08 August 2022

Macroeconomic updatel Ghana

Ghana sings the budget blues

IN BRIEF

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- John F. Kennedy, a former president of the United States (US), once said "The Federal Government is the people and the budget is a reflection of their need".

- But in reality, budgets are more about politics and offer a window into the priorities of the government of the day, rather than meeting the economic needs of the populace.

- Given its extremely volatile fiscal space, Ghana has had its fair share of macro-financial stress and finds itself in a long-held war on deficits and debt - amid perpetually weak domestic revenues.

- Underperforming revenues were a recurring theme in the country's previous International Monetary Fund (IMF) programs, and it has contributed considerably to the sharp deterioration in public finances in recent times.

- The resulting fiscal deficits - a development that is unsettling for investors - not only complicate the political calculus and threaten economic prospects, but will also complicate ongoing negotiations with the IMF for an Enhanced Domestic Programme (EDP).

- Therefore, the government of Ghana (GoG) is currently under pressure to stabilise public finances, but the 2022 Mid-Year Fiscal Policy Review (MYFPR) felt more like dropping a one-cent piece into a 44-gallon drum.

- The GoG needs to do more to reassure its investors that it is capable of reining in the fiscal deficit to avert more severe financial constraints and a dangerously high debt burden that could compel it to make much more overwhelming and self-inflicting adjustments in the future.

- As George Pataki – a former Governor of New York – once expressed, a budget should always reflect the right choice which may not always be easy.

- And the right choice will always be the one that takes the responsible and prudent path to fiscal stability and economic growth.

It is no news that the Ghanaian economy is sailing through troubled waters as the country's financial turbulence persists. From the downward review of 2022's economic growth forecast to an upward revision to its inflation forecast, and a smaller deficit projection in its 2022 Mid-Year Fiscal Policy Review (MYFPR), it is not hard to tell that the government of Ghana (GoG) is posturing for a sought-after International Monetary Fund (IMF) program.

With the GoG now at a high risk of debt distress following the extended episode of excessive risk aversion and illiquidity, its attempt to woo investors with a fiscal tightening posture did not do the magic on investor confidence as the reviewed budget is all sauce with no substance - and investors could see through the smokescreen.

Macroeconomic stability cannot be restored in Ghana without tangible progress on fiscal consolidation, and that will be a tough row to hoe. As the GoG progresses with negotiations with the IMF, it will need to demonstrate a high level of fiscal discipline that may cost it some of its gross fixed capital formation over the next few years because recurrent spending is sticky by nature.

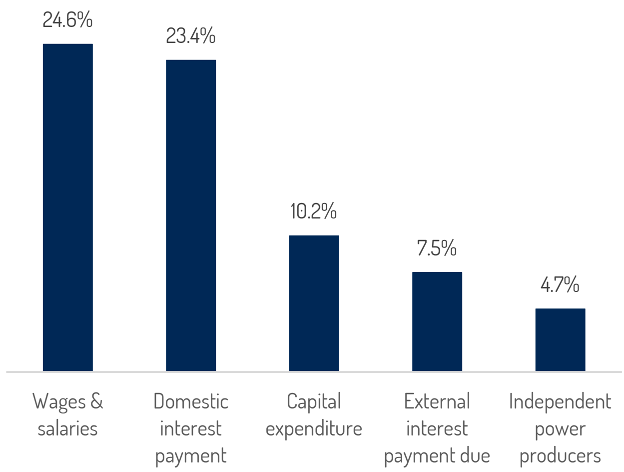
On an austerity footing

Public capital spending is likely to go increasingly awry and constrained over the medium term as the GoG may have to show more spending restraint over the next few years to win back investors' trust. Despite committing to cut public expenditure by around 30% early on in the year, spending does not appear to be under significant pressure.

Total spending by the GoG in 1H2022 was only scaled back by 0.5% from the initial proposal, even though revenues took a bigger plunge (-12.9%) in the face of domestic revenue mobilisation challenges. Unfortunately, around 58% of the GoG's total spending is made up of sticky items – wages and interest payment – which will make it difficult for it to re-appropriate spending more efficiently without adequate bridge financing.

