GCB CAPITAL LTD
Research & Analytics

November 2022

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Elevated Fiscal Rigidities Keep Budget Deficit High Despite the Urgent Need for Fiscal Consolidation

Ghana's Finance Minister, Honourable Ken Ofori-Atta, presented the national budget and economic policies for the 2023 fiscal year to parliamentarians on November 24, 2022. The budget came against a severely challenged macro-fiscal framework and a high risk of debt distress, necessitating a far-reaching fiscal consolidation and an imminent debt treatment to restore macroeconomic stability and fiscal and debt sustainability.

Over the near term and the medium term, the government targets the restoration of fiscal and debt sustainability through an imminent debt treatment and minimising fiscal risks, especially from contingent liabilities from SOEs. The government's blueprint for economic recovery is targeting, among other objectives, strengthening the exchange rate regime, deepening structural reforms, restoring investor confidence and regaining market access. Over the medium term, the government plans to deploy a progressive and sustainable fiscal consolidation strategy to reduce the overall fiscal balance to sustainable levels. This strategy will involve a mix of revenue-enhancing and expenditure containment measures and macro-critical structural reforms targeting the pre-existing structural bottlenecks and improving efficiency and competitiveness. The Minister indicated that the fiscal strategy would target a primary surplus (on a commitment basis) as the principal fiscal anchor.

Review of Fiscal Performance over 9-Months to Sept-22

Fiscal risks remain significantly elevated: The seriously challenged macro-fiscal environment has yielded a lower-than-expected growth in revenue while the expenditure pressures continue to mount, underpinning strained fiscal position thus far in 2022. At the close of Sept-22, total revenue (including grants) came in 2.84% short of the revised target at GH¢65.4 billion (11% of GDP | 64.5% of the revised annual target). Notwithstanding the narrower revenue gap, the elevated expenditure pressures from the wage bill and interest costs resulted in a less-than-proportionate cut in expenditure for the period as total expenditure (including arrears) came in at GH¢99.57 billion (16.8% of GDP |-2.9% relative to the target). The fiscal operation yielded an overall deficit (cash, discrepancy) equivalent to 7.4% of GDP (GH¢44.02 billion) relative to the period and the annual targets of 6.2% and 6.6% of GDP, respectively.

Fiscal rigidities to elevate budget deficit on a commitment basis despite the relatively improved revenue outlook for Q4 2022: We expect the slightly improved revenue performance in Q3 2022 to continue through the fourth quarter, with the Treasury now projecting total revenue and grants to exceed the revised target by about 1% to GH¢98.08 billion. However, the projected total expenditure (including arrears) could exceed the initial and the revised targets by 0.95% and 1.02%, respectively, reflecting the elevated budget rigidities as almost all expenditure line items exceeded their respective targets for the period. Notably, interest costs, employee compensation, and capital expenditure could exceed the target by about GH¢5.1 billion (0.86% of GDP). Additionally, we note a new outstanding expenditure claim line for 2022 amounting to GH¢22.09 billion (3.7% of GDP), which, together with the overruns, kept the deficit elevated. Consequently, the fiscal deficit on both cash and commitment basis is projected higher at 7.2% of GDP (vs revised target: 6.6%) and 9.9% of GDP (vs revised target: 6.3%), respectively.

Figure 1: Summary of revenue and expenditure over 9 Months 2022

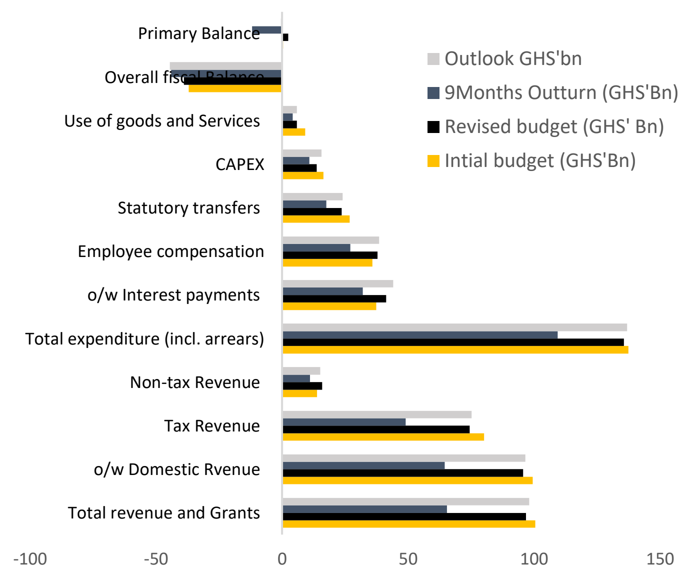
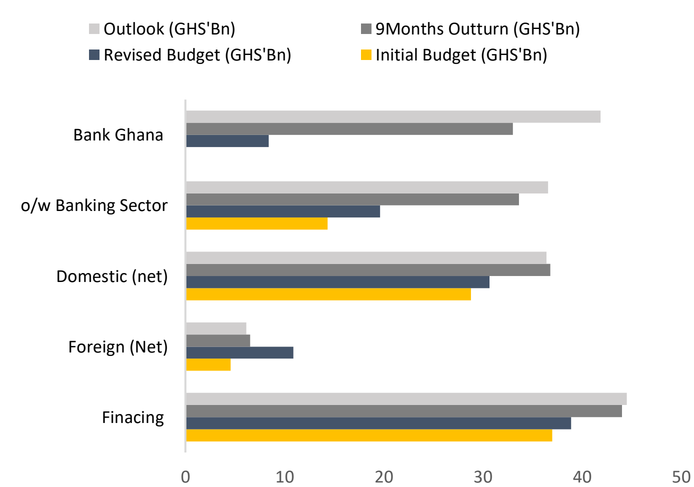


