Fundamentals

13 June 2022

Macroeconomic update | Ghana

A royal pain in the purse

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IN BRIEF

- Ronald Reagan – the 40th president of the United States (US) – said "inflation is as violent as a mugger, as frightening as an armed robber, and as deadly as a hit man." Although harsh, the words ring as true in Ghana today as when they were spoken in 1978, and the pain is just as palpable.
- As the Russia-Ukraine crisis is taking a toll on the world, its effects on emerging African markets like Ghana is more than ever imagined, as the country is facing new realities from a pandemic-induced crisis and fast-changing global trade dynamics with the warring Russia and Ukraine.
- Ghana's inflation reached an 18-year peak in May as it accelerated to 27.6% y/y from 23.6% in April, and its insidious effects are likely to continue weighing on business, consumer, and investor confidence.
- While the osmosis of the Bank of Ghana's (BoG) rate hikes from March and May is still ongoing, there is scope for more rate hikes in the near term as the previous hikes are not likely to halt the rise in prices.
- The concern will be the implication of all of these for the country's fiscal outlook, given that the pressure on the cedi could intensify in the coming days as investors continue to shy away from Ghanaian assets.

Ghana's inflation in May came in at a record high of 27.6% y/y, from 23.6% y/y in April. The country's inflation flare-up continues to be driven by rising global commodity prices that filtered into the cost of food, fuels, and transportation in the country.

With the pandemic still gripping other parts of the world, global supply chain snarls, and the protracted conflict in Ukraine, we anticipate a prolonged period of inflation scorches – especially from the hotspots of Ghana's price pressures (i.e. food and fuel). This will leave the Bank of Ghana (BoG) between a rock and a hard place as it tries to balance the wheel of Ghana's real, external and fiscal interests.

Food and energy prices stretching Ghanaians' pay checks

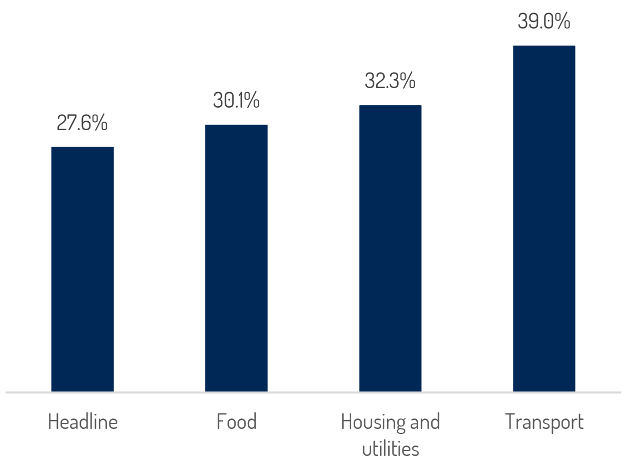
Ghana's inflation rates are likely to continue to soar in the coming months as the domino effects of the Ukrainian conflict and still-entangled China supply chains will continue to fan higher global commodity prices, and higher landing costs for staples, fuels, and intermediate raw materials in import-dependent economies like Ghana.

Food and energy prices remained the biggest drivers of Ghana's inflation in May. With a weight of 43.1%, food is the single largest category in the country's inflation basket. Food prices accelerated by 30.1% y/y in May from 26.6% y/y in April, as global food producers – such as Indonesia and India – took a more protectionist stance by restricting international food exports during the review period to curtail their domestic inflation.

The now-lifted ban on palm oil export by Indonesia was still in place for the most of May, while India also introduced a ban on wheat exports during the period. These bans added to existing pressures on global food prices from clogged global supply chains and the conflict in Ukraine, that unfortunately passed through to Ghana's food inflation.

The persistence of the European conflict also prompted a 32.3% y/y (April: 25.0% y/y) rise in housing and utility prices, and a 39.0% y/y (April: 33.5% y/y) rise in transport prices, because of its overall impact on the dynamics of the global energy market. These price jumps make it clear that, so long as the conflict protracts, hope for inflation to quickly return to acceptable levels is far-fetched.

Key annual inflation trends (%)



Source: Ghana statistical services

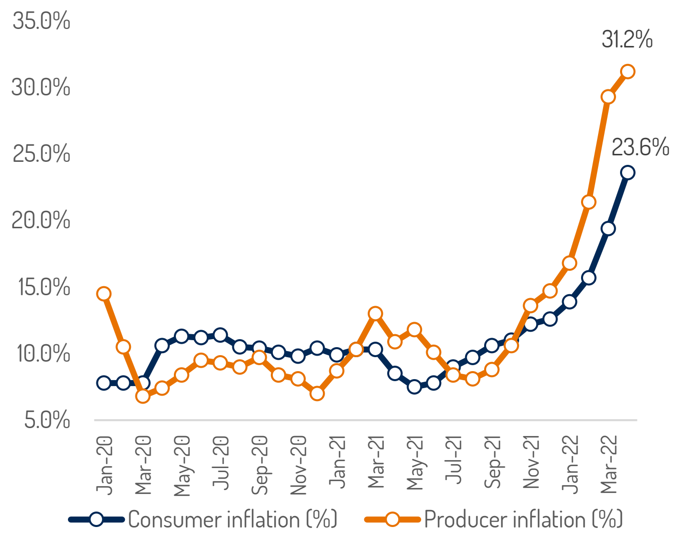
Has inflation reached its crest?

Consumer prices typically lag behind producer prices, and signs are flashing in food and energy manufacturing that Ghana's consumer inflation may not have peaked. As such, we do not expect any relief from rising prices any time soon. In April, producer prices rose by 31.2% y/y while consumer prices printed at 23.6% y/y in the same period. This leaves a pricing differential of 7.6% that is yet to be passed on to consumers as businesses are on the hook.

Much wider pricing differentials exist on food and petroleum products that significantly influence Ghana's inflation trends. As at April when Ghana's producer price index was last published, the costs that were borne by producers to manufacture food and petroleum products rose by 43.1% y/y and 76.1% y/y respectively. However, for food, and transport, consumer costs rose by only 26.6% y/y, and 33.5% y/y respectively.

The gaps between producers' prices and consumers' prices do not scream peak inflation. In fact, it indicates producer prices are likely to spill over into consumer prices down the road. As such, consumer prices have a lot more potential to rise in the coming months. Businesses that were reluctant early on in the inflation cycle to pass on price increases to their customers may now be compelled to actively pass on these costs, as the transitory inflation narrative is now dead and buried.

Producers' vs consumers' inflation trend (%)



Source: Ghana statistical services

High inflation to test central bank policy

The multiple global crises could be pushing Ghana back to the high-inflation era when obstinate inflationary pressure and cedi depreciation forced a high-interest rate regime. With the local currency down by 28.9% YTD, dwindling international reserves, and more room for inflation to run, the BoG may be left with no other option but to raise interest rates further to take the air out of the sails of the economy.

This implies that Ghana's local borrowing cost could rise further in the near term, especially as the international capital market remains inaccessible, with a counteractive impact on private-sector lending and broader economic activity. The elevated cost of borrowing would further weaken the country's fiscal position, intensify credit risk alarms, and spawn more volatility in Ghana's financial markets.

Conclusion

A perfect storm of COVID-19, supply chain disruptions, and the Russia-Ukraine conflict is behind Ghana's 18-year high inflation. Therefore, it is difficult to say whether Ghana has reached the end of its inflation cycle since turmoil overseas is the current trigger and this is not within the control of Ghanaian policymakers. In the end, inflation may turn out to be a big problem and the BoG may need to turn down the heat by tinkering with interest rates at the expense of the economy and the government's pecuniary interests.

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