

The 2009 “Ghana Economic Review & Outlook”

Presentation by
Centre for Policy Analysis (CEPA)
at the British Council Hall (Accra) on
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Presentation Outline

- Introduction & background
- A Strategy of Growth with Macroeconomic Stability
- The Move to a Pro-cyclical Stabilisation Programme
- Highlights of the Revised 2009 Budget
- The Fiscal Stance
 - mid-year 2009 Assessment
 - end-year 2009 outlook
- Developments in Money, Credit, and Prices
- International Trade and Payments

Introduction and Background

Conditions at end-December 2008

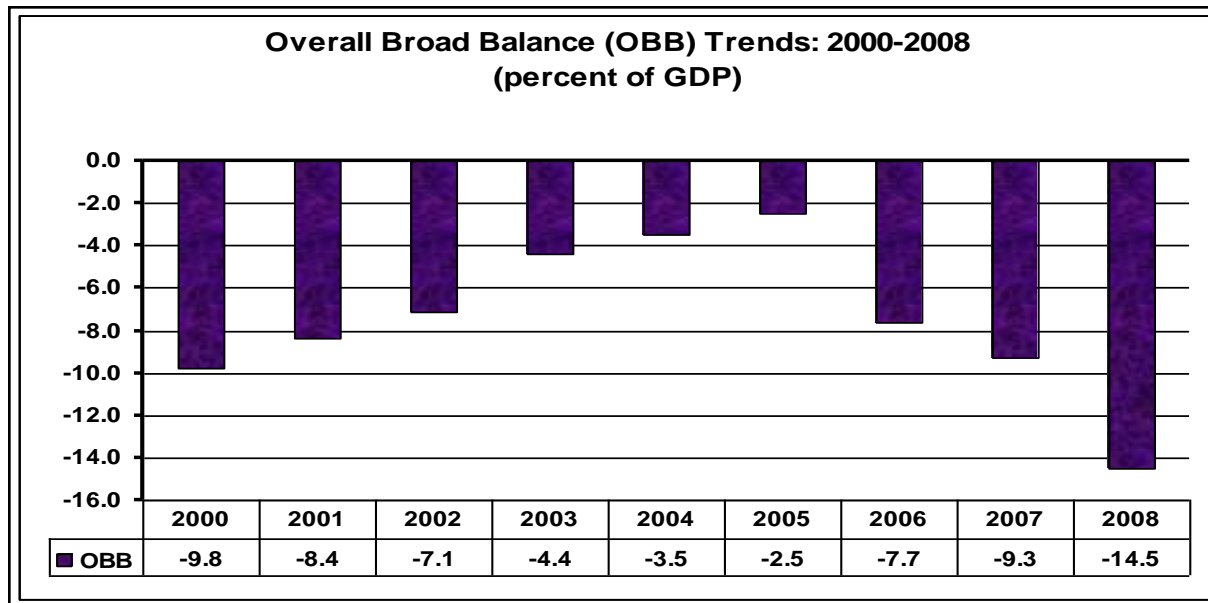
- An environment of macroeconomic instability which manifested itself in, *inter alia*, a huge budget deficit estimated at 14.5 percent of GDP at the end of 2008—including nearly 1.0 percent of GDP in respect of commitments and payments arrears from previous years.

Introduction and Background

Reason for the Large Deficit

- primarily due to spending excesses associated in a year characterised hotly contested presidential and parliamentary elections; but
- these exacerbated an underlining persistent deterioration of fiscal discipline which the Centre for Policy and Analysis (CEPA) had noticed and drawn attention to since 2006 — a phenomenon which the Centre has described in various presentations as “*stubbornly high and widening fiscal deficits*”.

Introduction and Background



Introduction and Background

High-spending Promises by Political Parties in an Election-Year

Against this background:

Many high spending-related promises were made by all political parties during the 2008 electioneering campaigns at a time when reality and objectivity rather called for policy packages geared more towards economic restraint



Introduction and Background

Adverse Developments on the Global Front

- The new Government also had to grapple with the adverse developments on the international scene — the global financial turmoil and the consequent world economic melt down.
- As a result it found itself in the rather unenviable position of being in a home-grown financial crisis in the midst of a global financial crisis and recession.

Introduction and Background

Policy Dilemma: “Tale of Two Cities”

The Government was, therefore, confronted with a policy dilemma referred to as “A Tale of Two Cities” by CEPA:

- on the one hand the own-inflicted financial crisis called for a reduction in government spending; whilst,
- on the other hand, the inhospitable global situation required the provision of massive governmental support in the form a hefty package of fiscal stimulus to re-ignite the ailing economy—a *counter-cyclical path chosen by most other countries with relatively better managed and more sound domestic economies.*

A Strategy of Growth with Macroeconomic Stability

Government made the attainment of macroeconomic stability an important goal in its maiden Budget presented to Parliament on March 5, 2009:

- with an objective to reducing the broad budget deficit to **9.4 percent of GDP at end-December 2009** from the **end-December 2008 outcome of 14.5 percent of GDP**.

A Strategy of Growth with Macroeconomic Stability

Consistency with the social democratic agenda of the Mills-led Government.

- The 2009 Budget also acknowledged the critical importance of broad-based economic growth in the fight against poverty and in improving the living conditions and welfare of all Ghanaians.