Figure 2: Budget Financing Over 9 Months 2022



Central Bank Dominates deficit financing over and above the regulatory threshold: Domestic financing dominated the overall financing mix through 9Months to Sept-22 as the Treasury raised 83.6% of the total funding from the domestic market (vs the period's target: 71.7%). Of the GH¢36.8 billion raised, the banking sector's share was 91.39%, dominated by Central Bank (CB) financing. CB financing amounted to GH¢33.03 billion (75% of total financing | 89.8% of domestic net funding), comprising GH¢5.1 billion of the outstanding balance on the IMF SDR allocation to Ghana in 2021 on-lent to the government and about GH¢21 billion in overdrafts from Treasury's main accounts with the Bank of Ghana. The increased CB financing reflects the challenging financing conditions that locked the Treasury out of the International Capital Market (ICM) in 2022 and the domestic market during the 2H22. We note that the size of CB deficit monetisation thus far exceeds the regulatory threshold of about GH¢3.5 billion (5% of the previous year's revenue). However, under the highly unfavourable market conditions and the high frequency of uncovered auctions since Q3 2022, the Treasury is targeting a total net CB financing of about GH¢41.9 billion by FY22.

Analysis of estimates, fiscal targets, programs, and policies for FY2022

Another ambitious revenue projection for 2023 backed by some new revenue measures expected to rake in about GH¢10billion: For the 2023 fiscal year, the government is expecting a 46.7% growth in total revenue and grants (relative to the projected outturn for 2022) to GH¢143.96 billion (18% of GDP) on the back of the existing and proposed revenue measures. Among many other revenue measures, the Treasury increased the standard VAT rate by 2.5% to 15% and converted the National Fiscal Stabilisation levy into Growth and Sustainability Levy (GSL) for all entities. Additionally, the government has suspended tax exemptions for all foreign firms, reduced the e-levy rate to 1% to encourage digital transactions and p hase out the benchmark value discount policy entirely in 2023. These new revenue measures are expected to rake in additional revenue of up to 1.35% of GDP in 2023 (about GH¢10.80 billion using the projected nominal GDP for 2023).

Expenditure pressures remain elevated despite the anticipated consolidation under an IMF program: On the back of this expected revenue for 2022, the government proposed a 39.5% growth in total expenditure and net on-lending for 2023 to GH¢191 billion (23% of GDP). An additional GH¢14.43 billion in arrears clearance (net change) and GH¢22.37 billion in amortisation brings the total appropriation for 2023 to GH¢227.81 billion (28.44% of GDP). Again the Treasury proposed several expenditure control measures in 2023 to support its efforts to consolidate, which is urgently required to restore fiscal and debt sustainability.

