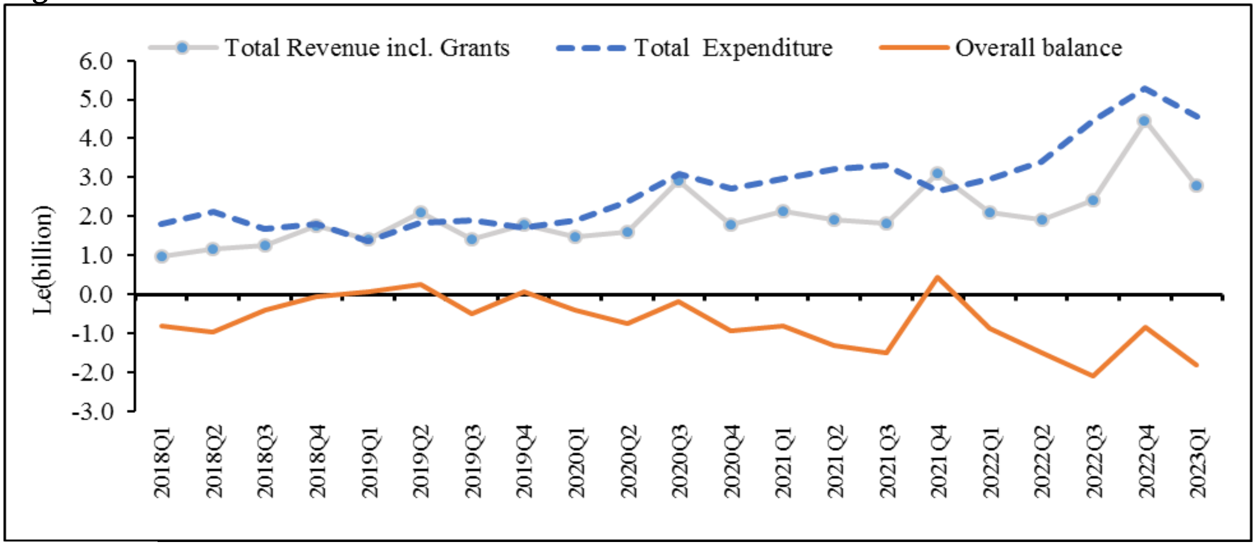
The overall fiscal deficit widened from NLe0.85bn in 2022Q4 to NLe1.81bn in 2023Q1. This was due to the contraction in total government revenue which outweighed the reduction in government spending. The reduction in total revenue was mainly the result of base effect, because most of the foreign grants in 2022 arrived in Q4.[4] Hence, the large decline in foreign grants was expected. Total revenue declined by NLe1.7bn to NLe2.77bn while total expenditure decreased by NLe0.7bn to Nle4.55bn in 2023Q1.

The primary deficit, excluding foreign grants, narrowed from NLe2.07bn in 2022Q4 to NLe0.83bn in 2023Q1, implying a large negative effect on domestic demand. Despite the improvement in the primary balance, it remained higher than in the pre-pandemic period. Even though fiscal policy became tighter in 2023Q1, it was mainly a reflection of the large expansion

[4] Foreign grants typically arrive once a year, usually in the second half of the year, and they can amount to a significant amount.

in 2022Q4. In effect, fiscal policy remained expansionary over the two quarters combined, albeit still less so than in preceding quarters.

Figure 36: Fiscal deficit

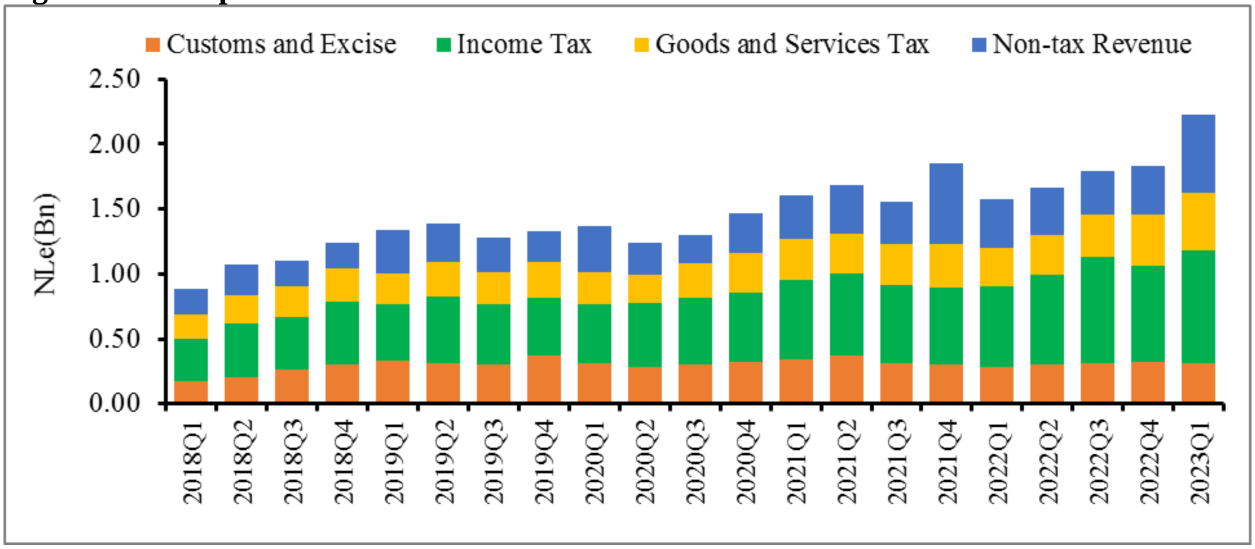


Source: MoF

2.4.2 Government Revenues and Grants

The decline in total revenue in 2023Q1 was mainly due to a significant reduction in foreign grants as expected. Foreign grants decreased by more than NLe2bn to NLe0.50bn in 2023Q1. However, domestic revenue expanded by 21.92 percent or NLe410mn to NLe2.28bn. Both tax and non-tax revenue increased, but non-tax revenue accounted for most of the improved performance of domestic revenue. Tax revenue rose by 12.4 percent to NLe1.63bn in 2023Q1 mainly driven by income tax and goods and services tax. Tax revenues grew well below inflation, i.e. they declined in real terms, due to declining domestic demand. Non-tax revenue increased to NLe0.65bn in 2023Q1 from NLe0.42bn in 2022Q4, driven by increased royalty payments related to diamond & gold mining.

