GHANA | MACROECONOMIC UPDATE | MONETARY POLICY | INSIGHTS

FUNDAMENTALS

GHANA MPC UPDATE: A DOVISH HIKE

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IN BRIEF

- The Bank of Ghana announced a 100bps hike in the monetary policy rate to 28.0% at its January 2023 Monetary Policy Committee (MPC) meeting (Market average expectation: +150bps | IC Insights: +200bps

- The 100bps hike marks a sharp slowdown in the pace of monetary tightening observed since 2022, which had averaged 250bps per hike until now. We reckon the MPC is leaning on fiscal adjustment and a successful debt restructuring agreement by end 1Q2023 to drive inflation on a downward path. This stance makes the latest increase in the policy rate feel like a dovish hike

- The budget deficit overshot its FY2022 target and the FY2021 outturn as perennial revenue underperformance amidst the rigid public expenditure framework widened the financing gap

- External debt burden intensified in 2022 due to higher borrowing and FX pressures

- Foreign portfolio outflows offset the marginal decline in the current account deficit but suspension of debt service could ease the pressure on forex reserves in 2023

Bank of Ghana hikes policy rate by 100bps

The Bank of Ghana announced a 100bps hike in the monetary policy rate to 28.0% at its January 2023 Monetary Policy Committee (MPC) meeting (Market average expectation: +150bps I IC Insights: +200bps).

The latest monetary policy rate of 28.0% sets a new peak along the policy curve, making it the highest policy rate since May 2003 and signalling that we may be near the end of a hiking cycle. The 100bps hike marks a sharp slowdown in the pace of monetary tightening observed since 2022, which had averaged 250bps per hike until now.

The MPC cited the need to remain "vigilant and moderate liquidity in the system" as support for its decision. We reckon the MPC is leaning on fiscal adjustment and a successful debt restructuring agreement by end 1Q2023 to drive inflation on a downward path. This stance makes the latest increase in the policy rate feel like a dovish hike.

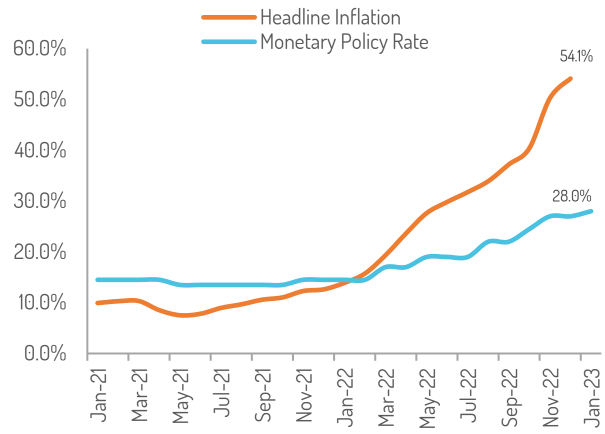
For outlays, total expenditure stood at 23.1% of GDP (GHS 142.2bn) as of November 2022 compared to 21.5% in the same period 2021 and 20.4% target for the period.

The revenue and expenditure performance reflects Ghana's difficulties with spending control as revenue underperformed. This fiscal performance translated into a wider budget deficit equivalent to 9.8% of GDP (GHS 60.4bn), exceeding the FY2022 target of 7.2% and the FY2021 outturn of 9.2%.

The resultant surge in the borrowing requirement was financed from domestic sources (98% of the total financing mix) with the Bank of Ghana providing significant support as the Treasury was priced out of the open market.

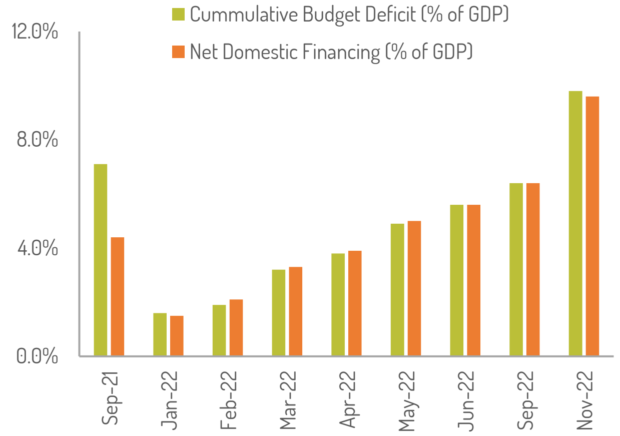
In view of the worsening fiscal position, we remain bearish on the fiscal outlook in the absence of an IMF programme. Under current conditions, the authorities will struggle to comply with the zero Central Bank financing indicated in the 2023 budget as the domestic market remains pricey.

INFLATION AND POLICY RATE PATH SINCE 2021



SOURCE: BANK OF GHANA, GHANA STATISTICAL SERVICE

EVOLUTION OF THE BUDGET DEFICIT AND FINANCING



SOURCE: BANK OF GHANA

Budget deficit overshoots its 2022 target as total revenue underperforms. Ghana's fiscal position weakened further in 2022 compared to the period target and the FY2021 outturn due to persistent revenue underperformance and rigid expenditure.

