Economic and Market Insight

Policy Update: November 2023 Monetary Policy Update

GCB CAPITAL LTD
Research & Analytics

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MPC Holds the Policy Rate at 30%, Despite the Ongoing Disinflation, to Anchor Inflation Firmly on a Downward Path Towards the Target Band

Summary

- *MPC holds the policy rate at 30% to anchor the disinflation process firmly.*
- *The Committee also unified the currency denomination for CRR holdings on Cedi and FX deposits and increased the CRR to 15%, effective November 30, 2023.*
- *Monetary policy could pivot in Mar 2023 once inflation recedes sufficiently.*
- *The challenged Macroeconomic environment stifles credit growth as banks tighten their credit stance amidst the elevated credit risks.*
- *The directive to unify the currency denomination of CRR holdings for Cedi and FX deposits will release some FX liquidity to the market around the Yuletide season.*

The Decision: The Monetary Policy Committee held the monetary policy rate at 30% for the second consecutive time at its Nov 2023 policy meeting. Additionally, the Committee unified the currency denomination of the Cash Reserve Requirement (CRR) holdings for Local Currency (LCY) and Foreign Currency (FCY) deposits for banks, to be held in the Cedi and reset the unified CRR to 15% (from 14%), effective November 30, 2023.

Justification for the policy stance: The MPC expects the disinflation process to continue, supported by ongoing fiscal consolidation and zero deficit financing, among other ongoing reforms. Regardless, the committee believes that while inflation is receding, it remains high relative to the target, necessitating a continuously tight policy stance until inflation is anchored downward.

Our view on the monetary policy stance: While inflation expectations are improving, the outlook is still fragile and highly susceptible to domestic and global shocks amidst the lingering domestic and external risk factors. At 35.2%, inflation is still high and distant from the medium-term target band, requiring an appropriately tight monetary policy stance to complement the ongoing fiscal, debt and structural reforms in firmly anchoring lower inflation expectations.

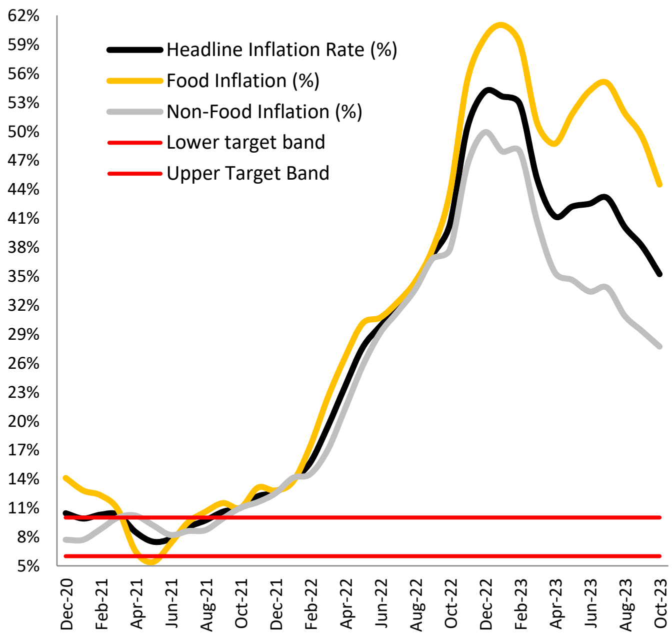
Despite the sharp decline in inflation thus far, the real policy rate and real returns on fixed-income securities are still negative, and the domestic investment climate in both the capital market and the real sector is highly unfavourable. These unfavourable conditions underpin the rising Non-Performing Loans (NPLs) and the tight credit stance, fueling the strong appetite for high-yielding T-bills and OMO bills and the high levels of interbank Cedi liquidity. Thus, we are aligned with the decision to keep the policy rate appropriately tight for longer to anchor inflation firmly towards the medium-term target band despite the decline in both headline and core inflation.

Insights from the Summary of Economic and Financial Data

Monetary policy to pivot by March 2024 once inflation recedes sufficiently: The return to the path of fiscal consolidation, the continuously tight monetary policy stance and the zero Central Bank deficit financing, among other reforms and favourable base effects, have supported the disinflation process thus far in 2023. Both headline and core inflation have eased broadly from their respective peaks of 54.1% and 53.2% in Dec 2022 to 35.2% (-18.9% YTD) and 36.2% (-17% YTD) in Oct 2023.

