AN ASSESSMENT OF THE ECF-SUPPORTED PROGRAM WITH THE FUND: FISCAL PERFORMANCE APRIL 2015 – APRIL 2016

1. Introduction

Ghana faces a looming financing crisis as a result of the way its medium-term debt strategy (MTDS) has been implemented since 2014. In the course of that year, the yield curve rose despite a US$1.0 billion Eurobond issuance. With headline inflation at 17 percent, real interest rates on short maturities reached about 8 percent at the close of the year. As yields rose, the government's focus shifted to cost minimization resulting in increasing refinancing risks despite the MTDS. The MTDS had the lengthening of the average maturity of the domestic debt stock as its primary objective. Nevertheless, several auctions of 3-year and 5-year notes were cancelled. In practice, the MTDS de facto became one of securing the government's financing needs at minimum cost.

With its focus on financial cost containment, the MTDS forced a shift in the debt portfolio composition towards the short end of the yield curve (Chart 3 below). This rebalancing towards short maturities to avoid locking in high rates into the medium term is a natural reaction of debt managers in the context of liquidity constraints and pressure to achieve overall fiscal targets. This shift, however, raised the general level of interest rates because capital is not mobile along the curve. The buyers in the long-end of the market – the non-resident investors - are mostly foreign institutional investors who are not allowed to participate in the short-term – originally 2-year or below, now one-year and below - government debt auctions.

The shortening of maturities also gave rise to liquidity and refinancing risks, which put upward pressure on risk premiums. Given Ghana's high debt level, the consequent rise in interest rates led to perceptions of unsustainable debt which further increased the risk premium. (World Bank Report No. 95284 – GH, June 2015, paragraph 21 page10) The high borrowing cost and the consequent high interest payments on the annual budget are the result of the way the MTDS pre-existing the stabilization program was implemented and not attributable to the increases in the MPR in the IT framework of the BoG.

Deepening the domestic debt market, however, is critical to enable the government to secure a stable source of financing without recourse to monetary financing and to implement its new and more comprehensive MTDS fully, thereby reducing debt and fiscal vulnerabilities (IMF Country Report No. 15/103, April 2015, Annex 1 paragraph 4 page 35).The credibility of the auction calendar needs to be reinforced..

To achieve the objective of lengthening the domestic debt maturities and reduce refinancing risk, secondary market trading is needed. Improved secondary market liquidity would minimize the risk of investor losses when selling the security for cash. It would broaden the universe of investor base willing to purchase longer-dated securities. Shortening maturities may reduce financial cost, but deviating from schedules reduces the credibility of the debt manager, and ultimately increases the cost of financing. Policy uncertainty is a major obstacle to issuing longer-term debt and reducing rollover risk. (ibid para 57 page 24)

The joint Debt Sustainability Analysis completed in March 2015 classified Ghana at high risk of external debt distress making Ghana not eligible for the guarantee the government had requested of the World Bank to support its borrowing in the Eurobond market. A waiver of some provisions in the bank's Development Policy Financing statutes had to be obtained from the Board of Executive Directors. Success of the complementary World Bank program and its partial guarantee in support of a Eurobond of up to US$1.0 billion itself is contingent on the successful implementation of the stabilization program. Consequently, the partial guarantee is a policy-based guarantee (PBG) – requiring the prior existence and successful implementation of the stabilization program. Without the stabilization program, there could be no support (including the PBG) from the World Band or for that matter from other development partners (DPs).

To somewhat paraphrase the World Bank: Supported by its US$150 million loan and its policy-based guarantee (PBG) for up to US$1.0 billion Eurobond, Ghana's net financing requirements will remain manageable, **so long as the stabilization program is successfully implemented** and the new medium-term debt management strategy (MTDS) is implemented. On the other hand, inadequate implementation would undermine policy credibility, forestall the expected decline in the interest rate and destabilize the exchange rate (World Bank Report No. 95284 – GH, June 2015, paragraph 92 page 35).

2. Performance over the Period

Both CEPA and the IMF have completed the first two reviews of the program. Neither, however, has completed the third. In its two completed reviews, the IMF concluded that the implementation of the program has been "broadly on track". For its part, CEPA identified financing shortfalls on both domestic and foreign debt markets. Net issuances of domestic securities during the first half of 2015 were dominated by 91-day and 182-day bills. The consequent shortening of the average maturity of the domestic debt stock represented a significant rollover risk for the government debt portfolio. "Domestic financing became more challenging during the second quarter when net issuance of securities turned negative…Tighter conditions on the domestic securities market posed financing risks for the budget." (IMF Country Report No. 15/245, September, 2015, paragraphs 8 and 11). Expenditure cutbacks/savings must have been how the financing shortfalls had been financed as implied in the IMF reviews. Non-accumulation of payment arrears is a continuous performance criterion in the program

An IMF staff study published in 2009 concluded that:

> *The growth of mandatory and similarly-protected spending commitments limits the space for fiscal manoeuvre. With a rising wage bill, an expansion of health care transfers in 2007, and the majority of capital spending (transfers to statutory funds) protected from annual budget review, the inflexible element of the annual budget has*

risen from 92 per cent of revenues and grants in 2006 to 107 per cent in 2009. (IMF Country Report No. 09/256, August 2009, paragraph 22, page 12)

Moreover, this was before the introduction of the single spine pay policy (SSPP) which has had such a ballooning impact on compensation of public employees,

In the light of this study and the impact of the implementation of the SSPP on compensation to public employees – cleaning up is still on-going - CEPA finds the apparent newly-found short-term ‘flexibility’ in the budget somewhat of a mystery.

Further deepening the mystery is the fact that despite the financing shortfalls in both domestic and foreign debt markets – the US$500 million Eurobond component of the net foreign financing (NFF) of the 2015 budget deficit was stood down:

- the continuous performance criterion of non-accumulation of domestic payment arrears was fully complied with;
- there was larger-than-programmed clearance of past arrears; and
- the wage bill (and therefore compensation to government employees) exceeded the budgetary provision.

In CEPA’s view the financing shortfalls are therefore more likely to have been financed by the use of the PBG-backed US$1.0 billion meant for purely liability swaps to finance the deficit together with accumulation of new payment arrears. All this hopefully will be clarified with required documentation requested by the IMF and the completion of the third review.

Accumulation of payments arrears has been routinely used as a financing option in Ghana. The Regional Economic Outlook for SSA (REO April, 2013) singled Ghana out and adjusted the end-December 2013 debt ratio upward by 5.0 percentage points to take account of the outstanding stock of securitized and un-securitized payment arrears. At the same time, the historical record shows that mounting payment arrears cannot be sustained in an election year.

