FUNDAMENTALS

LESS CLOUD ON THE HORIZON

UPDATED GHANA MACRO OUTLOOK 2023

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IN BRIEF

- Ghana commenced 2023 with cautious optimism for a credible fiscal path following the IMF Staff-Level Agreement (SLA) in December 2022 for a 3-year Fund-supported programme and ongoing debt restructuring negotiations as prior actions for the IMF Board approval.

- The authorities' new timeline to secure the Board approval by end-May 2023 appears consistent with our longstanding expectation for Ghana to miss the March 2023 initial target date but secure the Board approval in 2Q2023. With positive indications about China's commitment to restructure Ghana's debt, we believe there is less cloud on the horizon for Ghana to secure the much-anticipated IMF Board approval in 2Q2023.

- **Our views on the Treasury's market update in April 2023**

  The IMF Board approval is possible in 2Q2023.

  The ambitious fiscal adjustment hinges on a more credible public expenditure control to match revenue outturn, which we only see feasible under an IMF programme.

  The modest medium-term target of 3-months import cover for gross FX reserves suggests the absence of Eurobond issuances under the IMF programme.

  The World Bank's USD 250.0mn pledge for the Ghana Financial Stability Fund is positive but the other funding sources remain doubtful.

- **Our updated macroeconomic outlook for the rest of 2023**

  The Cedi will remain rangebound after the bear market rally in March 2023.

  Inflation has turned the corner, with a stronger tailwind for disinflation expected in 2Q2023.

  The growth prospects for 2023 remain dim, perhaps dimmer.

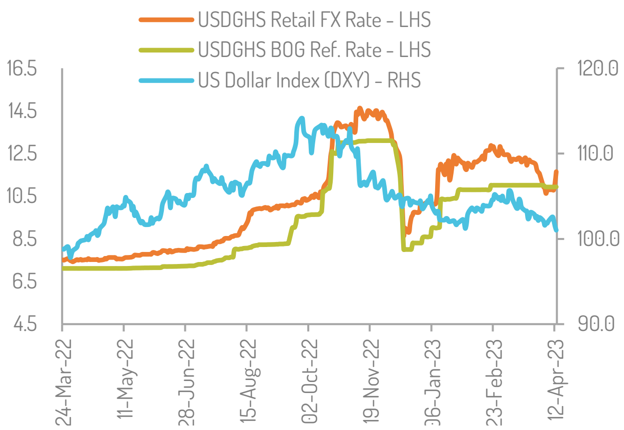
  Yields will resume the downturn in late 2023 with the IMF programme as a catalyst.

A ray of sunshine in 1Q2023

Ghana commenced 2023 with cautious optimism for a credible fiscal path following the IMF Staff-Level Agreement (SLA) in December 2022 for a 3-year Fund-supported programme. While the domestic debt exchange programme (DDEP) – as a prior action for IMF Board approval - was a point of market uncertainty in 1Q2023, the authorities successfully secured agreement with domestic bond investors on revised terms of the DDEP. This represented a major hurdle scaled by the Ghanaian Treasury in February 2023 to reignite market optimism on the fiscal outlook.

The exchange rate responded favourably to the conclusion of the "standard" DDEP, recovering from the 16.1% depreciation in January to post an 11.0% m/m appreciation in March 2023 (YTD: -14.1% as of mid-April 2023). Although the global weakening of the US Dollar since 4Q2022 contributed to the improved performance of the Ghanaian Cedi, we believe the successful DDEP conclusion in February 2023 also supported investor confidence.

INFLATION AND POLICY RATE PATH SINCE 2021



SOURCE: BANK OF GHANA, BLOOMBERG

Prior actions for an IMF Board approval are almost complete

Following the mid-2022 request for an IMF-supported reform programme, the Ghanaian authorities have implemented key measures to restore macroeconomic stability and secure Board approval for its adjustment programme.

These measures include:

- aggressive revenue measures via the 2023 budget,
- cumulative hike of 60% in electricity tariff since August 2022,
- continued increase in monetary policy rate to 29.5% as of March 2023,
- the suspension of external debt service,
- conclusion of the domestic debt exchange programme (for Treasury and Treasury-backed domestic bonds),
- ongoing negotiations with official bilateral and commercial creditors to restructure two-thirds of its USD 29.0bn external debt.

