ECONOMIC UPDATE: REVIEW OF MONETARY POLICY REPORT

Monetary Policy Rate (MPR) Reduced by 100bsp to 13.5% from 14.5%.

01/06/2021

Introduction

On Monday 31st May, 2021, the Monetary Policy Committee (MPC) of the Bank of Ghana concluded its 100th regular meeting. The Committee lowered the policy rate by 100 basis points (bsp) to 13.5% from 14.5% citing the following reasons:

- ✓ On the domestic front, economic activities have picked up strongly, evidenced by high frequency economic indicators. And that the projected growth in the extractive industries, steady rollout of the vaccination programme and recovery in industry and the services sectors should work their way in supporting a faster closure of the output gap in the medium-term.
- ✓ There are signs that the execution of the budget for the first four months' point to some improved revenue collections and expenditure containment to ensure real re-alignment to the consolidation path.
- ✓ The banking sector remains sound and profitable, with adequate levels of capital and liquidity to withstand moderate to severe shocks.
- ✓ Headline inflation eased sharply to within the medium-term target band, driven mainly by lower food prices and base drift effects, a tight monetary policy stance and stable exchange rate conditions. Risks to the inflation outlook appear muted in the near-term, but pressures from mostly rents and transport fares, would require some monitoring to anchor inflation expectations.

1. Global Developments

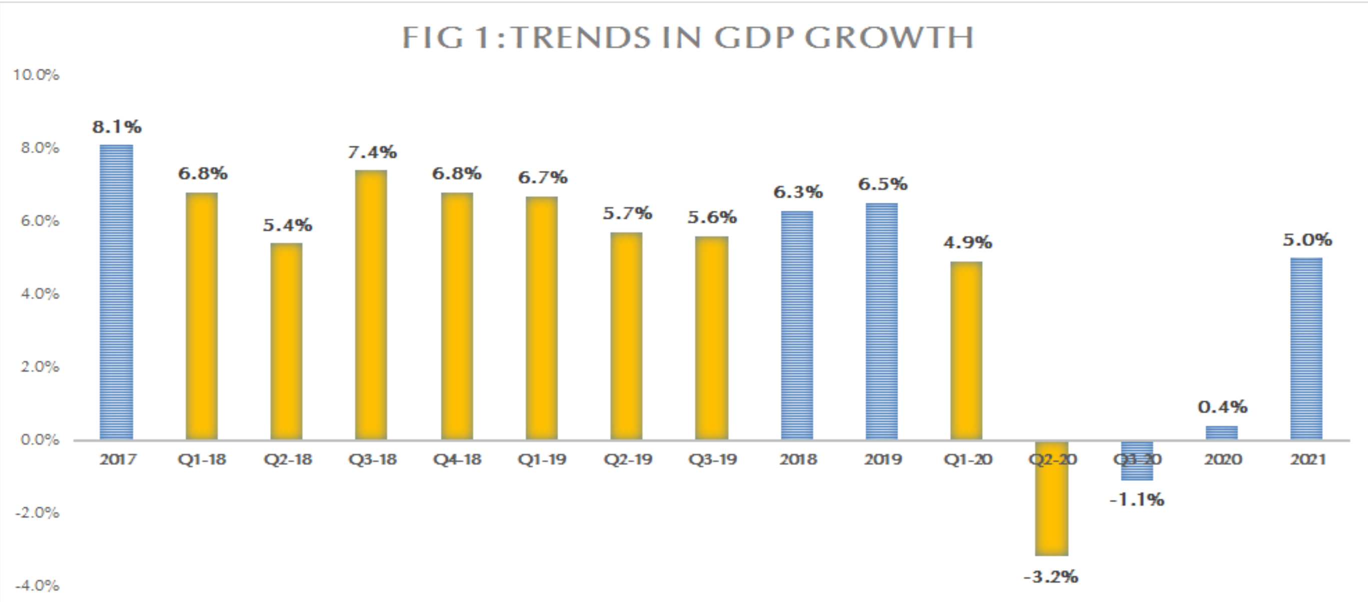
- ✓ Since the last meeting in March 2021, global growth momentum has strengthened, underpinned by the continued policy support, mass vaccinations, and relaxation of restrictions, especially in advanced economies.
- ✓ These efforts have helped to improve prospects of a rebound in economic activity, and which has been reflected in the revised IMF April 2021 global growth projections to 6.0 percent, up from 5.5 percent in the January 2021 projections.
- ✓ Nonetheless, the continued spread of the virus in parts of the world, emergence of new variants, and stalled vaccination efforts across emerging market and developing economies is continuing to cloud efforts at fighting the pandemic, creating some uncertainty which could undermine the global recovery efforts.
- ✓ Global financing conditions remain broadly supportive of the recovery process. The persistence of low borrowing costs, declining long-term bond yields, and compressed sovereign bond spreads, reflect the re-affirmation of accommodative monetary policy stance by major central banks.
- ✓ Also, equity markets have strengthened further, sustained by the continued policy support and optimism about global growth prospects, while portfolio flows to emerging market economies rebounded in April 2021. Market participants expect these favourable financing conditions to persist for some time.
- ✓ Global inflation pressures have risen in some advanced and emerging market economies, driven by the sharp rise in commodity prices, especially crude oil prices, and a combination of a surge in demand and supply constraints as economies re-open.