According to local media reports, pressure is steadily mounting on the finance ministry, among others, to clear deferred payments to teachers and nurses, arrears to SOEs like the national disaster relief agency (NADMO), the legacy debt of SOEs in the energy and water sectors, as well as the unfunded subsidies and exchange rate under-recoveries of the bulk distribution companies (BDCs) in the petroleum sector. The affected institutions are finding it increasingly difficult to honor their financial obligations to suppliers and creditors including their bankers – threatening the stability of the financial system. The Governor of the BoG is reported to have directed banks to reduce their exposure to the energy sector on account of the financing difficulties of the SOEs in the sector. The third review mission of the IMF also drew attention to the important need to address the financing difficulties of the SOEs in the energy in its press release.

Statutory Funds receive a fixed share of certain budgetary revenue. The fiscal authority views these earmarked funds as a contributory factor to the increasing rigidity in the budget with limiting effects on policy manoeuvring. As stated in the Memorandum of Economic and Financial Policy (MEFP) in the program, these earmarked funds "minimize government discretion on the use of its revenue and also partly **leads to a build-up of payment arrears**" (emphasis added). A review of the administrative and legal framework of statutory funds was planned for June 2015 as part of the yet-to-be-completed review of the PFM legal framework "with the **goal of introducing some flexibilities and efficiencies in overall fiscal management** (as well as) new measures to enhance their transparency and accountability in the 2016 budget." (IMF Country Report No. 15/103 MEFP paragraph 67, page 62)

The established schedule for transfers to statutory funds (IMF Country Report No. 15/103, April 2015, Technical Memorandum of Understanding paragraph11, page 77) is as follows:

- District Assemblies Common Fund – quarterly, with a one-quarter lag;
- SSNIT – monthly with a one month lag
- National Health Fund – monthly with a one month lag;
- Ghana Education Trust Fund – monthly with one month lag.
- Road Fund – monthly with a one month lag; and
- Petroleum-related Fund – monthly with a one month lag.

Payment arrears to statutory funds are any delays beyond the established time lag of one quarter. The finance ministry issued a press statement "Payments to Statutory Funds" on January 13, 2016. The statement claimed that the ministry had as of December 31, 2015 cleared all payments due to statutory funds including payments to the second-tier pension fund, the National Pension Regulatory Authority (NPRA) for the fiscal year 2015 in line with Government Public Expenditure Management and Arrears Clearance Program in the 2015 Budget Statement and Economic Policy. The statement emphasized that with the payments reportedly made, "no new arrears have been created in the fiscal year 2015." It continued: "The Ministry is thus on track to make good the planned payment schedule in 2016 and to clear the remaining arrears in 2017."

The important relevant point of note here is the implicit **acknowledgement that these payments to Statutory Funds had been delayed at best, until very late in the year** and therefore the **continuous performance criterion** on non- accumulation of arrears had been tripped. Statutory Funds were identified among CEPA's 'usual suspects' for arrears accumulation in its two completed reviews. The total stock of outstanding arrears is estimated at about GHc6.2 billion at end-2014. **The bulk of these arrears are concentrated in the SOEs and the statutory funds** (IMF Country Report No. 15/103 Debt Sustainability Analysis (DSA) March 2015 para.15 page 6).

The other usual suspects CEPA identified are the following:

- Compensation of government employees comprising wages and salaries, pensions, gratuities and transfers to SSNIT and second tier pension funds,
- Purchase of goods and services,
- Transfers to GNPC, and
- Domestic-financed (non-statutory) capital expenditure.

Payment arrears in respect of compensation of government employees (consisting of wages and salaries, pensions, gratuities, and social security arrears), is defined in the program as payments outstanding after the agreed date for payment to staff or the social security/pension funds.

MDAs' expenditure arrears (road and other MDAs expenditure such as on purchases of goods and services arrears), is defined as approved invoices (on the GIFMIS system) that remain unpaid three months after the quarter in which the invoices were approved by the MDA. This covers purchases of goods and services.

The goods and services in the budget are complementary inputs to labour for public service delivery. They are particularly important in the health and education sectors. A report from the public accounts committee (PAC) of Parliament says that not only was the national disaster relief agency (NADMO) under-stocked at the approach to the rainy season, it had been dragged to court by suppliers for unpaid previous supplies.

Finally arrears to SOEs, is defined as payments for debt owed to SOEs that are due and not settled within 30 days after the end of the quarter (see IMF Country Report 15/103, April 2015, paragraph 11, page 77). The legacy debt and current financing difficulties of ECG, GRIDCO and the VRA in the energy sector all show continued accumulation of arrears on account of unfunded subsidies. The VRA is indebted to N-Gas, its Nigerian gas suppliers leading to a cut-off in supply. At home its indebtedness to the Ghana Gas Company is reportedly making the latter unable to service the Chinese loan for its capital works.

Transfers to GNPC are essentially reimbursements for its share of operational costs of production at the Jubilee oilfield as the stand-in for Ghana. The GNPC is allowed to borrow in international capital markets with government guarantee. Therefore cutbacks in transfers to GNPC which will mean an inability to honour its obligations to the Jubilee partners would be financed with loans. The cutback thus results in proxy borrowing by government.

According to the 2015 Annual Report of the PIAC published in B&FT of June 29, 2016:

- Ministry of Finance owes GNPC US$75 million - special advance in 2014 for the Western Corridor Roads Project;
- TOR also owes GNPC US$52.35 million - outstanding balance on fuel supplied to TOR; and
- BOST is also named as a minor debtor to GNPC.

The PIAC has therefore appealed to Parliament "to ensure that the practice whereby GNPC is requested to release part of its allocations from petroleum receipts to government…. is discontinued." They end up being refinanced by the GNPC with government-guaranteed loans. The Debt Sustainability Analysis (DSA) conducted jointly by the IMF and the World Bank incorporates debt of SOEs like the GNPC into the public debt. In CEPA's view for clarity and simplicity, this must be the only definition of the public debt.

