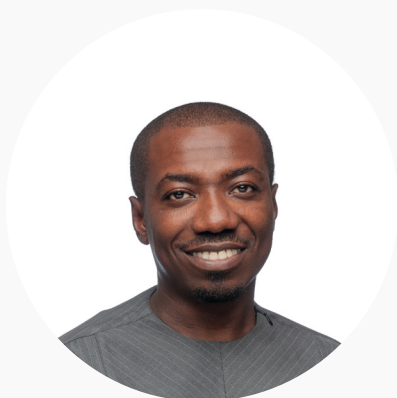


THE CIO MEMO

AUGUST 2022

**THE MUSIC APPEARS
TO HAVE STOPPED
GLOBALLY, AND
GHANA IS SCRAMBLING
FOR A CHAIR**



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IN BRIEF

- External events spiked risk aversion and shone a spotlight on Ghana's economic and fiscal policy credibility. In fact, most African Frontier Countries and Emerging Markets faced the same level of investor scrutiny.
- But Ghana's fragile domestic environment and large foreign exposure triggered a quick and brutal exit of foreign capital.
- The loss of access to both the external market (1Q2022) and the domestic market (2Q2022) nudged Ghana towards the IMF.
- However, the IMF bailout will not avert an imminent debt restructuring, despite offering policy certainty and direction.
- Given the current market conditions, Ghana's expensive local currency bonds look particularly vulnerable to either debt restructuring or funding of repayment through the central bank. The latter option poses a severe currency risk to investors.
- Converse to its local counterparts, we do not believe a default on Ghana Eurobonds is imminent as the country will have the USD 750.0m loan (hopefully) from the African Export-Import Bank, USD 1.3bn cocoa syndicated loan, and the windfall from its petroleum revenue. These inflows should shore up Ghana's foreign exchange reserves before an IMF bailout within the next 6-8 months.
- The music appears to have been switched off globally. And Ghana—like many other countries with persistent fiscal pressure—is scrambling for a chair. We have taken the intermission to look at our options from every angle, and believe that while we wait for the next tune, investors with limited options should take shelter in holding long-term local currency bonds, short-term Ghana Eurobonds, and US Dollars. In maintaining this active market stance, we continue to believe that tomorrow's winners belong to those who prepare for recovery.

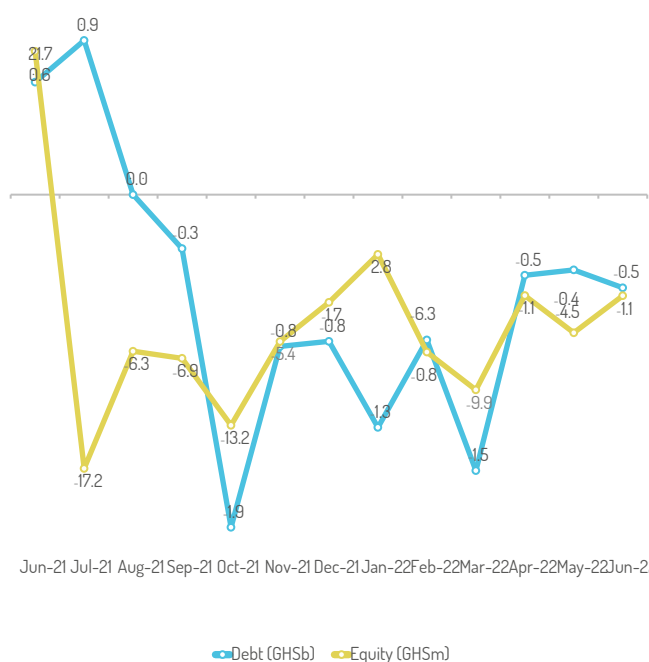
Just two years ago, foreign capital flooded Ghana's market. Global interest rates were low, and investors' appetite for well-priced leverage helped overburdened governments facilitate deficit spending. This saved lives and livelihoods during the worst of the pandemic, but masked Ghana's underlying fiscal and economic weaknesses.

The year 2022 upped the ante with two major global events: the US Federal Reserve (Fed) raised their interest rates to combat high inflation; and the Russia-Ukraine war sent shockwaves through the global financial and economic systems.

These external events spiked risk aversion and shone a spotlight on Ghana's economic and fiscal policy credibility. In deed, most African Frontier Countries and Emerging Markets faced the same level of investor scrutiny. However, Ghana's fragile domestic environment and large foreign exposure triggered a quick and brutal exit of foreign capital. Furthermore, Moody's downgraded Ghana's credit rating to CCC.