Global growth is projected to rebound in 2021 underpinned by continued policy support and increased optimism about the COVID-19 vaccinations. However, the lack of certainty about further waves of the pandemic with new variants and vaccination challenges, varying degrees of economic scarring and output losses, and limited fiscal space in emerging market economies among others, may slow the global recovery process. On that basis we foresee the pace of recovery varying greatly across regions. Asia and North America will recover first, with real GDP getting back to pre-coronavirus levels by the end of 2021. However, the recent spike in Covid cases in the Asian region especially India and Japan etc. makes the prospects for pre-pandemic growth levels uncertain by the end of the year. A fast rollout of vaccines and ample fiscal stimulus underpin positive US economic prospects. The recovery will take longer in Europe, the Middle East and Sub-Saharan Africa, stretching into 2022. The third wave of the pandemic in Europe which led to the reimposition of lockdown measures in many countries would impact on growth prospects this year. Latin America will be a laggard, with real GDP returning to pre-coronavirus levels only in 2023.

2. Domestic Economy

Real Sector Developments

- ✓ In the domestic economy, the recovery process from the pandemic gained some momentum evidenced by the latest high frequency indicators.
- ✓ The BoG's updated Composite Index of Economic Activity (CIEA) registered a strong annual growth of 26.8 percent in March 2021, compared to a contraction by 1.9 percent in the corresponding period of 2020.
- ✓ The key drivers of economic activity during the period were domestic consumption (proxied by VAT collection), construction activities, international trading activities, resumption of industrial production activities and air-passenger arrivals.
- ✓ The latest Ghana Purchasers Managers Index, which gauges the rate of inventory accumulation by managers of private sector firms and measures dynamics in economic activity, also improved in April 2021.
- ✓ However, the BoG's latest confidence surveys conducted in April 2021, showed some dip in both consumer and business sentiments. Consumer confidence dipped slightly on account of recent increases in petroleum prices at the pump, new taxes, and transportation fares.
- ✓ In a similar direction, the optimism of businesses observed at the last MPC round also softened at this MPC round on concerns that the imposition of new taxes as announced in the 2021 Budget statement and the ongoing electricity maintenance management programme would adversely impact operational costs in the short-term. Businesses however, expressed optimism about their company and industry prospects.



Source: Ghana Statistical Service, GCB Research

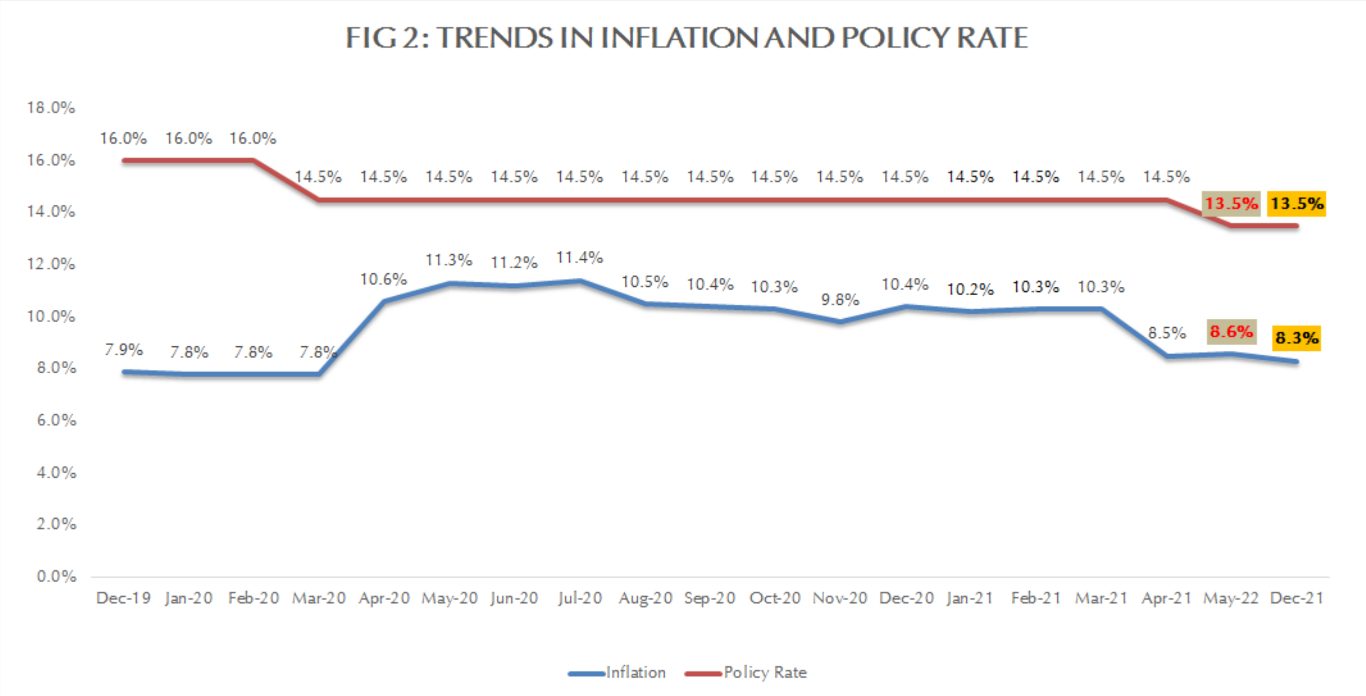
In the outlook, the committee noted that, economic activities have picked up strongly, evidenced by high frequency economic indicators. However, consumer and business confidence have softened, triggered by the new revenue measures and recent instability in power supply. These have served to dampen sentiments but are viewed as temporary and should improve in the near-term. Even though private sector credit growth still remains below pre-pandemic levels, the committee expect banks to respond to the observed emergence of increased demand for loans to support the expected pickup in economic activity.

