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FUNDAMENTALS

GHANA MPC UPDATE: A HAWKISH PAUSE

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IN BRIEF

- In line with the general market expectations, the Monetary Policy Committee (MPC) of the Bank of Ghana (BOG) maintained the policy rate at 29.5% at the May 2023 MPC meeting. The Committee found comfort in the strong return to the path of disinflation while ongoing liquidity management operations and the agreement on zero budget financing provides the basis for a hawkish pause on the policy rate hikes.

- The banking sector faces rising risk to asset quality and capital buffers despite rebound in profitability ratios. Given the DDEP-induced shock to capital buffers, the IMF has set a target date of end-September 2023 for banks to submit a timebound capital restoration plan to the BOG for approval. With the rebound in profitability indicators on the back of higher net interest margins, we expect the suspension of dividend payments to support capital buffers.

- Fiscal adjustment is underway with the help of expenditure containment. We attribute the GHS 19.4bn (2.3% of GDP) spending suppression to the impact of the Domestic Debt Exchange (DDE) and the suspension of external debt service. However, excluding the impact of lower interest payment, we opine that the lower-than-targeted primary deficit indicates fiscal adjustment is underway.

- External debt service suspension helped the current account balance into surplus. Given that ongoing negotiations with external creditors could stretch into late 2023, the suspension of external debt service should anchor the current account balance in 2023. However, a potential resumption of external debt service in 2024 will revive pressure on the current account balance if debt restructuring is not secured ahead of debt service resumption.

Time for a pause in rate hikes

In line with the general market expectations, the Monetary Policy Committee (MPC) of the Bank of Ghana (BOG) maintained the policy rate at 29.5% at the May 2023 MPC meeting. The "hold" decision represents the second pause in the rate hiking cycle after a similar outcome in September 2022, albeit with a different feel to the latest decision.

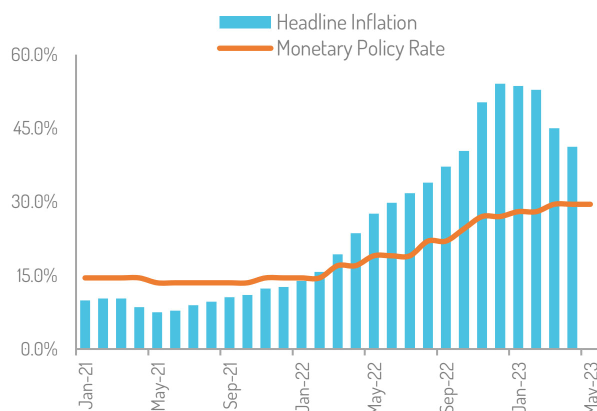
The Committee found comfort in the strong return to the path of disinflation while ongoing liquidity management operations and the agreement on zero budget financing provides the basis for a hawkish pause on the policy rate hikes.

Our views on the latest monetary policy decision

Our assessment of the tone in the MPC statement suggests the Committee believes the policy rate is sufficiently tight to signal its commitment to price stability. With our 12-month forecast inflation screening below 29%, we believe the authorities are justified to leave the policy rate unchanged at 29.5% as the future path of inflation suggests a near-term return to positive real policy rate.

In addition, we think the MPC will lean on the less observable but rapid pass-through effect of liquidity management operations going forward. In recent weeks, we observed an increase in the frequency of use of the 56-day BOG bill in place of the typical 14-day tenor for its weekly Open Market Operations. We expect the longer tenor BOG bills to strengthen the liquidity management outcomes with a more effective pass-through to inflation containment. As part of reforms in the IMF programme, which kick-started late last week, the BOG has eliminated financing of the Treasury's budget deficit. We view these combined monetary tightening measures as aligning with the IMF's directive for the BOG to "continue tightening monetary policy until inflation is on a firmly declining path". The use of these unconventional monetary policy tools makes the latest decision feel like a hawkish pause.

