GHANA | MACROECONOMIC UPDATE | FISCAL POLICY | INSIGHTS

FUNDAMENTALS

GHANA'S MID-YEAR BUDGET REVIEW: REALITY CHECK

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IN BRIEF

- In our November 2022 note on the FY2023 budget – In a Pickle – we argued that the revenue measures were broad-based and the new tax handles will build on the existing revenue collection framework. However, we opined that the authorities' target revenue growth of 47.0% y/y appeared bullish against our forecast revenue growth of 31.0%, given the challenging macroeconomic backdrop and perennial difficulties with revenue administration.

- In view of this, the revised macro-fiscal framework for 2023 appears to align with reality and the key forecasts under the IMF-supported Extended Credit Facility (ECF) arrangement aimed at restoring policy credibility.

- Fiscal consolidation and adjustments are on track with overall budget deficit (on cash basis) in 1H2023 at 1.3% of GDP, well below the 4.4% target for the period. On commitment basis, the primary balance recorded a surplus of GHS 8.8bn (1.1% of GDP) against a target of zero primary balance for the period. This translates into a year-on-year fiscal adjustment equivalent to 2.5% of GDP and raises our optimism about the authorities' capacity to achieve the revised adjustment target for FY2023.

- Fiscal adjustment will slow down marginally in 2H2023 but remains frontloaded in FY2023 while real GDP growth will soften under the squeeze of fiscal tightening.

- Inflation will remain sticky in 3Q2023 before enjoying a favourable base effect in 4Q2023. Against the sticky inflation backdrop and amidst elevated borrowing pressure, we believe domestic yields have found a new impetus for sustained rise in the near-term.

Ghana's budget execution in 1H2023 turned out as we expected when the authorities presented the FY2023 budget in November 2022. In our note on the FY2023 budget – In a Pickle –, we argued that the revenue measures were broad-based and the new tax handles will build on the existing revenue collection framework. However, we opined that the authorities' target revenue growth of 47.0% y/y appeared bullish against our forecast revenue growth of 31.0%, given the challenging macroeconomic backdrop and perennial difficulties with revenue administration.

On the spending side, we argued that expenditure containment in 2023 will depend on creditor benevolence as the key spending lines appear rigid. Expectedly, the updated fiscal performance in 1H2023 confirmed our fears about the bullish revenue target while expenditure containment was greatly helped by debt service suspension. In view of this, the revised macro-fiscal framework for 2023 appears to align with reality. Overall, we believe the revision to the macro-fiscal framework was underpinned by the need to align key quantitative targets with the IMF forecasts in the Extended Credit Facility (ECF) arrangement aimed at restoring policy credibility.

Oil-related revenues undershot target but green shoots are emerging in non-oil revenue. Total revenue (incl. grants) in 1H2023 came in below the authorities' target for the period despite an encouraging outturn in some line items. Total revenue (incl. grants) turned out GHS 59.3bn (7.4% of GDP), falling short of target by GHS 5.4bn (-8.3% vs target). The revenue shortfall reflected an undershooting across all revenue lines, both in terms of tax and non-tax revenues.

However, we disaggregated the bulk figures and found that there were encouraging performances embedded in the headline figures. Specifically, the outturns for Personal Income Tax (GHS 8.3bn) and Corporate Profit Tax (GHS 10.2bn) exceeded their respective targets by 15.5% and 16.3%. We believe the target overshooting by these non-oil direct tax revenue lines reflects inflation-induced increase in labour earnings, and improved topline with stringent cost controls by businesses, which upheld profitability in 1H2023.

KEY REVENUE TARGETS AND OUTTURN IN 1H2023

GHS Billion	FY2023 Target	1H2023 Target	1H2023 Outturn	1H2023 Deviation
Total Revenue & Grants	**144.0**	**64.7**	**59.3**	**-8.3%**
Tax revenue	112.4	49.6	47.8	-3.6%
Non-Tax Rev.	23.0	10.8	8.3	-23.1%
Other revenue	5.5	2.6	2.0	-23.1%
Grants	2.4	1.4	0.6	-57.1%

SOURCE: MINISTRY OF FINANCE, IC INSIGHTS

We also observed a better-than-expected outturn in VAT collections at GHS 11.4bn (+5.4% vs target), largely reflecting the impact of the 250bps hike in the standard VAT rate to 15.0% and partly due to enforcement of compliance. At this performance rate, we believe VAT collections are on track to exceed the initial FY2023 target of GHS 23.7bn (2.8% of GDP) and potentially match the revised target (GHS 26.2bn) if the authorities sustain the compliance measures. We also expect the planned streamlining of VAT exemptions under the IMF programme to reduce the revenue losses, which is estimated at 2.0% of GDP.