A Strategy of Growth with Macroeconomic Stability

Consistency with a strategy of “**Growth with Macroeconomic Stability**”

- Indeed, in its “Assessment and Critique of the 2009 Budget Statement and Economic Policy”, CEPA had contended that the economic programme for 2009 with its social democratic principles (and with the explicit provision of GH¢42 million in support) — presented and approved by Parliament — was consistent with a strategy of “**Growth with Macroeconomic Stability**” in which the growth objective is accorded more prominence.

The Move to a Pro-cyclical Stabilisation Programme

- Subsequent to the approval of the Budget by Parliament, the World Bank succeeded in mobilising the IMF, the Development Partners (DPs), and the new Mills Administration to move from the strategy of “**Growth with Macroeconomic Stability**” that informed the 2009 Budget into following a strategy of a “**comprehensive programme of macroeconomic stabilisation and reform**” :
 - a programme consistent with a strategy of “**Macroeconomic Stability with Growth**”, i.e. one that is heavily slanted towards stabilisation rather than pro-poor growth—which is contained in a new PRGF Arrangement with the IMF for the 3-year period July 2009-June-2012.

The Revised Budget and the new PRGF Arrangement

In the mid-year review of the 2009 Budget Statement and Economic Policy to Parliament on August 25, 2009, the Government also presented a revised Budget for the consideration of and approval by Parliament.

- In a technical sense the revised Budget sought to receive the blessing of Parliament to implement the new PRGF Arrangement with the IMF.
- Additionally, the revised Budget took into account events and developments which, according to the Minister of Finance and Economic Planning, were not available to Government at the time of presentation of the original Budget in March.

Highlights of the Revised 2009 Budget

Broad Fiscal Targets

- Overall fiscal deficit set at the 9.4 percent of GDP as in the original Budget.
- Deficit target includes a planned settlement of outstanding commitments and payments arrears equivalent to 3.1 percent of GDP.
- Deficit target is also preserved in the PRGF Arrangement with the IMF where it is made a programme conditionality and labelled a key quantitative criterion.

Highlights of the Revised 2009 Budget

Net Domestic Borrowing

- Consistent with the stabilization programme, a tight ceiling has been placed on net domestic financing of the budget.
- The level of such financing has been reduced from the *6.7 percent of GDP* projected in the original 2009 Budget Statement to a more stringent ceiling of *4.8 percent of GDP*.

Highlights of the Revised 2009 Budget

Loans (project and programme) and debt relief from Development Partners

- The projected contribution of donor resources (loans and exceptional finance from debt relief) to the total financing needs of government, both in the PRGF programme and the revised Budget is 49.2 percent, and is equivalent to 4.6 percent of GDP.
- By comparison, resources from these sources financed 9.2 percent of the deficit in 2008. In the original presentation of the 2009 Budget they accounted for 31.0 percent of the projected financing requirements.
- There is, therefore, the disturbing reality of increased donor-dependence in 2009 and the consequent vulnerability to donor conditionality and inflexibility as well as the proverbial unreliability of aid disbursements. A careful and masterful management of government-donor relations is, therefore, critical to ensure the successful implementation of the 2009 Budget and the achievement of its targets and objectives.

Highlights of the Revised 2009 Budget

Payment Arrears

- The revised Budget made provision for clearance of arrears amounting to GH¢626.5 million, equivalent to 2.9 percent of GDP, compared to a reported clearance in 2008 of GH¢142.3 million, equivalent to 0.8 percent of GDP.
- It includes GH¢492 million for non-road arrears; and GH¢135 million for road arrears.
- This is greater than the provision in the original Budget by some GH¢93 million to settle outstanding commitments including those in respect of court judgements against the state.

Programme Adjustors for Key Fiscal Targets under the new PRGF Arrangement

The Government has agreed with the IMF to take corrective measures in order to remain within the programme budget deficit ceiling of 9.4 percent of GDP, and for the government to not crowd-out the private sector from the domestic credit market.

■ **Adjustments to Expenditures and Domestic Revenue**

- Any expenditure over-runs or domestic revenue shortfalls that would lead to an increase in the deficit must be adjusted for by “appropriate measures” agreed with the IMF to ensure that the targeted ceiling is respected.

■ **Programme Quantitative Targets**

Two key fiscal quantitative targets are spelled out in the PRGF arrangement:

- one in respect the ***overall fiscal deficit of the government***; and
- the other in respect of ***net domestic financing of the government’s fiscal operations***.



The Fiscal Stance

Assessment of end-June 2009 Performance

Domestic Revenue & Grants

- Fiscal performance in the first-half of 2009 was characterised by a revenue and grants outturn that fell short of the budgetary target by 7.8 percent.
- Total receipts including grants at end-June 2009 amounted to 13.9 percent of GDP.

Domestic Revenue & Grants

- The outturn missed the budget estimate of 15.0 percent of GDP for the period and was below the 14.6 percent of GDP for the corresponding period in 2008.
- The shortfall was both in respect of the domestic revenue — a mid-year outcome of 11.1 percent of GDP compared to a budgeted 11.9 percent of GDP; and grants (including debt relief) — which registered an outturn of 2.7 percent of GDP compared to the programme target of 3.1 percent of GDP.

