GHANA | MACROECONOMIC UPDATE | FISCAL POLICY | INSIGHTS

FUNDAMENTALS

GHANA'S FY2023 BUDGET: IN A PICKLE

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IN BRIEF

- The implementation of Ghana's 2022 budget faced significant headwinds from both weak revenue performance and lax expenditure management

- The finance minister, Ken Ofori-Atta, confirmed a debt exchange programme as the preferred form of debt restructuring in collaboration with relevant stakeholders including the Ghanaian public, investor community, and development partners

- Our assessment of the 2023 budget leaves us with little conviction about austerity without an IMF programme. Basically, the Ghanaian economy could be in a pickle, if the government fails to secure financial guarantees from its creditors to pave way for the much-anticipated IMF programme

- Based on the expected impact of the new taxes on private sector activity, we are broadly aligned with the government's outlook on key macroeconomic indicators for FY2023

- The bears could remain rampant on the stock market while debt restructuring should force a downward shift in the Treasury yield curve

Budget performance in FY2022

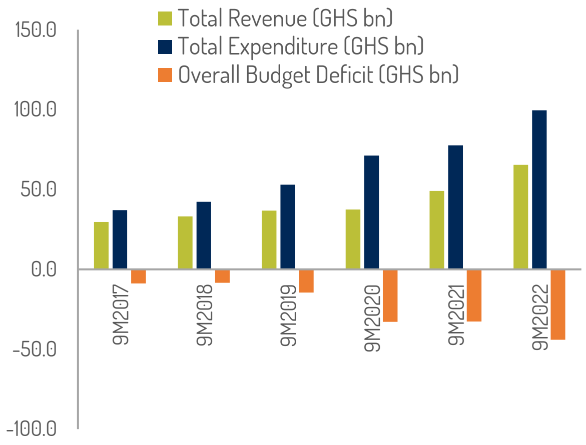
The implementation of Ghana's 2022 budget faced significant headwinds from both weak revenue performance and lax expenditure management. The main shocks emanated from the relentless rise in inflation, currency depreciation, upsurge in borrowing cost, and demand for Cost-of-Living Allowance (COLA) by public sector employees.

High inflation could support revenue in 4Q2022 but weakening business profitability is a downside risk. The authorities project FY2022 revenue & grants (GHS 98.1bn) to marginally exceed the revised target by 1.3%, ostensibly reflecting a push to indirect taxes from the higher-than-projected inflation in 2022. However, we believe business profitability is weakening amidst the inflation-induced squeeze in the operating environment, reflected in a 2.8% shortfall in total revenue for 9M2022 (GHS 65.4bn). The shortfall in the 9M2022 revenue was underpinned by lower-than-expected collections on direct taxes (GHS 24.8bn | -3.2%) and non-tax revenue (GHS 11.0bn | -9.2%). For 4Q2022, we forecast total revenue of GHS 31.5bn (GOG: GHS 32.7bn) as direct taxes are weighed down by weakening business profitability.

Elevated interest payment amidst payroll pressure drives budget overruns in 2022. Ghana's budget showed persistent signs of limited wiggle room in 2022 as the surge in domestic interest rates and GHS depreciation pushed the total interest payment to GHS 32.1bn in 9M2022 (+3.9% vs target). Against this backdrop, the Treasury has increased its projected interest payment for FY2022 to GHS 44.0bn (+6.4% vs the revised target at mid-year) with GHS 11.9bn budgeted for 4Q2022.

Similarly, the addition of a 15% COLA for public sector employees is expected to push total employee compensation to GHS 38.5bn (+1.4% vs revised target at mid-year). Consequently, we observed continued tight fiscal space with interest payment and payroll costs consuming 90.6% of total revenue in 9M2022, emphasizing the financing stress in 2022.

