GCB CAPITAL RESEARCH
Economic and Market Insight

Monetary Policy Update: July 2022 MPC Review July 2022

The Monetary Policy Committee Pulls the Break on Policy Rate Hike as Inflation Approaches a Peak, but Growth Concerns Emerge

Summary

- *The Monetary Policy Committee holds the policy rate at 19% amidst emerging growth concerns*
- *Fiscal vulnerabilities linger and may require stricter expenditure controls in 2H22 to anchor market expectations*
- *Weak external balances erode fundamental support for the Cedi*

The Monetary Policy Committee of the Bank of Ghana expectedly held the Monetary Policy Rate at 19% at its Jul-22 meeting. The rate-neutral decision pauses the committee's aggressive approach to rein in runaway inflation that resulted in a cumulative 450bps hike in the policy rate in 1H22.

Rationale for the Decision: The relentless surge in inflation driven by cost pressures has squeezed consumer and business confidence, with concerns about growth coming into sharp focus. Real GDP growth for Q1 2022 underwhelmed at 3.3% vs. 7% in Q4 2021, with the Composite Index of Economic Activity (CIEA) showing a slowing growth rate thus far in 2022. Given the reduced policy support amidst elevated price pressures and global economic uncertainty, the near-term growth outlook is constrained.

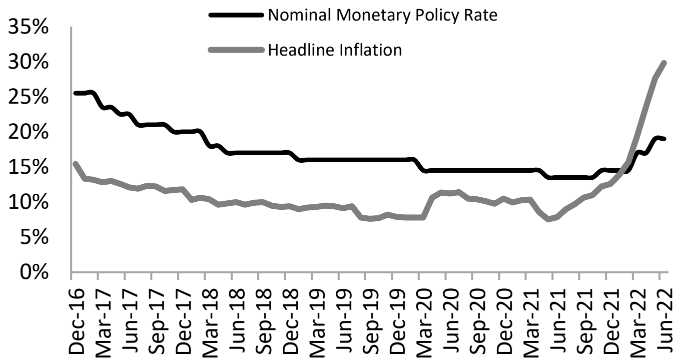
However, the rate of increase in inflation has moderated over the last two inflation data windows, with month-on-month food, non-food, and headline inflation peaking in Apr-22 (See figure 2). Year-on-year headline inflation could also peak over the next two inflation windows, which provides scope for a pause in the monetary tightening cycle to cushion growth. While the MPC flagged the risk of a wage-price spiral following the labor union agitations, they expect a more coordinated fiscal and monetary policy framework under an IMF program to prevent such an occurrence.

Our view on the decision: While we expect inflation to peak by Aug-22, the potential disinflationary process in 2H22 could be slow with contrasting fortunes. We flag the recent 15% adjustment in Cost-of-Living Allowance (COLA) to public sector workers, the impending utility tariff hike and cost pressures from cedi depreciation and rising ex-pump petroleum prices as an upside risk to inflation going forward. However, the new harvest season, a potential slowdown in crude oil prices on the back of slowing demand due to global recession fears, and a favorable base pull may support disinflation. Thus, the emerging signs point to slowing inflationary pressures, and a potential IMF program will provide a backstop. We are therefore aligned with the decision to hold the policy rate at 19% as new risks to growth emerge.

Insights from the Summary of Economic and Financial Data

Fiscal vulnerabilities linger and will require more pronounced expenditure adjustments to achieve the revised headline fiscal numbers: Budget