Although the Ghanaian authorities expectedly missed their indicated timeline of end March 2023 for IMF Board approval, the Treasury has assured a new target of end-May 2023 as most of the prior actions have been completed.

Our views on the Treasury's market update in April 2023

The Ghanaian Treasury updated the market on progress towards securing the much-anticipated IMF Board approval for USD 3.0bn funding under a 3-year reforms programme.

The IMF Board approval is possible in 2Q2023. Overall, the government expects to secure assurances from its official creditors between end-April/May 2023, paving the way for the IMF Executive Board approval in 2Q2023. This new timeline appears consistent with our longstanding expectation for the authorities to miss the March 2023 initial target date but secure the Board approval in 2Q2023.

As expected, the authorities reiterated the exclusion of T-bills from the domestic debt restructuring. However, negotiations continue for the restructuring of other domestic debts previously excluded from the "standard" DDEP – cocoa bills (GHS 8.1bn), domestic USD bonds (USD 800mn), local currency loans (GHS 700mn), Pension Funds holdings (GHS 29.2bn), and non-marketable debt held by the Bank of Ghana (GHS 77.6bn).

Notwithstanding these additional domestic restructuring, we believe the financing assurance from official bilateral creditors remains the main impediment to securing an IMF Board approval in 2Q2023. With positive indications about China's commitment to restructure Ghana's debt, we believe there is less cloud on the horizon for Ghana to secure the much-anticipated IMF Board approval in 2Q2023.

Ambitious fiscal adjustment hinges on a more credible public expenditure control to match revenue outturn. The finance minister indicated the government's ambitious fiscal adjustment plan to post a primary surplus ("the budget balance excluding interest payments") equivalent to 1.5% of GDP in the medium-term. This will entail boosting fiscal revenues from 15.7% of GDP in 2022 to c.18.5% in the medium-term.

Given the FY2023 revenue target (incl. grant) of 18.0% of GDP, inching up to 18.9% in FY2025, we estimate that the Ghanaian Treasury will prioritize aggressive revenue mobilization in the first 2-years of the fiscal adjustment programme to support its medium-term revenue target. However, the emerging slowdown in economic activity, reflected in lower import volumes and the ongoing squeeze on consumption expenditure, could undermine the ambitious revenue target of GHS 144.0bn (+49% y/y) in 2023.

The authorities also noted the start of a comprehensive structural reforms with public expenditure placed under review. However, we opine that a credible structural reform and a strict expenditure control is only possible with technical support from the IMF, a critical anchor for Ghana's primary surplus target of 1.5% of GDP. Our review of the April 2023 "Fiscal Monitor" published by the IMF suggests a less bullish medium-term outlook by the IMF. The Fund projects a peak primary surplus equivalent to 1.0% of GDP by 2025 and an average surplus of 0.8% over 2023 – 2028.

In view of the new revenue measures and expected marginal improvement in expenditure control, we trim our forecast pre-restructuring budget deficit for FY2023 by 0.2% of GDP to 7.9% of GDP (GOG target: 7.7%). Furthermore, we view the authorities' medium-term target of 1.5% primary surplus as ambitious within the context of historical performance, which shows a best case of +1.2% in 2017 and a worst case of -1.5% in 2016 during the 2015 – 2018 IMF programme.

The modest medium-term target for gross FX reserves suggests the absence of Eurobond issuances under the IMF programme. The authorities expect to restore Ghana's gross international reserves to 3-months of import cover by 2026 from the FY2022 cover of 2.8-months (USD 5.9bn). In our view, this target for rebuilding the gross forex reserves cover over the medium-term appears modest. While we anticipate an average disbursement of c. USD 1.0bn per year, among other inflows, under the programme to support the forex reserves, we expect the resumption of restructured external debt service to slow reserves build-up. This possibly explains the authorities' modest target of 3-months import cover by 2026.

