GHANA ECONOMIC REVIEW AND OUTLOOK

2013

1.0 EXECUTIVE SUMMARY

Economic Growth

Overall GDP growth is projected to slow down from 14.1 percent in 2011 to 8.5 percent in 2012 — a sharp decline of 5.6 percentage points. Subsequently, CEPA projects overall economic growth to rebound to 10.5 percent in 2013 and then fall back again to 9.0 percent in 2014. The non-oil sector is projected to grow at a trend growth rate of 8.6 percent over the period 2011-2014.

The volatility in the overall growth projections is due to changes in expected production levels of oil from the Jubilee oilfield. Due to technical difficulties experienced in 2011, production from the Jubilee oilfield has suffered persistent setbacks. Remedial strategies implemented are expected to raise production levels from 70,000 bopd at end-2011 to 90,000 bopd by end-2012. While higher in absolute terms than the production level reached in 2011, reckoned in units of non-oil GDP, however, the contribution from oil in 2012 to overall growth drops from 5.5 percent to 0.2 percent. With the relatively lower contribution from oil, overall GDP growth declines from 14.1 percent in 2011 to 8.5 percent in 2012.

In 2013, oil production schedules are expected to improve further, reaching a plateau of 120,000 bopd and remaining at this level over the medium-term. The increase from 90,000 bopd in 2012 to 120,000 bopd in 2013, reckoned in terms of non-oil GDP, raises overall GDP growth from 8.5 percent in 2012 to 10.5 percent in 2013. In 2014, with oil production remaining at 120,000 bopd, there will be no change in oil production. The same constant price GDP originating from the oil sector in 2014 as in 2013 when reckoned in terms of units of 2014 non-oil GDP constitutes a drag causing a deceleration in overall GDP growth from 10.5 percent in 2013 to 9.0 percent in 2014.

Our analysis strongly suggests that the discovery and production of oil have led to a structural change in the economy. Increased foreign exchange inflows from the oil sector have resulted in

an appreciation of the equilibrium real effective exchange rate. This has put in motion a self-adjusting process in which the real effective exchange rate has followed an appreciating path towards the new equilibrium, implying a loss of international price competitiveness of the non-oil sector. The persisting deceleration in agriculture sector growth over the period from the third quarter of 2010, reaching zero annualized growth by the first quarter of 2012, is consistent with the observation of loss of international price competitiveness of the non-oil sector.

The assumptions behind the trend growth projection for the non-oil sector over the medium term must be clarified. In the course of the Fourth Republic, every election year has been characterized by high domestic spending. The increased domestic demand has typically resulted in higher growth in nominal GDP, both higher real growth and higher rate of inflation. Developments in the first half of 2012 reflect these tendencies. Keeping the economic growth on the trend path assumes that the commitments made and measures taken to restore macroeconomic stability would achieve the objective. Third quarter developments support the view that this is possible though there can be no room for complacency.

Over the subsequent years, the assumption is that appropriate measures and policies would be adopted to counter the destructive consequences of the Dutch Disease which is indeed upon Ghana. Key among these measures would be those targeted at reducing the cost of doing business in Ghana particularly in the import competing subsectors of agriculture and manufacturing. The urgency of this is seen in the rising volumes of imports of food and beverages as well as light manufacturing goods. Traditional and non-traditional exports in the non-oil sector could also be adversely impacted on without these cost-reducing measures.

The Dutch Disease is really upon us

CEPA analysis points to important implications of the structural changes in the economy following upon the discovery and production of oil. Specifically, while oil production has boosted growth performance in the Industrial sector, it has also adversely impacted the tradable sub-sectors of agriculture and manufacturing. Thus, disappointing though oil production has been, the evidence strongly supports the view that the Dutch Disease is upon us.

CEPA research findings show that from about the fourth quarter of 2009, the impact of the oil discovery was evidenced and seen in the continued steady appreciation of the real effective exchange rate. The evidence suggests that the impact of the Dutch Disease on the non-oil sector activities can be timed to about the fourth quarter of 2010. The steady real appreciation of the exchange rate corresponded to a steady erosion of international price competitiveness of the tradable subsectors of the non-oil sector, marking the onset of the dreaded Dutch Disease. As a result, as the national accounts statistics show, growth particularly in agriculture has been dismal.

