ECONOMIC UPDATE

REVIEW OF MONETARY POLICY REPORT

31st January, 2020

Monetary Policy Rate (MPR) Maintained at 16%.

www.gcbbank.com.gh

your bank for life

Introduction

On Friday 29th January, 2020, the Monetary Policy Committee (MPC) of the Bank of Ghana concluded its 92nd regular meeting and released its first report for the year 2020. The Bank of Ghana (BoG) maintained the key policy rate at 16% citing the following views:

- ✓ The Committee noted that the synchronised slowdown in the global economy during 2019 is beginning to give way to a recovery, mainly in the emerging market and developing economies and at a modest and uneven pace.
- ✓ The coordinated monetary policy responses of the major central banks to keep interest rates on hold and adopt a dovish monetary policy stance should benefit emerging market economies with solid macroeconomic fundamentals.
- ✓ On the domestic economy, the latest data from the Ghana Statistical Service and the Bank's Composite Index of Economic Activity both show that economic growth continues to remain robust and broad-based, although at a moderated pace relative to 2018.
- ✓ Consumer confidence has rebounded and businesses are fairly optimistic about industry prospects.
- ✓ The external sector performance continued to remain strong, with an improved trade surplus for the third consecutive year. This contributed to further narrowing of the current account deficit and supported additional reserve build-up of US$1.3 billion. This should provide strong buffers to withstand shocks and ensure stability in the foreign exchange market.
- ✓ Fiscal policy has been a source of considerable stimulus. The 2019 budget execution was broadly in line with expectations with the budget deficit outturn almost on target and within the fiscal rule of 5.0 percent of GDP.
- ✓ Finally, the committee noted that the economy is positioned firmly on the path of stability with inflation forecasted to stay within the medium-term target band of 8±2 percent, barring any unanticipated shocks.

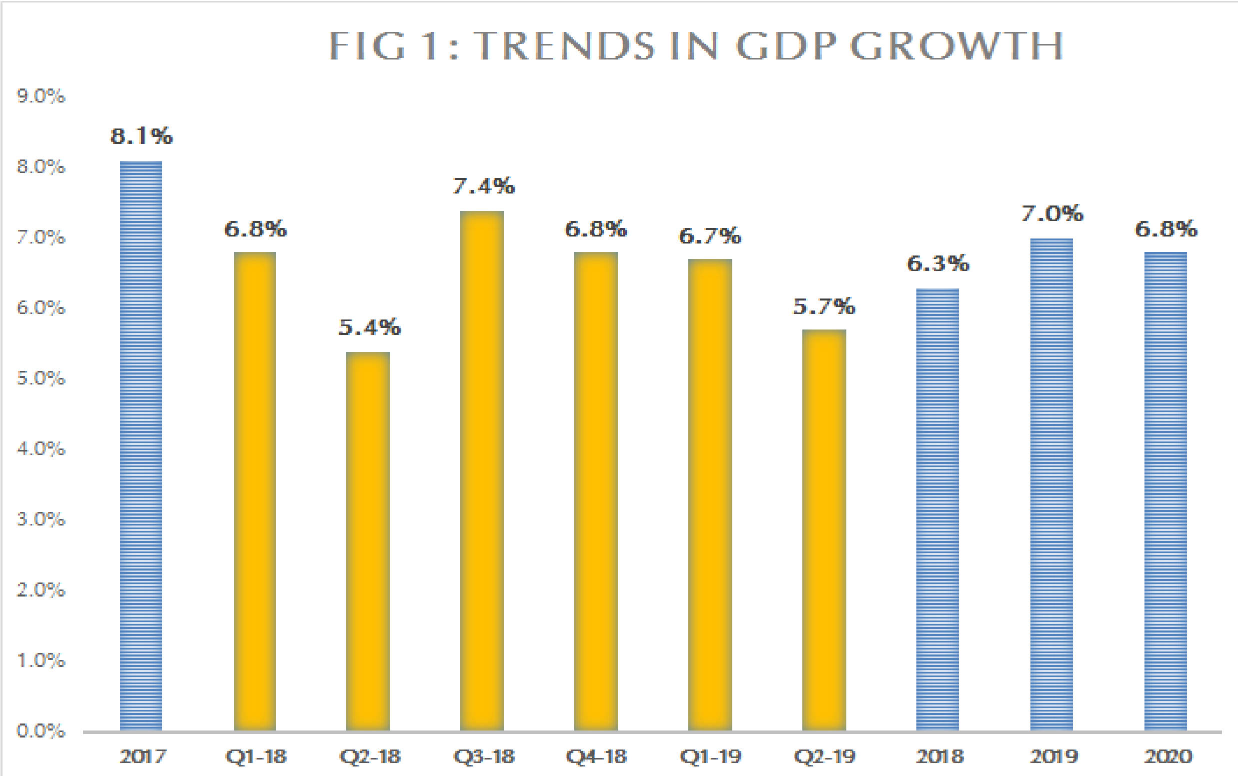
1. Global and Domestic Growth

- ✓ There are signs of recovery in global growth, following an assessment by the IMF of a synchronised slowdown in global growth in the last quarter of 2019. Global growth is now projected to rise from an estimated 2.9 percent in 2019 to 3.3 percent in 2020, and 3.4 percent in 2021.
- ✓ The key risks to the global growth outlook are geopolitical tensions between the US and Iran and worsening of relations between the US and its trading partners with the rising threat of protectionism and vulnerabilities in emerging markets.
- ✓ The outbreak of the Coronavirus poses a new risk to the global economy and its impact is yet to be assessed.
- ✓ Headline inflation in advanced and emerging market economies remained contained throughout 2019, reflecting moderated wage growth. In response to the low inflation environment, central banks in major advanced economies pursued accommodative monetary policy to support growth.
- ✓ These policy actions contributed significantly to favourable global financing conditions with positive effects on capital flows to emerging and developing market economies as investors searched for higher yields.