9-MONTH FISCAL PERFORMANCE (2017 – 2022)



SOURCE: MINISTRY OF FINANCE, IC INSIGHTS

.... heading into 2023 with a baggage of arrears

The Treasury expects the combined effects of the weak revenue performance and spending pressures to translate into an overall budget deficit (on cash basis) of GHS 44.5bn (7.2% of GDP), higher than the revised target of 6.6% for FY2022. However, our review of the fiscal data showed a significant build-up of arrears by GHS 16.4bn (2.7% of GDP), culminating in an overall budget deficit (on commitment basis) of GHS 60.9bn (9.9% of GDP). We believe these arrears emanate from overdue obligations to Independent Power Producers (IPPs) and contractors, which emphasizes the intensified fiscal stress, with debt restructuring being inevitable in 2023.

Nature of debt restructuring confirmed...... but details remain unclear

During the 2023 budget presentation, the finance minister confirmed that the authorities plan to implement a debt exchange programme as the preferred form of debt restructuring. This will, however, be done in collaboration with relevant stakeholders including the Ghanaian public, investor community, and development partners.

In our view, the debt exchange programme will offer investors an array of new bond securities with longer-dated maturities at lower interest rates to replace existing shorter residual maturities in their portfolio. Consequently, we expect any bond exchange transaction to reduce the present value of investment for bondholders.

We anticipate the debt operation to cover all public, publicly-guaranteed debt of the central government, and partial non-guaranteed debt of State-Owned Enterprises (SOEs). However, one of the deputy finance ministers, Abena Osei-Asare, noted in an interview with local media that Treasury bills will not be affected by any debt restructuring adopted by the government. We view the exclusion of Treasury bills from debt restructuring as keeping with the government's promise to preserve the Ghanaian investors' principal, albeit with the hope to refinance at lower interest rates after the debt operations.

In a separate interview with local media, another deputy finance minister, John Kumah, hinted at a potential interest suspension in 2023, revising to 5.0% in 2024, and a further 10.0% in 2025. The deputy minister further indicated a proposed 30% haircut on principal and interest on Government of Ghana issued Eurobonds. Although the Ministry of Finance released a statement to retract this comment, we believe the comments provide a hint of scenario discussions to be tabled for investors' consideration.

A closer look at the 2023 budget

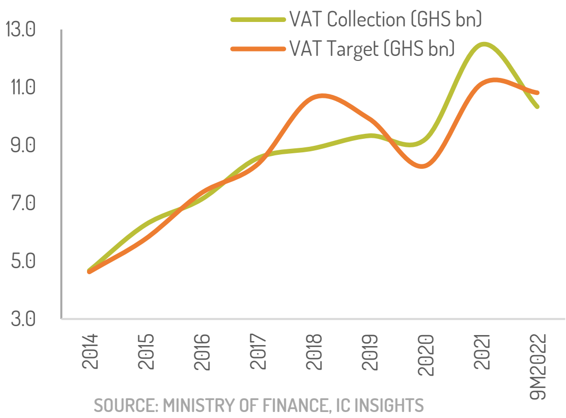
Ghana's FY2023 budget underscores the tough choices facing the authorities in their quest to reset the fiscal balance and restore debt sustainability. The proposed measures aimed at achieving the fiscal objectives signal the difficulties that lie ahead for the consumer sector, financial markets, and overall growth outlook. Basically, the Ghanaian economy could be in a pickle, if the government fails to secure financial guarantees from its creditors to pave way for the much-anticipated IMF programme. Our assessment of the 2023 budget leaves us with little conviction about austerity without an IMF programme. This sustains the risk of a continued build-up of arrears if the authorities fail to secure an early financial package from creditors and development partners.

Revenue measures are broad-based but target appears bullish. For the second consecutive year, it appears the Ghanaian government will rely on an ambitious revenue drive to lead the fiscal consolidation plan. Similar to 2022, the Treasury expects to achieve c.47% y/y growth in total revenue & grants in FY2023 with a target of GHS 144.0bn (18.0% of GDP). The authorities hope to achieve the revenue target with a 2.5% hike in the standard value-added tax (VAT) rate to 15.0% and a review of the VAT threshold. This is projected to rake-in an additional GHS 2.7bn (0.3% of GDP) with c.59% y/y growth in VAT collections to GHS 23.7bn.

