MONETARY POLICY STATEMENT – 3RD JANUARY 2023

The Monetary Policy Committee (MPC) of the Bank of Sierra Leone met on 29th December 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 domestic growth and inflation outlook. Based on its assessment, the MPC decided to raise the Monetary Policy Rate by 125 basis points to 18.25 percent. The key considerations that informed this decision are as follows:

Inflation

Inflationary pressures remained elevated in the review period, and is expected to remain on its elevated path in the next few quarters before moderating later in 2023. The continuous increase in inflation is driven mainly by elevated food and energy prices, disruptions in the global supply chains and high freight charges. Furthermore, the effects of the Russia-Ukraine War, the accompanying sanctions imposed by western countries to force Russia to end the war, and the tight monetary policies implemented by advanced economies to reduce inflation to a desirable level have led to tight financial conditions, all of which are fueling inflation in small open economies like Serra Leone. Additionally, the uncertainties induced by the resurgence of the COVID-19 pandemic in China and the response of western countries to require negative COVID-19 test results from travelers from China could further constrain global supply chains, thereby creating adverse implications for global inflation.

As a result of these developments, headline inflation increased from 27.95 percent in June to 29.10 percent in September, but moderated slightly to 28.15 percent in August. Thereafter, it accelerated to 32.98 percent in October, and further to 35.05 percent in November. This acceleration in headline inflation since June has been largely driven by food inflation, which increased from 28.49 percent in June to 35.21 percent in September, and further to 43.62 percent in November. Non-Food inflation, on the other hand, moderated from 28.66 percent in June to 25.37 percent in September, but increased to 29.38 percent in November.

The MPC is acutely aware of the adverse impact of high inflation on the purchasing power of especially the poor, and its pernicious adverse welfare implications. Taking cognizance of the fact that price- and financial-system stability are the Bank's two core mandates, the MPC therefore concludes that fiscal and monetary policy coordination is required to tame the extant stubbornly high inflation rate.

Furthermore, because the currently high domestic inflation is mainly supply-side driven, induced largely by the effects of the overlapping global crises, the MPC is of the view that containing inflation to its Pre-COVID-19 level should be the Bank's main focus. This requires a combination of a tight monetary policy and a tight fiscal policy. Furthermore, reform measures in the productive sectors of the economy (in particularly the agricultural sector) are also needed to boost domestic production and productivity in order to reduce the currently large supply gap.

Domestic Economic Activity

Sierra Leone's economic prospects remained challenging during the review period, largely reflecting the effects of negative supply shocks to short-run aggregate supply, which have produced stagflation. Accordingly, real GDP growth for 2022 has been revised downward to 2.8 percent, from its earlier estimate of 3.6 percent. Recent projections also suggest a 3.1 percent real GDP growth in 2023, which will be below its pre-pandemic level.

The subdued output growth is also reflected in the Bank's Composite Index of Economic Activity (CIEA), which shows that domestic economic activity slowed down to 0.97 percent in the third quarter, from a growth of 1.97 percent in the second quarter. The moderation in the CIEA mainly reflected the contraction in exports and capital expenditures.

The MPC noted the downward revision of real GDP growth on account of reduced economic activities in the productive sectors of the economy, and raised concern about its implications for fiscal operations, exchange rate and domestic price developments, as well as its effects on the welfare of particularly the poor. This convinced the Committee that there is a need for prudent policy reform measures to boost domestic production and productivity in order to reduce seemingly expanding output gap.

Global Economic Growth

Based on the October 2022 *World Economic Outlook* (WEO), the global economy is expected to continue facing significant challenges, which will be mainly induced by the lingering effects of the Russian-Ukraine War, the cost of living crisis caused by persistent and broadening inflationary pressures and the economic slowdown in China. Furthermore, the tight financial conditions induced by synchronized interest rates hikes across countries as central banks seek to control inflation in their territories, the growing debt stress in many regions, and the elevated energy prices due in part to effects of the war in Ukraine and production cuts by OPEC have weighed down heavily on global economic activity.

Accordingly, in the October edition of the WEO, global growth for 2022 was maintained at 3.2 percent, as in the July 2022 edition of the WEO. However, global growth for 2023 has been downgraded to 2.7 percent from the 2.9 percent earlier projected.

Economic growth in Advanced Economies (AEs) was revised downward to 2.4 percent and 1.1 percent, respectively, for 2022 and 2023, which is lower than the 2.5 percent and 1.4 percent forecasted earlier. In Emerging Market and Developing Economies (EMDEs), growth was revised slightly upward to 3.7 percent in 2022, from an earlier projection of 3.6 percent. However, for 2023, growth in EMDEs has been revised downward to 3.7 percent, from the 3.9 percent earlier forecasted. In Sub Saharan Africa, growth is projected to slowdown to 3.6 percent and 3.7 percent in 2022 and 2023 respectively, which is below the earlier respective forecasts of 3.8 percent and 4.0 percent. In the WAMZ, economic growth in 2022 was downgraded for Nigeria, Ghana, Liberia and Sierra Leone, and for all six economies in 2023.

Downside risks to the economic outlook remain elevated, as policy trade-offs to address the cost-of-living crisis have become acutely challenging. Furthermore, the risk of monetary, fiscal, or financial policy miscalculation has risen sharply at a time when the global economy remains highly fragile and financial markets are showing signs of distress.

