GHANA QUARTERLY STRATEGY– Review of FY2022 and Outlook for 2023

THE ROAD TO RECOVERY – Where are the Silver Linings?

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SUMMARY

- Despite the pronounced shocks from COVID-19 and Geopolitics, we believe pre-existing vulnerabilities related to revenue and expenditure mismatch underscore Ghana's debt problem.

- IMF Board-level approval could extend beyond Q1-2023 as engagements with bilateral creditors for financing assurance and debt restructuring hang in the balance.

- Successful debt restructuring could yield about 50% on debt service cost in 2023, creating the much-needed fiscal space to finance priority spending.

- USDGHS pair could close 2023 at GHS13.65, Inflation at 29%, GDP growth at 2.9% and fiscal deficit at 8.5% of GDP.

The global context: The global investment climate in 2022 was particularly challenging amidst the increased uncertainties and multiple shocks, most of which are recurrent, dragging inflation to multi-year highs and resulting in an aggressive monetary tightening that left some economies on the verge of recession. The Eurozone and the UK only narrowly escaped recession in 2022, with growth in the US below trend, while China's recovery could be shallow. With these cyclical headwinds, fixed income and equity investments suffered significant falls simultaneously in 2022, alongside other alternative asset classes for the first time in decades. However, the peak point for inflation may be near, and the monetary policy authorities could soon pivot from interest rate hikes to an accommodative stance, with the silver linings already beginning to emerge.

The EMDEs and the African Context: The multiple shocks and the highly uncertain global market conditions have spilt over into some emerging and frontier markets, including the African region, with most economies at their lowest ebb in decades. The quadruple whammy of aggressive monetary policy tightening in response to heightened inflation, external vulnerabilities and the resultant currency pressures, high public debt and an elevated risk of debt distress have shut access to the capital markets. Consequently, Africa's growth pulse slowed in 2022 following an impressive post-COVID recovery in 2021. Despite the lower growth outturn for 2022 (estimated at 3.6%), growth across the various regions was positive, and the near-term outlook, while fraught with uncertainty, appears resilient and cautiously optimistic. However, the high-interest rate conditions have worsened the debt service burden, with most countries on the continent, including the top investment destinations, at a high risk of debt distress. The debt situation and the high commodity dependence, given market uncertainty and the teething regional conflicts, pose downside risks to the pace of recovery on the continent.

Ghana in Perspective

With the key macroeconomic indicators turning south, Ghana's economic situation has worsened, and the sovereign remains effectively shut out from the international capital market over the medium term. We believe this run of economic deterioration, which underscored the debt distress and external sector vulnerabilities, pre-date COVID-19 and the Russia-Ukraine war. We reckon that the two events rather exposed pre-existing structural, macroeconomic and debt vulnerabilities that have led to multiple programmes supported by the IMF and the World Bank under the 4th republic. In particular, the several years of revenue and expenditure mismatch have resulted in large deficits in the primary and overall budget balances, with the large borrowing requirements elevating the public debt to unsustainable levels. For the fiscal year 2022, total debt service (excluding debts of SOEs and publicly guaranteed debts) used up 65% of tax revenue (FY21:59.3%) and about 50% of total revenue (FY21:47.8%) as of Sept-22. Interest payments and non-discretionary expenditures have consistently used up more than 100% of tax revenue in recent years, worsening the budget rigidities, hence the increased borrowing requirements to finance priority programmes and projects.

Chart 1: Widening fiscal gap underpins the faster growth in the debt stock

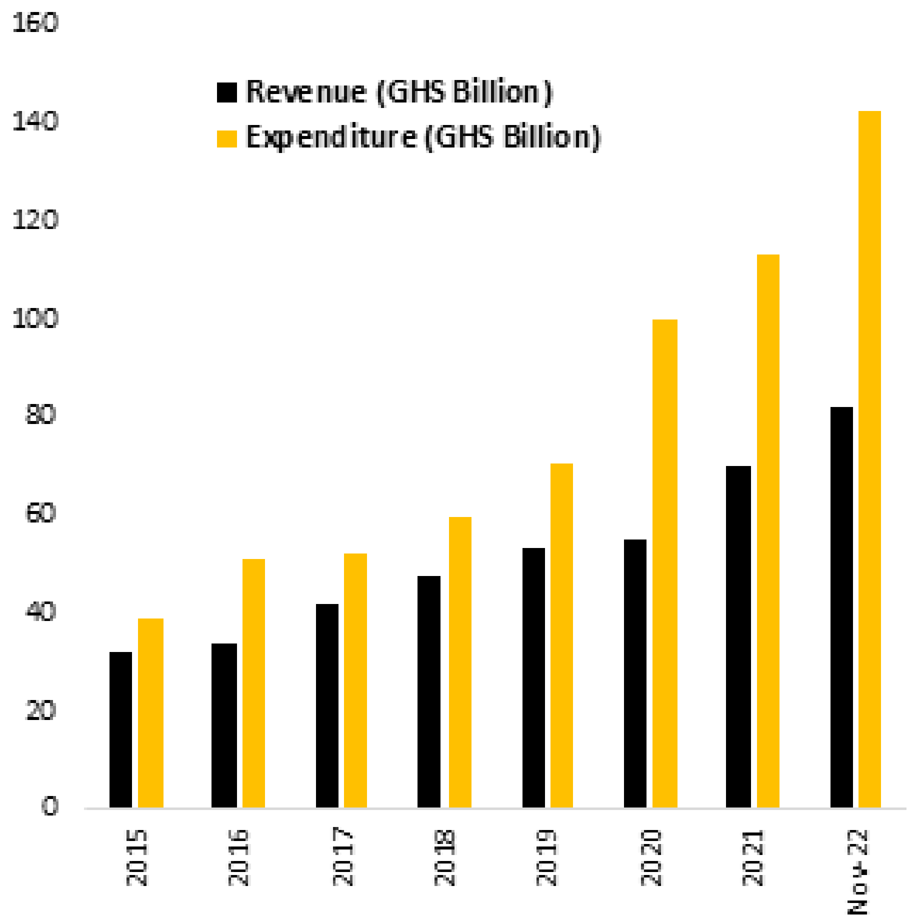
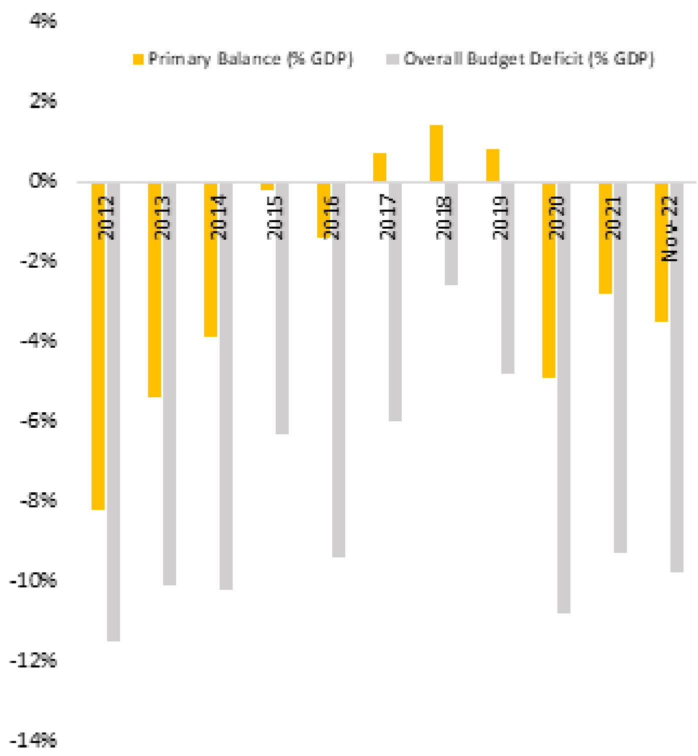