Figure 37: Components of Domestic Revenue

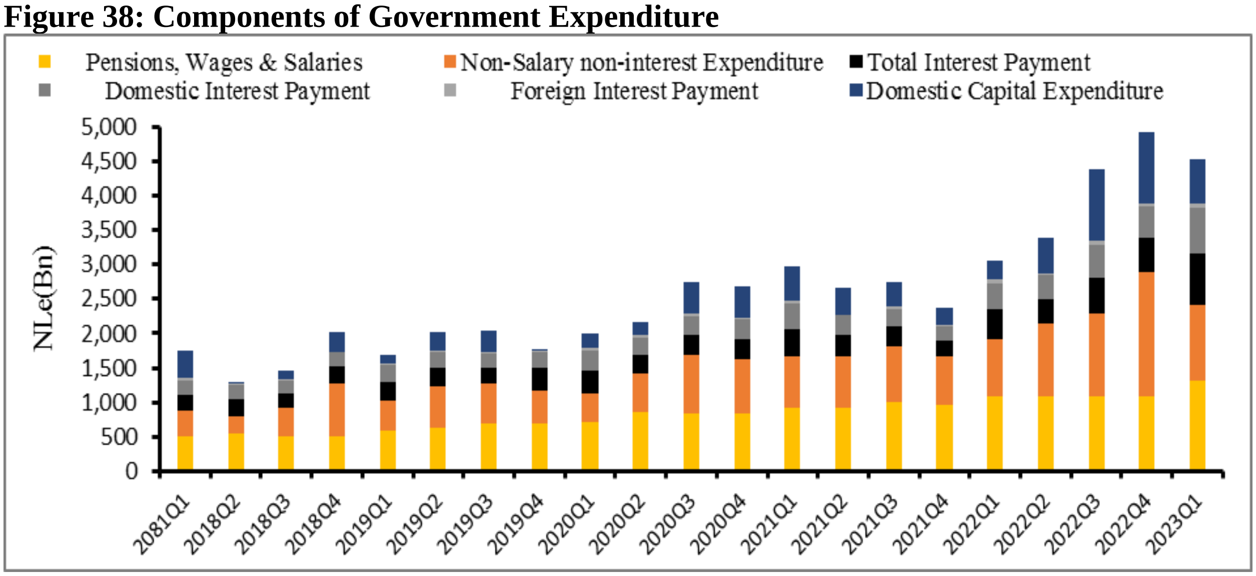


Source: MoF

2.4.3 Government Expenditures

Total government expenditure decreased as both recurrent and capital expenditure declined. The decrease in recurrent spending is attributed to the reduction in non-salary, non-interest expenditure, specifically goods & services spending and government transfers to MDAs. The fall in capital outlays was due to a drop in both domestic and foreign development spending. Overall, the government tightened fiscal policy in 2023Q1 by cutting back discretionary spending, i.e. non-salary, non-interest expenditure and capital expenditure.

Figure 38: Components of Government Expenditure



Source: MoF

2.4.4 Budget Financing

Overall, quarterly fiscal deficit was largely financed from domestic sources. Domestic deficit financing increased by 57 percent to NLe1.28bn, mainly due to borrowing from commercial banks. In contrast, both foreign and other sources of financing resulted in a net repayment of NLe0.33bn and NLe0.01bn respectively.

2.4.5 Fiscal Sector Outlook

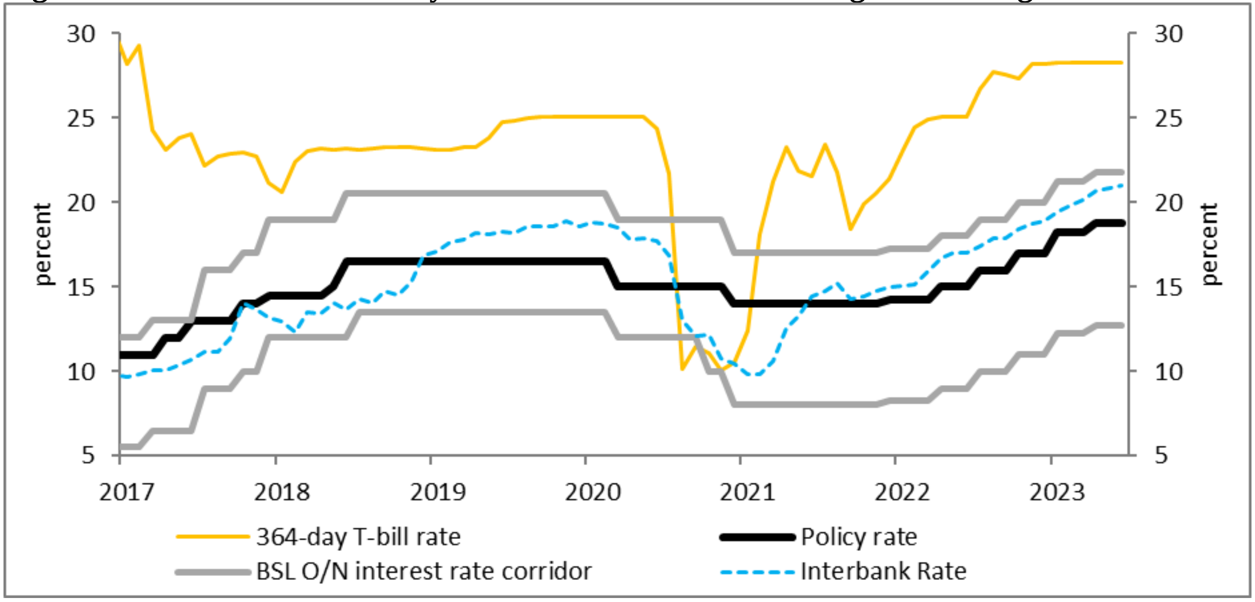
Fiscal policy is projected to be more expansionary in 2023Q2 on account of increasing government spending on national elections while revenues remained depressed due to low aggregate demand. However, fiscal policy is expected to tighten in the short to medium term in line with the IMF program, as one-off expenditures, such as election-related spending and spending on large investment projects, phase out, and additional revenue generating measures kick in on the back of improved revenue mobilization and the public financial management reform detailed in the Public Financial Management (PFM) strategy. Also, the anticipated disbursement from the approval of the sixth and seventh review of IMF/ECF program will boost revenue in the subsequent quarters.

2.5 Monetary Policy and Money Market Developments

2.5.1 Monetary Policy Stance

At its MPC meeting held on the 30th March 2023, the Monetary Policy Committee (MPC) decided to increase the Monetary Policy Rate (MPR) by 0.5 percentage points to 18.75 percent and adjust the Standing Lending Facility Rate and Standing Deposit Facility Rate upwards by the same margin.

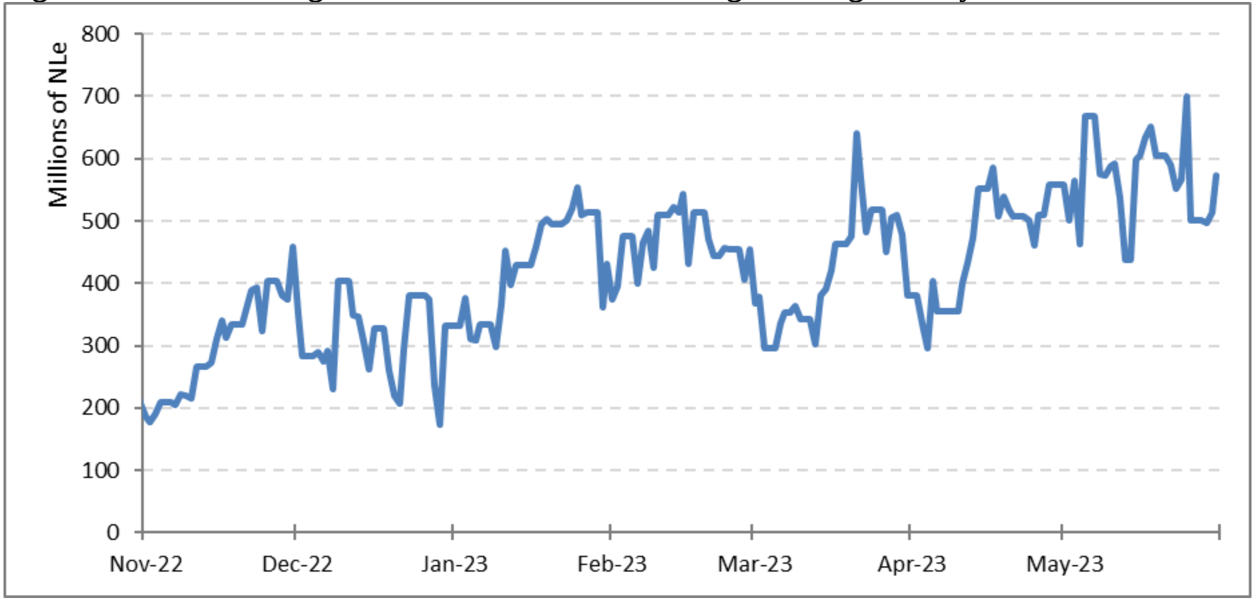
Figure 39: Trends in BSL Policy Rates and the Interbank Weighted Average Rates



Source: BSL

The rational for the moderate tight policy stance is to address the continued upward risks to inflation, reduce the impact of exchange rate depreciation and strike balance between low inflation, stable growth and financial stability. As a result, the MPR remained below inflation and the real MPR continued to decline.

