BANK OF SIERRA LEONE

MONETARY POLICY REPORT

SEPTEMBER 2023

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF TABLES

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

The Monetary Policy Report

The September 2023 edition of the BSL Monetary Policy Report provides an assessment of global and domestic economic developments, primarily during the second quarter of 2023. The report also assesses current developments in the third quarter of 2023 for which data is available, along with near-term prospects, with the objective of implementing appropriate monetary policies 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 Leonean economy. However, the Bank's mandate encompasses other important goals, including ensuring the stability of the financial system and the development of financial markets, as well as supporting the government's general economic policies to enhance overall macroeconomic stability.[1]

Monetary Policy Strategy

The BSL is the sole monetary authority in Sierra Leone with statutory operational independence to conduct monetary policy in the country. The Bank employs various policy instruments to achieve its stated objectives. These instruments 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 composed of seven members. The MPC includes the Governor of the Bank, who serves as the chairperson, the Deputy Governor for Monetary Policy, the 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 convenes quarterly to assess recent global and domestic economic developments, along with near-to-medium term prospects and inflation risks. Following these assessments, a policy decision is made, primarily using the MPR to signal the Bank's monetary policy stance.

During MPC meetings, each member proposes a preferred MPR decision supported by underlying reasons. The final decision is reached by vote, with the chairman having the deciding vote in the event of a tie. Subsequently, the final decision is published in a monetary policy statement on the Bank's website within forty-eight hours after the MPC meeting. Additionally, the Governor and other authorized staff engage with the public periodically 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 other matters.

---

[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 July 2023 edition of the IMF's World Economic Outlook (WEO) has revised global growth upward to 3.0 percent, with this revision attributed to a moderation in global systemic banking sector risks and a downward trend in global inflation. Global growth is expected to remain steady at 3.0 percent in 2024, although risks to this outlook are still skewed to the downside due to factors such as subdued activity in the United States and Euro Area, concerns about unresolved real estate issues in China, the ongoing Russia-Ukraine war, and tight global credit supply.

Global inflation continues to subside due to sustained restrictive monetary policies and improved supply conditions, leading the IMF to revise global inflation for 2023 downwards to 6.8 percent, with further moderation expected to 5.2 percent in 2024. However, variations in the pace of disinflation are observed across countries, reflecting different exposures to changes in commodity prices and exchange rates.

Regarding the domestic economy, the real GDP growth projection for 2023 has been adjusted downwards to 2.7 percent from the initial estimate of 3.4 percent. This revision is attributed to weak domestic demand, rising cost-of-living, limited fiscal space, and spillovers from the Ukraine War, despite the external sector showing relative resilience. However, the BSL's high-frequency Composite Index of Economic Activity (CIEA) indicates a slight improvement in economic activity in the second quarter of 2023.

While global inflation has been moderating, domestic inflation continues to rise, with headline inflation increasing from 41.74 percent in March 2023 to 44.81 percent in June 2023. It further rose to 44.98 percent in July 2023 and significantly increased to 50.94 percent in August 2023. This is primarily attributed to ongoing increases in imported food and energy prices and the initiation of fuel price subsidy elimination. The expectation is that inflation will continue to rise through the remainder of 2023 due to the phasing out of fuel and electricity price subsidies and tax hikes. However, inflation is anticipated to begin receding by the end of the first quarter of 2024, supported by tighter fiscal and monetary policies. Risks to the inflation outlook are tilted to the upside in the short term, driven by factors like the larger-than-expected impact of subsidy phase-outs and tax hikes, weak domestic productivity, faster exchange rate depreciation, higher-than-expected increases in the prices of major imported commodities, and rising inflation expectations.

The trade deficit slightly widened in the second quarter of 2023 compared to the first quarter, primarily due to a higher import bill that outweighed the increase in export earnings. Both imports and exports rose in response to higher U.S. dollar prices, consistent with global commodity price dynamics. The Gross Foreign Exchange Reserves of the Bank declined due to excess outflows over inflows, equivalent to 2.8 months of imports of goods and services, which is below the 3.3 months recorded in 2023Q1. While the exchange rate has remained relatively stable over the past six months, pressures persist, influenced by demand and supply factors.

In the monetary sector, monetary aggregates showed expansion in the second quarter of 2023. Reserve money growth was driven by the increasing NDA of the BSL, while growth in broad money was driven by the NDA of the Banking System. However, credit growth to the private sector decreased in the second quarter compared to the preceding quarter. Liquidity conditions remained tight, leading to the BSL's intervention in secondary market operations to support banking sector liquidity. The 364-day T-bill yield was oversubscribed, hovering around 28 percent in 2023Q2, while the 91-day and 182-day T-bills market remained dysfunctional. The interbank market rate continued to increase, moving closer to the Monetary Policy Rate (MPR), indicating tight liquidity in the banking system.

The financial sector remained relatively stable, with most Financial Soundness Indicators (FSIs) above regulatory thresholds. However, the Non-Performing Loans (NPLs) ratio increased and remained above the statutory limit of 10 percent. Risks to the financial system include limited intermediation to support growth, cybersecurity and information technology threats, an increase in foreign currency deposits, and a high level of NPLs.

On the fiscal front, the fiscal deficit widened in the second quarter of 2023, driven by a combination of lower government revenues and increased expenditures. However, domestic revenue increased, though it remained slightly below the quarter's target.

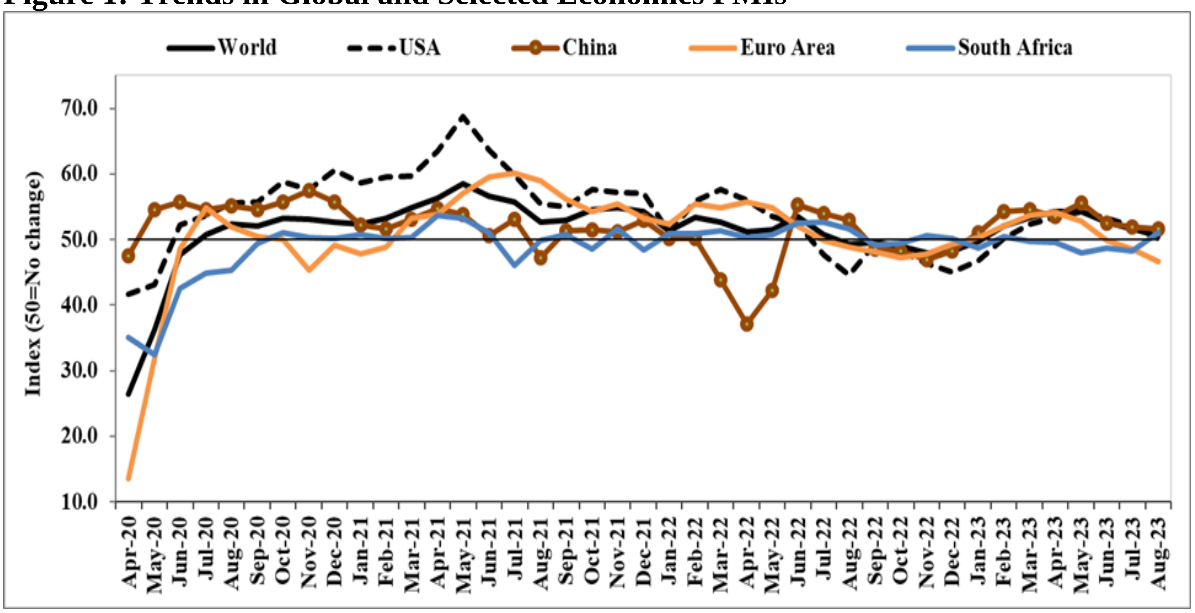
The report is structured as follows: The second section analyzes global economic developments, including global growth, inflation, commodity prices, and their implications for the Sierra Leone economy. The third section reviews domestic economic developments and outlook. The fourth section covers the conclusion and decision of the MPC during the September 2023 meeting.

1. GLOBAL ECONOMIC DEVELOPMENTS AND PROSPECTS

1.1 Global Output

The global economic outlook remains uncertain due to the prolonged effects of multiple shocks, which include the lingering impact of the COVID-19 pandemic, the ongoing conflict between Russia and Ukraine, fluctuations in energy and food markets, a surge in inflation, and a significant tightening of monetary policy. The Composite Purchasing Managers' Indices (PMI)[2] for July and August 2023 have indicated a slowdown in global private sector activity (Refer to Figure 1). High interest rates continue to exert pressure on manufacturing activity in the US and the Euro Area, along with a deceleration in the services sector. In China, there was a marginal improvement in manufacturing output and demand, but this was offset by a slowdown in the services sector.

Figure 1: Trends in Global and Selected Economies PMIs



Data Source: Markit Economics, through Trading Economics September 6, 2023.
Note: PMIs above 50% signals expansion in economic activity; below 50% signals contraction.

Despite the weak signals indicated by the composite PMIs, the IMF has upgraded its 2023 growth projection to 3.0 percent[3], which is 0.2 percentage points higher than the April 2023 World Economic Outlook (WEO) prediction. The growth projection for 2024 remains unchanged at the

[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.
[3] World Economic Outlook (WEO) July 2023 Update

same rate of 3.0 percent, which, however, is considered weak in historical context. The improved growth outlook for 2023 primarily results from reduced risks following the prudent actions taken by authorities to prevent a global systemic banking sector crisis. This was achieved through the swift addressing of turbulence in the US and Swiss banking system. Additionally, global inflationary pressures seem to be subsiding, which could lead to the conclusion of interest rate hike cycles in the near future.

Despite the moderation of some adverse risks to global growth, the overall risk balance remains skewed to the downside. This is mainly due to the intensification of the conflict in Ukraine and the occurrence of extreme weather-related events, both of which may trigger more restrictive monetary policy. Financial sector turbulence could resurface if markets strongly adjust to further policy tightening by central banks. China's recovery may slow down, partly due to unresolved real estate issues, potentially leading to negative cross-border spillovers. There is also a risk of worsening sovereign debt distress across the globe, which could further depress public consumption and investment.

1.1.1 Advanced and Emerging Market Economies

The growth forecast for advanced economies in 2023 has been upgraded by 0.2 percentage points to 1.5 percent, reflecting a better-than-expected year-to-date performance. However, this growth projection for 2023 is still significantly lower than the 2.7 percent growth recorded in 2022. Looking ahead, economic activity in this group is expected to remain subdued, with a growth forecast of 1.4 percent for 2024. The subdued outlook is evident in the performance of key economies, including the US, Euro Area, the UK, and Japan.

In emerging markets and developing economies, growth is expected to remain relatively stable, primarily sustained by robust activity in China and India. Growth in China is projected to improve to 5.2 percent in 2023, compared to 3.0 percent in 2022. Stronger-than-expected net exports have helped offset some of the investment weaknesses in the country, although this contribution from net exports is diminishing as the global economy slows. Growth in India is projected to reach 6.1 percent in 2023, reflecting a 0.2 percentage point upward revision, driven by momentum from stronger-than-expected growth in the fourth quarter of 2022, fueled by increased domestic investment. As a result, the region is expected to grow by 4.0 percent in 2023, the same as in 2022, but slightly higher compared to 4.1 percent in 2024. Nevertheless, risks for activity in emerging market economies could arise from challenges such as a faltering Chinese economy, de-globalisation, and higher-than-expected interest rates in the US.

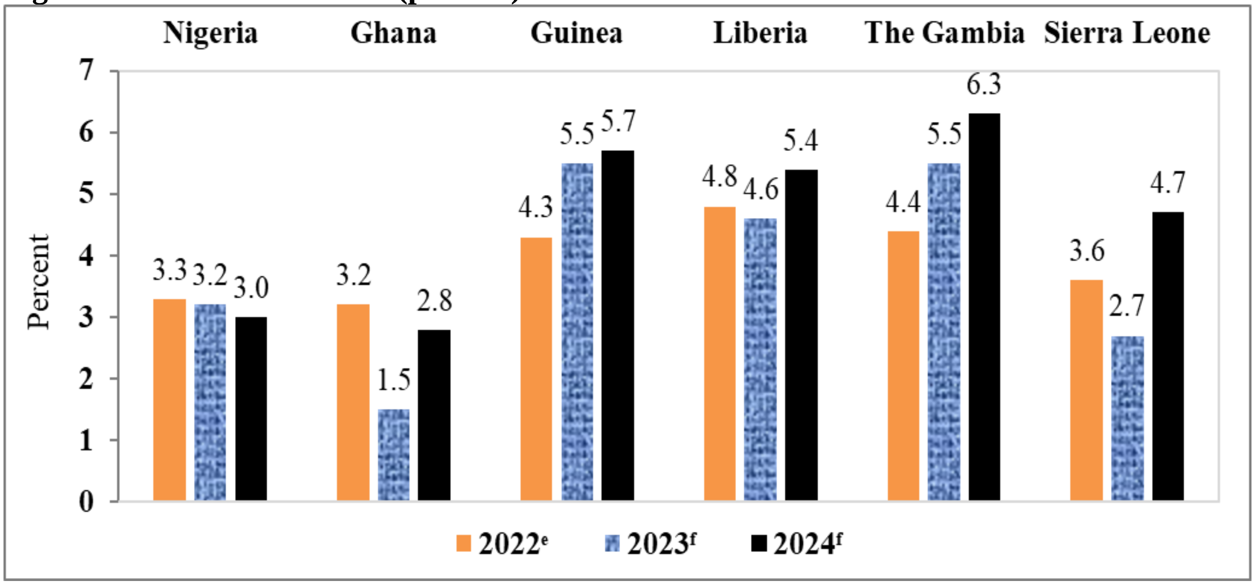
1.1.2 Sub-Saharan Africa

Socio-political instability and extreme weather conditions have amplified the downside risks to the growth outlook in sub-Saharan Africa. As a result, the growth projections for the region in 2023 and 2024 have each been reduced by 0.1 percentage point, resulting in figures of 3.5 percent and 4.1 percent, respectively. Growth in Nigeria is expected to gradually decline from 3.3 percent in 2022 to 3.2 percent in 2023 and further to 3.0 percent in 2024, primarily due to security challenges in the oil sector. South Africa's growth projection for 2023 has been revised upward by 0.2 percentage points to 0.3 percent, driven by the resilience exhibited in the services sector during the first half of 2023.

1.1.3 West African Monetary Zone (WAMZ)

Overall, economic performance in the WAMZ is anticipated to moderate in 2023, primarily due to subdued outcomes in Ghana and Nigeria, which together account for over 90 percent of the bloc's GDP. Sierra Leone, Nigeria, and Ghana are grappling with exchange rate depreciation pressures and record-high inflation rates, which are impacting investor sentiments. Externally, the sluggish momentum of the global economy is also expected to constrain economic growth in the bloc. The new government in Nigeria has introduced several economic reforms that may initially dampen short-term growth in the country before yielding positive gains in the medium-to-long term. Nonetheless, economic activity is projected to remain resilient in Guinea and The Gambia, as these countries have managed to maintain relatively stable exchange rates and keep inflation in check. Furthermore, activity across the bloc is anticipated to regain momentum in 2024, contingent on the diminishing headwinds from the global economic environment and improved domestic performance.

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



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

1.2 Global Trade Volume

Global trade growth is expected to decrease from 5.2 percent in 2022 to 2.0 percent in 2023, with a subsequent rebound to 3.7 percent in 2024. It is worth noting that this projected growth falls short of the 4.9 percent average observed between 2000 and 2019. The decline in 2023 can be attributed to several factors, including changes in worldwide demand, a shift toward domestic services, the lingering impact of the stronger US dollar in 2022, which hindered trade due to the prevalent use of US dollar invoicing, the Russian-Ukraine crisis and an increase in trade restrictions.

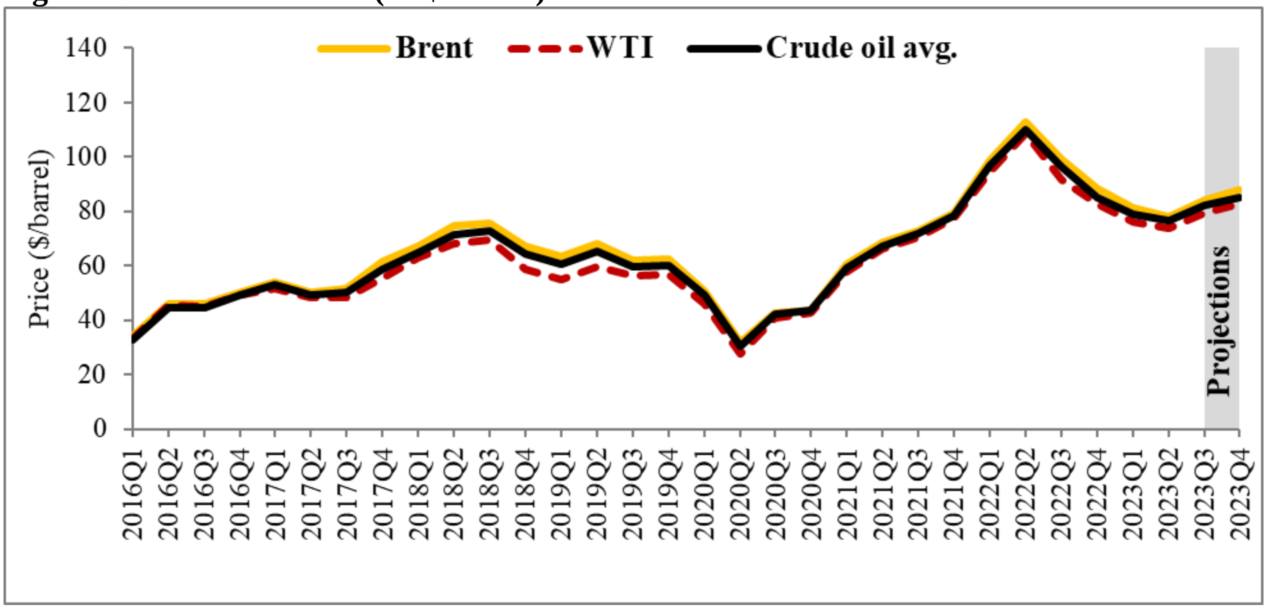
1.3 Global Commodity Prices and Inflation

1.3.1 Global commodity prices

Crude Oil Prices

Crude oil prices saw a significant increase in the middle of 2023Q3, following a decrease in the preceding four quarters. This price surge can be attributed to the extended crude oil output cuts by Russia and Saudi Arabia, which led to tightened global supply conditions for crude oil. Additionally, seasonal travel and increased activities in the services sector supported energy demand. As a result, the average crude oil price is estimated to be US$82.4 per barrel in 2023Q3, marking a 7.6 percent increase from the second quarter of 2023 (2023Q2). Both Brent and West Texas Intermediate (WTI) oil prices closely follow the movements in the average crude oil prices. It is anticipated that crude oil prices will continue to strengthen throughout the remainder of 2023, as markets are expected to tighten further due to sustained supply pressures from OPEC+.

Figure 3: Crude Oil Prices (US$/barrel)

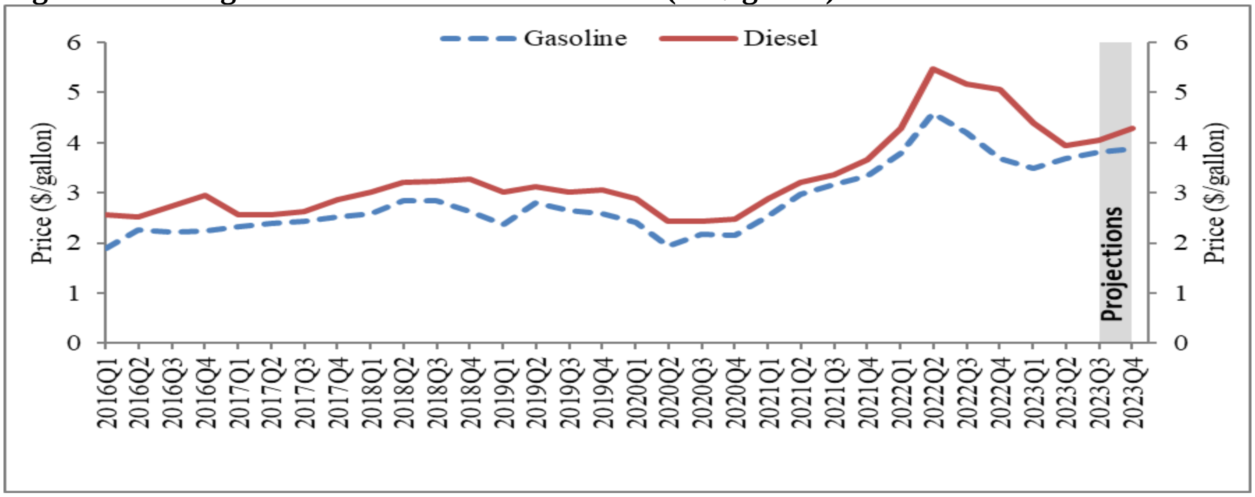


Source: World Bank Commodity Market Database September 2023

Petroleum Products (Retail Prices)

Movements in petrol and diesel prices broadly mirrored the movements in crude oil prices but were relatively more restrained. Petrol prices are estimated to be at US$3.81 per gallon in 2023Q3, indicating a 3.3 percent increase from 2023Q2. Similarly, diesel prices are estimated to be at US$4.05 per gallon in 2023Q3, marking a 2.8 percent increase from the preceding quarter.