Looking ahead, stabilisation of global economic data remains underway with an increasing number of indicators pointing to signs of a cyclical bottoming out of the global economy. For example, global PMI composite readings have picked up from the low of 50.8 in October to 51.7 in December, with a strong pick-up in services (51.0 to 52.1) and a muted improvement in manufacturing from 49.8 to 50.1 over the same period. While global trade volumes remain negative in year-on-year terms, there are early signs of an improvement in global trading conditions as the 'phase one' deal was signed in January and the trade cycle starts to turn. Furthermore, economic data of late have surprised analyst expectations across both Developed Markets (DMs) and Emerging Markets (Ems), which should in turn help

to support a pick-up sentiment and, hence, investment. While these dynamics point to a continued stabilisation of economic conditions, we do highlight some challenges that will likely prevent the economic recovery from gathering too much steam. First, the manufacturing sector in several major markets, such as the US and Germany, currently remains in contraction, which will cap the positive impact from the increase in services. Second, we believe that a 'phase two' deal between the US and China will be harder to clinch given that it addresses larger structural issues, which will be more challenging to agree on. Third, we flag that supply-side price pressures could emanate from global oil prices, coupled with tight labour markets and rising food prices (particularly in Asia) are starting to add upside pressure on inflation readings, which could create challenges for policymakers.

- ✓ On the domestic front, the latest data from the Ghana Statistical Service point to firmer growth during 2019, although at a relatively slower pace than was recorded in 2018.
- ✓ GDP growth outturn for the first three quarters of 2019 averaged 6.0 percent, almost unchanged from the 6.1 percent recorded in the same period of 2018. Similarly, non-oil GDP growth averaged 5.0 percent against 5.9 percent over the same comparative periods. Overall, GDP growth for 2019 is projected to be close to the target of 7.0 percent.
- ✓ Similar to trends in GDP growth, the Bank of Ghana's updated Composite Index of Economic Activity (CIEA) recorded high growth, although at a slower pace than in 2018. The CIEA recorded 3.1 percent year-on-year growth in November 2019, compared with 4.8 percent in the same period of 2018.
- ✓ This was mainly supported by port activity, domestic VAT, and Deposit Money Banks' (DMBs) credit to the private sector.
- ✓ Results from the Bank's latest confidence surveys conducted in December 2019 showed significant improvement in consumer confidence reflecting optimism about current and future economic conditions.
- ✓ Business confidence, on the other hand, softened marginally on account of the exchange rate depreciation in November 2019. However, businesses expressed positive sentiments about industry prospects and declining interest rates.



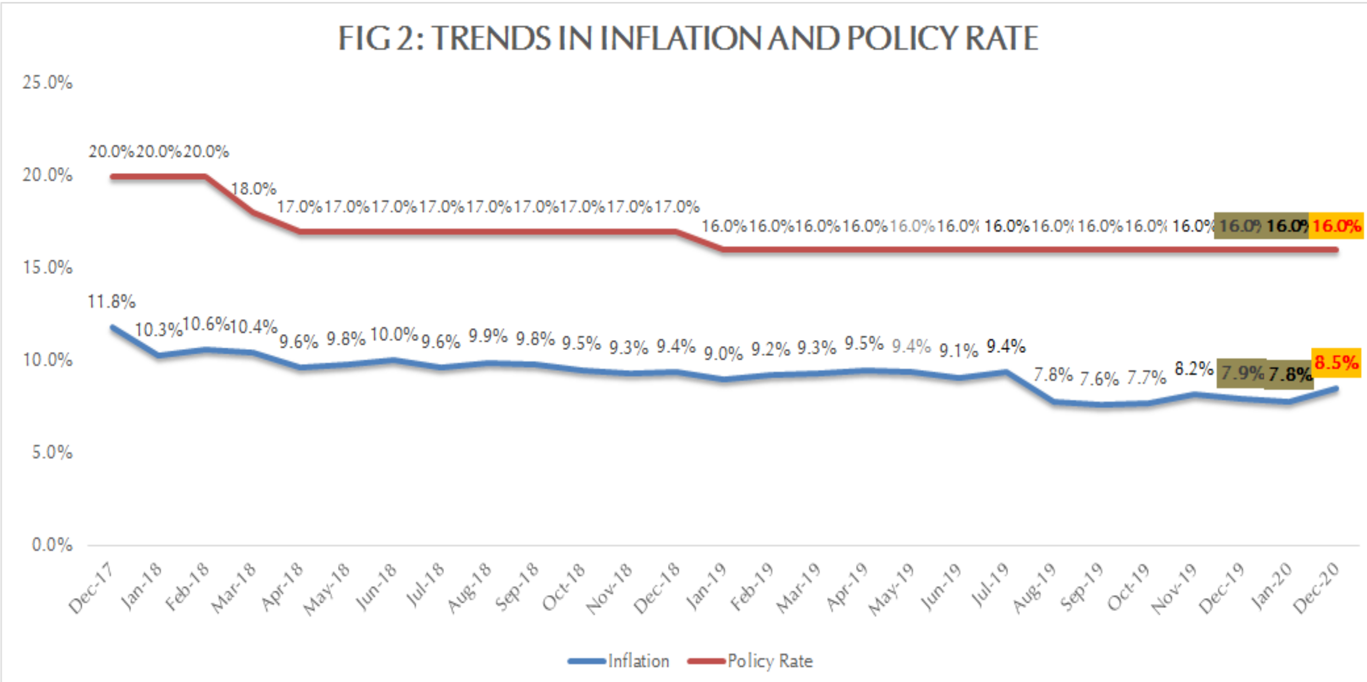
Source: Ghana Statistical Service

We project that Ghana's economy will continue to grow at a robust pace at 6.8% in 2020 although at a moderate pace compared to a projected 7.0% in 2019. This will be on the back of rising output in the mining, manufacturing and construction sectors. Over the medium to long term, we expect that growth will remain relatively robust, averaging 6.3% as output grows in the manufacturing, extractive and services sectors. Also, growth will also be supported by the services sector, especially as the banking sector continues to grow stronger and resilient, as well as the continued implementation of growth-oriented programmes in the industry and agricultural sectors of the economy. There remains a moderate downside risk that slowing growth in key Ghanaian export markets – such as China – may negatively impact on some economic sectors in Ghana and slow economic growth.