Domestically financed capital includes spending by the Road Fund. According to the official provisional outturn this was cut by half. This was in spite of a reported unutilised balance of US$ 250 million from the US$1.0 billion 2014 Eurobond. Moreover, domestically financed development projects are typically multi-year in implementation. According to the definition of arrears above, a 'cutback' in provision is typically delayed payment to road contractors, classifiable as payment arrears. These have often resulted in uncompleted/abandoned projects scattered all over the country. CEPA finds it difficult to reconcile the large cutback in domestically financed capital expenditure – presumably on account of the prescription for reduction in ABFA-funded expenditures to deal with the original large loss of oil revenue – and the negative impact on economic activity of the infrastructure deficit in the context of "relatively large government cash resources available at end-2015" (carried over from the 2014 Eurobond proceeds).

CEPA is unable to complete its third review and determine the size of the 2015 budget deficit. Not surprisingly and perhaps for similar reasons of data inconsistences that call for reconciliation, the IMF mission concluded its mission but <u>not yet the third review</u>. That must await the implementation of important but much delayed structural reforms – the Public Financial Management (PFM) law and the new BoG law – as well as further documentation of information.

3. Volatility in oil revenues and the fiscal deficit

The impact of oil revenue volatility on fiscal outcomes is recognized in the program. Adjustors to the Program Targets allow for adjustments to be made to the ceilings on the fiscal deficits for 2015, 2016 and 2017, for excesses and shortfalls in oil revenue. Specifically, the fiscal deficit will be adjusted downward (upward) by 50 per cent of any excess (shortfall) in oil revenue.

The benchmark oil price in the 2015 budget/program was US$99.4 per barrel. IMF staff projections in the World Economic Outlook (WEO April 2015) indicated an average oil price of US$52.8 per barrel. With unchanged production volume, this implied an oil revenue shortfall equivalent to about 2 percentage points of GDP. Therefore in line with the adjustors, the deficit ceiling of 6.5 per cent of GDP for 2015 had to be adjusted upward by 1 percentage points of GDP to 7.5 per cent of GDP. Moreover, given the importance attached in the program to stabilizing the debt ratio, additional measures needed to be adopted in order to ensure that the total debt accumulation – net incurrence of liability - remained in line with the level approved in the budget. This took the form of net drawdown from, as compared to the original net transfers into, the Stabilization Fund – amounting to about 0.8 percentage points of GDP. This is in line with the provisions in the Petroleum Revenue Management Act (PRMA).

Prescriptions were given for provisions in the budget for expenditures funded from the Annual Budget Funding Account (ABFA) to be reduced by the equivalent of the required 1.2 percentage points of GDP – a prior action.

The prescribed reductions in ABFA-funded expenditures were as follows:

- Purchases of goods and services by the equivalent of 0.3 percentage points of GDP;
- Domestically financed capital expenditure by the equivalent of 0.7 percentage points of GDP; and
- Transfer to GNPC by the equivalent of 0.2 percentage points of GDP.

The prescribed cutbacks in some ABFA-funded expenditures amounting to 1.2 percent of GDP and net drawdown of 0.8 percent of GDP made up for the projected oil revenue loss of 2.0 percent of GDP.

Subsequent developments in oil prices in international markets led to an upward revision of the benchmark oil price to US$58 per barrel in the Supplementary Budget. With unchanged production volume, this raised the projected oil revenue by the equivalent of 0.4 percent of GDP. Government proposed in the Supplementary Budget.

Continued volatility in oil prices in the rest of the year resulted in a lower realized average price of about US$53 per barrel for 2015. Furthermore, the planned production target could not be achieved on account of unexpected technical problems in operations on the Jubilee oilfield. In spite of the resultant oil revenue loss, higher- than-programmed clearance of arrears and higher compensation for government employees, however, the official provisional outturn for 2015 on the website of the finance ministry is a cash deficit of 7.1 percent of GDP. After technical corrections for a higher than projected nominal GDP – mainly as a result of inflation - the third review mission of the IMF in its press release, put the outturn at 6.7 per cent of GDP (with no accumulation of new payment arrears and larger clearance of existing arrears than had been programmed).

The Press Release of the IMF third review mission reports:

> *"The overall cash deficit improving from the original 9.4 percent to 10.2 percent and finally 10.6 per cent of GDP in 2014 to 6.7 per cent of GDP in 2015. (Moreover,)…on commitment basis, the adjustment was stronger still reflecting larger-than-programmed repayments of arrears."*

There are, however, serious problems of inconsistencies and of credibility with official fiscal data. The 2014 accounts appear not to have been properly closed. As a result, the deficit has been revised first from 9.4 percent of GDP to 10.2 percent of GDP and finally to the 10.6 percent of GDP in the press release cited above. The two reviews completed by the IMF were both delayed presumably on account of late submission of data. Six months into the following year, the accounts for 2015 are yet to be closed and the commitment to put information regularly and on schedule – six weeks after the month - on the finance ministry's website has been honoured more in the breach. Media reports including from the Public Accounts Committee of Parliament are full of instances of payment arrears to suppliers, unfunded subsidies to SOEs in the energy and water sectors, and to the BDCs in the petroleum sector as well as deferred compensation to government employees like teachers and nurses even as an overrun is reported for the wage bill.

The last Public Expenditure and Financial Accountability (PEFA) assessment completed in 2012 and supported by work done at the Fiscal Affairs Department of the IMF in 2014, highlight weaknesses in aggregate fiscal discipline. It revealed that there are significant gaps in terms of **credibility, predictability, and control in budget execution** that needed to be addressed. Follow-up reforms implemented for addressing public financial management (PFM) outcomes have only had uneven successes. The structural benchmark for PFM reform (December 2015) is yet to be complied with and has become a key requirement for the completion of the third review by the IMF.

The 2015 revised program deficit of 7.5 percent of GDP was planned to be financed largely from domestic sources. Recognising the difficulties in mobilizing the required financing on the domestic bond market – largely on account of the financing cost minimization objective - Fund staff took the position that the financing mix for the second half of 2015 be more externally oriented. "While the authorities (with PBG-backed Eurobond of the World Bank) would have preferred to use some of the proceeds of the Eurobond to buy back part of the Eurobond maturing in 2017 for external debt management purposes, staff advised not to buyback… at this stage given the currently tight domestic liquidity conditions and **use all the proceeds to reduce domestic financing pressures and rebuild international reserves."** (IMF Country Report No. 15/245, September 2015, paragraph. 14, page 13; emphasis added) The stated objective of the PBG, however, was to refinance or redeem part of the past expensive debt and not for financing the deficit which would result in increasing the debt stock. There is no indication that the World Bank granted any such waiver. The finance minister is reported in the local media to have said that no such waiver has been asked for or given.

