Economic and Market Insight

Policy Update: July 2023 Monetary Policy Update

July 2023

GCB CAPITAL LTD
Research & Analytics

MPC Raised Policy Rate by 50bps to 30% in Response to Re-emerging Upside Risks to Inflation

Summary

- *The MPC assess the risks to the inflation outlook as elevated but expects inflation to resume a decline in the near term.*
- *Consequently, the Committee hiked the policy rate in a precautionary move to counter the second-round effects of the heightened food prices from becoming embedded in underlying inflationary pressure.*
- *The external sector balances are improving, thanks to various factors, including reduced investment income outflows due to external debt service suspension.*
- *Revenue shortfalls remain pronounced, but steeper expenditure controls – on account of interest savings from DDEP and external debt service suspension – keep fiscal consolidation on track.*
- *Economic activity remains subdued despite the upbeat growth outturn in Q1 2023.*

The Monetary Policy Committee (MPC), at its Jul-2023 policy meetings, increased the Monetary Policy Rate (MPR) by 50bps to 30% in a precautionary move to address "the slightly elevated inflation profile".

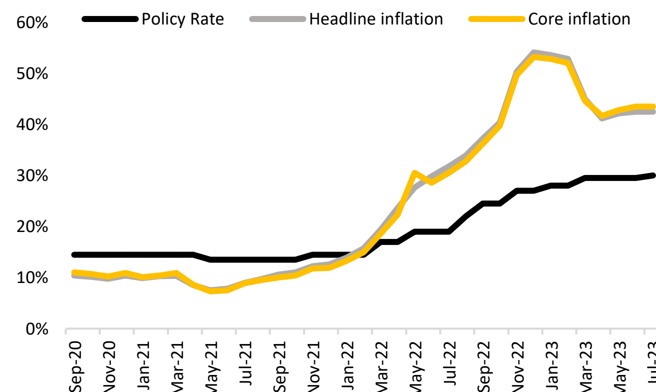
The decision follows two consecutive months of higher inflation prints in May and June despite the relatively stable exchange rate and petroleum prices as heightened food inflation, the price impact of the new revenue and tariff adjustments underpin the reversal of the disinflation process. The Committee, while expecting inflation to decline in the near term, argued that their baseline forecast shows an elevated inflation profile for the year ahead, which, if not contained, could reinforce underlying inflationary pressure for the remainder of 2023. The Committee observed that headline inflation hovered around 42% in Q2 2023 despite eliminating monetary financing of the fiscal budget through 1H23, with all the measures of core inflation also moving in tandem with the headline. Thus, the committee estimated that the anticipated second-round effect of the heightened food prices would keep headline inflation elevated, requiring an appropriate and decisive fiscal and monetary policy response to forestall these simmering pressures from becoming rooted in underlying inflationary pressure.

While we acknowledge the prevailing and emerging upside risks to headline inflation from the food basket, the quarterly utility tariff reviews and their potential second-round effects and lagged impacts, we believe there are equally potent drag factors on inflation. We believe the relative stability of the Cedi, amidst the improved outlook for 2H23, together with the stable ex-pump petroleum prices, the anticipated impact of the harvest season on food inflation and the continuous effect of a favourable base drift, will support disinflation in 2H23. Given the frontloaded fiscal consolidation ongoing, we do not envisage fiscal and monetary policy support for growth going forward, and real sector activity will be driven primarily by the private. However, credit growth has been subdued thus far in 2023 as banks exercise caution considering the shocks to capital from DDEP. Thus, despite the upbeat growth outturn in Q1 2023, the outlook remains bleak given the austerity envisaged under the IMF programme, and the tighter monetary policy stance could further stifle private-sector credit growth and depress activity in the real sector.