2. Inflation

- ✓ Headline inflation has remained in single digits since June 2018 and more recently remained steady around the central path of 8.0 percent.
- ✓ The two readings since the last MPC meeting showed that inflation increased to 8.2 percent in November from 7.7 percent in October 2019 due to upward adjustment in some administrative prices. However, it declined to 7.9 percent in December 2019 on the back of lower food prices amidst stable non-food prices.
- ✓ Also, the various measures of underlying inflation remained well-contained and the BoG's core inflation (defined to exclude energy and utility) has declined since June 2019, supported by well-anchored inflation expectations.

For 2020, we expect modest inflation due to demand-side pressure and rising import costs due to currency depreciation but limited global oil prices expectation in 2020 will also limit prices. We anticipate that Ghana's inflation will remain limited, averaging 7.4% in the short to medium term, thanks to a more stable currency and lower fiscal deficits. Therefore, barring any anticipated shocks, inflation is forecast to stay within the medium-term target band of 8±2 percent. We therefore forecast inflation of 7.8±0.2% for January 2020 and 8.5±0.2% for end of Dec. 2020.



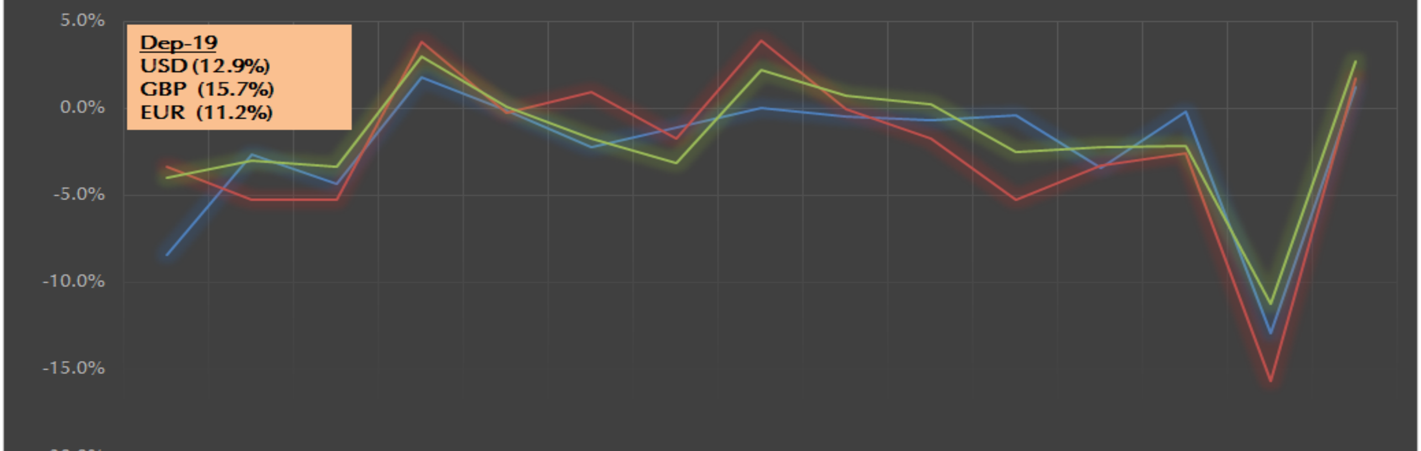
Source: Bank of Ghana

3. Trade and Exchange rate

- ✓ The Ghana cedi depreciated by 12.9 percent against the US dollar in 2019, compared with 8.4 percent depreciation in 2018.
- ✓ Against the British pound and Euro, the Ghana cedi cumulatively depreciated by 15.7 and 11.2 percent respectively, compared with 3.3 and 3.9 percent over the same period in 2018.
- ✓ By January 29, 2020, the Ghana cedi had recovered, appreciating by 0.3 percent compared with a depreciation of 2.5 percent in the same period of 2019.

We expect the cedi to experience gradual depreciation in the short term, driven by cautious investor sentiment. The combination of a strengthening US dollar and widening twin deficits will also drive depreciation over the longer term. However, the extent of depreciation will be contained by robust economic growth, which will limit the deterioration of investor sentiment, and attractive real rates – supported by limited inflation and a neutral monetary policy stance. We therefore forecast the cedi to trade within the range of GHS5.80-5.88: USD by end of 2020.

FIG 3: RATE OF CURRENCY DEPRECIATION & APPRECIATION



	FY-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19	Dep-19	Jan-20
USD	-8.4%	-2.6%	-4.3%	1.8%	-0.1%	-2.2%	-1.1%	0.0%	-0.5%	-0.7%	-0.4%	-3.4%	-0.1%	-12.9%	1.2%
GBP	-3.3%	-5.2%	-5.2%	3.8%	-0.2%	1.0%	-1.7%	3.9%	0.0%	-1.7%	-5.2%	-3.2%	-2.5%	-15.7%	1.7%
EUR	-3.9%	-3.0%	-3.4%	3.0%	0.1%	-1.7%	-3.1%	2.2%	0.7%	0.2%	-2.5%	-2.2%	-2.1%	-11.2%	2.7%