Chart 2: Summary of the fiscal balances at 1H22



Revenue and expenditure mismatch underscores Ghana's debt problem: Ghana's fiscal and debt challenges were pronounced ahead of the 2022 fiscal year and required a deeper and more credible fiscal consolidation. The government's fiscal consolidation drive for 2022 hinged primarily on strong revenue growth without the commensurate expenditure control measures investors preferred. The government expected a significant revenue boost from the new measures headlined by the unpopular E-levy. However, the delayed rollout of some key revenue measures for 2022, primarily due to the lack of bipartisan support, depressed revenue through the 1H22, with the much-touted E-levy only taking effect from May 22. The new property rate regime is yet to be rollout, while the 15% increase in fees and charges for public services and the new tax exemptions bills took effect belatedly in 2H22.

Consequently, revenue underwhelmed through 1H22, with the Treasury booking 87% of its revenue target for the period, representing a shortfall of GHS5.6bn. Regardless, expenditure controls were weak, with total expenditure through 1H22 only falling 0.53% short of the period's target. The belated rollout of some revenue measures in 2H22 improved revenue performance and narrowed the revenue gap to 3.2% relative to the target over 11 months in 2022 (compared to the 13% shortfall over 1H22). However, the expenditure pressures were more pronounced, and fiscal control was almost non-existent as expenditure over 11 months in 2022 exceeded the period's target by 13.4%.

As the debt stock reached unsustainable levels amidst the glaring signs of debt distress, Ghana was firmly shut out of the international capital market. Domestic funding options also dried up through 2H22. Thus, we believe the already tightened fiscal space and the weak expenditure controls reinforced the debt problem, resulting in multiple credit downgrades from the major rating agencies, which dented investor risk appetite. These concerns sustained the portfolio reversals that started in 3Q21, deepened the Cedi depreciation pressure and together with other cost-push factors, catapulted inflation to dizzying heights in 2022 (more on inflation and exchange rate in sections below).

CB deficit financing dominated domestic financing in 2022; could revert to zero under ECF: Budget execution over 11 months of 2022 shows the Treasury exceeded its revised financing target for FY2022, raising GHS44.02 billion (113% of the revised FY22 target |120% of the period's target). The total financing comprises GHS6.53 billion in net external financing and GHS 36.8 billion in net domestic funding, dominated by the banking sector. It appears that given the revenue shocks, and the increased financing gap from uncovered auctions due to hostile market conditions, the Treasury resorted to Central Bank (CB) deficit financing as a backstop, as the CB accounted for about 90% of the net domestic financing and about 98% of funding from the banking sector for the period.

The CB funding included a drawdown on the outstanding balance of Ghana's US$1 billion SDR allocation from 2021 and overdraft facilities on the Treasury's main accounts exceeding the regulatory threshold of 5% of the previous year's revenue. In a separate release, the CB reported total financing of the budget to the tune of about GHS44 billion in 2022. While monetizing the deficit was necessary to keep the government running and avoid a costly default amidst the resource constraints and uncovered auctions, it is sub-optimal, contributing to the heightened inflationary pressures. We expect a ceiling of zero deficit financing in 2023 as the government embark on ambitious reforms under the programme supported by the Extended Credit Facility (ECF).

The IMF came to the rescue, but the prior actions require immediate debt restructuring: The government of Ghana formally requested a programme with the IMF in Jul-22 to forestall an imminent Balance of Payments crisis. During the negotiations, the joint Debt Sustainability Analysis (DSA) classified the public debt as unsustainable, with Ghana at a high risk of debt distress, requiring an immediate debt restructuring to restore debt sustainability. In present value terms, the public debt reached about 105% of GDP relative to the 55% threshold for a market-access country. As a result, the government launched the domestic Debt Exchange programme on December 5, 2022.

Chart 3: Summary Expenditure Performance at 1H22

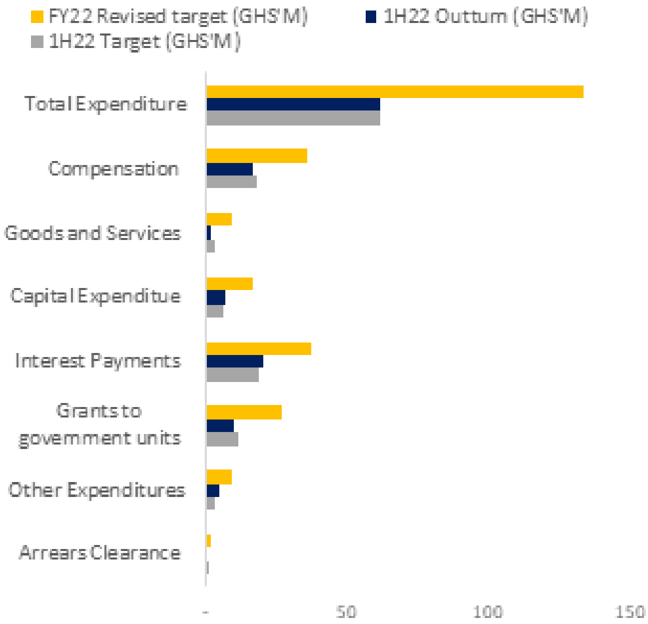
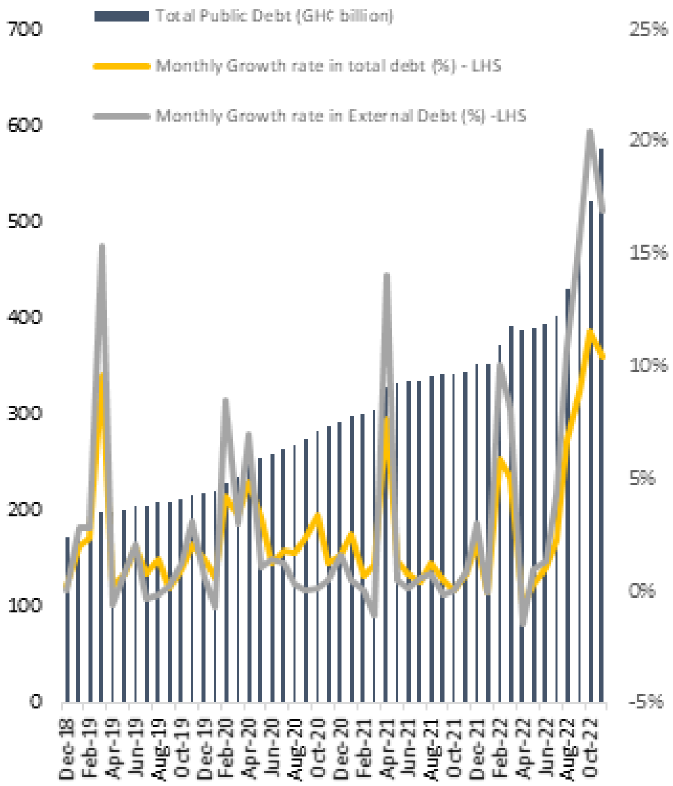


Chart 4: Evolution of the Public debt stock



The expedited negotiations culminated in a Staff-Level Agreement (SLA) on December 12, 2022, for a US$3 billion, 3-Year programme supported by an Extended Credit Facility (ECF), pending the IMF Board's approval and subject to some prior actions. As part of preconditions to secure the IMF executive board's approval, the government is expected to make significant progress with the Domestic Debt Exchange Programme (DDEP) and secure financing assurances with development partners. These prior actions emerged from the DSA, and the government must show a clear path to restoring fiscal and debt sustainability, necessitating the Domestic Debt Exchange Programme (DDEP) as a first step.