Notwithstanding these encouraging outturns, we observed shortfalls in other revenue lines, which outweighed the positives noted. Tax revenue from oil-related activities recorded a significant shortfall to GHS 1.8bn (-57.3% vs target) while royalties from oil turned out GHS 895.0mn (-56.7% vs target). These oil revenue shortfalls were due to lower-than-projected oil production at the Jubilee and TEN oil fields.

Overall, we observed that the shortfalls in total revenue and grant in 1H2023, largely reflected the challenges in the oil sector and weaker global oil prices in the period under review. On 17 July 2023, Tullow Oil Plc announced the start of the Jubilee South East (JSE) project, which has boosted production above 100,000 barrels per day (FPSO capacity: 120,000 barrels per day). While this bodes well for the Treasury's oil revenue outlook, we do not envisage a significant revenue improvement in the short-term as the hydrocarbon sector remains constrained by recent years of under-investment.

Lower interest payment and restrained CAPEX supported the fiscal consolidation in 1H2023. Total expenditure (excl. arrears payment) was impressively contained at GHS 68.5bn (-26.3% vs budget) despite marginal overruns on the payroll and payments for goods & services.

The spending restraint was aided by lower interest payments on account of the domestic debt operations and suspended external debt service. The authorities also held back CAPEX in 1H2023, indicating renewed commitment to align primary expenditure with revenue performance under the ongoing IMF programme.

KEY EXPENDITURE TARGETS AND OUTTURN IN 1H2023

GHS Billion	FY2023 Budget	1H2023 Budget	1H2023 Outturn	1H2023 Deviation
Total Expenditure + Arrears clearance	**205.4**	**100.2**	**72.5**	**-27.6%**
Employee Comp,	45.5	22.8	23.9	+4.8%
Interest Payment	52.6	28.6	15.1	-47.2%
Statutory Payment	30.1	13.5	13.0	-3.7%
Goods & Services	8.0	4.1	4.7	+14.6%
Capital Expenditure	26.5	16.6	7.9	-52.4%

SOURCE: MINISTRY OF FINANCE, IC INSIGHTS

Although payroll spending (GHS 23.9bn) exceeded the 1H2023 budget by 4.8%, we do not view this overrun as a fundamental risk to the fiscal outlook as it reflects the post-budget increase in public sector base pay in January 2023. We observed that the fiscal framework for FY2023 has been adjusted to keep the budget execution on the path of fiscal consolidation.

Consolidation and adjustments are on track

We observed a slower-than-expected pace of arrears clearance in 1H2023 with the GHS 4.0bn payment falling short of the period target by 44.1%. While this appears disappointing from the perspective of arrears clearance plan, we observed that the overall budget deficit (on cash basis) would not have been adversely affected if the authorities were current on arrears payment. The overall budget deficit (on cash basis) in 1H2023 was 1.3% of GDP (or 1.7% if we assume full arears payment), well below the 4.4% target for the period.

Impressively, we observed a stronger-than-anticipated fiscal adjustment in 1H2023 with the primary balance beating target on both commitment and cash bases. On commitment basis, the primary balance recorded a surplus of GHS 8.8bn (1.1% of GDP) against a target of zero primary balance for the period. This translates into a year-on-year fiscal adjustment equivalent to 2.5% of GDP and raises our optimism about the authorities' capacity to achieve the revised adjustment target for FY2023.

Updated outlook for 2H2023

Aligning the macro-fiscal framework with the IMF programme

Following the official commencement of Ghana's IMF-supported adjustment programme in May 2023, the authorities leveraged the mid-year budget review to align the FY2023 macro-fiscal targets with the IMF forecasts under the ECF programme. In summary, we observed adverse revisions to all the FY2023 macro-fiscal targets compared to their pre-ECF forecasts.

Fiscal adjustment will slow down marginally in 2H2023 but remains frontloaded in FY2023. After an aggressive start to fiscal adjustment in 1H2023, with a surplus primary balance, the revised fiscal framework shows a target primary deficit by FY2023 (vs initial target of primary surplus). Specifically, the revised FY2023 primary balance on commitment basis was reset to -0.5% of GDP (vs +0.7% in the original 2023 budget).