Domestic Revenue

The outturns for both taxes non-tax revenue were below expectation:

- taxes amounted to 10.2 percent of GDP compared to the Budget target of 10.8 percent;
- non-tax revenues — grossed up to include both lodgments and retentions by MDAs) — represented 0.9 percent of GDP compared to the programmed 1.1 percent.

DOMESTIC REVENUE & GRANTS: Half-year Performance Trends

Percent of GDP	2007	2008	2009	
	Actual	Actual	Prov. Outturn	Budget Target
DOMESTIC REVENUE & GRANTS	15.9	14.6	13.9	15.0
DOMESTIC REVENUE	12.1	11.5	11.1	11.9
Tax Revenue	11.0	10.4	10.2	10.8
CEPS (incl NHIL)	5.9	5.6	5.4	5.9
Lodgements into Govt Accounts	5.0	4.6	4.6	4.9
Exemptions (imports)	0.9	1.0	0.8	1.0
VAT Service (incl NHIL)	1.6	1.4	1.1	1.5
IRS	3.0	3.1	3.3	3.1
NHIL- SSNIT	0.6	0.2	0.1	0.1
Export Duty	0.0	0.0	0.0	0.0
Other Measres	0.0	0.0	0.2	0.2
Non-Tax Revenue	1.1	1.1	0.9	1.1
Lodgements	0.3	0.3	0.4	0.3
Retention	0.8	0.8	0.6	0.8
GRANTS	3.8	3.0	2.7	3.1
Project	1.0	1.3	1.3	1.2
Programme	1.1	1.3	1.1	1.5
Debt Relief	1.7	0.5	0.3	0.5
HIPC	0.3	0.3	0.2	0.3
MDRI	1.4	0.2	0.2	0.2

TAXES BY REVENUE COLLECTING AGENCY : half-year Trends				
Percent of GDP	2007	2008	2009	
	Actual	Actual	Prov. Outturn	Budget Target
CEPS	5.9	5.6	5.4	5.9
Lodgements into Govt Accounts	5.0	4.6	4.6	4.9
Import duties (collection)	1.8	1.6	1.7	1.8
Petroleum	1.5	1.2	0.7	1.0
Import VAT	1.6	1.5	1.8	1.7
NHIL	0.0	0.3	0.4	0.4
Exemptions (imports)	0.9	1.0	0.8	1.0
VAT Service	1.6	1.4	1.1	1.5
Domestic VAT	1.2	1.1	0.8	1.1
Excise	0.3	0.2	0.1	0.1
NHIL	0.0	0.2	0.2	0.2
IRS	3.0	3.1	3.3	3.1
Personal	1.2	1.4	1.5	1.4
Self employed	0.2	0.2	0.2	0.2
Companies	1.3	1.3	1.3	1.3
Other direct taxes	0.3	0.3	0.3	0.3

Government Expenditures

- In response to the resource shortfall, payments (including principal repayment of external debt, tax refunds, and payments for outstanding commitments and arrears clearance) were restrained resulting in an outturn that was below the budget provision by 5.4 percent. (18.7 Percent of GDP compared 19.8 percent of GDP)
- The major component, domestic primary expenditures (DPE) fell below the budget by 4.9 percent.
- The period recorded a budgetary shortfall of 7.9 percent in foreign-financed capital arising primarily from smaller inflows of project loans (17.0 percent less) than programmed.
- The expenditure programme was also encumbered by outstanding commitments from previous years, with such payments exceeding the budget provision for the half-year by 5.5 percent.
- Interest payments overshot the Budget by some 11.8 percent, mainly due to a 29.4 percent overrun in the domestic component. This latter development raises serious concerns about debt sustainability in the medium-term and the adequacy of the fiscal space required to fund pro-poor programmes. External interest payments were, however, below the Budget provision by 22.3 percent.

Central Government Expenditure by Broad Categories

Percent GDP	H1-2007	H1-2008	H1-2009	
	Actual	Actual	Prov. Outturn	Budget Target
TOTAL EXPENDITURE	19.8	21.8	18.7	19.8
Statutory and Quasi-Statutory	10.2	10.6	10.5	11.0
Expenditures tied to Specific Resources	4.0	4.8	3.6	3.8
Pure Discretionary Expenditures	5.7	6.3	4.6	5.0

Percent GDP	2007	2008	2009	2009
	<i>Half year</i>	<i>Half year</i>	<i>Half year</i>	<i>Half year</i>
	<i>Actual</i>	<i>Actual</i>	<i>Prov. Act</i>	<i>Budget</i>
STATUTORY AND QUASI-STATUTORY	10.2	10.6	10.5	11.0
External Debt Service	1.4	2.0	1.1	1.7
Principal	1.0	1.5	0.6	1.1
Interest	0.4	0.5	0.5	0.6
Domestic Interest	0.9	1.1	1.6	1.2
Transfers to Households	1.0	1.0	0.9	1.1
Pensions	0.3	0.4	0.4	0.4
Gratuities	0.1	0.1	0.1	0.2
Social Security	0.5	0.5	0.3	0.5
Transfers to Statutory Funds	2.1	2.0	1.8	2.0
District Assemblies Common Fund	0.5	0.7	0.6	0.7
National Health Fund (NHF)	0.8	0.6	0.5	0.5
Education Trust Fund	0.5	0.6	0.4	0.5
Road Fund	0.4	0.2	0.3	0.3
Petroleum-related Fund	0.0	0.0	0.0	0.0
Wages and Salaries	4.8	4.5	5.1	5.0