The confluence of these events lost Ghana access to international capital markets in 1Q2022.

NET FOREIGN PORTFOLIO INFLOWS

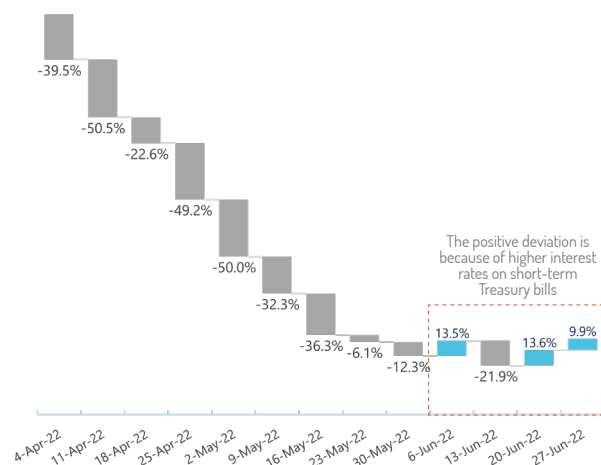


SOURCE: CENTRAL SECURITIES DEPOSITORY, GHANA

In 2Q2022 Ghana also lost the domestic market

Policy makers—still reeling from the first quarter's global events—had a currency crisis on their hands. In defence, the Bank of Ghana ("BoG") raised local banks' cash reserve requirements. But this hefty mandate caused a domestic market freeze, and lost Ghana access to its local market in 2Q2022.

AUCTION RESULTS (TARGETS VS ACTUAL DEVIATIONS)



Two domestic events drove Ghana's fiscal woes in 2Q2022.

Firstly, the electronic transfer levy (e-levy)—designed to bolster fiscal room and prevent another IMF bailout—met only ~10.0% of its revenue targets in the first two months of implementation. Ghana subsequently revised the programme's FY2022 revenue target down to ~GHS 611.0m, from GHS 6.9bn in the half year budget review.

Secondly, when inflation touched 29.8% in June, Ghana made a desperate attempt to issue a short-dated paper at almost 30.0%. This further worsened the debt profile and sent the wrong signal to markets.

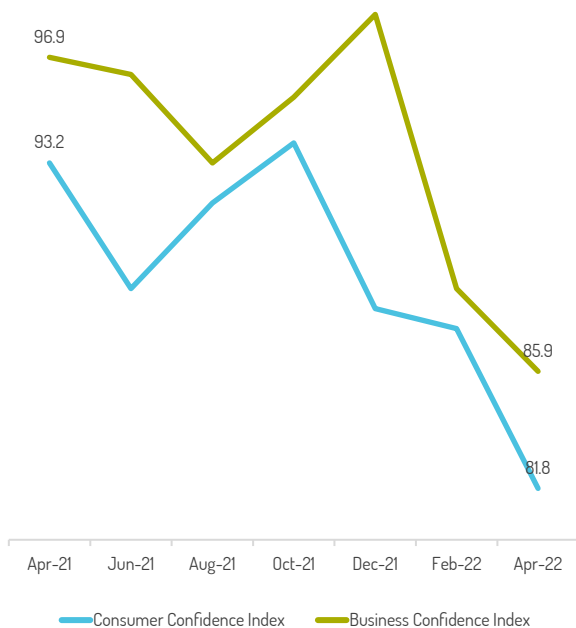
We believe the loss of the domestic and international markets nudged Ghana toward an IMF engagement in July 2022.

The IMF bailout provides policy direction but will not avert an imminent debt restructuring

When Ghana approached the IMF in July, it was a clear admission that the country's fiscal deterioration had accelerated.

And if a bailout is smoothly secured within the next eight months, it should provide some level of policy certainty and direction. Investors might also have the opportunity to fairly reprice Ghana's assets. This should help revive consumer and business confidence levels—which are both at devastating lows.

CONSUMER CONFIDENCE INDEX VS BUSINESS CONFIDENCE INDEX



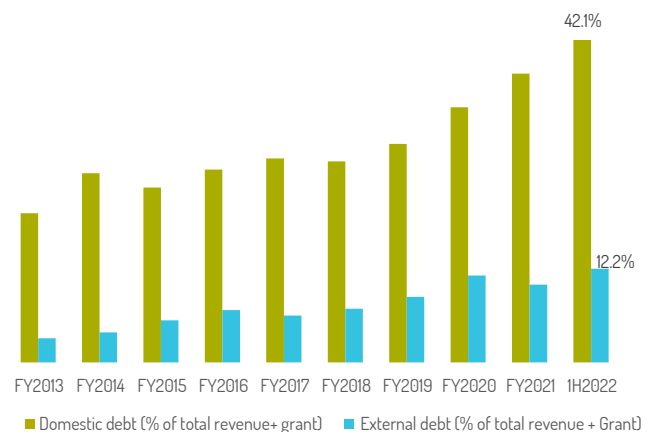
SOURCE: BOG

And though we do not expect the bailout to avert a debt restructuring, we do believe it will embolden policy makers to take interim measures that can relieve the fiscal burden.