After three extensions to the initial DDEP offer period following spirited resistance from different classes of investors, the offer closed on February 10, 2023, with an 84.91% success rate. Investors swapped about GHS83 billion worth of eligible bonds for new bonds against a revised target size of GHS97.75 billion. The lower target size relative to the exchange memorandum reflects adjustments that excluded non-marketable securities and bonds allocated to contractors as payment for their services. The government indicated less than 7% of the category A and B bondholders participated in the offer. Excluding interest accruals, the 85% success rate could yield about GHS11 billion in interest savings in 2023. With DDEP bagged, The government has turned attention to securing financing assurances from the bilateral creditors, with the non-cooperation of some creditor groups, including China, delaying the formation of the official creditor committee. Thus, the IMF Executive Board's approval required to officially start the US$3 billion, 3-Year programme supported by the ECF hangs in the balance, and the government is now racing against time to meet its internal Q1-2023 timeline for securing board-level approval.

A board-level approval by the end of Q1-2023 is imperative to kickstart credible economic recovery and provide a timely balance of payments support as Ghana's gross FX reserve position is almost threadbare. The reforms envisaged under the IMF programme built on the government's Post COVID-19 Programme for Economics Growth (PC-PEG) as the blueprint, targeting seven (7) key reforms. The reforms include 1) restoring fiscal and debt sustainability and minimizing fiscal risks, 2) re-anchoring price stability, 3) deepening structural reforms to restore market confidence and regain market access, and 4) building resilience against shocks, among others. Already, the government skipped its coupon obligation on its Eurobonds in January and February 2022 following the temporal suspension of external debt service. With this unilateral debt service suspension, the lack of progress with external debt restructuring could lead to more dire consequences.

Ghana remains shut out from the credit market in the near term: Despite the promise of the imminent economic and structural reforms supported under the Extended Credit Facility, we do not envisage a quick turnaround. We believe the macro-fiscal imbalances are more pronounced and will require evidence of a robust improvement to unlock market access. Beyond the frontloaded fiscal consolidation envisaged from 2023, the reforms must prioritize inclusive revenue growth and possibly amend the fiscal responsibility law to include a debt ceiling as a signal of intent. While the reviewed exemptions bill regime, the re-vamped property rates collection system, the ongoing

Revenue Assurance and Compliance Enforcement (RACE) programme and the digitization of revenue collection are promising, investors will hold out for evidence of robust revenue growth. Consequently, the Sovereign could remain shut from the International Capital Market over the next two years (minimum). Similarly, we expect investor interest in LCY bond offers to remain limited in a post-DDEP era despite the limited investment alternatives, only improving slowly and gradually as the economy rebounds.

Fiscal rigidities to persist in 2023 without more profound fiscal adjustments and significant success with debt operations: The expenditure pressures remain, which could further undermine the credibility of the budgetary framework without a much stricter consolidation. Debt service (including domestic and external debt amortization) due to uncovered auctions in 2022 used up 85% of tax revenue by Nov-22. Including the compensation of employees and statutory transfers, the non-discretionary expenditure outlay constituted more than 150% of tax revenue. For FY23, these three non-discretionary expenditure items are estimated to use up 113% of tax revenue and 88.7% of total revenue.

However, we consider the 2023 fiscal budget a pre-IMF budget as the proposed expenditure outlay shows an expansionary fiscal path, contrary to the frontloaded fiscal consolidation envisaged under the ECF. The DDEP is concluded, and conversations with external creditors towards debt restructuring under the common framework are underway amidst delays. Thus, an IMF board-level approval for Ghana's 3-Year programme should usher in deeper fiscal adjustments critical to restoring debt sustainability. Consequently, we expect a re-jigging of the fiscal framework during the mid-year budget review to reflect the imminent fiscal adjustments. External debt service remains suspended, and savings from domestic and external debt restructuring exercises could yield about 50% interest savings in 2023, creating a much-needed fiscal space for targeted spending. However, significant arrears build-up, the claims on the budget from the statutory funds and the government's flagship projects remain a drain on the budget, which will slow down the rate of deficit compression. *Against this backdrop, we expect the FY23 fiscal deficit to ease from over 10% of GDP in 2022 to 8.5%±50bps of GDP in 2023.*

EXCHANGE RATE REVIEW

The Cedi's rough start to 2022 lasted through the year, with the local unit plummeting to nearly 60% depreciation vs the USD at some point before recovering sharply in the final three weeks of Dec-22 to close the year 49.5% weaker on the retail market versus the USD (-29.97% on the interbank reference market).

Instructively, while the high import bill and the unfavourable terms of trade partly account for the Cedi's weakness, the widespread portfolio reversals due to heightened investor risk aversion chiefly underpinned the local unit's bearish run. Given Ghana's limited debt service capacity, the aggressive monetary policy stance in the advanced markets in response to inflation triggered investors' flight to safer havens. Consequently, the capital and financial account drifted sharply from a surplus position of US$3.3 billion in Dec-21 to a deficit of US$2.2 billion as of Dec-22 (-167% y/y), driven by a net portfolio reversal of US$ 2.06 bn (+199.4% y/y) along with a marked slowdown in net FDI flows. We believe the portfolio reversals and the elevated import bills due to the spillovers from geopolitics, disrupted global supply chains and heightened global inflationary pressures underscored the sharp depletion in gross FX reserves.

Gross reverses fell from US$9.7 billion (4.3 months of import) in Dec-21 to US$6.2 billion y/y (2.7 months of imports), and the net reserves only covered about 1.5 months of imports by Dec-22. Given the depleted reserves, the Cedi remains vulnerable to shocks and will remain news-sensitive until the official start of the IMF programme. From the official start of the IMF programme, however, we expect the balance of payments backstop and other concessional financing options from development partners envisaged for 2023 to shore up the gross reserve position and anchor Cedi stability. The external debt service suspension offers a temporary respite, with the ongoing external debt restructuring programme, when concluded, also slowing down the rate of reserve depletion. While the government's Gold for Oil (Gold4Oil) policy could also potentially reduce the oil import pill and conserve FX reserves, it is a temporal intervention aimed at dealing with the Balance of Payment (BoP) shock in the interim. Given the temporal nature of the policy and the fact that the policy switches control of gold receipts from the small-scale mining sector away from private dealers to the Central Bank, we expect the policy's impact on Cedi stability to be moderate in 2023 and almost negligible over the medium term.

Against this backdrop, we expect the USDGHS retail mid-rate at GHS13.65±20P (corresponding to annual depreciation of 11.15% to 13.7%) by FY23. This outlook assumes an official start of the IMF programme in Q1-2023. Delays in securing the IMF board's approval in the first quarter could deepen the reserve and exchange rate vulnerabilities, given the limited scope for the Bank of Ghana's spot and forward market FX liquidity interventions.