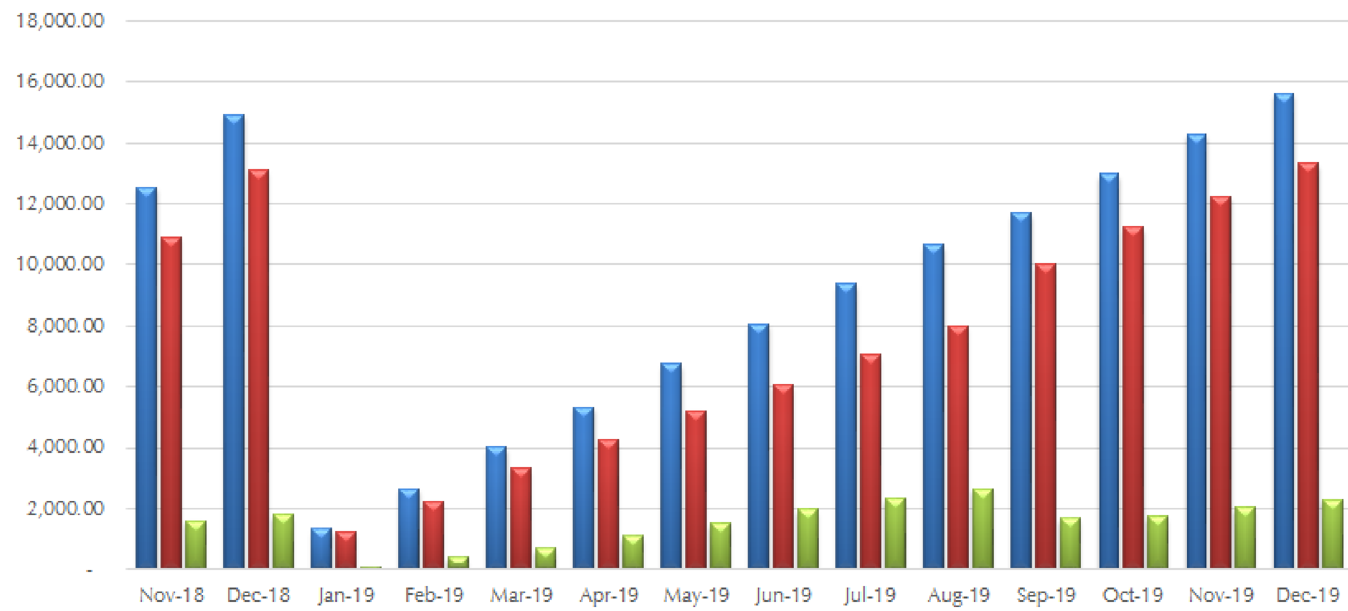
Source: Bank of Ghana.

- ✓ Price movements in the country's key export commodities, together with increased export volumes, impacted positively on the external sector.
- ✓ In 2019, total exports increased by 4.6 percent year-on-year to US$15.6 billion, driven mainly by 14.6 percent growth in gold exports and 8.6 percent growth in cocoa beans and products.
- ✓ Imports, on the other hand, grew at a slower pace of 1.5 percent to US$13.3 billion on account of a 4.2 percent growth in non-oil imports, while oil and gas imports contracted by 9.2 percent.
- ✓ These developments resulted in a trade surplus of US$2.3 billion (3.4 percent of GDP) in 2019, compared with US$1.8 billion (2.8 percent of GDP) in the same period of 2018.
- ✓ The trade surplus, together with improvements in net current transfers, especially remittances, resulted in further narrowing of the current account deficit to US$1.7 billion (2.5 percent of GDP) in 2019, compared to a deficit of US$2.0 billion (3.1 percent of GDP) a year ago.
- ✓ The current account deficit was financed by significant inflows into the financial account, driven in large part by foreign direct investments and portfolio investments.
- ✓ Consequently, the overall balance of payments recorded a surplus of US$1.3 billion (2.0 percent of GDP) over the review period, compared with a deficit of US$671.5 million in 2018.
- ✓ Gross International Reserves at the end of December 2019 was US$8.4 billion, providing cover for 4.0 months of imports of goods and services. The reserve level compares with a position of US$7.0 billion, equivalent to 3.6 months of import cover recorded at the end of December 2018.

Ghana's current account deficit will widen in 2020 and 2021 on weaker oil export revenues, high demand for capital goods imports and primary income outflows to service external debt. The degree to which the current account widens will be limited by robust gold exports. Over the medium to long term we expect that the gradual completion of construction projects will reduce capital goods imports while greater export diversification will boost export revenues. Extensive inflows of direct investment - to support several ongoing major projects - will ensure that there is broad external account stability and limited exposure to hot money flows. Therefore, our expectation is for the current account deficit to widen from 2.5% of GDP in 2019 to 3.3% in 2020 and 3.5% in 2021.

- ✓ The international commodities market remained buoyant, despite intermittent volatilities in the course of the year.
- ✓ Crude oil prices increased by 13.0 percent year-on-year, driven by OPEC production cuts and other geopolitical factors. Crude oil closed the year at an average of US$65.2 per barrel.
- ✓ Gold prices averaged US$1,481.3 per fine ounce, recording a year-on-year growth of 18.4 percent. The surge in gold prices was attributed mainly to the global economic slowdown and the low interest rate environment in major advanced countries.
- ✓ Cocoa prices averaged US$2,215.4 per tonne in 2019, an increase of 11.6 percent, due to the dry weather conditions which posed some threat to the quality of the bean.

