GHANA | MACROECONOMIC UPDATE | INVESTMENT INSIGHTS | MULTI-ASSET STRATEGY

IC BIG IDEAS

WHISTLING IN THE DARK

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IN BRIEF

- Ghana's 2023 Domestic Debt Exchange Programme (DDEP) left in its wake an inactive bond market, shortened domestic yield curve, weakened solvency ratios in the banking sector, and limited investment options for different categories of investors. On the stock market, banks felt the second-round effect of their significant exposure to the DDEP. As the sector's share prices plummeted to drag the Financial Stock Index to a FY2023 loss of 7.4%, Telco, FMCGs, and petroleum stocks defied the challenging macro backdrop, lifting the GSE-Composite Index to close 2023 with a full year gain of 28.1%.

- As Ghana and the global economy enters a new phase of uncertainty, marked by elections in some investible markets amidst heightened geopolitical conflicts in Eastern Europe and the Middle East, we issue our 2024 edition of the IC Big Ideas with cautiously optimistic perspectives – akin to whistling in the dark.

- **Idea #1:** Treasury and BOG securities are good for conventional low risk-appetite investors as the 182-day and 364-day T-bills will offer better inflation-adjusted returns over the holding period. However, we emphasize that the back-end of the T-bill curve is only suitable for investors who are indifferent to the uncertainty and likely macro-related shocks in the lead up to Ghana's upcoming elections in December 2024.

- **Idea #2:** During our 2023 local investor roadshows with our Global Markets team, a key takeaway from the investor meetings was the rising appetite for currency hedge. We think the heightened political activities and geopolitics in 2024 strengthen the case to hedge against potential election-related shocks to the Ghanaian Cedi. We recommend hedging via the IC Africa Fixed Income Fund, US Treasuries, USD-denominated Fixed Deposits, and US Exchange Traded Funds (ETFs).

- **Idea #3:** Plug into Ghana's infrastructure and credit gap to connect alternative assets with sustainable cashflow. Subject to diversified portfolio of properties and a sustainable revenue stream, we think the Real Estate and Real Estate Investment Trusts (REITs) sector provides an option. We also view the conservative credit stance of banks as a financing opportunity in the real sector. This could be filled by syndication of private pension funds and bank balance sheet with structured finance such as Asset-Backed Securities for energy, manufacturing, construction, and Transport sector businesses.

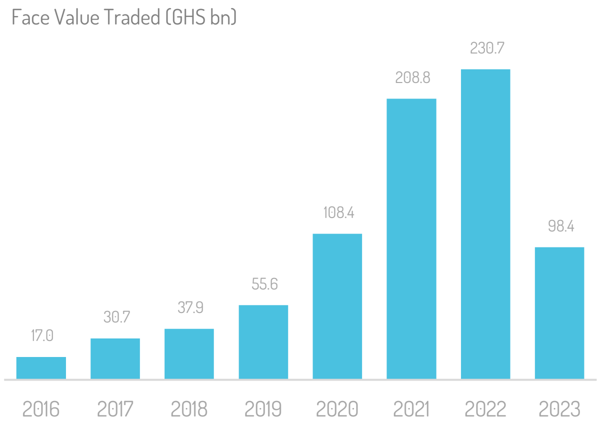
- **Idea #4:** Buying the dip: Explore stock picking opportunities in the banking sector. Given its reassuring investment thesis, SCB makes the cut and is our top pick in 2024, for now. We expound on the upside potential of the stock in our upcoming Initiation of Coverage Report in which we issue an **ACCUMULATE** rating on the stock with the fair value of the stock provisionally set at GHS 20.40 in our current model.

2023 in retrospect

Choppy markets with limited options

Ghana's 2023 Domestic Debt Exchange Programme (DDEP) left in its wake an inactive bond market as the segmented bond market structure and elevated short-term yields weighed on medium-to-long term fixed income investing. The Ghana Fixed Income Market (GFIM) endured a 57.3% y/y slump in trade volume to GHS 98.4bn as of FY2023 with the corresponding value traded at 80.0% of the face value, representing a 15.2% y/y drop in valuations. Amidst the growth in Asset under Management (AUM) of pension funds and strong interbank liquidity, the limited investment options restricted most of the GFIM trades to REPOs, Sell-buybacks, and T-bill purchases.