Figure 4: Average Prices of Petroleum Products (US$/gallon)

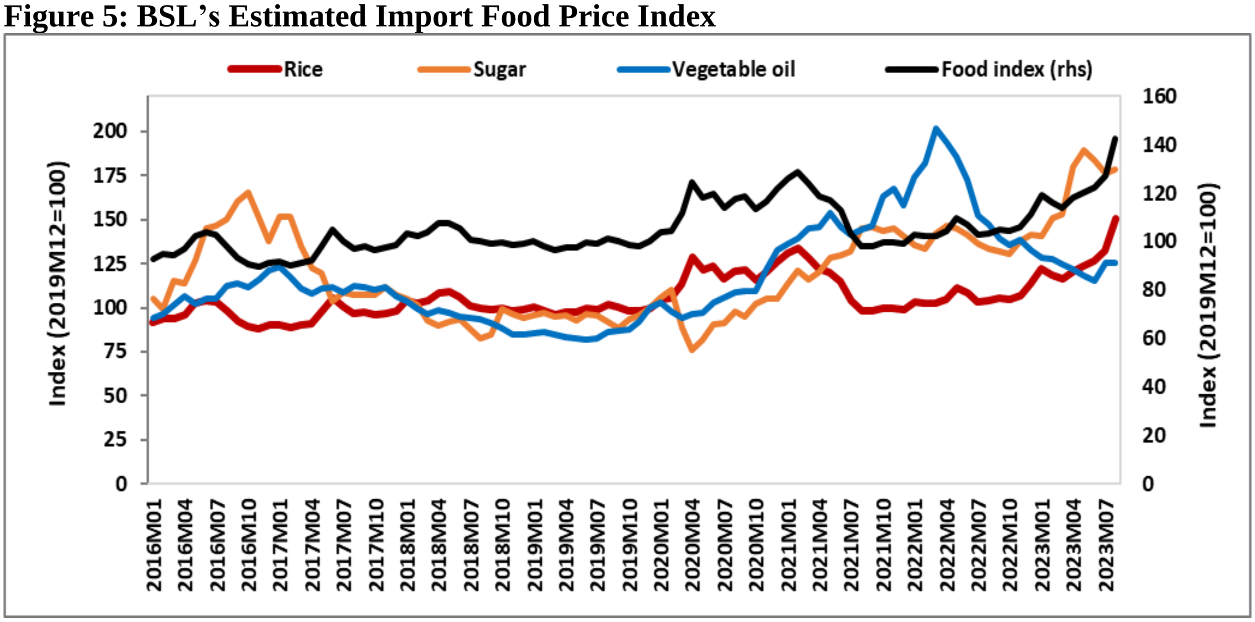


Source: U.S. Energy Information Administration, EIA (September 2023)

Food Price Index

Despite the continued decline in the FAO global food price index, the prices of food commodities imported into Sierra Leone have continued to trend upward. The BSL's estimated import food price index has been on the rise since 2022 and this growth has accelerated more recently. This increase is primarily driven by rising prices of rice and sugar.

Figure 5: BSL's Estimated Import Food Price Index

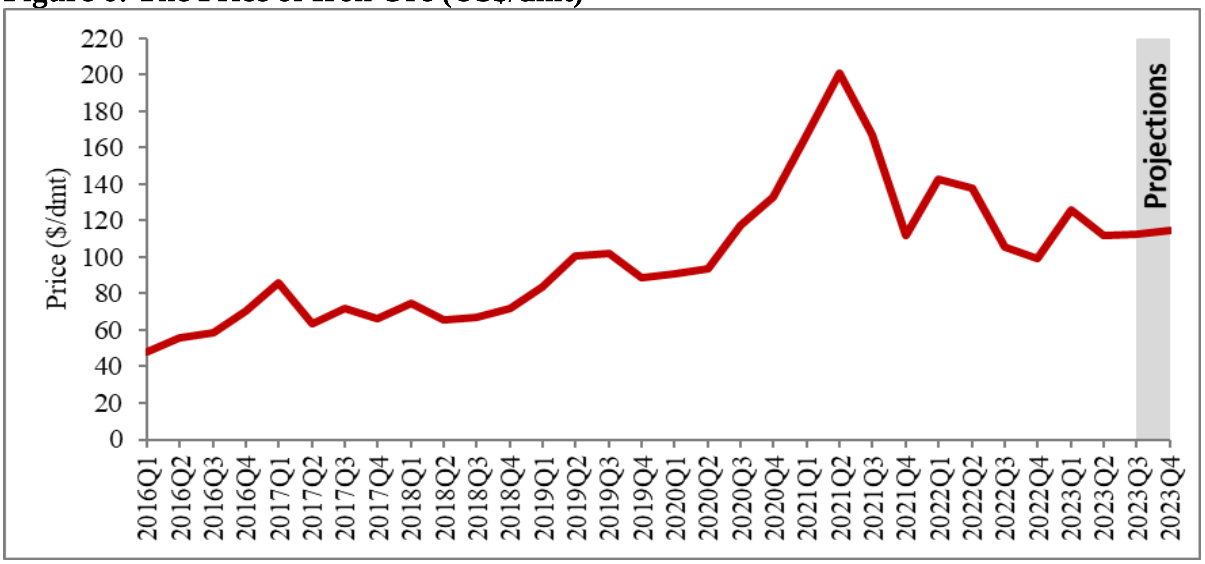


Source: BSL Staff estimation using data from the World Bank Commodity Market database, September 2023.

Iron Ore Price

Iron ore prices remained strong in 2023Q3 and are expected to further strengthen in 2023Q4, driven by anticipated robust demand for Chinese steel products. Anticipating imminent restrictions on steel production by Chinese authorities, steel mills have increased production in advance of these controls to mitigate potential damage, temporarily boosting the demand for iron ore. Furthermore, various measures aimed at supporting the struggling Chinese property sector could also lead to increased demand for steel and, consequently, iron ore. Iron prices are estimated to be at US$112.3 per dry metric ton (dmt), which is marginally higher in 2023Q3 than in 2023Q2. However, prices are projected to **experience** moderate increases in 2023Q4.

Figure 6: The Price of Iron Ore (US$/dmt)

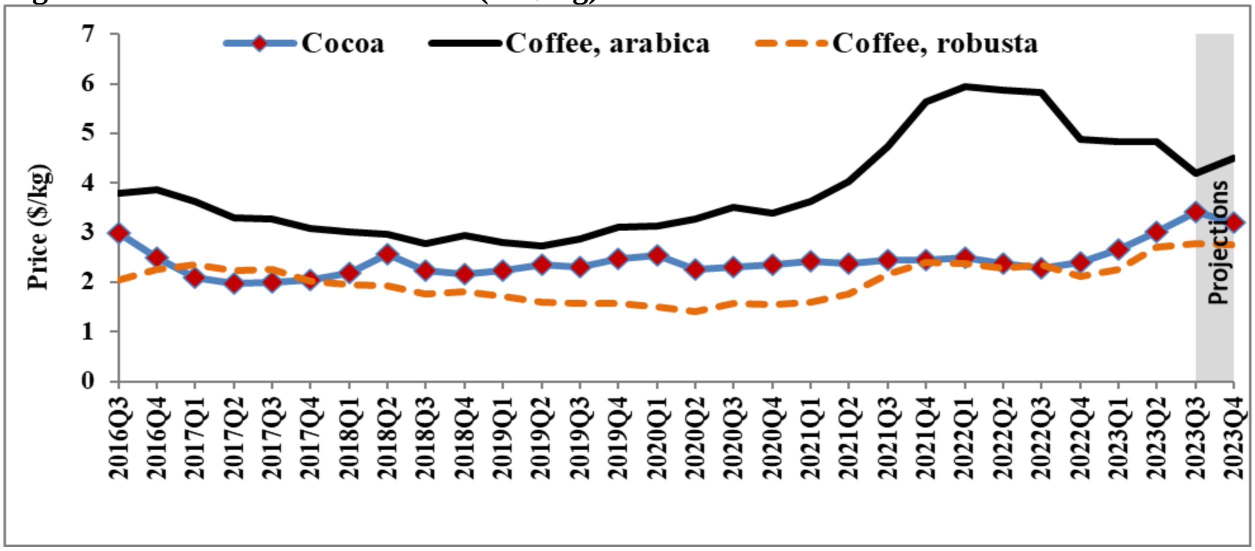


Source: World Bank Commodity Market Database June 2023

Cocoa and Coffee Prices

Cocoa and Robusta coffee prices increased by 13.6 percent and 2.2 percent, respectively, in 2023Q2. These price hikes are attributed to persistent supply concerns. Supply from the largest global producer, Côte d'Ivoire, decreased in 2023Q2. Furthermore, inventories in U.S. ports also declined during this period. Additionally, Ghana reported that farmers would be unable to fulfill some contracts due to a shortage of supply, as the country's output is expected to reach a 13-year low owing to a lack of fertilizer and disease issues. In contrast, Arabica coffee prices remained largely unchanged in 2023Q3 compared to 2023Q2.

Figure 7: Cocoa and Coffee Prices (US$/kg)

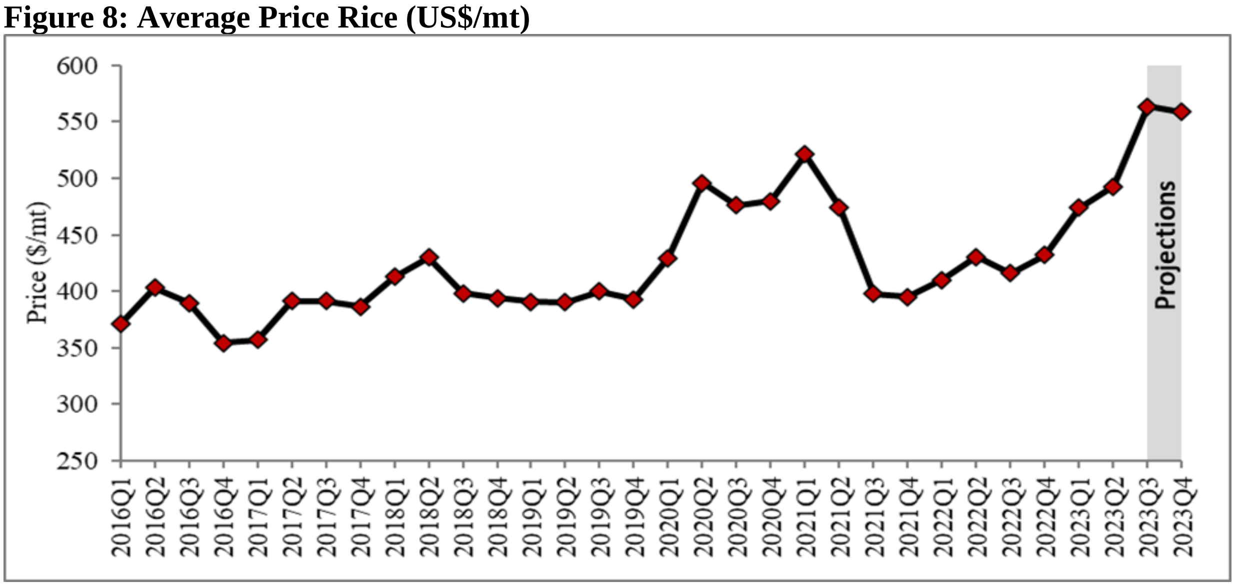


Source: World Bank Commodity Market Database September 2023

Rice Prices

Global rice prices continue to surge due to heightened supply constraints, primarily resulting from India, the top producer, imposing an export ban on white rice in July 2023 and introducing additional shipment restrictions in August 2023. Prices are estimated to increase by 14.4 percent in 2023Q3 compared to 2023Q2. It is anticipated that rice prices will remain elevated throughout the remainder of 2023, contingent on strong demand, India's export restrictions, and weather-related disruptions in other major rice-exporting countries.

Figure 8: Average Price Rice (US$/mt)

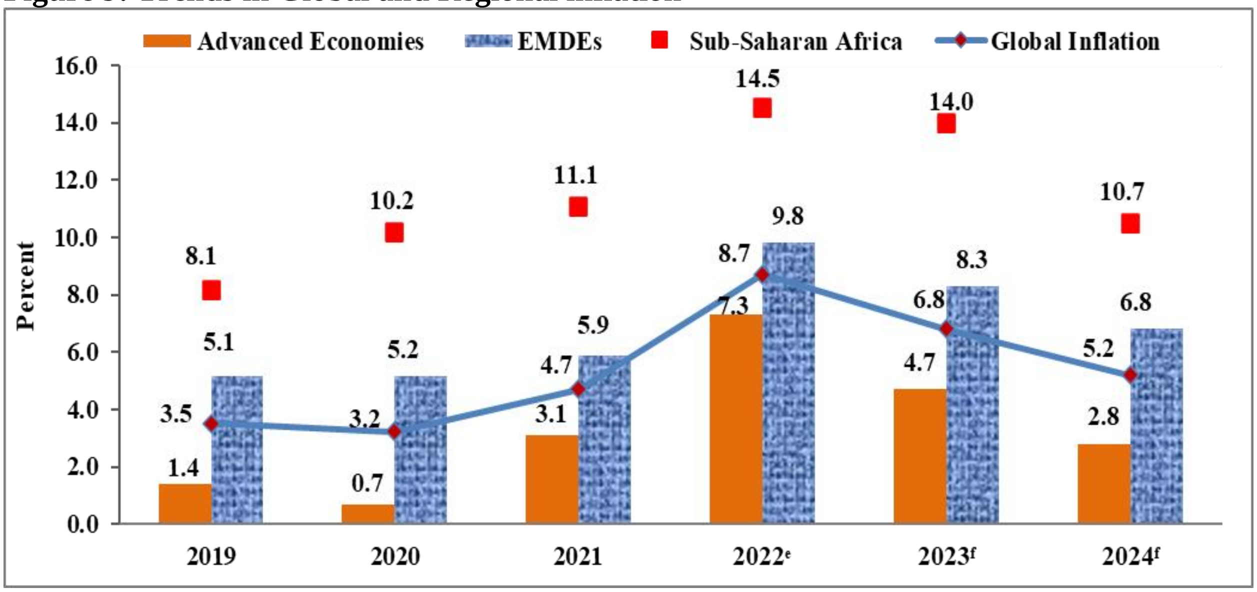


Source: World Bank Commodity Market Database September 2023

1.3.2 Global Inflation

Global inflation continues to cool, underpinned by the sustained implementation of restrictive monetary policy and the lagged effect of the moderation in global commodity prices in the second quarter of 2023. Global headline inflation is projected to decrease from 8.7 percent in 2022 to 6.8 percent in 2023, with further moderation to 5.2 percent in 2024.

Figure 9: Trends in Global and Regional inflation



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

Core inflation, previously quite resistant to change, has also begun to moderate. However, variations in the pace of disinflation across countries can be attributed to factors such as different levels of exposure to commodity prices, currency fluctuations, and varying degrees of economic overheating. The forecast for 2023 represents a 0.2 percentage point upward revision, primarily due to subdued inflation in China. Global inflation is anticipated to further decelerate to 5.2 percent in 2024, contingent on the continued stability of the commodity market and the persistent impact of restrictive monetary policy.

Sub-Saharan Africa (SSA) Inflation

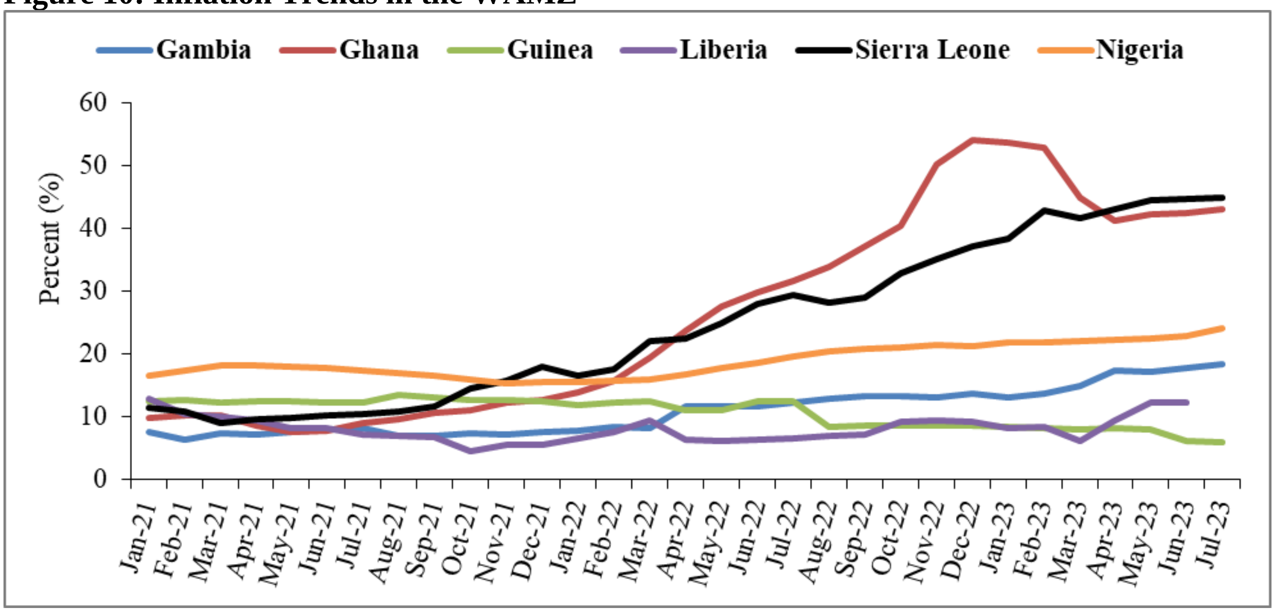
Inflation in Sub-Saharan Africa is projected to moderate slightly but remain elevated at 14.0 percent in 2023, compared to 14.5 percent in 2022. Price pressures moderated in most countries in the region, but they continued to be elevated in heavyweight nations like Ghana and Nigeria. In

Nigeria, inflation surpassed market expectations, driven by the removal of the fuel subsidy in May and the significant depreciation of the naira. These factors are likely to drive inflation throughout the remainder of 2023, and inflation is expected to remain significantly above the Central Bank's target until at least 2024 Q4.

Inflation in the WAMZ

Consumer price inflation trended upwards in 2023Q2 in all member countries of the WAMZ, except for Guinea. Domestic supply constraints and currency weakness continue to exert upward pressure on prices in the region. Ghana and Sierra Leone continue to experience record-high inflation rates, followed by Nigeria and The Gambia. In Liberia, inflation has also been on the rise since April 2023, following an extended period of price stability in the country. Guinea, on the other hand, has maintained a low and stable inflation environment, primarily supported by a relatively strong currency.

Figure 10: Inflation Trends in the WAMZ



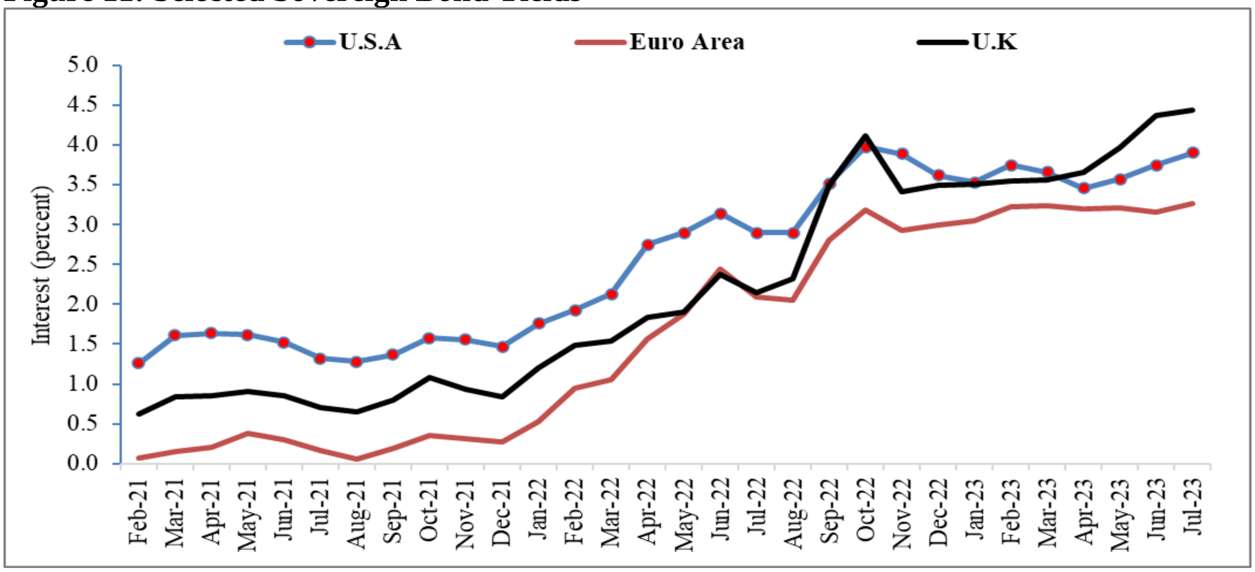
Data Source: Country Central Banks through Trading Economics

1.4 Monetary Policy and Financial Market Developments

Central banks have continued to raise interest rates to curb inflation, although the pace of these increases is slowing in most advanced economies as inflation recedes. This approach to higher interest rates has resulted in global financial conditions remaining tight, which, in turn, has put pressure on banks in advanced economies. This situation may potentially trigger financial turbulence like what was experienced earlier this year (as depicted in Table 3).

Sovereign bond yields saw an upward trend in June and July 2023. This was driven by the growing realization among market participants that monetary policy rates will likely remain high for an extended period. Additionally, market expectations of policy rate cuts in the United States and the euro area in 2024 have diminished, while anticipated policy rates by the end of 2023 have returned close to their March peaks, before the onset of banking stress (as illustrated in Figure 11).

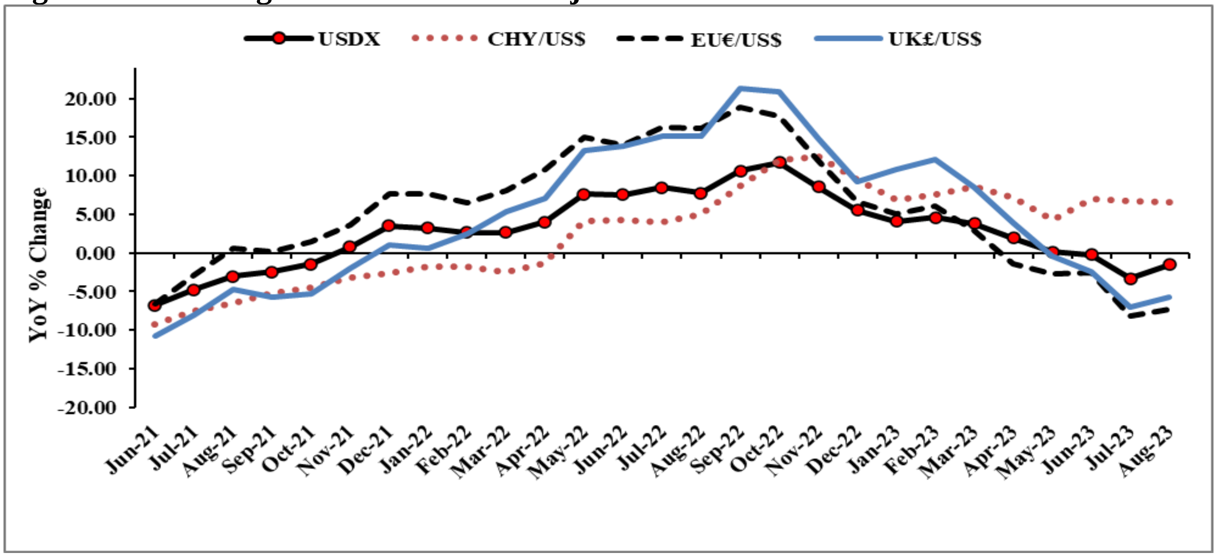
Figure 11: Selected Sovereign Bond Yields



Source: Federal Reserve Economic Data (FRED) September 2023

As U.S. bond yields increase, sovereign risk spreads in emerging markets and developing economies (EMDEs) are decreasing. This suggests that investors perceive reduced downside risks. Consequently, dollar-denominated borrowing costs in EMDEs have slightly declined. The US dollar weakened against other major global currencies for most of 2023, which mitigated depreciation pressures in EMDEs, including Sierra Leone. However, more recently, the US dollar has started to appreciate again, making financial conditions tighter for most EMDEs.