What can policy makers do on the local-currency-debt front?

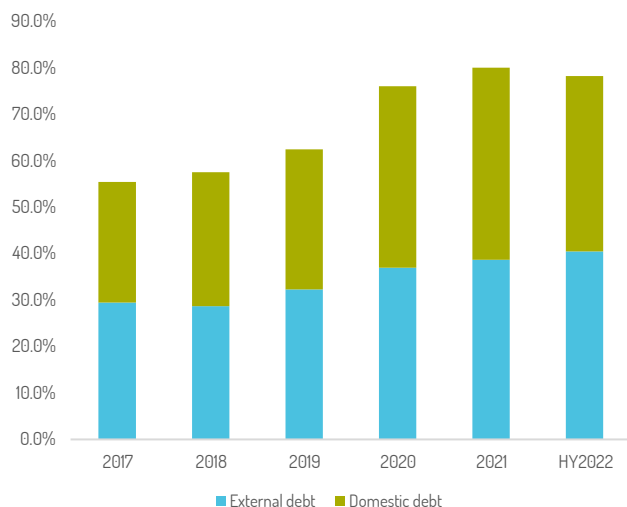
For one, policy makers could finally address the high costs of local currency debt. In 2Q2022, interest payments on local currency debt accounted for 42.1% of total revenue (including grants).

DEBT SERVICE COST: EXTERNAL DEBT VS LOCAL DEBT



SOURCE: MINISTRY OF FINANCE, GHANA

GHANA'S DEBT PROFILE (% OF GDP)

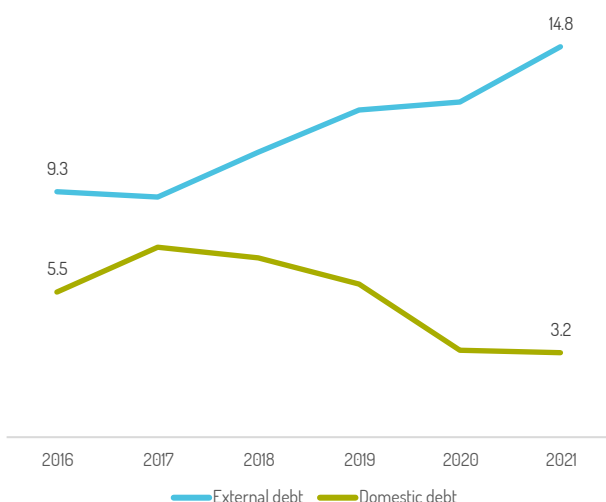


SOURCE: MINISTRY OF FINANCE, GHANA

Short-tenors and quick rollovers of local currency debt present an immediate concern

Secondly, local currency bonds have short-tenors and high rollover frequencies, which could immediately destabilise the fiscus if not addressed.

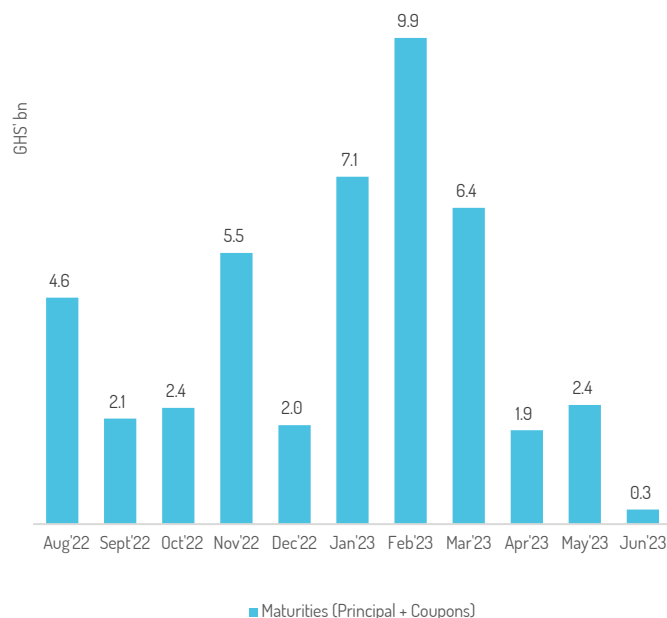
AVERAGE TIME TO MATURITY (YEARS): EXTERNAL DEBT VS LOCAL DEBT



SOURCE: MINISTRY OF FINANCE, GHANA

The local currency bond rollover requirement is a substantial GHS 44.7bn (including coupon payments) until 1H2023. And at the prevailing interest rate, policy makers might find greater value restructuring the local currency bonds that are close to maturity.