Information on the finance ministry website has a section: "Refinancing Ghana's 2017 Eurobond Maturity" in which a balance of US$ 257 million of the PBG Eurobond proceeds has been earmarked for use to retire a part of the 2017 Eurobond due to mature in October 2017. There is also information on the same website showing that the entire PBG-backed Eurobond proceeds were used for financing the 2015 cash deficit. At the same time the planned US$500 million Eurobond for financing the 2015 budget deficit was apparently stood down. Some clarification is needed here.

Turning attention to 2016, the MOU agreed between the fiscal and monetary authorities (prior action) left no room for monetary financing of the deficit in 2016. Moreover, as noted above, the program has the non-accumulation of new arrears as a continuous performance criterion. **Consequently, faced with an external financing shortfall, the program stipulates increased domestic borrowing and expenditure cutbacks**.

A Reuters report of April 2016 had speculated that Ghana "could try to come at a very high yield but that would potentially do more damage than good... 11 per cent or 12 per cent is not … the right signal you want to send to the market". There have been some reductions in traded yields on Ghanaian bonds in the Eurobond market and importantly, spreads with peers have reduced, but the yields still remain high (Chart 1 below).

The inevitable spikes in lending rates would no doubt be seen as further crowding out the private sector in domestic credit markets. The international evidence, however, suggests that private investment in developing countries depends more on factors such as access to bank credit, foreign exchange availability, and the level of public investment in infrastructure – for example, efficient supply of electricity. Cost of capital variables usually enter investment equations with the correct sign but are typically not statistically significant. Thus, interest rates may influence private investment only indirectly, through their effect on the real return on financial assets and thus on the volume of financial saving. (Agenor, Pierre-Richard and Peter J. Montiel Development Macroeconomics Princeton University Press_1996 page102). Monetary policy is and must continue to remain tight even if that would raise further the already high private sector borrowing costs. It is needed to preserve macroeconomic stability, notwithstanding the adverse effect on private sector activity growth and job creation in the short-term (REO April 2016 page 13). In a private sector-led economy, macroeconomic stability is a necessary though not sufficient condition for sustainable inclusive economic growth.

The latest IMF Regional Economic Outlook for Sub-Saharan Africa notes that most recent data highlights the fact that direct financing from the central bank has increased in many SSA countries on account of the current financing difficulties:

- In the Economic and Monetary Community of Central Africa (CEMAC) limits on the statutory advances to the government were increased in August 2015 – representing increases in individual country limits of up to 1.25 percent of 2015 GDP. Nonetheless most of the union's countries have already reached their new limits;
- Direct financing by the central bank to the government has also increased in other countries (Tanzania, Guinea, Sierra Leone, and Ethiopia). In the Gambia, overdue advances have been securitized into long-term loans but remain on the central bank's balance sheet;
- In some other cases, the provision of financing by the central bank to the banking system facilitated the placement of new government debt;
- In the West African Economic and Monetary Union (WAEMU), the positive spread between the Central Bank of West African States' (BECEAO) key refinancing rate and rates on treasury bills and bonds has increased banks' incentives to borrow from the central bank to invest in public debt; and the CEMAC's regional central bank injected funds into the regional development bank in January to support its role in financing regional public and private projects ***blurring the line between the traditional role of a central bank and development financing***.

The IMF is not in favour of these **i**nnovative and creative ways of central bank financing of budget deficits. Indeed, and unsurprisingly, the REO insists that central banks should limit the use of advances to governments for the mitigation of short-term financing constraints and avoid easing commercial banks' liquidity constraints with a view to facilitating lending to the government.

The REO notes that the external environment is likely to remain unfavourable into the medium-term. Mobilizing sufficient financing may become even more challenging. In the circumstances, one way or another, adjustment will take place. The only real choice is between orderly and disorderly adjustment. And by far to lay the ground work for a quicker durable and inclusive economic recovery lies in an orderly adjustment process. And in CEPA's view an orderly adjustment process calls for **national ownership** of the stabilization program.

National ownership of the adjustment program is critical to successful implementation. Commenting on Ghana's Economic Recovery Program (ERP), Stanley Fischer Vice President, Development Economics and Chief Economist. The World Bank (1988-91) stressed the critical importance of ownership of adjustment programs for successful implementation:

> *With respect to the mutual problems between the countries receiving adjustment loans and the World Bank, the crucial issue is "ownership" of the adjustment program. For some countries, ownership is virtually all that is needed. If a country "owns" a program and has the administrative capability necessary to design and implement it, we at the World Bank do not have to do very much. We can discuss the program with the country and see it get under way, but then we should relax. (Thomas, Vinod et al eds. World Bank Restructuring Economies in Distress page 527)*

The program recognizes the importance of preserving social gains and poverty alleviation. National poverty rates have fallen steadily over time although poverty incidence has remained concentrated in rural areas. In other words prosperity has not been equitably shared as inequality has persisted. Ghana's Gini coefficient rose slightly from 41.9 in 2005/6 to 42.3 in 2012/13. The increase is confirmed by other measures of inequality which show that Ghanaians have not benefitted equally from the robust growth in the oil era. Real incomes of the poor have also been eroded especially by food inflation in recent times

Safeguarding these social objectives by avoiding a disorderly adjustment requires that the impact of the austerity measures – taxes as well as expenditure retrenchment - on society is properly analysed by policymakers and explained to the general public to elicit support. Policymaking involves trade-offs. There are winners and losers with every change in policy. Optimality of a changed policy can be gauged by whether winners can compensate losers or not. With national ownership of the adjustment process and the support of the general public behind the program, the needed redistribution can be more easily effected to maintain the support of key stakeholders for the program.

Chart 1 shows yields on the 10-year Ghana 2023, and spreads against comparable 10-year bonds in the Eurobond market for a selected peer group - Ivory Coast, Kenya, Nigeria, Rwanda and Senegal – thus far this year. Chart 2 provides similar information against Kenya. The charts show a group effect of falling yields in the market with Ghanaian yields trending down more steeply, implying a narrowing of spreads against the peer group. This represents increasingly more favorable investor confidence towards Ghana. Thus yields on the Ghana 2023 have fallen from a peak of 16.34 percent on January 18, 2016 to 10.82 percent on July 6, 2016. A linear fit for the spreads yields the following results: The spread against peers **declined** at a rate of 0.0210 percent per trading day. A similar exercise against Kenya showed the spread **declining** at a rate of .0213 percent per trading day.