Figure 40: Outstanding Amount of BSL O/N Standing Lending Facility



Source: BSL

2.5.2 Interest Rates Developments

Treasury Bill Rates

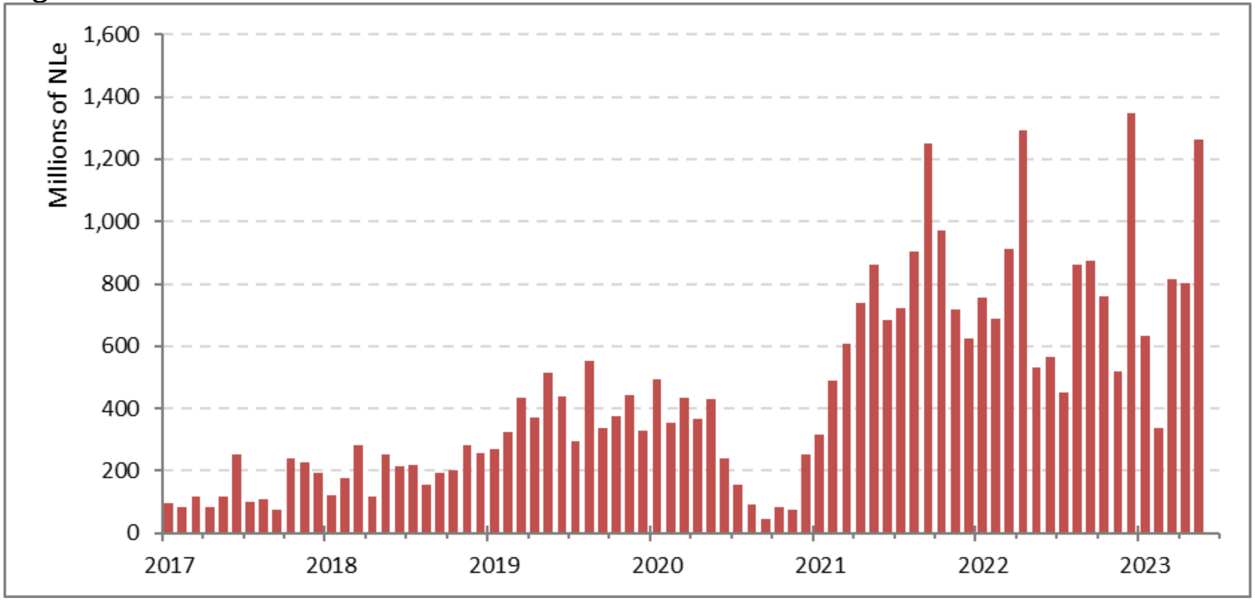
The annual yield of the 364-day T-bills did not follow the rise in the MPR in 2023. It was 28.24 percent in May 2023, virtually the same as the 28.23 percent value in December 2022. The yields remained very stable despite the large increase in inflation and the increasingly negative implied real rates (Figure 39).

The interbank weighted average yield increased by 126 basis points from 18.9 percent in December 2022 to 20.2 percent in March 2023, and further increased by 72 basis points to 20.9 percent in May 2023. This increase could be attributed to the increase in the MPR and the overnight interest rate corridor, while liquidity remained tight in the banking system (Figure 39).

2.5.3 Interbank Money Market

Turnover on the interbank money market marginally declined but overall remained broadly flat. Liquidity remained tight for most banks, and consequently no bank accessed the overnight (O/N) Standing Deposit Facility (SDF) window in 2023. In contrast, there was increased access to the O/N Standing Lending Facility (SLF) window by banks. The average outstanding amount of O/N SLF increased by roughly 18 percent in April and May relative to 2023Q1. It increased 23 percent in May 2023 compared to April to NLe570mn, hence underscoring the tight liquidity situation in the banking system (Figure 40).

Figure 41: Volume of Interbank Transaction



Source: BSL

2.5.4 Snapshot of Liquidity in the Banking System

Total liquidity in the banking system decreased by NLe126.4mn to NLe1,197.5mn in 2023Q1, and increased to NLe1,257.0mn by May 2023. Aggregate excess liquidity increased from NLe52.0mn in 2022Q4 to NLe107.7mn in 2023Q1, and further to NLe120.8mn in May 2023 and remained high, representing close to 10 percent of required reserves. The observed increase in excess liquidity could be mainly attributed to an increase in banks' settlement account balances in line with the increase in the reserve requirement.

2.6 Monetary Aggregates

Monetary aggregates increased during the first quarter of 2023 including both Broad Money (M2) and Reserve Money (RM).

Reserve Money (RM)

RM grew by 4.0 percent in 2023Q1. Both the Net Foreign Assets (NFA) and the Net Domestic Assets (NDA) of the BSL increased. The NFA increased by 16.1 percent while the NDA by 9.4 percent in 2023Q1, both exhibiting slower growth than in 2022Q4. The NDA was mainly driven by the 76.4 percent increase in the utilization of Ways and Means Account by the central government, coupled with the 8.3 percent increase in the holdings of government securities by the BSL.

The RM expanded by 33.4 percent year-on-year in 2023Q1, representing an acceleration from 25.6 percent growth in 2022Q4 and exceeding the target set out in the IMF programme. From the liability side, the expansion in RM can be attributed to the increase in currency issued (6.0 percent) which offset the 8.0 percent decrease in Banks' Reserves (see Table 4).

Broad Money (M2)

Broad Money (M2) grew by 44.9 percent year-on-year, implying further monetary expansion. M2 growth exceeded inflation so that it showed growth in real terms as well.

The expansion of M2 was almost entirely driven by Net Domestic Assets while the contribution of Net Foreign Assets was small on both a quarterly and annual basis. The expansion of NDA was mainly boosted by Net claims on Government by the Banking system. The bulk of the financing was provided by the banking sector, especially by commercial banks, while central bank financing was less in 2023Q1 than in the preceding quarter.

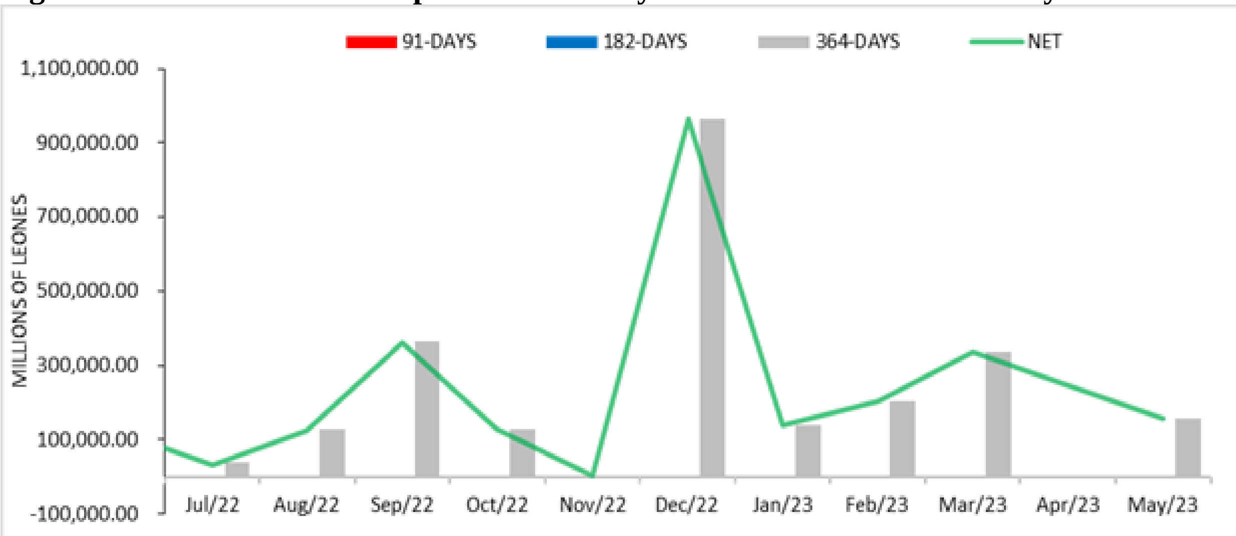
Net Credit to the Private Sector expanded by 21.5 percent in 2023Q1 compared to 2022Q1. Despite its acceleration, net lending to the private sector remained anaemic, and continued to decrease significantly in real terms due to crowding-out by government financing. (see table 3)