Chart 5: **External Sector Balances and the Reserve Position**

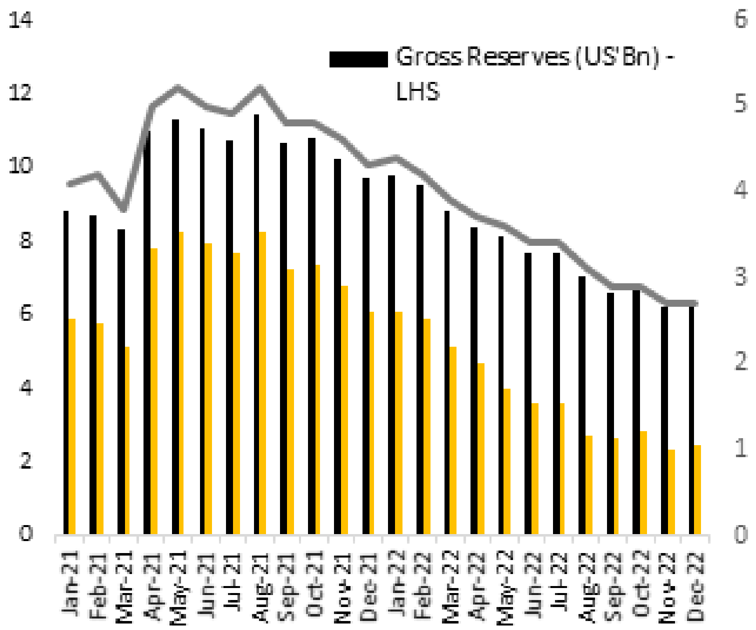


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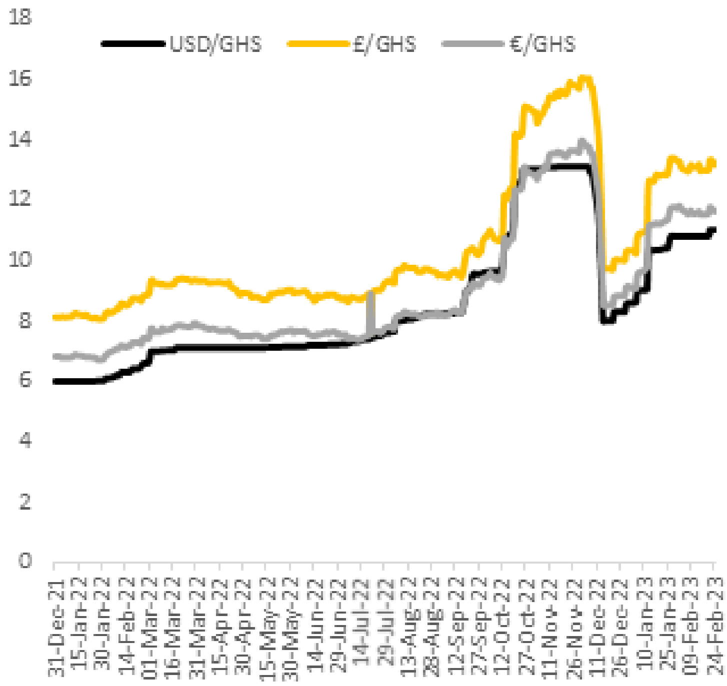
Chart 6: Performance of the Ghana cedi on the interbank FX market against the major trading currencies



INFLATION, INTEREST RATES AND MONETARY POLICY

Cost-push factors and supply chain disruptions lift inflation to multi-year highs, becoming endemic: The relentless inflationary run from June-21 continued through 2022, with 18 consecutive months of increases in headline inflation, bringing inflation to 54.1% in Dec-22 (from 12.6% in Dec-21). At 54.1%, inflation is 44.1% outside the upper inflation target and, together with the heightened underlying inflationary pressures, arousing the MPC's hawkish mood. The passthrough of the sharp depreciation of the Cedi through 2022, supply-side shocks, cost-push factors, and geopolitics are among the primary triggers of inflation. The inflationary pressures emanated from the food and non-food baskets, with inflation on imported items also elevated due to the depreciation effect and the heightened global inflation pressures. During the year, deficit financing from the Central Bank also became pronounced, and this increased deficit monetization without commensurate sterilization added a demand-pull leg to the inflation problem.

BoG maintains a tightening policy stance through 2022: The Monetary Policy Committee (MPC) responded to the overheating economy with jumbo hikes in the policy rate, cumulatively raising the policy rate by 1,3500bps from Mar-22 to 28% in Jan-23. Additionally, the BoG withdrew the non-conventional COVID-era policy interventions mainly to control the second-round effects of inflation, effectively withdrawing policy support for growth to focus on re-anchoring inflation expectations. Specifically, the MPC reset the Capital Conservative Buffer to 3%, effectively increasing the regulatory threshold for Capital Adequacy Ratio (CAR) to 13% and increasing the Cash Reserve Ratio (CRR) cumulatively by 7% to 15%.

Given the heightened inflationary pressures and the elevated fiscal risks, nominal yields soared across the LCY curve, with investors demanding higher risk premiums on new debt issuances and re-priced fixed-income securities. Consequently, nominal interest rates increased from 12.53% - 21% at the start of 2022 to about 35.8% - 65% by Dec-22. Regardless, real returns on fixed-income investments remained depressed, falling into negative territory.

Credit stance tightening as banks position themselves to deal with shocks from the DDEP: Generally, the financial soundness and asset quality indicators show a liquid, robust, well-capitalized banking sector with capital adequacy well above the regulatory threshold. However, total assets, deposits, advances and private sector growth appear to have moderated since Oct-22, reflecting the endemic risks to the banking sector from the DDEP, affecting the credit stance. While the domestic banking sector remains liquid, the banks are overexposed to the sovereign and liquidity conditions could deteriorate along the year due to slashed interest income from Treasury investment. Thus, we envisage a tighter credit stance going forward due to heightened credit risks, particularly as the growth pulse softens. The regulatory forbearances should lend support to the domestic financial sector in the interim, pending the government fledging out details of the proposed GHS15 billion Ghana Financial Stability Fund to deal with residual shocks to the domestic financial sector.

