Fundamentals

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Economic insights | Strategy | Budget analysis | Ghana

All sizzle but with very little steak

IN BRIEF

Economist, West Africa:
Mosope Arubayi +234 706 2774 539
mosope.arubayi@ic.africa

- Ghana's investors are not likely to raise a toast to the country's 2022 budget proposal as it fell short of expectation
- The steep sell-off in Ghanaian bonds which followed the budget reading is a testament of how unimpressed investors were
- The budget was unable to convince markets on a clear-cut path to fiscal consolidation, even though projections see fiscal deficits ebbing over the medium term to settle just below the threshold of 5% of GDP as stipulated in the Fiscal Responsibility Act (FRA)
- In our opinion, Ghana's fiscal consolidation proposal as contained in the 2022 budget may be difficult to achieve due to the ambitious tax assumptions and the absence of stringent spending caps to check cost pressures
- Given the unfolding high-yield environment, higher borrowing costs may be another layer of burden to the country's purse as plans are still in place to take on more local (5.6% of GDP) and foreign (0.9% of GDP) debts in the coming year
- The widespread negative market sentiment on Ghanaian bonds, which has pressured bond prices and sent yields soaring would play a major role in determining the success of Ghana's debt issuances in 2022
- As global policy normalisation looms large, we opine that the Bank of Ghana can better target liquidity injection in the fixed income market by lowering its Cash Reserve Ratio (CRR) requirements to release liquidity to the banking system to trigger repricing of Ghanaian bonds.
- This will not only soothe pressures from the cost of borrowing on future issuances, but the liquidity-induced rally can re-ignite foreign investors' interest in Ghanaian bonds. However, it is also likely to result in further inflationary and exchange rate pressures in the near term, that will require the central bank to raise its benchmark interest rate further

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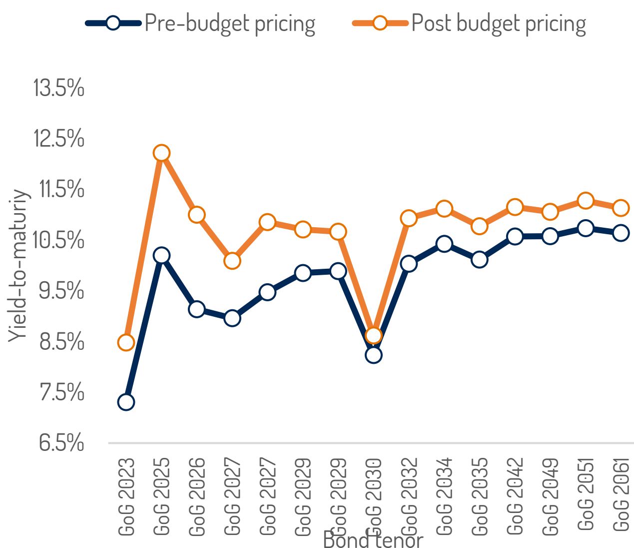
The last two years have seen Ghana exchange fiscal responsibility for economic stability. The country relied heavily on external debt financing to spend its way out of a pandemic induced recession and to a large extent, this was acceptable by investors as markets rallied in support.

The 2022 budget which was read on 17 November 2021, was widely anticipated given that it would provide a glimpse into the country's plan to build on a fragile recovery in a post-Covid economy. It was essential that the budget provided clear guidance on fiscal consolidation and an alternative to external debt refinancing given the elevated debt levels and rising cost of borrowing in a global economy where liquidity has begun to taper.

Unfortunately, in our opinion, the budget fell short of this expectation and the sell-off in Ghanaian bonds shortly after the budget was read is a testament that investors were also unimpressed.

Ghana Eurobonds yield curve

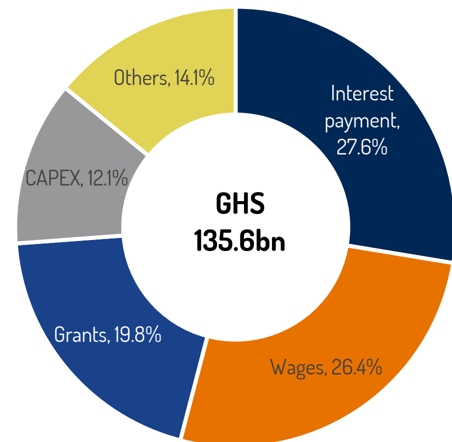


Source: Bloomberg; IC Insights

Narrowing of deficit hangs on ambitious revenue policies

Although several economic indicators appear positive and external developments have been largely favourable due to price gains on its major export commodities, public finances have already been weakened by the fiscal hole created by the tripartite impact of financial sector bailout costs, energy sector payments to independent power producers (IPPs), and non-discretionary COVID-related spending. The former two add around six percentage points to Ghana's debt stock at 77.8% of GDP, as of September 2021.

FY2022 split of public finances



Source: Ministry of Finance

So how does Ghana crawl out of this hole?

The 2022 budget is aiming for close to five-percentage points moderation in the size of its fiscal deficit from 9.3% as at 9M2021 to 7.4% through a plethora of exaggerated tax assumptions and weak austerity measures.

On the revenue side, government seeks to introduce a 1.75% levy on electronic transactions which is expected to generate around GHS 7.0bn (1.4% of GDP) according to the Ministry of Finance. While this may prove to be the goose that laid the golden egg, evidence from Uganda, where a 1.0% levy was introduced on mobile money transactions, points to a 24% decline in transaction value. Similarly, the impact of the e-levy can trigger a general aversion for electronic transactions. That notwithstanding, at a projected 6.9% of revenue, the potential income is not significant enough to support the narrowing of the deficit given the consistency with which traditional revenue sources continue to underperform. Realised revenues continue to undershoot forecasts despite the reopening of the economy with a -8% divergence from the revenue target for the first nine months in 2021.