Reuters quoted finance minister Seth Terkper: Ghana's prospects are very bright, we had a non-deal roadshow and we are waiting for a more favorable window. The yield of 10.82 percent is considered still too high – at that level the market is regarded as effectively closed to Ghana. The favorable trends, however, suggest Ghana may as yet have that window of opportunity, perhaps by September. Completion of the third review by the IMF may very well hold the key.

Developments on the domestic debt market paint a less rosy picture. The new MTDS has been implemented much the same way as its predecessor. Short-term maturities of one year or less continue to dominate. Thus data for the first half of 2016 show a rising share of the one year-or-less securities in auctions over the period from December 2015 value of 62.1 percent to 86.8 percent in June 2016 (Chart 3 below). The required deepening of the domestic debt market to develop a reliable source of financing the deficit without recourse to monetary accommodation is reportedly on-going with technical assistance from the IMF. The process, however, appears slow. A World Bank conditionality is the reduction of the share of the one year and less maturities from the December 2014 level of 55.43 percent to 40.00 percent for December 2017. On current trends, this is unlikely to be achieved.

The manner of implementation of the MTDS has not only contributed to delay in deepening the domestic debt market. In leading to the rebalancing towards short-term maturities it reduced participation of non-residents who are allowed to invest only in longer-dated maturities – until recently three-year or more maturities, currently the two-year securities have been included.

Charts 4, 5, and 6 depict the impact of the MTDS on developments in the domestic debt market over the first half of 2016.

Chart 4 of ratios of tendered/target shows that the number of undersubscribed auctions - ratios of less than one – exceeded the over-subscribed. This shows not only the delay in deepening the domestic debt market, but the frustrations of investors, especially the non-residents with the way the market has been managed – now managed by the fiscal authority with the BoG only as agent.

Chart 5 of ratios of accepted/target shows in the majority of auctions accepted bids were lower than the targets. This shows the tendency for the fiscal authority, the manager of the debt market, to use reserve – non-market clearing - prices to close auctions. Selling securities in amounts short of targets, however, results in financing gaps. The result is the financing shortfall in the domestic debt market.

Chart 6 of ratios of accepted/tendered shows that the MTDS has become one of ‘take all’ to meet financing needs. Given the preponderance of under-subscribed auctions there is little choice but to accept all on offer to minimize financing shortfalls

The market remains shallow as deepening process is still on going with technical assistance from the IMF. So failure to raise the US$750 million on the Eurobond market would mean a turn to the domestic debt market for the cedi equivalent i.e. GHc3.0 billion. Interest yields are most likely to skyrocket with no clear assurance of achieving the target. The delay in enacting the new BoG law aimed at the elimination of the persistent fiscal dominance of monetary policy therefore sends out negative signals about the intentions of the government as to how the looming financing crisis might be dealt with. Mandatory and similarly protected expenditures are estimated to amount to more than total revenue and grants – implying a substantial deficit before note is taken of discretionary spending. Meanwhile, non-accumulation of payment arrears is a continuous performance criterion in the program. Ghana could therefore be tempted to resort to monetary accommodation in present circumstances.