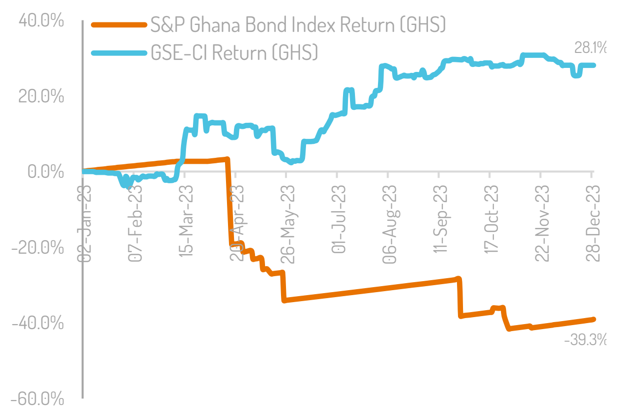
PERFORMANCE OF GHANA FIXED INCOME MARKET



SOURCE: GHANA FIXED INCOME MARKET, IC INSIGHTS

On the stock market, banks felt the second-round effect of their significant exposure to the DDEP as investors priced the financial and capital losses into valuations of listed banks. Consequently, the Ghana Stock Exchange Financial Stock Index (GSE-FSI) sank into the red (-7.4% FY2023) while gains for MTNGH, FMCGs, and TOTAL lifted the composite index above choppy waters (+28.1% FY2023).

FIXED INCOME & STOCK MARKET PERFORMANCE IN 2023



SOURCE: BLOOMBERG, S&P

Investing Ideas for 2024

Idea #1:

Treasury and BOG securities are good for conventional low risk-appetite investors as the 182-day and 364-day T-bills will offer better inflation-adjusted returns

Investment Horizon: Short-term

Key risk: Elections, Debt operations, FX, Inflation, MPC decisions

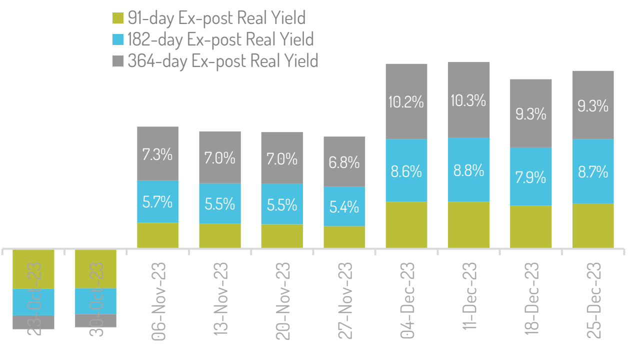
Money market yields remained broadly elevated in 2023 amidst a hawkish monetary stance, the Treasury's exclusive reliance on T-bills, and the early-year stickiness in inflation. However, strong disinflation since 2H2023 induced downward pressure in 4Q2023. On a year-on-year basis, the 91-day T-bill returned an average yield of 26.9% (+269bps y/y) despite the year-end yield dropping 600bps y/y to 29.4%. Similarly, the 364-day average yield returned 31.1% (+482bps y/y) while the year-end rate closed lower by 361bps at 32.5%. When we adjust the nominal yields for average inflation of 40.3% in 2023, we found that investors in money market securities endured a second straight year of negative real yields.

However, the tailwind to disinflation continues to strengthen with inflation plunging to 23.2% at the end of 2023 and flipping real yields into positive territory. We expect inflation to continue on its downward path in 2024, albeit with transitory upticks along the trend. Our downside view on inflation suggests downward pressure on nominal yields in 2024 although, the Treasury's heavy reliance on T-bill issuance, uncertainty around Eurobond restructuring, and a sluggish pace of monetary easing will limit the pace of yield decline in 1H2024.