National income statistics produced by the Ghana Statistical Service (GSS) show that the growth rate of the agriculture sector has followed a downward path over the period from the third quarter of 2010 to the first quarter of 2012 when it reached zero annual rate of growth – in other words stagnated. CEPA estimates built on the quarterly year-on-year growth statistics show that from a peak of just over 8 percent growth for the 12-month period ending in the third quarter of 2010, the growth in agriculture decelerated especially in 2011 despite the all-time record performance of the cocoa subsector. For the first time in Ghana's economic history cocoa production climbed to over one million tonnes. In spite of this the overall growth rate of the agriculture sector in 2011was a miserable 0.7 percent. Furthermore, the descending trend persisted into the following year, 2012, with the sector stagnating — i.e., recording no growth over the 12-month period ending in the first quarter of the year. On a year-on-year basis, the Ghana Statistical Service (GSS) estimated the value of real GDP for the first quarter of 2012 at 2.9 percent, below the value recorded for the corresponding first quarter of 2011 – i.e. negative growth.

In contrast, the industrial sector as a whole benefitted from the emergent oil subsector. Thus, in spite of the possible adverse impact of the Dutch Disease on some subsectors of manufacturing, the annualized growth rates of the industrial sector accelerated sharply from the same third quarter of 2010. In other words oil production more than made up for potential output losses in the tradable subsectors of manufacturing.

In respect of the services sector, the increased spending on account of oil revenue is expected to have boosted activities in some of the non-tradable subsectors of the services sector, such as accommodation, recreation, entertainment, household services etc. in support of the oil sector.

After what looks like a lackluster performance a mild growth recovery is observable in the Services sector from the third quarter of 2010. These developments are again consistent with what analysts would suggest.

In summary, the evidence supports the view that the Dutch Disease is indeed upon us. Urgent steps must, therefore, be taken to boost the competitiveness and profitability of the non-oil sector to ensure its continual growth and capacity to generate jobs, especially for the youth. While there is no room for complacency, there is nonetheless room for hope. CEPA analysis and projections support the conclusion in an IMF Working Paper of May 2011:

> *"Provided Ghana can preserve and improve its economic governance and also strengthen fiscal management, prospects look good for converting its oil wealth into sustained strong economic growth."*

Inflation

With regard to inflation, the Ghana Statistical Service (GSS) has decided that the CPI basket, which was established about 10 years ago, is now obsolete and becoming increasingly inappropriate. Rapid technological changes have also led to the appearance of new items which are substitutes for the original ones. In the nature of things, however, the new items differ, sometimes significantly, in quality — compact discs and audio cassette tapes or mobile phones increasingly replacing land lines. The improved quality has typically meant higher prices and hence automatic substitution would impart an upward bias to CPI inflation. On the other hand, deletions could create the so-called "zero-entry" problem which could result in a downward bias in the CPI inflation. The GSS plans to replace the consumer basket later this year or early next year. CEPA urges that this be done. Further, to avoid the credibility issue in future the GSS should improve its communications and keep users better informed about changes in data gathering and methodology and their likely consequences for the interpretation of the statistics.

Changes in methodology, and processes of data gathering and information processing, have been numerous over the period since 2002, especially with the rebasing of national accounts. These rapid changes have resulted in important problems of comparability over time, reconciliation and interpretation. The statistics produced in the country by the GSS, and other MDAs such as the

Ministry of Food and Agriculture (MOFA) are often inconsistent and create confusion. The importance of bringing greater coherence in official statistics cannot, therefore, be over-emphasised. The GSS needs to be adequately resourced to develop a well functioning research and analysis capability.

Fiscal Performance and Policy

Fiscal performance in 2011 was good, supported by a strong revenue performance and lower cash outlays. Net arrears clearance, however, fell considerably short of target leaving a considerable carryover into 2012.