FIG 4: TRENDS IN EXPORTS AND IMPORTS (USD MILLION)

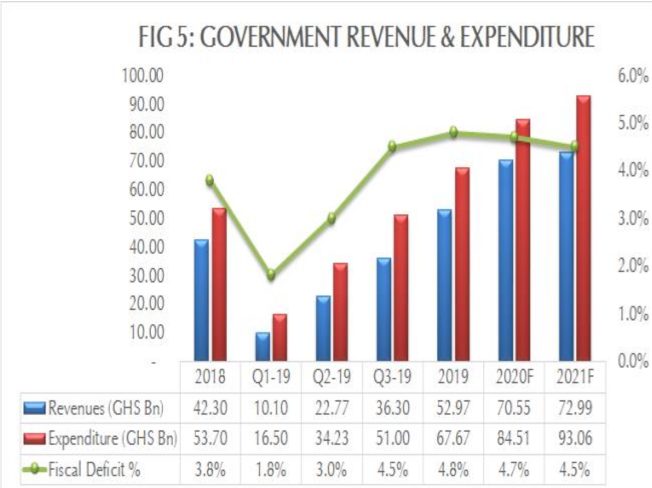


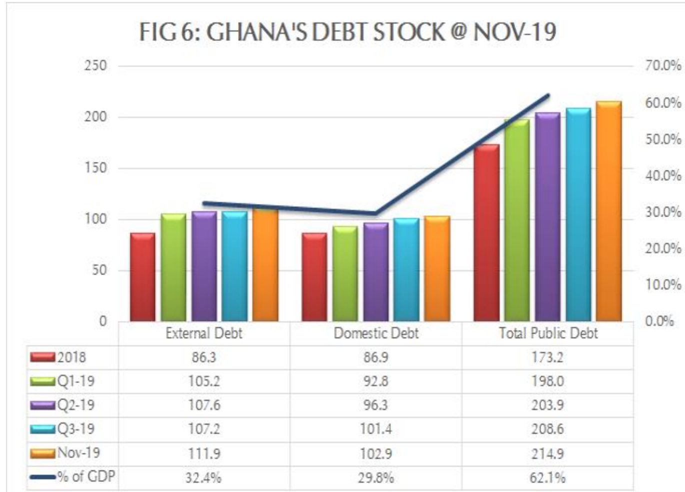
	Nov-18	Dec-18	Jan-19	Feb-19	Mar-19	Apr-19	May-19	Jun-19	Jul-19	Aug-19	Sep-19	Oct-19	Nov-19	Dec-19
Export	12,538.	14,942.	1,342.0	2,665.2	4,017.2	5,341.4	6,757.2	8,056.4	9,377.8	10,662.	11,692.8	12,985.2	14,288.7	15,634.0
Import	10,928.5	13,134.1	1,255.8	2,255.7	3,321.7	4,241.1	5,222.5	6,067.5	7,043.5	8,017.7	10,009.	11,240.	12,252.	13,335.
Trade Balance	1,610.1	1,808.6	86.20	409.50	695.50	1,100.3	1,534.7	1,988.9	2,334.3	2,644.4	1,683.3	1,745.2	2,036.3	2,298.1

Source: Bank of Ghana.

4. Fiscal Situation

- ✓ Provisional budget estimates from January to December 2019 indicated that total revenue and grants amounted to GH¢52.97 billion (15.3 percent of GDP) compared with the projected target of GH¢54.56 billion (15.8 percent of GDP).
- ✓ Total expenditures, including arrears clearance was GH¢67.67 billion (19.6 percent of GDP), below the target of GH¢70.19 billion (20.3 percent of GDP).
- ✓ These developments resulted in an overall fiscal deficit (on a cash basis) of 4.8 percent of GDP, slightly above the target of 4.7 percent of GDP but below the 5.0 percent fiscal rule.
- ✓ In line with these developments, the provisional estimates indicate that the stock of public debt rose to 62.1 percent of GDP (GH¢214.9 billion), at the end of November 2019 compared with 57.9 percent of GDP (GH¢172.9 billion) at the end of November 2018.
- ✓ Of the total debt stock, domestic debt was GH¢102.9 billion, while external debt was GH¢111.9 billion with a share of 52.1 percent in the total public debt.





Source: Bank of Ghana

On fiscal developments, the MPC observed that Fiscal policy has been a source of considerable stimulus. The 2019 budget execution was broadly in line with expectations with the budget deficit outturn almost on target and within the fiscal rule of 5.0 percent of GDP. Going into 2020, we expect that Ghana's fiscal deficit will widen from 4.7% of GDP in 2019 to 4.8% in 2020 on the back of higher capital spending and higher debt servicing costs. Revenue growth will nonetheless be robust given structural improvements to the tax base and robust economic growth supporting government income. While acknowledging that there are electoral cycle fiscal risks, strong commitment by the fiscal authorities to stay on the consolidation path should help sustain the stability and growth achieved over the past three years. Over the medium to long term we expect that fiscal consolidation will press ahead given the gradual conclusion of capital spending projects and rising revenue growth.

In relations to debt, Ghana's debt sustainability will remain a cause for concern in the years ahead, although we do expect that it will improve from current levels. A sustained fiscal deficit, albeit a diminishing one, will see Ghana's nominal debt stock continue to rise over the coming years, but as a proportion of GDP the outlook is brightening as the country recovers from its recent macroeconomic troubles, the fiscal deficit comes down and real GDP growth picks up. We note, however, that government support of newly-amalgamated banks and its push for large Eurobond issuances will likely see the debt-to-GDP ratio, external debt and foreign currency-denominated debt rise in the short term. Even though Ghana's debt position has high levels of exposure to foreign currency, robust economic growth and fiscal consolidation will gradually reduce the attendant risks.