Our projection is for a bounce back in real GDP growth to 5.0% in 2021, from 0.4% in 2020. The growth will be underpinned by a rebound in hydrocabons, gold and the services sectors. With external demand and prices picking up in 2021, oil production will increase. Gold production is expected to continue to rise amid high global prices, combined with government efforts to curtail illegal mining, which will boost formal sector activity. Services, which were affected by lockdown measures and falling private consumption in 2020, will recover somewhat in 2021 as most containment measures are lifted and private consumption picks up. The agricultural sector will also register growth, benefiting from government investment to improve crops and cocoa yields with its Planting for Food and Jobs Programme. However, our expectation is for the rolling power blackouts across large parts of the country in April-September due to upgrades and repaires to temper the pace of economic recovery in 2021.

3. Price Developments

Inflation

- ✓ Recent price developments show that headline inflation dropped sharply from 10.3 percent in March 2021 to 8.5 percent in April, almost back to pre-pandemic levels and within the medium-term target band of 8±2 percent. The decline in April inflation was driven by lower food prices and base drift effects.
- ✓ Food inflation dipped markedly to 6.5 percent in April from 8.8 percent in March, while Non-food inflation rose to 10.2 percent from 10.0 percent over the same comparative periods, on account of increases in ex-pump prices, and housing prices.
- ✓ Similar to the trends in headline inflation, underlying inflation pressures eased substantially in April 2021. The Bank's core inflation measure, which excludes energy and utility, declined to 8.6 percent in April, from 10.9 percent in March 2021.
- ✓ However, inflation expectations gauged from a survey of businesses, consumers and financial sector inched up in April, reflecting in part, sentiments surrounding tax adjustments and recent challenges associated with maintenance works in the power sector.



Source: Bank of Ghana, GCB Research

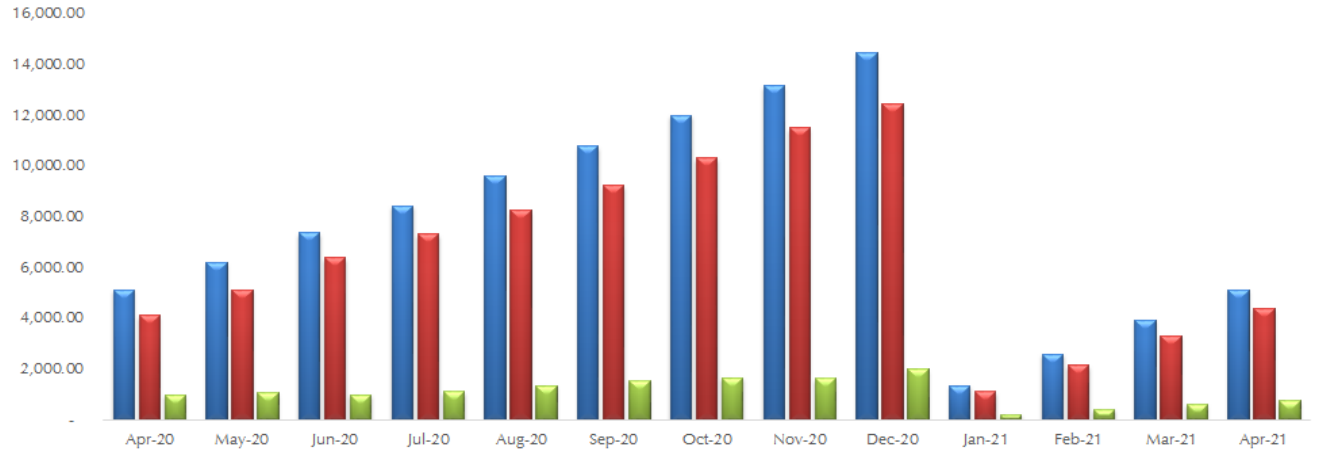
According to the MPC, headline inflation eased sharply to within the medium-term target band (8.0-10±2%), driven mainly by lower food prices and base drift effects, a tight monetary policy stance and stable exchange rate conditions. They indicated that risks to the inflation outlook appear muted in the near-term, but pressures from mostly rents and transport fares, would require some monitoring to anchor inflation expectations. From our point of view, inflation will moderate in 2021 to 8.3±0.2%, from 10.4% in 2020. Although domestic demand is still fairly weak, supply-side price pressures (including food prices, rising global oil prices, the revenue measures announced in the government budget statement and supply-chain disruption due to the pandemic) are keeping inflationary expectations elevated even though within the target band of the BoG. Therefore, due to the tight monetary policy stance by the BoG and the relatively stable exchange rate conditions, we do not expect inflation to breach the 10% mark by the end of the year. For the month of May 2021, we forecast inflation of 8.6±0.2%.