Payment of the carryover expenditures from 2011, equivalent to about 0.7 percent of non-oil GDP has contributed strongly to fiscal pressures in 2012. Additional pressures have come from the higher-than-budgeted public sector wage increases and the re-emergence of energy subsidies. A base pay increase of 18 percent — despite single-digit CPI inflation — was granted civil service unions in February 2012, raising the wage bill significantly above the budgeted amount.

Domestic pump prices of petroleum products that were raised by 15 percent in late December 2011 were subsequently reversed by 3 percentage points for fear of social unrest. As a result, by late May 2012, domestic pump prices were about 15 percent below their cost-recovery level – implying a monthly subsidy estimated at about GH¢60 million.

These additional expenditures threatened to widen the primary deficit by the equivalent of 1.9 percentage points of non-oil GDP.

With the increased risks to macroeconomic stability, fiscal policy needed to be tightened and credibility of the commitment to fiscal discipline restored. In light of this, the Government re-committed to maintaining the primary deficit of 0.1 percent of non-oil GDP on commitments basis. This required a fiscal adjustment of 1.8 percentage points of non-oil GDP. Achieving this target would be a considerably improved performance over the primary deficit outcome of 1.9 percent of non-oil GDP in 2011.

The Government agreed with the IMF to expenditure cutbacks and improved tax collection effort. The Government also expects to generate savings through the ongoing pension and payroll audits that could offset the cost of the pay increase. These savings, however, are expected to materialize in the later months of the year. If fully reached, these audits are projected to lower the overall wage bill permanently by between fifteen and twenty percent.

It is CEPA's view that the primary deficit target of 0.1 percent of non-oil GDP is achievable. The projected savings from the payroll and pensions audit and the expected cutbacks in expenditures, however, are not reliable as the means of achieving the primary deficit target. Projected expenditure cutbacks all too often have proved over-optimistic and typically ended up in payment arrears. The target outcome, in CEPA's view, would be achieved through the sustained efforts of the Ghana Revenue Authority (GRA).

Tax collection and administration efforts paid off well in 2011. The non-oil tax revenue as ratio to non-oil GDP rose from 13.2 percent in 2010 to 16.3 percent in 2011 — a remarkable jump of 3.1 percentage points of non-oil GDP in one year. Government has targeted further improvements — 0.4 percentage points of non-oil GDP — in 2012. On the basis of the first half year performance, this estimate is unduly conservative. We project an additional 1.3 percentage points of GDP to 18.0 percent of non-oil GDP for this year, bringing Ghana's tax performance closer to the average 20 percent for our peers.

The new tax measures introduced in the 2012 Budget are expected to yield more than had been originally projected. For example, the establishment of a uniform regime for capital allowances and the raising of the corporate tax rate from 25 to 35 percent are expected to yield an additional 0.3 percentage points of non-oil GDP this year.

The government also expects additional non-tax revenue from the negotiation of a new stability agreement in the mining sector. For these mining companies that have stability agreements, the government negotiated for compensation for maintaining the existing favorable terms. Furthermore, a number of the others have reportedly sought to negotiate new stability agreements with appropriate compensation to government. It is estimated that the compensation

fees from these stability agreements will bring in the equivalent of 0.8 percent of non-oil GDP of non-tax revenue.
The outcome of these negotiations, however, is uncertain and moreover, the timeline is rather ambitious. Consequently, CEPA prefers to be conservative and err on the side of caution by capping the additional non-tax revenue at half of the projected estimate — i.e. an increase of 0.4 percentage points of non-oil GDP.

The overall deficit is projected in the Supplementary Budget to widen by the equivalent of 1.9 percentage points of non-oil GDP. This is on account of increased debt service obligations — arising from the impact of the depreciation of the cedi on external debt service and of monetary policy tightening (raising interest on the domestic debt) — together with the clearance of payment arrears including the carryover expenditures from 2011. As the Minister of Finance noted in his presentation of the Supplementary Budget to Parliament, these revisions and resultant wider overall budget deficit are all in line with the outcomes reached in the concluding Sixth and Seventh Reviews of the stabilization program approved by the Executive Board of the IMF on July 13, 2012.