From the liability perspective of the Monetary Survey, the growth in M2 was driven by the increase in both Narrow Money (5.61 percent) and Quasi Money (10.39 percent). Narrow Money grew due to increase in currency outside banks (4.31 percent) and increase in Demand Deposit (6.90 percent). Quasi Money increased mainly on account of the 15.47 percent growth in Foreign Currency Deposits which more than outweighed the 0.12 percent contraction of Time and Savings Deposits

2.7 Domestic Debt Developments

The auctions for 364-day Government T-bills during the review period were oversubscribed on a net basis. The 182-day and the 91-day T-bill market remained dysfunctional with no meaningful price signals. These trends continued up to May 2023.

Figure 42: Under/Oversubscription of Treasury Bills Auctions in the Primary Market



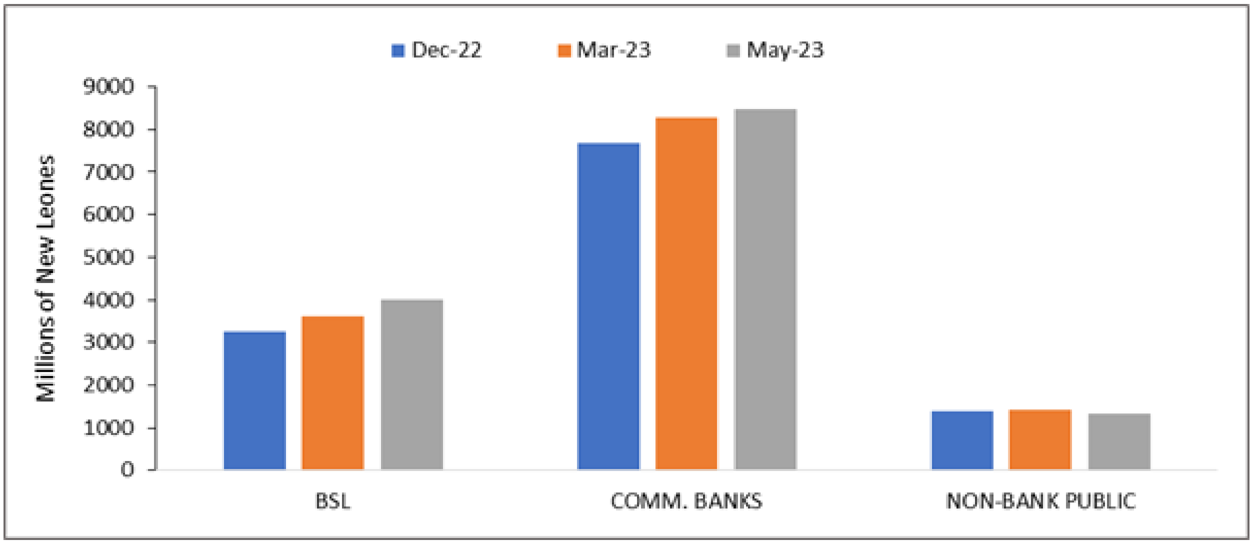
Source: BSL

The total stock of government securities increased by NLe1,036mn (7.5 percent) to NLe14,805mn by March 2023 and further by NLe709mn (4.8 percent) to NLe15,514mn by May 2023. Marketable securities accounted for 90.0 percent of the total stock of government securities, whilst non-marketable securities accounted for 10.0 percent. The stock of marketable and non-marketable securities increased by 8.1 percent and 2.7 percent, respectively. The issuance of new marketable treasury securities mainly served to finance the budget.

At the end of March 2023, the proportion of 364-days treasury bills to total marketable securities was 91.8 percent, while that of the 2-year treasury bonds was 8.0 percent. With regards to non-marketable securities, the 3-year and 5-year treasury bonds accounted for 74.5 percent, 24.8 percent respectively, while the 10-year treasury bond had negligible share.

Commercial banks held 62.2 percent of the marketable government securities, the BSL's holdings amounted to 27.2 percent while the non-bank public held 10.6 percent at the end of 2023Q1. relative to 2022Q4. Both the BSL and commercial banks increased their holdings further by 10.7 percent and 2.4 percent, respectively, by the end of May, while the holdings of the non-bank public decreased by 7.2 percent. The BSL' holdings increased mainly due to increased outright purchases of treasury bills for liquidity management.

Figure 43: Holdings of Marketable Government Securities by Sector



Source: BSL

3 FINANCIAL STABILITY ANALYSIS

The banking sector continued to be relatively stable as all key Financial Soundness Indicators (FSIs) recorded above the minimum thresholds in spite of the current inflationary and exchange rate challenges. The main reason for this performance continues to be the over reliance on investment in Treasury Bills. Income generated from this source continued to account for the largest share of banks total income which reflected the positive impact on the key FSIs.

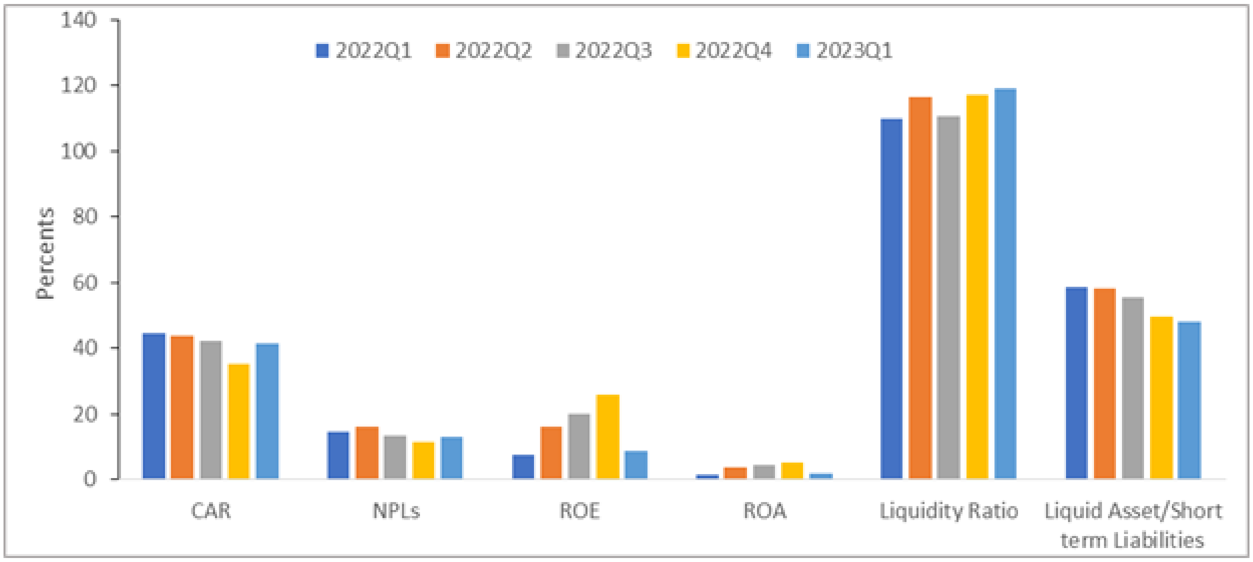
The proportion of Non-performing Loans (NPLs) increased marginally in 2023Q1 implying a deterioration in asset quality. Government securities continued to be the largest asset of banks and therefore the main source of income for banks. Treasury bills rates continued to remain relatively high and increased for the most part of the quarter.