Figure 12: Exchange rates of Selected Major Global Currencies to the U.S. Dollar

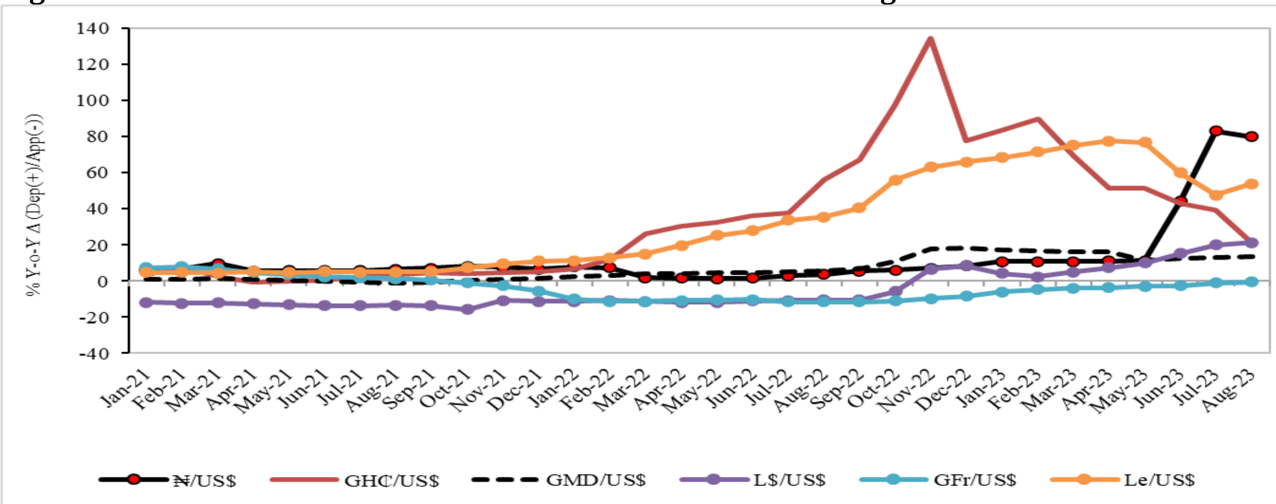


Data Source: FRED (September 2022) Note: a positive change indicate depreciation against the U.S. dollar and a negative change indicates an appreciation against the U.S. dollar.

1.5 WAMZ Exchange Rates

The currencies of Ghana and Sierra Leone, which have been the worst performers in the WAMZ bloc, experienced some gains during the review period. This was mainly due to a slowdown in demand for foreign exchange, coupled with diminished speculative activities in the foreign exchange market. The Gambian Dalasi and Guinea Franc remained broadly stable, although there have been some recent pressures on the Guinea Franc. The naira recorded a sharp depreciation in the months of June and July 2023 due to radical reforms in the foreign exchange market, initiated after President Tinubu assumed office in May 2023. The Liberian Dollar also faced increased pressure due to a slowdown in foreign exchange inflows.

Figure 13: Year-on-Year Movements in the WAMZ currencies against the US dollar



Source: Trading Economics

1.6 Implications for the outlook of the Sierra Leone economy

Global economic and financial conditions continue to impact the domestic economy through various channels, including trade, financial flows, and exchange rates. Elevated global uncertainty poses higher risks for the outlook of growth and inflation in Sierra Leone. Weak global trade could burden the country's exports and economic growth. Slower growth in major trading and development partner economies, such as the Euro Area and the US, could have negative spill-over effects through reduced foreign direct investment inflows. Rising socio-political instability and natural disasters in Africa could challenge foreign investment opportunities. Additionally, the war in Ukraine and various military conflicts and climate-related disasters around the world may limit grants and official lending to Sierra Leone. Persistent fluctuations in global commodity prices could adversely affect the country's terms of trade. Higher global interest rates could increase the country's external borrowing costs, potentially leading to challenges in debt management and reduced investment. However, the slowing global inflation and the weakening of the US dollar could have positive spill-over effects in the country through lower prices of imported goods. The strong inflow of remittances could also help alleviate pressures in the domestic foreign exchange market.

2 DOMESTIC ECONOMIC DEVELOPMENTS

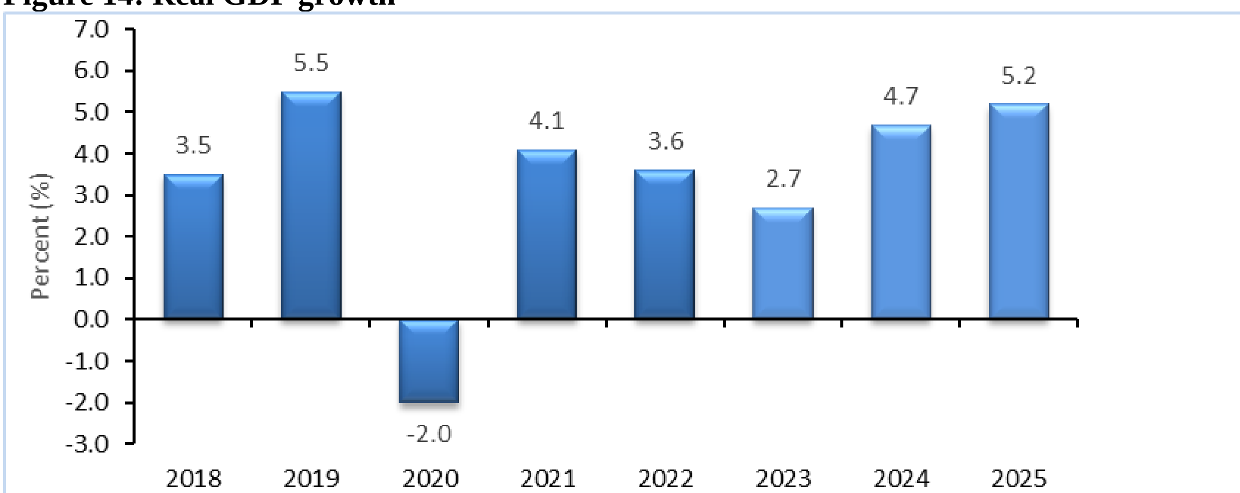
2.1 Real Sector Developments

2.1.1 Real GDP Growth

The domestic economy is estimated to experience moderate growth of 2.7 percent, down from an initial projection of 3.4 percent in 2023. This is in comparison to the 3.6 percent growth observed in 2022. The moderation in growth can be attributed to several factors, including weak domestic demand, a continued global growth slowdown, limited fiscal space, and larger than expected supply-side constraints due to spillovers from the Ukraine war. However, growth is expected to rebound to 4.7 percent in 2024 and maintain a similar growth rate in the medium-term (2025-2028).

This expected growth is largely driven by improvements and expansion in non-mining sectors such as agricultural investment, tourism, and manufacturing. Additionally, anticipated growth in other mining activities, improvements in the business environment, and the continued implementation of business-friendly regulatory and financial sector reforms are factors that could contribute to increased output.

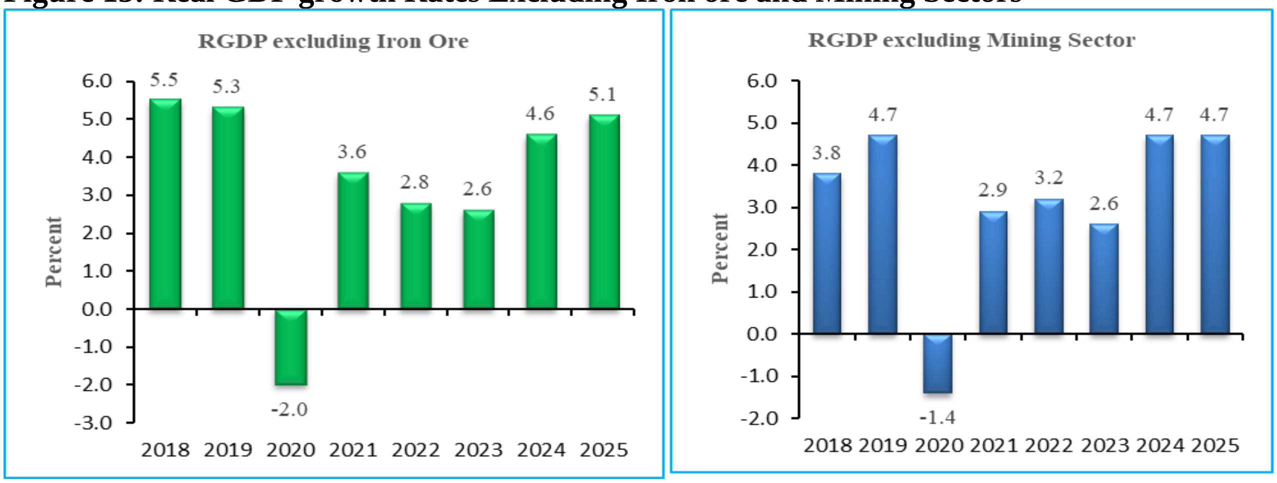
Figure 14: Real GDP growth



Source: Statistics Sierra Leone & IMF

Real GDP growth, excluding the mining sector and iron ore, **is** projected to slow down to a flat rate of 2.6 percent in 2023. This is in comparison to growth rates of 3.4 percent and 3.2 percent, respectively, in 2022.

Figure 15: Real GDP growth Rates Excluding Iron ore and Mining Sectors

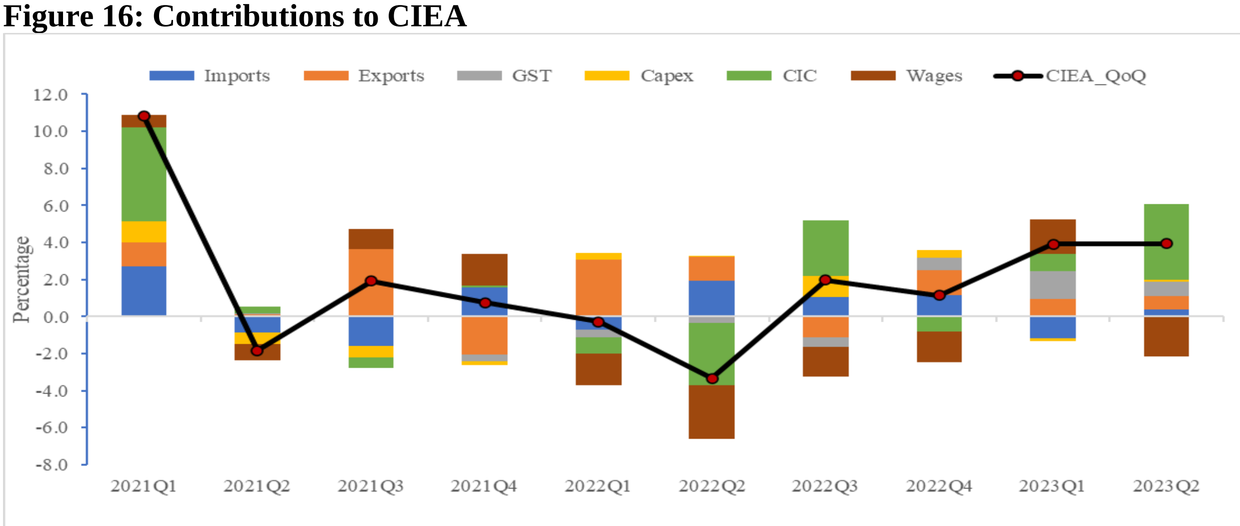


Source: Statistics Sierra Leone & IMF

2.1.2 Composite Index of Economic Activity (CIEA)

The Bank's analytical high-frequency indicator, the Composite Index of Economic Activities (CIEA), suggests a slight improvement in economic activity in 2023Q2. This growth in CIEA is mainly driven by improvements in foreign trade, growth in currency-in-circulation, and an increase in goods and services tax, which serves as a proxy for consumption.

Figure 16: Contributions to CIEA



Source: Bank of Sierra Leone

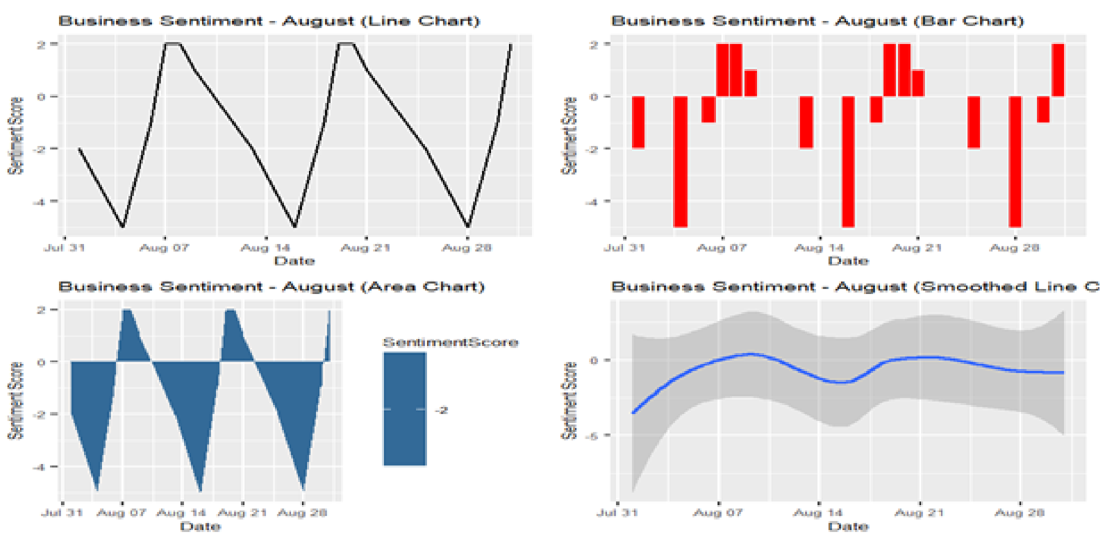
Box 1: Business Confidence[4]

The Bank conducted a comprehensive business perception survey for July and August 2023. Questionnaires were distributed through Google Forms to businesses nationwide, resulting in a substantial and diverse response from various sectors across the country. The collected responses served as valuable input data for the AFINN-111 lexicon model, **utilising** the R software to run the codes.

Following the conclusion of the June 2023 elections, the business sentiment score for July improved to +2. While this score reflected an overall positive sentiment, it was accompanied by lingering concerns and uncertainties within the business community.

However, the outcome of the August 2023 survey resulted in a score of -2, indicating that businesses hold a generally pessimistic or cautious outlook concerning their current circumstances and the near-term outlook. This sentiment is likely influenced by recent developments, including the upward revision of fuel prices and the impact of the rainy season on economic activities.

Figure 17: Business Sentiment Chart Grid



Source: BSL, staff calculation

2.1.3 Price Developments

Headline year-on-year inflation increased from 41.7 percent in March 2023 to 44.8 percent in June 2023 and significantly rose to 50.9 percent in August 2023. The increase in headline inflation has been primarily driven by food, especially imported food. However, the unusually large increase in August was also due to the elimination of fuel price subsidies, which ignited high fuel and

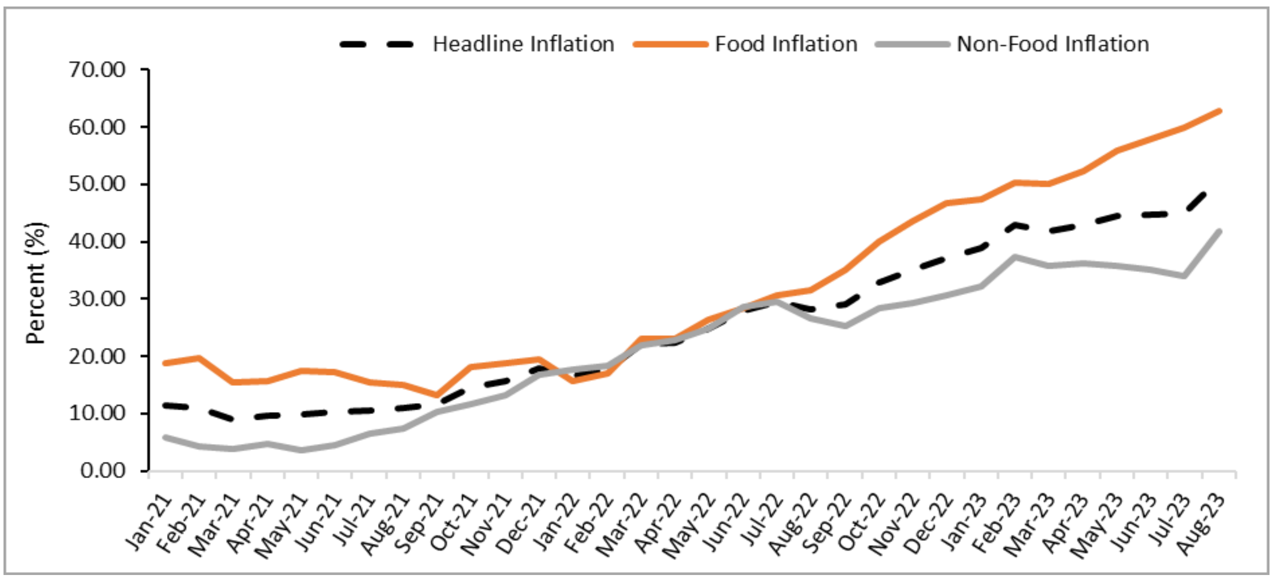
[4] The business confidence is still experimental.

transportation costs. Additional announced fiscal measures, including further cuts in subsidies and tax hikes, will further boost prices in September and October 2023.

Food inflation rose from 50.0 percent in March 2023 to 58.0 percent in June 2023, spiking to 62.8 percent in August 2023. Non-food inflation declined slightly from 35.8 percent in March 2023 to 35.0 percent in June 2023 but increased to 41.9 percent in August 2023.

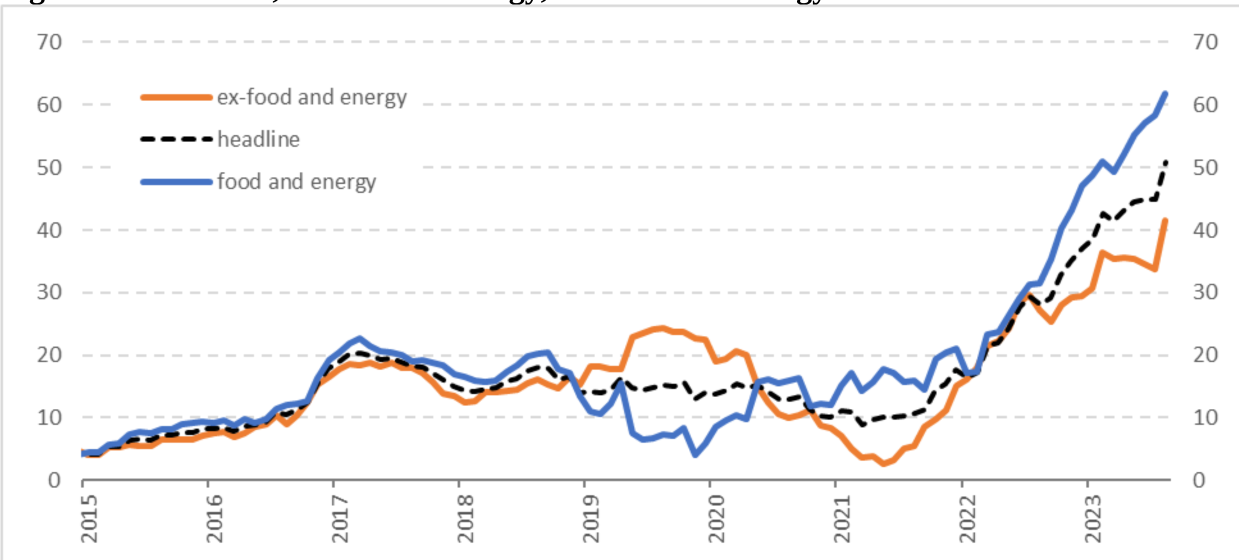
Food and energy inflation increased from 49.8 percent in March to 57.1 percent in June and further to 61.9 percent in August. Excluding food and energy, inflation fell from 35.3 percent in March to 34.6 percent in June and increased to 41.6 percent in August 2023, though it remained significantly lower than the headline figure.

Figure 18: Headline, Food and Non-Food Inflation



Source: Statistics Sierra Leone

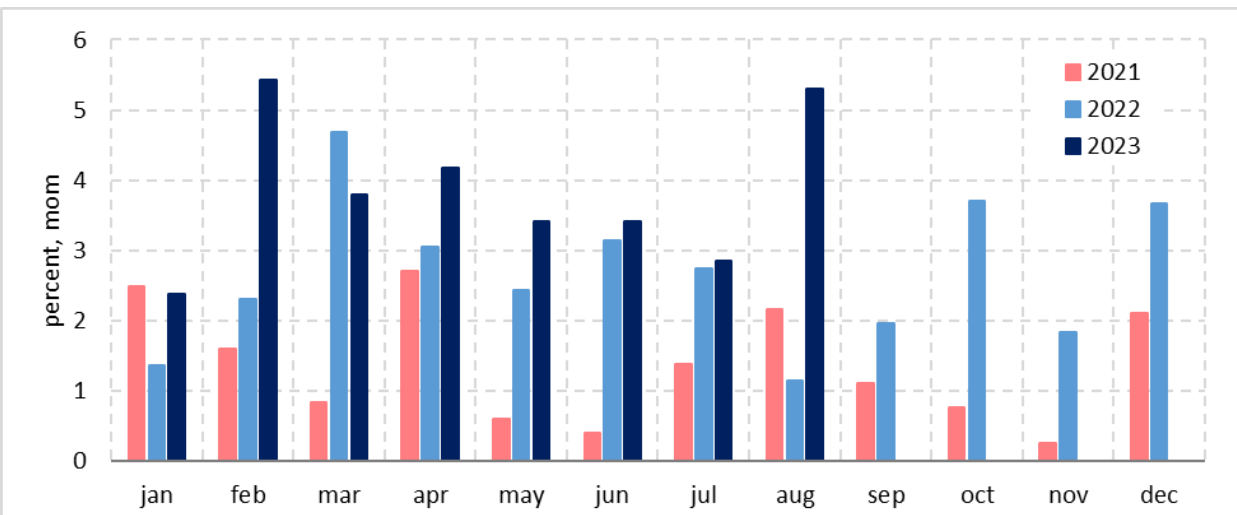
Figure 19: Headline, ex-Food & Energy, and Food & Energy Inflation



Source: Bank of Sierra Leone & Statistics Sierra Leone

Monthly inflation was on a downward trend, starting with an average of 3.8 percent in the first half of 2023 and further decreasing to 3.4 percent in June 2023, but it subsequently increased to 5.3 percent in August 2023. Throughout 2023, monthly inflation remained higher than the corresponding months in 2022, with the exceptions of January and March (refer to Figure 20).