On 23 August, 2012 the BoG issued a five-year bond which was over-subscribed and closed at a lower average interest rate of 23 percent compared to the 26 percent average interest rate realized from the previous five-year bond issue. The Minister of Finance and Economic Planning has stated that proceeds from this issue would be used, not to finance a wider budget deficit, but to lengthen the average maturity of the domestic debt. This decision is important for the achievement of the overall deficit in two ways:

- First, it re-enforces the commitment of the Government to resist spending pressures in this election year; and
- Secondly, it could potentially lower interest rates across the entire yield curve thereby lowering debt service costs, and creating additional fiscal space needed to effect greater complementarity between fiscal and monetary policies.

Monetary Policy

Monetary policy in the months leading up to 2012 was loose. Inadequate sterilization by the Bank of Ghana left a lot of liquidity in the system that had the potential to fuel inflation and a depreciation of the cedi. Evidence of the liquidity overhang is apparent in the large amounts of currency in the hands of the non-bank public and the large amounts of reserves of deposit money banks — both the reserve-to-deposit ratio and the currency-to-deposit ratio were generally rising in 2011. The evidence is also visible in the net foreign asset (NFA) of deposit money banks (DMBs) which rose sharply in the second half of 2011 — on average, in the second half of 2011, the NFA of the banks was about GH¢350 billion higher than it was in the first half.

In spite of the excess amount of cash in the system towards the end of 2011, the CPI measures of inflation failed — remaining “downwardly sticky” — to respond by rising. With a fairly stable MPR and a generally falling inflation rate, the real monetary policy rate — the MPR adjusted for inflation — was positive and rising, suggesting that monetary policy was rather tight. Had inflation responded appropriately to the excess liquidity in the system by rising, however, the real MPR would have been negative, supporting the view that monetary policy was in fact loose and, thus, signaling the necessity for the MPR to rise.

While not obvious when observed by the CPI-based measure of the real MPR, evidence of the liquidity overhang can be seen from the CEPA wholesale price index (WPI)-based measure of the real MPR — which fell sharply in 2011 and became negative in the second half of the year. This adds further to public concerns about CPI inflation. It also calls in question whether it is an appropriate inflation variable to be targeted by the BoG in its inflation targeting (IT) framework. It is pertinent to note that the Reserve Bank of India targets the WPI in its IT framework.

To be effective, monetary policy has to target a variable that responds positively to monetary conditions. The failure of the CPI inflation to respond appropriately to monetary conditions — generally falling until March 2012, instead of rising in the face of large excess reserves — and rapid depreciation of the cedi has led an analyst at Renaissance Capital to speak of “downwardly sticky inflation”.

The depreciation of the cedi at the beginning of the year — a seasonal phenomenon caused by a surge in domestic demand in the last quarter of the previous year — was intensified and sustained by the conditions of excess liquidity in the system. The initial response by the BoG was an injection of US$1.0 billion into the foreign exchange market. Given the conditions of excess liquidity, however, this had only a temporary effect in slowing down the depreciation.

Subsequently, the BoG has taken additional steps to tighten monetary policy. The policy rate has been raised three times thus far this year — from 12.5 percent in January to 13.5 percent in February, 14.5 percent in April, and 15 percent in June — and the BoG has reintroduced its own bills for open market operations (OMO) purposes. The BoG has also taken some off-market/administrative measures including:

- requiring that mandatory reserves on both cedi and foreign currency deposits now be held in cedis,
- requiring all banks to provide 100 percent cedi cover for their off-shore account balances — to be maintained at the BoG, and
- lowering the allowable limits on net open positions of banks.

Market interest rates have responded positively to these measures. However, further monetary policy tightening would be needed. With short-term interest rates above 20 percent, and the MPR at 15 percent, the gap between the MPR and market rates would have to be closed if the MPR is to remain an effective guide for market interest rates. This would require a greater reliance on market-based policies, rather than on administrative policies, with the MPR rising and or market interest rates falling.