The Treasury also announced a 50bps reduction in the E-Levy rate to 1.0% with a removal of the daily threshold exemptions, expecting to broaden the coverage and reduce avoidance of the levy. In view of this, the authorities project a bullish 276% y/y growth in the E-Levy collections to GHS 2.2bn (0.3% of GDP). Other key revenue measures include:

- a total removal of the benchmark discount on import duty computation
- a conversion of the National Fiscal Stabilisation Levy (NFSL) into a Growth and Sustainability Levy (GSL) to cover all entities at different applicable rates between 1% – 5%
- an amendment to the Income Tax Act to introduce an additional tax bracket of 35% amongst other changes.

ANNUAL VAT COLLECTION AGAINST TARGET



SOURCE: MINISTRY OF FINANCE, IC INSIGHTS

In our opinion, these revenue measures appear largely broad-based and builds on the existing collection framework. However, we are less optimistic in our expectation than the authorities' 47% revenue growth target. A 10-year historical analysis showed an average revenue growth of 20%, including an inflation-induced growth of 40% y/y in 2022. Adjusting the FY2022 revenue with the trend growth, in addition to the authorities' expected yield from the new measures (1.35% of GDP), we obtained a y/y revenue growth of 31%, falling below the government's FY2023 target by c.16ppts.

While the indirect tax revenue may be supported by high inflation, we view the weakening purchasing power, deteriorating business profitability, and potential income losses as downside risks to the revenue outlook in FY2023.

Expenditure containment hinges more on creditors' benevolence than self-restraints. The authorities estimate total expenditure (including arrears clearance) at GHS 205.4bn (25.6% of GDP) in 2023. This represents a 44% y/y growth in planned spending with a higher budget deficit (on cash basis) at 7.7% of GDP (FY2022 Target: 7.2%). Without a successful debt restructuring and the start of an IMF programme, we foresee elevated risk of budget overruns in 2023. In view of this, we peg our provisional forecast for the overall budget deficit (cash basis) at 8.1% of GDP (GOG target: 7.7%).
However, a successful implementation of the debt exchange programme should ease the debt service burden with a resultant decline in the total interest payment, which is tentatively estimated at GHS 52.6bn (36.5% of a bullish revenue target).

REVENUE TARGETS (FY2023 vs FY2022)

	FY2023 (p)	FY2022 (p)	Y/Y Change
Total Revenue & Grants	**144.0**	**98.1**	**46.8%**
Tax revenue (GHS bn)	112.4	75.3	49.3%
Non-Tax Revenue (GHS bn)	23.0	15.2	52.0%
Other revenue (GHS bn)	5.5	5.7	-3.8%
Grants (GHS bn)	2.4	1.5	59.8%

SOURCE: MINISTRY OF FINANCE, IC INSIGHTS, (p) → Projected

EXPENDITUE TARGETS (FY2023 vs FY2022)

	FY2023 (p)	FY2022 (p)	Y/Y Change
Total Expenditure + Arrears clearance (GHS bn)	**205.4**	**142.6**	**44.1%**
Employee Comp. (GHS bn)	45.0	38.5	16.9%
Interest Payment (GHS bn)	52.6	44.0	19.4%
Statutory Payment (GHS bn)	30.1	24.0	25.4%
Goods & Services (GHS bn)	8.0	5.9	36.9%
Capital Expenditure (GHS bn)	27.7	15.7	76.1%

SOURCE: MINISTRY OF FINANCE, IC INSIGHTS, (p) → Projected

The 2023 macroeconomic outlook

Based on the expected impact of the new taxes on private sector activity, we are broadly aligned with the government's outlook on key macroeconomic indicators for FY2023.

MACRO-FISCAL TARGETS BY THE GOVERNMENT

	FY2023 Target	FY2022 Target
Macroeconomic and Fiscal Targets		
Overall Real GDP Growth	2.8%	3.7%
Non-Oil Real GDP Growth	3.0%	4.3%
End-Year Headline Inflation	18.9%	28.5%
Overall Budget Deficit (% of GDP)	7.7%	6.6%
Primary Balance (% of GDP)	0.7%	0.4%
Gross International Reserves (Months of import)	3.3	3.5

SOURCE: MINISTRY OF FINANCE

Growth conditions to be weighed down by mounting tax burden and delayed impact of price shocks. We observed that the full impact of the price shocks witnessed in 2022 is yet to reflect in real GDP growth as 1H2022 churned out a 4.1% growth (vs 3.9% in 1H2021). Given the continued decline in the Purchasing Managers' Index (PMI) to below 50pts for the nineth straight month since February 2022, we foresee downside risk to growth in 2H2022 extending into FY2023.