GOG MATURITIES - LOCAL CURRENCY BONDS



SOURCE: INSIGHTS DESK - IC

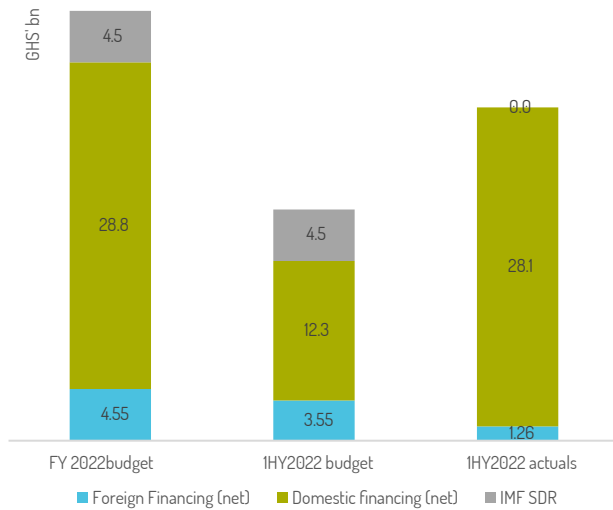
Another option is for Ghana to fund a debt rollover through the central bank. But this scenario would require the BoG's buy-in, and their funds.

What we gleaned from last week's 1H2022 budget review

At current market levels, it appears the BoG will fund Ghana's maturing bond repayments.

Ghana has already secured ~80.0% (~GHS 28.0bn) of the FY2022 budget financing from the domestic market, with substantial assistance from the BoG (~GHS 22.0bn—of which ~GHS 11.0bn is part of an active overdraft facility).

FUNDING OF GHANA'S FISCAL OPERATIONS FOR 2022



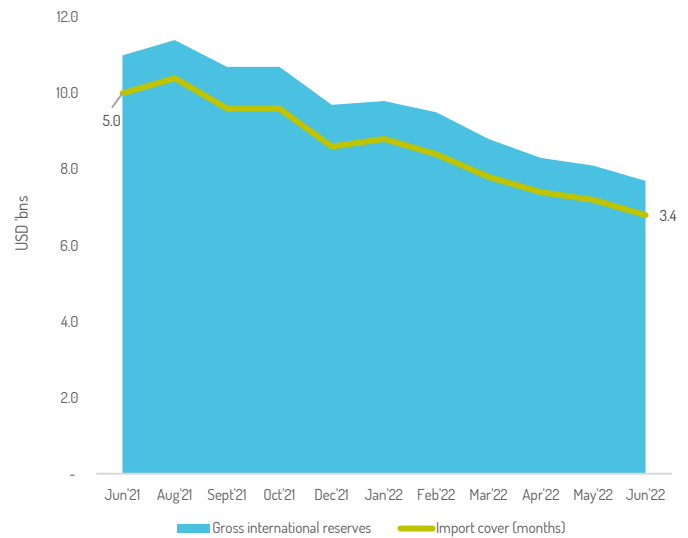
SOURCE: MINISTRY OF FINANCE, GHANA

We attach severe currency risk to the BoG stepping in to fund either budget operations or government's repayment of maturing bonds. Rational investors—aware that fiscal operations are centrally funded—may opt to buy and hold US Dollars.

Foreign Exchange Reserves are also in a precarious position

If history is anything to go by, it could take as long as eight months of negotiations to secure funding from the IMF. But considering the country's diminishing foreign exchange position—at a 12-month low of 3.4 months of import cover—policy makers must secure alternative funds soon.

GHANA'S FOREIGN EXCHANGE RESERVES



SOURCE: BOG

Assuming Ghana secures the USD 750m African Export-Import Bank loan and combines these funds with the USD 1.3bn annual cocoa syndicated loan, we think this will buy the country at least the next six months. Furthermore, windfalls from petroleum revenue might plug the hole between the next six months and when we expect an IMF bailout - eight months from now. However, if the negotiations take longer, Ghana will be in a BoP crisis.