Insights from the Summary of Economic and Financial Data

External sector outlook improving following a mix of factors, including external debt service suspension: The summary of economic and financial data for the Jul-23 monetary policy meeting shows a steadily improving external position thus far in 2023 which, in part, underscores the Cedi's relative resilience YTD. We note that while export receipts declined by 7.9% y/y to US$8.18bn in Jun-23 due to lower crude oil

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



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

Figure 2: ***Year-on-Year Headline Inflation Dynamics***

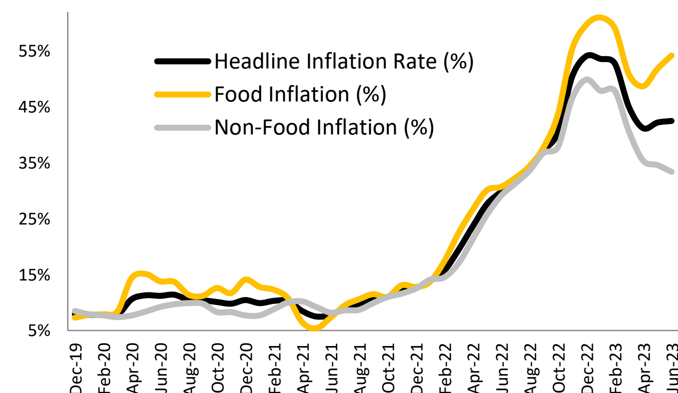


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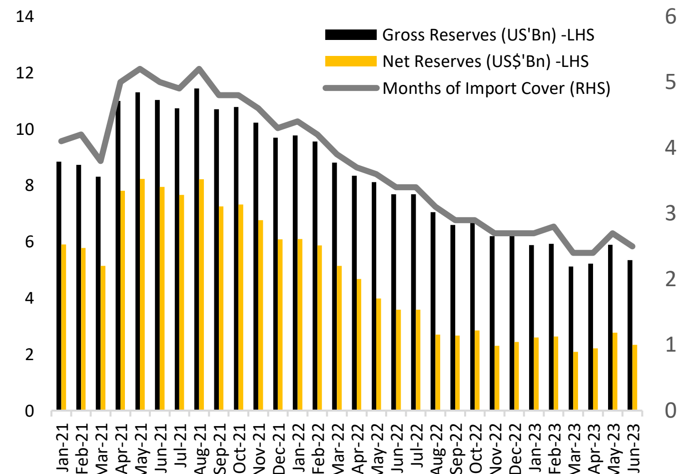
Figure 3: ***The Evolution of Ghana's Gross FX Reserves***



price and output, a sharper decline in the import bill to US$6.41 bn (-13.4% YTD) compensated for the lower export receipts, resulting in a larger merchandise trade surplus of US$1.77 bn at the close of 1H23 (+20.13% YTD |2.4% of GDP). The larger trade surplus and the lower investment income outflow following the temporal external debt service suspension since Dec-22 helped the current account to a surplus of US$849.2 mn (+176.4% y/y |1.1% of GDP). The surplus current account balance and the lower deficit on the capital and financial accounts due to slowing portfolio reversals underscored the improved overall Balance of Payments position, which slowed down the rate of reserve depletion through 1H23.

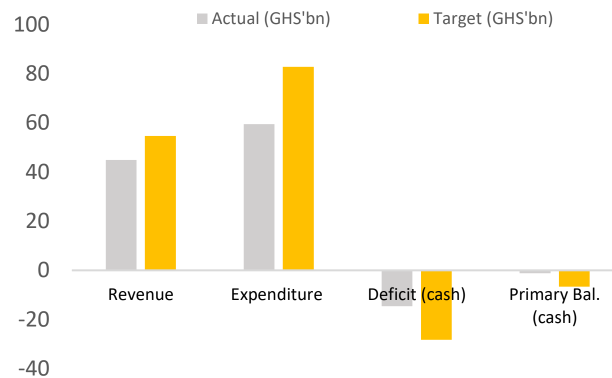
Consequently, the Gross International Reserves (adjusted for encumbered assets and petroleum funds improved from US$1.44 bn (0.6 months of imports) in Dec-22 to US$2.35 bn (1.1 months of import | +63.5% YTD). Thus, instead of the US100 mn net reserve depletion envisaged under the IMF programme during 1H23, the level of reserves improved by nearly a billion, supported by disbursements under the IMF programme and the Bank of Ghana's "Gold for Reserve" policy, which has accumulated 7.73 tonnes of gold since inception valued at US$480 mn. While the reserve position remains vulnerable and susceptible to shocks, additional disbursements under the IMF programme, multilateral funding in 2H23 and proceeds from the annual Cocoa Loan Syndication should support reserve build-up and sustain the Cedi's resilience through 2H23, all other things equal. An expedited external debt operation should also boost the stock of reserves and Cedi's near-term outlook.