Percent GDP	H1-2007	H1-2008	H1-2009	H1-2009
	<i>Actual</i>	<i>Actual</i>	<i>Prov. Outturn</i>	<i>Budget</i>
EXPENDITURES TIED TO SPECIFIC RESOURCES	4.0	4.8	3.6	3.8
Debt Relief	1.6	0.8	0.6	0.5
HIPC	0.7	0.5	0.4	0.3
MDRI	0.9	0.3	0.2	0.2
Foreign- Financed Capital (ODA)	2.4	2.8	3.0	3.3
Capital Markets Borrowing	0.0	1.2	0.0	0.0

Percent of GDP	H1-2007	H1-2008	H1-2009	H1-2009
	<i>Actual</i>	<i>Actual</i>	<i>Prov. Actual</i>	<i>Budget</i>
PURE DISCRETIONARY EXPENDITURES	5.7	6.3	4.6	5.0
Administration & Service	1.8	1.4	1.0	0.8
Domestically-financed capital	1.4	0.8	0.5	0.4
Transfers & subsidies	2.1	3.1	1.7	2.5
Net Lending	0.0	0.0	0.0	0.0
Outstanding Commitments and Arrears	0.4	0.9	1.4	1.3

BUDGET BALANCES & FISCAL OPERATIONS

Percent of GDP	H1-2007	H1-2008	H1-2009	H1-2009
	Actual	Actual	Prov. Outturn	Budget
DOMESTIC PRIMARY BALANCE (DPB)	-2.7	-3.3	-0.5	-0.3
OBB (modified payments basis)	-3.0	-5.7	-4.3	-3.7
OBB (below-the-line)	-3.8	-5.9	-4.5	-6.5
TOTAL FINANCING REQUIREMENTS	3.8	5.9	4.5	6.5
DIVESTITURE PROCEEDS (NET)	0.0	0.1	0.0	0.0
NON-DIVESTITURE FINANCING	3.8	5.8	4.5	6.5
Development Partners (DPs)	1.5	0.8	1.5	3.7
External Private Loans & Equity	0.0	1.2	0.0	0.0
Domestic Financing (<i>net</i>)	2.3	3.8	2.9	2.7
Banking Sector (<i>net</i>)	-0.5	2.0	1.9	0.9
Non-Bank Public (<i>net</i>)	2.8	1.0	0.7	1.6
Other Domestic	0.0	0.7	0.3	0.3



Projected Outlook for end-December 2009

Based on August-year-to-date
data from officialdom



Projected Outlook for end-December 2009 ants

Domestic Revenue & Grants

Domestic Revenue and Grants: 2007-2009 (percent of GDP)					
<i>Percent of GDP</i>	2008	2009	2009	2009	2009
	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Projection</i>
DOMESTIC REVENUE & GRANTS	31.9	34.6	20.5	18.8	32.5
DOMESTIC REVENUE	27.3	28.5	16.5	15.3	26.5
TAX REVENUE	24.8	25.1	15.1	13.8	23.3
CEPS	13.4	13.1	8.2	7.1	11.8
Lodgements into Govt Accounts	10.7	11.0	6.9	6.0	10.1
Exemptions (imports)	2.7	2.1	1.3	1.1	1.7
VAT SERVICE	3.1	3.5	2.1	1.6	2.6
IRS	7.1	7.2	4.2	4.7	8.0
NHIL- SSNIT	0.6	0.5	0.3	0.2	0.3
Export Duty	0.2	0.2	0.0	0.0	0.2
Other Measres	0.4	0.5	0.3	0.3	0.5
NON-TAX REVENUE	2.5	3.4	1.4	1.5	3.2
Lodgements	0.7	1.7	0.4	0.5	1.5
Retention	1.7	1.8	1.0	1.0	1.6
GRANTS	4.7	6.0	4.0	3.5	6.0
Project	2.3	3.2	1.8	1.8	3.2
Programme	1.5	1.8	1.5	1.2	1.8
Debt Relief	0.9	1.0	0.7	0.6	1.0
HIPC	0.5	0.6	0.4	0.3	0.6
MDRI	0.4	0.4	0.3	0.2	0.4

TAXES BY REVENUE COLLECTING AGENCY					
<i>Percent of GDP</i>	2008	2009	2009	2009	2009
	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Projection</i>
CEPS	13.4	13.1	8.2	7.1	11.8
Lodgements into Govt Accounts	10.7	11.0	6.9	6.0	10.1
Import duties (collection)	3.9	4.3	2.6	2.2	4.1
Petroleum	2.2	2.0	1.3	0.9	1.4
Import VAT	3.8	4.0	2.4	2.3	3.8
NHIL	0.8	0.7	0.5	0.5	0.8
Exemptions (imports)	2.7	2.1	1.3	1.1	1.7
VAT Service	3.1	3.5	2.1	1.6	2.6
Domestic VAT	2.4	2.7	1.6	1.2	2.0
Excise	0.3	0.3	0.2	0.1	0.2
NHIL	0.4	0.5	0.3	0.2	0.4
IRS	7.1	7.2	4.2	4.7	8.0
Personal	3.0	3.1	1.9	2.2	3.5
Self employed	0.4	0.4	0.2	0.2	0.4
Companies	3.1	3.1	1.7	1.8	3.2
Other direct taxes	0.7	0.7	0.5	0.5	0.9