Chart 7: **The trajectory of food, non-food and headline inflation**

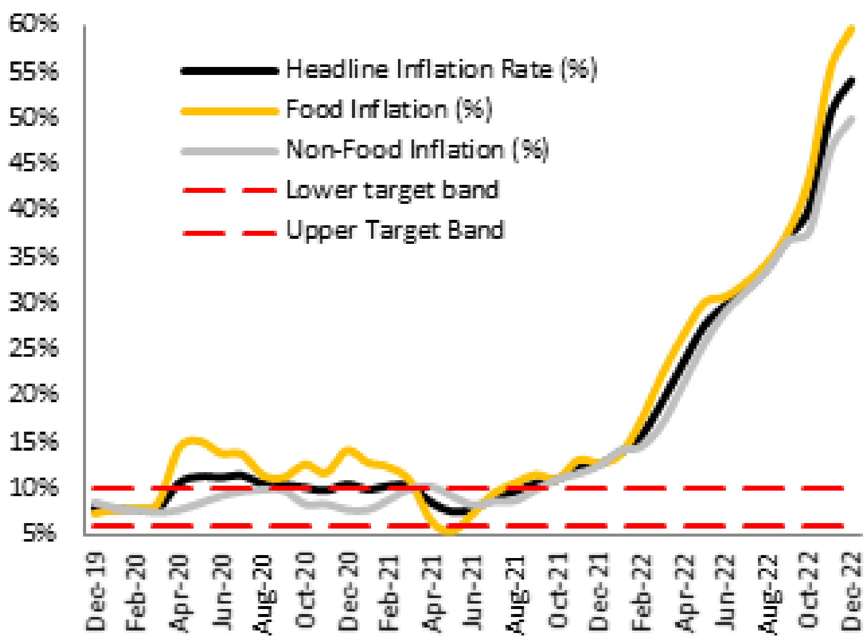


Chart 8: Inflation and the monetary policy stance

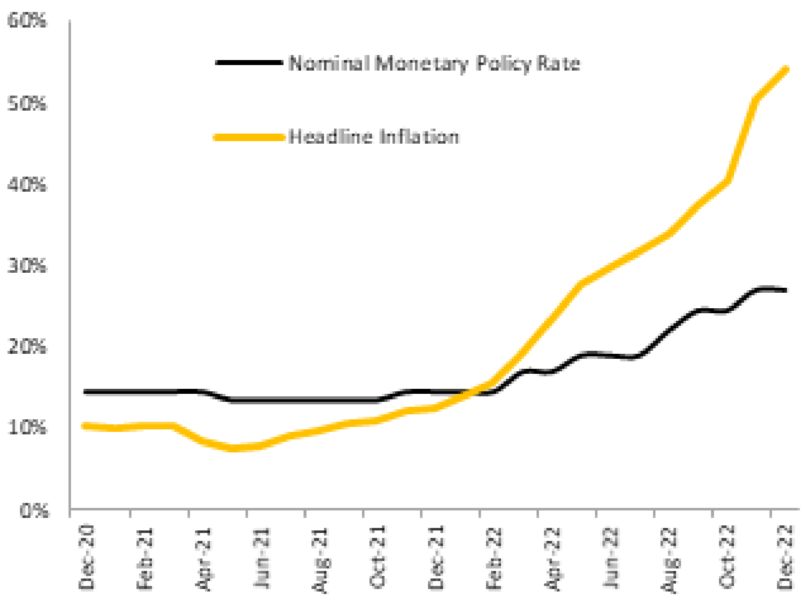
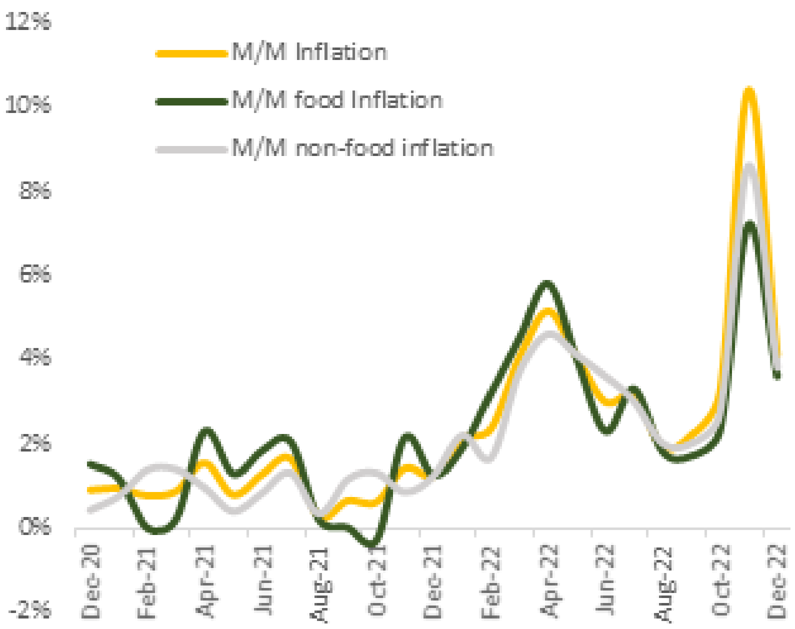


Chart 9: Disaggregation of the Sept-22 Inflation Print



OUTLOOK

Inflation curve to plateau through Q1 2023 despite some renewed price pressures: We may have experienced the worst of inflation in 2022 following 18 consecutive months of increase. We believe inflation is near a peak. While headline inflation only eased marginally in Jan-23, month-on-month food, non-food and overall inflation appear to have reached a point of inflexion in Nov-22 and have declined after that. This trend underpins the slower rate of growth in headline inflation since Nov-22.

Following the breakthrough with DDEP, an IMF executive board approval appears imminent. The resultant balance of payments backstop should moderate the passthrough of Cedi depreciation to inflation beyond Q1-2023. Additionally, the price-friendly developments in the global oil market could sustain the decline in petroleum prices at the pumps and moderate the passthrough from rising transport fares to inflation, all things being equal. The official start of the IMF programme should also result in zero Central Bank deficit monetization over the medium term and limit the upside risks to inflation. On the flip side, the new revenue interventions for 2023, utility tariff hike, the simmering Cedi and petroleum price pressures will prove inflationary. However, we expect their passthrough to moderate during the year.

Against this backdrop, we expect a sharper cooling of inflation from Q2-2023 with an end period forecast of 29%±100bps, supported by easing price pressures, favourable base drift and complementary monetary policy. However, we expect the monetary policy stance to remain cautious in the bid to anchor inflation expectations, with only marginal cuts later in 2H23 when inflation is on a clear and sustained path of decline.

GROWTH PERFORMANCE

Growth pulse expectedly softened in Q3-2022: The level of economic activity slowed down in 2022, mainly due to the limited fiscal and monetary policy support for growth arising from the deteriorated fiscal position and the inflation-induced surge in the cost of credit for businesses. From a 7% growth in Q4 2021, GDP growth eased to 3% in Q1-2022 and averaged 3.53% over the first three quarters of 2022. Non-oil GDP came in slightly higher at 4.43% over the reference period, which falls short of the 6.7% average growth recorded over the comparable period in 2021.

The agriculture sector registered the highest growth rate in the third quarter, returning a growth rate of 4.6% y/y, with all sub-sectors expanding for the period. The services sector (with a 44% share) recorded a slower growth rate of 3.9% in Q3 2022 compared to the first two quarters. Contraction in five (5) sub-sectors depressed growth from the sector despite the impressive growth from six (6) sub-sectors, including ICT (18.4% y/y), education (10.2% y/y), health and social work (8.1%) and transport & storage (6.4%). The industrial sector returned the weakest growth in Q3 2022 of 0.9% despite the 14.9% growth in the mining and quarrying sub-sector. The unimpressive industrial sector performance stems from contraction in four (4) sub-sectors, including manufacturing (-7%.4y/y), construction (-7% y/y) and electricity (-3.9%).

The outlook for growth remains dim in 2023: We note over the period that some leading high-frequency indicators of economic activity published by the Bank of Ghana have turned south, reflecting a challenged growth outlook over the near term. The Composite Index of Economic Activity (CIEA) has declined since Jun-2021, contracting since Aug-2022 before closing Nov-22 at -6.2%. Other high-frequency indicators of economic activity, such as port arrivals, cement sales, private sector SNNIT contributions and job adverts, have declined, reflecting the slowing growth momentum. The heightened inflationary pressures and the Cedi's bearish run also rattled consumer and business confidence, potentially undermining new investments.