In view of the downward pressure on nominal yields in 2024 and noting that the Treasury officially announced an end to its DDEP, we recommend buying the 364-day T-bill for investors agnostic to elections and debt restructuring uncertainty. On an ex-post basis, investors who bought the Nov-24 maturities of 364-day bill have locked-in a positive average real yield of 7.1% with the potential for this inflation-adjusted return to widen as inflation declines in the months ahead. Our forecast suggests the positive real yield on the Nov-24 maturities could widen to the mid-teens upon redemption at face value. However, we emphasize that this tenor exposure is only suitable for investors who are indifferent to the uncertainty and likely macro-related shocks associated with the 2024 elections which is slated for 07 December 2024. We also reiterate that the prevailing yields on T-bills continue to slightly reflect the Treasury's 2022 default on domestic bonds.

For investors who are averse to elections and default risk, we believe a direct exposure to T-bill with an exit by July 2024 will maximize inflation-adjusted returns. We note that investors who bought the May-24 T-bill maturities in November 2023 have booked an average positive ex-post real interest rate of 5.5%, which would widen with disinflation in the months ahead. Upon maturity in May 2024, we believe the risk-averse investor could deploy cash via REPOs and sell-buybacks without direct exposure to the underlying T-bills for the full term, but enjoy the prospect of some gains. We also believe that this REPO strategy will keep the portfolio sufficiently nimble to take advantage of any investment opportunities during the year.

INFLATION-ADJUSTED YIELDS ON GHANAIAN T-BILLS



SOURCE: BANKOF GHANA, IC INSIGHTS

Idea #2:

Heightened political activities and geopolitics in 2024 strengthen the case to hedge against near-term policy and security risks

Investment Horizon: Short-to-medium term

Key Risks: Ghana elections, US elections, Geopolitics, FX, Inflation, FED rate decisions

During our 2023 local investor roadshows with our Global Markets team, the key takeaways from the investor meetings were the rising appetite for alternative investments and demand for currency hedging products. The appetite for currency hedging products intensified as a consequence of the 38.9% depreciation of the Ghanaian Cedi in 2022, which imposed significant losses on portfolios that were less nimble to allow for flight to safe assets.

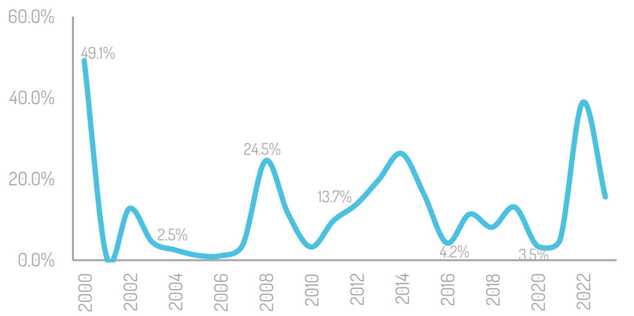
In 2024, we foresee a stronger push for currency hedging options as domestic and global elections heighten the policy uncertainty while elevated geopolitical risks fuel global insecurity.

Ghanaian elections have typically churned out sharp depreciation of the local currency with an average annual depreciation of 16.3% in the past six election years since 2000. We ran different election-year scenarios and arrived at a conclusion that hedging the investment portfolio against election-year currency shocks is optimal, despite the seeming comfort from an IMF anchor.

In one scenario, we excluded election years under an IMF/World Bank programme and obtained an average annual depreciation of 22.7% (higher than the 16.3% in unadjusted election years). This suggests that currency depreciation in election years under IMF programmes are relatively moderate and less volatile. We confirmed this with another scenario using elections under IMF/World Bank programmes to obtain an average annual depreciation of 3.4%, with 2004 at 2.5% and 2016 at 4.2%.

Lastly, we considered FX performance in election years in which the incumbent political party had completed two terms as these elections are typically highly competitive. In these election years, we observed the highest average annual depreciation at 26.0%. Given that Ghana's 2024 election aligns with our last scenario, we would typically expect high risk of FX volatility. However, we view the ongoing IMF programme as a crucial policy anchor to mitigate the risk of fiscal excesses while the risk of policy uncertainty arising from the vote outcome remains unmitigated.