Figure 1: The Bank of Ghana's Monetary Policy Stance



Source: GCB Capital Research | Central Bank Websites | Ghana Statistical Service

Figure 2: Month-on-Month Inflation dynamics

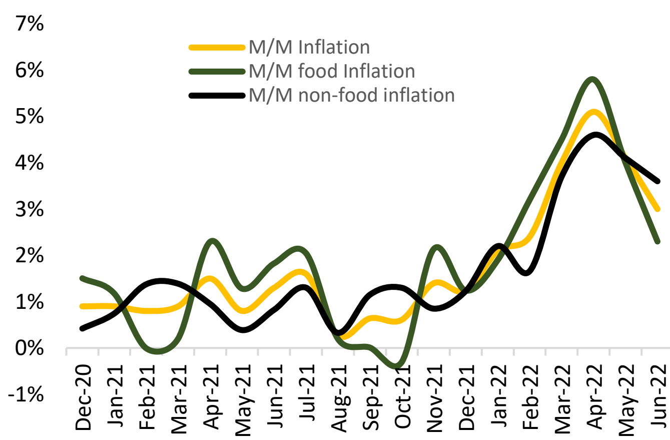


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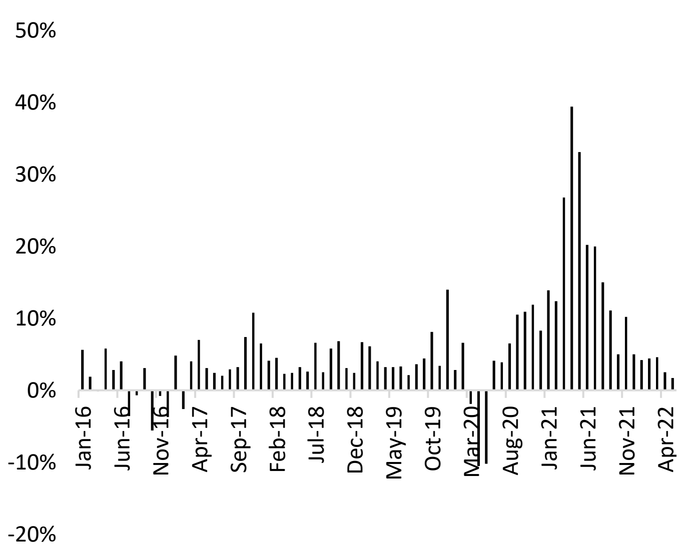
Figure 3: The Composite Index of Economic Activity



performance over 1H22 significantly missed the target as the Treasury missed both the revenue and expenditure numbers. Total revenue and grants fell 12.9% short of the target for 1H22, coming in at GH¢37.81bn (7.5% of GDP | +24%.1 y/y). Despite this pronounced revenue shortfall, total expenditure (including arrears clearance) run 4.4% faster than target at GH¢65.96bn (13.1% of GDP | +30.2% YTD), resulting in a higher fiscal deficit equivalent to 5.6% of GDP (vs. target: -3.9% of GDP). The revenue and expenditure numbers resulted in a primary deficit equivalent to 1.5% of GDP (vs. target: -0.1% of GDP). The higher primary deficit resulted in higher domestic borrowing at the punitive cost, with interest payments exceeding the target for the period by 7.4% to GH¢20.48bn (4.1% of GDP).

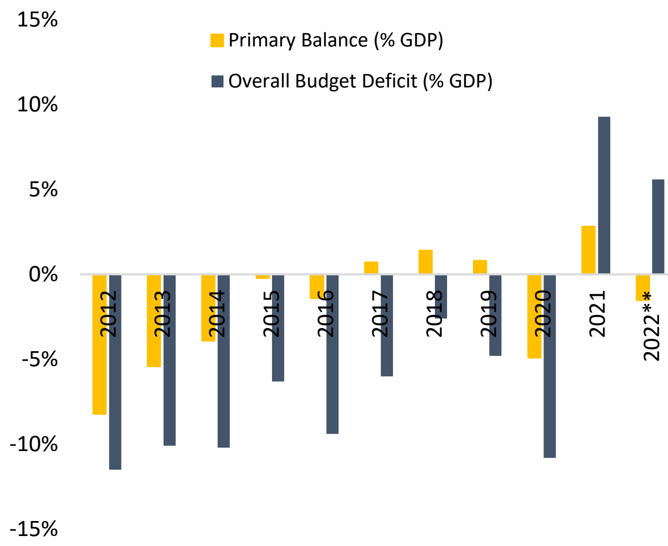
We note that the delayed rollout of the key revenue measures partly accounts for the more pronounced shortfall in revenue for the period. However, we maintain that the revenue projection for 2022 was overambitious and while the government has rightly revised downward its revenue expectations from the new revenue measures, any anticipated boost from the new revenue interventions in 2H22 will be minimal. Thus, we still perceive the revised revenue target of GH¢96.84bn (16.4% of GDP |-3.7% relative to the initial target) for FY22 as ambitious, increasing the risk of fiscal overrun. Against this backdrop, we reckon that the GH¢1.79bn downward revision to expenditure to GH¢133.84bn (22.6% of GDP) is inadequate and may require deeper expenditure cuts in 2H22 to close the financing gap and sustain the fiscal outlook.