The fiscal path does not connote the much-anticipated consolidation investors craved, but the devil is in the detail: The revenue and expenditure framework is expected to yield an overall deficit (cash) estimated at GH¢61.48 billion (7.7% of GDP). This outturn compares with the revised cash deficit of 7.2% for 2022, corresponding to a primary deficit (cash) equivalent to 1.1% of GDP. On the surface, these numbers represent an expansionary budget, especially given the urgent need for fiscal consolidation to restore fiscal and debt sustainability as a first step towards improving market sentiments. However, a second look at the numbers reveals the heightened rigidities in the budget. We note from the fiscal numbers that the projected recurrent expenditure worth GH¢146.6 billion (18.3% of GDP) exceeds total revenue by 1.81%. Interest payment alone is estimated at GH¢52.55 billion (6.6% of GDP| +19.4% y/y relative to the outlook for 2022), with domestic interest cost accounting for 60% (GH¢31.58 billion) of the total interest cost (domestic debt/total debt: 41%). Non-discretionary expenditures from interest costs, employees' compensation, and the use of goods and services by MDAs will consume 73% of total revenue and grants and about 94% of tax revenue in 2023. This expenditure leaves a limited fiscal space to finance other statutory and social expenditure obligations and growth-enhancing spending, which are necessary for the smooth functioning of the economy. Thus, the economy remains vulnerable to significant revenue or expenditure shocks, with the projected GH¢36.8 billion additional expenditure on amortisation and arrears increasing the deficit to 9.9% of GDP in commitments.

Table 1: Summary of Macroeconomic indicators

	2022 (GoG)	2023 (GoG)	2023 GCL
Overall GDP	3.50%	2.80%	2.70%
Non-Oil GDP	3.60%	3.0%	-
Inflation	28.50%	18.90%	19.80%
Fiscal Deficit (cash)	7.20%	7.70%	8.20%
Primary Balance	-0.10%	0.70%	-

Figure 3: **Summary of Revenue projections for 2023 (GHS'Bn)**

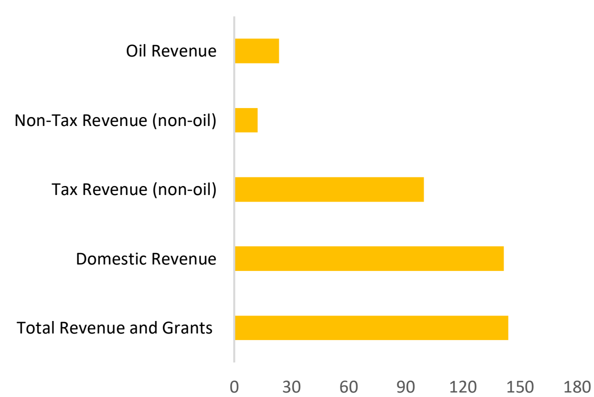
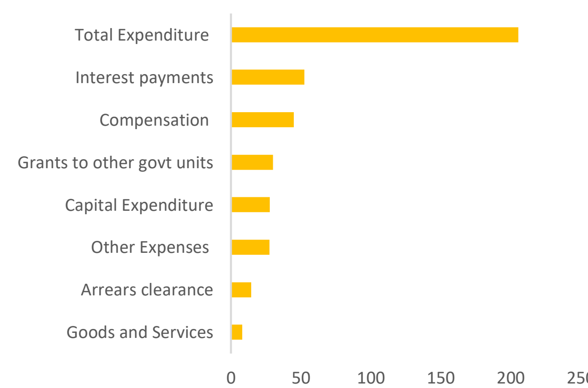


Figure 4: Summary of Expenditure projections for 2023 (GH'Bn)



Debt restructuring inevitable amidst the limited scope for fiscal manoeuvre: Against this backdrop of heightened fiscal rigidities and limited legroom, debt restructuring is unavoidable and could become a pre-condition for closing a deal with the IMF for a balance of payment support. The Minister indicated that the Debt Sustainability Analysis puts Ghana at a high risk of debt distress and announced a debt exchange program but stopped short of disclosing the details. Given the weak fiscal position and the heightened risk of debt distress, we expect the imminent debt treatment to include domestic and external debts and a mix of interest haircut and tenor extension on domestic debts and potentially principal and interest haircut on the dominant external debt stock. For example, a 100% interest haircut on domestic debts and a 1-Year maturity extension will yield savings of nearly GH¢50 billion in 2023, which will afford the government a much-needed fiscal space and slow down the rate of debt accumulation and will fastrack the restoration of fiscal and debt sustainability.

Government suspends non-concessional financing for 2022 in the hope that an IMF program will unlock concessional funding from regional and international financial partners: Given Ghana's significantly deteriorated macro-fiscal position, the budget deficit could remain elevated over the medium term. Thus, Ghana's path to fiscal responsibility could extend beyond 2024, as envisaged in 2020. The medium-term projections show that the deficit will remain above 7% through 2024 before receding to around 4.9% of GDP by 2026. Given that the imminent debt treatment could further undermine investor appetite for the credit, we expect Ghana to remain shut out of International Capital Market through 2025, at the minimum. Against this backdrop and given the highly bearish domestic market sentiments and the anticipated impact of domestic debt restructuring, the Treasury expects to fund the deficit entirely from concessional borrowing in 2023. Thus, the budget proposed a cap on non-concessional financing in the medium term with no Eurobond issuance envisaged over the next four years to 2026 and only expected to regain access to the domestic market in 2024. The government expects an IMF deal to open up other funding sources, including Multilateral and other international partners. Potential domestic market offers could be limited to rollover transactions subject to market conditions.