Despite the expected slowdown of fiscal adjustment in 2H2023, we note that the year-on-year pace of adjustment remained strong at 3.8% of GDP by FY2023. In our view, this revised pace of adjustment appears more realistic and attainable compared to the pre-ECF adjustment target of 5.0% in 2023.

Our review of the revenue and expenditure figures revealed that the authorities trimmed the revenue targets in line with the outturn observed in 1H2023. Total revenue (incl. grants) was cut to GHS 134.9bn (-6.3% vs initial target), translating into a 39.5% y/y growth (IC Insights revised forecast: +37.4% y/y). In our view, the revised revenue target appears realistic against historical trend and the new measures ongoing in the 2023 budget.

On the expenditure front, the payroll budget was revised upward to GHS 51.3bn (+12.8%), reflecting the 30.0% increase in public sector base pay which caused the temporary overshooting in 1H2023. To more than offset the higher wage bill, the authorities trimmed the budget for interest payment to GHS 44.9bn (-14.6%) and CAPEX to GHS 20.4bn (-23.0%). We observed that the CAPEX cut impacted the Annual Budget Funding Amount (ABFA) allocated for Ministries, Departments, and Agencies (MDAs). In our view, this reflects the commitment to control primary expenditure as oil revenue is forecasted to fall below initial expectations. Consequently, the revised expenditure lines culminated in a lower total expenditure (on commitment basis) at GHS 183.9bn (-3.8%).

We also noticed that the authorities have reduced the FY2023 arrears payment plan to GHS 6.0bn (-58.3% vs pre-ECF budget) and the external debt amortisation plan to GHS 16.1bn (-27.8%).

In view of the realistic revenue and expenditure targets with an inflation-induced increase in the forecast nominal GDP, we trim our forecast FY2023 overall budget deficit (cash) by 1.4pp to 6.5% ± 0.5pp (GOG revised target: 6.4%).

REVISED MACRO-FISCAL TARGETS FOR FY2023

	GOG Original Target	GOG Revised Target	IC Revised Forecast
FY2023 Macroeconomic and Fiscal Targets and IC Insights Forecast			
Overall Real GDP Growth	2.8%	1.5%	1.4%
Non-Oil Real GDP Growth	3.0%	1.5%	NA
End-Year Headline Inflation	18.9%	31.3%	29.9%
Overall Budget Balance – Cash (% of GDP)	-7.7%	-6.4%	-6.5%
Primary Balance – Cash (% of GDP)	-1.1%	-1.2%	NA
Overall Budget Balance – Commitment (% of GDP)	-5.9%	-5.7%	NA
Primary Balance – Commitment (% of GDP)	0.7%	-0.5%	NA
Gross International Reserves (Months of import)	3.3	0.8	NA

SOURCE: MINISTRY OF FINANCE, IC INSIGHTS

Inflation will remain sticky in 3Q2023 before enjoying a favourable base effect in 4Q2023. In recent weeks, we observe an uptick in risk to the inflation outlook, mainly from a surge in global energy prices with Brent crude oil racing above USD 85 per barrel as of end-July 2023. Resultantly, domestic ex-pump prices jumped 4.4% in the first pricing window in August 2023 with potentially higher prices in the outlook.

Furthermore, we perceive emerging inflation risk from El Nino and geopolitics-induced rise in imported food prices, which could mute the benefit of the expected domestic harvest in 3Q2023. Additionally, we foresee the ongoing implementation of new taxes in the original 2023 budget and enforcement of compliance as upside risk to inflation, especially in 3Q2023, before slowing sharply in 4Q2023 due to favourable base effect.

Against this inflation backdrop, we foresee a higher food and non-food inflation profile than initially anticipated. Consequently, we raise our end-2023 inflation forecast by 310bps to 29.9% ± 1.0pp (GOG revised target: 31.3%).

