Economic and Market Insight

Policy Update: May 2024 Monetary Policy Update

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GCB CAPITAL LTD
Research & Analytics

Staying the Course: MPC Maintains Policy Rate at 29% Amidst a Slightly Elevated Inflation Profile

Summary

- *MPC stays the course, holding the MPR at 29% for the second consecutive meeting*
- *C/A balance halved y/y in Q1-24 amidst mixed external sector performance*
- *Rife speculation due to uncertainty among the key factors driving Cedi volatility*
- *Cedi liquidity levels tightened in response to the CRR directive, but private-sector credit could remain sluggish until full economic recovery.*

The Monetary Policy Committee (MPC) expectedly stayed the course, maintaining an appropriately tight monetary policy stance amidst the emerging upside risks to inflation from currency pressures, recent transport fare hikes and their potential lagged impact on inflation. The committee indicated that its latest forecasts show a slightly elevated inflation profile, attributed to the recent spate of Cedi depreciation and transport fare hikes. However, the committee expects the disinflation process to continue broadly, projecting headline inflation to end 2024 within the monetary policy consultative clause of 13% to 17%, which is contingent on sustaining the tight monetary policy stance, including aggressive liquidity management operations.

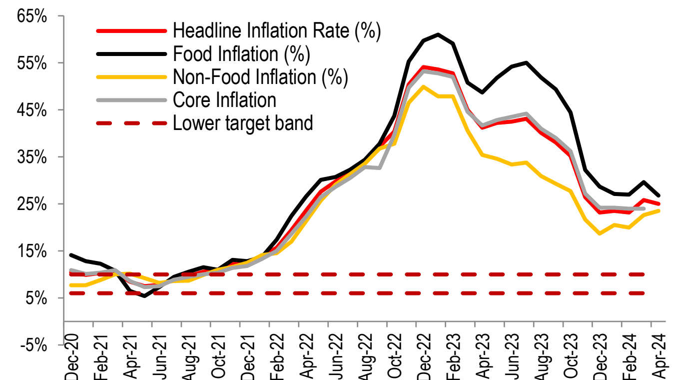
The decision is consistent with our expectations and the consensus market view as the upside risks to inflation are evident. While we expect the disinflation trend to continue (GCL expects the May 2024 headline inflation rate to print around the mid 21% levels) and end 2024 around 17%, the anticipated pass-through of the current spate of Cedi depreciation and its lagged impact and second round effects remains an upside risk to the near-term outlook. We have also seen the multiple upward adjustments in ex-pump petroleum prices, which result in transport fare hikes, and its full pass-through to general prices is yet to come. With the quarterly utility tariff adjustment still to come amidst the general macroeconomic uncertainties, the risk to near-term inflation is quite pronounced, requiring a continuously tight monetary policy stance to anchor inflation expectations and the disinflation process.

Insights from the Summary of Economic and Financial Data

Mixed developments in the external balances resulted in a weaker C/A position, but overall BoP switched to a surplus, and reserve accumulation is ahead of schedule. An analysis of the external balances revealed a mixed performance through April 2024. Export receipts recorded a modest increase of 4.9% y/y in April despite the 138.9%, 15.2% and 14.7% YTD appreciation in the prices of the three main export commodities - cocoa, crude oil and gold, respectively. The combination of significantly low output and the low locked-in prices on Ghana's cocoa futures resulted in a 49% decline in cocoa receipts y/y, moderating the impact of the 37.1% and 9.4% increase in gold and crude oil receipts stemming from both price and output effects. On the import side, however, non-oil imports grew by 31.2% y/y, reflecting the ongoing recovery in economic activity. The sharper growth in non-oil exports thus nudged the total merchandise import bill to US$5.08 bn (+22.2% y/y) relative to the modest growth in exports, resulting in a marked slowdown in the merchandise trade balance to a surplus of US$744.3 M (-46.5% y/y).

This trade dynamics, coupled with the 43.1% increase in net income payments, trimmed the current account surplus by 40.8% y/y to US$372.1 M despite the strong growth in inward remittances. However, disbursements from the IMF and the World Bank, among other credit facilities, the slight increase in FDIs and the 102.3% recovery in net portfolio investment inflows to a surplus helped switch the overall BoP into a surplus of US$84.7 M (+114.4% y/y | 0.1% of GDDP) in Q1 2024. This outcome supported the ongoing strategic reserve build-up efforts, with the Bank of Ghana reporting the accumulation of US$600 M in new reserves through May 2024 to US$6.59 billion, enough to cover 3 months of imports and be ahead of schedule under the IMF programme.