4. External Sector Developments

- ✓ On the external sector, the average prices of cocoa, gold and crude oil traded mixed in the year to April 2021.
- ✓ Crude oil prices rebounded strongly and increased by 30.0 percent to settle at an average price of US$65.3 per barrel compared to US$55.3 per barrel in January, supported by production restraints from OPEC+ and re-opened economies as vaccinations expanded across most advanced countries.
- ✓ In contrast, gold prices declined by 5.3 percent to US$1,760.7 per fine ounce on account of stronger US dollar and rising US Treasury yields.
- ✓ Similarly, cocoa prices eased to US$2,419.5 per tonne in April 2021 compared to the US$2,523.9 per tonne in January. The decline in cocoa prices was attributed to increased supply in Ivory Coast.
- ✓ These commodity price trends adversely impacted the trade balance. For the first four months of the year, total exports declined marginally by 0.2 percent year-on-year to US$5,131 million, driven mainly by a 21 percent decline in volume of gold exported attributed to instability in the sector.
- ✓ Total imports, on the other hand, rose by US$239.3 million to US$4,372 million, supported by increased non-oil imports. As a result, the trade balance recorded a surplus of US$759.1 million (1.1 percent of GDP) compared with a surplus of US$1,006.3 million (1.4 percent of GDP) in the same period of 2020.

- ✓ Gross International Reserves stood at US$10,990.3 million at the end of April 2021, providing cover for 5.1 months of imports of goods and services. The reserve level compares with a stock position of US$8,624.4 million, equivalent to 4.1 months of import cover recorded at the end of December 2020.

FIG 3: TRENDS IN EXPORTS AND IMPORTS (USD MILLION)



	Apr-20	May-20	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Apr-21
Export	5,134.30	6,209.00	7,386.80	8,438.30	9,620.60	10,789.60	12,001.30	13,162.80	14,452.80	1,357.90	2,596.40	3,945.40	5,131.10
Import	4,132.70	5,143.50	6,390.50	7,323.40	8,271.60	9,244.00	10,332.30	11,518.10	12,437.40	1,134.30	2,160.10	3,324.40	4,372.00
Trade Balance	1,001.60	1,065.50	996.30	1,114.90	1,349.00	1,545.60	1,669.00	1,644.70	2,015.40	223.60	436.30	621.00	759.10

Source: Bank of Ghana

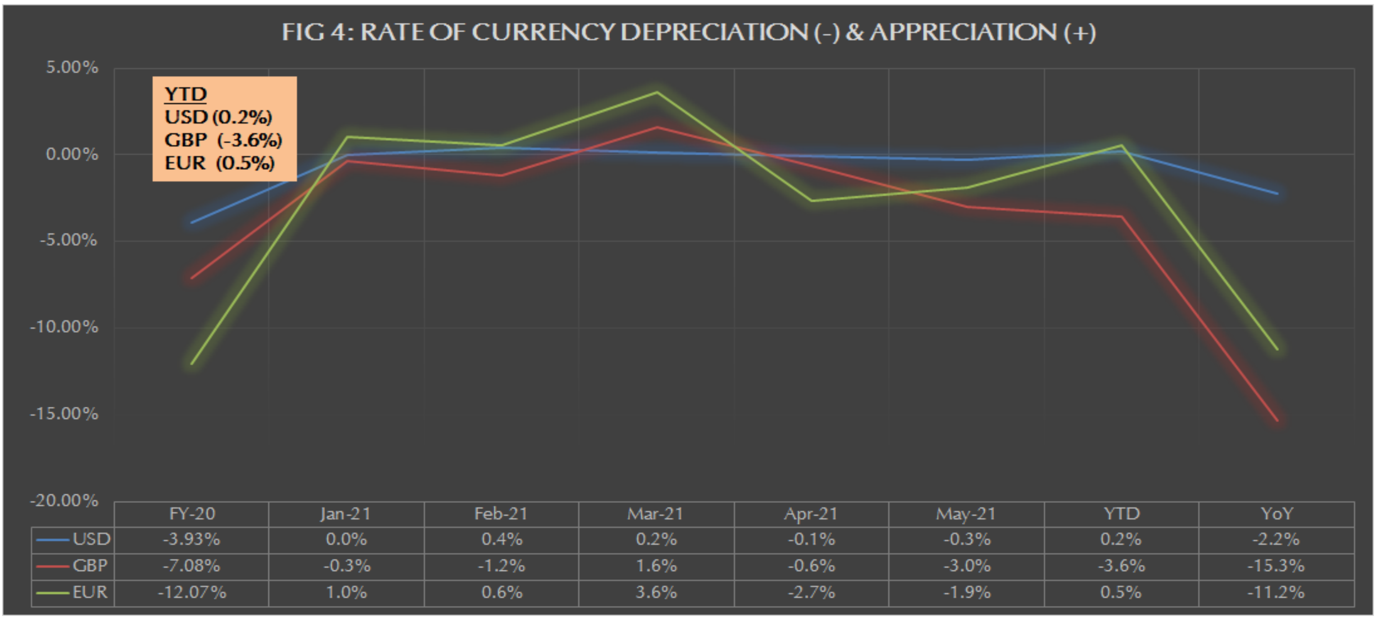
The external accounts have been affected by the economic fallout from the pandemic, owing mainly to falling oil export revenue. However, Ghana's other major export commodities (gold and cocoa, which account for about 40% and 10% of export earnings, compared with 30% for oil) held up well in 2020, which cushioned the overall impact on the current account. Consequently, the trade account remained comfortably in surplus in 2020. We expect the surplus to widen in 2021 as export earnings recover, reflecting higher average oil and gold prices and production, although cocoa revenue will fall. As a proportion of GDP, the trade surplus will steadily decline in the medium term, reflecting firmer growth in imports as domestic demand picks up and sluggish export growth as oil prices decline in the medium term.