INFLATION AND POLICY RATE PATH SINCE 2021



SOURCE: BANK OF GHANA, GHANA STATISTICAL SERVICE

Banking sector faces rising risk to asset quality and capital buffers despite rebound in profitability ratios. The updated summary of economic and financial data revealed further weakening in asset quality and erosion in capital buffers during the first 4-months of 2023. As of April 2023, Capital Adequacy Ratio (CAR) dropped from 15.1% (DDEP-adjusted) at FY2022 to 14.8% while Non-Performing Loans (NPLs) ratio surged 320bps YTD to 18.0%.

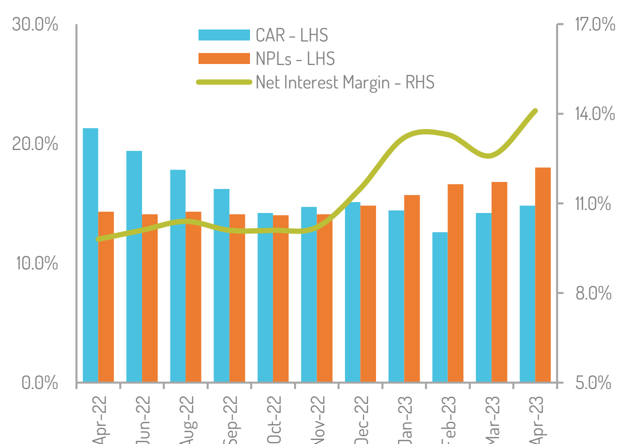
The 30bps YTD weakening in the sector's CAR leaves the excess cover at 480bps compared to the new regulatory minimum of 10.0% and 180bps above the pre-DDEP minimum CAR of 13.0%.

The deterioration in asset quality, indicated by the higher NPLs, reflects the negative spillovers from the surge in the sector's risk-weighted assets amidst the heightened credit risk occasioned by the macroeconomic shocks in 2022. Against this backdrop, we observed a general tightening in credit stance as nominal growth in credit to the private sector slowed by 12.0pp to 19.8% y/y as of April 2023. Amidst the elevated average inflation rate, this culminated in a 15.2% y/y contraction in real private sector credit.

Given the DDEP-induced shock to capital buffers, the IMF has set a target date of end-September 2023 for banks to submit a timebound capital restoration plan to the BOG for approval. In addition to the suspension of dividend payments, the BOG will impose restrictions on risk exposures of banks that do not meet the minimum CAR. In view of this, we reiterate our expectation for banks to maintain a subdued loan book growth in 2023 as rebuild of capital buffers is prioritized.

With the rebound in profitability indicators on the back of higher net interest margins, which stood at 14.1% as of April 2023 (+260bps YTD | +430bps y/y), we expect the suspension of dividend payments to support capital buffers.

BANKING SECTOR INDICATORS



SOURCE: BANK OF GHANA, IC INSIGHTS

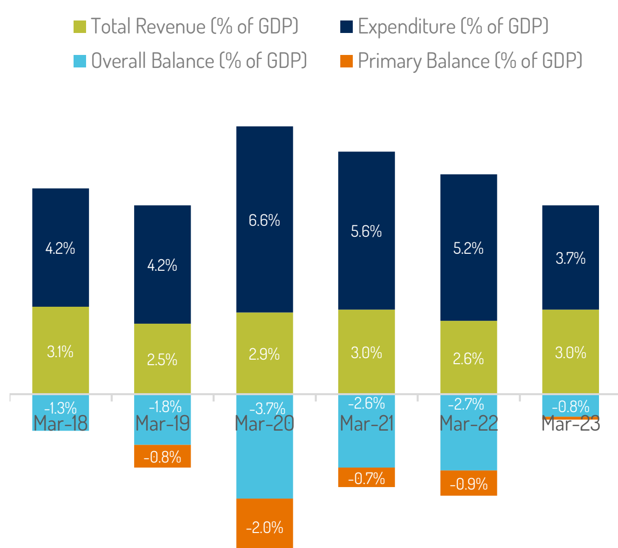
Fiscal adjustment is underway, with the help of expenditure containment. The Treasury's budget execution for the first 3-months of 2023 showed a lower overall fiscal deficit of GHS 6.7bn (0.8% of GDP) against a target of 2.3% in 1Q2023. Specifically, we observed a year-on-year fiscal adjustment equivalent to 0.8% of GDP as the primary deficit narrowed to 0.1% of GDP in 1Q2023 compared to the target of -0.6% and outturn of -0.9% in 1Q2022.