While inflows from the aforementioned revenue initiatives could bolster the country's coffers, their impact is likely to be counter-balanced by the zero tolls policy, a halving of the withholding tax for small-scale gold miners, and the raising of the income tax turnover threshold to GHS 500,000, from GHS 200,000.

On the expenditure front, we failed to see any significant cost-cutting measures meant to narrow the deficit. Actually, at 27% of GDP – more than twice the size of Nigeria's budget, Ghana is unrelenting in its spending in 2022. Recurrent expenditure is expected to take up a lion share of the appropriation (88.1%), creating less wiggle room for more austere measures. Taxpayers' money (77.5% of domestic revenue) will be spent on interest

payment (27.2% of total expenditure), the wage bill (26.1% of total expenditure), and capital expenditure (11.9% of total expenditure).

In our opinion, Ghana's fiscal consolidation proposal as contained in the 2022 budget may be difficult to achieve due to the ambitious tax assumptions and the absence of stringent spending caps to check cost pressures

FRA suspended

The path to fiscal consolidation may be much slower than government's medium-term targets. Revenue projections over the medium-term suggests that ongoing revenue mobilisation efforts may not be as effective, given that projected revenues remain relatively constant at 20% of GDP. On the other hand, spending sees a snail-paced moderation to 24.5% of GDP in 2025 from 27.4% of GDP in 2022.

Essentially, the Financial Responsibility Act (FRA) which seeks to cap the budget deficit at 5% of GDP is likely to remain suspended until 2025

Time to recalibrate monetary policy tools?

Given the unfolding high-yield environment, higher borrowing costs may be another layer of burden to the country's purse as plans are still in place to take on more local (5.6% of GDP) and foreign (0.9% of GDP) debts in the coming year. Foreign financing is on the table, with a proposed USD 750mn Eurobond issuance - that can be increased to USD 1.5bn-, subject to pricing conditions in the international market. However, to keep external debt in check and ensure sustainability, the total limit for concessional and non-concessional financing have been scaled down to USD 2bn, from USD 2.5bn.

The widespread negative market sentiment on Ghanaian bonds, which has pressured bond prices and sent yields soaring would play a major role in determining the success of Ghana's debt issuances in 2022. Given the current bond market clime and persistent red-radar sentiment on SSA debt instruments - as a result of the elevated risks of debt distress - Ghana's borrowing costs are likely to remain elevated next year.

However, Ghana is not alone in struggling to balance its fiscal book. Zambia, for instance, is already in debt distress due to years of fiscal slippage. The country's West African peer – Nigeria – is also struggling with implementing revenue-based fiscal consolidation initiatives, whose absence has intensified pressure on its hydrocarbon receipts. Therefore, we believe Ghanaian bonds currently trade at a steep discount to its African peers and there is room for the Bank of Ghana to engineer a haircut.

As global policy normalisation looms large, with South Africa's recent 25bps interest rate hike hitting close to home, we opine that the Bank of Ghana can better target liquidity injection in the fixed income market by lowering its Cash Reserve Ratio (CRR) requirements. This would release liquidity to the banking system - that will most likely find its way to the fixed income market-, engineering a re-pricing of Ghanaian bonds.

This will not only soothe pressures from the cost of borrowing on future issuances, but the liquidity-induced rally can re-ignite foreign investors' interest in Ghanaian bonds – since it offers one of the most competitive rates in the African region. However, it is also likely to result in further inflationary and exchange rate pressures in the near term, that will require the central bank to raise its benchmark interest rate further.

For more information contact your IC representative

Business development & client relations

Derrick Mensah
Head, Business Development
+233 24 415 5765
derrick.mensah@ic.africa

Dora Youri
Head, Wealth Management
+233 23 355 5366
dora.youri@ic.africa

Kelvin Quartey
Analyst, Business Development
+233 57 604 2802
kelvin.quartey@ic.africa

Corporate Access

Joanita Hotor
Corporate access
+233 50 137 6100
Joanita.hotor@ic.africa

Investing

Isaac Adomako Boamah
Chief Investment Officer
+233 24 337 3118
isaac.boamah@ic.africa

Derrick Mensah
Portfolio Manager, Equities
+233 24 415 5765
derrick.mensah@ic.africa

Obed Odenteh
Portfolio Manager, Fixed Income
+233 54 707 3464
obed.odenteh@ic.africa

Timothy Schandorf
Portfolio Manager, Credit & Alternative assets
+233 24 292 2154
Timothy.schandorf@ic.africa

Bernard Tetteh
Analyst, Equities
+233 24 864 7114
bernard.tetteh@ic.africa

Herbert Dankyi
Analyst, Rates
+233 55 710 6971
herbert.dankyi@ic.africa

Operations

Nana Amoa Ofori
Chief Operating Officer
+233 24 220 6265
nanaamoa.ofori@ic.africa

Emmanuel Amoah
Fund Administrator
+233 20 847 2245
emmanuel.amoah@ic.africa

Kelly Addai
Fund Accountant
+233 20 812 0994
kelly.addai@ic.africa

Trading

Randy Ackah-Mensah
Head, Global Markets
+233 24 332 6661
randy.amensah@ic.africa

Allen Anang
Trader, Equities
+233 54 084 8441
allen.anang@ic.africa

Isaac Avedzidah
Trader, Fixed income
+233 24 507 782
isaac.avedzidah@ic.africa

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