We also believe the modest target for gross reserves is an indication of Ghana's continued absence from the Eurobond market, partly due to potential IMF restraints, and a limited window to re-enter the international capital market. Although the Ghanaian Treasury emphasized its intention to resume Eurobond issuances in the future, we believe the modest medium-term target for the gross FX reserves cover reveals the authorities' cautious optimism about regaining market access.

The World Bank pledge for the Ghana Financial Stability Fund is positive but the other funding sources remain doubtful. Ghana's Finance Minister reiterated the World Bank's pledge to support the country with USD 250.0mn towards the establishment of a USD 1.5bn Financial Stability Fund to mitigate potential adverse impacts of the DDEP on banks. The authorities also hope to provide USD 500.0mn in addition to ongoing discussions for extra support from unnamed development partners. While the World Bank's pledge improves the outlook for the Stability Fund, we remain unsure of the Treasury's capacity to finance its USD 500.0mn pledge. Together, the World Bank and the Treasury's pledge amount to 50.0% of the total target of USD 1.5bn for the Stability Fund. With less clarity around the Treasury's funding capacity in addition to a funding gap of at least USD 750.0mn, we remain cautious on the hazy outlook for the Ghana Financial Stability Fund. However, domestic banks have weathered the initial storm so far, with robust GHS liquidity in the interbank market in 1Q2023, prompting the Bank of Ghana's decision to reset the Cash Reserve Ratio (CRR) to 14.0% (+200bps).

The prevailing strong liquidity in the interbank market amidst the capital support pledge from some parent companies of foreign banks has deepened our confidence of a low and mitigated systemic risk within the Ghanaian banking industry.

Our updated macroeconomic outlook for the rest of 2023

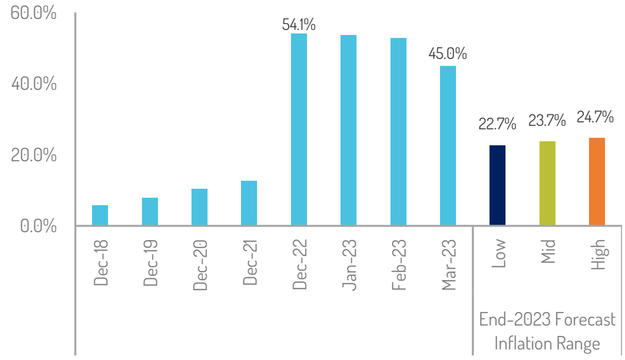
The Cedi will remain rangebound after the bear market rally in March 2023. The Ghanaian Cedi enjoyed a stellar performance with an 11.0% m/m gain in March, paring its early-year losses to close 1Q2023 with a net depreciation of 12.6% against the US Dollar. The impressive performance was helped by the moratorium on external debt service, the domestic debt restructuring, a weaker import demand, and the softening US Dollar. At the end of the Cedi's purple patch, we observed a support level at ≃ GHS 11/USD, at which point the weak economic fundamentals could not support further appreciation.

While the gradual return of forex demand since mid-April 2023 is exerting a modest depreciation pressure on the local currency, we view ≃GHS 13/USD mark as a psychological barrier beyond which profit-taking will ease the pressure. Consequently, we expect the Ghanaian Cedi to continue oscillating within the GHS 11 – GHS 13/USD range as investors await the start of Ghana's IMF support programme with a potential to close FY2023 around the GHS 12/USD mark.

Inflation has turned the corner, with a stronger tailwind for disinflation expected in 2Q2023. Headline inflation peaked at 54.1% in December 2022, approximately 2-months earlier than we anticipated. After a sluggish decline in the first two months of the year, we observed a sharper-than-expected fall to 45.0% in March 2023 on the back of a favourable base effect and a possible demand destruction.

In the months ahead, we expect the favourable base effect to provide a stronger tailwind to sustain the disinflation until year-end. Although we view the Treasury's revenue measures as an upside risk to price expectations, we expect the favourable base effect to outweigh the upside risk while the tight monetary stance works to re-anchor inflation expectations. Against this backdrop, we forecast a FY2023 headline inflation between 22.7% – 24.7%.