We believe the reduced fiscal and monetary policy support for growth, the elevated capital flight, and the dent in consumer and business confidence will continue to subdue economic recovery through 2023. While we expect inflation to ease through 2023, inflation expectations could remain elevated through 1H23, undermining aggregate demand and growth. *Accordingly, we slash our FY2022 real GDP growth forecast to 3.0% (±0.5%) and further down to 2.9%±0.5% in 2023.*

Chart 10: Quarterly oil and non-oil GDP growth (2021 to 2Q22)

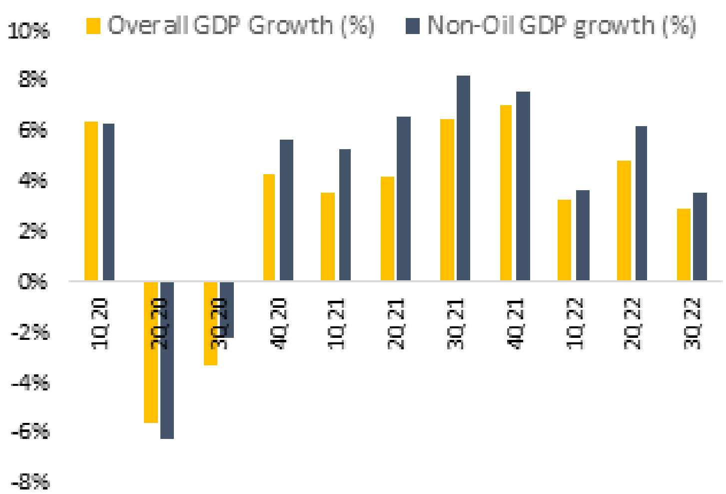
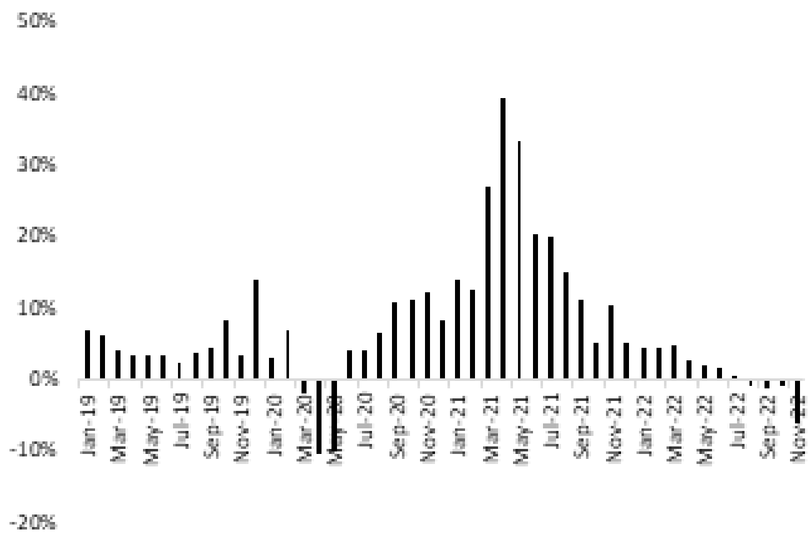


Chart 11: The evolution of the Composite Index of Economic



FIXED INCOME MARKET REVIEW

Bond valuations plummet due to increased risk aversion: The heightened inflation and macro-fiscal risks and the general macroeconomic uncertainty triggered risk-off sentiments that persisted through 2022. This increased risk aversion resulted in a slashed valuation for GHS-denominated bonds as offshore investors cut their LCY exposure in favour of more attractive options in the developed markets. Thus, the secondary bonds market became highly net-offered with the lingering concerns about debt sustainability and the induced GHS liquidity preference due to the rising cost of living propelling domestic yields higher, keeping investors extremely short on the LCY curve. Consequently, bond valuations on the secondary market, which, on average, opened the year priced near par, plummeted to close the year averagely priced at about 40% discount to the face value with corresponding offer yields around 60% to 67% levels.

T-bills dominate primary market activity amidst the increased uncertainty: Primary activity on the domestic bonds market ground to a halt in 2H22 amidst the pronounced revenue and expenditure mismatch, increasing concerns about debt sustainability and an imminent debt treatment. With the heightened uncertainty on the nature and form of the domestic debt restructuring, investors generally opted to stay short on the LCY curve, with the attractively priced T-bills sustaining interest. Consequently, demand for T-bills surged for most of the third and fourth quarters following the clarity that T-bills were exempt from the domestic debt restructuring programme. Cumulatively, the Treasury raised GH¢72bn across the 91-day to 364-day tenors in 2022 from total bids valued at GH¢73.95bn against a target T-bill issuance size of GH¢69.09. The over GH¢2bn excess uptake reflects new financing from the short term as the Treasury build up liquidity buffers for liability management.

Secondary bonds market to recover slowly as the fiscal, debt and structural reforms begin: We expect activity on the secondary bonds market to recover slowly but steadily following the closure of the DDEP. Investor appetite remains subdued, and the terms of the exchanged bonds are not attractive, which should keep activity in the secondary bonds market muted. However, the Treasury could remain shut out of the primary bonds market through 1H23, pending progress with the fiscal and structural reforms envisaged under the impending IMF programme. Thus, without attractive alternatives to T-bills (which we expect to dominate investor interest in Q1 2023), risk-averse investors may seek to accumulate the lowly-priced LCY bonds for capital gains as the market corrects over the near term.

Eurobond yields remain depressed pending breakthroughs with external debt restructuring: Following the conclusion of the domestic debt exchange, the government has shifted focus to external debt restructuring under the G20 common framework, starting with engagements with the bilateral creditors. While some creditor groups have signaled intent to support the government's efforts to restore debt sustainability, the bilateral creditor committee is yet to be constituted as cooperation from large creditors like China is needed to progress. The government has suspended external debt service on categories of bilateral and commercial debts pending progress with external debt restructuring. Thus, further delays in the external debt restructuring conversation could result in further defaults as Ghana is adjudged to be in selective default after skipping interest payments of about US$40.6 million on the Jan-2026 Eurobond maturity. Ghana's Eurobonds are already trading at highly distressed levels, with coupon payments on the Feb-2027, Feb-2035 pending and the Mar-2027, Mar-2032, Mar-2051 and Mar-2061 tenors falling due in Q1-2023. Thus, Ghana's Eurobond yields could remain depressed until the government secures financing assurances with bilateral creditors to pave the way for progress in external debt restructuring.

Chart 12: Economic Uncertainty sustains Demand for T-Bills

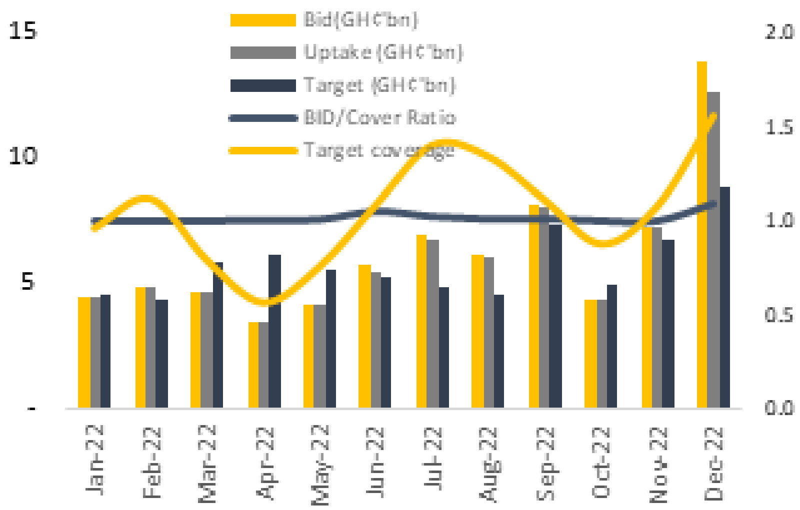


Chart 13: T-bill yields surged amidst inflation uncertainty.