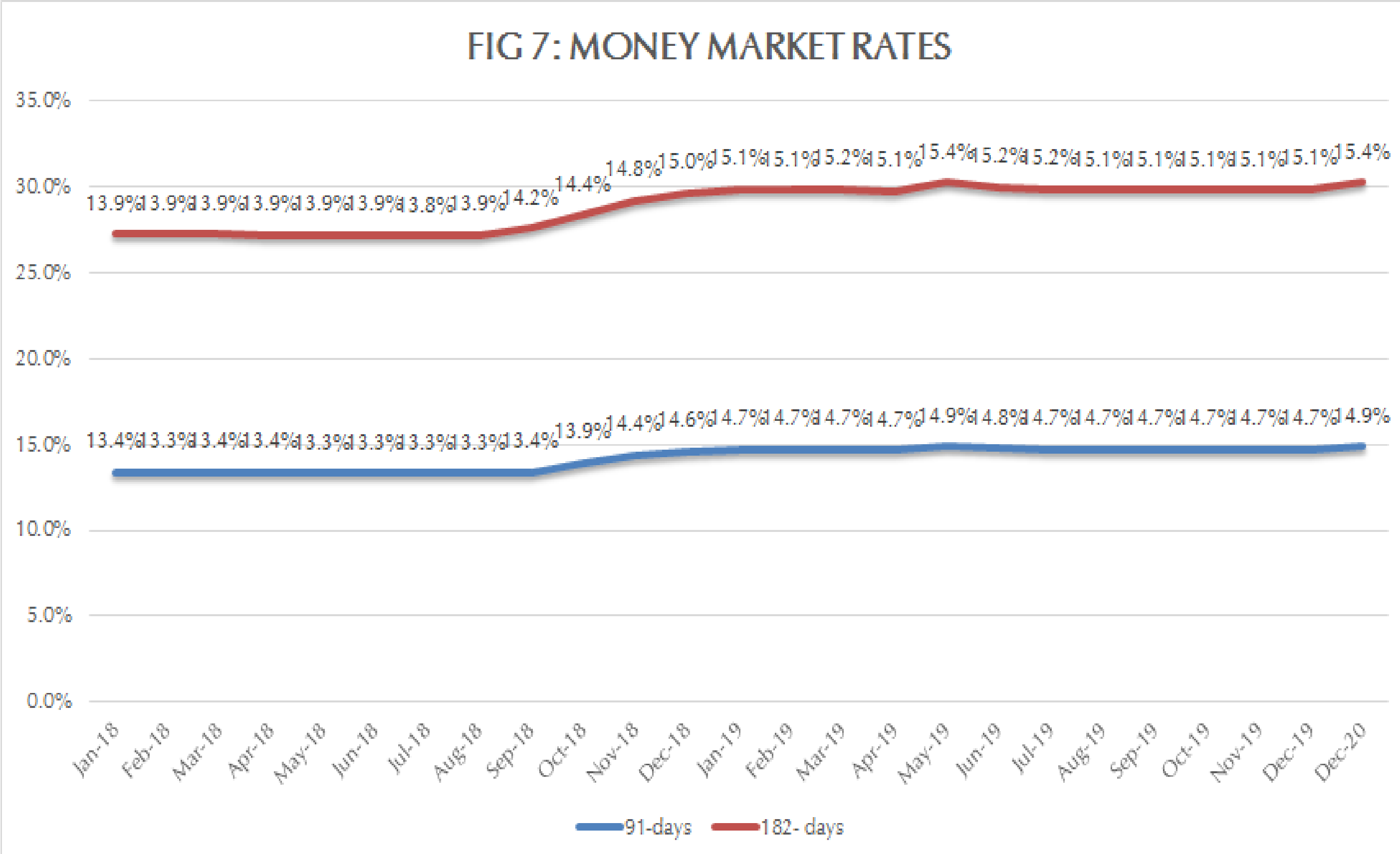
5. Monetary Aggregates and Credit Growth

- ✓ Growth in the key monetary aggregates firmed up in 2019, driven largely by increased accumulation of net foreign assets by the Bank of Ghana.
- ✓ Broad money supply (M2+) recorded an annual growth of 21.6 percent in December 2019 compared with 15.4 percent a year ago.
- ✓ The increase was mainly reflected in increased deposits, signifying deposit flight to quality, as the clean-up process boosted a return to confidence in the banking sector.
- ✓ Deposit Money Banks (DMBs) credit to the private and public sectors rebounded strongly in 2019. Private sector credit grew by 18.3 percent year-on-year to GH¢44.5 billion in December 2019, compared with 10.6 percent in December 2018.

- ✓ In real terms, private sector credit growth was 9.7 percent. Distribution of the credit was broad-based and almost all the key economic sectors recorded higher credit growth in 2019 relative to what was observed in 2018.
- ✓ The major sector beneficiaries were Services with 24.1 percent, Commerce and Finance with 20.9 percent, and Manufacturing with 10.9 percent.
- ✓ Supporting the rebound in credit growth, the BoG's latest credit conditions survey conducted in December 2019 pointed to a net easing in overall credit stance to enterprises. The survey findings also showed that credit demand by enterprises would increase in the first quarter of this year.
- ✓ Underscoring these favourable survey results, the banking sector data showed a significant jump in new advances by 27.3 percent year-on-year to GH¢29.7 billion in 2019.

6. Developments in the Debt Markets

- ✓ Interest rates on the money market increased slightly across the various maturities of the yield curve.
- ✓ The 91-day Treasury bill rate inched up to 14.7 percent in December 2019 compared with 14.6 percent a year ago.
- ✓ Interest rates on the 182-day instrument also moved up to 15.2 percent, from 15.0 percent over the same period a year ago.
- ✓ In contrast, rates on the secondary bond market broadly declined. Yields on the 7 and 15-year bonds marginally declined to 21.0 and 19.9 percent in December 2019, from respective 21.0 and 21.4 percent in December 2018.
- ✓ The yield on the 10-year bond, however edged up slightly to 21.3 percent from 21.2 percent over the same review period.
- ✓ The weighted average interbank lending rate declined to 15.2 percent in December 2019, from 16.1 percent in the same period a year earlier.
- ✓ In a similar trend, average lending rates compiled from the banking sector marginally declined to 23.6 percent in December 2019, from 23.9 percent in December 2018.