The services account will remain in deficit in 2021 and beyond owing to sustained expenditure on technical services for oil and gas projects, but the deficit will narrow gradually as the Pecan oilfield starts up in 2024. The primary income deficit will narrow but remain large, reflecting interest payments on external debt and profit repatriation. The secondary income account will continue to post large surpluses, underpinned by inflows of workers' remittances. Overall, we forecast that the current-account deficit will narrow to 0.5% of GDP in 2021 (from 3.2% of GDP in 2020), before widening steadily to 1.8% of GDP in the medium term. The deficits will be financed through external borrowing and FDI flows.

Exchange Rate Developments

- ✓ The strong foreign exchange reserve position has provided an anchor for exchange rate stability.
- ✓ Cumulatively, the Ghana Cedi appreciated by 0.2 percent against the US dollar in the year to May 2021, compared with a depreciation of 1.5 percent in the same period of 2020.
- ✓ The Ghana cedi also appreciated by 0.5 percent against the Euro and depreciated by 3.6 percent against the Pound Sterling, compared with corresponding 0.5 percent depreciation and 5.7 appreciation over the same period in 2020.

- ✓ Year-on-Year, the cedi has depreciated by 2.2%, 15.3% and 11.2% respectively against the dollar, GBP and EUR.



	FY-20	Jan-21	Feb-21	Mar-21	Apr-21	May-21	YTD	YoY
USD	-3.93%	0.0%	0.4%	0.2%	-0.1%	-0.3%	0.2%	-2.2%
GBP	-7.08%	-0.3%	-1.2%	1.6%	-0.6%	-3.0%	-3.6%	-15.3%
EUR	-12.07%	1.0%	0.6%	3.6%	-2.7%	-1.9%	0.5%	-11.2%

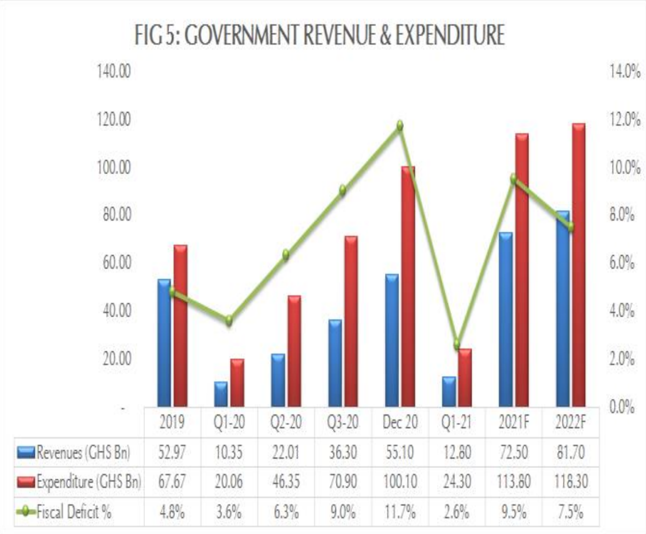
Source: Bank of Ghana & GCB Research.

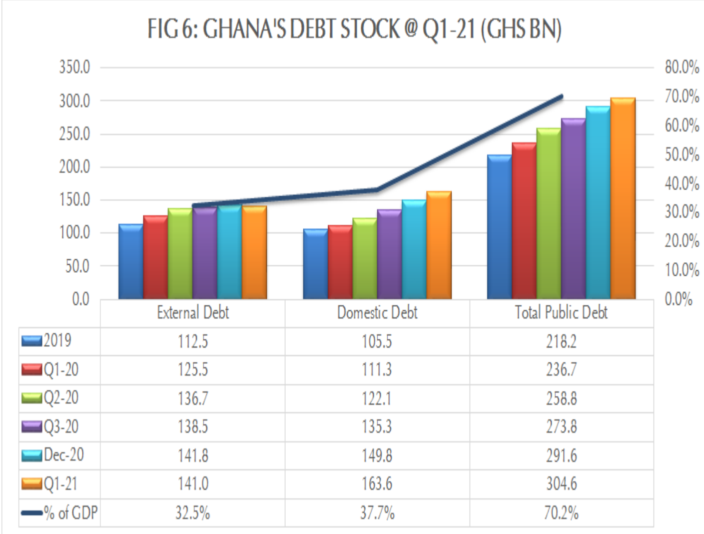
Looking ahead, we project the cedi to depreciate at a slower rate (to an average of GH¢5.79:US$1) owing to improved domestic and global sentiment, as well as narrowing fiscal and current-account deficits. We also expect the regular Fx auction and regulation by the BoG to cushion the cedi in the months ahead. In the medium term, we expect the rate of depreciation to be unhurried (with the cedi averaging GH¢6.25:US$1) as monetary tightening supports the currency.