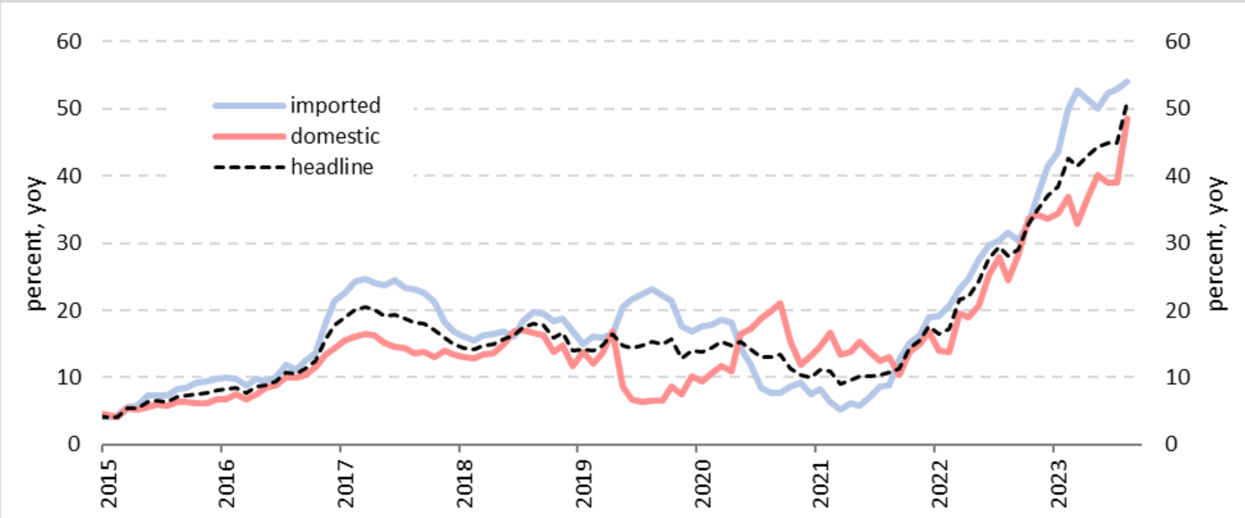
Figure 20: Path of Monthly Inflation within the Years of 2021-2023



Source: Statistics Sierra Leone

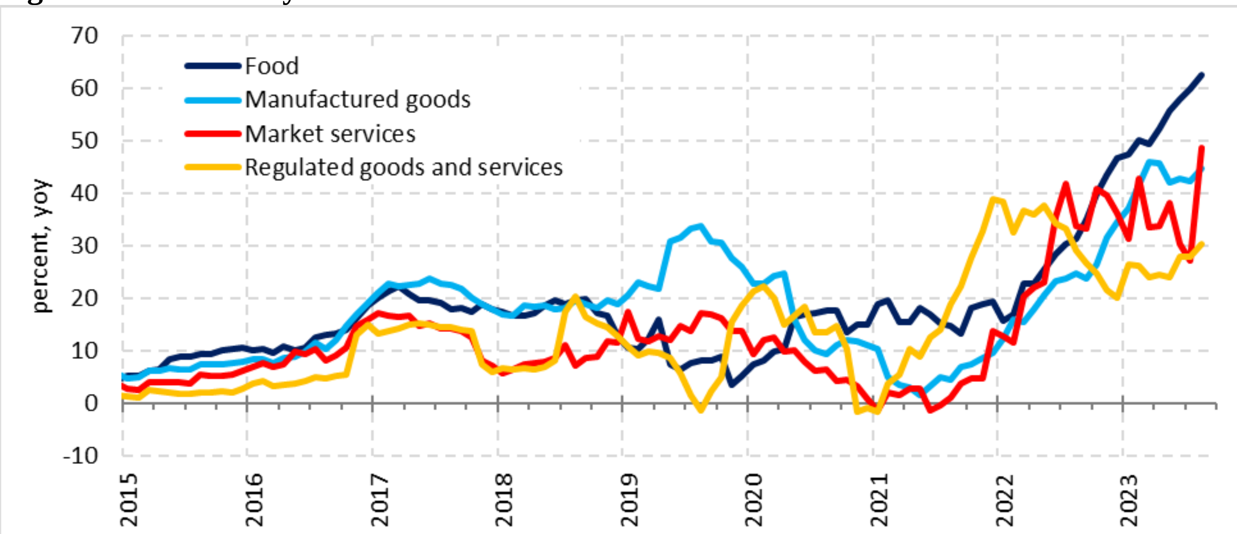
The depreciation of the exchange rate is a key factor driving inflation, given that the inflation rate of imported items surpasses that of locally produced items. Domestically produced inflation surged from 33.4 percent in March to 38.9 percent in June, reaching a new historic peak at 48.4 percent in August due to the government's measures impacting the prices of domestic services, notably in the transportation sector. In contrast, imported goods inflation, which had consistently remained in the range of 50 to 53 percent since February 2023, saw a slight increase to 54.1 percent in August.

Figure 21: Domestically Produced and Imported Goods and Services Inflation



Source: Statistics Sierra Leone , BSL

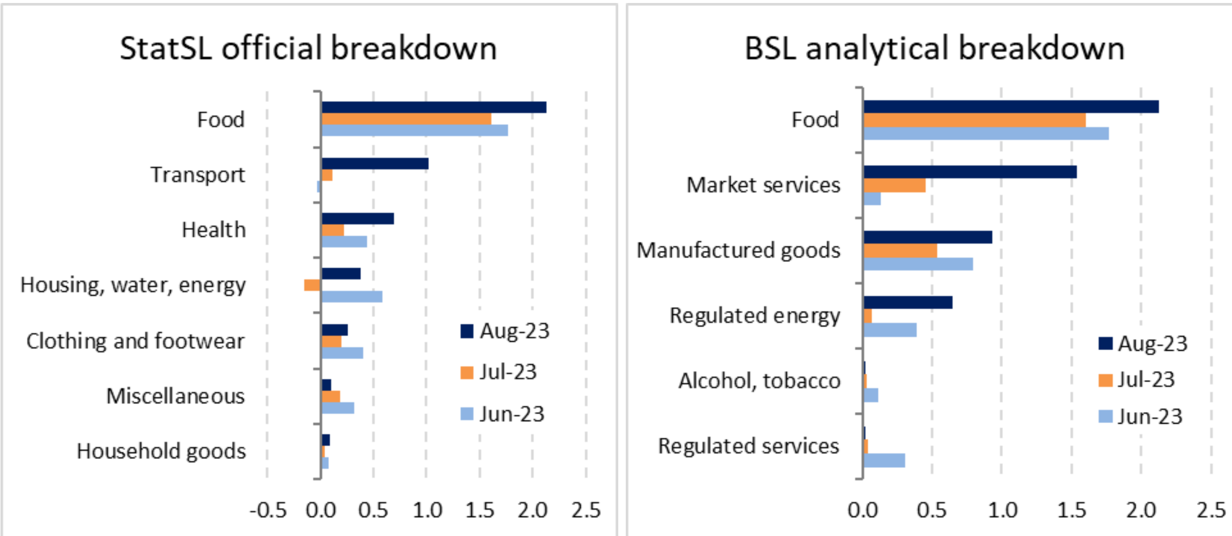
Figure 22: BSL Analytical Breakdown of Inflation



Source: Statistics Sierra Leone, BSL

Headline inflation is primarily driven by food due to its high inflation rate and substantial share in the consumer basket. Non-food inflation, on the other hand, has been chiefly influenced by market services, alcohol and tobacco, and regulated goods and services. Until July, market services inflation remained relatively low, possibly attributable to weak domestic demand from households (as depicted in Figure 22).

Figure 23: Contribution to Monthly Inflation



Source: Statistics Sierra Leone, BSL

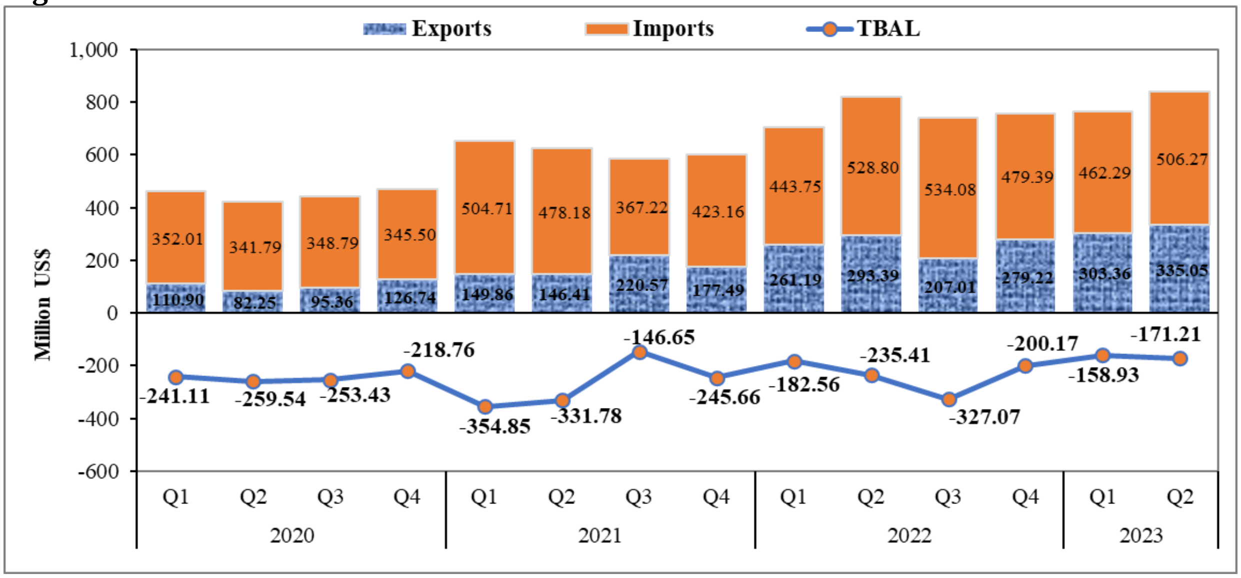
Market services inflation experienced a significant spike in August, influenced by government measures and elevated crude oil prices, resulting in higher bus and taxi fares. Additionally, the prices of medicines witnessed an increase, as indicated by the notable contribution of the transport and health COICOP groups to the monthly inflation figures in August 2023 (refer to Figure 23). In the case of regulated goods and services, the planned gradual reduction of energy and fuel subsidies is anticipated to contribute to higher inflation within this category. The previously announced increases in fuel, transportation, and electricity prices are expected to further exacerbate the existing inflationary pressures in the months of September and October.

2.2 External Sector Developments

2.2.1 Merchandise Trade

Sierra Leone's trade deficit with the rest of the world expanded by 7.7 percent, reaching US$171.2 million in 2023Q2. This growth was primarily driven by an increase in the import bill, which surpassed the rise in export receipts. Nonetheless, it is worth noting that this figure still marked the most favorable Q2 performance in the past four years. The increases in both imports and exports can be largely attributed to higher US dollar prices, aligning with the global commodity price trends.

Figure 24: Merchandise Trade

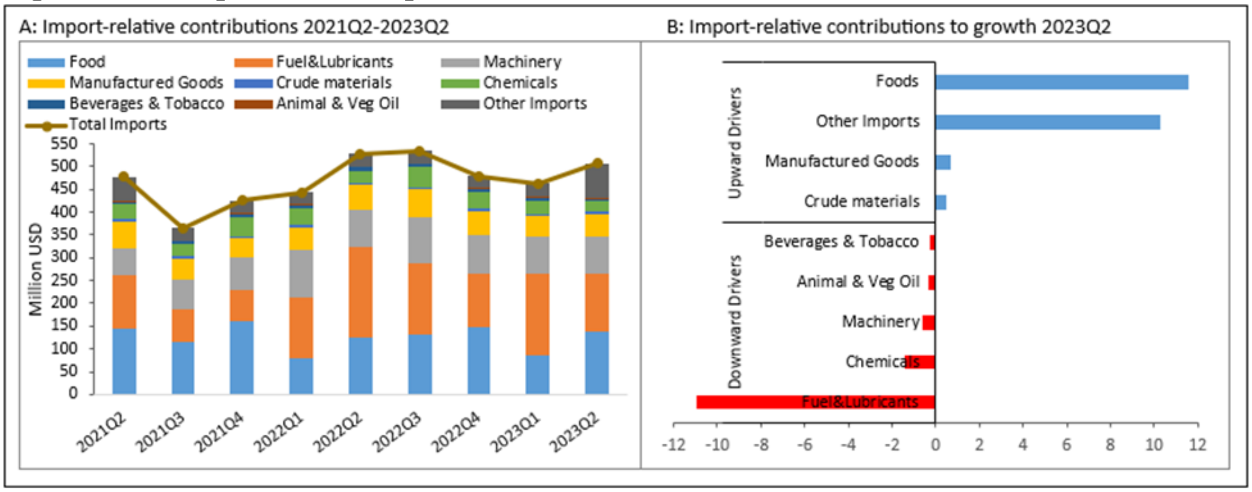


Source: NRA/Customs & BSL

Components of Import

The value of merchandise imports reached US$506.3 million in 2023Q2, marking a 9.5 percent increase from 2023Q1. The rise in merchandise imports was primarily instigated by increases in food and other imports, while fuel and lubricants had a substantial negative impact (as illustrated in Figure 255). The growth in food imports can be largely attributed to higher global prices, whereas the decline in fuel imports is more likely associated with sluggish economic growth in Sierra Leone.

Figure 25: Components of Import

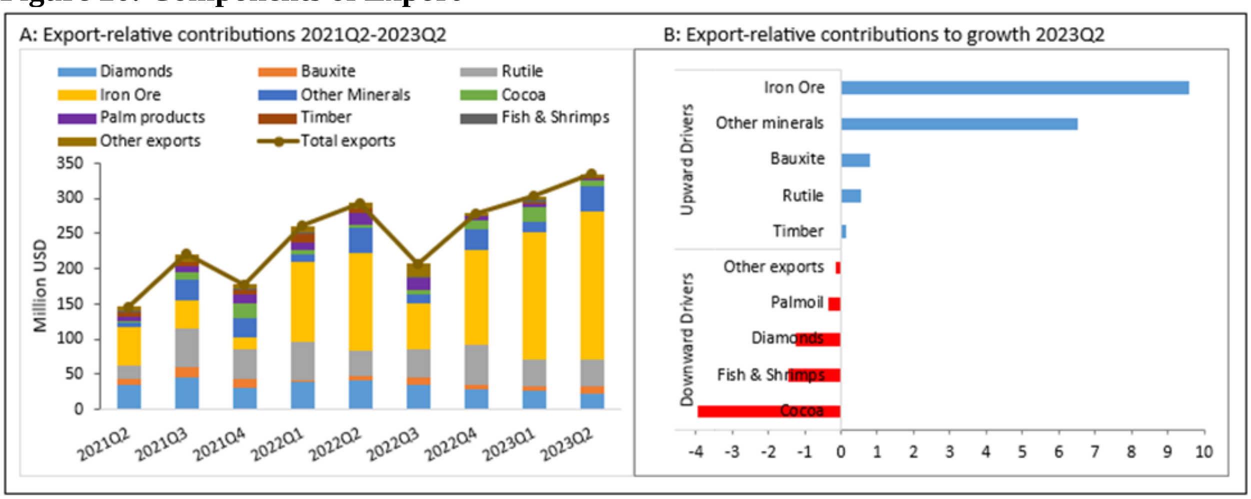


Source: NRA/Customs & BSL

Components of Export

The total value of merchandise exports witnessed a notable 10.2 percent increase, rising to US$345.5 million in 2023Q2 compared to 2023Q1. This growth in merchandise exports was primarily driven by iron ore and other minerals exports, which exceeded the decline in exports of diamonds, cocoa, and fish and shrimps. The iron ore mining sector's robust performance is anticipated to persist in the upcoming quarters.

Figure 26: Components of Export

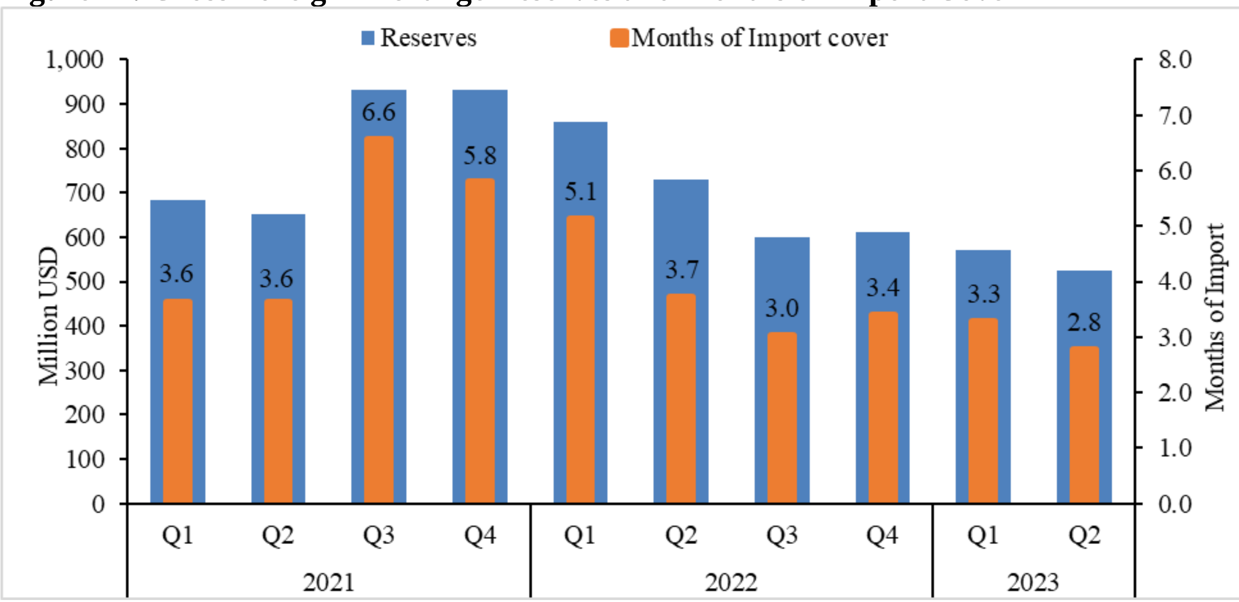


Source: NRA/Customs & BSL

2.2.2 Gross Foreign Exchange Reserves

The gross foreign exchange reserves of the Bank of Sierra Leone dwindled to US$523.8 million in 2023Q2, primarily due to an excess of outflows over inflows. As a result, the import cover of the reserves decreased to 2.8 months of imports of goods and services in 2023Q2, in contrast to the 3.3 months recorded in 2023Q1 (as illustrated in Figure 277).

Figure 27: Gross Foreign Exchange Reserves and Months of Import Cover

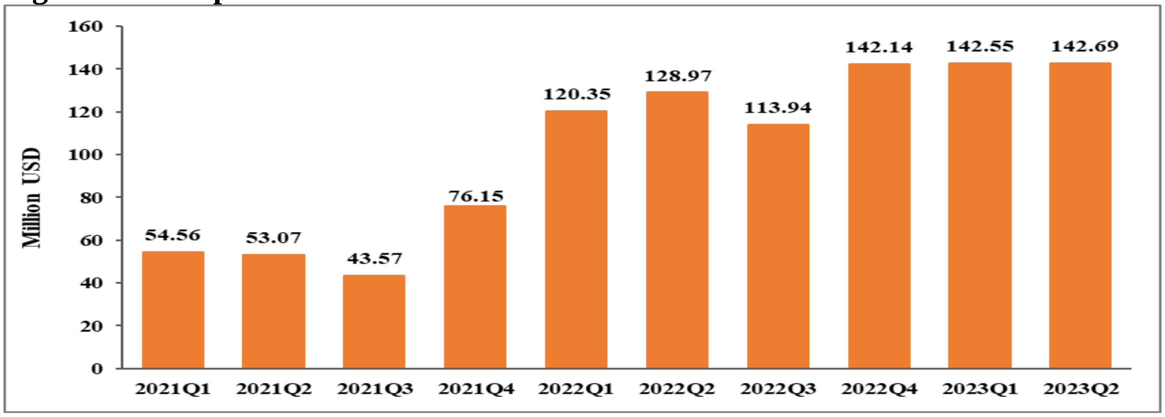


Source: Bank of Sierra Leone

2.2.3 Diaspora Remittances

Diaspora remittance inflows have remained robust and stable, consistently hovering around US$142 million since 2022Q4 (as depicted in Figure 288). It is anticipated that remittances will persist at their current trend, with migrants abroad sending funds to their families back home to mitigate the increasing cost of living.