Slower growth, rising inflation, and a looming debt restructuring; so, where do investors look?

In 1Q2022, we took inspiration from Winston Churchill, who said: "If you are going through Hell, keep walking." And we advised investors to look through the dip toward a recovery rally.

Though times are a lot tougher now, and investors face increasingly limited options, we still see opportunities in long-term positions if investors are willing to look through the next few years.

We anchor our investment strategy on our currency expectations into mid-2025.

HY 2022 (current)	HY 2025		
	Worst case	Base case	Best case
GHS 8.6	GHS 13.5	GHS 12.0	GHS 10.9

Despite the headwinds, buy long-term local currency bonds

As safety-first money managers, we infamously plan for the worst while hoping the best case plays out.

We therefore look for at least a ~60.0% return over the next three years, with a safety margin of approximately half the minimum return. This provides a ~90.0% holding period return for local currency bonds over the next three years. Long-term local currency bond holders will earn an annual return of ~30.0%, and will also benefit from capital appreciation when global and local conditions improve in the next few years.

We favour the short-end of the Eurobond curve

Converse to our local currency bond strategy, we favour the short-end of Ghana's Eurobond curve. These dollar-denominated assets are driven by US Fed policy. We believe the Fed will institute further rate hikes, holding a restrictive monetary policy stance over the next few years. From a price standpoint, this makes longer-term dollar bonds particularly unattractive, hence, our tilt towards the short end of the curve.

Could Ghana default on its Eurobonds?

We do not believe a Eurobond default is imminent. Especially because debt service cost on Eurobonds are currently low—at 12.2% of total revenue and grants. This drastically reduces the possibility of a default on Eurobonds within the next six months, *ceteris paribus*.

Even when we take Ghana's BOP pressures into account, the Eurobond risk profile changes slightly—but not by much.

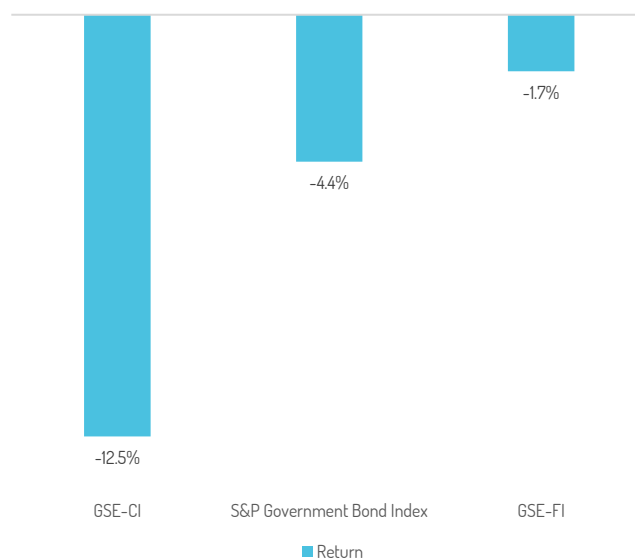
And in the worst case—if Ghana were to default on its Eurobonds, the following scenario would play out. At the current price of ~47.0c to the USD, investors could find themselves firmly in the money even with a hefty haircut of ~40.0%.

For all these reasons, our valuations have led us to the Eurobonds time and time again.

Financial stocks are a resilient bunch, but negative sentiment dominates equities

The Accra bourse returned -12.5% YTD¹ on the back of bearish global sentiments.

PERFORMANCE OF LOCAL ASSETS



SOURCE: GHANA STOCK EXCHANGE, S&P

Financial stocks have outperformed all other sectors so far in 2022, with a year-to-date return of -1.7%. This confirmed our 1Q2022 suspicion that banks could be the next alpha generator. Four out of 13 listed financial stocks returned positive gains, namely: SIC (-300.0%), TBL (29.4%), EGL (18.3%), and ETI (14.3%).

And though together they comprise 32% of Ghana's Financial Index, their total value traded across all financial stocks accounts for only 18.5%. This is why we believe these moves were largely sentimental.

Looking ahead, we expect the bearish sentiment to hold sway over the equity market, which reinforces our risk neutral stance on stocks.

Tomorrow's winners belong to those who prepare for a recovery

The music appears to have been switched off globally. And Ghana—like many other countries with persistent fiscal pressure—is scrambling for a chair. We have taken the intermission to look at our options from every angle and believe that while we wait for the next tune, investors with limited options should take shelter in holding long-term local currency bonds, short-term Ghana Eurobonds, and US Dollars. In maintaining this active market stance, we continue to believe that tomorrow's winners belong to those who prepare for recovery.

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