Bank of Sierra Leone

MONETARY POLICY STATEMENT

The Monetary Policy Committee (MPC) of the Bank of Sierra Leone (BSL) met on 30th June 2022 under the Chairmanship of the Governor, Professor Kelfala M. Kallon. After a thoughtful review of global, regional and domestic economic and financial-market developments, the MPC decided to raise the Monetary Policy Rate (MPR) by 100 basis points to 16.0 percent. The factors that informed this decision are hereby explained below.

Inflation

Inflationary pressures remain elevated in the domestic economy, driven mainly by the effects of the COVID-19 pandemic, the Russo-Ukrainian War, and the resultant sanctions that have been imposed on Russia by the United States and its allies, all of which have produced significant increases in commodity prices (particularly food and energy prices), disruptions in the global supply chain and increased freight charges. Furthermore, the tight monetary policies implemented by advanced economies have tightened financial conditions and created broad-based inflationary pressures within small-open economies like Sierra Leone. Resultantly, the initial non-core inflation (energy- and food-price inflation) created inflationary expectations that also raised core inflation, even though not at the same rate as the non-core inflation. This phenomenon was passed on to the exchange rate, which is the price of foreign currency in the economy.

These developments have caused a sharp increase in headline inflation, which increased from 17.94 percent in the fourth quarter of 2021 to 22.06 percent in the first quarter of 2022, and further to 24.87 percent in May 2022. However, it must be noted that these price developments are global in nature and not unique to Sierra Leone. It must be similarly noted that the currently persistent increases in domestic prices are largely driven by supply-side factors, for which short-term macroeconomic policy instruments (such as monetary policy tools) are by themselves woefully inadequate—especially in an environment of stagflation. Hence, the MPC is of the view that, in addition to its tight monetary policy stance, which it expects will dampen demand pressures on the price level, policy reforms that would boost total factor productivity (in the agricultural sector, particularly) are direly needed to complement the Bank's contractionary monetary policy stance.

Domestic Economic Growth

Domestic economic activities picked up by more than expected in 2021, with real GDP growth revised upward to 3.2 percent in 2021, relative to 2.9 percent earlier estimated. The improvement largely reflected higher than expected performance in all the growth enhancing sectors of the economy, including mining and agriculture sectors.

However, economic growth prospects for 2022 have been downgraded, with real GDP growth revised downward to 3.6 percent for 2022 from an earlier estimate of 6.0 percent. The downgrade largely reflects the effects of Russia's war on Ukraine and the resultant rising energy and food prices, high freight charges, and the lingering effects of the COVID-19 pandemic. Risks to even this 3.6-percent-growth forecast are tilted to the downside, and may depend largely on the duration of the war in Ukraine and the extent of its spillovers to small open economies like Sierra Leone.

This predicted slower economic recovery is also evidenced by the Bank's high frequency indicator of economic activity—the Composite Index of Economic Activity (CIEA), which shows that economic activities contracted by 2.01 percent in the first quarter of 2022, after recording a growth of 1.32 percent in the fourth quarter of 2021. As noted already, the MPC opines that the negative economic fallout of the Ukraine War on the global economy, including the Sierra Leone economy, requires not only short-term macroeconomic stabilization tools, but also supply-side policy reforms in key sectors (especially agriculture) to boost total factor productivity.

Global Economic Growth

Based on the April 2022 edition of the IMF's *World Economic Outlook* (WEO), global economic prospects have deteriorated significantly since the previous forecast in the January 2022 WEO edition, due largely to the Russo-Ukrainian War. The situation has been worsened by the sanctions imposed by the United States and its allies to force Russia to end the war. Furthermore, the frequent and wide-ranging lockdown measures adopted in China to contain the spread of COVID-19, in especially the manufacturing hubs, slowed down economic activity in those areas. This imposed taut constraints on the global supply chain. Additionally, the high, looming global inflationary pressure has led to the implementation of tight monetary policies in many advanced economies, which have resulted in the tightening of financial conditions.

Consequently, in the April 2022 edition of the WEO, global growth forecast for 2022 was downgraded to 3.6 percent in 2022, about 0.8 percent lower than its 4.4 percent forecast in the January 2022 edition. Similarly, the growth forecast for Advanced Economies was revised downward to 3.6 percent in 2022, from the earlier forecast of 4.4 percent. The forecast for Emerging Market and Developing Economies was also revised downward from 4.8 percent to 3.8 percent in 2022.