ANNUAL DEPRECIATION OF THE GHS AGAINST THE USD



SOURCE: BLOOMBERG, IC INSIGHTS

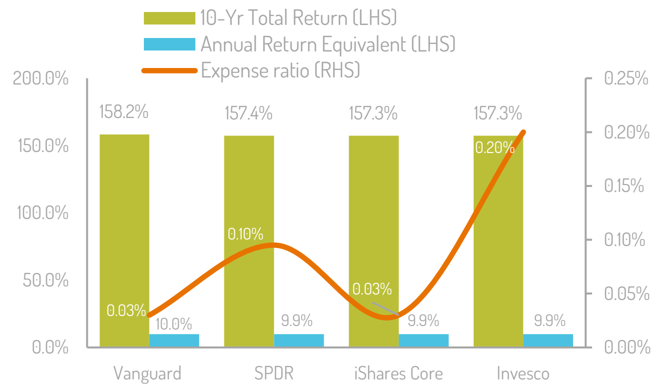
Our scenario analyses support a hedging strategy against a likely unexpected FX shock that may not be fully mitigated by the IMF programme. The ongoing geopolitical conflict in the Middle East could combine with deeper output cuts by OPEC+ to fuel oil prices above USD 90pb (currently under USD 80pb). This will raise Ghana's energy import bill and inflationary pressure, with elevated risk to the Ghanaian Cedi. While our expectation for the US to avoid recession in 2024 limits the upside for Gold, we think geopolitical tensions amidst global elections in 2024 throws the cat among the pigeons.

Consequently, we recommend FX-denominated assets to hedge against the FX risk in addition to the expected return on the underlying assets. The strategy could involve direct exposure to assets such as IC Africa Fixed Income Fund, US Treasuries, USD-denominated FDs, and Gold. Alternatively, the route of defensive Exchange Traded Funds (ETFs) with a low expense ratio could be explored. Generally, we tip the S&P 500 ETFs as viable hedges against shocks to the Ghanaian Cedi and with a healthy history of annual returns in USD terms. Specifically, the Vanguard S&P 500

ETF imposes the joint least expense ratio of 0.03% but generated the highest average annual return of 9.95% in the past 10-years.

If we assume the average unadjusted election-year FX depreciation of 16.3% (USDGHS: 14.3), we believe an asset class with at least 4.0% return in USD terms will be sufficient to outperform our forecast GOG yield of between 20.7% – 23.7%.

PERFORMANCE OF S&P 500 ETFs WITH EXPENSE RATIOS



Idea #3:

Plug into Ghana's infrastructure and credit gap to connect alternative assets with sustainable cashflow

Investment Horizon: Medium-to-long term

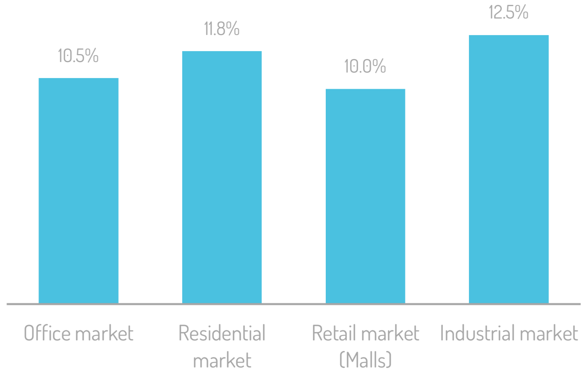
Key Risks: Ghanaian elections, policy changes, interest rate, FX, credit risk, technology

As of end-September 2023, Ghana's Securities and Exchange Commission (SEC) pegged pension funds under management at GHS 33.1bn (at mark-to-market valuation). According to the investment guidelines by National Pensions Regulatory Authority (NPRA), pension funds are allowed to allocate up to 25% of assets under management to alternative assets. Per our estimates, this translates into potential demand of over GHS 8.0bn for alternative investments as of FY2023.

