Economics

Ghana: Annual economic outlook

The eve of oil production

Standard Bank

April 2010

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Projections for 2010:

- Real GDP growth to increase to 5.8%
- Average annual inflation to slow to 11.9%
- The exchange rate is expected to average GHC1.42/USD
- Current account deficit to widen to 16.1% of GDP
- Fiscal deficit to moderate to 8.3% of GDP in FY 2010

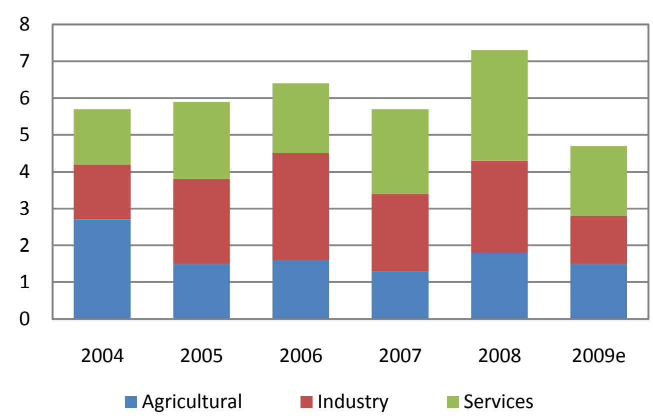
Recent trends

Production

Ghana's economic growth is estimated to have slowed to 4.7% in 2009, which is slightly higher than our 4.5% projection, from 7.3% in 2008. The slowdown in economic activity is attributed to subdued growth in the non-agricultural sectors, which is contrary to their performance in recent years. The central bank's composite index of economic activity (CIEA) suggests that economic activity began to recover in the second half of 2009. The CIEA declined by 2.1% and 0.3% in the first and second quarters of 2009 respectively. Positive growth in economic activity resumed in the third quarter when the CIEA increased by 2.3% and strengthened in the last quarter when the index rose by 9.9%. The recovery was led by a pickup in construction activity and port harbour activity, an improvement in the industrial consumption of electricity, an increase in demand for imports and a rise in tourist arrivals. However, uncertainty in the industrial sector and weak private sector credit extension continued to place a dampener on economic activity during this green shoots period.

When the agricultural sector's definition is broadened to include the cocoa industry, forestry and logging, and fishing, it generates over one-third of national output. Agriculture and livestock are the mainstay of the primary sector: the sub-sector produced 66% of the primary sector's output; however, it is responsible for almost 90% of the sector's growth. The cocoa production and marketing sector's contribution to the primary sector's growth increased during the past decade in response to increasing investment. The sub-sector has undergone several reforms in recent years to incentivise productivity gains and prevent smuggling by assuring farmers a larger proportion of international prices for their produce, which is internationally marketed by Ghana's Cocoa Board. At the end of the last cocoa season in 2008/09, which ended in October, cocoa production had increased by 4.2% to 710 000 tonnes. Despite the expansion in cocoa production, the broad agriculture sector's contribution to national output has decreased moderately since 1993, when it generated 41% of Ghana's gross domestic product (GDP), to 37% in 2008. This while the industrial and services sectors expanded. Both the latter sectors' contributions to GDP increased by two percentage points to 33% over the same period.

Figure 1: Economic sectors' contribution to GDP growth (%)



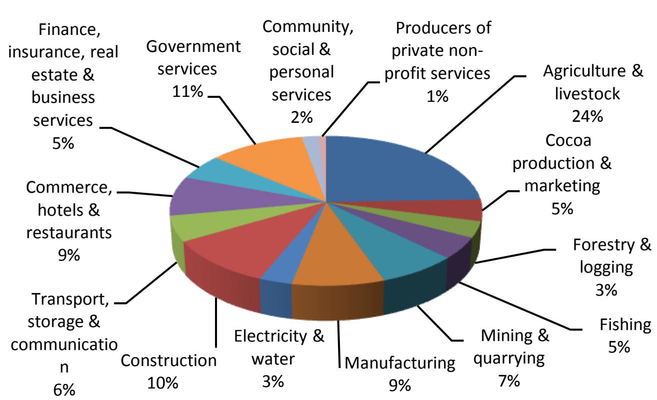
Sources: Bank of Ghana, Standard Bank est.

Over the course of the last decade, Ghana's economic growth accelerated from 5.2% in 2003 to 7.3% in 2008. The strengthening of economic activity in this period is largely attributed to the non-agricultural sectors, particularly services. However, in 2008 and 2009 the services sector's growth rate fell below the government targets. The services sector includes government; commerce and hospitality; transport and communications; financial, real estate and business services. Its contribution to GDP growth has increased, from 28% in 2003 to 40% in 2008. This remarkable strengthening in services' growth is largely due to the financial, real estate and business services; and wholesale and retail trade (from here on referred to as 'commerce') and hotels and restaurants (from here on referred to as the 'hospitality sector') sectors, whose contributions to services' growth increased significantly. Together the two sectors were responsible for almost two-thirds of the services sector's growth in 2008, up from 41% in 2003. Over the same period, government services' contribution dropped from 31% to 12%, implying that activity in the tertiary sector is less dependent on the government and increasingly driven by the private sector. However, in 2009 activity in the services sector slowed, on the back of a decline in government services owing to the reining in of fiscal spending, and subdued growth in the financial services, commerce, and transport and communication sectors.

The agriculture and livestock sector (the agricultural sector's narrow definition) produces about one-quarter of Ghana's GDP. Good rainfall and the revamp of the Aveyime rice project boosted agricultural production in 2009. Given that Ghana imports about 80% of the 560 000 metric tonnes of rice that it consumes, the overhaul of the Aveyime rice project, which was initiated by the National Democratic Congress (NDC) administration that came into power in January 2009, after it was abandoned by the previous administration, the New Patriotic Party (NPP), is a boon to local production and the trade balance.

President John Atta Mills's inaugural speech in February 2009 highlighted his administration's focus on the agricultural sector given that it is Ghana's largest economic sector and employs 60% of the country's workforce. The president expressed a desire to increase the sector's output through the expansion of irrigation facilities and maintenance of farm subsidies and credit. This administration also seeks to increase the yield of the country's second-biggest export, cocoa, through a range of agricultural extension programmes and producer price revisions, and to develop additional cocoa-processing facilities. The government's investment in agriculture and favourable weather conditions largely explain the better-than-expected performance of the sector in 2009.

Figure 2: Contribution to GDP (2008)



Source: Ghana Statistical Service

The sectors that underperformed in 2009 include construction, manufacturing and commerce. Preliminary estimates suggest that the construction sector was the worst hit by the global economic crisis. Indications are that the construction sector contracted in 2009, following strengthening growth in previous years that increased from 4.8% in 2001 to an estimated 13.0% in 2008, which increased the sector's contribution to GDP to 10%. The increase in Ghanaian banks' non-performing loans (NPLs) was more pronounced in three sectors, including construction, which is indicative of the slump in the secondary sector.

The other two sectors that experienced a slowdown in economic activity, as indicated by the increase in their respective NPLs, are forestry and mining. The fall in commodity prices partly explains the underperformance of the timber industry and extractive industry. However, the impact of the crisis on the prices of Ghana's metals and minerals was muted by the fact that the price of gold, which constitutes 90% of the country's mineral revenue, remained relatively strong. The production of timber reportedly fell in 2009, which coupled with lower prices explains the underperformance of the forestry sector in 2009. The forestry and logging sector generates about 9% of the primary sector's GDP. The volatility of the sector's growth is partly due to the fact that about 60% of logging in Ghana is illegal, which adversely impacts revenue and exacerbates the rate of deforestation.

The manufacturing sector, which produces about one-tenth of GDP, underperformed largely because the Tema Oil Refinery was inoperative for most of 2009. The refinery generates one-sixth of Ghana's manufacturing output and has the capacity to process 45 000 barrels per day. But maintenance works and a large debt burden prevented it from operating and purchasing crude oil for most of 2009. The refinery owed US$660 million to its creditors at the end of 2009. In 2009, the Ghanaian government appointed a pan-African bank to arrange a syndicated US$600 million facility to refinance half of the debt owed to the biggest creditor (who was owed about 90% of the total debt) and use the other US$300 million to shore up the refinery's balance sheet. As a result of this financial arrangement and a deal that the government struck with the Nigerian government to supply Ghana with about 60 000 barrels of crude oil per day, the refinery resumed operations in October 2009 when it received its first shipment of crude oil in 10 months. The recommencement of production at the refinery in the last quarter of 2009 is expected to have provided a lift to manufacturing activity in that period. The manufacturing sector's contribution to the secondary sector's GDP has decreased in recent years, as has its contribution to growth. The sector's slowdown in 2009 implies the manufacturing sector's importance to the secondary sector continued to slide during the year.

Industry in Ghana is constrained by the country's bedevilled electricity sector, which produces 1 702 mega watts (MW) of power per annum, of which 50-60% is sourced from the Akosombo and Kpong dams. Hydropower is relatively cheap; however, seasonal droughts have compelled the authorities to increase thermal power generation rapidly. The supply of gas to Ghana's thermal power stations through the West African Gas Pipeline (WAGP) was interrupted by the Niger Delta conflict, so some of the major thermal power plants had to substitute crude oil imports for gas. The cost of power generation thus exploded in 2008 on the back of strengthening economic activity, soaring international oil prices, and a weaker exchange rate. The resumption of normal rainfall in 2009 eased Ghana's energy supply shortfall however, supply remains volatile at times.