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*

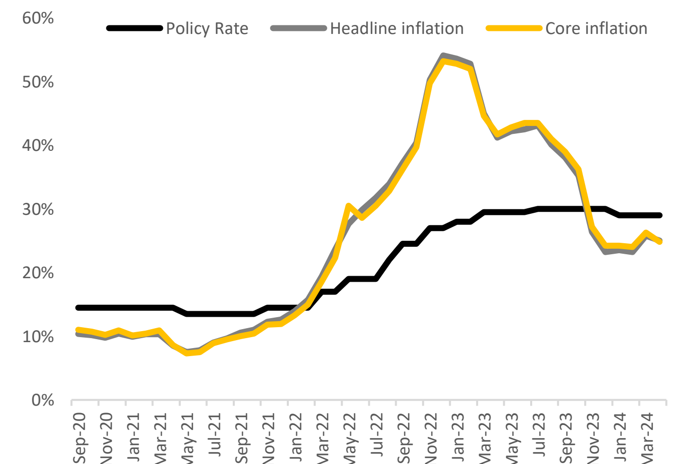


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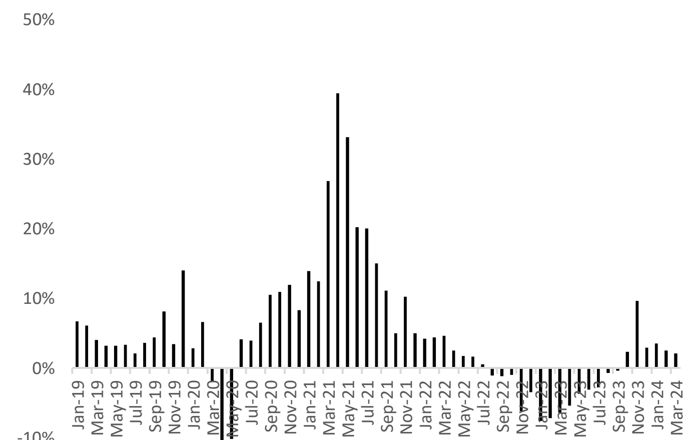
Figure 3: *Trajectory of economic activity depicted by the Composite Index of Economic Activity (CIEA).*



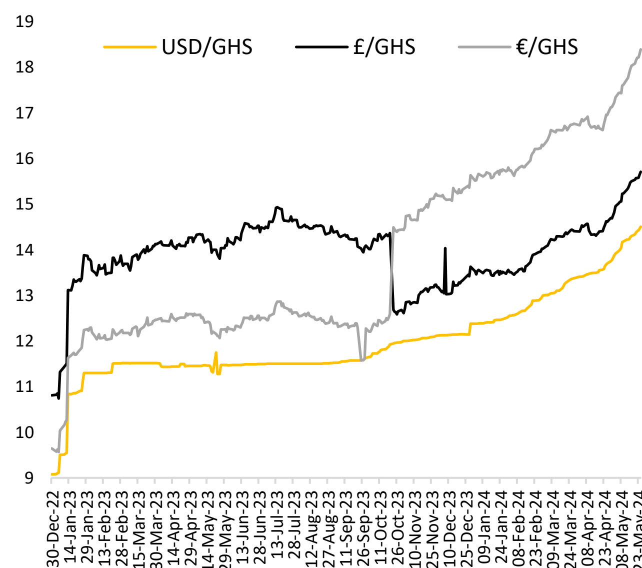
Speculative demand, IPPs and contractor payments, faster growth in imports, firm corporate demand and seasonality pressures underscore the Cedi's bearish run: While the performance under the 3-year IMF-supported programme has been impressive thus far, with the macroeconomic and structural reforms broadly on track amidst the emerging signs of economic recovery, the Cedi remains bearish. The relatively stable start to the year has given way to patches of pronounced depreciation from late February into March 2024 and through May 2024, with the indicative USDGHS retail rate drifting past the GHS15/US$ market. The general macroeconomic uncertainties, Ghana's chequered history of election-induced fiscal slippages, and the protracted negotiations around external debt exchange continue to fuel negative sentiments around the Cedi's outlook in the near term, underscoring the rife speculative demand pressures on the FX market. Additionally, seasonality effects from the corporate sector, the sharper increase in the import bill through Q1 2024, and IPP-related and contractor payments, among other factors, have also enhanced GHS liquidity levels and continue to fuel speculative tendencies.