3.1 Financial Soundness Indicators (FSIs)

The banking sector continued to be stable and adequately capitalised. Most of the key FSIs remained above the minimum thresholds stipulated by BSL. The system regulatory capital to risk-weighted asset, denoted by the Capital adequacy Ratio (CAR) increased by 6.28 percentage point to 41.45 percent in 2023Q1 from 35.17 percent in 2022Q4. The CAR position remained above the regulatory minimum capital indicating the accumulation of adequate capital by banks to absorb losses. The increase in the CAR resulted from an increase in the capital base position and an improvement in the Risk Weighted Assets of banks which led to an overall improved systems' CAR position.

Asset quality deteriorated slightly in 2023Q1, as the ratio of non-performing loans to total loans increased to 12.91 per cent in 2023Q1 from 11.59 per cent in 2022Q4. However, NPLs remain above the prudential limit of 10 percent. The Banks' profitability indicators such as Return on Assets (ROA) and Return on Equity (ROE) recorded 1.87 and 8.92 percent respectively for 2023Q1, 2023, while 5.46 percent and 26.03 percent, were recorded respectively for both indicators in 2022Q4. The Liquidity Ratio of the Banking Sector increased in 2023Q1 to 119.36 percent relative to 117.16 percent in 2022Q4, representing a 2.20 percentage point increase. Liquid assets to short term liabilities decreased by 1.73 percent points from 49.69 percent in 2022Q4 to 47.96 percent in Q1, 2023.

Figure 44: Key FSI's

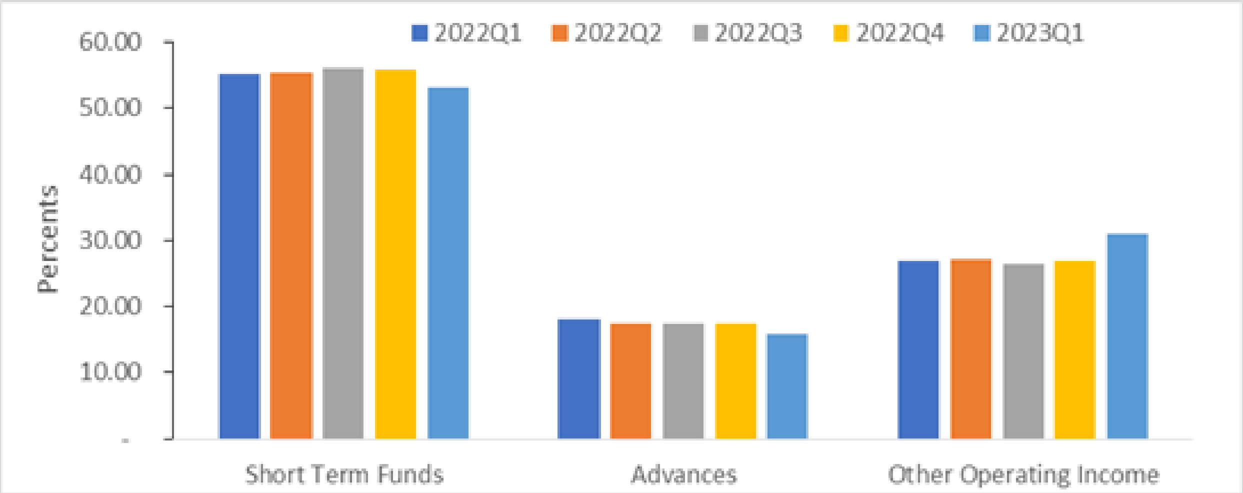


Source: BSL

3.2 Income composition

The banking sector continued to rely largely on government securities for its income. This is mainly as a result of high interest rates on government securities with a zero percent risk rating. In 2023Q1 the proportion of income from short term funds decreased by 2.54 percentage points from 55.75 percent in 2022Q4 to 53.20 percent in 2023Q1.

Figure 45: Income Composition for the banking sector



Source: BSL

Income from advances also marginally decreased from 17.41 percent in 2022Q4 to 15.82 percent in 2023Q1. Other operating income which consists mainly of commission, fees and profit on foreign exchange dealings increased by 4.13 percentage points from 26.85 percent in 2022Q4 to 30.98 percent in 2023Q1.

3.3 Sources and utilization of funds

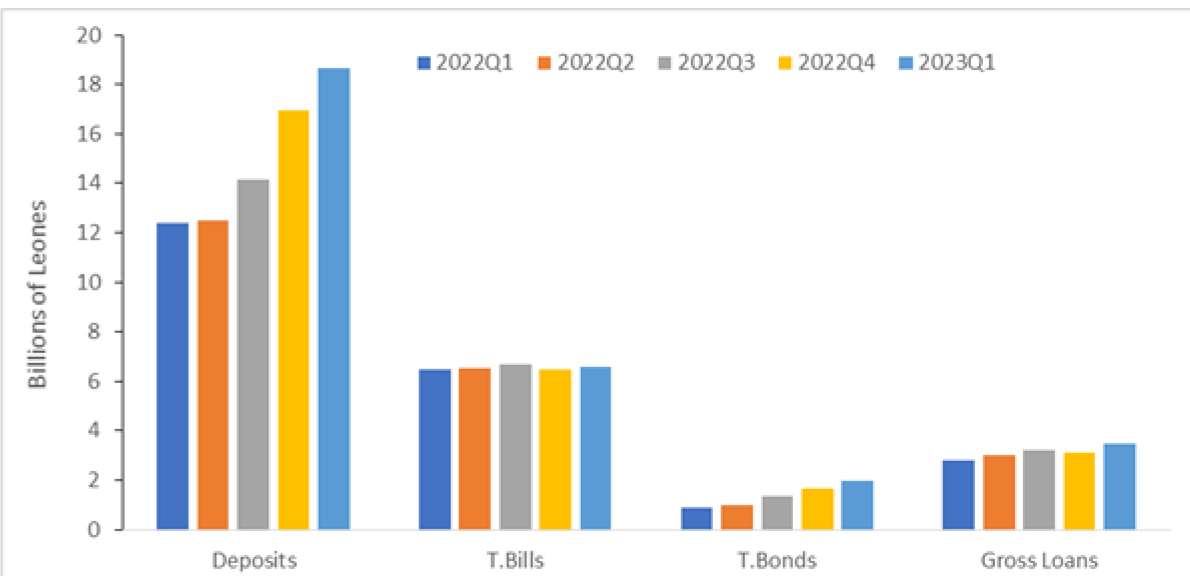
- Total Deposits, which is the main source of funds for banks, increased in 2023Q1 by 1.71 percentage points from NLe 16.94 billion in 2022Q4 to NLe 18.65 billion in 2023Q1.

- T-bills holdings by the banking sector slightly increased by 0.12 percent from NLe6.49 billion in 2022Q4 to NLe6.61 billion in 2023Q1 despite a slight increase in the average interest rate from 27.92 percent in 2022Q4 to 28.28 percent in 2023Q1.

- T-bond holding by the banking sector increased by 0.36 percent from NLe1.64 billion in 2022Q4 to NLe2.20 billion in 2023Q1.