The revenue and expenditure dynamics revealed that the fiscal adjustment in 1Q2023 was largely driven by expenditure controls instead of the revenue-based consolidation envisaged in the FY2023 budget. Total revenue and grants in 1Q2023 turned out at GHS 26.0bn (3.3% of GDP), falling short of target by 0.9% of GDP. Total expenditure amounted to GHS 32.7bn (4.1% of GDP), sufficiently below the target of GHS 52.1bn and supported the faster-than-expected compression in the budget deficit.

We attribute the GHS 19.4bn (2.3% of GDP) spending suppression to the impact of the Domestic Debt Exchange (DDE) and the suspension of external debt service. However, excluding the impact of lower interest payment, we opine that the lower-than-targeted primary deficit indicates fiscal adjustment is underway.

On the revenue side, we attribute the shortfall to the lingering challenges with tax administration and compliance as well as the softening economic activity. We also believe the adverse impact of the DDE on banks' financial results exerted a negative spillover to tax obligations toward the Treasury. In our view, the weakening economic activity and the medium-term impact of the DDE on banks financial position will pose a downside risk to the Treasury's plan for a revenue-based fiscal adjustment.

FIRST QUARTER FISCAL PERFORMANCE (2018 - 2023)



SOURCE: BANK OF GHANA, IC INSIGHTS

External debt service suspension helped the current account balance into surplus. The trade surplus widened in the first 4-months of 2023, hitting USD 1.6bn (2.2% of GDP) compared to the USD 1.2bn (1.6% of GDP) recorded in the same period last year.

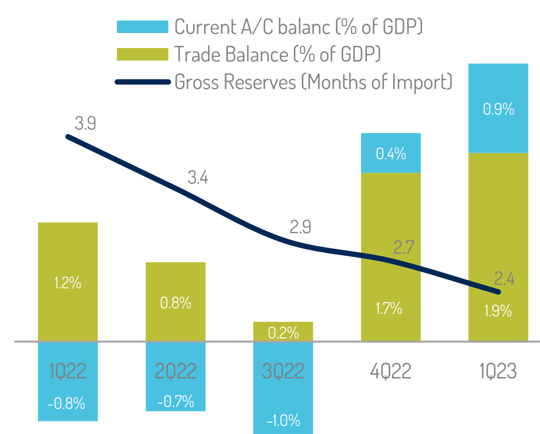
The wider trade surplus was supported by a sharper compression in total imports to USD 4.0bn (-13.9% y/y) compared to a 3.6% y/y decline in total export revenue (USD 5.6bn).

The wider trade surplus combined with an improvement in the services account to swing the current account balance from a deficit in 1Q2022 into a surplus of USD 661.4mn (0.9% of GDP) in 1Q2023. The BOG attributes the improved services account balance to the suspension of external debt service and higher remittance inflows. During 1Q2023, inward remittances increased by 16.3% y/y to USD 1.2bn, combining with the debt service suspension and the trade surplus to churn out a surplus on the current account.

Given that ongoing negotiations with external creditors could stretch into late 2023, the suspension of external debt service should anchor the current account balance in 2023. However, a potential resumption of external debt service in 2024 will revive pressure on the current account balance if debt restructuring is not secured ahead of debt service resumption.

The BOG Governor – Dr. Ernest Addison – confirmed receipt of the first tranche disbursement of USD 600mn under the ongoing IMF programme. The forex inflow supported the gross international reserves (per BOG definition) to USD 5.7bn, equivalent to 2.6 months of import cover as of 19 May 2023. This suggests lingering weak external account buffer with a limited capacity to fund real sector demand, emphasizing the vulnerability to exchange rate shocks and a bearish outlook for real GDP growth.

QUARTERLY EXTERNAL SECTOR PERFORMANCE



SOURCE: BANK OF GHANA, IC INSIGHTS

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