HISTORICAL AND FORECAST HEADLINE INFLATION



SOURCE: GHANA STATISTICAL SERVICE, IC INSIGHTS

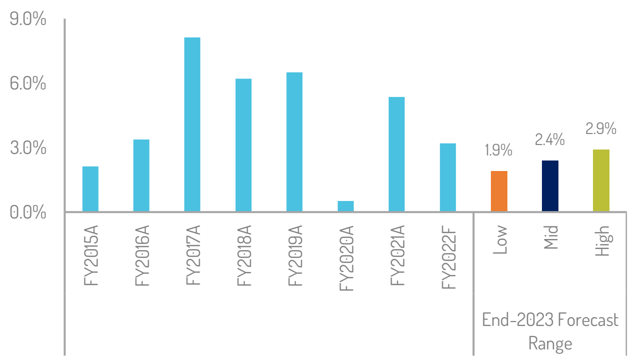
The growth prospects for 2023 remain dim, perhaps dimmer. As expected at the start of the year, the authorities' focus on restoring macroeconomic stability will inevitably weaken 2023 real GDP growth below the estimated 3.4% in FY2022. The trades sector is showing signs of cooling momentum as port activity weakens with a 20.0% y/y decline in container traffic weighing on import volumes in the first two months of 2023. The removal of the discount on benchmark values for import duty computation will exert higher cost on importers, reducing gross margins and profitability. This will potentially weigh on the trades and manufacturing sectors with downside risk for overall growth.

The volume of cement sales continues to slide with 227,000 tons recorded in January 2023, representing a 38.0% y/y decline in sales volume as FX shocks from last year spilled over into 2023. A prolonged contraction in cement sales will possibly weigh on the construction sector, although we see continued recovery in mining activity as a support for industry growth.

Furthermore, we expect a derailment in the growth of the financial services industry as net impairment losses from the DDEP and elevated credit risk weigh on banks' profitability amidst expected contraction in trading income.

Consequently, we trim our FY2023 forecast real GDP growth by 0.3pp to between 1.9% – 2.9% as economic activity bears the brunt of fiscal austerity and complementary monetary squeeze.

HISTORICAL AND FORECAST REAL GDP GROWTH



SOURCE: GHANA STATISTICAL SERVICE, IC INSIGHTS

Yields will resume the downturn in late 2023 with the IMF programme as a catalyst. After plummeting from a peak of 35.0% to between 18.5% and 26.8% by mid-March 2023, yields on T-bills have found renewed upward drive from the unexpected 150bps hike in the policy rate. In the near-term, the Treasury's continued dependence on the money market, without an active primary bond market, will hold yields elevated around current levels of between 19.0% – 27.0%.

However, we foresee scope for a renewed decline in late 2023 towards the 15.0% - 19.0% range. Our outlook is supported by the expected start of Ghana's IMF programme, which will strengthen expenditure controls and reduce the Treasury's borrowing requirements. Additionally, a sustained and potentially faster pace of disinflation will intensify the downward pressure on yields as the Treasury deepens its domestic liability management.

On the secondary fixed income market, we continue to expect a quiet bond market as investors and traders struggle to price the new "payment in kind" bonds while the higher risk-rating on the old bonds dampens their appeal. However, we observe strong secondary market activity for T-bills as investors cheer its exclusion from the domestic debt restructuring amidst sizable uptakes at the weekly primary market offers.

We expect trading in T-bills to continue dominating the secondary fixed income market in 2023 amidst the lack of price action on the bond market. This will drive down trading yields with a spill over to the primary market for T-bills, supporting our downside view on yields by FY2023.

Key factors that could impact our views

- **Unfavourable market reaction to the Treasury's plan to restructure pension funds holdings:** Labour unions have reacted negatively to the latest indication by the Treasury to restructure the GHS 29.2bn bonds held by pension funds. A prolonged and intensified resistance, including strike actions, could weigh on the FX, CPI inflation, and further dampen the outlook for real GDP growth in 2023.
- **A delayed start to the IMF programme:** Our outlook on the key macroeconomic indicators is hinged on Ghana's IMF programme commencing in 2Q2023. While we remain confident of this outcome, an unexpected delay in securing a Board approval in 2Q2023 for programme commencement could trigger a re-pricing of financial assets with pressure points for the Ghanaian Cedi and domestic interest rates.

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