- Gross loans and advances marginally increased by 0.34 percent from NLe3.14 billion in 2022Q4 to NLe3.48 billion in 2023Q1.

Figure 46: Trend in Deposits, T-bills and Gross Loans



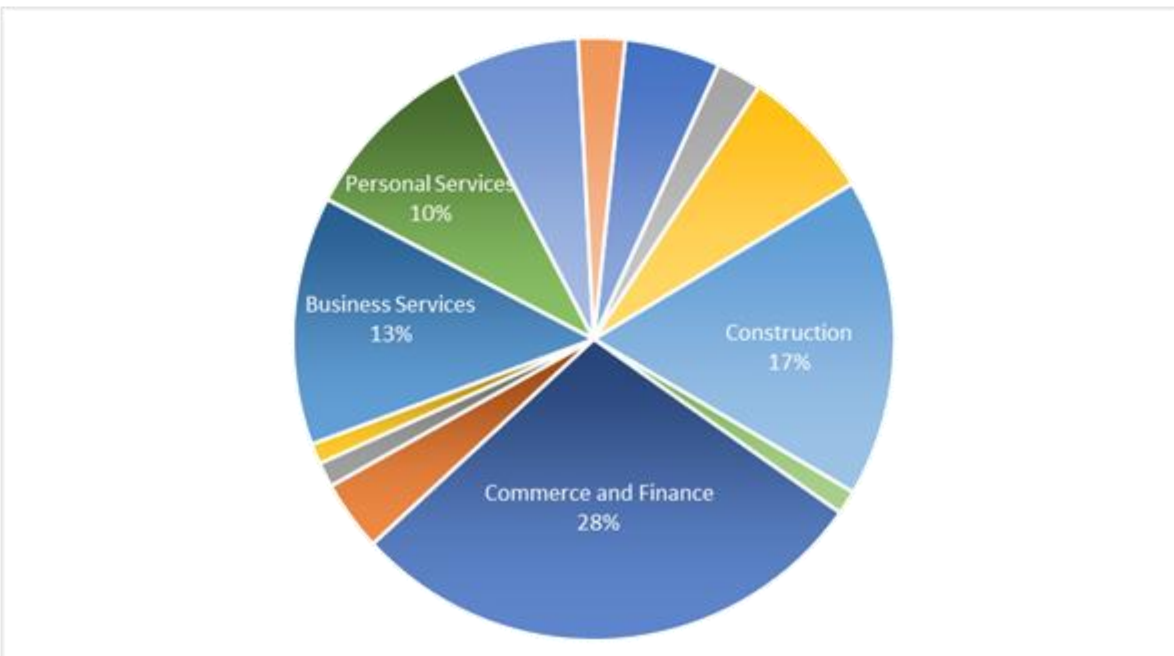
Source: BSL

3.4 Sectoral distribution of gross loans & advances and NPLs

The Commerce and Finance, Business Services, Personal Services and Construction dominated the loan portfolios of the banking sector in the fourth quarter of 2022. These four sectors accounted for 65.07 percent of gross loans in 2022Q4.

Similarly, commerce and finance, construction and Business services sector contributed the most to NPLs. In terms of sectoral NPLs, the Commerce and Finance sector has the highest NPL ratio though it only holds 12.19 percent of the total gross loans of the banking sector. Construction and other services sectors also have high NPLs ratio and were 24.00 percent and 18.79 percent respectively in 2022Q4.

Figure 47: Sectoral Share of Gross Loans

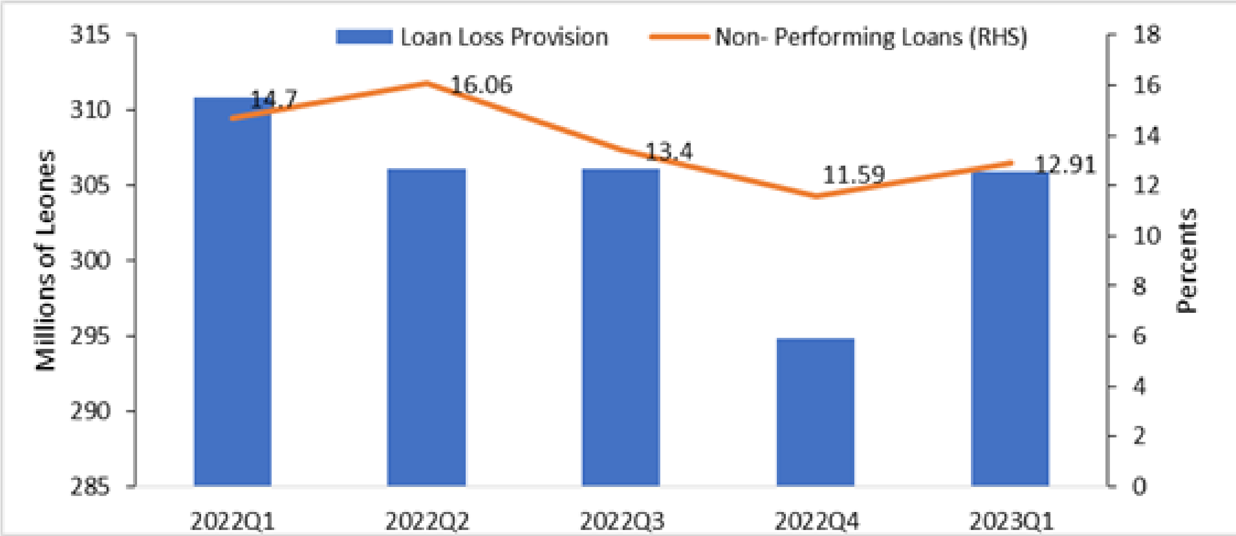


Source: BSL

3.5 NPL Trend and Loan Loss Provisions

The proportion of Non-Performing Loans (NPLs) increased marginally within the review period of 2022Q1. The NPL ratio for 2023Q1 increased by 1.32 percentage points from 11.59 percent in 2022Q4 to 12.91 percent in 2023Q1. However, Loan loss provision significantly increased by NLe11.05 million (3.75 percentage point) to NLe305.95 million in 2023Q1 from NLe294.90 million in 2022Q4.

Figure 48: Trend of NPLs and Loan Loss Provision



Source: BSL

3.6 Risks and Vulnerabilities to the Stability of the banking sector

Despite the stability of the financial system, there are some risks and vulnerabilities that could pose threat to the banking sector as follows:

High level of NPLs poses a financial stability risk.

- Whilst the aggregate capital adequacy ratios appear strong and are comfortably above the minimum threshold, asset quality remains a concern.
- There is large variation in asset quality, with five banks recording NPLs far above the maximum threshold with four (4) of these banks being local banks.

Limited intermediation to support economic growth

- Banks struggle to identify bankable projects in the private sector.
- Credit remains concentrated to few sectors.

Banking sector earnings are heavily reliant in government securities

- Banks use deposits to fund their investments in Government securities.
- Banks excessive preference for government securities at the expense of credit to the private sector with potential sovereign debt risk.

Increase in foreign currency deposits

- There has been continuous increase in foreign deposits since 2022 to Q1 2023, posing potential threat to the system, given the continuous depreciation of the Leone.

Cyber Security and Information Technology Threat

- Potential threat to cyber-security due to shift from traditional banking to more technology driven banking.

3.7 Banking Sector Outlook

The banking sector will continue to be stable going forward given that majority of the banking system asset are government securities as government appetite for borrowing increases. However, the continuation of the Russia-Ukraine war coupled with currency depreciation and high inflation will remain a threat to the banking sector. Increased government borrowing will continue to provide risk-free investment opportunities for banks thereby improving the risk weighted assets of the banking sector. Interest from investment in government securities will continue to be the main source of income for banks. However, rising inflation and depreciating Leones can reduce the fiscal space leading to the accumulation of arrears which could impact the NPLs of the banking sector.