We observed on our 2023 local investor roadshows that there is growing appetite for alternative assets as investors seek to dilute the concentration of Treasury securities in their portfolio post-DDEP. However, the limited scope of investible assets in the Ghanaian alternative space continues to undermine investors attempt to diversify.

Given the difficulties with engaging a viable private equity (PE) fund, we think the private debts route is worth exploring. Subject to diversified portfolio of properties with sustainable revenue streams, the Real Estate, or Real Estate Investment Trusts (REITs) sector provides an option. We also view the excess demand for hostel facilities across Ghana's public university campuses as a viable investment opportunity with a possible syndication of pension funds. The Ghana Investment Promotion Centre (GIPC) pegs the average yield on office real estate investment at between 8.5% – 12.5% while residential market yields between 10.0% - 13.5% in USD terms. Given the ongoing disinflation with a corresponding downturn in domestic interest rates, we believe real estate investments will generate GHS-equivalent yields to outperform T-bills in the near-to-medium term.

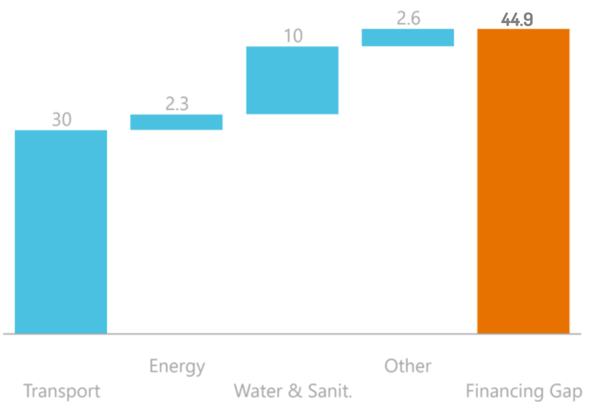
AVERAGE YIELD ON REAL ESTATE INVESTMENT IN GHANA (in USD)



SOURCE: GIPC, IC INSIGHTS

We also believe infrastructure projects supported by anchor investors such as Development Finance Institutions (DFIs) and government agencies via the Ghana Infrastructure investment Fund (GIIF) offers a route to public projects.

GHANA'S INFRASTRUCTURE INVESTMENT GAP by 2040 (USD 'bn)



SOURCE: MINISTRY OF FINANCE, (2021 SDG INVESTMENT FAIR), GIH (2020)

With a paid-in equity capital of USD 345mn, the GIIF is mandated by an Act of Parliament to attract private capital for investment in commercially-viable projects under Public-Private Partnerships, Joint Ventures, and Concessions. As of February 2022, total project cost was worth USD 3.3bn, spread across transport (28%), tourism (16%), mining (13%), ICT (12%), power (11%), oil & gas

(10%), and other sectors (10%). Under the transport sector projects, we think planned and ongoing expansion of Ghana's ports and airports hold commercial value with sustainable revenue stream. We believe the participation of DFIs through the GIIF provides a reassuring anchor consistent with the NPRA guidelines on project finance via syndication of pension funds.

PIPELINE OF GHANA'S RAIL INFRASTRUCTURE PROJECTS

	Metro/Light Rail Transit System	Central Spine Rail Line	Trans-ECOWAS Railway Line
Location	Kumasi	Kumasi - Paga	Aflao - Elubo
Sub-sector	Light Rail	Rail	Rail
CAPEX Need	USD 5.8bn	USD 3.3bn	USD 3.8bn
Debt Financing	70%	TBD	100%
Equity Financing	30%	TBD	NA
Project Structure	PPP	PPP/BOT	PPP (Hybrid BOT Options)
Operation Start	2025	2029	2025
Concession period	30 years	30 years	

SOURCE: MINISTRY OF RAILWAY DEVELOPMENT, (2021 SDG INVESTMENT FAIR)

Plugging the credit gap in 2024 with patient capital from pension funds via structured finance. In 2024, we anticipate banks' credit stance to remain generally tight as the sector works to rebuild its capital buffer in an election year amidst the high non-performing loans (20.7% in December 2023). However, our expectation of a modest rebound in economic activity in 2024 suggests potential financing need by private sector firms who may be in a post-crisis recovery mode but may be unable to access traditional bank credit. This creates a financing gap in the real sector that could be filled by syndication of private pension funds and bank balance sheet with structured finance. The financing structure will be based on the business' need for specialized tenors, debt service schedule, or pricing structures to match the firms cash flow cycle – whether in construction, transport, energy, or manufacturing. In our view, Asset-Backed Securities (ABS) for firms in the energy, manufacturing, and transport sectors (especially, ports and harbours) could bridge the long-term financing gap while securing cash flow to investors.