Figure 28: Diaspora Remittances into Sierra Leone

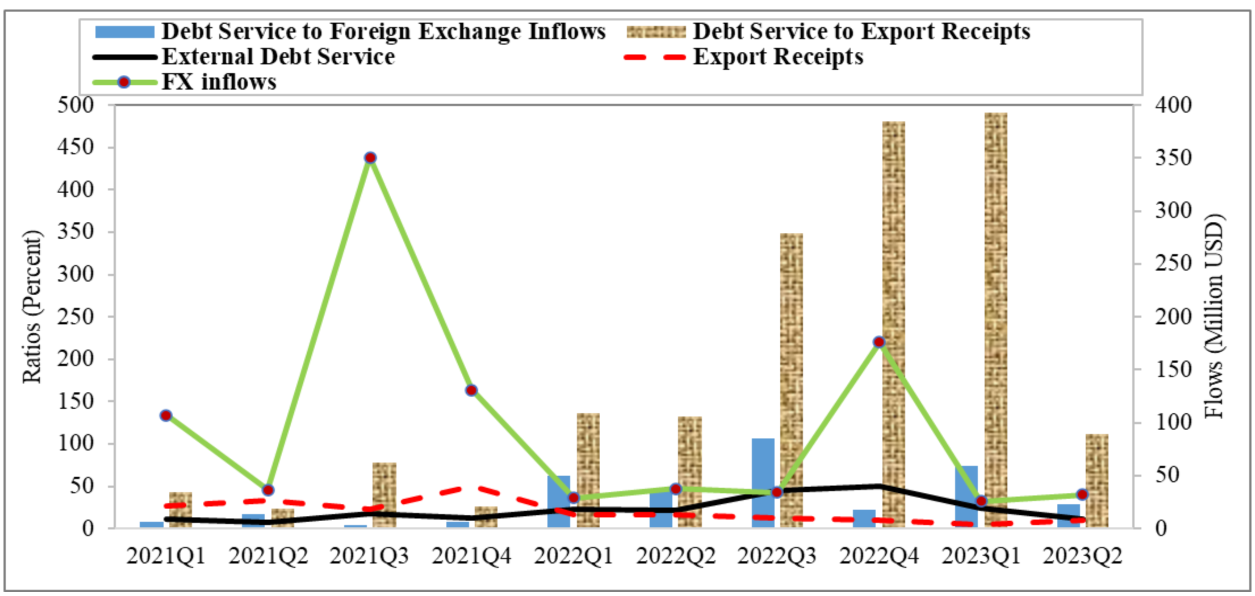


Source: Bank of Sierra Leone

2.2.4 External Vulnerability Ratios

External debt service payments decreased significantly to US$9.0 million in 2023Q2, down from US$19.0 million in 2023Q1. Conversely, forex inflows increased to US$32.0 million in 2023Q2 from US$25.9 million in 2023Q1, while export tax receipts increased to US$8.1 million in 2023Q2 from US$3.9 million in 2023Q1. Accordingly, both the ratios of debt service payment to export tax receipts and debt service payment to FX inflows decreased.

Figure 29: External Vulnerability Ratios

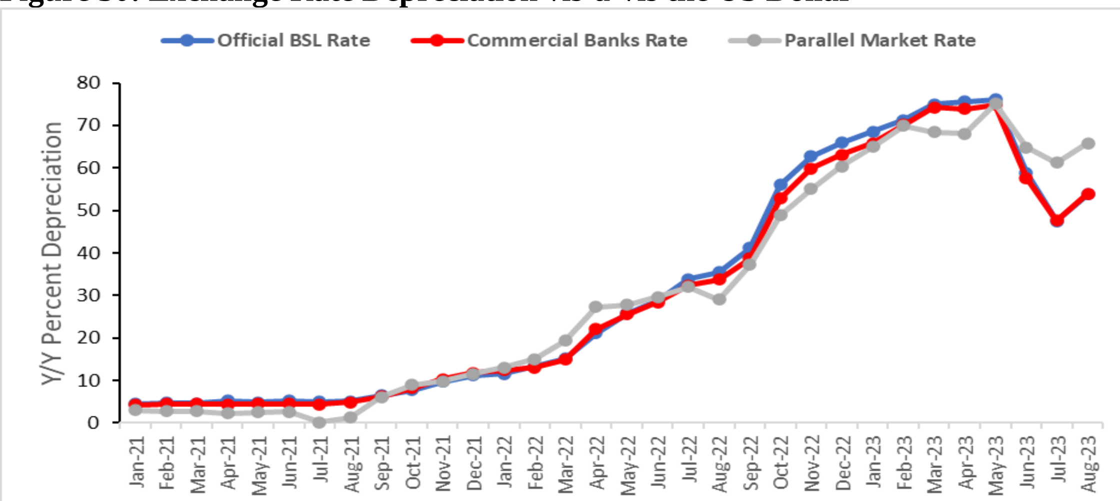


2.3 Exchange Rates and Foreign Exchange Market Developments

2.3.1 Exchange Rate Movements

The Leone continued its depreciation in the early period of 2023Q2, despite the improvement in the foreign trade balance and strong remittances. One of the key drivers of depreciation is the shift of local currency savings into foreign currency due to its expected higher return compared to local currency assets and its ability to hedge against domestic inflation. This is highlighted by the increasing share of foreign exchange-denominated deposits in the banking sector. Bilaterally, the Leone depreciated against the British Pound (13.5 percent), the Euro (11.5 percent), the US dollar (9.9 percent), and the Chinese Renminbi (10.0 percent).

Figure 30: Exchange Rate Depreciation vis-à-vis the US Dollar



Source: Bank of Sierra Leone

Box 2: Exchange Rate Developments since June 2023

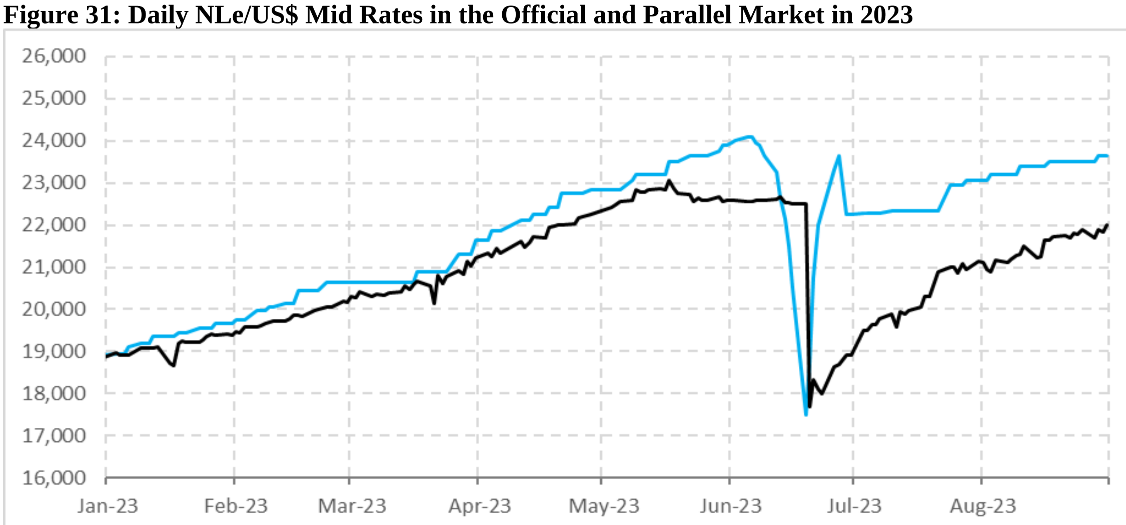
The Leone broke its depreciation trend in May-June, and the second half of June brought the largest daily volatility of the exchange rate in years (Figure 31).

- First, the official exchange rate broke the trend as it started to appreciate slightly in nominal terms in the middle of May, while the parallel rate continued its slide. Then, in early June, the parallel rate also started to appreciate but this has quickly turned into a free fall, and a few days later the official exchange rate also followed suit.
- The parallel market rate has quickly rebounded although it settled at a rate stronger than before, corresponding to rates seen in April. The parallel rate started to depreciate again in July albeit at a lower rate than earlier in 2023. In contrast, the official exchange rate started to gradually depreciate again immediately after its fall. As the rate of depreciation of the official rate exceeds that of the parallel market rate, the spread between the two market has been continuously narrowing since June.

The brake in the trend of depreciation in May and early June can be attributed to lower import demand ahead of the national elections, as some of the importers decided to hold back purchases and reduce inventories. Also, the successful conclusion of the 6th and 7th review of the IMF's ECF program implied the release of US dollar 20 million funds for the authorities. Finally, the large number of foreign election observers led to an increase in tourism inflows.

As the depreciation stalled, the profitability of the strategy of purchasing foreign currency for hedging income against inflation became more uncertain, possibly leading to panic sales, and driving down the exchange rate. The large volatility has most likely increased the risk of investing into foreign currency permanently.

Figure 31: Daily NLe/US$ Mid Rates in the Official and Parallel Market in 2023



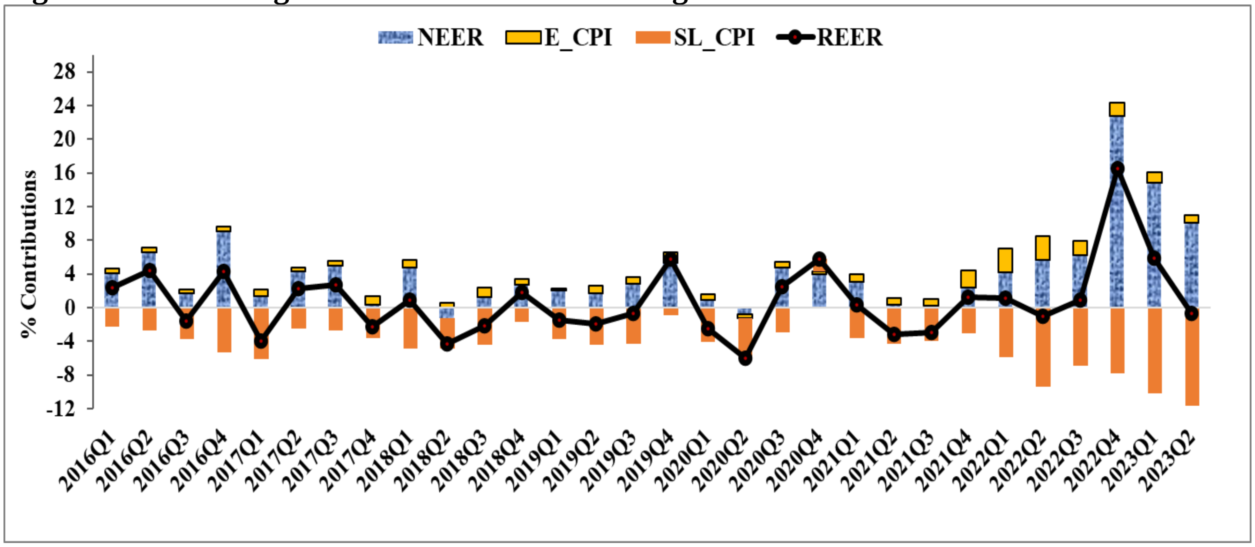
Source: Bank of Sierra Leone

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 10.7 percent in 2023Q2 compared to the previous quarter.

However, the real effective exchange rate (REER), which measures the competitiveness of Sierra Leone's traded goods relative to those of its trading partners, appreciated marginally by 0.6 percent in 2023Q2 compared to 2023Q1. The REER appreciation was mainly due to a slowdown in nominal depreciation while domestic inflation remained elevated.

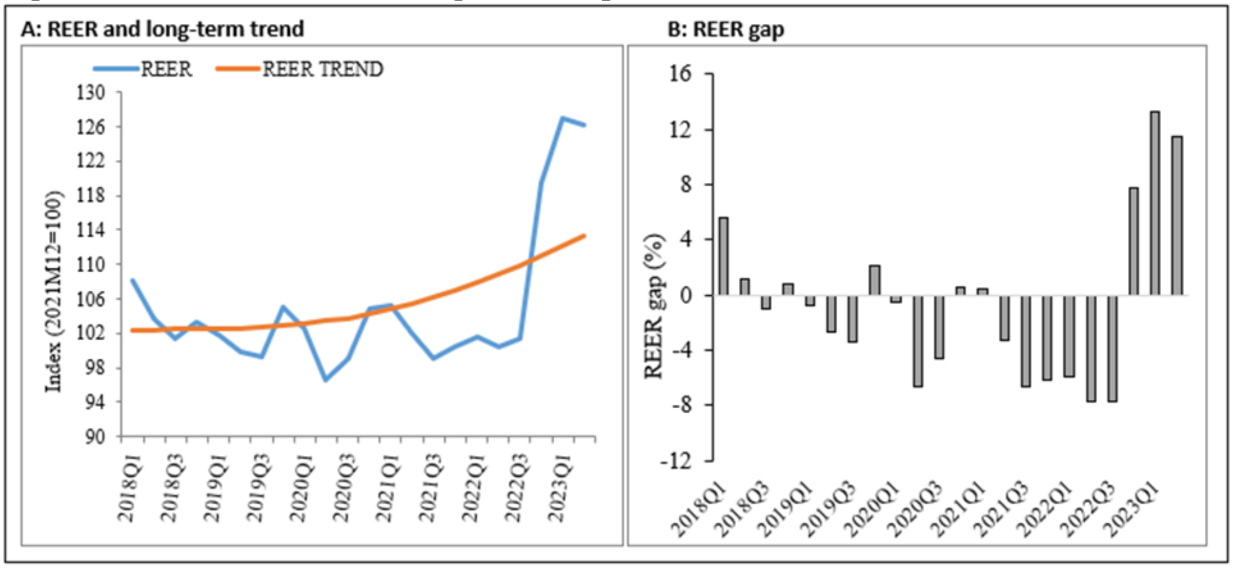
Figure 32: Percentage Contributions to the Change in REER



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

Despite the appreciation in 2023Q2, the REER has remained above its recent trend, implying a significant adjustment over the last three quarters. However, due to the persistently high inflation and the break in the depreciation trend in 2023Q2, which resulted in the Leone still being below its 2023 peak in 2023Q3, the REER is expected to appreciate further in 2023Q4, closing most of the gap relative to its trend.

Figure 33: Real Effective Exchange Rate Gap



Source: BSL, staff estimation

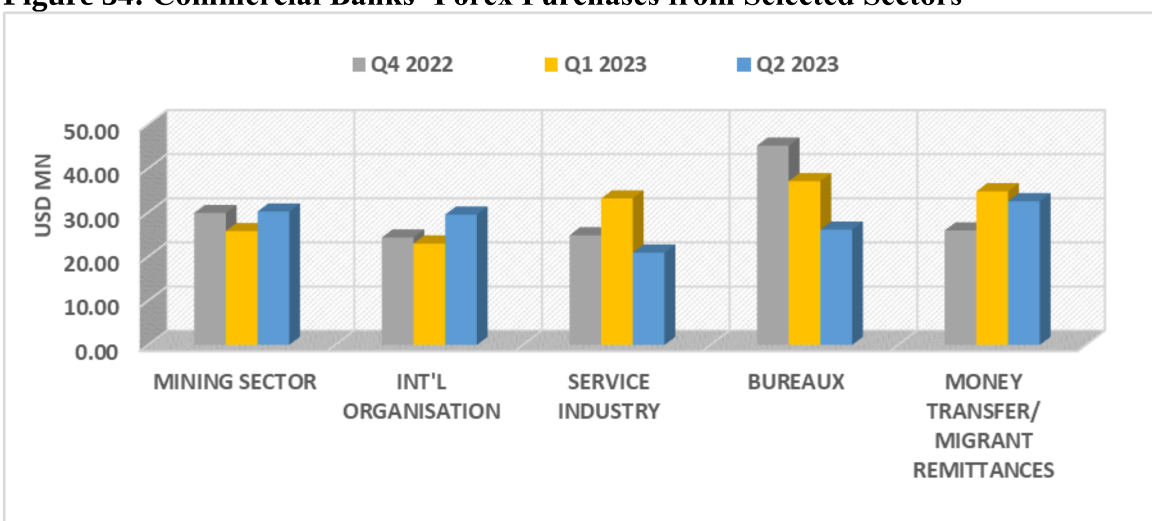
2.3.3 Foreign Exchange Market Turnover

The foreign exchange market comprises the official market, including banks and FX bureaus, and the parallel market, which is unofficial. Although prices are observable, there is no data on parallel market turnover. Still, anecdotal evidence indicates that it is deeper and more liquid than the official one.

The total amount traded in the foreign exchange market (including purchases and sales) during 2023Q2 was USD 348.1 million, marking a 24.1 percent decrease compared to 2022Q2 and a 6.0 percent decline from 2023Q1.

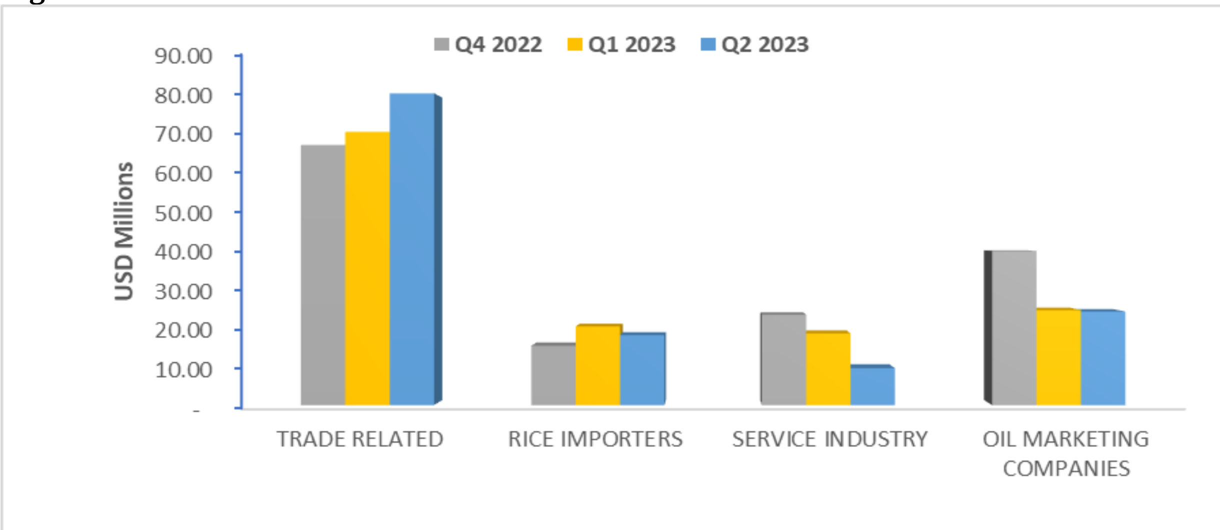
Banks typically acquire FX from various sources, such as the mining sector, international organizations (mostly NGOs), FX bureaus, and the service industry. Foreign exchange from remittances is usually acquired either directly from remittance companies or indirectly from FX bureaus. Banks typically sell FX to importers, including rice importers, oil marketing companies, and the service industry.

Figure 34: Commercial Banks' Forex Purchases from Selected Sectors



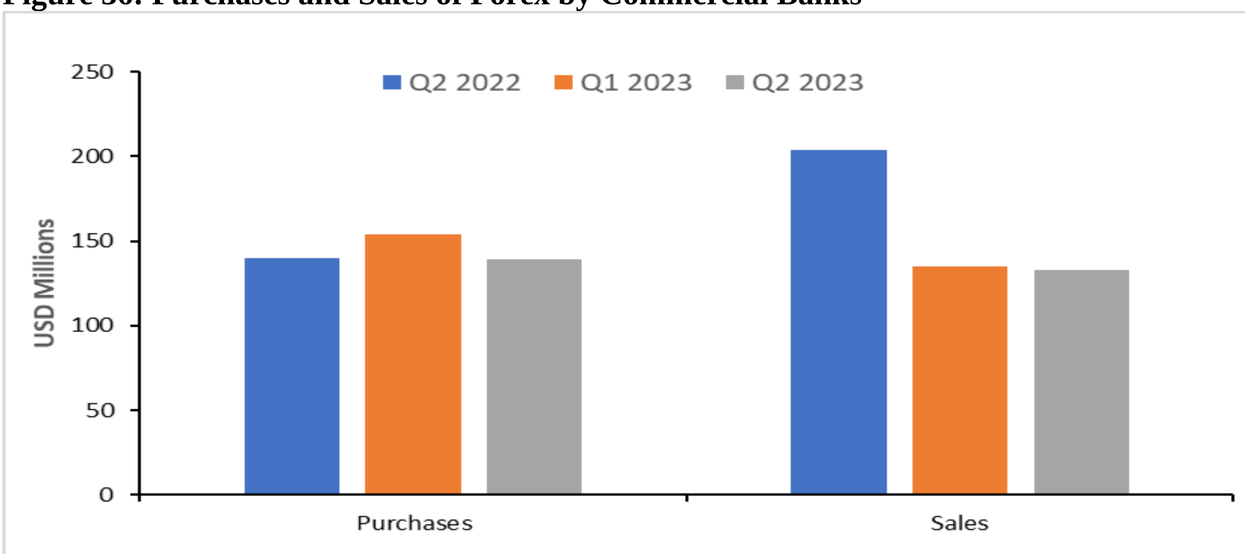
Source: Bank of Sierra Leone

Figure 35: Commercial Banks Sales from Selected Sectors



Source: Bank of Sierra Leone

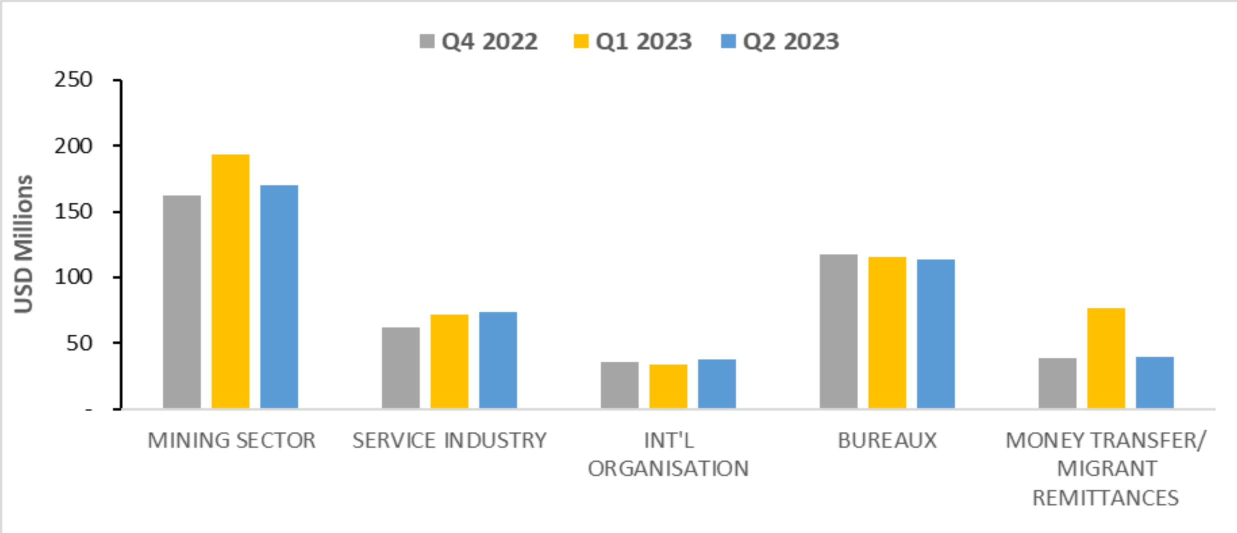
Figure 36: Purchases and Sales of Forex by Commercial Banks



Source: Bank of Sierra Leone

Receipts into customer foreign currency accounts decreased in 2023Q2 by 5.2 percent to USD 524.4 million from the USD 553.0 million recorded in the corresponding period in 2022. The major contributors to the decline in receipts were the mining sector, service industry, and migrant remittances. On the other hand, receipts into customer foreign currency accounts also decreased by 9.1 percent from USD 576.7 million in 2023Q1 due to a decline in receipts from the mining sector, bureaus, and migrant remittances.

