Fundamentals

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Ghana | Macroeconomic update | Monetary Policy | Insights

Ghana's MPR Hike: Little to cheer

IN BRIEF

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- As Ghana's monetary policy rate falls behind the runaway inflation, the monetary authorities had little choice against aggressive back-to-back rate hikes.
- The ongoing monetization of the budget deficit provides a strong basis to expect sustained upswing in near-term inflation, building a case for further rate hikes if inflation does not reverse course in 1Q2023.
- The Treasury could overshoot its FY2022 deficit target with financing needs remaining elevated in the near-term.
- The Ghanaian Cedi could remain under pressure as risk-aversion supports foreign portfolio outflows to chip away Ghana's external buffer.
- The bearish run could continue on rates as bids for local currency bonds remain scanty amidst the flight to safe haven assets such as the USD.

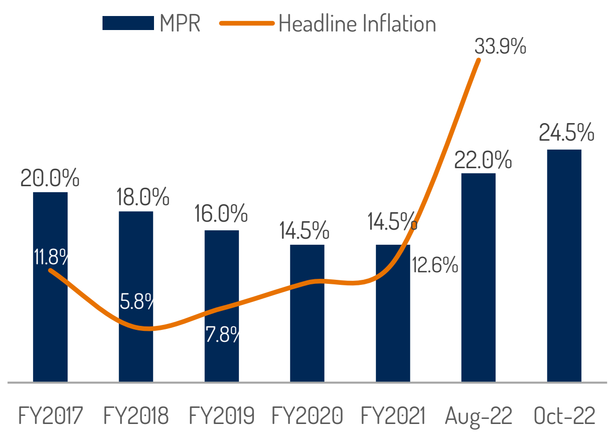
An inevitable hike

The Bank of Ghana's Monetary Policy Committee (MPC) delivered a 250bps hike in its Monetary Policy Rate (MPR) at the rescheduled MPC meeting in October 2022, pushing the MPR to a 5-year high of 24.5%.

The latest hike translates into a cumulative increase of 550bps in the past two (2) months, following the 300bps emergency rate hike in August 2022 (+1,000bps YTD). The new MPR of 24.5% would combine with the staggered increases in the Cash Reserve Ratio (CRR) of banks, which is expected to terminate at 15.0% in November 2022 (vs 12.0% in August 2022).

While the pace of monetary tightening has quickened since March 2022, the near-term outlook for inflation remains elevated on the back of the year-long FX pressures, utility tariff hikes and potential increase in transport fares. These factors combined with the lingering fiscal risk to support the latest hike in the MPR.

Policy rate falls behind the inflation curve in 2022



Sources: Bank of Ghana, Ghana Statistical Service

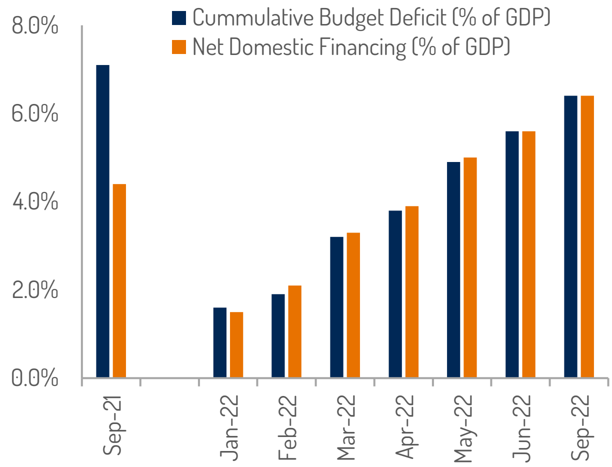
Deficit financing could sustain price pressures

The Treasury's budget execution for the first nine (9) months of 2022 culminated in a wider deficit of GHS 37.6bn (6.4% of GDP) compared to the target of GHS 29.6bn (5.0% of GDP). The wider-than-expected deficit was occasioned by a 14.3% shortfall in total revenue (vs target of GHS 60.1bn), although expenditure was in line with the target of GHS 89.5bn.

Against the backdrop of underperforming revenue amidst spending pressure, we expect the FY2022 budget deficit to settle around the 8.0% area (vs the 6.6% of GDP FY2022 target by the Treasury).