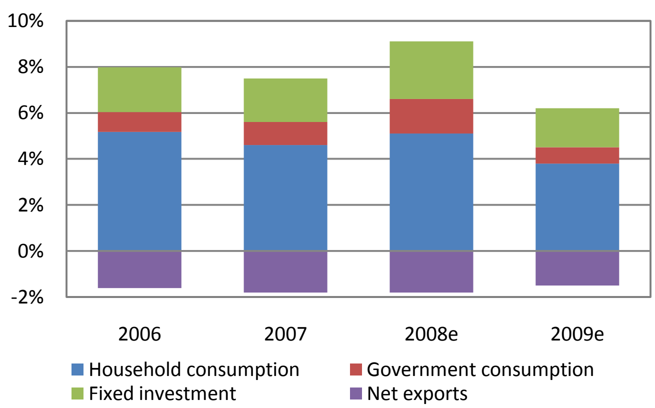
Activity in the commerce sector was also dampened in 2009 by the global economic slowdown. The tightening of commercial banks' lending conditions and subdued growth in some significant economic sectors, including construction and manufacturing, partly explain the dampener placed on commerce activity in Ghana. The commerce and hospitality sector's contribution to the tertiary sector has steadily increased, from 23% in 2003 to 25% in 2008, and its contribution to growth has increased at an even faster rate, implying that the commerce and hospitality sector's growth has been stronger than that of the other services sectors.

Domestic expenditure

Spending in the Ghanaian economy in 2009 was moderated by a slowdown in household consumption expenditure, tightening of government spending and decline in export earnings. However, fixed investment, particularly from the private sector, is estimated to have mitigated the slowdown in the aforementioned constituents of domestic expenditure. The country's nascent hydrocarbons industry was the biggest destination of investment flows in 2009.

Household spending is the largest source of spending in the Ghanaian economy. However, its contribution to GDP decreased during the last decade from about 85% in 2000 to just below 80%, while government spending and fixed investment's respective contributions to GDP rose.

Figure 3: Contribution of expenditure constituents to GDP growth



Sources: IMF, Standard Bank

Households' spending growth has averaged between four and five per cent in recent years, which is slightly slower than real GDP growth of 5-6% in this period. A high inflation environment is expected to have reduced the purchasing power of Ghanaian households in 2009, particularly in the first half of the year. Although inflation slowed in the second half of 2009, the average for the year was still higher than that for 2008. Fiscal consolidation in 2009 implied that the government had to rein in spending and to offer below-inflation or muted wage increases. This implies that public servants' real incomes decreased in 2009, which impacted their purchasing power and propensity to consume. However, above-average performance in the agricultural sector, which employs three out of every five Ghanaians, strengthened the financial security of over half of the country's households and underpinned their consumption activity. Moreover, households employed in the cocoa industry received a bonus of Ghc25.36 million (US$17.71 million), which translated into a payment to farmers of 40 cedi per tonne. This additional financial support for cocoa farmers, which is intended as an incentive to production in the future, improved incomes, and by implication allowed for an increment in consumption. As such, the slowdown in household spending is estimated to have been moderate in 2009.

Fixed investment's double-digit growth in recent years largely explains the increase in its contribution to GDP, from about 23% in the early part of the last decade to about 30% in 2009. As such, fixed investment's contribution to GDP growth has increased in recent years. The commodity boom of 2004 to mid-2008 is partly responsible for the rising investment. However, the discovery of crude oil and gas reserves just off the coast of Ghana spurred an increase in foreign direct investment (FDI). The increase in Ghana's FDI inflow over the past decade has actually been phenomenal; it increased from US$58.9 million in 2002 to US$2 120.4 million in 2008. Ghana's FDI increased by a multiple of 36 over a period of seven years and increased by more than twofold between 2007 and 2008. Public investment, especially in infrastructure, also increased over this period but at a relatively pedestrian pace. Fixed investment's rapid expansion in recent years has thus been the primary driver of expenditure growth and the acceleration in GDP growth in recent years.

Government consumption's contribution to GDP increased over the course of the last decade to about 18% in 2008, from 10% in 2000. Things came to a head in 2008 when a particularly expansionary budget led to the ballooning of the fiscal deficit to 14.5% of GDP. When the NPP administration came into office in 2009, one of its fast actions was to rein in spending. The 2009 budget was thus a fiscally restrained budget. Utility subsidies were removed, the increase in the wage bill was smaller and spending on goods and services was cut in 2009. The resultant moderation in government spending contributed to muting real GDP growth in 2009.

An expansion in export earnings is positive for GDP growth; however, its potency is dependent on the size of the import bill. Ghana's trade balance the difference between its exports and imports (net exports), is typically negative and has increased over the course of the past decade. This implies that the negative net export balance's impact on real GDP growth has been deteriorating in recent years owing to on average stronger real growth in imports than that of exports. In 2009, Ghana's exports' growth did not fall as much as that of its peers largely because of the prices of its main exports, gold and cocoa, which remained strong. The import bill declined on the back of a lower international oil price; however, capital equipment imports, especially for the hydrocarbons industry, sustained their growth. Preliminary indications suggest that the negative net exports' balance halved in 2009, implying that its negative effect on real GDP growth decreased significantly, which is positive for growth.

Economic activity in 2009 was thus mainly driven by fixed investment, especially from the private sector, and supported by a smaller trade deficit. However, the expansion in fixed capital formation was not sufficient to counter the slowdown in households' consumption expenditure, and decline in government spending.

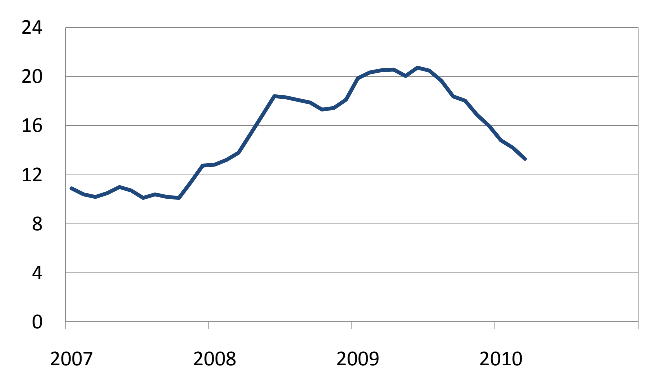
Monetary policy

Unlike most central banks, which combated the global crisis through the relaxation of monetary policy, the Bank of Ghana was compelled to tighten policy in 2009. The high inflation environment, which made real interest rates barely positive, was the primary reason behind the policy decision. Moreover, inflation had escaped the central bank's target, and its divergence from the medium-term target undermined the credibility of the monetary authority's inflation targeting (IT) regime.

In May 2007, IT was formally adopted by the Bank of Ghana. Ghana thus became one of the few emerging market economies and first low income country to adopt this regime. Ghana's IT framework targets the 12-month change in the headline consumer price index (CPI) and the central bank also monitors a few core inflation measures. The central bank set a medium-term inflation target of five per cent within a band of +/-1%, along with some intermediate inflation-reduction targets.

Unfortunately for the monetary authority, within months of adopting the IT regime, international food and fuel price shocks put upward pressure on inflation. Inflation increased from 10.1% y/y in October 2007 to 18.4% y/y in June 2008. Thereafter the global financial crisis began to unwind and commodity prices declined, which enabled Ghana's inflation to ease moderately to 17.3% y/y in October 2008. However, the impact of the fall in commodity prices was soon compounded by fiscal slippages related to the energy crisis, which fuelled inflation. A depreciating cedi added to the inflationary pressures. Ghana's inflation began to climb again, in a period when inflation was slowing in most economies as the global economic recession unravelled, and peaked at 20.7% y/y in June 2009.

Figure 4: Inflation (y/y %)

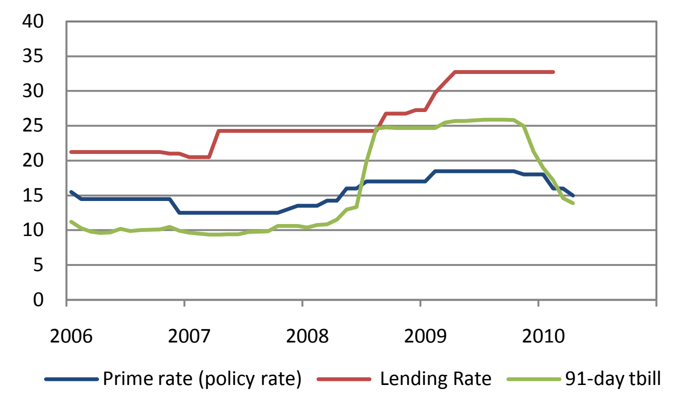


Source: Ghana Statistical Service

Inflation began to decrease in the second half of 2009. The fall in inflation was led by a slowdown in food price inflation and housing and utilities' price inflation. A moderate appreciation of the cedi against the US dollar also subdued the country's strong inflation pressures in this period and allowed for annual inflation to fall below 20%. Inflation decreased to 16% y/y in December, from 20.7% y/y in June.

The central bank employs operational tools to influence inflationary pressures through credit markets. The subsiding of fiscal dominance in 2009 strengthened the monetary authority's management of policy and improved the potency of policy tools. Parallel to the adoption of fiscal restraint in 2009, the monetary policy committee (MPC) continued to tighten policy and increased the policy interest rate, the prime rate, by 1.5 percentage points in February 2009 to 18.5%. This policy move was contrary to that of most central banks that were loosening monetary policy in order to boost liquidity and encourage credit extension to the private sector during the height of the global economic crisis. This turned out to be the last interest rate hike following a cumulative increase of 4.5 percentage points in the prime rate in the preceding two years.