While the Bank of Ghana and the Ministry of Finance have deployed moral suasion as the main tool to calm sentiments, assuring investors of adequate reserves to meet the market's needs, it appears investors will hold out for hard evidence fiscal discipline to complement the recovery in other macroeconomic indicators. The pronounced revenue gap in Q1-2024 and the frontloaded expenditure for the period already yielded a higher primary deficit (on commitment) of 0.7% GDP (versus target:-0.2%). This fiscal outturn will require a stronger revenue performance through the remaining quarters of 2024 and a commitment to fiscal consolidation and expenditure rationalization to restore a balance, which is key for anchoring sentiments. We welcome the targeted support to selected corporates to ease the FX pressure build-up and the partnership with the Ghana Association of Bankers to streamline documentation around foreign payments to minimize the incentives to resort to the parallel market. Beyond the clamp-down on advertised rates, stricter supervision and enforcement of FX rules could be more effective in quelling the speculative pressures.

The full implementation of the dynamic CRR directive expectedly slowed the growth of monetary aggregates, but loan book growth, unsurprisingly, remains sluggish: Following the 3-tier CRR directive in April 2024, GHS liquidity conditions tightened considerably in the interbank market. The dynamic CRR directive complemented the continuously tight monetary policy stance and the aggressive liquidity management operations, resulting in slower growth in M2+ y/y (29.9% in April 2024 versus 45.6% over the same period in 2023), with all components of M2+ recording slower growth. Expectedly, commercial bank reserves held at the Bank of Ghana increased by GHS16bn in the first month of the recalibration (+18% m/m | 51.9% y/y). This liquidity tightening initially undermined demand for T-bills at the weekly auctions as banks slowed down on T-bills to free cash to meet the regulatory requirement, with most banks drawing down on their OMO bill exposures to comply with the CRR directive.

However, given the severely challenged operating environment and increasing asset quality concerns, loan book growth (the main alternative to avoid the higher brackets of the CRR) was sluggish, predicated on full recovery in the business operating environment. Private sector credit for the period grew by a paltry 1.1% since the directive took effect (+1.02% YTD, +6.8% y/y). In real terms, private sector credit contracted by 11.4% y/y (-4.2% ytd; -0.71% m/m) amidst the elevated risks to lending and the tight financing conditions. Thus, we expect a gradual approach to loan book expansion, with bank Treasuries expected to favour deploying their ALM books into the high-yielding money market instruments to drive interest income. Therefore, we expect continuously firm demand for T-bills, with the anticipated sharp decline in inflation in the months ahead further dragging money market yields lower.

Figure 4: ***Trend of Cedi performance against the major trading currencies***



Source: GCB Capital Research | Ministry of Finance

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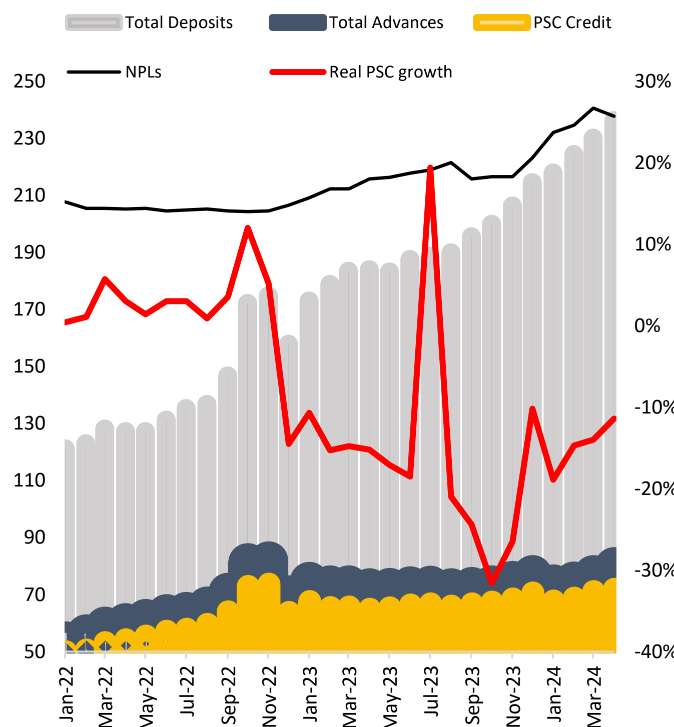
Figure 5: Deposits, Advances and growth in private sector credit



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