Tuesday, February 18, 2014

Cedi measures cost dearly

The Bank of Ghana's (BoG) big interest-rate hike to shore-up the cedi is taking its toll on government, with domestic borrowing costs -- measured by Treasury and bond yields -- surging in a manner reminiscent of two years ago.

When the BoG's Monetary Policy Committee (MPC) met on February 5-6, its principal immediate concern was to staunch an alarming decline in the cedi. Thus the MPC, for the first time in 10 months, raised its market-signalling policy rate by two percentage points to 18 percent, citing the need to make local-currency investment assets more attractive compared to the dollar.

The central bank followed by offering enhanced yields on short-term debt sold on February 7 and 14, as well the three-year bond issued on February 13.

The yield on 91-day debt, which banks use to benchmark their own lending rates, jumped to 20.8 percent on Friday, its highest level since September 30. The 182-day yield also hit 20.3 percent, the highest since October 21, while the cost of borrowing for three years soared from 19.2 percent in May 2013 to 23 percent at the latest auction on Thursday.

The implication of these numbers is that government is borrowing more expensively and running up extra interest bills that will add pressure to a budget already constrained by wages and earmarked revenues.

In 2012, when the BoG took similar action to boost confidence in the cedi, government's short-term borrowing costs doubled within a year and the budget for domestic interest payments was overrun by 35 percent. There are fears the fallout will be no different this time.

"If we're not careful, debt service is very soon going to displace the wage bill as the single biggest item of expenditure," warned Dr. Joe Abbey, Executive Director of the Centre for Policy Analysis (CEPA) in Accra.

The rise in interest rates also raises the spectre of more non-performing loans in the banking sector, and could further slow already lacklustre growth in the real economy, he said. He also believes economic growth possibly slid to a four-year low in 2013, with his think-tank estimating a 4.8 percent expansion compared to the government's 7.2 percent projection.

"When the interest burden goes up, there's a consequence for the government, private borrowers and the real sector. Government of course cannot default, but private sector borrowers may be forced to do so. We also know that next to power, high real interest rates are the biggest factor retarding businesses."

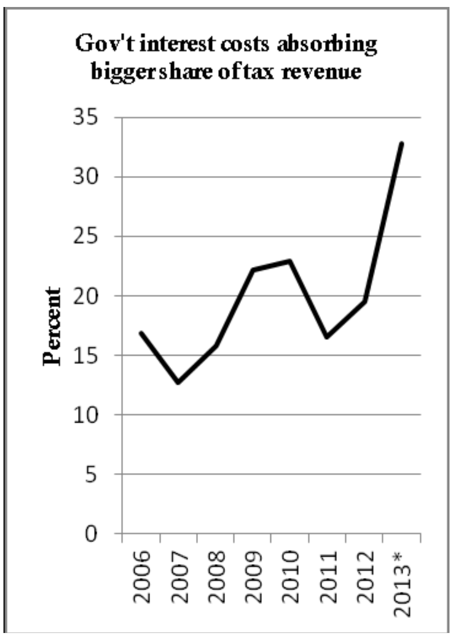
If higher interest rates depress business activity, tax revenue could take a hit, said Philip Walker, an analyst at the London-based Economist Intelligence Unit (EIU).

That would put fiscal consolidation at risk in a time when it has become the most important priority of government. Seth Terkper, the Finance Minister, is aiming to trim the deficit to 8.5 percent of GDP this year, after overshooting a 9 percent target in 2013.

The worst that could occur is that in spite of the costly intervention by the central bank, the cedi depreciates further -- which is what analysts at Barclays, Fitch Ratings and the EIU have predicted, blaming the absence of supportive fiscal policy to ensure effectiveness of the BoG's measures.

According to Fitch, which downgraded Ghana from B+ to B in October, "the decision to increase interest rates and introduce new foreign exchange controls is unlikely to ease pressure on the cedi, in the absence of accelerated fiscal consolidation to address growing domestic macro-economic imbalances".

The evidence of what transpired two years ago however suggests that -- at least in the short-term -- lucrative cedi yields, despite their demerits, improve the currency's fortunes and help the BoG to stabilise prices -- which, as its Governor Henry Kofi Wampah stressed on February 6, is what the central bank is set up to do.



Source: Ministry of Finance *Jan-Sep

Source: B&FT