As of November 2022, total revenue and grants for the 11-months stood at 13.3% of GDP (GHS 81.3bn), lagging the FY2022 target by GHS 16.8bn. Given the average monthly collections, adjusted for potential seasonality in December, we believe the authorities probably garnered total revenue and grants of GHS 90bn (14.6% of GDP) by FY2022. This would translate into an 8.2% (GHS 8.1bn) shortfall relative to the full year target, widening the financing gap amidst the rigid public expenditure framework.

External debt burden intensified on account of higher borrowing and FX pressures. Surprisingly, we noticed an increase in the USD-denominated external debt stock in a period when the authorities had declared debt distress, pending debt restructuring. After remaining relatively stable around USD 28bn since April 2021, Ghana's external debt stock jumped 2.8% in 2-months (+USD 800mn) to USD 29.2bn in November 2022. While we remain surprised by the new borrowing amidst debt distress, we reckon the increase in external borrowing may be due to project loans which were already contracted but belatedly disbursed.

In addition to the sharp depreciation of the Ghanaian Cedi, the GHS-equivalent of external debt stock surged by 132% y/y to GHS 382.7bn. Consequently, the total central government debt soared to GHS 575.7bn (93.5% of GDP) despite a 1.3% decline in the domestic debt in the 2-months to November 2022.

While Ghanaian authorities made progress in the domestic debt restructuring negotiations, we are cautious on the pace of negotiations with external creditors under the G20 Common Framework amidst the upsurge in external debt stock.

Foreign portfolio outflows offset the marginal decline in the current account deficit but suspension of debt service could ease the pressure on forex reserves in 2023. The trade surplus improved markedly in 2022, increasing by 151% y/y to USD 2.8bn (3.8% of GDP) at FY2022. The improved trade balance was underpinned by an 8.3% y/y decline in the value of non-oil imports (USD 10.0bn) and an 18.2% increase in the value of total exports (USD 17.4bn). The stronger trade surplus and a 4.2% y/y growth in inward remittances culminated in a narrowing of the current account deficit to USD 1.6bn (2.3% of GDP) compared to a deficit of USD 2.5bn (3.2% of GDP) in 2021.

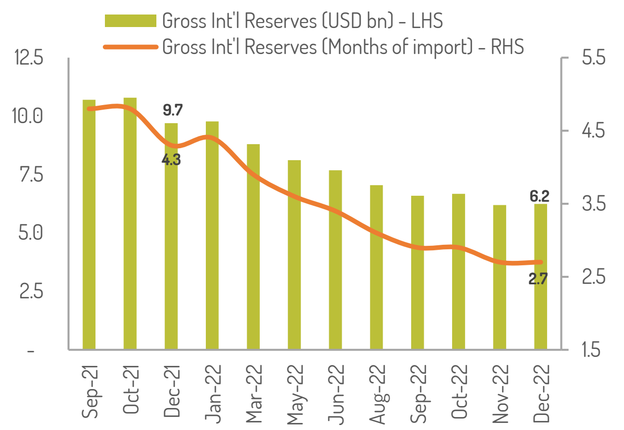
However, the sharp deterioration of investor confidence amidst the downgrades to Ghana's credit rating fuelled aggressive outflow of foreign capital in 2022. The movements in foreign portfolio investment closed FY2022 with a net outflow of USD 2.6bn compared to a net inflow of USD 2.7bn at FY2021. Foreign Direct Investments (FDI) also declined by 39% y/y to close FY2022 at USD 1.5bn. Overall, the capital and financial account balance plummeted to a deficit of USD 2.2bn (3.0% of GDP) compared to a surplus of USD 3.3bn (4.2% of GDP) in 2021. Consequently, the Balance of Payments (BoP) recorded a deficit of USD 3.6bn (5.0% of GDP) compared to the surplus of USD 510.1mn (0.6% of GDP) in 2021.

In the absence of the regular Eurobond inflow to finance the BoP deficit, we observed a 35.7% y/y decline in the stock of gross forex reserves to USD 6.2bn (2.7 months of import cover) as at FY2022. In terms of liquid reserves, we estimate the net forex reserves of USD 2.4bn at 1.1 month of import cover, sustaining the bearish outlook on the Ghanaian Cedi in the near-term.

The local currency commenced 2023 with a 16.2% loss against the US Dollar on the retail market (-20.6% on the BOG reference rate) as forex liquidity remains tight. We believe the government's decision to suspend external debt service will ease the FX demand and limit the decline in forex reserves. Also, a successful conclusion of the domestic debt exchange will limit the supply of local currency through bond maturities and coupons, which tends to fund demand for FX. Consequently, we believe the ongoing debt restructuring efforts will reduce the demand for FX and cap the depreciation pressure on the local currency, pending the start of an IMF programme.

On the FX supply side, Governor Addison noted the authorities' expectation for an IMF Board approval of Ghana's 3-year fiscal adjustment programme by end 1Q2023 as the debt negotiations with both domestic and external creditors are progressing positively. The IMF Board approval will trigger an immediate disbursement of the first tranche from the USD 3.0bn Extended Credit Facility (ECF) to prop-up the forex reserves and anchor exchange rate expectations.

EVOLUTION OF INTERNATIONAL RESERVES



SOURCE: BANK OF GHANA

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