As previously mentioned, the five-year bond issued by the BoG in August was over-subscribed at a lower interest rate of 23 percent. That the Minister of Finance has stated that proceeds from this issue would be used to lengthen the average maturity of bonds is a step in the right direction towards re-aligning the MPR with market interest rates. This decision could lower the yields on Treasury bills and bonds, effectively lowering the entire yield curve and bringing market interest rates in better alignment with the MPR.

While the Bank of Ghana has contended that administrative measures are a useful and cost-effective complement to market-based policies, the BoG must take care to assess their full implications before they are implemented. Non-market measures, for example, may impose costs on banks which may evoke responses from them that could have unintended negative consequences for their clients. Non-market means of sterilization may also force market interest rates to rise by more than is indicated by the MPR, thus leading to a misalignment of the MPR and market interest rates. There is, thus, the need for information sharing and improved communication from the BoG to the general public, as well as total cooperation of banks with regards to the implementation of non-market measures.

Monetary policy needs to be tightened. But, more importantly, greater co-operation, collaboration, and complementarity in macroeconomic policymaking and implementation would also be needed. Currently the burden of stabilization rests, in a lopsided way, on monetary policy. However, a better balance must be achieved between fiscal and monetary policy in the task of regaining macroeconomic stability. The BoG's resource constraint in effective sterilization must also be resolved. This can be achieved through the provisioning for open market operations (OMO) in the budget. The projected lowering of the yield curve in line with improved expectations should yield good dividends — more fiscal space and lower cost of OMO.

External Trade and Payments

In the domestic foreign exchange markets, the nominal effective exchange rate (NEER) — a trade-weighted summary index of the cedi exchange rate with currencies of major trading-partner countries — depreciated sharply in the first six months of this year by 17½ percent, more than twice the pace of nominal depreciation in the whole of 2011. This rapid depreciation was fuelled by "loose monetary conditions", high domestic demand associated with a four-year political business cycle (PBC) commencing in each election year, thus far a regular feature in the Fourth Republic, and reinforced by unanchored expectations.

The un-anchoring of expectations stemmed from heightened inflationary expectations on the domestic front sparked off by the withdrawal of subsidies on the prices of petroleum products,

and electricity and water tariffs — an ironical negative outcome from the effort to tighten fiscal discipline. The withdrawal of subsidies had been agreed with the IMF in the fifth review of the three-year stabilization programme, as required, to keep to the fiscal targets on the programme. The fact that 2012 is an election year was particularly pertinent to the need to commit to fiscal discipline.

Over the course of the Fourth Republic, an observed regular characteristic has been the political business cycle (PBC). In each election year macroeconomic policies have been loose, resulting in currency crises and accelerating rates of inflation. A World Bank study found that the election-year budget deficit was, on average, 1.5 percentage points of GDP over the budget deficit of the preceding year. Moreover, domestic credit was also found to increase sharply in election years. Loose macroeconomic policies resulted in high domestic demand.

On the external front, concerns about the PBC had been expressed by investors and ratings agencies particularly in the second half of 2011. Consequently, continued "loose monetary conditions" into 2012 seen in excess reserves in the banking system and high holdings of currency by the non-bank sector served to confirm the fears of investors.

In the second half of 2011 there were notable shifts in the asset structure of the commercial banks with large movements from cedi-based assets into foreign currency-based assets. The signals of increased speculative activities by some of the banks, however, were ignored — net open positions of banks remained long and full cedi provisions were not made for the vostro accounts of banks — in effect, allowing foreign banks and investors to trade in short-term securities contrary to the regulations.

Moreover, over the recent period, speculative activities by some dealers and traders in the foreign currency markets have been associated with a decline in interbank trading and a widening of spreads between the interbank transactions and foreign exchange bureaus' rates. It was not until February 2012 that the Bank of Ghana (BoG) instituted measures to end the speculative activities of "currency traders and dealers". The BoG also moved to curb what it considered to be speculative behavior by commercial banks. Among other things, the BoG

instructed that 100 percent cedi-cover be provided by all commercial banks for their offshore balances.