5. Fiscal Developments

Fiscal/Debt Situation

- ✓ Provisional data on budget execution for the first quarter of 2021 indicated an overall broad cash budget deficit of 2.6 percent of GDP, against the target of 2.5 percent of GDP.
- ✓ The primary balance also recorded a deficit of 0.7 percent of GDP compared to the target deficit of 0.4 percent of GDP.
- ✓ Over the first quarter, total revenue and grants amounted to GH¢12.8 billion (3.0 percent of GDP), lower than the projected GH¢15.8 billion (3.7 percent of GDP).
- ✓ Total expenditures and arrears clearance amounted to GH¢24.3 billion (5.6 percent of GDP) against the target of GH¢26.5 billion (6.1 percent of GDP).
- ✓ Financing of the fiscal deficit in the first quarter was mainly from domestic sources, which pushed up the stock of public debt to GH¢304.6 billion at the end of March 2021, compared with GH¢292.7 billion at the end of December 2020.
- ✓ Of the total debt stock, domestic debt was GH¢163.6 billion (37.7 percent of GDP), while the external debt was GH¢141.0 billion (32.5 percent of GDP).





Source: Bank of Ghana.

According to the MPC, the fiscal data shows that fiscal revenues have significantly outpaced developments a year ago but slightly lags behind target. The gap in revenue performance viz-a-viz the budgeted target has been somewhat compensated for by expenditure containment measures. However, in the near-term the Committee noted risks in the fiscal outlook surrounding wage settlements, energy IPP payments, the potential for arrears build-up, potential for scaled-up expenditures associated with COVID-19 waves and mass vaccination efforts, and the implementation of the Ghana CARES programme, would have to be carefully managed in a time consistent manner to minimize any deviation from the path of fiscal consolidation.

Our standpoint is not much different from the MPC as we also for see an increase in fiscal revenue in 2021, owing to a rise in both oil production volumes and global oil prices this year. Nonoil revenue—which was also hit in 2020 by a lower tax take due to declining domestic economic activity and by lower import duty receipts due to reduced trade flows—will increase in 2021 as the economy recovers. The tax measures announced in the budget and the combined efforts to improve tax collection methods will also boost tax revenue. With the authorities still attempting to limit the fallout from the pandemic, the 2021 budget envisages further strong nominal growth in expenditure. We still expect spending to fall as a proportion of GDP, but not rapidly in the context of the sharp increase in 2020.

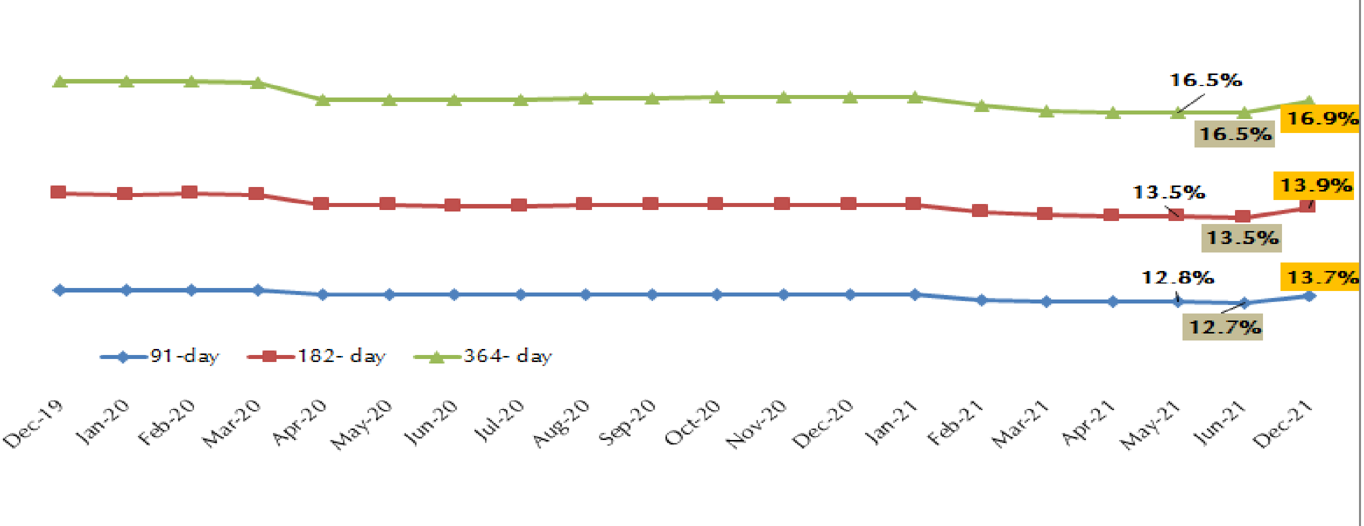
The fiscal deficit is expected to narrow to 9.5% of GDP in 2021, from 11.7% of GDP in 2020, before narrowing further, to 5.5% of GDP in the medium term, as spending falls and revenue picks up.