Appendix

Chart 1: Spread of Ghana's Eurobond from Comparators

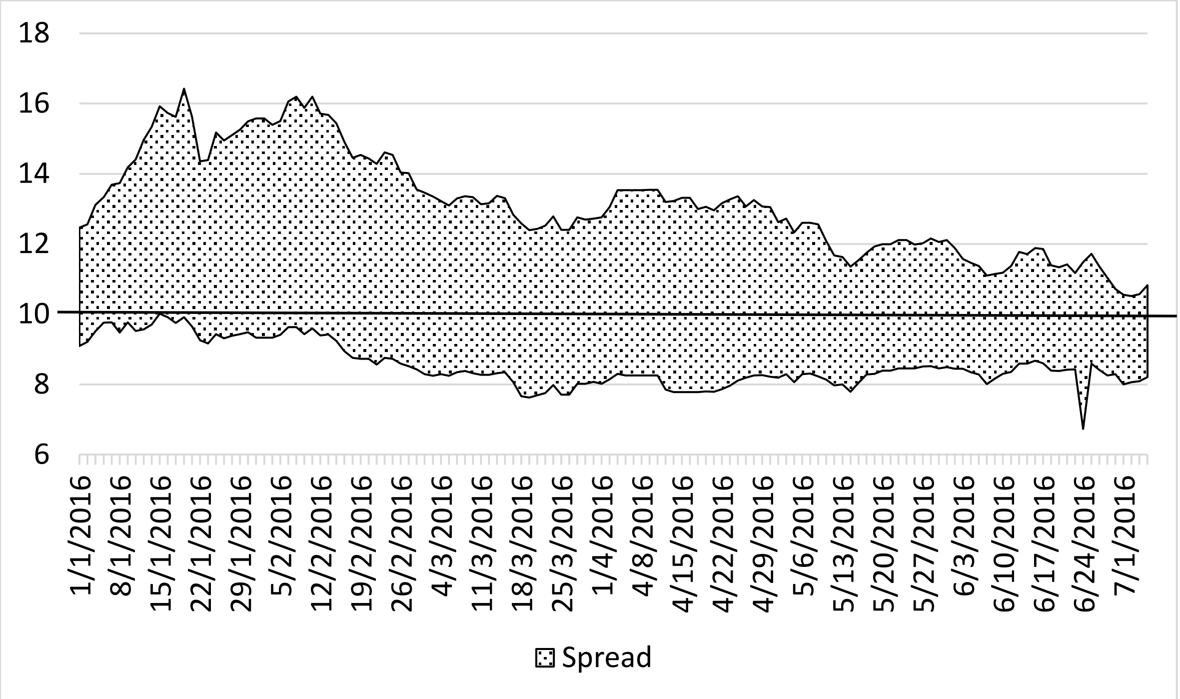


Chart 2: Spread of Ghana's Eurobond from Kenya

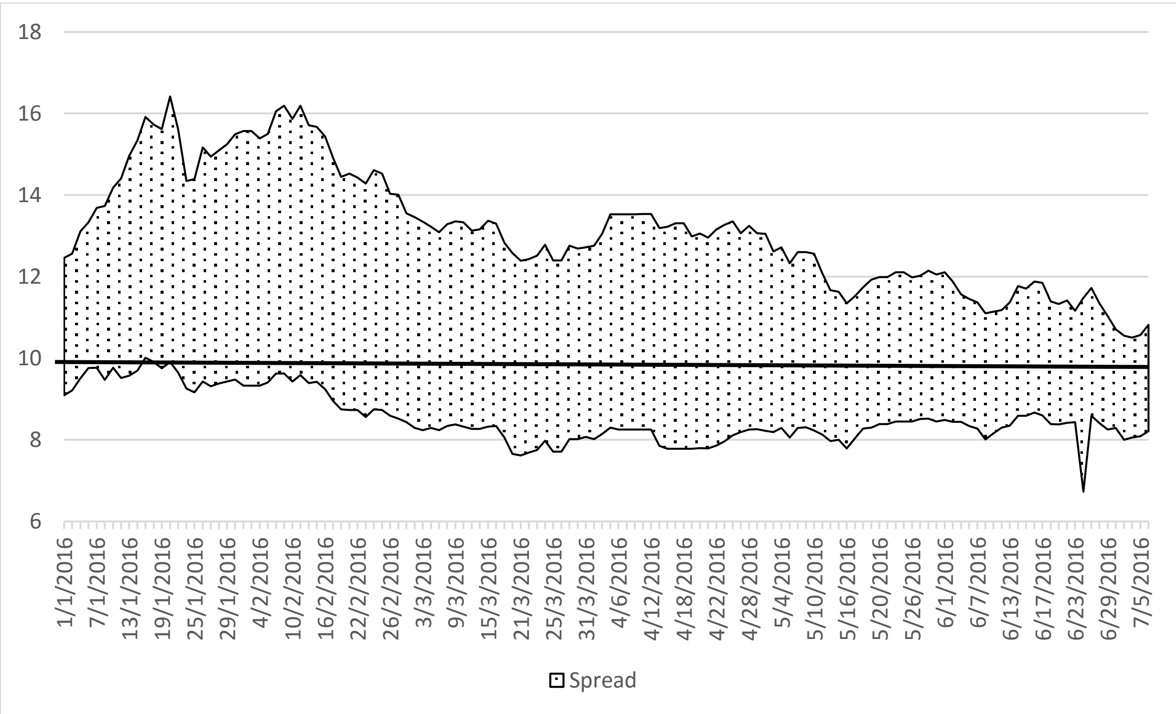
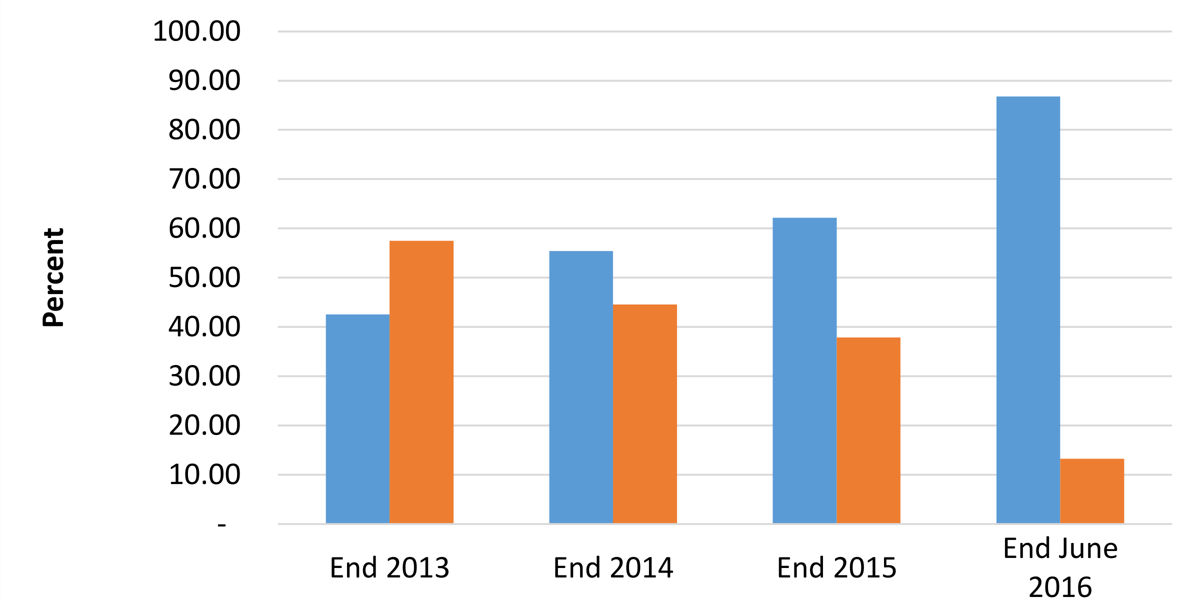


Chart 3: Composition of domestic Securities



	End 2013	End 2014	End 2015	End June 2016
Short-term	42.53	55.43	62.14	86.79
Medium- term	57.47	44.57	37.86	13.21