Subsequent interventions by way of foreign exchange market operations (FEMO) saw the gross international reserves (GIR) held by the BoG falling from US$5.5 billion at the end of December 2011 to US$4.3 billion by the end of the first half of 2012. This is equivalent to 2½ months of imports cover of goods and services — down from the more comfortable level of 3.1 months registered at the end of 2011. Typically, economies with import cover of less than 3 months are considered to be vulnerable to external shocks, such as a sharp increase in the global market price of crude oil. With such an uncomfortably low level of GIR, the BoG would do well to heed the call to refrain from further FEMO interventions to support the cedi and rather to generally restore the stock to more comfortable levels — i.e., to at least 3 months of import cover.

The IMF and Bank of Ghana staff concurred that a depreciation of the cedi in the early months of 2012 should not be "surprising in the context of the sizeable inflation differentials and a high current account deficit". They also agreed that the pace of depreciation in recent months had created challenges for anchoring expectations. Initial triggers for the depreciation, in their view, included seasonally strong demand for foreign exchange at the beginning of the year.

Meanwhile, Ghana's external payments position continued to be strong in 2011, with an overall balance of payments surplus amounting to US$611 million. As in the preceding two years, this surplus was achieved on the back of much improved commodity terms of trade, significant financial resources from development partners, and foreign direct investments to finance the development of the oil field and widening current account deficits. It may be noted that the increase in the current account deficit is also, in part, due to the increase in services and income payments that comes with the new oil and gas industry.

The core commodity terms of trade — based on world market prices of cocoa, gold and crude oil — has been relatively benign, ,while the broader overall terms of trade has been a lot more favorable to Ghana. An important point to note about the two exogenous shocks that typically impact on the Ghanaian economy — commodity terms of trade and weather shocks affecting

agriculture — is their volatility or quick reversibility. Changes in the commodity terms of trade are hardly predictable. Ghana's economic history clearly and strongly suggests a need for caution here. Positive gains from the terms of trade are best treated as temporary and reversible and hence not to be relied on to choose FEMO over OMO in defense of the currency.

The favorable developments in the external sector helped to mask the potential adverse consequences of loose monetary conditions at the turn of the year. CEPA analysis suggests that with the discovery of oil and entry into the oil era, from about the turn of the year in 2010 into 2011, the equilibrium real effective exchange — the real effective exchange rate (REER) consistent with the structural changes in the economy on account oil discovery and production — appreciated by about 12.3 percent. This set in motion an autonomous self-correcting process with the REER on a path of steady appreciation to the new oil era equilibrium real effective exchange rate, consistent with the economic fundamentals. The widening inflation differential alluded to by the Fund and the BoG can therefore be viewed as part of the automatic self-correcting process to equilibrate the REER to the oil-era equilibrium real effective exchange rate.

The point to underscore in all of this, however, is that the REER appreciation lies at the heart of the Dutch Disease, which, left to itself, could destroy the non-oil sector over time. The self-correcting process of steady appreciation of the REER reflects a corresponding steady loss of international price competitiveness of the relevant non-oil tradable subsectors of agriculture and manufacturing, putting a tightening squeeze on profitability, growth and job creation in these sectors. Unfortunately, as borne out by the national accounts statistics, since the third quarter of 2010 symptoms of the Dutch Disease have been experienced in the non-oil tradable subsectors of agriculture — specifically, non-cocoa crops, livestock, and fishing which are considered import-competing — and the light manufacturing subsectors of manufacturing.

One approach to slow down the appreciation of the REER is to sterilize the oil revenues. In Ghana a Heritage Fund to receive about 30 percent of the net (of GNPC expenses) oil revenue has been set up under the Petroleum Revenue Management Act (Act 815). Thus far, Ghana appears to have thereby held against the pressure to spend the oil revenue immediately to alleviate poverty. Sterilization helps to reduce the 'spending effect', alleviating inflationary

tendencies and real appreciation pressure from widening inflation differentials with main trading partners.