Figure 5: Interest rates (%)



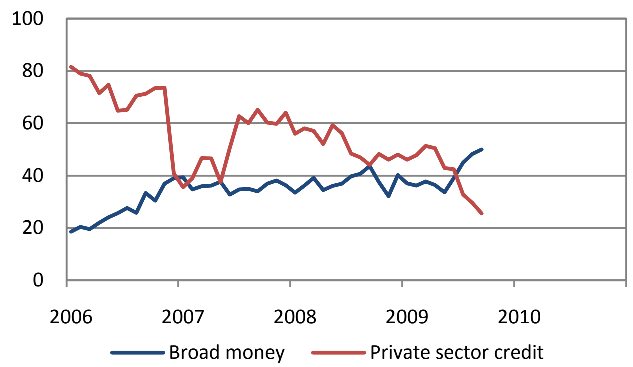
Source: Bank of Ghana

The first policy decision of the new central bank governor, Kwesi Amissah-Arthur, was to cut the prime rate. This move did not reflect a change in policy approach by the new governor, who took office in October 2009, but rather an improvement in the inflation outlook. The prime rate was reduced by half a percentage point in November 2009 to 18% following a sustained slowdown in inflation during the second half of 2009. As the softening of inflation appears to be durable, the MPC elected to cut the prime rate further in February 2010 by a larger-than-expected two percentage points and by another one percentage point in April 2010.

The commercial bank lending rate generally tracks the central bank's prime rate, although the spread between the two interest rates did widen in 2009. The yield on the 91-day Treasury bill came off its high level, which was induced by a significant increase in public sector borrowing in 2008, in the tail end of 2009. During 2008, the yield on the short-term government paper increased twofold from 10.4% in January to 24.7% in December. The yield then remained relatively flat in the 25.5% region during the first three quarters of 2009 and only began to go south in the last quarter of the year. The new administration's fiscal restraint, lower borrowing requirement and deliberate policy to restructure domestic debt into the longer end of the yield curve largely explain the fall in the yield, which slid to 13.9% in mid-April 2010.

Broad money growth was relatively stable in the first half of 2009 because its constituents, net foreign assets and net domestic assets were balanced by an increasing preference to hold foreign currency deposits due to a weakening cedi and slowing domestic credit growth. Domestic credit growth was influenced by the change in fiscal policy in 2009 and the global economic recession. Following public sector credit growth's acceleration in 2008, which crowded out the private sector, it slowed in 2009 under a more fiscally prudent administration. However, as public sector credit growth slowed, the global crisis emerged and further subdued the private sector's appetite for credit.

Figure 6: Broad money (M2+) and private sector credit (y/y %)



Source: Bank of Ghana

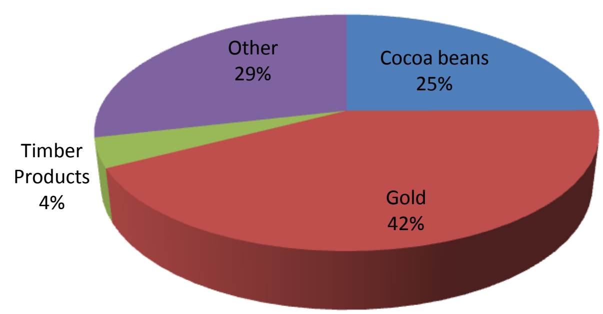
The slowdown in economic activity in 2009 depressed incomes and reduced borrowers' abilities to service their debt. As a result, the ratio of NPLs increased to 9.6% at the end of March 2009, with above-average ratios in the forestry, mining and construction sectors. The increase in defaults among the timber industry's borrowers is partly due to the almost 30% fall in earnings from timber exports, which suggests the global demand slump and credit squeeze hindered the purchasers of Ghana's exports, *inter alia*, from honouring the trade credits that had been extended to them and paying Ghana's timber exporters. As such, the timber industry was unable to meet its debt obligations with local commercial banks. The NPL ratio continued to increase during 2010 and reached an alarming 20% in February 2010. In response to the rising NPL ratio, commercial banks tightened their lending standards as a means of limiting their risk exposure. As a result, private sector credit growth began to decelerate at a faster rate in 2009. It slowed to 25.6% y/y in September, from 51.4% y/y in March.

External sector

Ghana's external sector was cushioned by relatively strong gold and copper prices, whose decline during the height of the crisis was moderate relative to the prices of other metals and minerals, and energy commodities. This implies an important source of inflows to the balance of payments, export earnings, was shielded from the worst of the crisis. Similarly, FDI inflows, particularly those headed for the hydrocarbons industry, were resilient in 2009, owing to the long-term view that these investors were taking.

The largest sources of inflows to the balance of payments are export earnings and current transfers in the current account, and private capital in the financial account. Unlike most of the world economies' export earnings, Ghana's export earnings increased in the first three quarters of 2009 to US$4 176.29 million, compared to US$4 077.66 million during a similar period in 2008, albeit by a modest 2.4%. This modest growth was due to a 6.3% increase in cocoa export earnings, a 1.2% increase in gold export earnings and a 7.4% increase in other export earnings. Other exports include cocoa products, electricity, residual fuel oil, manganese, bauxite and diamonds. Strong cocoa and gold prices partly explain the increase in export earnings during the global recession. Notably, cocoa output continues to be dogged by the smuggling of Ghanaian output to Cote d'Ivoire and Togo. Conversely, timber exports, which generate about 5% of Ghana's export earnings, contracted by 28.2% to US$168.6 million in the first nine months of 2009.

Figure 7: Composition of exports (January to September 2009)



Source: Bank of Ghana

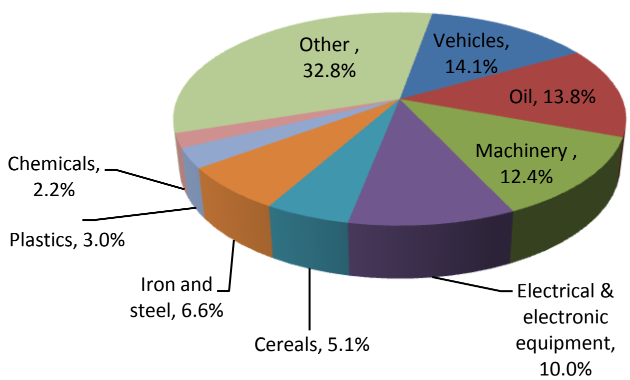
The prices of agricultural commodities fared relatively well during the crisis, compared to those of metals and minerals, and energy commodities. After the cocoa price peaked at US$3 021.76 per metric ton in June 2008, it fell by 32.3% to a low of US$2 046.08 in November 2008. Thereafter, the cocoa price increased steadily in 2009, with the exception of a temporary dip in March, to a record high of US$3 527.34 in January 2010. The 45% increase in the cocoa price in 2009 largely explains the increase in cocoa export earnings for the year.

Similarly, the gold price was fairly resilient during the crisis because, unlike other metals and minerals, gold is also considered a safe haven asset, especially when global risk aversion rises. The gold price's peak in 2008 was US$974.17 per ounce in February. In the second half of 2008, the price slid to US$725.55 at the height of the global financial crisis, and thereafter recovered during 2009 and breached the US$1 000 psychological mark in September 2009. The price of the yellow metal is now flirting with the US$1 200 level. The incline of the price of Ghana's biggest export, gold, in 2009, off a high base, largely explains the resilience of gold export earnings.

Contrary to export earnings, Ghana's import bill for the first three quarters of 2009 contracted by 20.9% to US$5 918.54 million, compared to US$7 479.19 million in the corresponding period of 2008. Both non-oil and oil imports decreased in this period; however, the fall in oil imports was more pronounced. The oil import bill shrank by 40% in the period under analysis largely because of a sharp decrease in the international oil price and more moderate slowdown in Ghana's demand for oil. Although the international oil price doubled during the course of 2009, the year's average price was still 33% lower at US$62.42 per barrel than it was in 2008 at US$92.94. This decline in the average annual oil price largely explains the decrease in Ghana's oil imports in 2009. Non-oil imports decreased by a less marked 15.4% in the first three months of 2009, compared to that from a similar period in 2008.

The resultant effect of a sharp decline in the import bill, relative to the modest increase in export earnings, was a significant improvement in 2009's trade deficit. Preliminary estimates suggest that the trade deficit for the first three quarters of 2009 halved to US$1 742.25 million, from US$3 401.53 million in the corresponding period of 2008.

Figure 8: Composition of imports (2008)



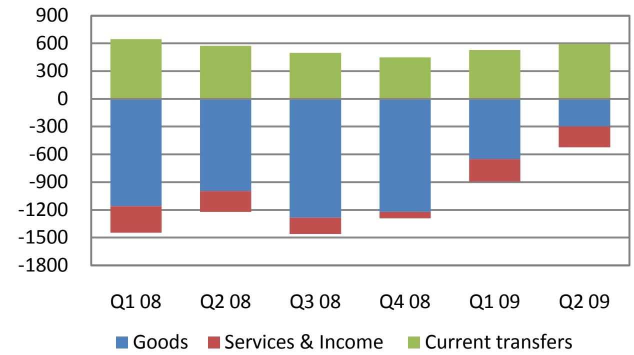
Source: International Trade Centre

Current transfers slowed in 2009 on the back of a decrease in their largest constituent, private transfers, which are mainly made up of remittances from Ghana's diaspora. It is estimated that private remittances fell by about one-fifth, compared to their 2008 level. Conversely, the smaller constituent of current transfers, official transfers, increased in 2009. The rise in official transfers in 2009 was partly due to the front loading of aid by donors to help Ghana and other low income countries combat the crisis. However, the increase in official transfers is not likely to have been sufficient to offset the decrease in private transfers, so the current transfers' balance is expected to have decreased in 2009.