In the year ahead, we forecast overall real GDP growth at 2.7% (GOG: 2.8%, IMF: 2.8%) as the full impact of the 2022 price shocks is felt amidst an intensified tax burden on producers, sellers, and consumers. Specifically, we foresee growth in finance & insurance activities at 1.5% amidst muted appetite for loan book expansion and liquidity constraints from the government's debt restructuring.

We project growth in the manufacturing sector to plummet to 0.3% in FY2023 from our forecast of 3.1% in FY2022. Similar to manufacturing, we expect subdued activity in the construction sector as the year-long FX and price pressures crystalize. We also view the 2.5% hike in the VAT rate, the removal of exemptions on electronic transfers, and an introduction of a 35% income tax bracket as downside risk to purchasing power in 2023.

Inflation should moderate in 2023 on a favourable base effect. The surge in the consumer price index (CPI) in 2022 provides a favourable reference point for a slower increase in the CPI for 2023. Energy prices should be fairly contained in 2023 by expected global recession and the G7's proposed price cap of between US\$65 – US\$70pb on Russian oil. A more stable GHS under an improved monetary policy environment should ease the upside risk from ex-pump prices and transport fares, although the new taxes will exert upward pressure. **Against this backdrop, we forecast FY2023 inflation at 19.3%** (GOG: 18.9%).

Domestic market outlook for 2023

.... on the stock market

The bears could remain rampant. The operating environment for businesses could get tighter in 2023 as the new taxes squeeze production and consumption possibilities. The Fast-Moving Consumer Goods (FMCG) sector is at the highest risk of a squeeze from higher VAT and increased import duty benchmark in 2023.

Financial sector stocks could also remain in the red zone with potentially uninspiring financial results in 2023, due to weaker asset quality, muted loan book expansion, and a softened growth in interest income from the debt restructuring.

Amidst the uncertainty, we continue to view the NewGold ETF as a defensive asset in 2023 due to the lingering GHS vulnerability without assurances on external financing. Also, precious metals, particularly Gold, could regain a safe-haven appeal if the risk of global recession materializes in 2023.

.... on the fixed income market

Debt restructuring should force a downward shift in the Treasury yield curve. In the past few weeks, we have seen a bear market rally on the domestic fixed income market as liquidity from maturing Treasury bonds and the cocoa syndicated loan clouded the underlying market risk. We observed a stronger price action at the back-end of the curve with the bid/offer spread tightening from 600bps on 11 November 2022 to 350bps as of 25 November 2022. Consequently, bid yields have declined by 950bps to 42.5% while offer yields compressed by 700bps to 39.0% at the back-end of the Treasury curve.

The impending Treasury debt exchange could sustain the appeal of longer-dated bonds with relatively lower coupon rates as investors attempt to minimize exposure to losses, in present value terms. In this regard, we reckon the May-28 (coupon: 17.5% | Bal: GHS 1.6bn) could offer a refuge although the low outstanding balance on the security will impede liquidity.

We view the 2023 to 2026 maturities as possible targets for a debt exchange offer due to their associated high debt service cost and refinancing pressure on the Treasury. Specifically, the Nov-26 bond (coupon: 19.0% | Bal: GHS 8.5bn) is highly vulnerable to an exchange offer due to its elevated refinancing risk in 4-years. With a possible suspension of debt service in the near-term and a revision to significantly lower coupon rates in subsequent years, debt exchange offers at the current bond prices will force a decline in yields across the domestic curve.

However, we anticipate negotiations between the government and investors for a workable debt operation to stretch beyond 1Q2023, potentially pushing the yield curve correction into 2H2023.

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