Idea #4:

Buying the dip: Explore stock picking opportunities in the banking sector

Investment Horizon: Medium-to-long term

Key Risks: Ghanaian elections, interest rate risk, credit risk, Eurobond restructuring.

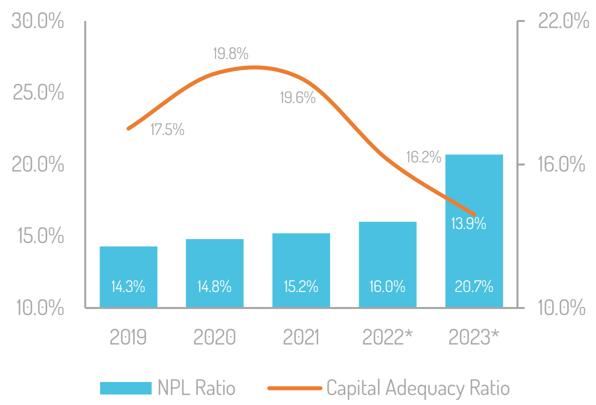
On the local bourse, financial stocks closed out the 2023 financial year in negative territory, albeit paring back some of the losses sustained during the first eight months. The DDEP-induced losses of 2022 and the resulting weakening of the sector's solvency position amidst elevated credit risk fuelled negative sentiments for the most part of the year, with prices of banking stocks plummeting. Consequently, the Ghana Stock Exchange Financial Stock Index (GSE-FSI) bottomed out at 1,658.1 points with a YTD return of -19.2% in August 2023.

Market sentiments somewhat improved as investors received better clarity on banks' recapitalization plans, even as the sector's earnings performance continued to outstrip that of 2022 amidst cooling inflation. Resultantly, The GSE-FSI recovered some losses during 4Q2023 to end the year with a 12-month return of -7.4%.

Banks witnessed a remarkable rebound in earnings, yet the sector's solvency position weakened. The sector's reported profit after tax stood at GHS 7.1bn in October 2023, compared to the loss of GHS 6.0bn booked in FY2022. Growth in earnings was driven by robust increase in net interest income on account of the double-digit yields on government securities as banks played the volume game. Despite the recovery in earnings, the sector's capital adequacy ratio (CAR), with regulatory reliefs, declined to 13.9% in December 2023 from 16.2% in 2022 as risk-weighted assets increased amidst moderating credit growth. The recovery in earnings in 2023 suggests that banks are well on their way to close the capital gap created by the DDEP. For banking stocks under our coverage universe, Standard Chartered Bank (SCB) was the only bank to have successfully restored its retained earnings to pre-DDEP levels as at 9M2023. For other banks, the required amount of capital injection may be lower than previously planned, depending on the current level and expected growth in risk-weighted assets, as well as the targeted CAR ratio.

Lingering asset quality issues continue to pose a significant challenge for banks. The combination of high lending rates, elevated inflationary pressures and slowing growth over the last two years culminated in the sector's NPL ratio nearing its 10-year peak at 20% at the end of 2023. In response to the high credit-risk environment, credit growth slowed to 13.8% in 2023 from 25.5% the previous year. We expect banks to maintain a conservative stance on lending in 2024 on the back of the prevailing high default risk, fragile solvency position and subdued economic growth.