External Sector

External-sector performance continued to worsen during the third quarter of 2022, as the trade deficit widened from US$235.41 million in the second quarter to US$327.07 million in the third quarter. This was mainly due to the combined effects of the increase in import bills and decreased in export receipts. The former was largely on account of increased payments for food, chemicals, machinery and manufactured goods, while the latter was mainly on account of a decline in export earnings from iron ore, diamonds and timber.

Gross international reserves of the Bank of Sierra Leone declined from US$860.42 million in the first quarter of 2022 to US$729.84 million in the second quarter, and further to US$599.51 million in the third quarter. However, it remained adequate to cover three (3) months of import of goods and services. As at 27th December 2022, the gross international reserves of the Bank of Sierra Leone stood at US$588 million, supported by the World Bank disbursement of budgetary support to the tune of US$103 million on December 21 2022.

The decline in the gross international reserves of the Bank of Sierra Leone was partly due to the Special Credit Facilities created by the Bank to support the private sector for the importation of essential goods, including food and fuel as well as payments of external obligations, including debt service.

The MPC noted the improvement in Workers' remittances inflows in recent times, reaching US$113 million in the third quarter of 2022. This could help reduce the structural imbalance between demand for, and supply of, foreign exchange, and help to reduce the pressures on the international reserves going forward.

Exchange rate pressures remained elevated in the third quarter, and it continued into the fourth quarter, which was mainly due to a structural imbalance between the demand for, and supply of, foreign exchange. In response to the foreign exchange market pressures, the BSL set aside US$40 million in September 2022 to support liquidity in the foreign exchange market. The Bank conducted three weekly foreign exchange auctions in tranches of US$8 million, totaling US$24 million. However, because of increased pressure from the oil marketing companies, and considering the importance of energy for productive activities, the remaining US$16 million was offered through commercial banks to oil marketing companies to enhance the supply of fuel in the economy.

The MPC noted that foreign exchange inflows remained low in the face of increasing demand. This reinforces the MPC's position that policy reform measures to support domestic production and productivity are required to help reduce demand for foreign exchange. Also, full implementation of the requirement that exporters repatriate thirty (30) percent of export proceeds should help to enhance foreign exchange inflows.

Fiscal Policy

The overall fiscal deficit continued to widen in the third quarter of 2022, from NLe1.51 billion in the second quarter to NLe1.84 billion in the third quarter. The deterioration was mainly due to increased government expenditure and net lending which was more than the increase in total government revenues. The primary balance also worsened, as the deficit increased from NLe978.90 million in the second quarter to NLe1.46 billion in the third quarter.

The MPC noted that domestic revenue mobilization remained subdued, as the growth in total revenue was mainly in respect of foreign grants which increased from NLe196.74 million in the second quarter to NLe782.89 million in the third quarter. Domestic revenue, though improved, was below the target for the third quarter of 2022. Going forward, the MPC recommends heightened fiscal consolidation efforts in order to counterbalance the expected election-related expenditure increase for the 2023 general elections.

Money and Banking

Monetary aggregates were expansionary during the third quarter, as evidenced by the growth in both Broad Money (M2) and Reserve Money (RM). Credit to the private sector increased by 6.64 percent in the third quarter, from 5.56 percent in the second quarter. The MPC noted that although credit to private sector continued to improve in the review period, it remains below the expected level. This is due in part to credit concentration to the government sector as financial institutions seek the high interest rates on government securities. Furthermore, the high lending rate by commercial banks continued to stifle private sector growth and development.

In the money market, yields on government securities continued to increase in both the third and fourth quarters. This persistent increase in the yields on government securities reflects the high appetite for government borrowing, which could have adverse implications for debt sustainability and limit the fiscal space for essential government programs. The interbank rate also continued to trend upward, but remained within the Policy Corridor, indicating an improvement in the monetary transmission in the wholesale market, and tight liquidity conditions in the market.

Financial Sector Stability

The banking sector remains relatively stable, well capitalized, liquid and profitable as most of the key financial soundness indicators (FSIs) remained above their minimum thresholds set by the Bank of Sierra Leone. Although the non-performing loans ratio (NPLs) decreased from 14.5 percent in the second quarter to 13.8 percent in the third quarter, it remained above the prudential limit of 10 percent. The MPC also noted that the spread between banks' lending rates and deposit rates remained very high. The high NPLs ratio and the wide interest-rate spread pose challenges for financial intermediation and private sector growth and development.

Conclusion

Inflationary pressures remained elevated in the review period, and it is expected to remain so in 2023. This is due mainly to supply-side factors such as rising global commodity prices, higher freight charges, disruption in the global supply chain, uncertainty surrounding the COVID-19 pandemic and the Ukraine war. The MPC noted with concern the high domestic prices and their likely effect 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 its productive sectors, particularly the agricultural sector, to support aggregate supply growth remain vital to low-inflationary 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 125 basis points to 18.25 percent and adjust the Standing Lending Facility Rate and the Standing Deposit Facility Rate upward by the same margin.

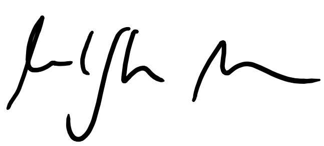
Hence, effective 3rd January, 2023, the following rates are published for the information of the public:

Monetary Policy Rate is 18.25 percent

Standing Lending Facility Rate is 21.25 percent

Standing Deposit Facility Rate is 12.25 percent

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



Professor Kelfala M Kallon
Governor