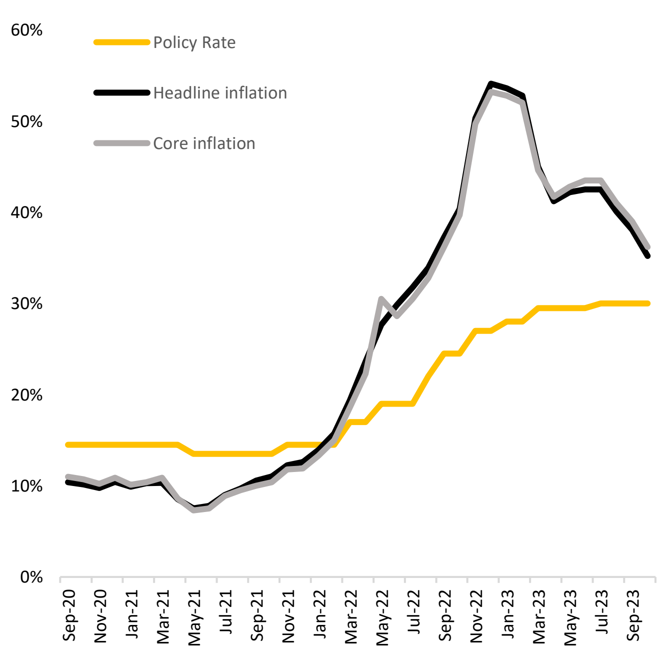
We expect the disinflation process to continue through 2024, all things being equal, supported by the tight monetary policy stance and the ongoing economic reforms. We envisage sharp declines in the headline over the next two inflation prints, going sub-30% for the Nov 2023 print and closing 2023 around 25% on the back of a favourable base drift. Both headline and core inflation could print near 20% by Feb 2024, barring any seasonality-induced exchange rate and external shocks, and we expect monetary policy to pivot by March 2023 in support of growth as inflation firmly assumes a downward path towards the medium term target band and low inflation expectations become entrenched.

Figure 1: *Year-on-year Headline Inflation Dynamics*



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

Figure 2: *The Trajectory of Inflation and the Monetary Policy Gap*



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The Challenged Macroeconomic Environment is Stifling Credit Expansion as Banks Adopt a Conservative Credit Stance Amidst the Elevated Credit Risk. Despite the better-than-expected growth outturn through 1H23 and the steady recovery in some leading indicators of economic activity, including the Bank of Ghana's Composite Index of Economic Activity (CIEA), growth remains depressed and below trend, with limited support through both policy and credit channels. Under fiscal consolidation and given the broad-based economic and structural reforms ongoing under the 3-Year IMF-supported programme, fiscal and monetary support for growth is limited.

However, support for growth through the credit channels also appears challenged due to the difficult operating environment. Despite the impressive deposit mobilisation drive in a market low on confidence, commercial banks have adopted a tight credit stance to preserve capital, channelling a chunk of their deposits into investments. The updated economic and financial data from the Bank of Ghana show a 16.2% y/y growth in industry deposits by Oct 2023. However, total loans and advances contracted by 9.5% y/y, along with a 7.5% contraction in private sector credit for the same period (- 31.6% YTD in real terms). This cautious credit stance stems from the elevated credit risks, as reflected in the rising NPLs, limiting banks' appetite for risk and exposure to the real sector.

Consequently, growth could remain below trend in the near term, pending a robust recovery in the operating environment. We expect private capital inflows into the real sectors of the economy to remain limited until the completion of the ongoing external debt restructuring programme and a more robust economic recovery.

BoG Unifies Currency Denomination of CRR holdings of Banks on Cedi and FX Deposits; Raised CRR to 15%: Broadly, banks have channelled their deposits into the high-yielding T-bills and OMO bills without other credible investment alternatives on the market, which underpins the 9.5% y/y contraction in total credit and advances.

The Bank of Ghana indicated that it has mopped up over GHS40 billion thus far in 2023 through its OMO operations. However, the attractive rates on the OMO operations represent a rising cost to the Bank of Ghana amidst the need to keep the policy rate tighter for longer as an anchor for the disinflation process.