Chart 4: Ratio of treasury bills and bonds tendered to target

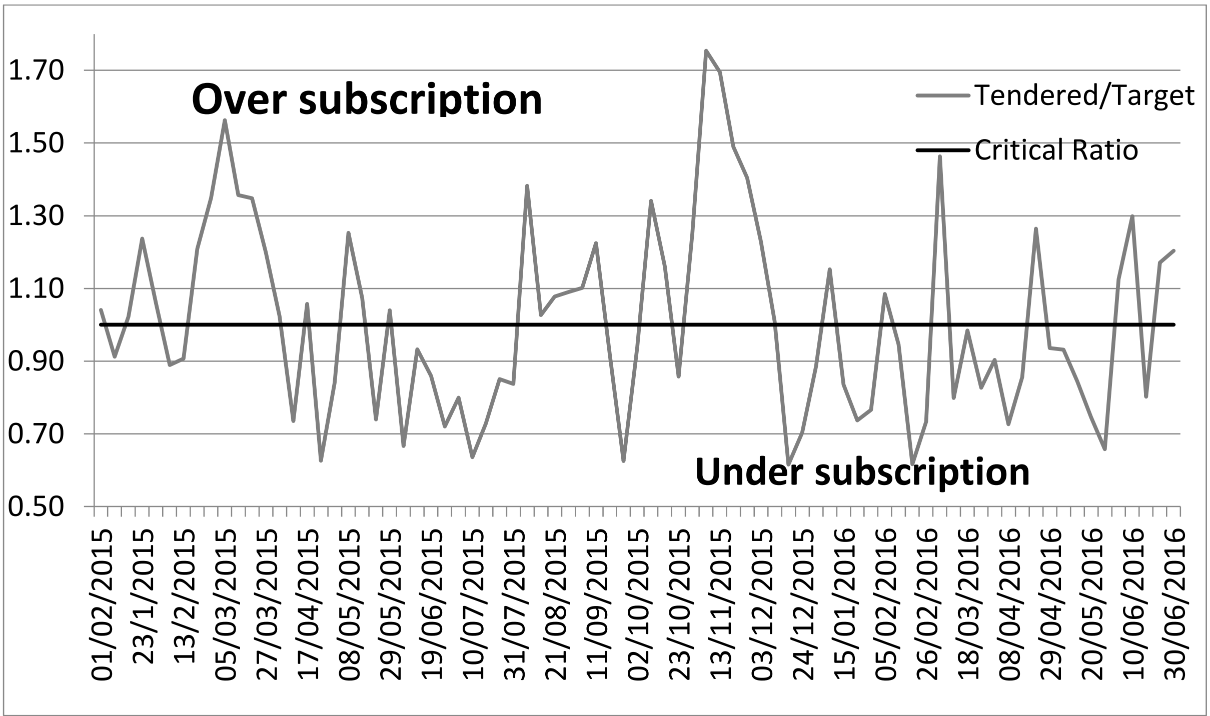


Chart 5: Ratio of treasury bills and bonds accepted to target

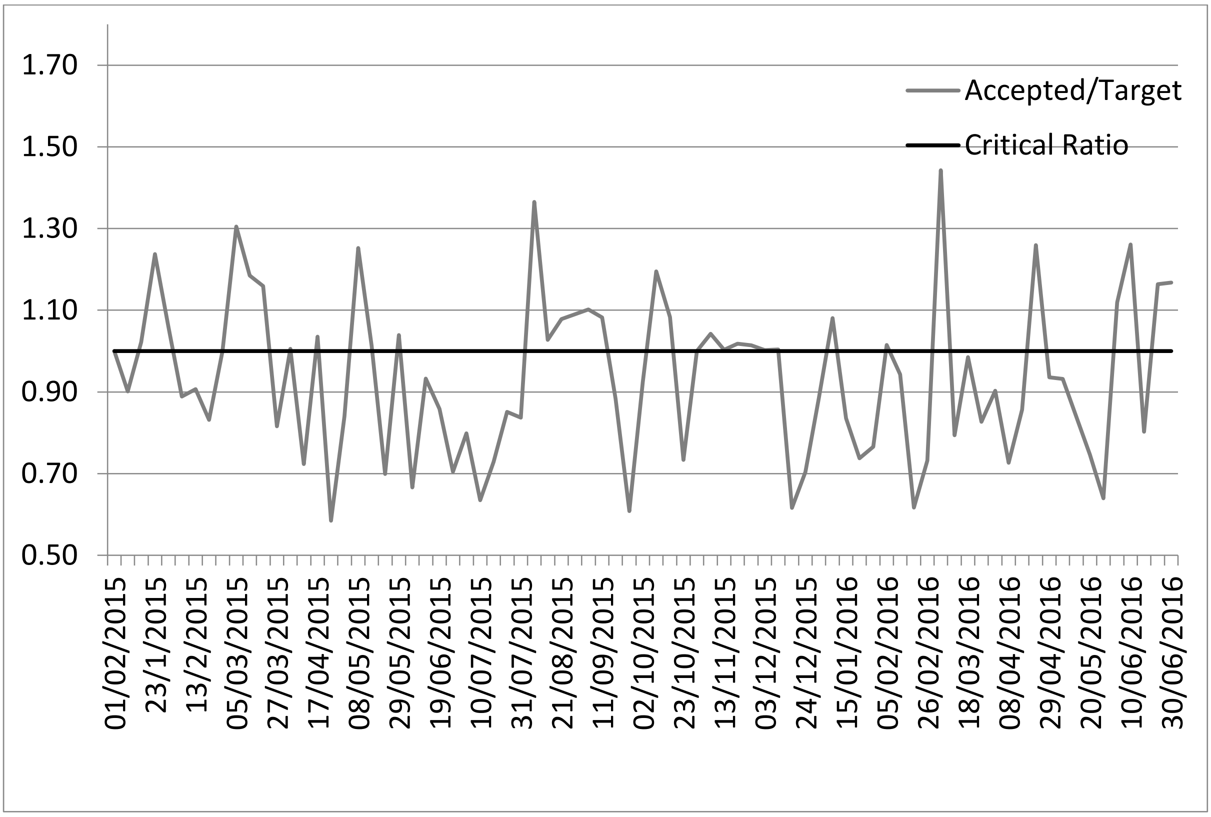
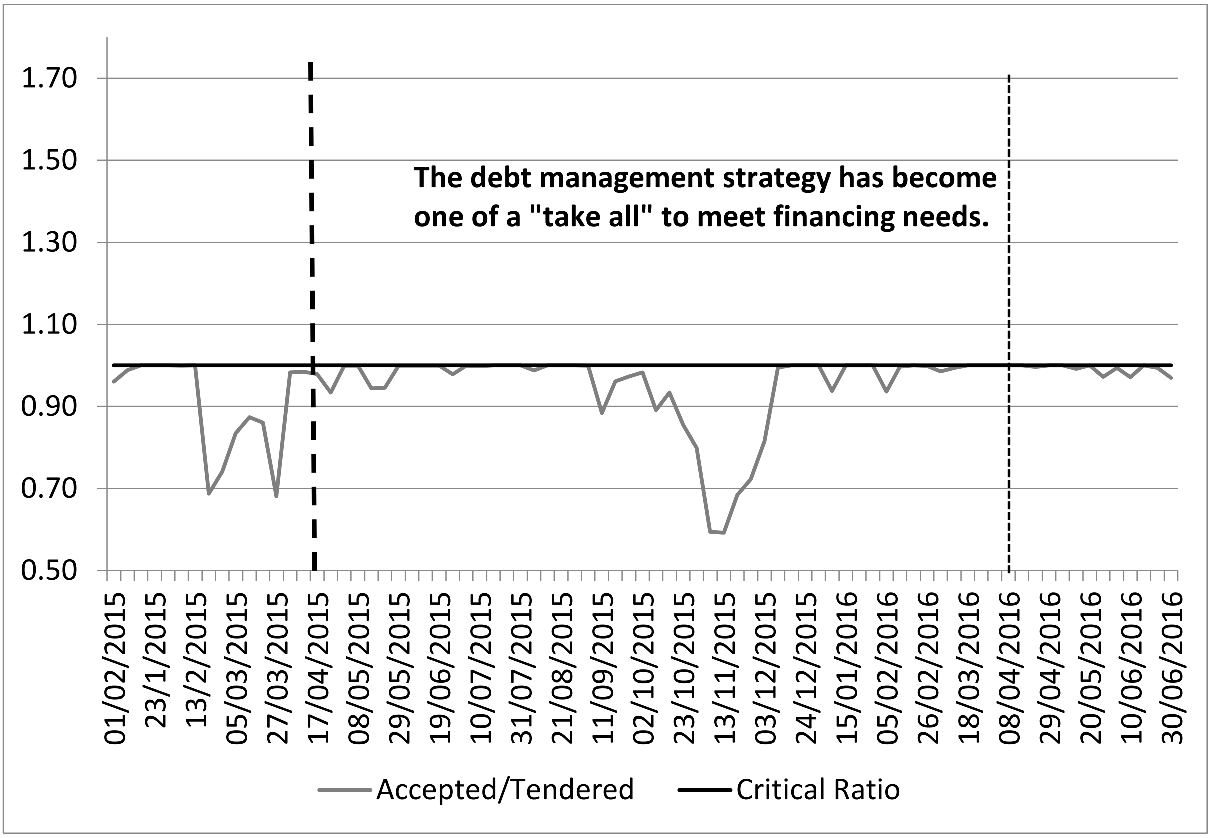