BANKING SECTOR ASSET QUALITY AND SOLVENCY



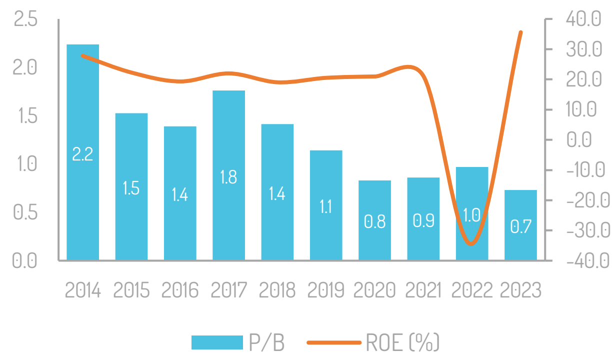
SOURCE: BANK OF GHANA, IC INSIGHTS

* Capital Adequacy Ratio adjusted for regulatory reliefs

Restructuring of Eurobonds could attract additional impairment charges for some banks. While we are still in the dark on the sector's overall exposure to Eurobonds, it is public knowledge that listed banks such as CAL, EGH and GCB have some exposure to these instruments. The impending restructuring of Eurobonds imply that additional impairment charges could come through for these banks in 2024. This will be determined by the size of provisions already booked on these securities, the final terms of the restructured bonds as well as the performance of the local currency against the US Dollar.

Banks' depressed market valuation presents an entry opportunity for value-seeking investors. The banking sector is currently trading at an average discount of 43.2% to its 10-year historical average price-to-book ratio (P/B) of 1.3x. As the sector suffered a barrage of shocks over the last decade, trading multiples have sunk to new lows despite the strong financial performance demonstrated by listed banks. We are of the view that the current dip in the market prices of some fundamentally sound banking stocks presents an excellent entry-point for value-seeking investors. We prioritize undervalued banking stocks with strong solvency position and demonstratable adept management of credit risk and operating costs.

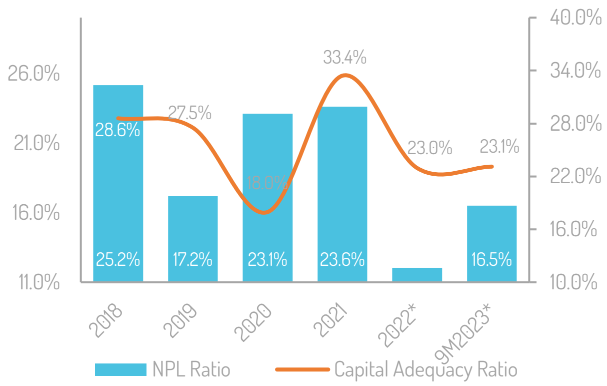
BANKING SECTOR TRADES AT A DISCOUNT TO LONG-TERM HISTORICAL AVERAGE



SOURCE: BANK OF GHANA, WORLD BANK DATABASE, IC INSIGHTS

SCB makes the cut and is our top pick in 2024, for now. Despite the headwinds, the banking sector is poised to record decent earnings in 2024 overall. We expect banks to benefit from double-digit yields on government securities and the impact of easing inflation on operating costs in 2024. We view SCB as a high-quality bank with CAR, excluding regulatory forbearance at comfortable levels. Per our analysis SCB's CAR, excluding regulatory reliefs, improved to 18.5% in 9M2023 from 16.0% at the end of 2022. We are of the view that given SCB's strong solvency position, the bank is better placed to resume dividend payments post-2025, once the dividend suspension is lifted. Adding to the appeal, SCB has no exposure to Ghana Eurobonds and is thereby insulated from the potential impairment charges that could arise from the restructuring of these instruments. The bank has also registered some improvement in its asset quality profile with its NPL ratio broadly retreating to the teens in recent times. We expound on the upside potential of the stock in our upcoming Initiation of Coverage Report in which we issue an **ACCUMULATE** rating on the stock with the fair value of the stock provisionally set at GHS 20.40 (+16.3% upside) in our current model.

SCB'S ASSET PROFILE IMPROVES BROADLY AS CAR REMAINS AT COMFORTABLE LEVELS



SOURCE: SCB ANNUAL REPORTS, IC INSIGHTS

* Capital Adequacy Ratio with regulatory reliefs

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