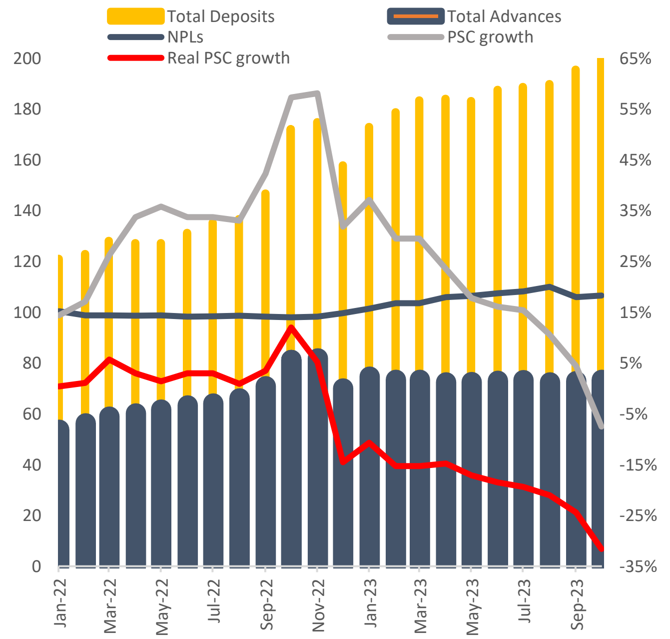
We believe considerations around the highly liquid banking sector, the medium-term inflation objectives and the cost implications of the OMO operations around the interest rate corridor necessitated the unification of the currency denomination of the Cash Reserve Ratio (CRR) holdings of commercial banks with the Bank of Ghana. Effective November 30, 2023, banks will hold 15% of their LCY and FCY deposits in Cedi with the Bank of Ghana.

We see the unification and the upward adjustment of the CRR as a timely intervention to reduce the cost of the BoG's OMO operations. The adjustment should help the BoG withdraw more liquidity from the cash-rich banking system without a commensurate increase in the cost while re-injecting FX liquidity held in reserves back into the economy to support continuous Cedi stability.

Ghana is Racing against time to secure an MOU with External Creditors, and the Anticipated Inflows in December Could Ease the Seasonal FX Pressure: While the standstill between official and commercial creditors to Zambia is a major concern, the Ghanaian authorities hope to secure a Memorandum of Understanding with creditors in time for the IMF Executive Board's scheduled meeting early in December to consider the first review of Ghana's programme.

A successful completion of the review and the subsequent disbursement of the second tranche of US$600 million under the programme should support the imminent inflow from the annual cocoa loan syndication in boosting FX reserves and easing seasonality pressures around the Yuletide season and in Q1 2024.

Figure 3: ***Deposits, Advances and grwoth in private sector credit***



Source: GCB Capital Research | Ministry of Finance

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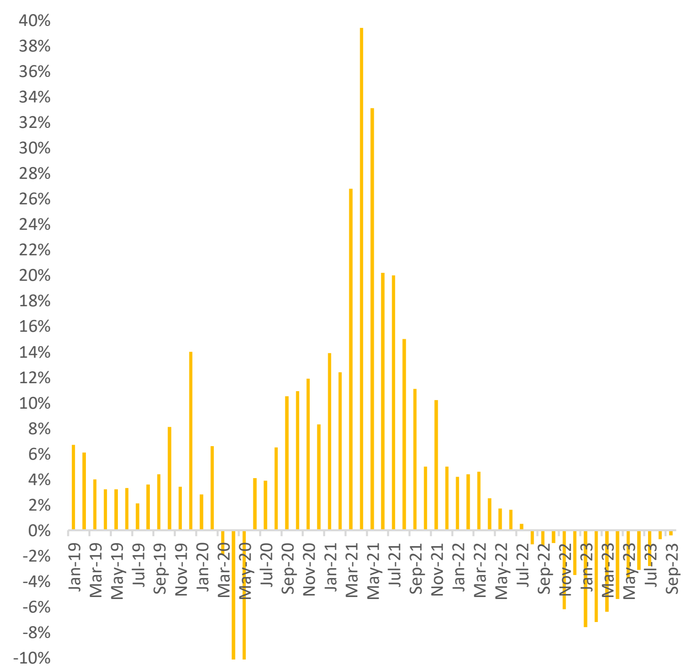
Figure 5: Trajectory of economic activity depicted by the Composite Index of Economic Activity (CIEA).



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3