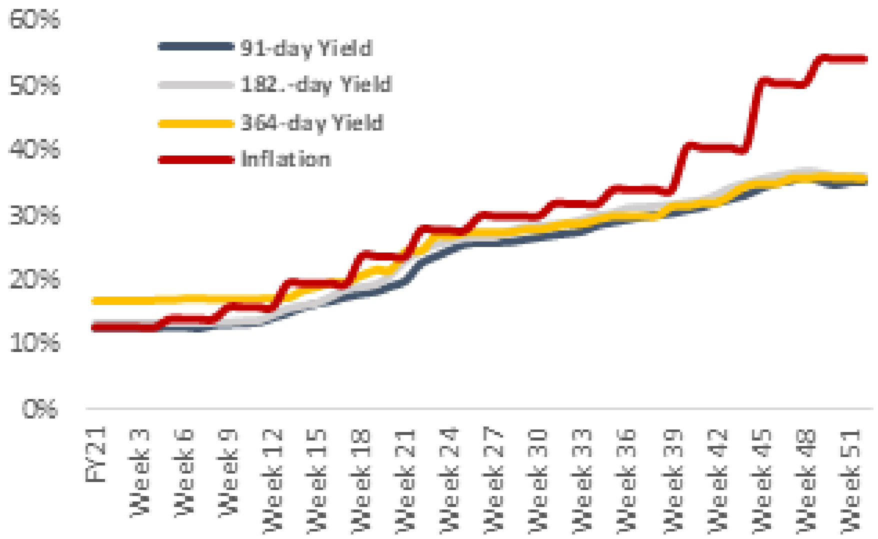
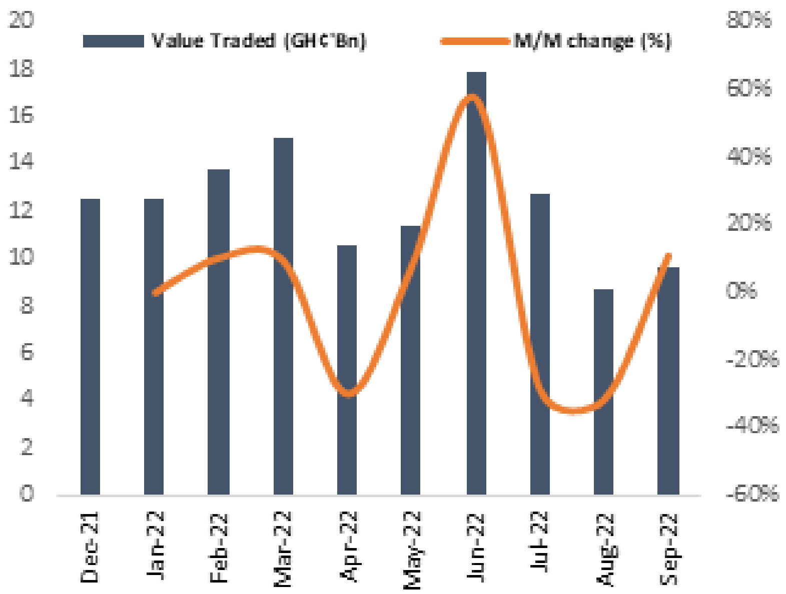


Chart 14: Sells-offs sustain trading activity on the GFIM



COMMODITY MARKET REVIEW

The market for Ghana's primary export commodities (Gold, cocoa, and crude oil) recorded a mixed performance in 2022, characterized by volatile commodity prices, supply bottlenecks related to the pandemic, geopolitical tensions, and tightening financial conditions. Gold and crude oil recorded price appreciation for the period, with the combination of price and output effects yielding a 30% increase in gold receipts and a 37.5% increase in receipts from crude oil exports. Revenue from cocoa exports, however, dipped by 22.04% due to the combination of adverse price and output effects.

Spikes in Crude oil price stabilize, reaching its lowest price in December: The near-unprecedented price volatility in 2022 saw the Benchmark Brent Crude oil touch US$130/bbl in 1H22 before easing to close the year at US$85.99/bbl. (+10.22 y/y). We attribute the surge in crude oil prices mainly to supply shocks from the Russia-Ukraine conflict and the low global crude oil inventories at the time. However, increased concerns about global recession following a sharp slowdown in the Eurozone and prolonged lockdown in China due to rising COVID-19 cases weakened the oil demand. Additionally, the unprecedented release of Strategic Petroleum Reserves (SPRs) from the US and other major economies eased the supply tightening and, together with the weak demand, triggered price correction in 2H22.

The outlook for the oil market for 2023 remains clouded in uncertainty. While the supply risks from sanctions, embargoes and price caps remain in force, global oil demand conditions are depressed due to the increased risk of recession in key markets. Russian oil production continues to exceed expectations and together with increasing supplies from Venezuela (due to the partial easing of sanctions) and Iran (potentially due to the weaker implementation of sanctions), results in an uncertain outlook for the supply side of the market. This uncertainty complicates the outlook for crude oil in 2023.

Lingering geopolitical tensions and the increasing threat of recession to improve the safe-haven appeal of Gold in 2023: The conflict-induced rally of the precious metal at the beginning of 2022 was short-lived, with the metal's price peaking at US$2,057/oz in Mar-22 but retreating after that. The retreat followed the synchronized tightening of the monetary policy stance by global central banks, which resulted in significantly higher interest rates, thereby depressing the metal's safe-haven appeal. The metal plummeted to its lowest price of US$1,621.57/oz. in the third quarter before recovering slightly to close the year at US$1,822/oz. The price recovery in Q4 2022 stemmed primarily from the USD's decline in Dec-22, following the slower rate hikes, reinforcing the expectation of an imminent shift in the Fed's policy stance.

Lingering concerns about weak global growth, geopolitics, and the possibility of slower rate hikes by the Fed and other major central banks as inflation eases could improve the safe-haven appeal of Gold, at least through 1H23.

Cocoa prices remained depressed through 2022 due to weak demand: Cocoa futures traded south for most of 2022 despite the adverse weather conditions and input supply shortfalls in the main crop region of West Africa which affected cocoa production. Cocoa futures mainly traded in the negative for most of 2022, with price peaking at around US$2,681.11/tonne during the lean crop season, where production was significantly depressed. Thereafter, the cash crop's price retreated due to weak global demand (as measured by grinding statistics) before climbing marginally to close the year around US$2,592/tonne (+2.3% y/y).

Chart 15: Slowing oil demand pulling price down, reaching its lowest price by FY 2022(US$/bbl.)