After peaking at an estimated 76.1% at end-2020, we expect the public debt/GDP ratio to trend downwards to 72.1% at end-2021, as the economy grows. The government will remain reliant on borrowing from both external and domestic sources. Ghana plans to borrow a total of US$5bn in 2021 through two Eurobond issues (of which US$3bn was raised in March), which will be used to roll over existing obligations, as well as finance the fiscal deficit.

6. Monetary Developments and Debt Market

- ✓ Latest trends in monetary aggregates point to significant expansion in reserve money and sharp growth in broad money supply, reflecting lingering effects of the liquidity injection and Covid-related fiscal stimulus programmes implemented during 2020.
- ✓ Reserve money increased by 32.0 percent in April 2021, compared with 21.7 percent in the corresponding period of 2020.
- ✓ Similarly, broad money supply (M2+) grew by 25.8 percent, relative to 16.8 percent over the same corresponding period of 2020. The increased M2+ growth was largely driven by the net domestic assets of the banking system. In terms of components, the observed expansion in M2+ was reflected in increased growth in currency outside banks and total deposits.
- ✓ Notwithstanding sluggishness in credit demand conditions due to the pandemic, the COVID-related regulatory reliefs and policy measures continue to support lending activities in the banking sector.
- ✓ From the beginning of the year to April 2021, New Advances totalled GH¢10.5 billion, compared to GH¢10.9 billion for same period in 2020.
- ✓ Total restructured loans, executed by banks to cushion customers severely impacted by the pandemic stood at GH¢4.65 billion as at March 2021, representing some 9.8 percent of industry loan portfolio.
- ✓ On a year-on-year basis, annual growth in private sector credit as at April 2021 stood at 6.9 percent compared with 17.9 percent in April 2020.
- ✓ Interest rates on government securities trended downwards across the maturity curve. The 91-day and 182-day Treasury bill rates declined to 12.8 percent and 13.6 percent respectively in April 2021, compared with 14.1 percent and 14.3 percent respectively, in April 2020.
- ✓ Similarly, the rate on the 364-day Government instrument declined marginally to 16.5 percent from 16.7 percent over the same comparative period. Broadly, the yield on all the medium- to long-term Government debt instruments declined over the review period, relative to the same period last year.
- ✓ The weighted average interbank rate declined to 13.6 percent from 14.0 percent, largely reflecting improved liquidity conditions on the interbank market.
- ✓ This translated into a marginal decline in average lending rates of banks to 20.9 percent in April 2021, compared to 22.4 percent recorded in the same period of 2020.

FIG 7: INTEREST RATES

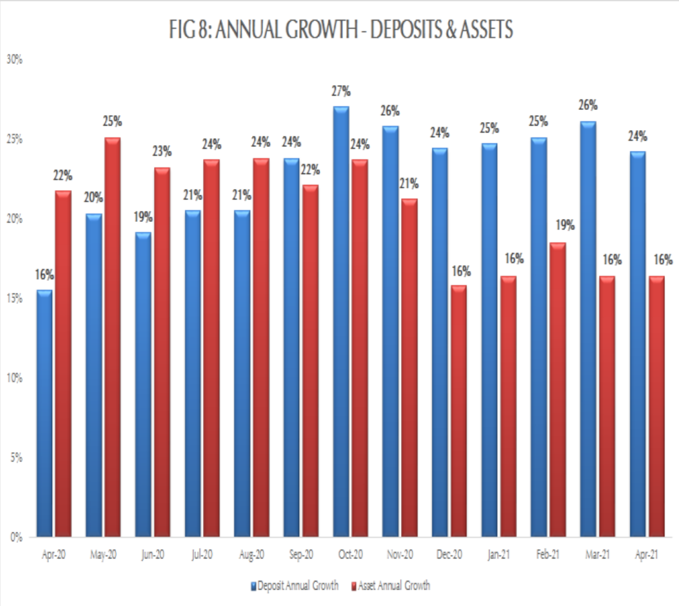


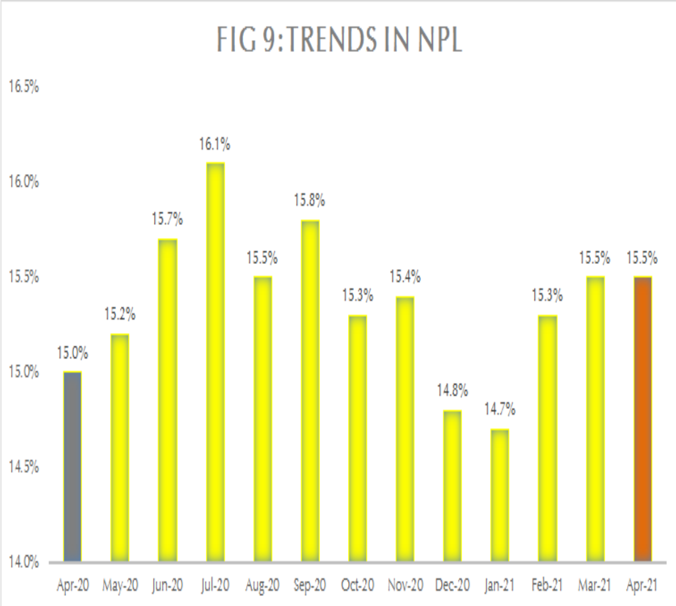
Source: Bank of Ghana & GCB Research.