The services and income account deficit is likely to have moderated in 2009, compared to 2008's deficit, on the back of a slowdown in net payments for services, such as transportation and travel, which are provided by foreigners for Ghanaians, and a decrease in investment income repatriated owing to the slowdown in economic activity.

A smaller trade deficit, decrease in current transfers and improvement in the services and income account are expected to have allowed for Ghana's current account deficit to narrow in 2009. Preliminary estimates for the first half of 2009 reveal that the current account deficit dropped to US$293.85 million, which is one-fifth of its value, in the corresponding period of 2008, of US$1 448.98 million. It is estimated that Ghana's current account deficit fell to a five-year low in 2009.

Figure 9: Current account constituents (US$, millions)



Source: Bank of Ghana

Ghana's capital and financial account surplus deteriorated in 2009 on the back of an increase in the financial account's outflows and a slowdown in capital transfers entering the capital account. The financial account's largest source of inflows is private capital, particularly FDI. Official financing and short-term capital make up the remainder of inflows. The global credit crunch and slump in economic activity increased net short-term capital outflows and subdued Ghana's FDI inflows, which were mainly held up by oil-related FDI. It is estimated that FDI fell to a four-year low in 2009. According to the IMF, about one-third of Ghana's FDI in 2009 headed for the country's nascent oil industry.

Official financing increased in 2009 on the back of concessional loans that Ghana's government mainly received from the World Bank and IMF. In March 2009, the World Bank pledged US$1.2 billion in interest-free loans over three years, of which US$250 million was paid out immediately to help cushion the effects of the 2009 crisis. In July, the IMF approved a US$602.6 million facility under one of the Fund's programmes, of which about US$105.2 million was disbursed immediately. In August, Ghana received its special drawing rights' allocation from the IMF of US$420 million, which was extended to help the country tackle the dampening effects of the crisis. These three lending facilities alone raised Ghana's official financing in 2009 and provided a significant boost to the country's financial account.

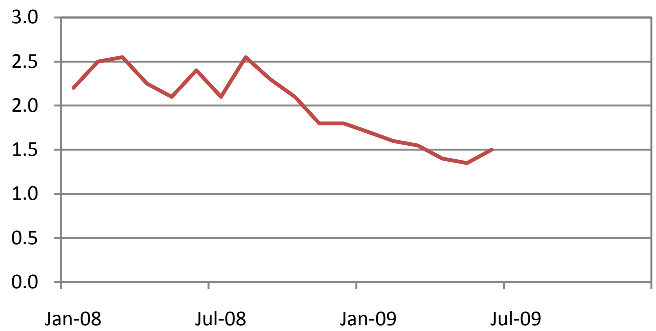
Short-term capital was on balance negative in 2009, as more portfolio flows exited the country than entered it during the year. However, the negative short-term capital balance in 2009 is expected to have been smaller than that of 2008.

The increase in official financing and slowdown in the flight of short-term capital were not large enough to counter the decrease in FDI. As such, the financial account is presumed to have decreased in 2009. Despite the decrease in the capital and financial account balance, the shrinkage of the current account deficit allowed for an improvement in the balance of payments' deficit in 2009. Preliminary estimates for the first half of 2009 show that the negative overall balance decreased by 25% to US$625.98 million, from US$782.67 million in the corresponding period of 2008.

A smaller deficit in the balance of payments in 2009 was positive for the country's foreign exchange position, which began to rebuild in mid-

2009 following an almost 12-month decline. In the year to June 2009, Ghana's gross international reserves dropped by 36% to US$1 705.22 million. This implies the country's import cover declined to 2009's low of 1.35 months in May 2009, from 2008's high of 2.55 months. Ghana's foreign exchange reserves, even during the 2008's boom, were still below the recommended minimum of three months, which implied that the economy was vulnerable to exogenous shocks and it became even more so during the global economic recession.

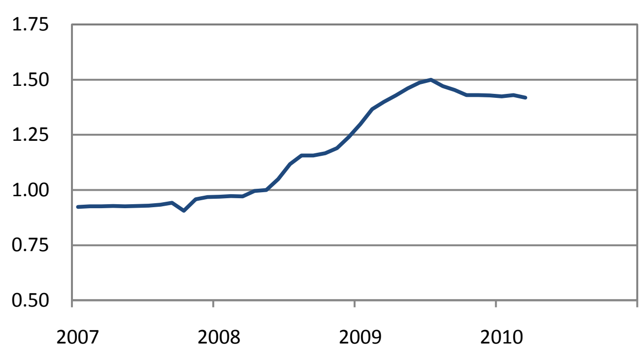
Figure 10: Foreign exchange reserves (months of import cover)



Source: Bank of Ghana

An improvement in export earnings and capital inflows, in the second quarter of 2009, on the back of strengthening commodity prices and injections of concessional loans and grants, enabled the rebuilding of the country's foreign exchange reserves to begin from mid-2009. The increase in Ghana's supply of foreign exchange reserves improved the value of the cedi, and stemmed the depreciation of the exchange rate, which began to appreciate in August 2009, after weakening steadily since the last quarter of 2007.

Figure 11: Exchange rate (cedis per US dollar)



Source: Bloomberg

The cedi appreciated by 4.9% against the US dollar in the July 2009 to January 2010 period and settled at a monthly average exchange rate of GHC1.43/USD. Thereafter, the exchange rate remained fairly stable during the first quarter of 2010.

Fiscal sector

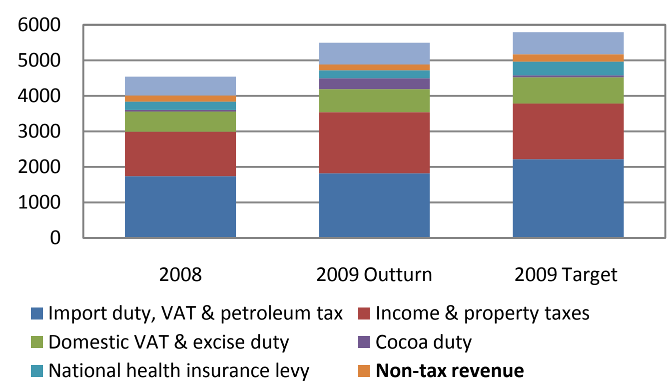
Ghana's new NDC administration had little option but to implement a contractionary fiscal budget in fiscal year 2009, because of the large fiscal deficit of 14.5% of GDP in 2008 that its predecessor had saddled it with, which was compounded by an economic slowdown that subdued fiscal revenue collections. The fiscal authority was thus unable to implement a counter-cyclical policy in order to stimulate economic growth. Instead the NDC government was compelled to cut spending and appeal for concessionary financing from its development partners, and the front loading of grants from donor partners.

Preliminary data show that total revenue and grants increased by 23.9% to GHc5 921.99 million in 2009, compared to 2008's level. It exceeded the target by 2.3%, implying that some of the measures the government took to shore up revenue, including the removal of tax exemptions, were fruitful. There was a mixed performance from the various sources of revenue. Overall, tax revenue increased by 22.9%; however, it was 4.9% below the programmed target. The largest source of tax revenue, import duty, import value added tax (VAT) and petroleum tax, which is related to international trade and typically constitutes about 40% of tax revenue, underperformed in 2009. The decline in global trade in 2009 largely explains the slowdown in this important source of Ghana's tax revenue. Preliminary data reveal that the import duty, import VAT and petroleum tax outturn was 82% of the target for the year.

Conversely, income and property tax revenue increased by an annual rate of 37% in 2009 and exceeded the programmed target by almost 10%. This source of tax revenue generates about 35% of total taxes. The expansion of income and property taxes suggests that domestic business activity, employment and real estate activity were less affected by the crisis than exporters.

Domestic VAT and excise duty collections increased by 14.5%, compared to the previous year's collections, but came in 12% below target. These sales taxes generate about 15% of total tax revenue. Their decline reflects the slowdown in wholesale and retail trade activity and subdued demand related to the erosion of purchasing power by high inflation.

Figure 12: Total government revenue (millions of Ghanaian cedis)



Source: Bank of Ghana

The biggest surprise in the resource envelope is cocoa duty, which exceeded its target by a multiple of six. Cocoa duty is a tariff or tax on the export of cocoa. Revenue from cocoa duty is ordinarily a small contributor to total tax revenue. In 2008, it only made up 1% of total tax revenue. However, the surge of cocoa duty revenue was even more notable in 2009 because of the slowdown in trade-related tax revenue and sales tax revenue. The 500% increase in cocoa duty revenue raised its contribution to total tax revenue to 5%.

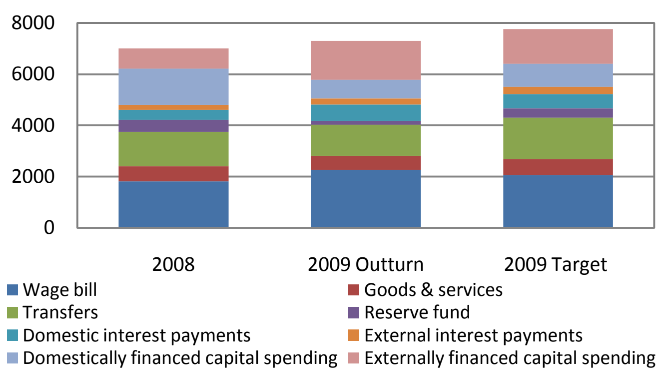
Revenue from the national health insurance levy decreased by 5.7% in 2009, compared to the previous fiscal year's collection, and only amounted to 58% of the target for 2009.