4 CONCLUSION AND DECISION OF THE MPC

4.1 Conclusion

Real GDP growth moderated to 3.6 percent following a strong rebound of 4.1 percent growth in 2021, due to multiple supply side shocks. Growth is projected to slow down to 2.7 percent in 2023 from an initial estimate of 3.4 percent, due to less-than expected improvement in mining output and uncertainties surrounding the other growth sectors, as well as the spillovers from the Russia-Ukraine war. This evidence is corroborated by the Bank's analytical high frequency indicator of economic activities, the Composite Index of Economic Activity (CIA), which signaled a slight improvement in economic activity during 2023Q1 but forecasted to slow by 2023Q3. Going forward, domestic economic activity is projected to reach 4.2 percent, on average, over the medium-term (2023-2025), driven mainly by the anticipated increase in agricultural investment, possible increase in mining activities, expansion in manufacturing, recovery in the tourism sector and the general improvement in the business environment, as the implementation of the much-needed financial sector and regulatory reform continue.

4.2 Decision of the Monetary Policy Committee

The MPC acknowledges that current inflationary pressures pose a challenge for domestic macroeconomic stability and the potential impact on real household incomes. Upside risks, such as exchange rate pressures, monetary expansion, increased government expenditure, and inflationary expectations, reinforces these concerns. Despite these upside risks, there are downside risks to the outlook, including lower imported inflation due to receding global commodity prices, strong iron ore prices, potentially mitigating the depreciation of the exchange rate and its attendant inflationary effects, and tighter fiscal and monetary policy going forward. Therefore, based on its assessments of the risks to inflation and economic activity in the near-term, and considering the BSL's responsibility to safeguard price and financial system stability, while supporting economic growth, the MPC decided to raise the Monetary Policy Rate (MPR) by 0.50 percentage points, to 19.25 percent, and adjust the Standing Lending Facility Rate by the same margin, while the Standing Deposit Facility Rate remain unchanged.

5 APPENDIX

Inflation Outlook

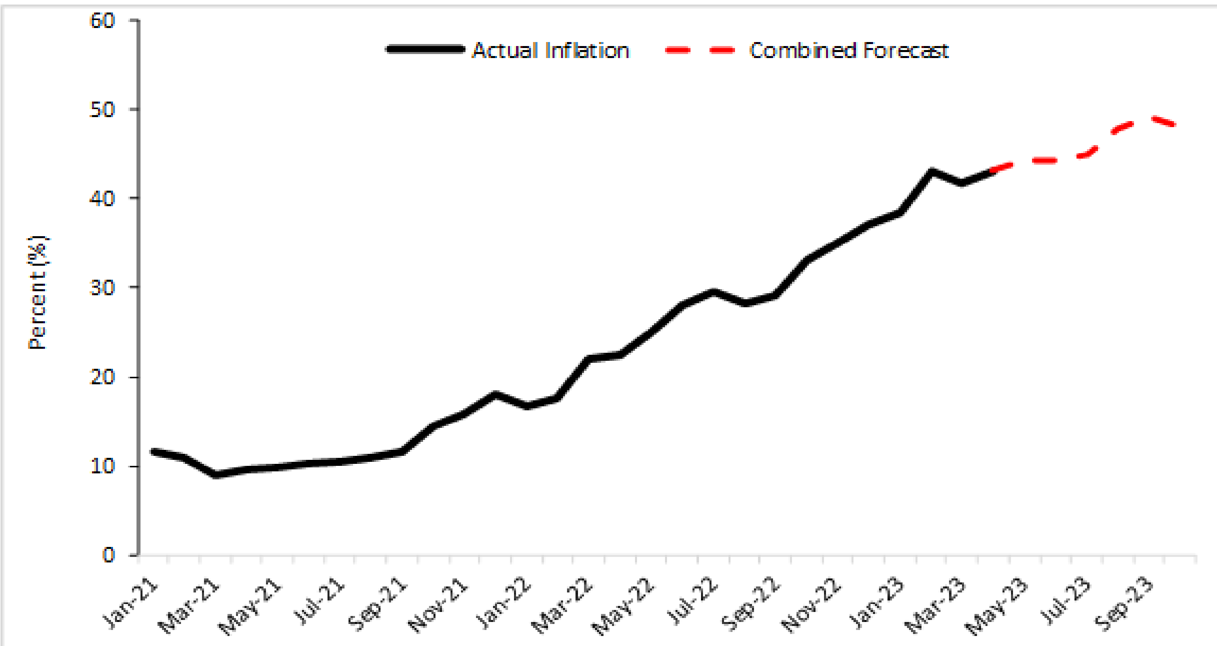
The Bank uses a suite of near-term models to forecast inflation. The combined forecast projects inflation to hover around 44% between May to July 2023, and to peak at 49.2% in September 2023, before moderating at 48.1% in October 2023 as show in the table below.

Table 1: Combined Inflation Forecast

Months	Forecast
May-23	44.33
Jun-23	44.28
Jul-23	44.96
Aug-23	47.68
Sep-23	49.15
Oct-23	48.11

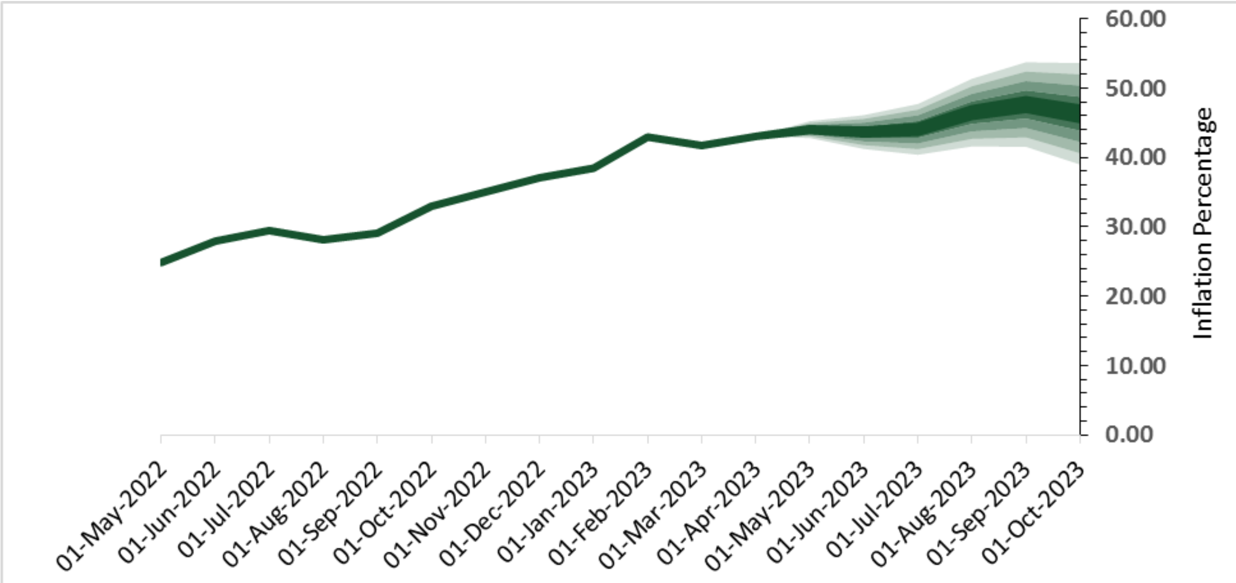
Source: BSL, Staff projections

Figure 49: Combined Inflation Forecast



Source: BSL, Staff illustrations

Figure 50: Inflation Forecast Fan Chart



Source: BSL, Staff illustrations

Table 2: Summary of Global Growth Projections (percent)