Projected Outlook for end-December 2009

Government Expenditures

	2008	2009	2009	2009	2009
Percent of GDP	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Prov. Outturn</i>	<i>CEPA Projection</i>
TOTAL EXPENDITURE	49.3	46.4	28.1	26.3	45.5
Statutory and Quasi-Statutory	24.7	24.6	15.6	14.8	24.7
Expenditures tied to Specific Resources	10.1	7.9	5.0	5.2	7.9
Pure Discretionary Expenditures	14.5	14.0	7.4	6.4	13.0

Percent GDP	2008	2009	2009	2009	2009
	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Projection</i>
STATUTORY & QUASI-STATUTORY	24.7	24.6	15.6	14.8	24.7
External Debt Service	3.9	4.0	2.3	2.2	3.7
Principal	2.8	2.5	1.5	1.5	2.5
Interest	1.1	1.5	0.8	0.7	1.2
Domestic Interest	2.7	2.9	1.6	2.1	3.1
Transfers to Households	2.1	2.4	1.4	1.1	2.5
Pensions	0.8	1.0	0.6	0.5	1.0
Gratuities	0.3	0.4	0.3	0.2	0.5
Social Security	0.9	1.0	0.6	0.3	1.0
Transfers to Statutory Funds	4.6	5.3	2.8	2.4	4.8
District Assemblies Common Fund	1.4	1.6	1.0	0.7	1.5
National Health Fund (NHF)	1.5	1.8	0.7	0.8	1.4
Education Trust Fund	1.2	1.3	0.7	0.5	1.2
Road Fund	0.6	0.6	0.4	0.4	0.7
Petroleum-related Fund	0.0	0.0	0.0	0.0	0.0
Wages and Salaries	11.3	10.0	7.4	6.9	10.6

	2008	2009	2009	2009	2009
Percent GDP	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Projection</i>
EXPENDITURES TIED TO SPECIFIC RESOURCES	10.1	7.9	5.0	5.2	7.9
Debt Relief	1.6	1.0	0.7	0.9	1.0
HIPC	1.1	0.6	0.4	0.6	0.6
MDRI	0.5	0.4	0.3	0.3	0.4
Foreign- Financed Capital (ODA)	5.2	6.8	4.4	4.3	6.8
Capital Markets Borrowing	3.3	0.0	0.0	0.0	0.0

Percent GDP	2008	2009	2009	2009	2009
	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Proj.</i>
PURE DISCRETIONARY EXPENDITURES	14.5	14.0	7.4	6.4	13.0
Administration & Service	3.7	3.6	1.2	1.7	3.2
Domestically-financed capital	2.4	1.2	0.7	0.7	1.2
Transfers & subsidies	7.5	6.1	3.6	2.8	5.4
Net Lending	0.0	0.0	0.0	0.0	0.0
Outstanding Commitments and Arrears	1.0	3.1	1.9	1.1	3.1



Projected Outlook for end-December 2009

Budget Balances & Fiscal Operations

	2008	2009	2009	2009	2009
Percent of GDP	<i>Actual</i>	<i>Revised Budget</i>	<i>Jan-Aug Budget</i>	<i>Jan-Aug Outturn</i>	<i>CEPA Projection</i>
DOMESTIC PRIMARY BAL. (DPB)	-9.2	-1.2	-1.3	-1.2	-2.3
OBB (modified payments basis)	-14.5	-9.4	-6.0	-6.0	-10.5
OBB (below-the -line)	-15.3	-9.4	-7.4	-5.9	-10.5
FINANCING REQUIREMENTS	15.3	9.4	7.4	5.9	10.5
Divestiture Proceeds (net)	4.0	0.0	0.0	0.0	0.0
Non-Divestiture Financing	11.3	9.4	7.4	5.9	10.5
Development Partners (DPs)	1.4	4.6	3.9	2.4	4.6
External Private Loans & Equity	3.3	0.0	0.0	0.0	0.0
Domestic Financing (net)	6.5	4.8	3.5	3.5	5.9
Banking Sector (net)	3.8	2.6	1.4	2.9	3.5
Non-Bank Public (net)	1.4	2.2	1.8	0.6	1.7
Other Domestic	1.3	0.0	0.3	0.0	0.6



Money, Credit & Prices

Monetary Policy Framework

The renewed quest for price stability has altered the monetary policy framework of the Bank of Ghana (BoG):

- from **directly targeting monetary aggregates** such as reserve money and the money supply;
- to *inflation targeting (IT)*.

The BoG formally adopted the IT framework in May 2007 after almost three years of informal IT management.

Monetary Policy Framework

With the adoption of IT framework, the *interest rate (Prime Rate)* became the instrument of choice of monetary policy by the Bank of Ghana. In addition to the prime rate, the Bank of Ghana also relies on a variety of instruments in the conduct of monetary policy, including:

- Reserve requirements (currently only mandatory cash requirements of 9 percent of eligible deposits);
- Open market operations (conducted at the weekly auctions);
- Repurchase and reverse-repurchase agreements (conducted daily on week days); and
- Auctions of government debt instruments of various maturities (also conducted at weekly auctions).