Contingent liabilities (i.e. payments to independent power producers) also remain a risk, with a 58% increase in its appropriation size from GHS 4bn in the initial 2022 budget to GHS 6.4bn in the 2022 MYFPR.

Size of key expenditure line items (% of total expenditure)



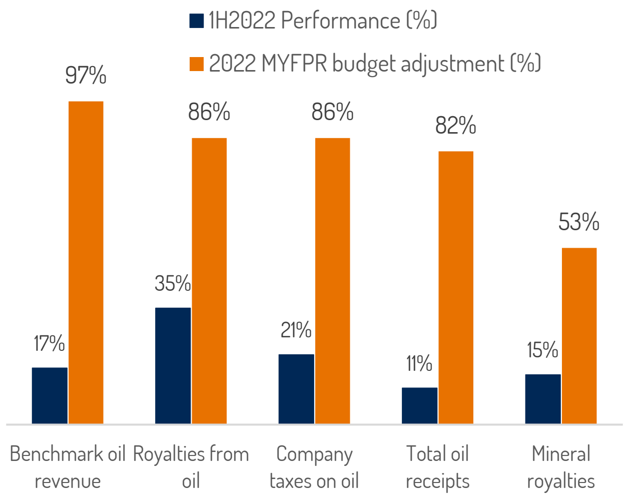
Source: Ghana's Ministry of Finance

A complex maze of revenue mobilisation

While on the surface, the 2022 MYFPR may signal a strong and frontloaded fiscal deficit reduction by the GoG, in our opinion, it may be leaning too heavily on its oil and mining windfall to beat its fiscal blues as the outlook for tax revenue remains pretty bleak.

Price upswings in two of Ghana's key exports – gold and crude oil – have seen its related revenue line-items outperform their targets in 1H2022. However, the conspicuous upward adjustments made to the projected inflows from these line items - as global economic storm clouds gather and crude oil demand worries grow - may prove to be ambitious, increasing the risk of fiscal slippage if the GoG continues to bite more than it can chew.

1H2022 performance & 2022 MYFPR adjustments to key revenue line items relative to the November 2021 budget (%)



Source: Ghana's Ministry of Finance

Household disposable incomes, business spending, and profitability are already constrained by rising costs, limiting the potential for revenue generation from company taxes and value-added taxes (VAT) - both of which constituted around 40% of tax revenue in 1H2022. The controversial e-levy is still a bit of a fool's errand, adding less than 10% of its target to the country's revenue kitty in 1H2022, and the extent to which roads will be paved via tolls is still an open question.

Therefore, should oil and mining receipts fall short and spending cuts become more socially and politically difficult, fiscal slippage cannot be ruled out given the acceleration of inflation. This is especially because of public-service wages and interest payments which already took up 58% of fiscal resources in 1H2022.

Inflating fiscal deficit away?

With public-service wages and interest payments likely to weigh heavily on Ghana's fiscal deficit in the current year, the GoG appears to be riding the inflation wave by expecting the fiscal deficit to moderate further even with an anticipated worsening in the overall balance.

Despite the fact that Ghana's macroeconomic fundamentals have softened in recent times, the GoG expects FY2022's fiscal deficit to narrow further to 6.6% of GDP, compared with an initially targeted 7.4% of GDP, and down from 11.4% of GDP in 2021. This represents a narrowing of 0.8 percentage points (ppts) from the initial deficit target, even though the deficit balance is expected to widen by another 5% to GHS 38.9bn due to higher wages and interest rate commitments. The size of both items is projected to be 12.6% of GDP in 2022, using up 76.8% of total fiscal revenue.