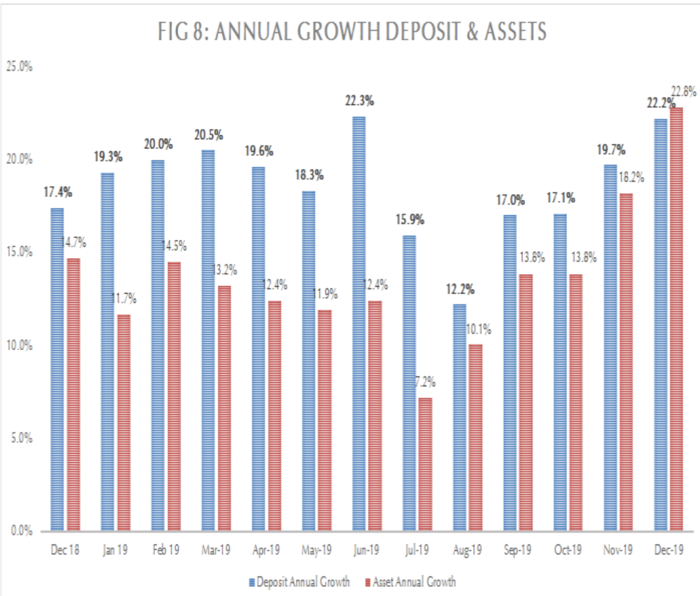
Source: Bank of Ghana

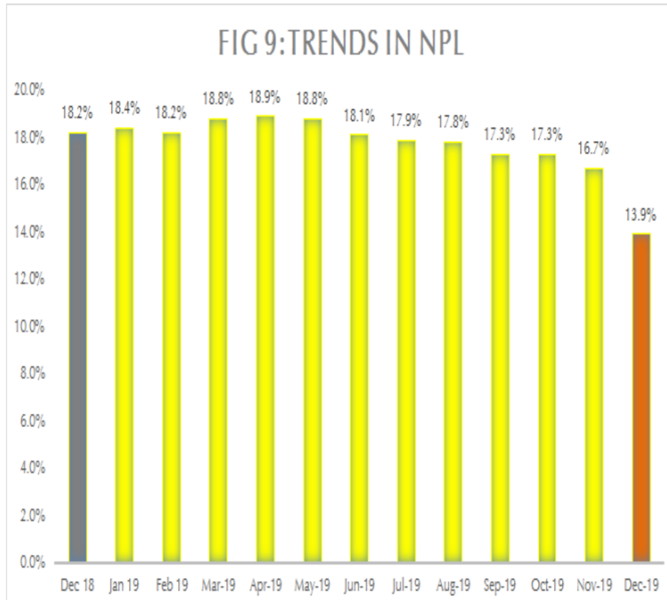
Our projection is for the short end of the market to be fairly stable rising gradually on the back of expected increases in domestic borrowing. We expect the yield curve to continue to steepen over the near term with long term rates rising faster than short term rates supported by tight monetary policy and the re-profiling of government debt amid growing fiscal consolidation efforts.

7. <u>Banking Sector Developments</u>

- ✓ A year after the completion of the clean-up and recapitalization exercise, the performance of the banking sector has improved markedly, signifying positive dividends from the reform programme.
- ✓ Enforcement of the new Corporate Governance Directives issued by the Bank as part of the recent reforms led to several board chairs of banks and CEOs ending their tenure, while Board members who have served for prolonged periods were all replaced.
- ✓ Total assets of the banking sector increased to GH¢129.06 billion at end-December 2019, representing a 22.8 percent year-on-year growth.
- ✓ The increased total assets were on account of significant growth of 22.2 percent year-on-year in deposits to GH¢83.46 billion underscoring renewed confidence in the banking sector.
- ✓ The industry's Capital Adequacy Ratio, computed in accordance with the Capital Requirement Directive under the Basel II/III capital framework, stood at 17.5 percent at the end of December 2019, and above the 13 percent minimum regulatory benchmark.
- ✓ Asset quality also improved significantly and the NPL ratio declined sharply to 13.9 percent in December 2019 from 18.2 percent in December 2018, reflecting increased loan recoveries, write-offs, and higher credit growth.

- ✓ From the forgoing, the banking industry has built up a much stronger balance sheet and recorded strong asset growth, improved quality of loans and profitability for 2019. All the financial soundness indicators, measured in terms of earnings, liquidity, and capital adequacy remained strong.
- ✓ Payment systems data point to continued expansion in the use of mobile money, further supporting the inclusive financial sector agenda. As at December 2019, total active mobile money accounts stood at 14.5 million, up from 13.1 million a year earlier.





Source: Bank of Ghana

In the outlook, we expect that loan growth will accelerate from a tepid 12.9% y-o-y in 2018 to 22.4% in 2019 and to 30.0% in 2020. In 2018, the Bank of Ghana forced all commercial banks to either significantly increase their minimum capital reserves or amalgamate by the end of the year, which resulted into five banks merging. Meanwhile the government has taken over responsibility for impaired debt incurred by state-owned power firms, and is in the process of paying them down. This has seen non-performing loans (NPLs) decline from 18.2% of total loans in 2018 to 13.9% in December 2019. Taking loss provisions into account, the December NPLs figure stands at 6.7%. These efforts have been accompanied by a concomitant rise in credit to the private sector, with loan growth rising from 12.9% in 2018 to 22.4% in 2019.

We believe that this positive trend will continue into 2020 and beyond, as a result of robust demand for credit from most economic sectors boosted by broad-based economic growth. We expect that the mining sector will remain on an expansionary trend given the incentive of high gold prices and the lifting of government restrictions on small scale mining. Meanwhile, the services sector will be a major source of credit demand. The services sector is the largest sector, making up 45.8% of GDP and growing at 5.7% y-o-y - as of Q319. Limited inflation – set to average a low 8.5% in 2020, down from 8.7% in 2019 and the average of 12.8% between 2010 and 2017. Weaker price pressure will help safeguard consumer purchasing power, adding tailwinds to demand for commercial credit.