Meanwhile, growth in Sub-Saharan Africa is projected at 3.8 percent in 2022, relative to the 4.5 percent growth in 2021. Finally, growth projections for the WAMZ region for 2022 have also been revised downward in almost all member states, except Nigeria, where it was revised upward by 0.7 percent to 3.4 percent in 2022, due to Nigeria's status as an oil-exporting country and the fact that oil prices are forecast to rise in the near future. Finally, the MPC noted that the downgrade in economic activities in China and Europe (Sierra Leone's two key trading partners) are also likely to have adverse consequences on domestic growth and price developments.

External Sector

External sector performance was mixed during the first quarter of 2022**.** The trade deficit narrowed from US$245.66 million in the fourth quarter of 2021 to US$168.77 million in the first quarter of 2022. The improvement reflected an increase in export receipts mainly from iron ore, rutile and diamond exports, which partially offset the increase in import payments. The MPC noted that global prices of the country's key exports (iron ore, cocoa and coffee) remain strong. Coupled with improved remittance inflows, these could help to moderate the effects of the adverse global exogenous shocks to the economy.

The stock of gross foreign exchange reserves of the Bank of Sierra Leone (excluding swaps) decreased from US$931.76 million in the fourth quarter of 2021 to US$860.42 million in the first quarter of 2022. This notwithstanding, the stock of gross reserves can adequately cover 4.9 months of imports of goods and services.

As noted earlier, exchange rate pressures remained elevated in the first quarter of 2022, reflecting the structural imbalance between the demand for, and supply of, foreign exchange. The MPC expects exchange rate pressures to persist much longer than ordinarily expected because of subdued supply of foreign exchange in the face of high demand. The MPC is of the view that although the two new BSL Special Facilities for Food and Fuel remain in place, policy reforms that boost productivity in especially the export sector are necessary to support external stability.

Fiscal Policy

The overall fiscal balance deteriorated in the first quarter of 2022, as it moved from a surplus of Le439.55 billion in the fourth quarter of 2021 to a deficit of Le324.78 billion in the first quarter of 2022. The deterioration was mainly due to a larger decline in government revenue than the decline in government expenditures. However, the primary balance narrowed from a deficit of Le321.67 billion in the fourth quarter of 2021 to a deficit of Le204.16 billion in the first quarter of 2022. In view of the above, the MPC concludes that further fiscal consolidation efforts are needed to narrow the fiscal gap, especially given the expected increase in expenditures to support the 2023 general elections.

The MPC further noted the recent IMF disbursement of budgetary support of US$20.8 million to the government (after a successful 5th review of the IMF Extended Credit Facility Program) as a silver lining in the country's gloomy fiscal skies. Further such disbursements from other developments partners could moderate the current fiscal pressures.

Money and Banking

Growth in monetary aggregates moderated during the first quarter of 2022, reflecting in part a decline in currency-in-circulation and banks' reserves with the Central Bank. Accordingly, credit to the private sector declined by 1.59 percent in the first quarter of 2022, after expanding by 8.27 percent in the fourth quarter of 2021. The MPC noted that credit to private sector remained subdued, and that the prevailing high bank lending rate poses challenges for private sector investment and growth.

In the money market, the yields on government securities continued to rise in the first quarter of 2022, due mainly to increased demand for the 364-day Treasury bills. This 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, an indication of improvement in the monetary transmission in the wholesale market.

Financial System Stability

The banking sector remains relatively stable, as most of the key financial soundness indicators (FSI) remained above their minimum thresholds during the first quarter of 2022. However, the MPC noted that although the Non-Performing Loan (NPL) ratio declined marginally from 15.23 percent in the fourth quarter of 2021 to 15.13 percent in the first quarter of 2022, it remained above the minimum regulatory limit of 10 percent. The high NPL ratio poses challenges for financial intermediation and could stifle private sector growth and development.

Conclusion

Inflationary pressures have persisted, and it is expected to remain on an elevated path in the next few quarters, due mainly to supply-side factors including, rising global commodity prices, higher freight charges, disruption in global supply chain, uncertainty surrounding the COVID-19 pandemic and the Russian-Ukrainian war. The MPC noted with concern the persistent increase in domestic prices and the likely effects on the welfare of the people, particularly the poor. Because of the environment of stagflation in which the economy is currently anchored, the MPC recommends supply-side policy reforms to increase aggregate supply, thereby concurrently lowering the price level and boosting economic growth. Finally, 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 16.0 percent as a short-term anti-inflationary measure. It also decided to adjust the Standing Lending Facility Rate and the Standing Deposit Facility rate upward by the same margin. Hence, effective 5th July 2022, the following rates are published for the information of the public:

Monetary Policy Rate: 16.0 percent
Standing Lending Facility Rate: 19.0 percent
Standing Deposit Facility Rate: 10.0 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
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