Snapshot of changes to key budget items

	2022 Budget	2022 MYFPR	Adjustment direction
Headline inflation (% year-end)	8.0	28.5	↑
Real GDP growth rate (%)	5.8	3.7	↓
Nominal GDP (GHS bn)	502.4	591.9	↑
Total expenditure (GHS bn)	135.6	133.8	↓
Total revenue & grant (GHS bn)	100.5	96.8	↓
Wages & interest payment (% of total revenue)	68.0	76.8	↑
Fiscal balance (GHS bn)	-37.0	-38.9	↑
Fiscal deficit (% of GDP)	-7.4	-6.6	↓

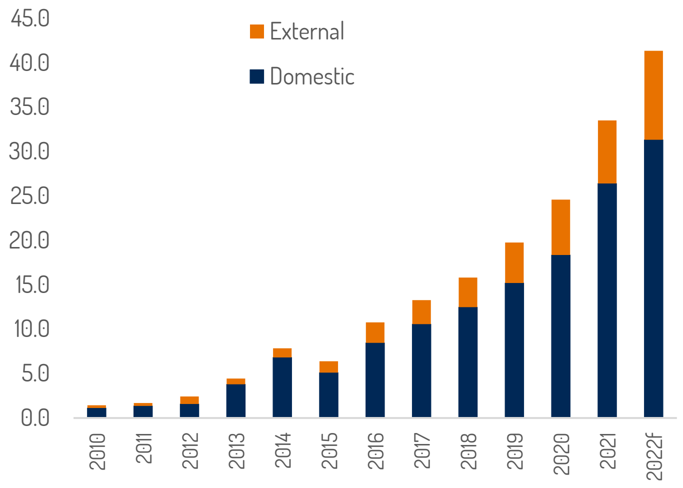
Source: Ghana's Ministry of Finance

Typically, sovereign deficits and debts are meant to be reduced by cutting public spending and/or growing the economy, but when the economic growth outlook grows bleak fiscal restraint is the last resort to ease financial pressures. Given that the MYFPR was short of a strong fiscal restraint posture, we are led to conclude that the GoG is banking on inflation-adjusted gains in nominal GDP to moderate the impact of a wider budget balance projection in the MYFPR - rather than implementing fiscal cuts. Therefore, we remain cautious of the lower deficit target projected in the MYFPR.

Bridge loans come in handy

Although Ghana may be on the cusp of a debt crisis, bridge financing can hold the reins. One sound fundamental about the 2022 MYFPR was that it did not see a request for fresh funds to be allocated, but the shaky fundamental is the GHS 22bn monetary financing by the Bank of Ghana (BoG). As global uncertainties kicked in, shutting Ghana out of the international capital market (ICM) and with limited bridge financing options, the GoG turned to domestic financing – largely from the BoG. The nodus that accompanies the GoG's fall back on domestic financing – in the face of external liquidity strains – is the crowding out of the private sector and higher refinancing risks at a time when the government's interest bill is already high.

Trend of Ghana's interest bill (GHS bn)



Source: Ghana's Ministry of Finance

Earlier liquidity tightening measures by the BoG (i.e. raising the cash reserve and adequacy ratios) has pushed local interest rates significantly higher and impaired the capacity of domestic investors (banks) to absorb new debts. The series of unsuccessful bond auctions in 2Q2022, which resulted in a 39% issuance deviation, lends credence to the stretch in the capacity of local banks to rack up more GoG papers and the recourse to the BoG to plug financing gaps.

With bridge loans from multilateral lenders, however, Ghana may be able to better optimize its debt-financing options in the near term by easing the pressure on the local debt market and averting a catastrophic budget failure. Already, a USD 750mn facility from the African Export-Import (AFREXIM) Bank has been approved by parliament and another USD 250mn-worth of syndicated loans from other international banks is still undergoing scrutiny. Also, a loan from the IMF early in 2023 can help the GoG stabilise its finances until global financing conditions improve and the country's access to the ICM is restored.

Conclusion

The GoG has no doubt been humbled by Ghana's legacy fundamental macroeconomic weaknesses (i.e. fiscal instability, and accumulated debt overhang). We have however not seen enough in the 2022 MYFPR to make us confident about the fiscal outlook. While we await the outcome of negotiations with the IMF, we reckon that fiscal consolidation will be a major theme as questions about debt sustainability remain.

Although the assumptions that underpinned the country's 2019-2021 fiscal expansion may have been dramatically stripped away, Ghana's medium to long-term economic markers remains in situ. However, in terms of its finances, the odds are no longer in favour of gradualism, and the GoG may need to do more to turn the tables on fiscal credibility. It needs to convince the IMF and its investors of its proposed fiscal path to restore financial and economic stability and avert a deeper crisis later.

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