Ghana's non-tax revenue constitutes a very small share (5%) of the government's total revenue, which is low by regional standards. Non-tax revenue includes profits from state-owned enterprises. In 2009, non-tax revenue decreased by 2.2% compared to 2008's level, and was 20% below the year's target.

Grants constituted about 13-14% of the Ghanaian government's total revenue. In 2009, they are estimated to have increased by 15.2%; however, they were about 1% below the programmed target. The fiscal constraints that Ghana's donor partners in the developed world are facing partly explain this slight underperformance. However, an increase in concessional financing is expected to have compensated for the revenue and grants' shortfall.

Total government spending in the first 11 months of 2009 is estimated to have increased by 3.6% to Ghc7 963 million, compared to the previous fiscal year's amount; however, it was still 5.6% below the target for that period. The underperformance in government spending was largely due to the under-execution of the recurrent expenditure budget, which is made up of the wage bill, spending on goods and services, transfers, the reserve fund and interest payments.

Figure 13: Total government expenditure (Jan-Nov 2009, millions of Ghanaian cedis)



Source: Bank of Ghana

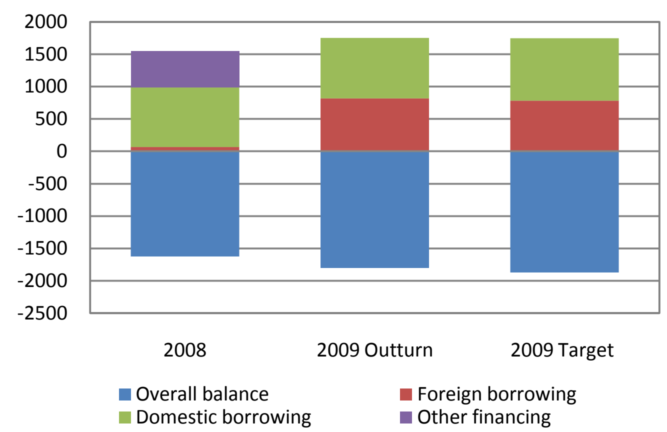
The lower-than-programmed outturn for recurrent spending was largely due to underspending in the reserve fund, transfers, and goods and services categories. The reserve fund holds contingency reserves for once-off unexpected expenditure that the budget may not have anticipated. Reserve fund spending dropped by an annual rate of 71% in the period under assessment, and thus came in almost 65% below target. This implies that the unexpected expenditures that emerged during this period were significantly lower than those of the preceding period. Transfers, which include pensions, gratuities, social security and the national health fund, constitute about 30% of recurrent spending. They declined by 10% in the January to November 2009 period and were 25% below target. Spending on goods and services decreased by an annual rate of 7% over the same period, and was 12% below target.

The wage bill's performance was contrary to that of the aforementioned recurrent expenditure items. The wage bill is the largest recurrent expenditure item. Wages, which make up 40% of recurrent spending, increased by an annual rate of 25% during the first 11 months of 2009 and thus came in 10% above the programmed target. The ever burgeoning wage bill is a perennial burden on Ghana's fiscal resources, and its large increase under a contractionary fiscal policy is indicative of the challenge of reining it in.

Interest payments surged by an annual rate of 55% in the January to November 2009 period, and were 7.4% above the programmed target. That interest payments were higher than projected was largely due to domestic interest payments, whose increase was more pronounced than that of external interest payments. Domestic interest payments swelled by an annual rate of 68% in the period under analysis, which brought them 20% above target. This increase is attributed to higher-than-projected domestic borrowing and increases in the cost of borrowing. External interest payments also increased by an annual rate of 29% during this period but were still unable to meet the target.

On the capital expenditure front, foreign financed capital expenditure outperformed domestic capital spending. Total capital expenditure, which makes up 30% of total government spending, was probably the only expenditure item that met its target for the 2009 budget. However, the performance of its constituents, domestically and foreign financed capital expenditures, was mixed. In the January to November 2008 period, domestically financed capital expenditure made up two-thirds of capital spending. In the corresponding period of 2009, domestically financed capital spending decreased by 50%, and thus came in 20% below target. Conversely, foreign financed capital spending increased by a remarkable 90%, which put it 13% above target.

Figure 14: Budget balance and financing (Jan-Nov 2009, millions of Ghanaian cedis)



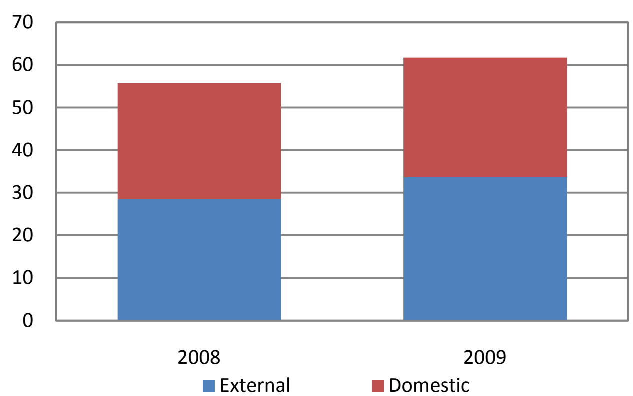
Source: Bank of Ghana

Total expenditure may have missed the target by 5% and total revenue and grants by 8% but the stronger 19.3% growth of revenue and grants than the 3.6% growth in spending, in the January to November 2009 period, compared to a similar period in 2008, allowed for the fiscal deficit (including grants) to fall to 9.7% of GDP, from 14.0%.

The negative overall balance or fiscal deficit was financed with a combination of foreign and domestic borrowing. However, the composition of borrowing changed significantly in 2009. Where foreign loans financed 5% of the 2008 budget deficit, they financed 45% of 2009's budget deficit. Foreign borrowing is estimated to have increased by a multiple of 12 in the 2009 budget, compared to that for 2008, to 3.8% of GDP. This surge in foreign borrowing partly reflects the large loans that the government received from the World Bank and IMF. Conversely, the increase in domestic borrowing in 2009 was modest and as such it came in slightly below the programmed target at 4.3% of GDP.

The rise in government borrowing in 2009 explains the 16% increase in total public debt to US$9 202.94 million (61.7% of GDP) at the end of 2009, from US$7 918.1 million (54.6% of GDP) a year earlier.

Figure 15: Public debt (% of GDP)



Source: Bank of Ghana

Public external debt increased by 25% to US$5 007.88 million (33.6% of GDP), from US$4 035.07 million (28.5% of GDP), while public domestic debt swelled by 27% to GHc6 083.19 million (28.1% of GDP), from GHc4 800.73 million (27.2% of GDP). This level of debt is only manageable as long as real GDP growth strengthens and the fiscal deficit is reined in.

National policy assumptions and the international environment

Monetary policy management

According to Ghana's draft medium-term national development policy framework for the 2010-2013 period, the authorities' monetary policy objectives include ensuring price stability; the deepening of the capital market; and the creation of a more diversified financial sector with more accessible financial services. These goals were selected with the aim of tackling high inflation and interest rates, and a depreciating exchange rate, and of stemming increasing levels of speculative capital and capital flight.

The authorities seek to achieve price stability through the promotion of competition in the financial sector as a means of narrowing the high interest rate spread and bringing about competitive rates. Liquidity management will also be enhanced. Stability of the cedi's external price will be sought through the strengthening of the interbank foreign exchange market.

The deepening of the capital market will be addressed through the implementation of schemes to increase long-term savings and funds, and the development of a market for long-term securities, including bonds. The authorities also plan to mobilise savings for investment and to restructure financial institutions to help them improve the availability of credit to the productive sector.

The authorities plan to develop a more diversified and accessible financial sector by offering a discounted tax rate to financial institutions that lend to businesses in the priority sectors and to small and medium enterprises. Microfinance's administrative framework will be improved and its product customised for the agriculture sector. There is also a plan to enact a long-term savings law for private housing schemes to promote home ownership.

As part of the plan to diversify the financial sector, the government plans to implement a law that establishes a regulatory framework for a three-tier pension system. The first tier comprises a mandatory state non-funded pension scheme, the second tier a mandatory state-funded pension scheme, and the third tier a voluntary private pension scheme. Simultaneous existence of all three pension tiers ensures the stability of the system because it reduces the eventual demographic or financial risk of the tiers. The development of pension funds will increase the country's savings pools.

Financial institutions will also be encouraged and given incentives to mobilise resources for priority sectors, including social infrastructure. Universal banking will be promoted and supported as these institutions are able to offer mortgage banking, term and start-up financing, and other activities that support economic growth.

Fiscal policy management

The draft medium-term national development policy framework for the 2010-2013 period outlines four policy objectives for fiscal policy management: to improve the mobilisation of fiscal resources; improve public expenditure management; promote effective debt management; and institute mechanisms that manage external shocks. These four goals are intended to combat high unsustainable fiscal and trade deficits; address the country's low foreign exchange cover; improve poor revenue administration; and redress poor expenditure management.

The swell of Ghana's fiscal deficit to 9.2% of GDP in 2007 and 14.5% in 2008 raised concern about the government's inability to spend within its means and to meet its financial obligations. The new NDC administration sought fiscal consolidation in 2009 by reining in spending; however, the country's multitude of developmental needs imply that the country's tax base has to be widened. The fiscal authority plans to mobilise fiscal revenue by minimising leakages in all collecting agencies and providing sufficient and consistent funding to the agencies. Tax reforms that focus on indirect taxes are expected to tap into a pool of available resources. Tax incentives and awareness programmes are also expected to generate additional sources of tax revenue. Computerising the tax system is expected to improve the efficiency of tax collections.

