Databank: Economy & Policy Brief

February 15, 2013

Bank of Ghana's decision to keep its policy rate at 15% is likely to keep average lending rate above 20% for most part of HY-2013

The decision of the Monetary Policy Committee (MPC) to maintain the country's MPR at 15% could potentially keep Ghana's lending rates at current high levels for most part of HY-2013. *We have seen a gradual softening of market expectations towards lower interest rates since Q3-2012, as inflation remained in single digit and currency stability was reinforced (albeit with uncertainty of the sustainability of the trend in 2013).* The steady rate decision however has sent a mixed signal to the market on concerns about fiscal imbalances and the possible impact of the removal of subsidies on domestic petroleum prices over the next 3 months.

In our assessment, the Bank of Ghana views current challenges in energy and utility pricing as problematic, and the need to remove subsidies on domestic petroleum prices as inevitable going forward. Also, ongoing wage negotiations and distortions in the newly implemented single spine salary structure are likely to put pressure on yields at the short-end of the treasury market. *We believe that it will be very efficient for government to streamline domestic petroleum prices, and increase prices by about 15-30% in the first quarter of the year as the basis to rein in on public debt, which has escalated to 46.7% of GDP (GH₵33.5bn)*. Over the medium term, reducing public sector borrowing requirements is essential if average interest rates are to decline to acceptable levels (arguably within the region of 9-10% on the 91-day Treasury bill).

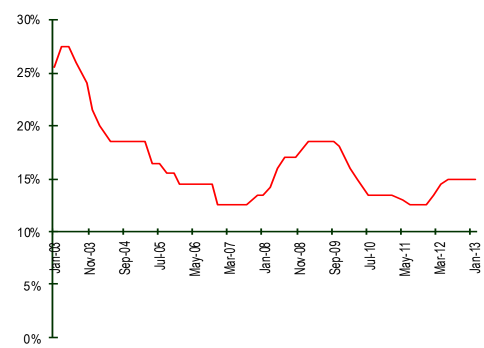
Ghana's reinvestment risk on fixed income securities is likely to be minimal during the first half of 2013, and portfolio investors are expected to continue benefiting from abnormal yields on benchmark securities during the period. *While average lending rate will be sticky upwards, we foresee some correction in medium-term benchmark yields; but money market yields will remain fairly stable in the next 3 months.* Shifting preference towards the equity market is therefore not likely to be stronger in 2013 than in 2012. The interest rate environment over the next 3 months, however, will remain unfavorable for Ghana's real sector. Essentially, we think that a paradigm shift is necessary to make macroeconomic policy more supportive of real sector competitiveness. This will facilitate industry growth which is essential for job creation.

Overall, we anticipate that government will strongly push for reforms on the fiscal front in 2013 – especially in streamlining utility and petroleum subsidies, but any effective consolidation must address the weaknesses of the single spine salary structure and also aim to reduce the size of government to be effective. We are of the view that a successful fiscal consolidation would lead to lower interest rates and private sector job creation over the medium term.

Key Issues

- ✓ *Debt stock at GH₵33.5bn and trend shows it could escalate if petroleum subsidy continues*
- ✓ *Crude oil now second largest export earner after gold, and before cocoa beans.*
- ✓ *Trade deficit widens despite strong inflows from crude oil*
- ✓ *Inflation risk heightened by possible removal of subsidies and wage agitations*

Ghana: Monetary Policy Rate Dynamics (2003-2013)



Source: Databank Research Databases

Analyst: Sampson Akligoh

Databank Leadership

Databank: Economy & Policy Brief

GDP Growth Upbeat on Oil, Commodities, Services, Construction…

We expect economic growth to remain upbeat at 7-8.5% in 2013. The main drivers of output growth in 2013 will be commodity export (including oil and gas), construction and real estate, and the financial sub-sectors. Ongoing energy sector challenges will pose a problem to industry competitiveness, and growth could be seriously hurt if domestic electricity supply remains very erratic and fuel price increases are not well managed. *There are certainly concerns for the real sector – as unstable electricity supply necessitates recourse to generator plants, operating cost will be impacted by substantial increases in domestic fuel prices.* Another downside risk to growth is credit constraint, which may remain unchanged in lieu of the policy orientation signaled by the Bank of Ghana in Feb-13.

Outlook for Inflation Mix

CPI inflation for Jan-13 was unchanged at 8.8% as currency, food and domestic petroleum prices were fairly stable during the period. Inflation for Ghana has remained in single digit since May-10 mainly due to the introduction of a buffer stock company which helps to stabilize domestic food prices. *There is however uncertainty over the outlook for inflation in the next 3 months as the Ghana Statistical Service will start releasing figures based on a revised basket in Mar-13 and debates about the possibility of lifting fuel subsidies continues.* In our view, inflation could edge marginally above 10% if domestic fuel price is increased by more than 20%. Meanwhile, we maintain our end of year inflation target within the band of 10-12%.

Fiscal Imbalances pronounced

Ghana's fiscal account presents the most challenge for macroeconomic stability in 2013. Fiscal slippages in 2012 have led to a worse fiscal deficit to GDP outturn of 12.6% (compared to the target of 6.7%). Poor implementation of the single spine salary structure, interest rate hikes (with an associated high interest cost) to compensate for currency depreciation, and prolonged fuel subsidies led to a substantial increase in public debt to GH¢33.5bn (46.7% of GDP). *In our view, the current trend for public sector debt accumulation is not sustainable, and has the potential to derail earlier macroeconomic gains*. We will however encourage portfolio investors to take advantage of prevailing interests, as it is likely that the yield curve will be corrected over the medium term and yields could noticeable decline beyond an 18-month horizon. This could be on the back of restructuring the public debt profile and extending the yield curve actively beyond 3 years.

Trade Deficit Widens

Despite the support from crude oil export, Ghana's trade deficit widened to US$4.2bn in 2012 from US$3.1bn. Crude oil has the second largest share of total exports in 2012 at US$3bn. The deterioration in the trade balance was due mainly to non-oil imports – which reflect some fundamental challenges on the external front. We expect the trade deficit to remain problematic in 2013, except for the capital and financial account where we continue to anticipate strong net inflows. The impact of the deterioration of trade balance on the domestic currency is likely to be moderated by the relatively strong reserve position of US$5.5bn (equivalent to 3.1 months of import cover. This should support a cedi/USD depreciation of between 8-10% in 2013.

KEY ECONOMIC INDICATORS

INDICATORS	2012	2013E
Monetary Policy Rate	15%	13%
CPI Inflation	8.8%	10-12%
Real GDP Growth	7.1	7-8%
Cedi/USD Depr.	16%	9-11%
GIR (Months of Import Cover)	3.0	3.5
Public Debt (GH₵'bn)	33.5	n.a.

Source: Databank Research