Elevated risk-off sentiments dragged the external balances into deficit position and erodes fundamental support for the cedi: Ghana's merchandise trade receipts amounted to US$9.0bn over 1H22, thanks to favorable price effects from gold and crude oil. However, the higher oil imports pushed the total import bill to US$75.69bn (+11.93% y/y). Consequently, the trade balance closed the period with a surplus worth US$1.44bn (+30.82% YTD |+62% y/y) owing to these favorable price effects. However, net outflows on the services and investment income accounts eroded the gains from merchandise trade, with the current account closing 1H22 with a wider deficit of US$1.09bn (1.5% of GDP |+43.60% y/y). Similarly, the widespread portfolio reversals that started from 4Q21 and the reduced FDI flows switched the capital and financial account to a deficit of US$1.29bn (1.8% of GDP | -142.73% y/y).

Consequently, the overall balance of payment account ended 1H22 with a deficit of US$2.5bn (-205.4% y/y), which underpins the Cedi's increasing vulnerability to external shocks. The sustained selloffs triggered a faster depletion of the FX reserves with the liquid FX reserves declining sharply to US$3.58bn (-70% YTD) over HY22.

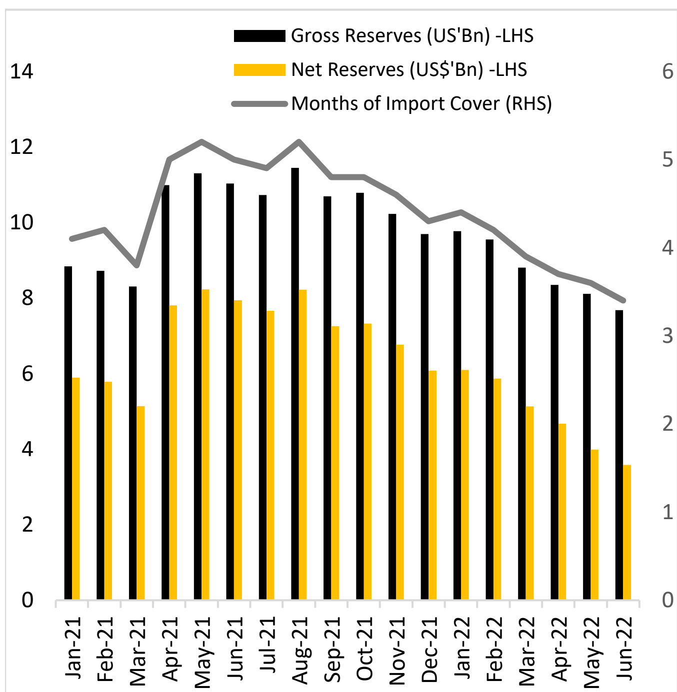
Against the backdrop of an imminent disinflation cycle subject to renewed price pressures, we recommend a portfolio strategy that balances the near-term risks to returns and potential refinancing risks going forward.

Figure 4: Fiscal Account Balances (Expressed as % of GDP)



Source: GCB Capital Research | Ministry of Finance

Figure 5: Build-up of Ghana's Forex Reserves (In US$'Bn; Months of Import cover



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