Table 6: Ratio of treasury bills and bonds accepted to tendered



Media Reports on Arrears Accumulation

The Press Release of the third review mission of the IMF referred to the development of a strategy by the gov’t “to address the difficult financial situation of the state-owned enterprises (SOEs) in the energy sector (largely on account of payment arrears to ECG, VRA and GRIDCO). This strategy will be critical to **avoid additional fiscal pressures and possible spillovers on to the banking system, (through non-performing loans reported by B&FT 27/6/2016 at a six-year high of 16.2 percent) as well as to sustain the improvement in electricity delivery achieved recently”** (emphasis added). The difficult financial situation of the SOEs in the energy sector – ECG, VRA and GRIDCO is largely the result of unfunded subsidies in the sector. A Ghanaian Times report of June 24, 2016 “WAPCO stops gas supply to Ghana” stated that on June 22, 2016 the West African Gas Pipeline Company WAPCO said it had suspended the flow of gas from Nigeria to Ghana over unpaid bills by the Ghana government. The VRA “owes Nigeria’s N-Gas around US$180 million, while N-Gas in turn owes the WAPCO US$104 million citing a WAPCO spokeswoman. Only a small portion of Ghana’s energy needs are supplied through WAPCO, but the suspension is exacerbating the power supply problems given the low water levels at the main hydroelectric power plants. The Press Release of the IMF third review mission cited above underlined the importance of addressing the financial situation SOEs like the VRA “to sustain the improvement in electricity delivery achieved recently.”

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There are similar problems of payment arrears at another SOE - the water company (GWCL).

Report from Bloomberg regarding these huge payments arrears is that Ghana will sell US$$2 billion in bonds by the end of the year to clear the debt of four state utilities. The debt will be financed through the 10 percent tax on electricity tariffs and the surcharge on petroleum products. The bond proceeds are expected to clear $1.5 billion of debt the VRA, GRIDCO and the ECG. Part of the balance of US$500 million will be used to clear the debt of the GWCL.

The terms of the proposed 10-year loan are expected to be agreed end-June. Public complaints persist about the hikes in utility tariffs and the taxes that have been levied on them. But reductions or elimination of these could also raise questions as to the servicing of the debt.

The bulk oil distributing companies (BDCs) in the petroleum sector, mostly private sector enterprises in the petroleum sector are faced with the same problem of payment arrears for foreign exchange losses and price recoveries' the international auditing firm, Ernst & Young has been commissioned to audit the claims – presumably the reason for these payment arrears.

The position of the government is that the claims of BDCs on account of under recoveries are being audited by international auditing firm, Ernst and Young. A provision of GHc800m expected to be made in the 2016 budget for partial clearance on completion of the audit. The problem with this is whether this would suffice for banks to resume normal relations with their client BDCs since failure to do so could mean shortages of petroleum products in the course of the year. The backlog of payment of arrears to the BDCs makes it difficult for them to service their debt to banks. This is seen as a contributory factor to rising ratio of non-performing loans (NPLs) in the banking sector – a potential threat to financial stability.

The CEO of the National Petroleum Authority (NPA) the regulatory body in the sector has announced government intention to issue a US$500 million bond to settle these arrears. There is an alternative issuance in about the same amount by the BDCs but serviced by government also under consideration.

The payments arrears to these service providers, in turn, create arrears on their part to their banks as well as to their suppliers and other creditors. According to the Ghana Gas Company the outstanding stock of receivables from the VRA is up to the tune of US$ 103.63 million. A claim of about US$180 million is being made by N-gas, the Nigerian supplier of gas and which has resulted in a cut-off of supply from the West African Pipeline Company (WAPCO). The VRA, in turn, explains that it is saddled with debts because to start with, the PURC - the regulatory body in the sector – persistently sets tariffs at lower than full cost recovery levels which results in unfunded subsidies on the books of ECG, the main off-taker. Moreover, government and its agencies were indebted to the Electricity Company of Ghana (ECG) making it difficult for the ECG to pay fully its power purchases from VRA. The VRA is therefore unable to clear its debts to its bankers and its creditor gas suppliers in both Ghana and Nigeria (Daily Graphic 28th April, page 42; "Huge Debt Sophisticates VRA").

The emergency relief agency (NADMO) told the Public Accounts Committee (PAC) of Parliament that it is not only low on relief items even as we approach the heavy rains season, it has been dragged to court by suppliers and service providers. The Ghana School Feeding Program (GSFP) is in payment arrears to its 5,000 caterers across the country. A Daily Graphic report of June 24, 2016 stated that as at that date, "the GSFP was yet to pay the feeding fees of outstanding 40 days of the second term of the 2015/16 academic year and about 30 days of the third term of the academic year." Some GHc28 million released by government the day before was "to settle part of the indebtedness" to the caterers.

Media publications paint a disturbing picture of a creeping return to the infamous 'cash and carry' as health service providers turn away holders of National Health Fund (NHF) cardholders. They complain of frequent long delays in getting reimbursement from the NHF. The Nsawam General Hospital – a government hospital – has reportedly requested the authorities not to send inmates of the Nsawan medium-term prison – all presumably NHF cardholders – for treatment at the hospital (IMF Country Report No. 15/103 Technical Memorandum of Understanding para.11 page 77 defines domestic payment arrears that CEPA uses).