Monetary Policy Framework

The Bank of Ghana uses these instruments to influence:

- *the cost of borrowing;*
- *returns on assets; and*
- *to shape the incentives for market participants to hold more cedi balances in the banks and less foreign exchange deposits domestically or abroad.*

Objectives of Monetary Policy

In conformity with the macroeconomic targets set for the 2009 fiscal year, monetary policy is focused on:

- reducing the end-period year-on-year rate of inflation to 12.5 percent (*later revised upwards to 14.6 percent*) by end-2009 and further to 10.0 percent in 2010 and 8.0 percent in 2011.

The BoG will, in effect, use its inflation targeting framework to guide inflationary expectations in line with the medium-term forecast.

Objectives of Monetary Policy

Underlying the *medium-term forecast* of inflation is a *fiscal consolidation path* which will *stabilize the domestic debt* and help *anchor inflationary expectations*.

This will be buoyed up by a *tighter control of liquidity* — as evidenced by a programmed annual growth of broad money (including foreign currency deposits) of *21.7 percent at end-December 2009* compared to an outturn of *40.2 percent at end-December 2008*.

Objectives of Monetary Policy

Monetary policy will also seek to actively promote financial deepening. To this end measures are to be put in place to:

- encourage further development of the market for bonds and other long-term securities;
- mobilize savings for investment, and restructure the financial system to enhance the flow of credit to the private sector; and
- sustain the current flexible exchange regime and BoG interventions will be confined to smoothing out volatility in the foreign exchange market.

Objectives of Monetary Policy

Key challenges to meeting the medium-term inflation include:

- the fiscal stance, and in particular wage policy in 2009; and
- a possible resurgence in prices of crude oil forecasted (in March 2009) to rebound in the year 2010.

Trends in Monetary Targets and Aggregates (Total Liquidity & Reserve Money)

Over the past three years, annual growth of key monetary aggregates — *Total liquidity (M2+)*, *Reserve Money (RM)*, and *deposit money banks' (DMBs) credit allocations to the private sector* — have tended to exceed the targets set by the Monetary Authorities.

The estimated annual growth rates in Total Liquidity (M2+) and Reserve Money remained increasingly strong in both 2007 and 2008, exceeding the set targets by considerable margins.

Trends in Monetary Targets and Aggregates (Credit to the Private Sector)

Growth in credit to the private sector (excluding public sector enterprises and organizations) is reported to have slowed down sharply in 2009—as a result of the current stabilization programme with the BWIs:

- it increased by 42.2 percent per annum in the 12-month period to June 2009, following a 56.2 percent annual increase over the same period a year before in 2008

Composition of Credit

In the recent period to end-December 2008, there has been a general tendency for the share of credit to the non-government sector to rise:

- At the end of 2005, the non-government share stood below **60 percent**.
- This rose steadily to reach almost **80 percent** at the close of 2007.
- In the course of 2008, it declined to about **70 percent**, recovered somewhat at the end of the first quarter of 2009 before falling again to about 70 percent at the end of the first half of 2009.
- Given the ceiling on net domestic financing of the government deficit in the stabilization programme, it is expected that the non-government share would rise by end-2009.

Interest Rates & Money Market Developments

- At the September 2009 meeting of the Bank of Ghana's Monetary Policy Committee (MPC), the prime rate — *an important policy instrument and the lead indicator of interest rates on Ghana's domestic money market* — was left unchanged at **18.5 percent** per annum.
- This policy rate has been maintained at that level for well over six months since it was last adjusted upwards by 150 basis points in February 2009 from 17 percent per annum.

Interest Rates & Money Market Developments

According to the MPC Press Release, the decision to leave the prime rate unchanged at 18.5 percent per annum was informed by a number of developments in the domestic economy, the most notable being the following:

- volatility of the exchange rate eased in the third quarter of 2009, with a slowdown in the nominal depreciation of the cedi vis-à-vis the US dollar;
- inflationary expectations were turning around and ...there were signs of reduced volatility in prices;
- fiscal policy, together with a tightening of monetary and credit conditions, were putting pressure on prices as growth eased downward close to trend.

Interest Rates & Money Market Developments

Serious concerns continue to be raised about the prevailing high interest rates on the domestic money market in the midst of high and increasing inflation and inflationary expectations:

- Many industrialists, exporters and domestic import-competing producers have complained that successive interest rate hikes have sharply raised the cost of doing business in Ghana — an unwelcome situation, particularly in the present circumstances of a global financial crisis and recession.

The inhospitable global environment is already adversely impacting on trade, finance, export earnings, and economic growth.

Interest Rates & Money Market Developments

- Bank interest *rates*—*the prices customers earn for depositing their monies (or pay for borrowing money) from banks in Ghana*— are fragmented into ranges, as pertains in a number of countries,.
- The interest rate segmentation provides the *raison d'être* for banks to reward customers with large bank balances — mostly corporate bodies and high net-worth clientele — higher deposit savings rates as well as lower borrowing rates.
- The latter is mostly based on the notion that such clients, though in the minority of bank customers, fetch banks higher deposit sizes and thus in many instances have the clout to negotiate for lower lending rates than what prevails on the market.
- This covert action leaves the rest of bank customers (unfortunately in the majority but with smaller shares of total bank deposits), to bear the full brunt of the banking business by not only earning smaller savings deposit rates on their accounts but also charged higher lending rates.

