GHANA | MACROECONOMIC UPDATE | MONETARY POLICY | INSIGHTS

FUNDAMENTALS

GHANA MPC UPDATE: THE MONSTER'S NOT GONE YET

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IN BRIEF

- The Monetary Policy Committee (MPC) of the Bank of Ghana delivered a 50bps hike in the Monetary policy Rate (MPR) to 30.0% at its July 2023 MPC meeting. The MPC cited a potential 2nd round effect of the recent food price shocks as an elevated risk to the inflation outlook, which required decisive fiscal and monetary tightening to avert.

- Encouragingly, the Committee allayed our fears that the recent inflation upturn may have deviated from the target band as the MPC noted that inflation as of June 2023 was within the target band under the IMF Monetary Policy Consultation Clause.

- However, upside risks abound as the MPC's baseline forecasts show a slightly higher elevated profile in the year ahead. This could become embedded in underlying inflationary pressures, if not contained with further policy tweaks. Essentially, the inflation monster has only been dazed by ongoing fiscal and monetary tightening but will not be finished off without further policy tightening.

- The scars from the DDEP are visible but ongoing recovery in profits is soothing for the banking sector. We view the strong rebound in banking sector profitability as positive in the medium-term amidst the existing suspension of dividend payments, which will aid the retention of profits and rebuild of capital buffers faster.

- Fiscal execution in the first 5-months of 2023 revealed ongoing adjustments in line with the IMF programme target and indicates a steady moderation in the fiscal risk, albeit still elevated. While we are confident of continued FX stability in 2H2023, we note that the supporting anchors are delicate in the immediate term as Net International Reserves (NIR) remain low ahead of the expected annual cocoa loan syndication. In our view, this will sustain the tight monetary stance in the near-term, pending moderations in inflation and fiscal risk.

Pre-empting the second-round effect

The Monetary Policy Committee (MPC) of the Bank of Ghana delivered a 50bps hike in the Monetary policy Rate (MPR) to 30.0% at its July 2023 MPC meeting. The MPC cited a potential 2nd round effect of the recent food price shocks as an elevated risk to the inflation outlook, which required decisive fiscal and monetary tightening to avert.

Encouragingly, the Committee allayed our fears that the recent inflation upturn may have deviated from the target band. After declining for 4-consecutive months to 41.2% y/y in April 2023, headline inflation reversed course to hit 42.5% in June 2023. In reference to the Monetary Policy Consultation Clause (under the ongoing IMF programme), the MPC noted that inflation as of June 2023 was within the target band.

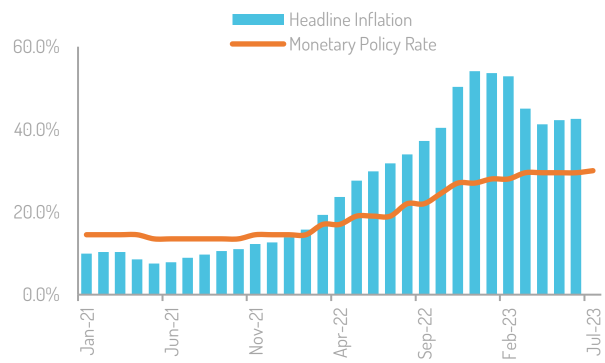
.... but the monster's not gone yet

Overall, the outlook supports a near-term return to the path of disinflation with anticipated food harvest in mid-3Q2023 and a favourable base effect in 4Q2023. However, upside risks abound as the MPC's baseline forecasts show a slightly higher elevated profile in the year ahead. This could become embedded in underlying inflationary pressures, if not contained with further policy tweaks.

The recent inflation expectation survey by the Bank of Ghana indicates that business expectations of inflation remain flat at an elevated level. We believe the unchanged inflation expectations reflect the favourable impact of the 4-consecutive months of decline which was offset by the supply-side and tax-induced inflation upticks in the past 2-months.

The renewed spike in crude oil prices on the global market, with Brent crude nearing USD 83pb as of 24 July 2023, could revive non-food inflation with higher utility tariffs under the baseline. Essentially, the inflation monster has only been dazed by ongoing fiscal and monetary tightening but will not be finished off without further policy tightening.