		WEO January 2023 Projections		WEO April 2023 Projections		CHANGE IN Projections	
	2022	2023	2024	2023	2024	2023	2024
World Output	**3.4**	**2.9**	**3.1**	**2.8**	**3.0**	**-0.1**	**-0.1**
Advanced Economies	**2.7**	**1.2**	**1.4**	**1.3**	**1.4**	**0.1**	**0.0**
United States	2.1	1.4	1.0	1.6	1.1	0.2	0.1
Euro Area	3.5	0.7	1.6	0.8	1.4	0.1	-0.2
United Kingdom	4.0	-0.6	0.9	-0.3	1.0	0.3	0.1
Japan	1.1	1.8	0.9	1.3	1.0	-0.5	0.1
Emerging Market and Developing Economies	**4.0**	**4.0**	**4.2**	**3.9**	**4.2**	**-0.1**	**0.0**
Brazil	2.9	1.2	1.5	0.9	1.5	-0.3	0.0
Russia	-2.1	0.3	2.1	0.7	1.3	0.4	-0.8
India	6.8	6.1	6.8	5.9	6.3	-0.2	-0.5
China	3.0	5.2	4.5	5.2	4.5	0.0	0.0
Sub-Saharan Africa	**3.9**	**3.8**	**4.1**	**3.6**	**4.2**	**-0.2**	**0.1**
Nigeria	3.3	3.2	2.9	3.2	3.0	0.0	0.1
South Africa	2.0	1.2	1.3	0.1	1.8	-1.1	0.5

Source: IMF World Economic Outlook (WEO) April 2023 and January 2023 update.

Table 3: Monetary Policy Stance of Selected Central Banks

Country	Recent Inflation (%)		Monetary Policy Rates (%)				
			Current		Previous		Change
WAMZ							
Sierra Leone	43.05	April .23	18.75	May .23	18.75	April.23	0.00
Nigeria	22.22	April .23	18.50	May.23	18.00	Mar.23	0.50
Ghana	42.2	May .23	29.50	May.23	29.50	Mar.23	0.00
Guinea	8.04	March .23	11.50	May.23	11.50	April.23	0.00
Liberia	8.30	Feb.23	17.50	May.23	15.00	Mar.23	2.50
The Gambia	17.37	April .23	16.00	May.23	14.00	Mar.23	2.00
Major Economies							
USA	4.0	May .23	5.25	June.23	5.25	May.23	0.00
China	0.2	May. 23	3.65	May.23	3.65	April.23	0.00
Euro Area	6.1	May .23	4.0	June.23	3.75	May.23	0.25
UK	8.7	April. 23	4.5	May.23	4.25	Mar .23	0.25

Source: Central Banks through Trading Economics (June 2023)

Table 4: Money supply and its Components

	2022	2023	Quarterly percent change		Yearly percent change	
Billions of New Leones	**Q4**	**Q1**	**2022Q4**	**2023Q1**	**2022Q4**	**2023Q1**
Reserve money	**5.78**	**6.01**	**22.61**	**3.96**	**25.55**	**33.39**
Broad money (M2)	**20.30**	**21.98**	**19.16**	**8.27**	**41.05**	**44.94**
Narrow money (M1)	**9.00**	**9.51**	**10.13**	**5.61**	**19.40**	**24.66**
Currency outside banks	4.49	4.68	25.52	4.31	29.03	40.61
Demand deposit	4.51	4.82	(1.85)	6.90	11.15	12.29
Quasi Money	**11.30**	**12.47**	**27.49**	**10.39**	**64.89**	**65.46**
o.w. FX deposit	7.59	8.76	42.91	15.47	104.94	105.12
Time and saving deposit	3.70	3.70	4.44	(0.12)	17.80	13.52
Net Foreign Asset	**3.59**	**3.84**	**127.36**	**6.77**	**3.22**	**7.49**
BSL	(4.64)	(5.39)	20.46	16.10	2,643.26	711.90
ODCs	8.24	9.23	51.55	12.03	125.62	117.97
Net Domestic Assets	**16.70**	**18.14**	**8.09**	**8.59**	**53.13**	**56.48**
Net Domestic Credit	**17.27**	**18.59**	**(0.06)**	**7.62**	**30.25**	**30.27**
Government (Net)	13.95	14.92	0.60	6.97	34.27	31.20
o.w.BSL	7.17	7.59	7.15	5.83	62.76	61.60
ODCs	6.77	7.33	(5.51)	8.17	13.28	9.81
Private Sector	3.54	3.90	(2.06)	10.24	11.93	21.41
o.w. ODCs	3.52	3.88	(2.03)	10.19	12.05	21.53
Other Sectors (Net)*	(0.21)	(0.23)	10.20	8.69	(25.64)	(26.06)
Other Items (Net)	**(0.57)**	**(0.45)**	**(68.96)**	**(20.91)**	**(75.88)**	**(83.24)**
Money Multiplier	**3.51**	**3.66**				

Source: BSL

Table 5: Reserve Money and Components

Billions of New Leones	2022 Q4	2023 Q1	Quarterly percent Change 2022Q4	Quarterly percent Change 2023Q1	Yearly percent Change 2022Q4	Yearly percent Change 2023Q1
Net Foreign Assets	**(4.64)**	**(5.39)**	**20.46**	**16.10**	**2,643.26**	**711.90**
Net Domestic Assets	**10.42**	**11.40**	**21.64**	**9.37**	**118.44**	**120.60**
Government Borrowing (net)	**7.17**	**7.59**	**7.15**	**5.83**	**62.76**	**61.60**
o.w. 2.11 Securities	3.70	4.00	83.20	8.33	232.97	218.84
2.12 Ways and Means	0.12	0.21	#DIV/0!	76.44	(39.86)	(14.81)
2.13 GoSLWB /IMF Budget financing	3.53	3.53	(26.29)	-	4.91	8.39
3. Reserve money	**5.78**	**6.01**	**22.61**	**3.96**	**25.55**	**33.39**
o.w. 3.1 Currency issued	4.92	5.21	20.36	5.96	28.48	39.61
3.2 Bank reserves	0.86	0.79	37.68	(7.97)	11.28	3.17

Source: BSL

Table 6: Interest rates

	2022										2023		
	Mar	**Apr**	**May**	**Jun**	**Jul**	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Jan**	**Feb**	**Mar**
91-day T-Bills	5.4	7.78	7.78	4.11	4.11	4.11	4.11	4.11	8.21	8.44	8.44	8.44	8.44
182-day T-Bills	13.21	13.04	13.21	13.17	13.17	13.17	13.19	13.19	13.21	13.21	13.21	13.21	13.43
364-day T-Bills	24.95	25.04	25.04	25.08	26.68	27.69	27.59	27.35	28.18	28.23	28.26	28.27	28.28
Interbank rate	15.96	16.73	17.01	17.04	17..50	17.85	17.9	18.44	18.77	18.9	19.47	19.82	20.26
SLF	17.25	18	18	19	19	19	20	20	20	21.25	21.25	21.25	21.25
SDF	8.25	9	9	10	10	10	11	11	11	12.25	12.25	12.25	12.25
MPR	15	15	15	16	16	16	17	17	17	18.25	18.25	18.25	18.25
Av. Lending rate	19.81	19.81	19.81	19.77	19.88	20.02	20.1	20.1	20.1	20.1	20.14	20.14	20.18
Lending (Prime)	19.11-20.50	19.11-20.50	19.11-20.50	19.11 - 20.42	19.26 - 20.50	19.60 - 20.44	19.60 - 20.59	19.60 - 20.59	19.60 - 20.59	19.60 - 20.59	19.68 - 20.59	19.68 - 20.59	19.62 - 20.74
Savings deposits	2.27	2.27	2.27	2.17	2.17	2.17	2.17	2.17	2.17	2.17	2.17	2.17	2.17

Source: BSL