Figure 37: Receipts into CFC Accounts – Selected Sectors



Source: Bank of Sierra Leone

2.3.4 Outlook of the Foreign Exchange Market

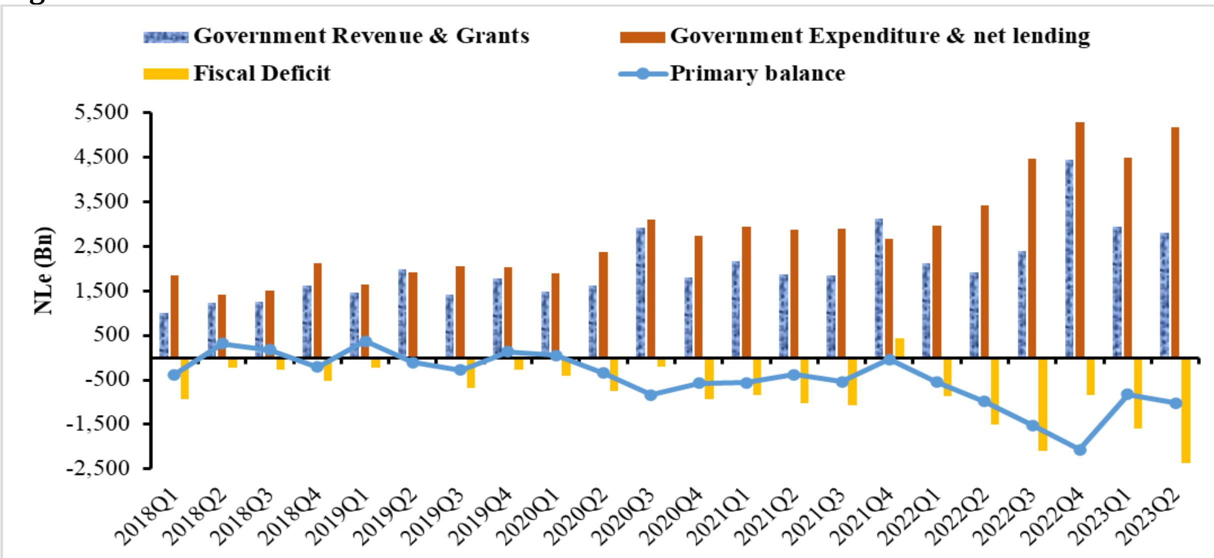
The volatility of exchange rates subsided in 2023Q3. However, the depreciation of the exchange rate resumed, even though both the official and parallel nominal exchange rates against the US dollar were still below their 2023 peaks in May-June. The depreciation is expected to continue due to the large inflation differential with trading partners, albeit at a slower pace as fiscal policy tightens and the supply of forex in the market increases by the end of 2023, with the expected inflows from donor disbursements. Also, foreign trade is expected to hold up well, while remittance inflows stay strong.

2.4 Fiscal Developments

2.4.1 Fiscal Policy Stance

The overall fiscal deficit widened in 2023Q2 to NLe2.4 billion compared to NLe1.6 billion in 2023Q1, based on provisional data. The broader deficit reflected increased expenditure coupled with a contraction in revenue. Similarly, the primary balance worsened with the deficit widening to NLe1.01 billion in 2023Q2 compared to NLe0.82 billion in 2023Q1 (Figure 38).

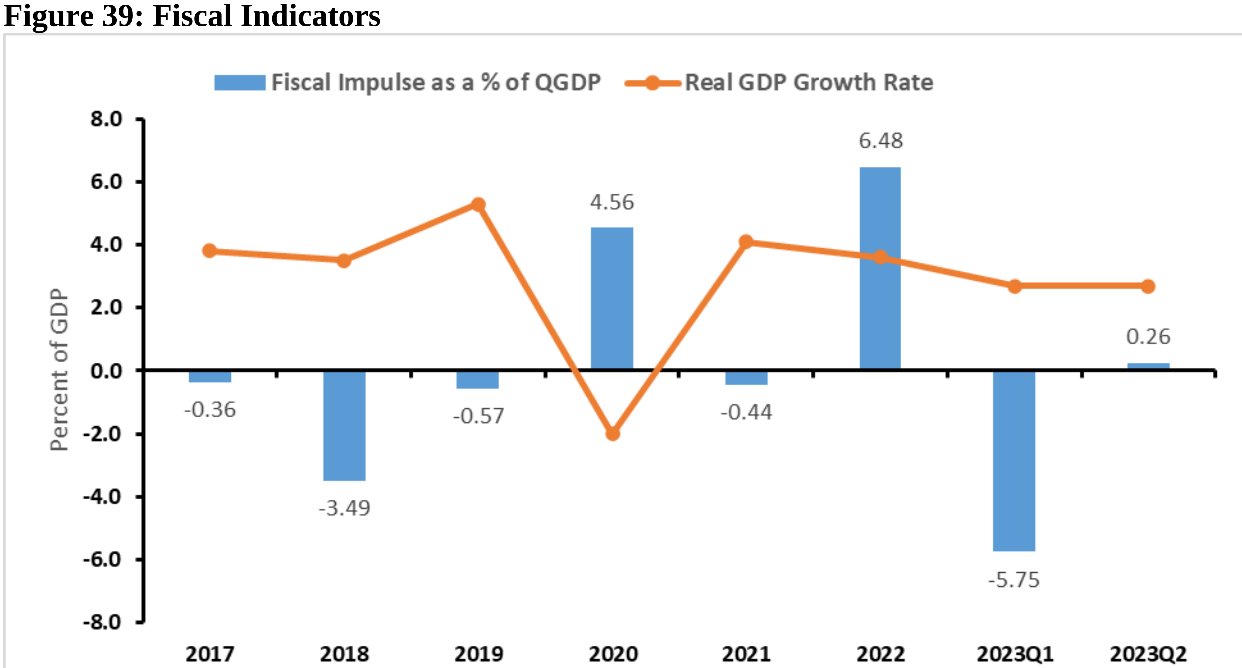
Figure 38: Fiscal deficit



Source: Bank of Sierra Leone

Government fiscal policy was slightly expansionary in 2023Q2 relative to 2023Q1 (Figure 39). Discretionary government spending expanded significantly, primarily due to spending on the security sector ahead of the elections, an increase in goods and services expenditure, and overruns on capital expenditure.

Figure 39: Fiscal Indicators



Sources: Ministry of Finance & Bank of Sierra Leone

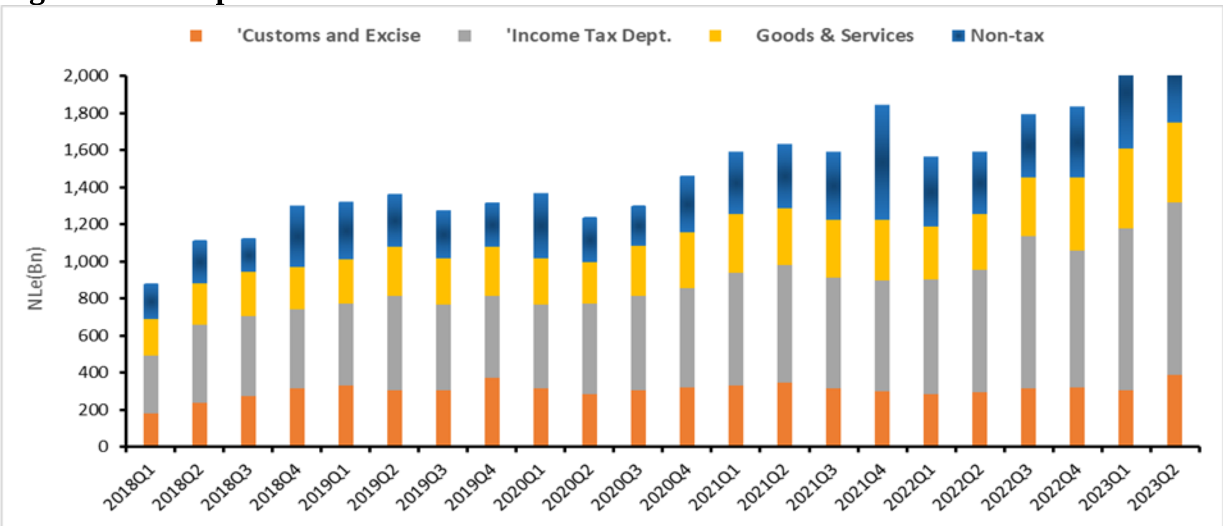
2.4.2 Government Revenues and Grants

Total revenue and grants contracted by 4.9 percent to NLe2.8bn in 2023Q2 compared to 2023Q1, falling short of the quarterly target of NLe3.2bn. This reduction was mainly due to a decrease in foreign grants received.

Domestic revenue increased by 3.6 percent to NLe2.4bn in 2023Q2 compared to the previous quarter, although it still fell short of the NLe2.5bn target. The growth in domestic revenue was attributed to the recovery of tax arrears, the implementation of innovative mechanisms to enhance tax compliance through the Electronic Cash Register (ECR) using the ECR Dashboard, as well as receipts from licenses and royalties from mining and other sectors.

- Tax revenue increased by 8.7 percent to NLe1.75bn in 2023Q2 compared to 2023Q1. This increase in taxes was broad-based and reflected in all tax components.
- Non-tax revenue, on the other hand, declined by 9.5 percent to NLe0.55bn in 2023Q2 due to a drop in receipts from other departments.
- Foreign grants received, however, contracted by 33.0 percent to NLe0.44bn in 2023Q2 from NLe0.65bn in 2023Q1, falling significantly below the quarterly target of NLe0.67bn.

Figure 40: Components of Domestic Revenue

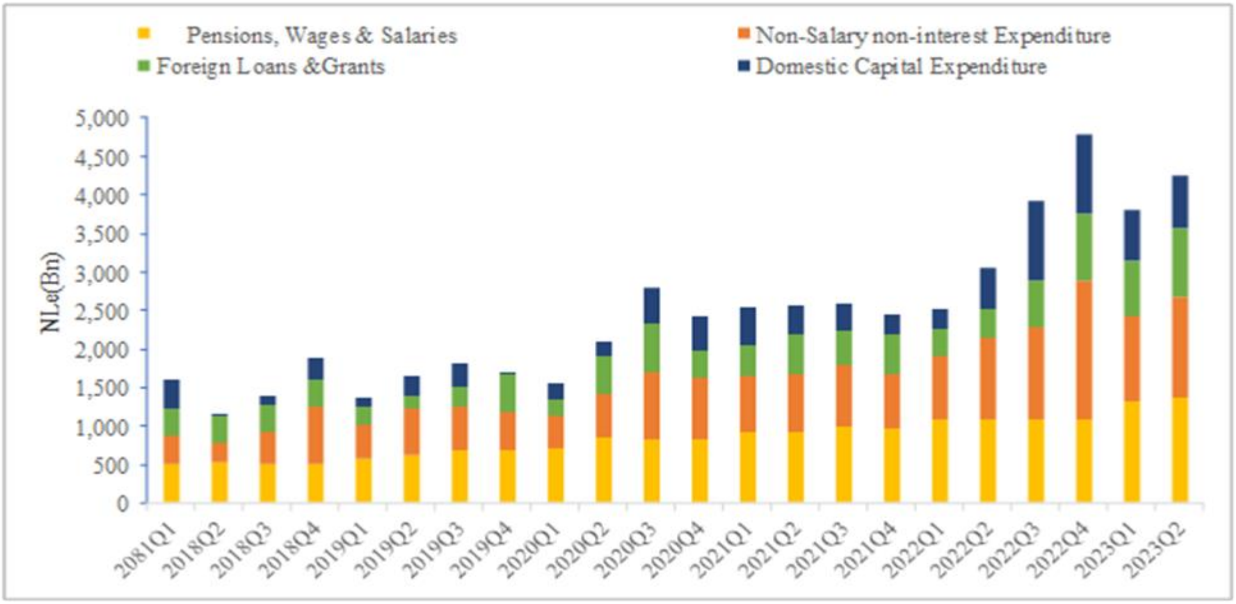


Source: Bank of Sierra Leone

2.4.3 Government Expenditures

Total government expenditure increased by 14.92 percent to NLe5.17bn in 2023Q2, up from NLe4.50bn, slightly exceeding the quarterly ceiling of NLe5.12bn. Both recurrent and capital expenditures saw increases, with discretionary spending being the primary driver behind the rise in total expenditure.

Figure 41: Components of Government Expenditure



Source: Bank of Sierra Leone

Capital expenditure increased by 35.8 percent to NLe1.85bn in 2023Q2, up from NLe1.37bn in 2023Q1. Recurrent expenditure rose by 5.9 percent to NLe3.3bn in 2023Q2, largely due to an increase in non-salary, non-interest expenditures. The wage bill increased marginally, while debt service payments moderated.

2.4.4 Financing and Public Debt Analysis

The fiscal deficit was primarily financed from domestic sources. Domestic deficit financing amounted to NLe1.33bn, representing 57 percent of the total financing. Foreign financing amounted to NLe490mn, and other sources amounted to NLe50mn.

Total public debt reached NLe53.9bn, or 72.2 percent of GDP, in June 2023, representing a 4.3 percent increase compared to December 2022. This growth reflected the increase in domestic borrowing by 13.4 percent from December 2022, reaching NLe18.2bn in June 2023.

2.4.5 Fiscal Sector Outlook

Domestic revenue is expected to improve following the full implementation of the Finance Act in 2023Q4, the restoration of the full pass-through petroleum pricing formula ensuring excise duty on petroleum products, and other reform measures. Simultaneously, the government is expected to exercise tighter control over expenditure in line with the IMF-ECF program. This will involve compensating for lower revenue by reducing spending on goods and services and phasing out energy subsidies.

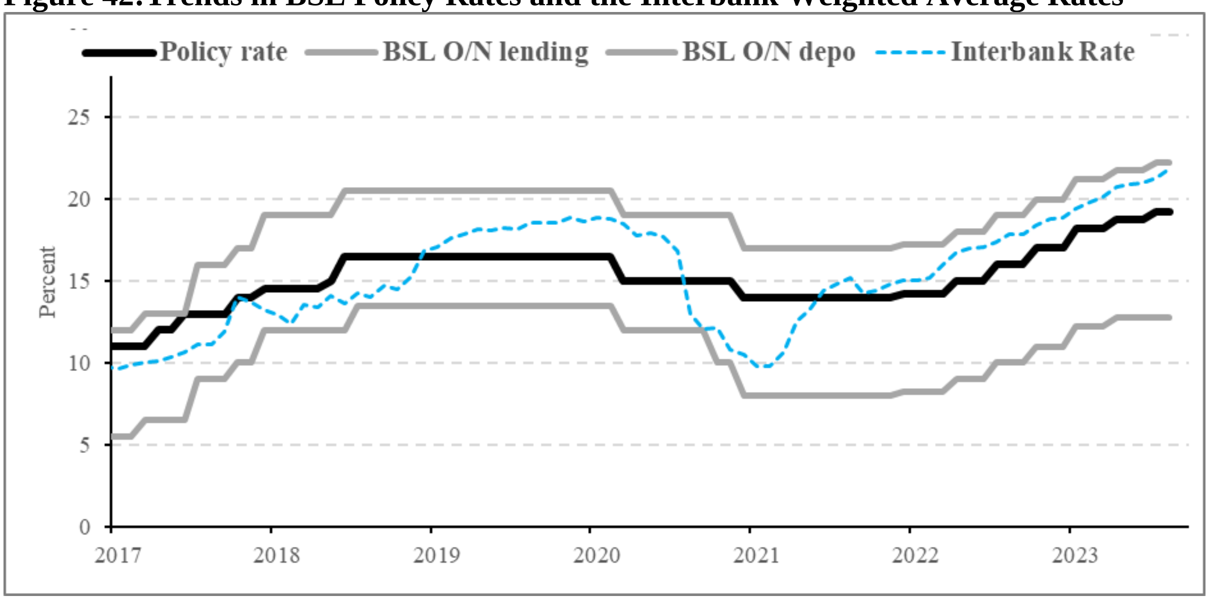
Meanwhile, several external and local risk factors challenge the outlook. These include the creation of new MDAs, geopolitical conflicts, tensions in the sub-region, declining international donor support, weaker than expected domestic demand, a faster than expected depreciation of the exchange rate, debt service payments, and intensifying inflationary pressures, all of which may complicate the execution of the supplementary budget in the next two quarters.

2.5 Monetary Policy and Money Markets Developments

2.5.1 Monetary Policy Stance

During the last meeting on July 6, 2023, the MPC raised the Monetary Policy Rate (MPR) from 18.75 percent to 19.25 percent. The standing lending facility rate was also raised to 22.25 percent, while the standing deposit facility rate was maintained at 12.75 percent.

Figure 42:Trends in BSL Policy Rates and the Interbank Weighted Average Rates



Source: Bank of Sierra Leone

2.5.2 Interest Rates Developments

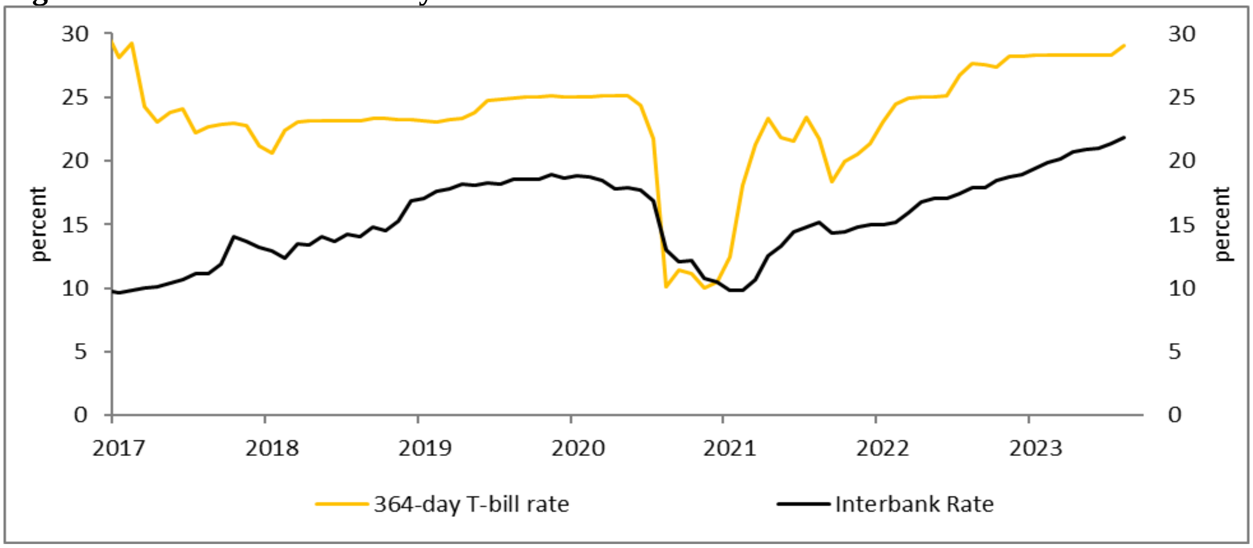
Treasury Bill Rates

The annual yield of the 364-day treasury bills remained unchanged at 28.28 percent from March to June but saw an increase of 74 basis points to 29.02 percent in August 2023. However, the 182-day and 91-day Treasury bill markets remained highly illiquid, with their rates failing to reflect the underlying economic and financial environment.

Interbank Money Market

The increase in policy rates resulted in a gradual rise in money market rates, with both 364-day T-bill yields and interbank rates moving higher. The interbank weighted average rate increased by 86 basis points, climbing from 20.16 percent in March 2023 to 21.02 percent in June 2023. It further rose by 82 basis points to 21.84 percent in August 2023. This increase can be attributed to the elevated MPR, combined with the emergence of liquidity pressure in the banking system.

Figure 43: Yield on the 364-day T-bill and Interbank Rates

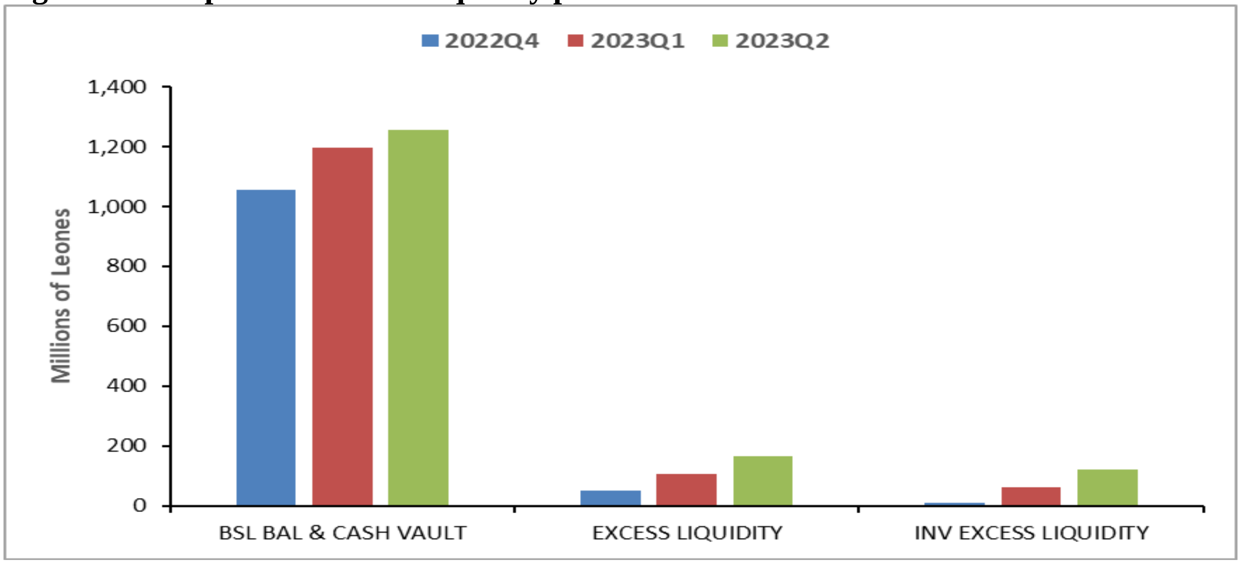


Source: Bank of Sierra Leone

2.5.3 Liquidity in the Banking System

Total liquidity in the banking system decreased by NLe112 million in 2023Q2, reaching NLe1,085 million. The aggregate volume of excess liquidity decreased from NLe108 million to NLe24 million, primarily attributed to the growth in government revenues, resulting in an increase in the government's deposits with the BSL.