Better public expenditure management will be pursued through the institution of legislation on fiscal responsibility and the use of the expected oil revenue. The fiscal authority also plans to pursue transparency in the utilisation of public funds. Budget controls on state-owned enterprises will be tightened and cost recovery management in key sectors of the economy, including energy, will be introduced. On the administration front, the government plans to introduce a single Treasury account. To prevent the uncontrolled ballooning of the wage bill, the fiscal authority plans to put in place a payroll management system, hiring controls and payroll audits.

Effective debt management will be sought through the maintenance of debts at sustainable levels. The government will also seek to meet financing needs by obtaining debt with a minimal cost of borrowing. To minimise the risk of exposure to market and refinancing risk, debt instruments and derivatives will be employed. To broaden the government's sources of domestic financing, a well-functioning domestic debt market will be developed.

Lastly, the government will seek to build up the buffers that will cushion the economy from exogenous shocks such as the food and fuel price shocks of 2008. It aims to do this by maintaining an adequate and stable level of reserves. Ghana's foreign exchange reserves are presently at the recommended ceiling of three months.

International trade management

With regard to the external sector, the medium-term national development policy presents three objectives, which are improving import competitiveness; diversifying and increasing the export base; and accelerating economic integration with other regional and/or sub-regional states. These policy objectives are intended to address the country's persistently high negative trade balance.

The authorities plan to improve import competitiveness by maintaining competitive real exchange rates, improving the import/export regime, and minimising the incidence of dumping. The substitution of imports with local production is another strategy the government is pursuing. Rice is Ghana's main staple food; however, the country only produces 20% of its total consumption. This implies that the surge of the rice price in 2008 contributed significantly to the swelling of the import bill and deterioration of the trade deficit, which increased to an extraordinary 31.1% of GDP. Increasing the share of rice that is produced domestically would ease the pressure on the country's current account and foreign exchange reserves. The imminent commencement of oil and gas production is in ideal import substitution boon for the economy that is expected to shrink the import bill and strengthen the country's external sector.

The diversification and increase of the export base will be pursued through promoting new areas of competitive advantage; taking full advantage of preferential access to markets such as the African Growth and Opportunity Act (AGOA); and engaging fully in multilateral trade negotiations. Ghana's exports to the United States under AGOA have grown at a slower rate than its imports, so Ghana's trade deficit with the US has increased over the years. Ghana's biggest exports to the US are agricultural products, forest products, and energy-related products. Its biggest import from the US is transportation equipment.

The start of oil and gas production in the 2010-2011 period is expected to ease Ghana's import bill. Oil constitutes 15-20% of the country's import bill.

Lastly, the authorities plan to speed up economic integration with other regional and/or sub-regional states by implementing the West African Monetary Zone (WAMZ) programme. The WAMZ is a group of five countries in the Economic Community of West African States (ECOWAS) that plan to introduce a common currency, the Eco, by 2015. The government also plans to ensure that the national trade policy reflects ECOWAS protocols. The links between industrial and trade policies will also be strengthened.

2010 Budget management medium-term macroeconomic framework

The government's objectives under the macroeconomic framework for the 2010-2013 period include:

- The achievement of non-oil real GDP growth of 8%
- A reduction in the overall budget deficit to 3% of GDP, through cuts in low-priority spending and re-allocation of resources to priority areas
- The continued focus of monetary policy on stabilising price and exchange rate expectations
- The reduction of the inflation rate to less than 10%

International environment

The close of 2009 signalled the end of the global economic recession. The global economy shrank by 0.6% in 2009, following growth of 3.0% in 2008. The advanced economies were by far the worst affected by the recession; the collective of economies contracted by 3.2% in 2009. Of these economies, Japan, the Euro-area and the United Kingdom were the hardest hit by the global financial and economic crisis. Conversely, the emerging and developing economies showed positive growth of 2.4% in 2009, albeit significantly slower than the buoyant 6.1% of 2008.

Of the BRIC economies, Russia and Brazil were the laggard performers, with negative growth rates of 7.9% and 0.2%, respectively, in 2009. China and India's economies were a lot more resilient to the recession than expected. China's economy exhibited growth of 8.7% in 2009, which is less than a percentage point lower than its growth rate for 2008. In contrast, sub-Saharan Africa's real economy was pummelled by the global economic slump and, in particular, the collapse in global trade. As a result, economic growth slowed to 2.1% in 2009, from 5.5% in 2008.

The resilience of the emerging and developing economies partly explains the bounce back in economic performance projected for 2010. A brisk recovery of 4.2% is projected for the world economy in 2010, which is even stronger than its 2008 growth performance. This strong projection is largely based on an expectation that the advanced economies will exhibit a convincing recovery in 2010, with a growth rate of 2.3%. However, increasing concerns about a double-dip recession, partly due to the rising risk of sovereign debt defaults, especially in the Euro-area, could mute the strength of the recovery. The strengthening of advanced economies is necessary to lift consumer spending, which is supportive of a recovery in export-led emerging economies that will in turn support a recovery in demand for Africa's commodities.

Table 1: Global economic outlook

Real GDP growth (year-on-year)				
	2008	2009	2010p*	2011p*
World	3.0	-0.6	4.2	4.3
Advanced economies	0.5	-3.2	2.3	2.4
United States	0.4	-2.4	3.1	2.6
Euro-area	0.6	-4.1	1.0	1.5
United Kingdom	0.5	-4.9	1.3	2.5
Japan	-1.2	-5.2	1.9	2.0
Emerging and developing economies	6.1	2.4	6.3	6.5
China	9.6	8.7	10.0	9.9
India	7.3	5.7	8.8	8.4
Brazil	5.1	-0.2	5.5	4.1
Russia	5.6	-7.9	4.0	3.3
Sub-Saharan Africa	5.5	2.1	4.7	5.9
Developing Asia	7.9	6.6	8.7	8.7

** p = projection*

Source: IMF

Higher commodity prices and an increase in economic activity are expected to spur an increase in inflation in 2010. Average inflation in the advanced economies is thus projected to increase to 1.5% in 2010, from 0.1% in 2009, while that of the emerging and developing world is expected to increase from 5.2% to 6.2%.

Forecast summary

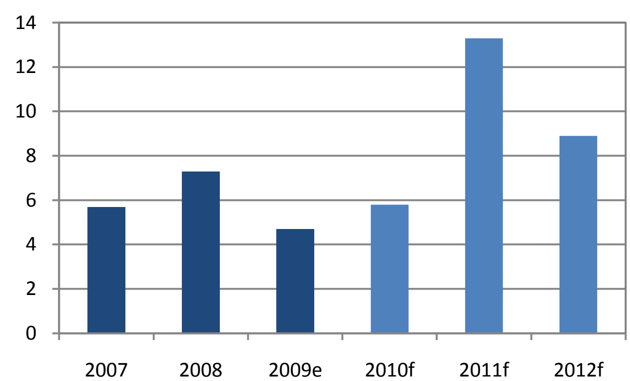
Growth outlook

The emergence of the global economy from the recession bodes well for Ghana's economic outlook in 2010. Barring unfavourable weather, household spending is expected to expand on the back of a lower inflation environment, which will improve households' purchasing power. Fixed investment is also projected to increase in 2010, particularly in the energy industry in the run up to the commencement of oil production in the last quarter of 2010 and liquid gas production in 2011. Compared to 2009, foreign investment inflows are expected to be more diversified in 2010 as risk appetite improves and investors seek long-term opportunities in other sectors of West Africa's most stable economy. Private domestic investment is expected to be constrained by tight credit conditions that stem from banks' risk aversion in light of the increase in NPLs to 2004's level of around 20% of gross loans.

As government spending growth is set to remain flat in 2010 at 23%, its contribution to domestic expenditure growth is projected to moderate on the back of stronger growth of households' consumption expenditure and fixed investment.

The return to positive global trade growth in 2010 is constructive for Ghana's external sector. Stronger commodity prices and the bottleneck on global cocoa supply due to the political instability in neighbouring Cote d'Ivoire suggest an improvement in export earnings. However, the projected increase in export revenue is likely to be countered by a bigger import bill, partly owing to a higher international oil price and growing capital equipment imports for infrastructure and other development projects. This implies a wider merchandise trade deficit in 2010, which is negative for GDP growth. All in all, an increase in households' consumption expenditure and a recovery of fixed investment growth are expected to bolster real GDP growth in 2010 to 5.8%, from 4.7% in 2009.

Figure 16: Real GDP growth (%)



Source: Standard Bank

On the production side, the construction sector is expected to realise an increase in growth on the back of a recovery in private sector activity, including real estate activity and petroleum industry-related construction, and infrastructure investment. On the infrastructure front, the Ghanaian government plans to raise domestic electricity generation capacity from 1 800 MW to 5 000 MW in the medium term. To this end, the Brazilian government has signed a memorandum of understanding with the Ghanaian government for the construction of a 90 MW hydroelectric dam that will cost US$300 million, of which US$250 million will be financed by the Brazilians. Construction is expected to begin in 2010.

The manufacturing sector will receive a boost from the resumption of gas supplies from Nigeria through the WAGP, which will offer relief to consumers of industrial power. Moreover, the recommencement of crude oil shipments to the Tema Oil Refinery in October 2009 allowed for operations to resume and supported a pickup in manufacturing activity.

Ongoing investments and good rains are expected to sustain solid growth in the agriculture sector, which is positive for employment as six out of every 10 jobs in the economy are generated in the sector.

Activity in the extractive industry will be spurred by stronger commodity prices, particularly the price of gold, which constitutes 90% of mining output. Prospects from the mining industry are supported by plentiful mineral reserves and a beneficial regulatory framework. However, insufficient and unreliable domestic power supply will continue to undermine the industry until addressed. Mining companies presently have to acquire their own diesel-run power generators to escape disruptions to their operations. In the last quarter of 2010 the extractive industry will also receive a boost from the commencement of gas production.