Figure 5: Significant increase on domestic and external debt service costs makes debt restructuring inevitable.

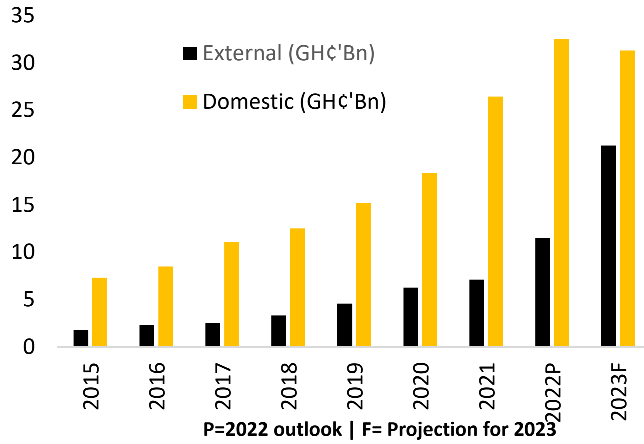
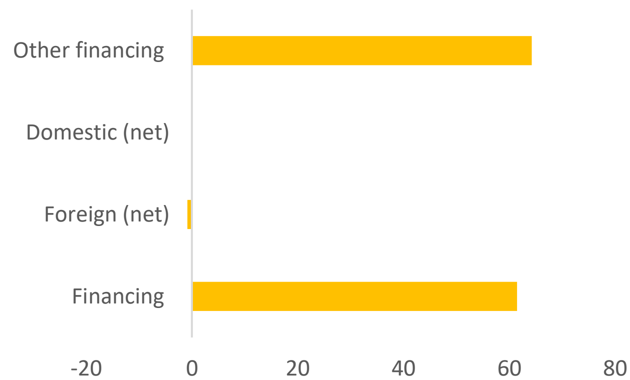


Figure 6: Treasury shifts to concessional funding amidst difficult market conditions (GHS'Bn)



Government hopeful of reaching a Staff-level agreement with the IMF by the end Dec-2022 ahead of the next staff mission to Ghana: The Minister indicated that negotiations with the IMF for a program had advanced a Staff-Level agreement that could be in place by the end of December. The progress follows two rounds of negotiations that culminated in broad agreements on program objectives and the preliminary path of fiscal adjustment to achieve fiscal consolidation and debt sustainability. The IMF and the Ghanaian authorities have also agreed on the debt management strategy after concluding a Debt Sustainability Analysis (DSA). The third round of negotiations will agree on structural reforms required, benchmarks, prior action, and key macro-fiscal indicators, culminating in the Memorandum of Economic and Financial Policies (MEFP) ahead of a staff-level agreement. Barring any prior actions on debt treatment, we expect a program with the IMF to start by Mar-23 to usher in the much-needed fiscal, structural and debt reforms required to restore macroeconomic stability. A delayed program start beyond 1Q23 could sustain the fiscal deterioration and complicate the government's financing options.

Capital Market interventions

The government also proposed several reforms and interventions for the capital market in 2023, which, we believe, are long-term plans to increase new listings on the GSE and the GFIM. These proposals include:

- **Benchmark bond guidelines:** The Treasury is working with the GFIM to develop benchmark bond program guidelines for the domestic market, intended to reduce the number of outstanding bonds into a few benchmarks with large sizes to improve liquidity, efficiency, transparency and price discovery.
- **Listing SOEs to Improve Corporate governance**: The ministry of finance indicated that it is working with the Ministry of Public Enterprises, the State Interest and Governance Authority (SIGA) and the GSE to enhance corporate governance among SOEs through listing in the equity and debt markets.
- **Mandatory Listing of mining companies on the GSE**: The GSE is working with the Minerals Commission on a local content regulation that will require mining companies with a specified minimum capital expenditure to list on the GSE, offering the opportunity for local participation in these mining companies.
- **ESG guidelines and sustainability-themed bonds:** The GSE has also developed Environmental, Social and Governance (guidelines) and established a sustainability-themed bonds market with rules embedded in the GFIM rules, paving the way for diversified product offerings on the capital market.
- **GSE partnering market participants for FINTECH solutions:** Increasing collaboration between the GSE and market participants to introduce FINTECH-related products to improve participation in the market.

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