Figure 44: Snapshot of DMBs Liquidity position



Source: Bank of Sierra Leone

2.6 Monetary Aggregates

Key monetary aggregates, including Reserve Money (RM) and Broad Money (M2), continued to experience rapid growth during the second quarter of 2023.

Reserve Money (RM)

Reserve Money (RM) expanded by 17.2 percent in 2023Q2 compared to the previous quarter and a remarkable 57.3 percent growth on a year-on-year basis. The yearly expansion of RM exceeded the IMF's end-June 2023 program target of 34.1 percent. Additionally, RM growth surpassed the inflation rate, resulting in real RM growth of 8.6 percent year-on-year, marking the highest rate observed in the past two years.

The surge in RM primarily reflects an increase in the Net Domestic Assets (NDA) of the BSL. The NDA expanded due to the government's heightened borrowing from the central bank to support fiscal operations. On the liability side, the growth in RM was primarily driven by the issuance of currency, while commercial banks' reserves deposited at the central bank exhibited only moderate growth.

Broad Money (M2)

Broad money grew by 2.6 percent in 2023Q2 compared to the previous quarter and a substantial 47.4 percent growth on a year-on-year basis. The yearly growth in M2 exceeded the 38.3 percent assumed in the IMF/ECF program. However, the real growth in broad money was nearly negligible as the higher nominal M2 growth primarily offset the impact of elevated inflation.

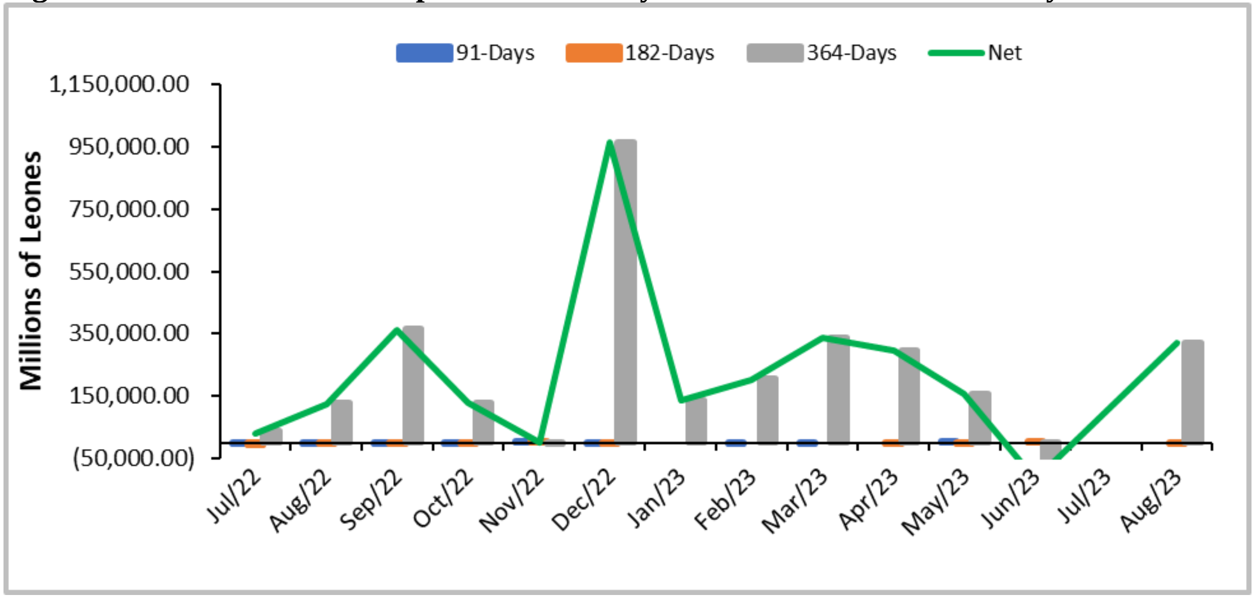
The surge in M2 was primarily attributed to the expansion of the Net Domestic Assets (NDA) of the banking system, although it was partially offset by a decline in the Net Foreign Assets (NFA). The NDA witnessed an 11.9 percent growth in 2023Q2 compared to the previous quarter, primarily driven by a 17.1 percent increase in financing fiscal operations by the banking system. In contrast, credit to the private sector experienced a marginal decline of 0.26 percent from the previous quarter, resulting in a noticeable slowdown in its annual growth rate to 14.8 percent. This signifies a significant reduction in real private sector credit, with a 10.3 percent decrease on a quarterly basis and a 20.7 percent drop on a yearly basis. The NFA of the banking system declined by 23.5 percent in 2023Q2, mainly due to a decrease in the NFA of commercial banks.

On the liability side, the expansion in M2 was primarily driven by an increase in Narrow Money (M1). M1 expanded by 11.1 percent in 2023Q2 compared to 2023Q1, and this expansion was a result of the growth in both currency outside banks and customers' demand deposits. In contrast, quasi money witnessed a 3.97 percent decline, primarily caused by a decrease in foreign currency deposits, while time and saving deposits increased. The drop in foreign currency deposits largely reflected the appreciation of the official exchange rate by the end of June.

2.7 Domestic Debt Market

The 364-day tenure was oversubscribed in the months of April and May 2023 but faced undersubscription in June 2023. In 2023Q2, both the 182-day and the 91-day tenures also experienced undersubscription, with the primary markets for these T-bills remaining dysfunctional. As a result, liquidity conditions in the banking system remained tight, prompting the intervention of BSL in the secondary market to bolster liquidity.

Figure 45: Under/Oversubscription of Treasury Bills Auctions in the Primary Market



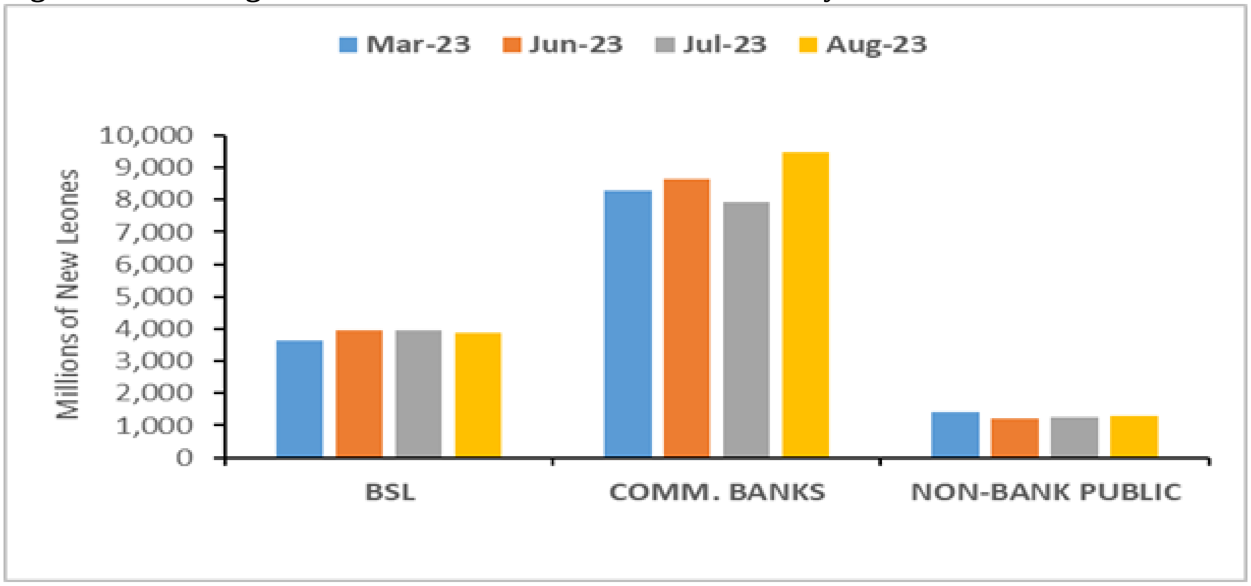
Source: Bank of Sierra Leone

The total stock of government securities increased by 5.1 percent in 2023Q2 compared to the previous quarter, and by a further 6.0 percent relative to June 2023, reaching NLe16,501 million as of August 28, 2023. Marketable securities account for 88.8 percent of the total. The issuance of new treasury securities primarily served to finance the budget.

As of the end of June 2023, the proportions of 91-day, 182-day, and 364-day treasury bills to total marketable securities were 0.01 percent, 0.02 percent, and 92.54 percent, respectively, while the 2-year treasury bonds accounted for 7.44 percent. Concerning non-marketable securities, the 3-year, 5-year, and 10-year treasury bonds represented 78.23 percent, 21.12 percent, and 0.65 percent, respectively.

Commercial banks hold majority of the marketable government securities, representing 64.7 percent of the total. Holdings by commercial banks increased by 4.3 percent in 2023Q2 and further by 9.7 percent to NLe9,476 million by August 28, 2023. Non-bank holdings decreased by 7.6 percent between March and August 2023. BSL's holdings increased by 9.2 percent in 2023Q2 and decreased by 2.2 percent to NLe3,866 million by August 28, 2023. This increase can be largely attributed to outright purchases of Treasury bills by the BSL for liquidity management purposes.

Figure 46: Holdings of Marketable Government Securities by Sector



Source: Bank of Sierra Leone

3 FINANCIAL STABILITY ANALYSIS

Overview of banking sector developments

The banking sector has maintained relative stability, with all key Financial Soundness Indicators (FSIs) remaining above the minimum thresholds, despite facing exchange rate challenges. This stability is underpinned by the ongoing reliance of banks on the Treasury Bills market, which has had positive impacts on the key FSIs.

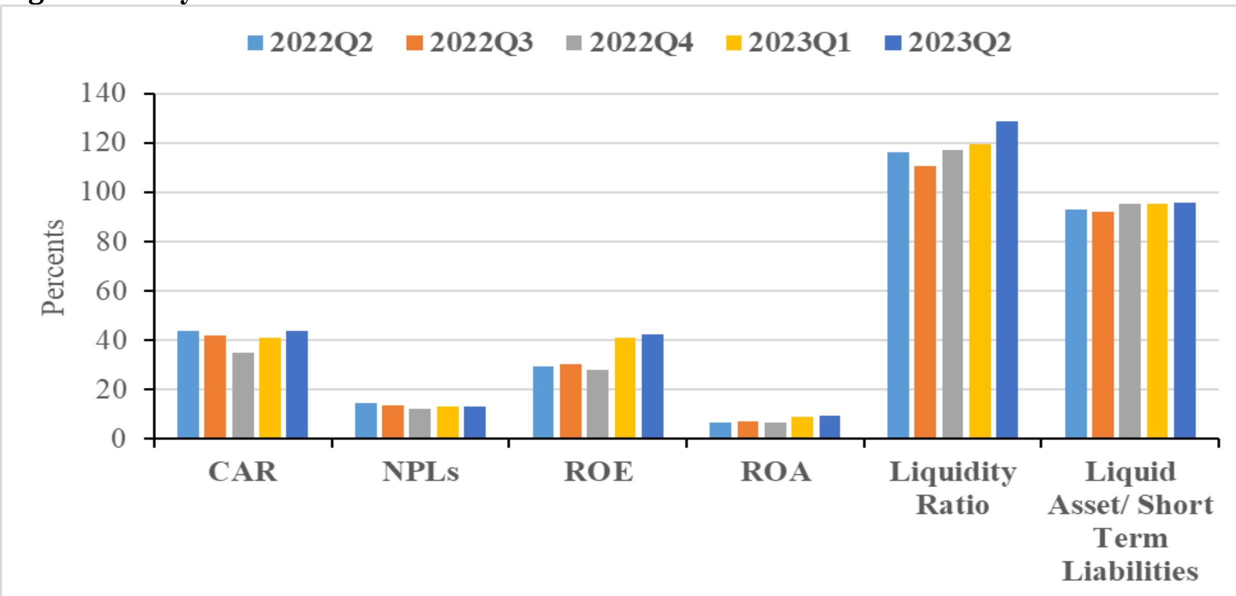
However, there was an increase in the proportion of Non-Performing Loans in 2023Q2, indicating a deterioration in asset quality. Government securities continue to represent the largest asset category for banks, serving as the primary source of income. While Treasury bills increased in 2023Q2, there was a marginal decrease in deposits within the banking system. Treasury bill rates remained relatively high and increased for most of the quarter.

3.1 Financial Soundness Indicators (FSIs)

The banking sector remained stable and adequately capitalised during the period. Most of the key Financial Soundness Indicators (FSIs) stayed above the minimum thresholds set by the BSL. The Capital Adequacy Ratio (CAR), denoting the regulatory capital to risk-weighted assets, increased by 7.3 percentage points to reach 43.9 percent in 2023Q2, up from 40.9 percent in Q1, 2023. The CAR remained well above the regulatory minimum capital requirement, indicating that banks have accumulated sufficient capital to absorb potential losses.

However**,** asset quality slightly deteriorated in 2023Q2, with the ratio of non-performing loans (NPLs) to total loans increasing to 13.4 percent, up from 13.1 percent in 2023Q1. NPLs exceeded the prudential limit of 10 percent by 3.4 percentage points. Banks' profitability improved in the review period, with both return on assets (ROA) and return on equity (ROE) increasing to 9.5 percent and 42.6 percent, respectively, for 2023Q2, compared to 9.2 percent and 41.2 percent in 2023Q1. The Liquidity Ratio in the banking sector also increased in 2023Q2 to 128.6 percent, up from 119.4 percent in 2023Q1. Likewise, the ratio of liquid assets to short-term liabilities marginally increased by 0.5 percentage points, rising from 95.4 percent in 2023Q1 to 95.9 percent in 2023Q2. Figure 1 below provides an overview of the key FSIs in the banking sector.

Figure 47:Key FSI's

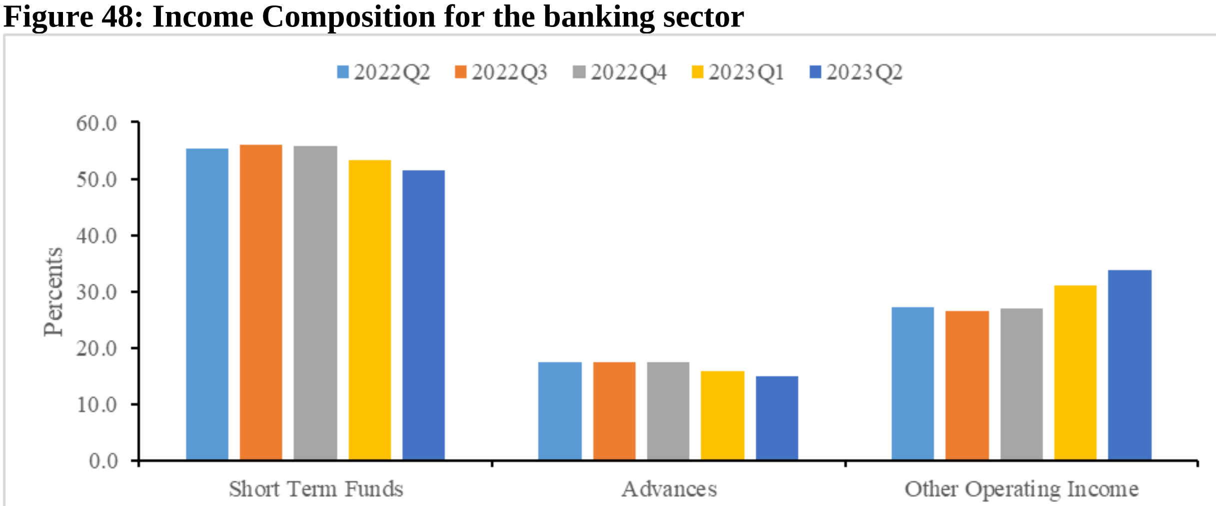


Source: Bank of Sierra Leone

3.2 Income composition

The banking sector continued to rely primarily on government securities for its income. This reliance is mainly due to the relatively high rates of return on government securities and the minimal investment risk they pose. In 2023Q2, the proportion of income from short-term funds marginally decreased by 3.4 percentage points, falling from 53.2 percent in 2023Q1 to 51.4 percent in 2023Q2.

Figure 48: Income Composition for the banking sector



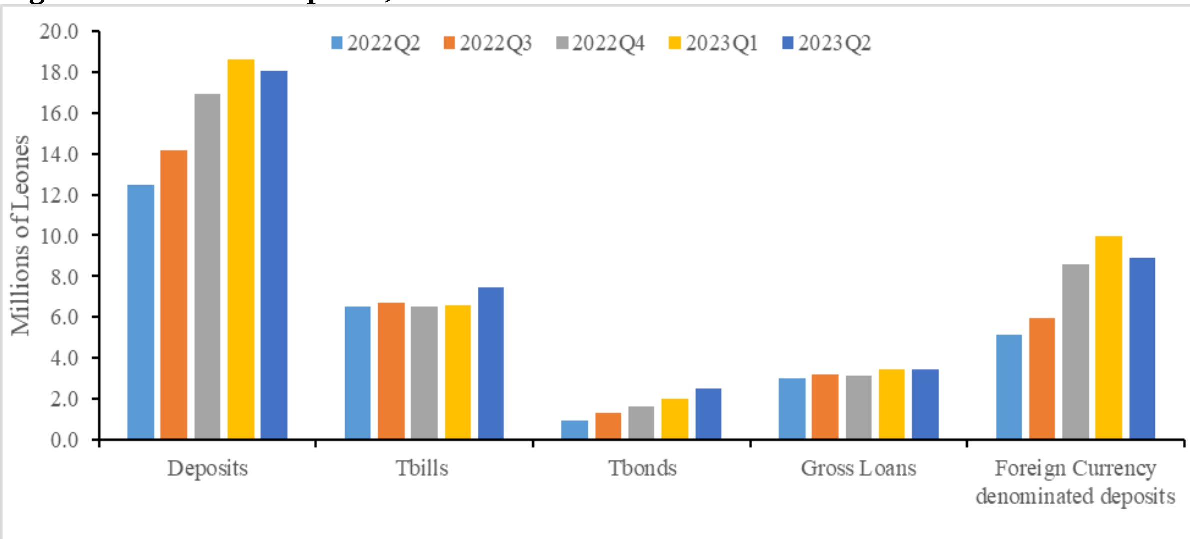
Source: Bank of Sierra Leone

Income from advances decreased from 15.8 percent in 2023Q1 to 14.9 percent in 2023Q2. On the other hand, other operating income, which mainly comprises commissions, fees, and profits from foreign exchange dealings, increased by 8.7 percentage points, rising from 31.0 percent in 2023Q1 to 33.7 percent in 2023Q2. The decrease in the proportion of income from short-term funds may be attributed to a reduction in both bank holdings of government securities and a decrease in the yield of 364-day instruments in 2023Q2.

3.3 Sources and utilization of funds

- Total Deposits, which is the main source of funds for banks decreased marginally in 2023Q2 by 3.1 percentage point from NLe18.6 million in 2023Q1 to NLe18.1 million in 2023Q2.
- Foreign currency-denominated deposits to total deposits declined in 2023Q2 by 10.7 percentage points to 49.3 percent (NLe8.9 million) from 53.4 percent (NLe10.0 million) in 2023Q1.
- Foreign currency-denominated liabilities to total liabilities decreased in 2023Q2 to 37.0 per cent from 42.7 percent in 2023Q1.
- T-bills held by the banking sector increased by 12.8 percent from NLe6.6 million in 2023Q1 to NLe7.5 million in 2023Q23, though interest rate remained unchanged at 28.28 percent for the two quarters.
- T-bond holding by the banking sector increased by 24.0 percent from NLe2.0 million in 2023Q1 to NLe2.5 million in 2023Q2.
- The loan to deposit ratio marginally increased in 2023Q2 to 19.2 percent from 18.7 percent in 2023Q1 and remained far below the prudential threshold of 80 percent.
- Gross loans and advances marginally decreased by 0.4 percent from NLe3.48 million in 2023Q1 to NLe3.46 million in 2023Q2.

Figure 49:Trend in Deposits, T-bills and Gross Loans



Source: Bank of Sierra Leone

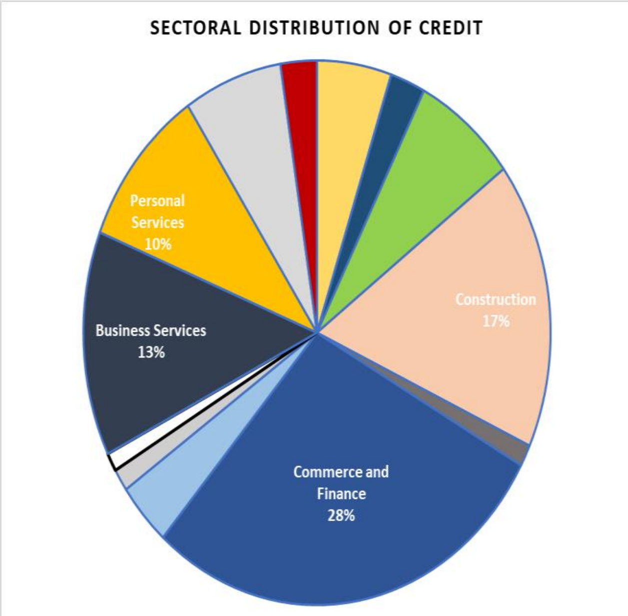
3.4 Sectoral distribution of gross loans & advances and NPLs

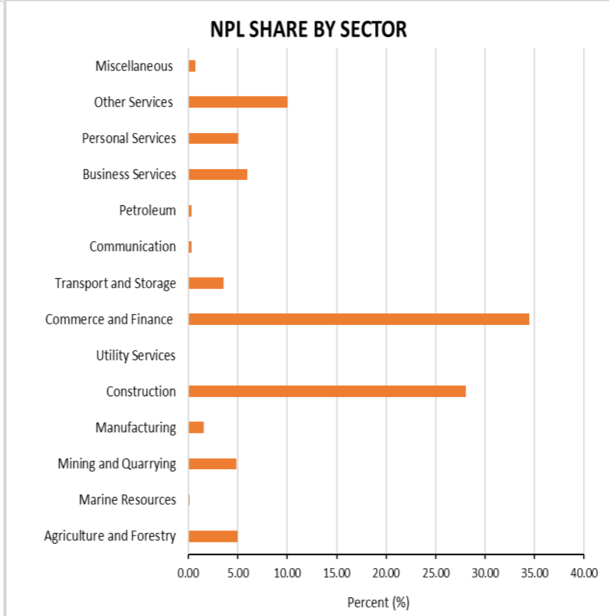
In 2023Q2, the Commerce and Finance, Business Services, Personal Services, and Construction sectors dominated the loan portfolios of the banking sector, collectively accounting for 62.48 percent of gross loans.