Although credit to the private sector will grow at a relatively robust pace, rising government demand for credit means that private loan growth will be weaker than it could have otherwise been. Even though, we expect government budget deficit to widen a bit in 2020 due to Ghana's history of overspending in election years, this will likely see the government increasingly rely on the banking sector for its financing needs at a time when the public external debt is at an elevated 32.4% of GDP (as of November 2019). Commercial banks continue to increase their bond holdings bringing bond portfolio up to 39.2% of total assets as at October 2019. This reflects high government demand, as well as the banks' effort to *increase their lower risk assets during restructuring in 2018. This has not crowded out commercial lending significantly thus far in 2019, but we believe that a strong and rising government demand for credit will have a crowding out effect in the coming quarters, albeit only on a limited scale. This will make commercial loan growth slower than it would otherwise be in 2020.*

There remains a downside risk to our credit growth forecast if the government were to experience fiscal slippage in 2020 and require higher than expected borrowing. In such circumstance the yields on government bonds would rise, possibly forcing banks to charge higher interest rates to commercial lenders and crowding out many, likely slowing loan growth far more than we currently expect.

On Asset Quality, NPLs as a proportion of total loans are falling as a result of government and central bank efforts to clear NPL stocks. However, NPLs still remain fairly high in Ghana, coming in at 13.9% in December 2019. This level of NPLs is still high compared to the 11.2% recorded in June 2015, but marks a reduction from a peak of 23.4% in April 2018. High levels of NPLs are costly as they lead to impairment charges on a bank's income statement, contributing to the poor profits of Ghanaian banks. The gradual pass-through effects of 1000 basis points of interest rate cuts between November 2016 and January 2019 and government rationalisation of SOE debts will see these NPLs begin to come down once again, although we anticipate that this will be a gradual process.

8. Our View and Outlook for the Policy Rate

We expect that the BoG will keep its key policy rate at 16% in 2020 on balanced risks. Monetary easing is unlikely this year, as a robust growth outlook will reduce the scope for further monetary policy accommodation. Moreover, although loose monetary policy has not yet completely fed through to the banking sector which still charges relatively high interest rates, the completion of a major overhaul of the sector by the government and BoG in 2018 has succeeded in boosting loan growth in 2019 as indicated earlier in this report. The BoG stressed the positive outlook for both commercial lending and for the wider economy in its policy meeting last week, which we expect will remain a key factor driving the BoG's policy decisions.

While we deem further monetary easing unlikely, we also expect no monetary tightening as this would impact on commercial lending and economic growth. Though commercial lending has been rising sharply, commercial interest rates were still high at an average of 23.6% as at December 2019, a rise from May 2019 (23.1%) that mirrors a corresponding increase in yields on some government bonds. This has not been sufficient to crowd-out private borrowers so far; yet, any sign of monetary tightening would risk increasing treasury yields, forcing commercial banks to increase interest rates for private borrowers. This cycle could risk choking off commercial credit, thus slowing economic growth.

A modest uptick in inflation will also contribute to the BoG's neutral policy stance. The Ghana Statistical Service (GSS) rebased inflation in August which has seen headline inflation fall to an average of 8.7% y-o-y. We expect that inflation will rise in 2020, driven by currency depreciation and demand-side pressure from economic expansion, resulting in average annual price growth of 8.5% in 2020 – down from an average of 8.7% inflation in 2019. That said, this inflation rate will remain well within the BoG's 6.0-10.0% target band in 2020. Furthermore, pressures on prices will be limited by falling global oil prices – reducing pressure on transport and fuel costs – and by the effects of inflation rebasing on price growth.

There are however both upside and downside risks to our forecast for the central bank policy rate. Firstly, the risk of further easing will rise if Ghana's economy were to experience sluggish growth. This could be the result of an unexpectedly strong decline or deceleration in demand in key export markets – such as China or India. In such circumstances the BoG may feel compelled to cut rates to support the economy, even if this did pose risks to the exchange rate – and thereby to the fiscal and external position. If, on the other hand, the exchange rate was to face unexpectedly strong depreciatory pressure in the event of global risk-off sentiment towards emerging markets - outpacing our current expectations - then the BoG may feel compelled to undertake monetary tightening to prevent unsustainable pressure on the fiscal and current account balances.

9. Implications for GCB Bank

1. The decline in non-performing loans (NPLs) (from 18.2% of total loans in 2018 to 13.9% in December 2019), increased capital base of the banks and government taken over the responsibility of paying for impaired debt incurred by state-owned power firms is expected to further fuel credit growth in 2020. The drop in NPL has already seen concomitant rise in credit to the private sector, with loan growth rising from 12.9% in 2018 to 22.4% in 2019. We expect that the mining sector will remain on an expansionary trend given the incentive of high gold prices and the lifting of government restrictions on small scale mining. Meanwhile, the services sector will also be a major source of credit demand being the largest sector and at the same time always showing robust growth over the years. This therefore provides an opportunity for the Bank to generate income by focusing on these sectors on the back of stringent credit delivery.

2. We also believe that commercial banks will continue to increase their bond holdings in 2020 (total bond portfolio of 39.2% of total assets as at October 2019). This would be on the back of high government demand, as well as banks' effort to hold lower risk assets of their asset mix to minimise losses. Therefore, while GCB looks at taking higher risk in creating loans, we recommend that we also generate returns in less riskier assets in government bonds with favourable rates in the long and short end of the money markets.

3. Tapping into the merchandise trade flows to generate off-balance sheet income. Our expectation is for growth in imports of capital goods and consumer goods in 2020 due to the robust growth anticipated in the economy especially from the mining, construction, 1D1F and services sectors. These will ensure capital goods imports as well as consumer goods by firms and traders. We therefore reiterate the need for GCB to strategically position itself by financing the trade needs of companies in these sectors through Letters of Credit (LCs) to generate deposits as well as off-balance sheet revenues for the bank. It is also an opportunity for Fx trading by the Bank with clients of these sectors. This we believe will go a long way in enhancing the financial performance of the Bank in 2020.

4. Interest rates on the money market increased slightly across the various maturities of the yield curve. Our expectation is for the slight increase to reflect in our pricing.