Another strategy for avoiding REER appreciation is to increase national savings in the economy, reducing the large capital inflows that could cause currency appreciation. This can be done, for example, by running a budget surplus — increasing government savings. The country can also encourage individuals and firms to save more by reducing income and profit taxes. By increasing savings, Ghana can bridge the yawning savings-investment resource gap and thereby reduce the need to borrow to finance government deficits, as well as for foreign direct investment (FDI).

Investments in human capital — education, health, water, sanitation, and malaria eradication — and in physical infrastructure development have the ability to increase the competitiveness of the tradable subsectors of agriculture and manufacturing. Protection, by way of subsidies and/or import tariffs, can be dangerous and must be avoided. This could worsen the Dutch Disease syndrome. Large inflows of foreign capital are usually provided by the oil sector and bought up by the import sector. Imposing tariffs on imported goods will artificially reduce the import sector's demand for foreign exchange which could contribute to REER appreciation.

Conclusions

The withdrawal of energy subsidies in December 2011 unanchored inflationary expectations. This was further boosted by the sharp rise in domestic aggregate demand pressures from the political business cycle of election year 2012. In the context of a liquidity overhang this sparked off a self-fulfilling speculative attack on the cedi. The resort to foreign exchange market operations (FEMO) rather than open market operations (OMO) — the more appropriate in the circumstances — provided only temporary relief and resulted in a costly loss of international reserves.

The successful completion of the three-year stabilization programme with the IMF under the Extended Credit Facility (ECF) arrangement has contributed to anchoring expectations in financial markets and to boosting investor confidence in the economy of Ghana. With the final disbursement of US$178.74 million in July 2012, the Bank of Ghana (BoG) received a boost to

its gross international reserves (GIR) which has enhanced market perceptions about its ability to defend the cedi. This has contributed to alleviating depreciation fears and consequently has lowered the cost of borrowing by Government.

The second five-year bond issued by the BoG on 23 August 2012 was over-subscribed; and at a lower average yield of 23 percent compared to an average yield of 26 percent from the previous five-year bond issue in June 2012. Through the Finance Minister, government has committed itself to dedicate the extra finance in the amount of GH¢598 million to lengthen the average maturity of the domestic public debt rather than to finance a wider budget deficit.

Ghana's US$750 million Eurobond has been benefiting from these developments. In August 2012, the yield on the Eurobond fell by 13 basis points to 5.4 percent — the lowest rate since March 28, 2012. A Reuters report noted that yields on the bond fell steadily after the disbursement by the Fund in late-July into the easing of fears over the value of the cedi.

There has also been evidence pointing to a possible trend reversal in the fortunes of the cedi — from depreciation to appreciation — observable from about mid-August. The lessons for now and the future are clear. It is important that macroeconomic policy be tightened over the course of the remaining four months of this election year in order to save the succeeding years 2013 and 2014 from the austerity of the stabilization experiences of 2009 and 2010. Mild deviations from the fiscal targets in the context of tight monetary policy may be tolerable. Large accumulations of payment arrears or cash deficits in excess of one percentage point of non-oil GDP could be severely punished by the market and cause a return to depreciating trends.

What is needed is stronger coordination and greater complementarity between fiscal and monetary policies and strengthening information sharing and communication with the public. The Bank of Ghana and the Ministry of Finance and Economic Planning must work together to improve the functioning of the domestic bonds and foreign exchange markets. To reduce volatility and ensure convergence of exchange rates in the markets will require:

- restricting BoG interventions primarily to market with preference for OMO over FEMO and as much as possible eliminating multiple exchange rate practices;

- enhancing transparency and providing regular and frequent information with the view to bringing the general public — and not just the banks — into greater appreciation of macroeconomic policies;
- continued strengthening of the structures of oversight, particularly banking supervision and regulation, for stricter enforcement of rules and insisting on their compliance, while at the same time seeking greater cooperation from the commercial banks; and
- persisting with the rebuilding of the GIR back to the levels at end-2011 with import cover of at least three months.