Similarly, when considering non-performing loans (NPLs), the Commerce and Finance, Construction, and Other Services sectors were the largest contributors. Specifically, the Commerce and Finance sector had the highest NPL ratio, despite holding only 34.47 percent of the total gross loans in the banking sector. Additionally, the Construction and Other Services sectors also had notable NPL ratios, with 28.03 percent and 10.04 percent, respectively, in 2023Q2.

Please refer to Figure 50 below for detailed information regarding the sectoral distribution of gross loans and the share of NPLs by sector.

Figure 50: Sectoral Share of Gross Loans



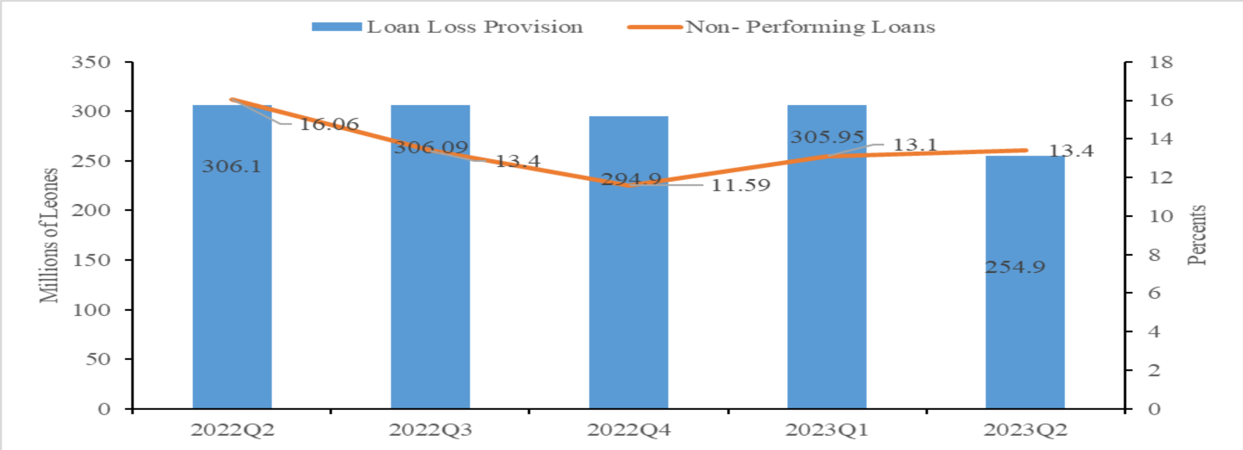


Source: Bank of Sierra Leone

3.5 NPL Trend and Loan Loss Provisions

The proportion of non-performing loans to gross loans saw a marginal increase during the 2023Q2 review period. The NPL ratio for 2023Q2 rose by 2.84 percentage points, increasing from 13.1 percent in 2023Q1 to 13.4 percent in 2023Q2. However, it's worth noting that loan loss provisions declined by 20.0 percentage points, amounting to NLe254.9 million in 2023Q2, down from NLe306.0 million in 2023Q1.

Figure 51:Trend of NPLs and Loan Loss Provision



Source: Bank of Sierra Leone

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.

- Asset quality remains a concern. There is large variation in asset quality, with five banks recording NPLs far above the maximum threshold with four of those banks being local banks.

Limited intermediation to support growth

- Banks are hesitant to support bankable products in the private sector.
- Credit remains concentrated in a few sectors.
- Banking sector earnings heavily reliant in securities

Cyber Security and Information Technology Threat

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

Increase in foreign currency deposits

- There has been continuous increase in foreign currency deposits since 2022Q1 to 2023Q2, posing potential threat to the system, given the continuous depreciation of the Leone.

3.7 Banking Sector Outlook

The banking sector is expected to remain relatively stable going forward, primarily because the majority of the banking system's assets are in government securities, which are considered relatively risk-free. Increased government borrowing will continue to provide risk-free investment opportunities for banks, thereby improving the risk-weighted assets of the banking sector. Interest income from investments in government securities will remain the primary source of income for banks. However, the challenges of rising inflation and the depreciating Leone can reduce fiscal space, potentially leading to the accumulation of arrears, which may, in turn, impact the non-performing loans (NPLs) of the banking sector.

4 CONCLUSION AND DECISION OF THE MPC

4.1 Conclusion

Real GDP growth was revised downward to 2.7 percent in 2023 compared to 3.6 percent in 2022, following the IMF review of the Extended Credit Facility (ECF) for Sierra Leone in June 2023. The downward revision reflects weak domestic demand, limited fiscal space, and spillovers from the Russia-Ukraine War. However, the MPC noted that the BSL's high-frequency Composite Index of Economic Activity (CIEA) indicates a slight improvement in economic activity in 2023Q2. Going forward, GDP growth is expected to increase to 4.7 percent in 2024, primarily due to expected improvements in mining and agriculture, in addition to other policy reform measures in the productive sectors of the economy.

Inflation remains a serious and persistent challenge, and there are upward risks to the outlook for inflation. These risks include further hikes in fuel and transportation costs, exchange rate depreciation, expansion in monetary aggregates, the continuous rise in the price of imported commodities, and inflation expectations. Given these risks and the level of persistence, the MPC is of the view that the stance of monetary policy going forward has to be contractionary (tight) over the next few quarters. Furthermore, careful coordination with the fiscal authority is required to reduce the fiscal deficit, which will also allow reserve money growth to subside, to a level consistent with the objective of achieving low and stable prices. This also reinforces the need for policy reforms geared towards boosting real sector activity.

4.2 Decision of the Monetary Policy Committee (MPC)

Based on the assessment of the risks to inflation and economic activity in the near term and in view of the BSL's primary mandate of ensuring price and financial stability while supporting economic growth, the MPC decided to increase the MPR by 2.0 percentage points to 21.25 percent and to adjust the Standing Lending Facility and Standing Deposit Facility rates by the same margin.

5 APPENDIX

Inflation Outlook

The inflation forecast indicates a 3.2 percentage point increase in inflation in September, and it is expected to continue rising from October until January 2024 when it is projected to peak at 59.8 percent.

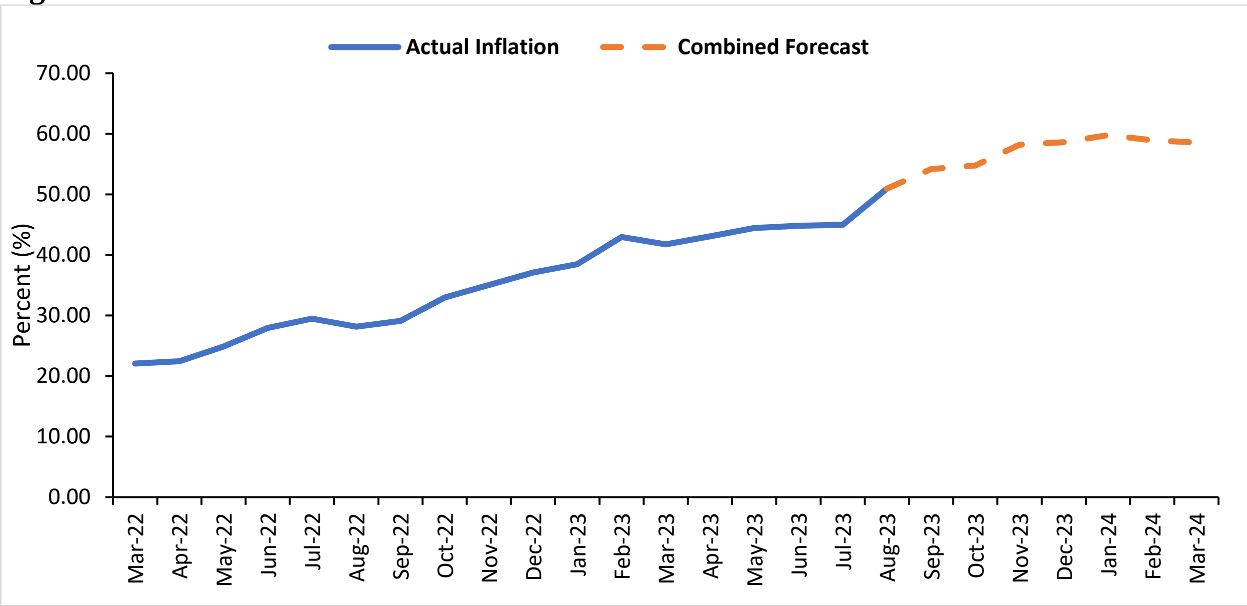
The previous forecast, presented in the 2023Q2 MPC meeting, proved to be highly accurate for the May-June period, with minimal forecast errors compared to the actual data published by Statistics Sierra Leone. However, the forecast error increased for August, which can be attributed to the rise in fuel and public transportation prices.

Table 1: Combined Inflation Forecast and Actuals

Months	Forecast	Actuals	Forecast Error
May	44.33*	44.43	0.1
June	44.28*	44.81	0.53
July	44.96*	44.98	0.02
August	47.68	50.94	3.26
September	54.17	-	-
October	54.74	-	-
November	58.17	-	-
December	58.60	-	-
January 2024	59.78	-	-
February 2024	58.95		
March 2024	58.57		

** denotes the inflation forecast from the Q2 MPC meeting*
Source: BSL Staff projections

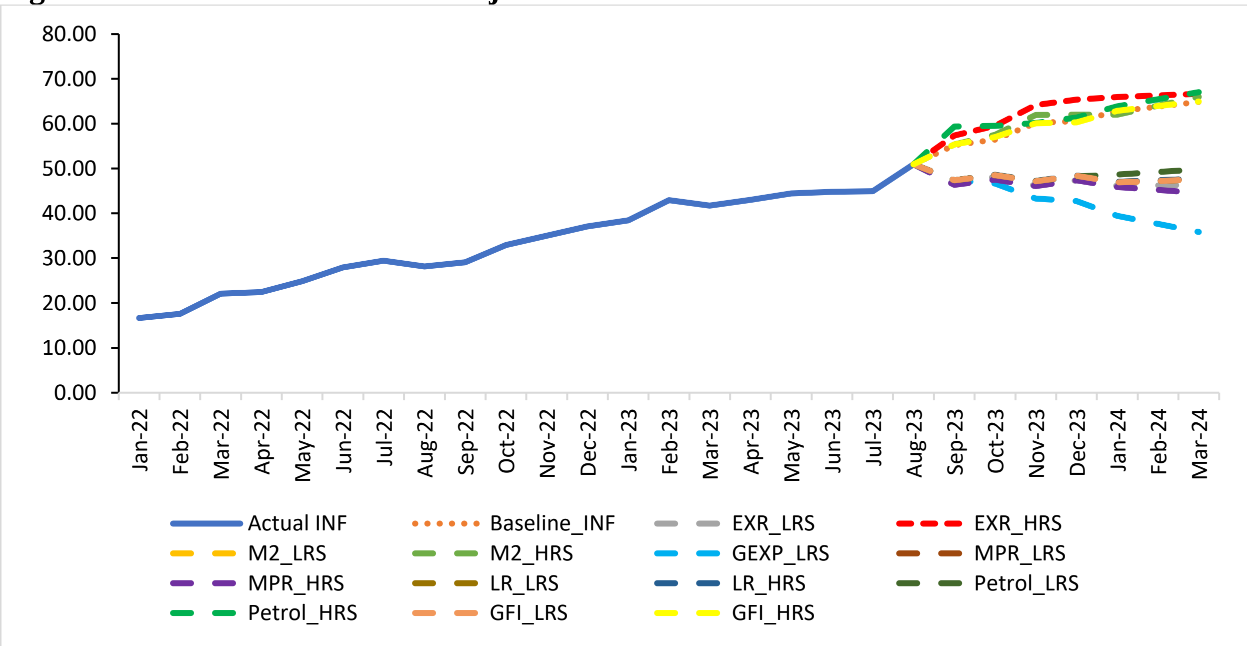
Figure 52: Combined Inflation Forecast



Source: BSL Staff illustrations

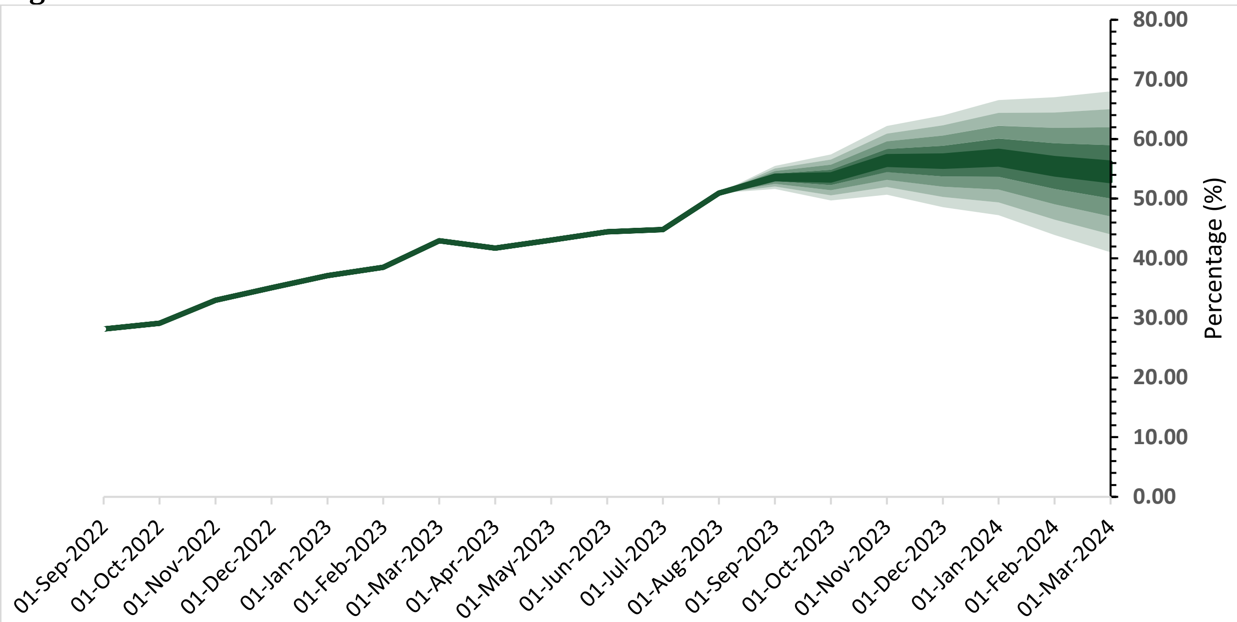
In the high-risk scenarios, variables such as energy prices (Petrol), exchange rates (EXR), food index (BSL FI) and Money Supply (M2), are projected to exert inflationary pressures beyond the initially predicted baseline projection. Conversely, the low-risk scenarios indicate that a reduction in government expenditure by the fiscal authority would lead to a fall in inflation, as shown in the figure below.

Figure 53: Combined Scenarios Projection



Source: Bank of Sierra Leone

Figure 54: Inflation Fan Chart



Source: Bank of Sierra Leone

Table 2:Summary of Global Growth Projections

		WEO April 2023 Projections		WEO July 2023 Projections		CHANGE IN Projections	
	2022	**2023**	**2024**	**2023**	**2024**	**2023**	**2024**
World Output	**3.4**	**2.8**	**3.0**	**3.0**	**3.0**	**0.2**	**0.0**
Advanced Economies	**2.7**	**1.3**	**1.4**	**1.5**	**1.4**	**0.2**	**0.0**
United States	2.1	1.6	1.1	1.8	1.0	0.2	-0.1
Euro Area	3.5	0.8	1.4	0.9	1.5	0.1	0.1
United Kingdom	4.0	-0.3	1.0	0.4	1.0	0.7	0.0
Japan	1.1	1.3	1.0	1.4	1.0	0.1	0.0
Emerging Market and Developing Economies	**4.0**	**3.9**	**4.2**	**4.0**	**4.1**	**0.1**	**-0.1**
Brazil	2.9	0.9	1.5	2.1	1.2	1.2	-0.3
Russia	-2.1	0.7	1.3	1.5	1.3	0.8	0.0
India	6.8	5.9	6.3	6.1	6.3	0.2	0.0
China	3.0	5.2	4.5	5.2	4.5	0.0	0.0
Sub-Saharan Africa	**3.9**	**3.6**	**4.2**	**3.5**	**4.1**	**-0.1**	**-0.1**
Nigeria	3.3	3.2	3.0	3.2	3.0	0.0	0.0
South Africa	2.0	0.1	1.8	0.3	1.7	0.2	-0.1

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

Table 3: Monetary Policy Stance of Selected Central Banks

Country	Recent Inflation (%)		Monetary Policy Rates (%)				
			Current		Previous		Change
WAMZ							
Sierra Leone	50.9	Aug.23	19.25	Jul.23	18.75	Mar.23	0.50
Nigeria	25.8	Aug.23	18.75	Jul.23	18.50	May.23	0.25
Ghana	40.1	Aug.23	30.00	Jul.23	29.50	May.23	0.50
Guinea	6.0	July .23	11.50	Aug.23	11.50	Jun.23	0.00
Liberia	12.4	Jun.23	20.00	Aug.23	19.00	Jul.23	1.00
The Gambia	18.4	Aug.23	17.00	Jul.23	16.00	Jun.23	1.00
Major Economies							
USA	3.7	Aug.23	5.50	Sep.23	5.50	Jul.23	0.00
China	0.1	Aug.23	3.45	Aug.23	3.55	Jul.23	0.01
Euro Area	5.2	Aug.23	4.50	Sep.2	4.25	Jul.23	0.25
UK	6.7	Aug.23	5.25	Sep.23	5.25	Aug.2	0.00

Source: Central Banks through Trading Economics (September 2023)

Table 4: Total Public Debt

	FY2022		FY2023	%Change Dec-2022 to Jun-2023
	End June	End Dec	End June	
A. Domestic Debt Stock	**14,453.81**	**16,056.16**	**18,203.96**	**13.38%**
Treasury Bills	*9,420.93*	*11,542.83*	*12,794.90*	*10.85%*
Treasury Bonds	*1,925.14*	*2,700.11*	*3,471.45*	*28.57%*
Ways and Means Advances	*7.74*	*117.99*	*242.37*	*105.42%*
Domestic Arrears	*3,099.99*	*1,695.24*	*1,695.24*	*0.00*
B. External Debt Stock	**25,797.43**	**35,642.61**	**35,717.25**	**0.21%**
Multilateral	*20,252.26*	*28,055.21*	*28,212.65*	*0.56%*
Bilateral	*3,360.77*	*4,522.06*	*4,512.44*	*(0.21%)*
Commercial	*2,184.41*	*3,065.35*	*2,992.16*	*(2.39%)*
Total Public Debt Stock (A+B)	**40,251.24**	**51,698.77**	**53,921.21**	**4.30%**
Total Public Debt Stock (US$'m)	**3,029.90**	**2,731.17**	**2,835.41**	**(2.69%)**
Nominal GDP	*50,662*		*74,733.00*	
% GDP	*79.45*	*102.05*	*72.15*	

Source: Ministry of Finance

Table 5: Central Bank Survey

Millions of Leones	2023 Q1	2023 Q2	Quarterly % Change 2023Q1	Quarterly % Change 2023Q2	Yearly % Change 2023Q1	Yearly % Change 2023Q2
1. Net Foreign Assets	**(3,411.83)**	**(3,043.17)**	**14.21**	**(10.81)**	**413.67**	**44.38**
2. Net Domestic Assets	**9,436.12**	**10,105.29**	**7.65**	**7.09**	**82.61**	**53.16**
Government Borrowing (net)	6,725.46	8,569.19	(6.24)	27.41	43.16	58.67
o.w. Securities	4,004.87	4,064.78	8.34	1.50	218.86	126.15
Ways and Means	208.18	242.37	76.44	16.43	(14.81)	3,029.59
GoSL/IMF /WB Budget financing	3,530.75	3,995.16	-	13.15	8.39	13.15
3. Reserve money	**6,024.29**	**7,062.12**	**4.26**	**17.23**	**33.78**	**57.29**
o.w. Currency issued	5,206.08	6,218.44	**5.88**	**19.45**	**39.50**	**65.97**
Bank reserves	810.72	836.73	(5.39)	3.21	6.07	13.45

Source: Bank of Sierra Leone

Table 6: Monetary Survey

Billions of Leones	2023Q1	2023Q2	Quarterly % Change 2023Q1	Quarterly % Change 2023Q2	Yearly % Change 2023Q1	Yearly % Change 2023Q2
Reserve money	**6,006.77**	**7,062.12**	**3.96**	**17.57**	**33.39**	**57.29**
Broad Money (M2)	**21,972.78**	**22,534.55**	**8.24**	**2.56**	**44.91**	**47.38**
Narrow money (M1)	**9,503.17**	**10,559.54**	**5.56**	**11.12**	**24.61**	**43.02**
Currency outside banks	4,679.44	5,588.00	4.22	19.42	40.50	67.90
Demand deposit	4,823.73	4,971.54	6.90	3.06	12.29	22.60
Quasi money	**12,469.62**	**11,975.01**	**10.38**	**(3.97)**	**65.45**	**51.45**
o.w. Foreign currency deposit	8,764.79	7,885.34	15.47	(10.03)	105.12	73.65
Time and saving deposit	3,697.34	4,082.71	(0.12)	10.42	13.52	21.51
Net Foreign Asset	**5,819.37**	**4,453.10**	**10.79**	(23.48)	**62.97**	**74.42**
BSL	(3411.83)	(3043.17)	14.21	(10.81)	413.67	44.38
ODCs	9231.20	7496.28	12.03	(18.79)	117.97	60.83
Net Domestic Assets	**16,153.51**	**18,081.45**	**7.36**	**11.94**	**39.35**	**41.96**
Net Domestic Credit	**18,629.28**	**21,260.65**	**7.86**	**14.12**	**30.56**	**38.87**
Government (Net)	14,958.00	17,517.15	7.25	17.11	31.54	43.04
BSL	7629.66	8569.19	6.37	12.31	62.41	58.67
ODCs	7328.33	8947.96	8.17	22.10	9.81	30.71
Private Sector Credit	3901.49	3890.87	10.24	(0.27)	21.41	14.80
o.w ODC	3883.31	3873.29	10.19	(0.26)	21.53	14.83
Other Sectors (Net)*	(230.22)	(147.37)	7.08	(35.99)	(27.15)	(54.77)
Other Items (Net)	**336.48**	**(317.17)**	**(159.31)**	**(194.26)**	**(112.57)**	**(87.67)**
Money Multiplier	3.66	3.19				

Source: Bank of Sierra Leone