Our expectation is for interest rates to remain steady in 2021 declining marginally on the back of tight monetary policy stance as domestic demand strengthens and inflationary pressures persist.

7. Banking Sector Developments

- ✓ The banking sector has maintained its resilient performance from January to April 2021, with strong growth in total assets, deposits and investments.
- ✓ Total assets increased by 16.4 percent to GH¢155.7 billion. This reflected strong growth in investments in government securities by 34.9 percent to GH¢73.3 billion funded by deposits and loan repayments.
- ✓ Total deposits recorded an annual growth of 24.2 percent to GH¢104.9 billion on the back of the strong liquidity flows from the fiscal stimulus and payments to contractors, and to depositors and clients of defunct SDIs and SEC-licensed fund managers respectively.
- ✓ Overall, the impact of the pandemic on the industry's performance was moderate, as banks remained liquid, profitable and well-capitalized. Also, Financial soundness indicators remained strong, underpinned by improved solvency, liquidity and profitability indicators.
- ✓ The industry's Capital Adequacy Ratio of 21.8 percent as at end-April 2021 was well above the regulatory minimum threshold of 11.5 percent.
- ✓ Core liquid assets to short-term liabilities was 24.9 percent in April 2021, relative to 30.1 percent in April 2020.
- ✓ Net interest income grew by 18.4 percent to GH¢4.1 billion, compared with the 18.8 percent growth over the same comparative period.
- ✓ Net fees and commissions grew stronger by 26.5 percent to GH¢917.6 million, relative to 8.8 percent growth during same period last year, reflecting a gradual recovery in trade finance-related and other ancillary businesses of banks.
- ✓ Accordingly, operating income rose by 16.8 percent, marginally higher than the corresponding growth rate of 15.2 percent a year ago.
- ✓ The banking sector deployed effective cost control measures which resulted in a marginal 1.7 percent growth in operating costs over the review period, significantly lower than the 17.8 percent growth for the same period in 2020.
- ✓ Loan loss provisions however increased by 29.4 percent, compared with 7.1 percent a year ago, on account of continued elevated credit risks.
- ✓ Profit before tax increased by 39.6 percent to GH¢2.3 billion, recovering from the marginal growth of 7.5 percent a year ago.
- ✓ Non-Performing Loans (NPL) ratio increased marginally from 15.0 percent in April 2020 to 15.5 percent in April 2021 arising partly from the general pandemic-induced repayment challenges as well as some bank-specific loan recovery challenges.





Source: Bank of Ghana

8. Our Outlook for the Policy Rate

In its quest to foster economic growth and ensure financial stability in response to developments on the local and external front, the MPC has for the first time since March 2020 reduced the policy rate to 13.5 percent. The Committee however indicated that they will continue to monitor price developments closely and take appropriate action, where necessary, to contain all potential pressures to the inflation outlook. Also, we are certain that the lowering of the policy rate is to support access to credit to ensure the faster closure of the output gap created by the pandemic. Therefore, with the drop in the policy rate to support growth, we do not anticipate any further drop in the policy rate till the end of the year. We confident that it is only inflationary pressures (crude prices, instability in the exchange rate market, rising food prices and transport prices) in the short term that will trigger any upward adjustment in the policy rate. However, with risks to the inflation outlook projected to be muted in the near-term, we do not expect any adjustments in the policy rate in the next six (6) months.

9. Implications for GCB Bank

1. Data from the MPC indicates that the recovery process from the pandemic gained some momentum evidenced by the latest high frequency indicators. The key drivers of economic activity during the period were domestic consumption (proxied by VAT collection), construction activities, international trading activities, resumption of industrial production activities and air-passenger arrivals. The report also indicated that projected growth in the extractive industries, steady rollout of the vaccination programme and recovery in industry and the services sectors should work their way in supporting a faster economic growth in the medium term. Hence, a bounce back in these sectors of the economy and their value chain creates enormous opportunities for deposit mobilisation and asset creation by the business units of the Bank. That notwithstanding, we employ business managers as well as Relationship Managers to be weary of Covid stricken sectors like the hospitality and aviation sectors.
2. The report also indicated that Loan loss provisions in the banking sector witnessed a massive increase to 29.4 percent, compared with 7.1 percent a year ago, on account of continued elevated credit risks. This is a warning that the risk of credit arising out of the pandemic continue to persist in the economy. We therefore advise the need for the Bank to be stringent in its credit underwriting to prevent loan losses.
3. The drop in the MPC rate by 100bsp to 13.5% is expected to trigger marginal declines in interest rates in the months ahead. This is an indication that margins which are already thin, are going to be reedier

come end of 2021. Hence, off-balance sheet revenues would become the focal point of supporting revenue targets by banks in the industry. Therefore, charges and fees from transactional related products such as Mobile App, PoS, Money wallet multi-currency cards, batch payment solutions, prestige banking services, credit/debit cards, G-Money etc. and Letters of Credit (LCs) would go a long way in enhancing the revenues of banks. On that basis, we recommend the need for GCB to fast-track the deployment and marketing of its digital products to augment convenience in service delivery and revenue generation.

4. Also, we expect the marginal easing in rates on the back of the drop in the MPC rate in the months ahead to reflect in the pricing of our asset and liability products.