INFLATION AND POLICY RATE PATH SINCE 2021



SOURCE: BANK OF GHANA, GHANA STATISTICAL SERVICE

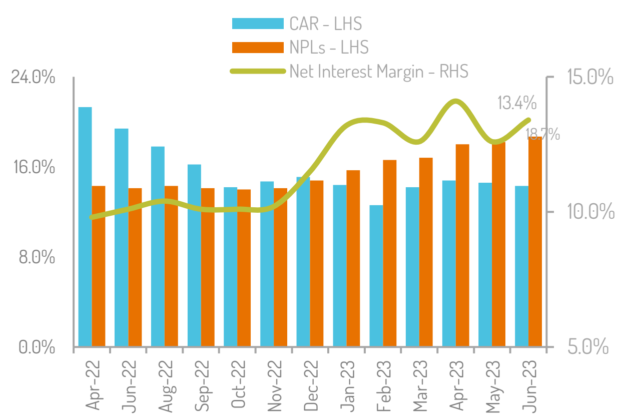
The scars from the DDEP are visible but ongoing recovery in profits is soothing for the banking sector. The 1H2023 financial results of the banking sector showed a strong rebound in post-DDEP profitability, on the back of a 41.4% y/y growth in the industry's net interest income to GHS 9.9bn (+12.4% growth in 1H2022). When combined with a 30.6% y/y growth in net fees & commissions, total operating income surged by 46.1% y/y.

Despite the inflation-induced rise in operating cost by 44.9%, the industry's profit-after-tax expanded by 51.2% y/y to GHS 4.3bn in 1H2023. This translated into a return on equity of 37.6% in 1H2023 (vs 21.9% in 1H2022). We view the strong rebound in profitability as a positive sign for the banking industry in the medium-term as the ongoing suspension of dividend payments will aid the retention of profits and rebuild of capital buffers faster.

We observed a strategic rebalancing of the industry's asset mix, which was funded by a 42.8% y/y growth in total deposits at GHS 187.6bn as of June 2023. Investment securities increased by 11.0% y/y to GHS 89.9bn with short-term securities surging 149.6% y/y to GHS 39.9bn while medium-to-long term investments declined by 22.9% y/y to GHS 50.1bn. The portfolio rebalancing strategy was underpinned by the scars of the DDEP, which continues to impose mark-to-market losses as the restructured securities currently trade at ≈25.0% discount to par value. We also believe the increased short-term investments include placements in the higher-yielding BOG bills and T-bills at average yields of between 25.8% – 30.2% in 1H2023 to prop up interest income.

While financial soundness indicators remained supported by the DDEP-induced temporary regulatory reliefs, the industry's Capital Adequacy Ratio (CAR) averaged 14.3% as of June 2023. The prevailing CAR level is a 430bps buffer on the revised prudential minimum of 10.0%, a 130bps cushion on the pre-DDEP minimum requirement of 13.0%, but 230bps worse compared to FY2022. Overall, we expect this CAR position to constrain credit growth and sustain the preference for the "safe-haven" BOG bills.

EVOLUTION IIN BANKING SECTOR INDICATORS



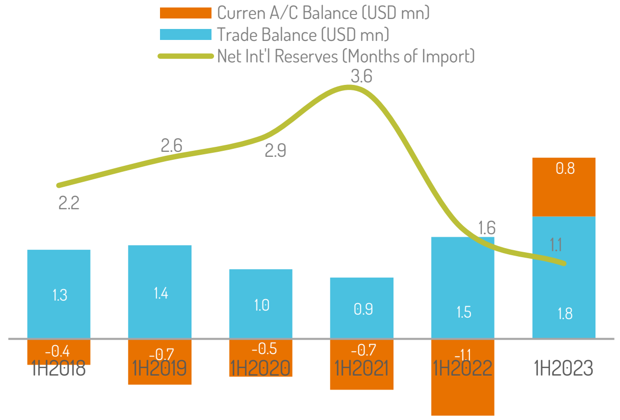
SOURCE: BANK OF GHANA, IC INSIGHTS

Forex cover remains fragile despite improvements in current account balance. The Ghanaian Cedi has enjoyed a re-assuring stability since 2Q2023, owing largely to a tighter monetary stance, the commencement of the IMF programme, a widening trade surplus, and the ongoing suspension of external debt service. In recent weeks, the demand management measures have been supported by improved FX supply on the domestic market, largely from energy and services sector firms. While we are confident of continued FX stability in 2H2023, we note that the supporting anchors are delicate in the immediate term as Net International Reserves (NIR) remain low ahead of the expected annual cocoa loan syndication. In our view, this will sustain the tight monetary stance in the near-term, pending moderations in inflation and fiscal risk.