Revenue shortfalls remain pronounced, but steeper expenditure controls, largely from interest savings from DDEP and external debt service suspension, keep fiscal consolidation on track: The summary of fiscal operations in the year to May-23 shows continuous revenue underperformance. Total revenue and grants for the period fell GH¢9.70 bn short of the GH¢44.90 bn target (5.6% of GDP | -21.6% versus target). However, the Treasury compensated for the pronounced shortfall in revenue with a steeper cut in expenditure for the period to GH¢59.5bn (7.4% of GDP | -39.2% vs target). The steeper expenditure cut helped to sustain fiscal consolidation under the programme with the fiscal operations resulting in an overall cash deficit of 1.8% of GDP (vs target: 4% of GDP) and a cash primary deficit equivalent to 0.1% of GDP (vs target: -0.8% of GDP).

However, it appears a greater proportion of the expenditure control through May-23 were interest savings from DDEP and the external debt service suspension rather than actual expenditure cuts. The Treasury estimates the interest savings from the initial DDEP in 2023 at GH¢34 bn, and we expect further interest savings from the ongoing restructuring of the domestic dollar bonds and external debts to strengthen the fiscal position further and aid arrears clearance. With the three new revenue measures taking effect from May 1, 2023, their full impact should also boost revenue performance in 2H23. This mix of an anticipated revenue boost, increased interest savings from debt restructuring and the ongoing structural reforms should help sustain the fiscal consolidation drive towards restoring fiscal and debt sustainability.

Economic activity to remain subdued despite the upbeat growth outturn in Q1 2023: Despite the surprise 4.2% real GDP growth recorded in Q1 2023, we expect real sector growth to remain broadly depressed through 2023. While improving, the Composite Index of economic activity has contracted in the last seven (7) months, driven by the slowdown in leading indicators such as port activity, cement sales, private sector credit and imports. The consumer and business confidence surveys also show mixed results, reflecting the uncertain macroeconomic climate. With the tightening credit conditions and the slowing industrial activity, growth and employment creation in the real sector could remain subdued through 2023.

Figure 4: ***Revenue and expenditure performance vs target (May-23)***



Source: GCB Capital Research | Ministry of Finance

Figure 5: Summary of fiscal balances

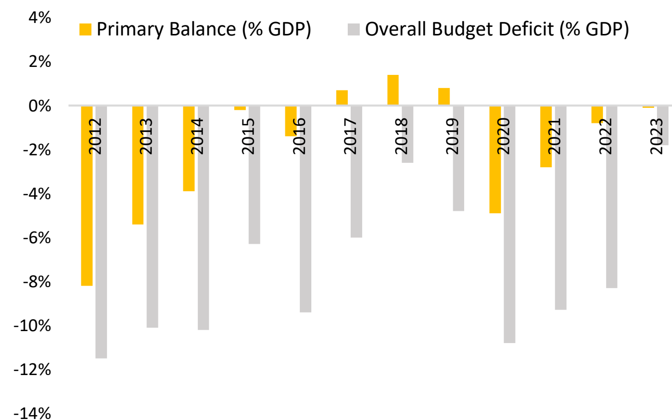


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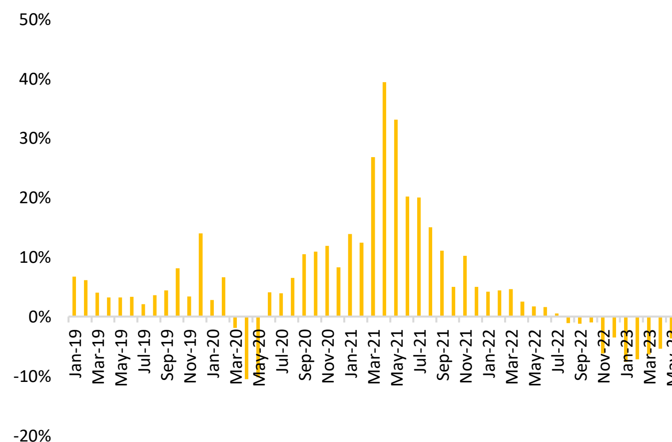
Figure 5: Trajectory of economic activity depicted by the Composite Index of Economic Activity (CIEA).



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