Inflationary Developments & Outlook

- In Budget 2008 the Bank of Ghana (BoG) was expected to direct monetary policy towards reducing the end-period inflation to a target range of 6-8 percent at year-end and further down to a range of 4-6 percent by end-2009. As it turned out, the set target for 2008 was missed — in fact, overshoot by a significant margin.
- Given the experience of persistent overshooting of inflation targets, the assessment of CEPA had been that with no change in the monetary policy framework and target setting, the target for 2009 would prove unrealistic and go the way of its predecessors — missed by considerable margins.
- It was therefore not surprising — indeed, somewhat a validation — when the target for 2009 was revised upwards from 12.5 percent to 14.6 percent.

Inflationary Developments & Outlook

In its July deliberations, the Monetary Policy Committee (MPC) of the Bank of Ghana had indications from its Composite Index of Economic Activity (CIEA) and elsewhere that the economy was slowing down rapidly — implying potential output and job losses.

Consequently, in spite of the inflation rate remaining above the projected path, the MPC concluded that the prime rate should be kept unchanged at 18.5 percent, for the reason that — *“the risks in the outlook for disinflation and growth are balanced”*

Inflationary Developments & Outlook

Contrary to a forecast of a decline in the rate of inflation during the second quarter of the year, inflation went up, even if only marginally, from 20.5 percent in March to 20.7 percent in June 2009 — significantly above the 14.6 percent inflation target for the end of the year.

At the same time core inflation (which strips out price changes of energy and utility items from the consumer basket) increased by 2 percentage points during the second quarter to 21.3 percent.

Inflationary Developments & Outlook

Several factors contributed to the 2009 half-year inflationary experience. Key among these include:

- an increase in the price of petroleum products by 30 percent which pushed up transportation costs — which in turn impacted on the price of most goods and services, especially food staples in the economy; and
- the pass-through to domestic prices of previous exchange rate depreciations, a situation that impacted adversely on the exchange rate and also on inflationary expectations

Inflationary Developments & Outlook

- There are leads and lags in the monetary dynamics with changes in the growth rate of money supply impacting on inflation — some three to five months later, in the Ghanaian context.
- This suggests that the monetary surge in the second half of 2008, particularly in the fourth quarter, was expected to impact in the first half-year of 2009 and, therefore, sustain the surge in inflation which started in fourth quarter of 2007.

Inflationary Developments & Outlook

- As indicated earlier, a tightening of macroeconomic policy was signaled with the approval of the 2009 Budget in March.
- Subsequently, in June 2009 agreements were reached on a new 3-year PRGF Arrangement with the BWIs which effectively converted the Government's development strategy articulated in the Budget Statement and Economic Policy approved by Parliament to a comprehensive stabilization programme.

Inflationary Developments & Outlook

CEPA understood the need and importance of the re-establishment of macroeconomic discipline after three continuous years of fiscal excesses. Nonetheless, CEPA sought to draw attention to three important issues vis-à-vis the stabilization programme:

- that there was the need to avoid an inflexible adjustment path that could exact higher than warranted socio-political costs;
- that the disinflation path needed to be more gradualist than implied in the programme; and
- that there was a need to emphasize the critical importance of a *growth with stability strategy* rather than one of *stabilization with growth*, although this would also call for more resources from donors than would appear to be the case in the agreed programme.

Near-Term Inflation Outlook

Projections from the May 2009 meeting of the MPC indicated that inflation could begin to decline:

- from a peak of around 20 percent early in the second quarter of the year and towards the target range of 12.6–16.6 percent at the end of the year; and
- then to a range of 6.7-12.7 percent by the end of June 2010

Near-Term Inflation Outlook

According to the MPC the set of initial conditions which influenced the forecasts at its May meeting have all moved in directions that point to low inflationary pressures in the outlook.

Developments of some of the key macroeconomic indicators show some degree of unwinding in the imbalances observed in the previous year and should help in the whole process of disinflation over the forecast horizon:

- “Exchange rate volatility is reducing;
- short-term interest rates seem to have peaked; and
- consolidation in the fiscal balances are taking place”.

All of these are supportive of a disinflation process.

Near-Term Inflation Outlook

CEPA has also estimated the stabilization effect of the PRGF arrangement and has factored into its forecast of inflation for 2009. The result is that:

- the year-on-year rate of inflation is projected by CEPA to fall further from the 18.37 percent attained in September and it now looks likely that the target rate of 14.5 percent could be achieved — confirming the optimism of the MPC.

Near-Term Inflation Outlook

- data (from the MPC) for the first two quarters pointed to steep declines in real economic activity with real GDP slowing down below the 4.5 percent projected by the IMF to around 4.0 percent.

Near-Term Inflation Outlook

- On balance:

- given the downward trend in of the inflation path; and
- the projected steep declines in real economic activity,

a strong case could be made for a policy consideration to revise interest rates downwards.

- Consistent with the growth with macroeconomic stability strategy, a quarter of 1.0 percent downward adjustment in the policy rate before year-end may be recommended.
- CEPA also recommends strongly a move to the average rate of inflation rather than the discrete adjustment based on the relatively more erratic year-on-year rate measure.