Activity in the transport and communication industry, which was largely sustained by the growing telecommunications sub-sector, is projected to increase on the back of an increase in trade activity in 2010.

Economic growth is expected to spike in 2011 at a projected 13.3% on account of the commencement of both crude oil and gas production. Ghana's proven reserves are estimated to range between 800 million and two billion barrels. It is estimated that oil production from the 2007 Jubilee Field discovery, which will begin in the fourth quarter of 2010, will amount to 160 000 barrels of gross liquid per day in 2011, including 120 000 barrels of oil per day. The remainder is natural gas. Gas production will begin first and production of oil will commence once the necessary infrastructure is in place.

The expansion of power generation is one of this government's priorities and as such gas resources from the Jubilee Field will be used for domestic consumption and production partners have acceded to the request to provide the first 200 billion cubic feet of natural gas to the government at zero cost. Moreover, the government plans to spend about two-thirds of the tax and royalty revenue from the petroleum industry on investment projects that are growth enhancing, including transportation infrastructure, telecommunication, power and energy, and improving the productivity of agriculture. The oil and gas industry will thus spur an increase in activity in other sectors of the economy.

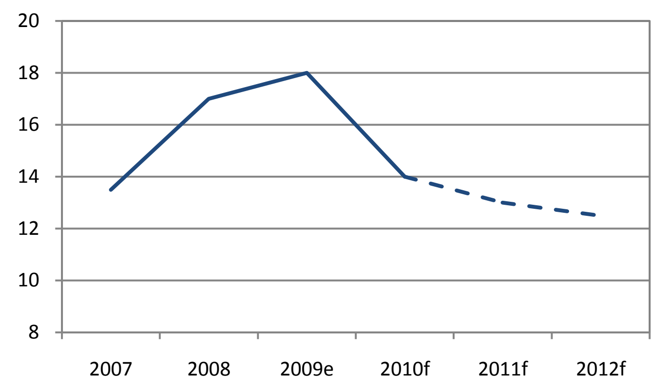
Production of crude oil and gas is expected to peak over an initial five years and thereafter decline. As such, the extractive industry, which presently just consists of mining and quarrying, is projected to expand its current contribution to GDP of 7% to beyond 10%. Initial production is projected at about 17% of non-oil GDP and is expected largely to substitute for oil imports.

Notably, the authorities are rebasing the national accounts. Preliminary back-of-the-envelope calculations suggest that the national accounts revision will result in a 50% upward adjustment in real and nominal GDP. This would match Ghana's growth performance with that of Uganda and bring it closer to middle income status. Ghana's economy and average income per person is thus presently underestimated. These revisions will improve its economic standing in sub-Saharan Africa.

Monetary policy

The subsiding of fiscal dominance has improved the potency of the Bank of Ghana's monetary policy tools and their effectiveness at containing low and stable inflation. Monetary policy will be more accommodative in 2010 owing to a lower inflation environment. Broad money growth is expected to be weak in 2010 on the back of subdued credit growth. The policy interest rate, the prime rate, has already been cut twice in 2010; by two percentage points in February to 16% and one percentage point in April to 15%. In light of the slowing inflation environment and stronger cedi, we are of the view that the Bank of Ghana has room to cut the prime rate by one percentage point before year end to 14%.

Figure 17: Prime interest rate (end year, %)



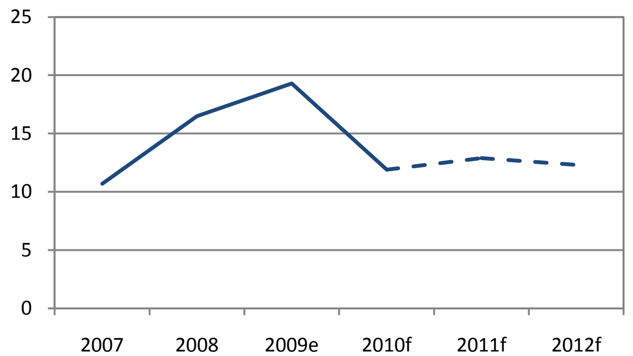
Source: Standard Bank

Ghana's lending rate to private enterprises has not taken its cue from the decreasing prime rate and yields on short-term government paper, by concurrently easing. Actually, the central bank's March 2010 survey shows that there has been a net tightening of credit to businesses and households for mortgages in the first quarter of 2010. The downwardly sticky lending rate likely reflects lending institutions' preference for keeping credit conditions tight on account of the incline of NPLs. According to the central bank, NPLs increased during 2009, and between December 2009 and February 2010 were at levels last seen in 2004, 20% of gross loans. The contractionary response of lenders is contrary to the monetary policy stance and is likely to constrain the economic recovery in 2010. On the upside, the projected decrease in the government's domestic borrowing requirement in 2010 is expected to support the crowding in of the private sector.

Although the central bank governor has appealed for commercial banks to respond to the loosening of policy by easing their lending rate, he has thus far refused to put in place upper and lower interest rate limits on deposit and lending rates. The margin between deposit rates of 16% and average lending rates of 32% is one of the highest in the world and compounds Ghanaians' ability to service their debt, even more so during an economic slowdown. The high NPL environment is not conducive to an easing credit environment and as such we expect the lending rate to remain fairly stable in 2010.

Fiscal constraint, tight lending conditions and a strong cedi support a lower inflation environment in 2010. We expect headline inflation to slow to an annual average of 12.9% in 2010, from 19.3% in 2009. Monthly food prices in the first quarter of 2010 have been lower than those of the corresponding period in 2009, which is favourable for headline inflation, especially as food constitutes 45% of Ghana's CPI. The other major pressure in CPI is fuel prices; the international oil price is expected to increase compared to last year's levels; however, a stronger cedi is expected to mute this impact on inflation. The downside risks to inflation are upward public sector wage adjustments, a poor food harvest and a stronger-than-expected global recovery that will push up fuel prices.

Figure 18: Inflation (annual average, %)



Source: Standard Bank

Monetary policy is expected to remain accommodative going into 2011 because of the weak credit extension environment and below potential growth. Ghana's credit environment will need to be addressed through an improvement in internal risk management. Banks' high capital adequacy ratio, lending that is underpinned by deposits, the resolution of the Tema Oil Refinery's debt overhang, and the passing on of international oil prices to consumers have buttressed the banking sector's health. These coupled with an economic recovery will ease credit conditions.

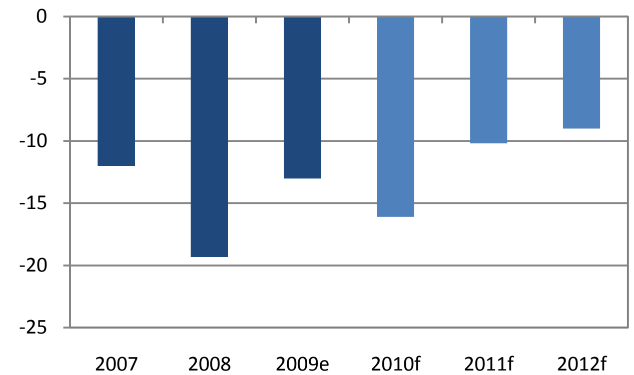
External sector

The global recovery and subsequent strengthening of commodity prices are expected to improve the country's balance of payments' position through higher export earnings, a recovery of private current transfers and stronger capital inflows. In 2009, the price of Ghana's biggest exports, gold and cocoa, supported export revenue. However, in 2010, stronger global demand for commodities is expected to boost export revenue further. The constraint placed on global cocoa supply by the political instability in neighbouring Cote d'Ivoire also helps Ghana's cocoa industry by placing a floor under prices. The government's plan to increase cocoa production to one million tonnes per annum in the medium term bodes well for the trade account.

The gold price has already exceeded the World Bank's forecast of US$1 000 per tonne and is likely to breach the US$1 200 level in the near term because of uncertainty about the global economic recovery, particularly due to elevated risks of sovereign debt defaults in the Euro area, that has elevated the yellow metal's status as a safe haven asset.

Higher commodity prices also imply a bigger import bill. The international oil price is already higher than the 2010 forecasts that were made early this year. The price of rice, another important import, is expected to remain fairly stable and below the historic peaks of the recent past, which is favourable for the squeezed import bill. However, capital equipment imports intended for the hydrocarbons sector and infrastructure projects are expected to put pressure on imports. We thus project a wider merchandised trade deficit in 2010. That coupled with a bigger services and income account deficit, owing to an increase in economic activity, implies an increase in the current account deficit in 2010.

Figure 19: Current account balance (% of GDP)



Source: Standard Bank

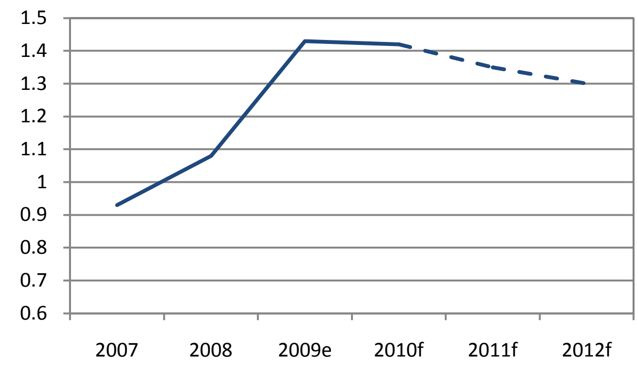
The relative improvement in global risk appetite is expected to stem the financial account's outflows in 2010. However, the lower yields may subdue the appetite for Ghana's government paper. FDI related to the oil and gas industry is expected to dominate Ghana's fixed investment in 2010. This will be complemented by public investment in infrastructure. Official financing will be sustained in 2010 by the subsequent disbursements from the World Bank's three-year interest-free loan and the IMF's Extended Credit Facility that were first made in 2009.