On a positive note, the trade surplus widened further in 1H2023 to USD 1.8bn (2.4% of GDP), surpassing the pre-pandemic half-year peak. The improved trade balance was helped by a sharp decline in import bills to USD 6.4bn (-13.4% y/y), although export receipts also fell to USD 8.2bn (-7.9% y/y). Also, the ongoing improvement in the current account balance continued, reaching a surplus of USD 849.2mn in 1H2023 (vs a deficit of USD 1.1bn in 1H2022). The improved current account balance was aided by a 22.5% y/y growth in inward remittances to USD 2.4bn and the ongoing suspension of external debt service. While the growth in remittances supported FX supply on the market, the suspension of external debt service has reduced the outflows on the services account.

Notwithstanding the improvements in the external accounts in addition to the programme-related inflows of USD 600mn from the IMF, we observed a 15.6% m/m drop in the Net International Reserves to USD 2.3bn in June 2023 (1.1 months of import cover). The Governor attributed this drawdown to liability settlements such as FX SWAP maturities. While the Governor's indication that the Central Bank is ahead of target on its Gold-for-Reserves purchase programme is re-assuring, we view the lingering liability settlements (such as SWAPs and multilateral debts) as downside risk to FX reserves in the near-term. This should however be mitigated by multilateral supports and cocoa loan syndication.

HALY-YEARLY EXTERNAL SECTOR PERFORMANCE



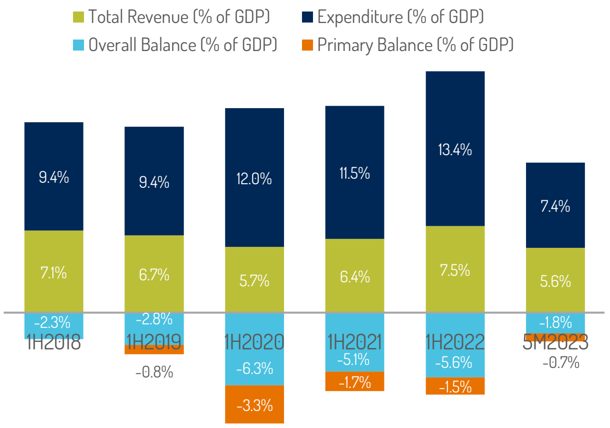
SOURCE: BANK OF GHANA, IC INSIGHTS

Fiscal risk is moderating on the back of expenditure control. Fiscal execution in the first 5-months of 2023 revealed ongoing adjustments in line with the IMF programme target and indicates a steady moderation in the fiscal risk, albeit still elevated. The summary of economic and financial data showed a primary deficit equivalent to 0.7% of GDP, below the target deficit of 0.8%. Our review of the fiscal numbers showed that the better-than-expected non-interest deficit was aided by a suppression in primary expenditure within the context of enforcing structural reforms to rationalize spendings.

Total revenue for the first 5-months undershot the target by 17.8% at GHS 44.9bn (5.6% of GDP). This represents a 47.2% y/y growth, partly due to the elevated inflation for the period. While the target undershooting was expected, we anticipate a slight improvement in the months ahead as the latest revenue measures took effect from May 2023 and are outside the reported revenue data. Amidst the revenue shortfalls and ongoing debt restructuring, the authorities reported a total expenditure of GHS 59.5bn (7.4% of GDP), a 28.1% compression below the budget limit. While this largely reflects the short-term benefits of suspended debt service, the y/y fiscal adjustment of 0.5% of GDP emphasizes the steady progress in restoring fiscal sustainability with successful debt restructuring as a crucial anchor, in our view.

On external debt restructuring, the Governor confirmed that formal discussions are yet to commence between the Ghanaian authorities and the bilateral creditors. However, he indicated that a crucial target of Ghana's external debt restructuring is to reduce the sensitivity of the debt portfolio to FX adjustments. Given that the current level of external debt accounted for 56.3% of the total debt stock as of April 2023, we believe the target to reduce FX-sensitivity implies a potential haircut on principal of outstanding external debt. In our view, this burden is most likely to fall on holders of Ghana's external commercial debts, including the Eurobonds.

HALF-YEARLY FISCAL PERFORMANCE (2018 - 2023)



SOURCE: BANK OF GHANA, IC INSIGHTS

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