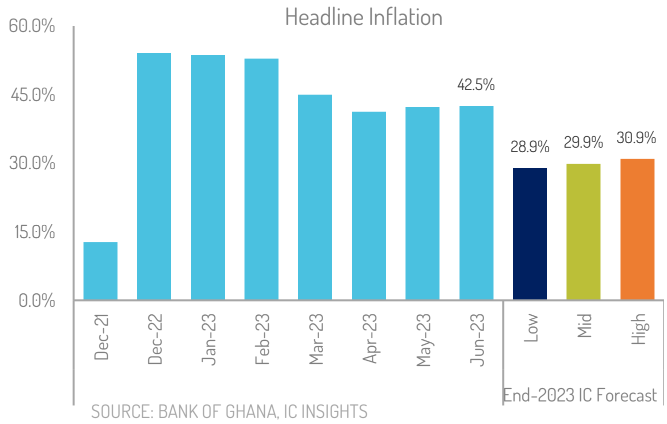
Real GDP growth will soften in FY2023 under the squeeze of fiscal tightening. In our update on the real GDP growth in 1Q2023 – Peeling the Onion – we opined that the 4.2% y/y growth will not be sustained in the subsequent quarters. Our bearish view on growth was underpinned by the expected squeeze from fiscal austerity which was not reflected in the 1Q2023 GDP growth.

Expectedly, the authorities' revised FY2023 growth target of 1.5% (-130bps) appears to align with our longstanding bearishness on growth amidst the contractions in the industry sector. Given the further cut to FY2023 public expenditure and arrears payment, together with the unexpected hike in the monetary policy rate in July 2023, we lower our FY2023 forecast real GDP growth to 1.4% ± 0.5pp (-100bps).

Domestic yields have found a new impetus for sustained rise in the near-term. We view the inevitable switch to a primary deficit target in FY2023 (vs pre-ECF target surplus), as a signal for higher-than-envisaged borrowing need in 2H2023. Also, the upward revision in the year-end target inflation to 31.3% (vs 18.9% previously signalled) communicates prolonged upside risk to real returns on investment.

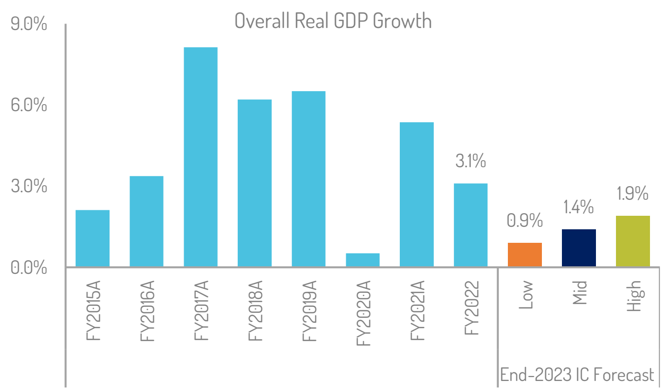
Given that Treasury bills remain the only domestic borrowing instrument available to the authorities amidst conditional inflows from IMF-related sources, we expect yields to remain under upward pressure in the near-term. As of end-July 2023, we estimate the upcoming T-bill maturities at GHS 38.0bn (USD 3.5bn) with the 91-day maturities truncated at end October 2023. In addition to the projected deficit financing of GHS 41.4bn (USD 3.8bn) via T-bills in 2H2023, we obtained a baseline gross financing requirement of GHS 79.4bn (USD 7.2bn) in 2H2023. In our view, the continued high borrowing requirement with a potentially sticky inflation profile will sustain the upward pressure on short-term yields as investors hold out for higher risk premiums.

HISTORICAL AND FORECAST INFLATION FOR 2023



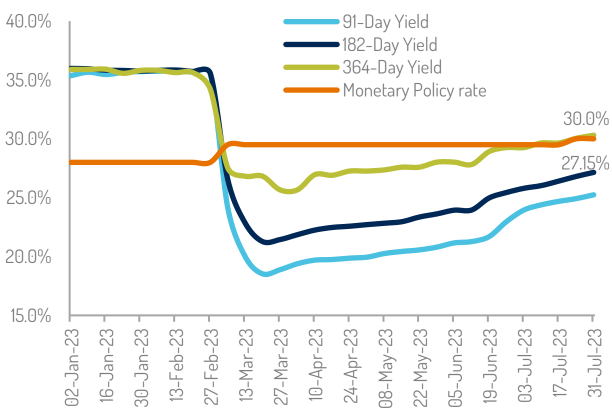
SOURCE: BANK OF GHANA, IC INSIGHTS

HISTORICAL AND FORECAST REAL GDP GROWTH FOR 2023



SOURCE: GHANA STATISTICAL SERVICE

TREASURY BILL YIELDS RESUMED AN UPTURN IN 1H2023



SOURCE: BANK OF GHANA

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