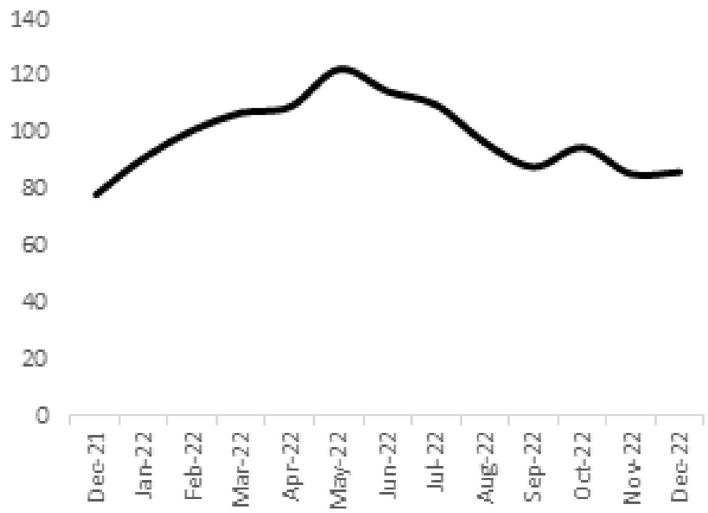


Chart 16: Gold price after a deep plunge bounce back in FY 2022 (US$/oz)

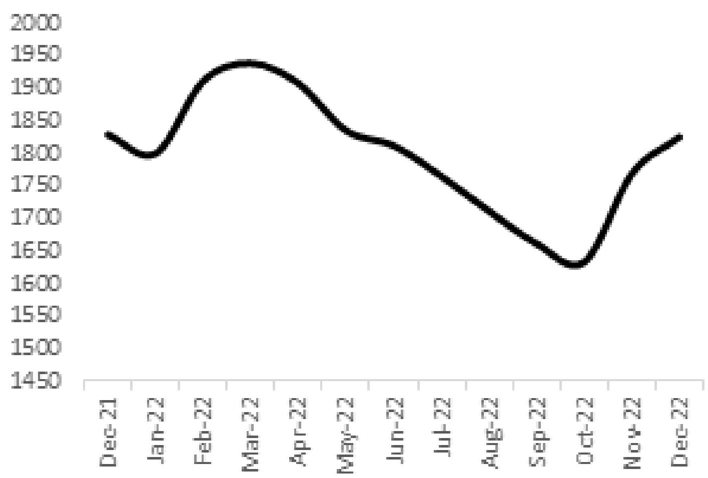
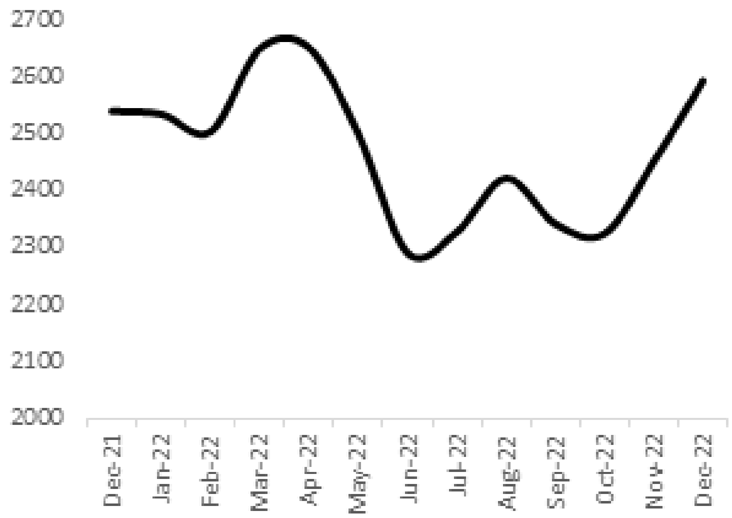


Chart 17: Cocoa confectionery strengthened by FY 2022 (US$'MT)



SUNNING IT ALL UP

Ghana is facing another challenging year ahead with the frontloaded fiscal consolidation envisaged under the 3-Year programme supported by the Extended Credit Facility expected to encourage aggressive revenue growth and deep cuts in discretionary expenditure. While these are necessary to rebuild the fiscal buffers and restore debt sustainability, GDP growth could remain subdued and disposable income further depressed. The slowing economic activity, high living conditions, and depressed disposal income levels could also challenge aggregate demand and revenue growth in the near term.

Given the generally unfavourable market conditions and limited capital flows, external sector vulnerabilities, particularly the balance of payment vulnerability, may be more pronounced in 2023. With the lost access to the capital market, urgent BoP support under the ECF is required to forestall a full-blown exchange rate crisis. Thus, we envisage dire consequences, particularly for the exchange rate, if the delays in securing financing assurances from development partners as a prior action of the IMF Board's approval extends significantly beyond Q1 2023.

Thus, we expect investor sentiments to remain generally cautious, with local currency exposures limited to the short ends of the curve. We expect the Treasury to be absent from the LCY bonds market at least through 1H23, with any immediate bond market activity only limited to liability management. While the Treasury's seemingly insatiable appetite for short-term funds, the extremely high returns on the money market, and the limited investment options continue to sustain demand for T-bills, we do not expect these conditions to last. Money market yields could tumble along with easing inflation and the re-pricing of the LCY curve as the economy recovers. With these near-term uncertainties, we recommend capital preservation, pending the anticipated improvements in the domestic market.

FORTUNE FAVOURS THE BOLD - WHERE ARE THE SILVER LININGS?

Seek capital gains at the front end of the LCY curve post DDEP: The protracted Domestic Debt Exchange Programme (DDEP) is concluded, and attention has shifted to external debt restructuring. In addition to external debt restructuring, the government is also seeking financing assurances with development partners towards securing the IMF Executive Board's approval to kickstart the IMF programme and usher in far-reaching fiscal, monetary and structural reforms towards restoring debt and fiscal sustainability and macroeconomy stability. In the meantime, we expect the government to remain locked out of the domestic market, which could improve activity and valuations of the new bonds on the secondary market as the macroeconomic outlook steadily improves. At current prices, LCY bonds are trading at nearly 50% discount, and for risk-loving investors, the front end of the LCY curve (2027 and 2028 maturities) offers the prospect for capital gains.

Selective risk-taking in the local burse could return value: Expectedly, the challenging macroeconomic environment has negatively impacted the earning potential of listed firms on the Ghana Stock Exchange, with the composite index posting a negative return in 2022 and thus far in 2023. We expect the prevailing macroeconomic backdrop to undermine profitability from the fast-moving consumer goods and banking sectors post-DDEP as interest income is eroded. Thus, equity valuations will remain depressed through 2023, and the burse is expected to post a negative return for the second consecutive year in 2023. However, these low valuations present opportunities for selective risk-taking on the ICT, energy, mining, and distribution stocks to return value in the medium term.

Explore HC fixed income options with other sovereigns: While the prevailing macroeconomic crisis and debt problem extend across many economies, countries with sound fundamentals and stronger resilience better navigated COVID-19 and geopolitical shocks. We recommend selective risk-taking in hard currency exposures in these sovereigns with relative resilience to shocks, robust external balances and credible policy environment as a strategy for diversifying the bond portfolio with new money.

Consider gold-backed ETFs, rather than hard currency, to conserve capital: With weak investor confidence, eroded reserves and elevated Cedi vulnerabilities, hard currency trades offer value. However, the resultant inflationary from depreciation passthrough could erode the real returns on currency trades in the near term. Thus, we recommend commodity-backed ETFs as a hedging strategy to preserve value. New Gold, a gold-backed ETF listed on the GSE, has started the year positively, following an impressive return in 2022, offering a safer currency hedge to preserve capital.

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Considered exposures to alternative assets: Amidst the limited investment alternative, investors should consider real estate investments and exposure to agriculture and energy-focused PE funds as alternative investments, commodities such as Gold and other precious metals, infrastructure, and cryptocurrencies.

However, effectively harnessing these opportunities will require changes to the existing investment guidelines from the Securities and Exchange Commission (SEC) and the National Pensions Regulation Authority to increase the investment ceilings on other asset classes as the current ceiling assigns heavyweights to the sovereign debt.

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