International Trade & Payments

Foreign Exchange Markets

- The microstructure characteristics of the domestic foreign exchange market in Ghana remained unchanged over the last two years, with the US dollar accounting for over 80 percent of the transactions in the market.
- At the same time, transparency and the ability of market participants to observe information about the trading process remained low.
- Four authorized dealer participating banks continued to account for the bulk of foreign exchange transactions.
- The market also continued to be segmented

Foreign Exchange Markets

- The ability of the central bank — the Bank of Ghana — to intervene in the market was eroded as a result of dwindling external reserves consequent on the world economic crisis and the decline in private transfers.
- A huge increase in public sector expenditures as a result of the 2008 Presidential and Parliamentary elections also created increased demand for foreign exchange.
- At the same time, the uncertainty associated with the election and the subsequent policy stance resulted in heightened expectations and speculative behavior

Foreign Exchange Markets

- As a result of this combination of factors, the foreign exchange market became volatile in 2008 compared with the stability observed in previous years.
- Increasing volatility was also characterized by sharp depreciations in the nominal exchange rate and increasing spreads between buying and selling rates in the interbank foreign exchange market

Foreign Exchange Markets

- Measured by nominal effective exchange rate (NEER) the cedi depreciated continuously throughout the period from May 2002 to August 2009, accelerating in 2008 and 2009.
- The cedi, however, appreciated in real terms over the period.
- The real appreciation of the cedi over the period is, therefore, due to the relatively higher rates of inflation in Ghana compared with her trading partners.
 - **This is interpreted as loss in competitiveness as shown in declining market share of Ghana's exports in world markets and particularly her traditional trading markets, the euro zone and the sterling area.**

Foreign Exchange Markets

- Since the major source of the real appreciation or loss of price competitiveness is relative inflation, the situation may not be helped by inducing nominal appreciation as an anchor against inflation.
- Perhaps, changes in productivity, fiscal and monetary policies may be more appropriate.

Balance of Payments

- Ghana continued to face protracted trade and current account deficits on her balance of payments.
- These twin deficits widened in 2008 in spite of the country benefiting from continuing terms of trade gains.
- The empirical evidence is that, for the first time in the last five years, the overall balance of payments situation deteriorated sharply, plunging into a huge deficit of US\$940.8 million — the equivalent of **5.8 percent of GDP in 2008**.

Balance of Payments

- The worsening of the external payments position in 2008 may be attributed mainly to policy adjustment failures to contain domestic demand pressures on the external accounts.
- A highly expansionary fiscal policy as a result of election-year spending led to an increased demand for imports, and high inflation and inflationary expectations.
- At the same time, the inability to pass-on the effects of changes in world market prices of crude oil and petroleum products and the depreciation of the cedi compounded the situation.

Balance of Payments

On the demand side, Imports amounted to US\$10,261 million at the end of 2008 compared to US\$8,069.2 million in 2007, with almost 33 percent increase in the non-oil imports component.

The huge increase in imports was driven by :

- strong domestic demand on account of increasing public expenditure; and
- continuing appreciation of the real effective exchange rate of the cedi vis-à-vis currencies of major trading-partner countries.

Balance of Payments

- On the supply side, Ghana's major export commodities — gold, cocoa beans and products — seemed to have benefited in 2008 from a more favourable external environment even in the midst of the global financial crisis and recession.
- Ghana's terms-of-trade — the relative price of imported goods (mainly crude oil) to that of major exports (cocoa beans and gold) on world markets — generally strengthened in 2008, supporting incomes and growth, while the domestic financial system proved to be relatively insulated from the global financial storm.

Balance of Payments

- This situation appeared to have been reversed since the first quarter of 2009, with the core terms-of-trade sharply deteriorating against Ghana as the average price of crude oil on world markets continue to rise.

Balance of Payments

- CEPA estimates that by the close of the year, the average price of crude oil will be within a range of US\$78 and US\$80 per barrel.
- Being a net crude oil-importing country, and dependent largely on imports of petroleum products, any further rise in the average price of crude oil beyond the upper limit of US\$80 per barrel will adversely affect Ghana's import bill with ominous consequences for the economy.

Balance of Payments

- Fortunately, the hydro/thermal mix with respect to the energy generation requirements of the economy has been in Ghana's favour for the most part of this year.
- This favourable development calls for a combination of more practical methods for harnessing the immense water resources with proactive strategies for their effective management.
- This is deemed very critical not only for purposes of avoiding higher costs associated with thermal generation of power in the future, but also for advancing the socio-economic development of the country as a whole.

Balance of Payments

- There are also indications that for the first time in the last five years, non-oil imports into Ghana decreased by nearly 7 percent per annum in value terms — from US\$3,674.4 million in the first half of 2008 to US\$3,429.1 million in the same period of 2009.
- This magnitude of decline in the non-oil imports bill compares with annual increases of 12.3 percent and 40 percent per annum registered in the first six months of 2007 and 2008 respectively.

Balance of Payments

- Barring any structural changes in the current hydro/thermal mix for power generation for the rest of the year, CEPA estimates are that by year-end, the overall import bill will amount to no more than US\$8,082 million with the oil import bill being US\$1,214 million while the non-oil component amounts to US\$6,868 million.
- The CEPA estimates are about US\$523 million less than programmed in the Budget Statement of 2009 and some US\$1,217 million less than the IMF projection for 2009.



Thank you for your
kind attention and
patience