Given the punitive market conditions, the Bank of Ghana (BOG) has been providing the main financing line for the budget deficit. While we believe the BOG's interventions to bridge refinancing shortfalls and foreign portfolio outflows are necessary to prevent a Treasury default, we view the monetization of the budget deficit as a key driver of inflationary pressure. The MPC rightly recognizes this financing arrangement as "sub-optimal" but expects to continue until an agreement is reached with the International Monetary Fund (IMF) for a fiscal adjustment programme.

Financing the 2022 deficit solely from domestic sources



Sources: Bank of Ghana, IC Insights

In our view, the sizable BoG financing suggests an elevated inflation profile over the near-term with a potential for further rate hikes if inflation does not start to decline by end of 1Q2023. Given inflation at a 20-year high of 33.9% in Aug-2022, we perceive scope for more rate hikes with the MPR still below its 2003 peak of 27.5%.

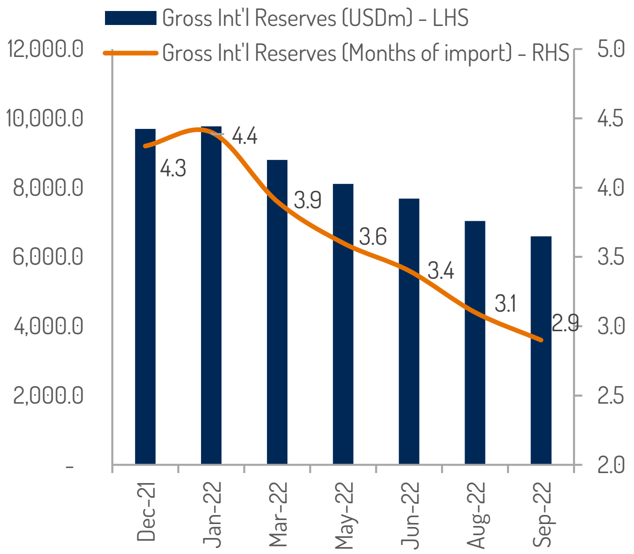
External buffer weakens on portfolio outflows

The wider trade surplus of 2.2% of GDP in Aug-2022 (vs 1.1% a year ago) did not reflect in a build-up of forex reserves due to offsetting outflows on the current account as well as the capital and financial accounts. The strong reversal of foreign portfolio switched the capital and financial account balance into a deficit, equivalent to 1.9% of GDP as of June 2022 (vs 3.8% surplus in June 2021).

The Treasury also tapped the Ghana Stabilisation Fund (GSF) as part of its gross domestic financing for the first 9-months of 2022. We estimate the utilised amount from the GSF at USD 243.8m. This combined with the outflows occasioned by foreign portfolio reversals to drain the gross international reserves to USD 6.6bn (or 2.9 months of import cover) compared to 4.3 months of import at FY2021. In net terms, the net international reserves dropped to USD 2.7bn as of Sep-2022, which we estimate to cover 1.2 months of imports (vs 2.7 months at FY2021).

We expect the tranche disbursements of the cocoa syndicated loan, worth USD 1.1bn, to prop-up the forex reserves. However, we believe the prevailing risk-aversion could sustain the pressure on the Ghanaian Cedi until an IMF programme is agreed with clarity on the treatment of government debt.

Declining forex reserves sustains market uncertainty



Sources: Bank of Ghana, IC Insights

The bearish run continues for rates investors

We see little incentive for a let-up in the bond market selloff as investors struggle to spot a ray of optimism in the latest economic data. Yields across the front-end of the domestic curve re-priced higher as the bearish macro-fiscal data weighed on valuation for near-term maturities. The Sep-23 (coupon: 19.0%) and the Dec-24 (coupon: 19.8%) curves gained an average of 10bps post-hike to open this week at 37.3% and 40.4%, respectively.

We expect risk aversion to remain the central theme across the market for the rest of 2022 with bids for local currency bonds remaining elusive despite the higher yields. With the latest indication of fiscal overruns amidst the heightened risk of debt distress, we believe investors would intensify their demand for safe-haven assets such as the USD and USD-denominated securities with significant caution around bids for local currency bonds despite the attractive valuations.

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