The upward revision in the national accounts data owing to the rebasing effect is expected to improved measures of macroeconomic performance, including the current account deficit to GDP ratio.

Overall, an improvement in the capital and financial account surplus is expected to counter the projected deterioration of the current account deficit. The balance of payments' negative balance is thus projected to narrow or possibly revert to a small positive balance in 2010, which is favourable for the country's foreign exchange position and cedi. Ghana's foreign exchange reserves improved to the recommended floor of three months at the end of 2009 and are expected to remain fairly stable in 2010.

Following two years of depreciating, the cedi to US dollar exchange rate began to recover in the second half of 2009 and strengthened moderately in the first quarter of 2010. Our real effective exchange rate analysis suggests that the cedi has become increasingly competitive in recent years. The slowdown of Ghana's domestic inflation rate implies that the differential between the country and that of its trade partners has narrowed, supporting the stabilisation of the nominal exchange rate.

Figure 20: Exchange rate (cedis per US dollar)



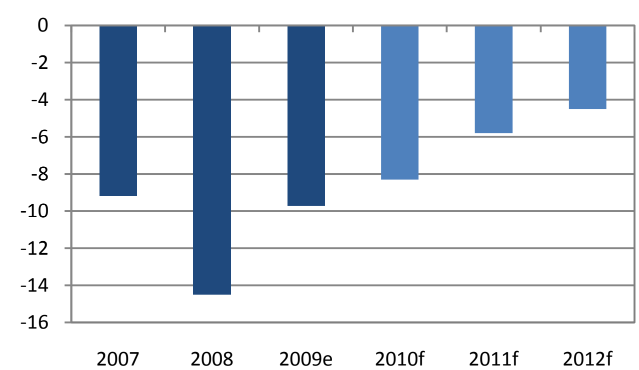
Source: Standard Bank

Over the short term as oil and gas production begin, the country's petroleum imports are expected to slow, which is supportive of a stronger foreign exchange reserves' position and narrower current account deficit. We thus expect the exchange rate to be dominated by appreciation pressures over the medium term.

Fiscal sector

The 2010 Budget proposes another year of fiscal consolidation as the fiscal authority seeks to reduce the deficit and contain it at manageable levels. The government's deficit target for 2010 is 8% of GDP and 3-5% for the medium term. Stronger economic activity and recovery of global trade are expected to improve tax revenue collections. The government expects revenue and grants to increase by 33% to Ghc9.6 billion (US$6.7 billion). This projection is based on a brisk economic recovery but the dampener on lending is likely to hinder strong recovery in activity and tax revenue.

Figure 21: Fiscal budget balance (% of GDP)



Source: Standard Bank

On the expenditure front, the government plans to increase spending by 22% to GHc10.8 billion (about US$7.5 billion). To prevent expenditure overruns the government needs to contain the wage bill, which makes up the bulk of the budget. However, the planned salary structure reform and the restraint on capital spending may not be achievable given the growing infrastructure needs. The government is under pressure to implement the 'Single Spine Pay Structure' (SPSS) that simplifies the public sector wage system and introduces pay equity for government employees and the private sector. However, ensuring that public sector wages are competitive will inflate costs. The SPSS was initially due in June 2009 and strike action could put pressure on the government to implement the reforms sooner rather than later, which would put pressure on the fiscal deficit to widen.

In December 2009, the co-chair of Ghana's Multi-Donor Budget Support (MDBS) programme, which was created by the country's development partners and the Ghanaian authorities, announced US$450 million in direct support for the 2010 Budget. The government also expected a 12% increase in grants in 2010 to about US$950 billion. Fiscal constraints in donor countries that prevent the scaling up of aid, especially after the front loading of aid in 2009, suggest that grants may come in below expectations in 2010.

The downside risk to this outlook is that a smaller fiscal deficit implies a decline in the recourse to lending. The government's domestic borrowing requirement is projected to decrease in 2010, thus allowing for the crowding in of the private sector. The projected slowdown in the take up of debt in 2010 is positive for the country's debt sustainability following the almost six percentage points' increase in public debt in 2009.

The rebasing of Ghana's national accounts data is likely to improve some core macroeconomic measures, including the fiscal deficit and public debt as a share of GDP. However, this must not detract from addressing the government's compulsive expenditure overruns. Moreover, the revised GDP data will make the ratio of tax revenue collections to GDP lower and thus result in Ghana dropping in its ranking for this indicator, against its peers. The mobilisation of additional streams of tax revenue and plugging of leakages at the various tax collection agencies are of even greater importance to the containment of a low and sustainable fiscal deficit.

Over the medium term, Ghana's fiscal environment will improve significantly on the back of a new income stream from the budding petroleum sector. Once production begins, oil-related tax revenue is expected to add five percentage points of GDP to tax revenue collections, which are presently at about 20% of GDP. This jump in tax revenue will translate into a smaller budget deficit that will narrow to a projected 4.5% of GDP in 2012, and allow for public debt to decrease to below 60% of GDP.

Despite the positive prospects of a new source of tax revenue, emphasis should not be taken away from mobilising additional tax revenue through the broadening of the tax bases. It is estimated that Ghana's informal sector employs almost 90% of the workforce, implying that the government is over-dependent on the taxation of workers in the formal sector for revenue and overlooks wealthy persons in the informal sector. Measures to formalise opaque sectors of the economy are necessary to tap into the country's latent resources.

To ensure prudent management of petroleum revenues, the ministry of finance unveiled a revenue management plan in March 2010 that provides for a clear and transparent process in the allocation of funds between the national budget and savings. Savings will mainly be directed into a sovereign wealth fund, namely the Heritage Fund, but also into a stabilisation fund that will come into effect when petroleum revenue falls below the budget. These savings will enable the fiscal authority to finance priority infrastructure projects, including electricity generation infrastructure.

Conclusion

Ghana's medium-term growth outlook looks very promising. In the near term, the global economic recovery is expected to enable a pickup in economic activity; however, it is the country's evolution to oil producer-status in 2011 that will spur its economic take-off.

An improvement in Ghanaian households' consumption expenditure on the back of a lower inflation environment and favourable harvest, and stronger investment activity are expected to manifest in real GDP growth of 5.8% in 2010, up from 4.7% in 2009. However, the expansion of national output will be constrained by conservative government consumption expenditure and a wider trade deficit.

On the production side, construction activity is projected to pick up, following its decline in 2009, on the back of a recovery in investment flows. The rebound in trade is expected to support stronger growth in the transport and communication sector, which will partly manifest through an increase in port activity. Good rains will support solid growth in the agriculture sector, which has positive implications for the manufacturing sector, particularly agro-processing. However, the tight credit environment will hinder the recovery of the financial services sector.

The commencement of oil and gas production in 2011 and its multiplier effect on the rest of the economy is projected to manifest in double-digit growth. Thereafter, growth is expected to return to and stabilise in the upper single-digit range over the medium term.

Higher commodity prices and an increase in global trade are expected to improve export earnings in 2010. However, the impact of this on the current account will be tempered by an increase in the income and services account deficit as a pickup in domestic economic activity results in an increase in repatriated investment income and services that Ghanaians outsource to foreigners. The current account deficit is thus projected to widen to 16.1% of GDP in 2010 but the effect of this on the country's foreign exchange reserves' position will be mitigated by an expected improvement in the capital and financial account balance due to higher capital inflows. The recently attained stability of the exchange rate will thus be sustained during 2010.

Monetary policy will remain broadly accommodative in 2010 owing to the significant slowdown of inflation and the tight credit environment. The prime interest rate has already been cut twice in 2010 to 15% and we expect a further one percentage point reduction by year end. The average lending interest rate has not taken its cue from the policy rate, partly because of the significant increase in the local banking sector's non-performing loans during 2009 and into 2010. As a result, lenders have elected to tighten credit to businesses and households. We thus expect credit extension to be weak in 2010.

Fiscal consolidation is expected to continue in 2010 as the authorities seek to reduce the fiscal deficit progressively. An improvement in revenue collections in 2010 owing to the strengthening of economic activity and prudent fiscal spending is expected to realise a budget deficit of 8.3% of GDP. However, over the medium term, the fiscal deficit is expected to decrease at a faster rate on account of the projected expansion of revenue collections due to a new stream of tax revenue from the hydrocarbons industry.

Ghana

Standard Bank forecasts of selected indicators

	2007	2008	2009	2010	2011	2012
National accounts						
Gross Domestic Product, real GDP growth (%)	5.7	7.3	4.7	5.8	13.3	8.9
Prices						
Inflation (annual average, %)	10.7	16.5	19.3	11.9	12.9	12.3
Monetary sector						
Policy interest rate (%), end period	13.5	17.0	18.0	14.0	13.0	12.5
Exchange rate (GHC/USD), average	0.93	1.08	1.43	1.42	1.35	1.30
External sector						
Current account (% of GDP)	-12.0	-19.3	-13.0	-16.1	-10.2	-9.0
Import cover (months), end period	2.7	2.2	3.0	3.1	3.5	3.8
Public and external solvency indicators						
Fiscal balance, including grants (% of GDP)	-9.2	-14.5	-9.7	-8.3	-5.8	-4.5
Public sector debt (% of GDP)	51.2	58.2	61.7	61.5	59.0	58.0

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