GHANA: MLT POLITICAL RISK CLASSIFICATION RECENTLY DOWNGRADED

29/11/2022

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Event

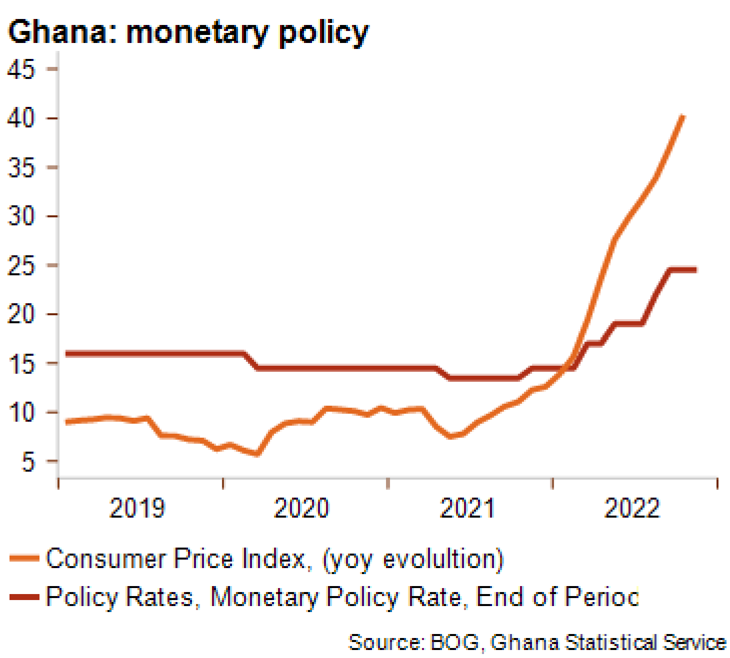
The risk of a sovereign default or profound debt restructuring has increased over the past three months. Ghana turned to the International Monetary Fund (IMF) in July 2022 for a USD 3 billion financial support programme after it lost access to the financial markets earlier this year. To cover its financial needs, Ghana's government has been taking on expensive domestic debt and turned to the central bank for monetary financing. Ghana is expected to be locked out of the international financial markets for quite some time and restructuring domestic and/or external debt might be a condition for accessing financial support from the IMF. The cedi has been one of the worst performing currencies this year amid spiralling inflation that reached 40% in October 2022. As the real economy is progressively being affected by the high risk of a sovereign debt crisis through tight foreign exchange availability, high inflation, large exchange rate depreciation, soaring financing costs and aggressive efforts to increase tax revenues, Credendo decided to downgrade Ghana's MLT political risk classification from category 5 to 6.

Impact

Ghana's public finances have gradually worsened over the years, following years of loose government spending (especially in election periods), the end of the commodity price boom in 2014 and serious energy crises. Moreover, following debt relief under the Heavily Indebted Pour Countries (HIPC) Initiative in the early 2000s, almost two decades of extensive borrowing and spending was not matched by a structural increase in revenues. Consequently, Ghana's public debt sustainability has been classified as 'at high risk of debt distress' by the IMF since 2016. In 2020, decisive actions to mitigate the impact of Covid-19 helped the business environment and households, but came at a major fiscal cost. Although Ghana was eligible for the Debt Service Suspension Initiative (DSSI), it did not make a request for debt service suspension to cover the immediate financial needs related to the Covid-19 pandemic. Instead, it maintained a strategy of large external borrowing and issued a USD 3 billion Eurobond early 2021. In 2022, the Russian invasion of Ukraine quickly worsened the situation both indirectly, with global food prices jumping up, and directly as Ghana imports a quarter of its wheat from Russia. Early this year, it became clear that public finances were further derailing and Ghana lost access to the international capital markets while credit agencies started downgrading Ghana to levels reflecting a substantial risk of default.

GDP growth was revised down for 2022 from 5.2% to 3.6% and the projection for 2023 was lowered to 2.8%. The fiscal deficit is expected to reach 9.2% of GDP in 2022 and is forecast to be higher than 8% for the next three years despite the limited primary deficit (fiscal deficit before interest payments). Indeed, the government's interest burden is the main concern until at least 2025 (at current policies). About 90% of the external public debt is denominated in foreign currency, so with global interest rates rising and the US dollar appreciating, Ghana might no longer be able to service its foreign debts.

The impact of a public sector crisis on the private sector is fears and has been spiralling faster during the past three months. Ghana's government bond yields are trading at more than 20% and the cedi lost almost 60% against the US dollar this year, making it one of the worst performing currencies in the world. Gross international reserves took a sharp dive and in order to stabilise the foreign exchange market, the Ghanaian government might choose to prioritise certain imports while other types of capital controls could also be considered. Obviously, this raises the risk of non-payment in international transactions considerably. The weakening exchange rate has pushed year-on-year inflation to 40% in October (see graph), raising the cost of living and putting additional pressure on foreign currency denominated debt servicing. In its efforts to lower the pressure on the cedi and halt inflation, the Bank of Ghana has been aggressively raising the policy rate up to 24.5% in October. The monetary policy is likely to further tighten as the real policy rate is still negative. Due to expensive domestic borrowing terms, Ghana has once again been turning to its central bank for budget financing despite the fact that monetisation further worsens inflation.



Deprived of international (and domestic) financial access, Ghana started negotiating with the IMF in July to secure a USD 3 billion financial support programme. Under current circumstances, a public debt restructuring – be it domestic and/or external – might probably be required as prospects for recovered debt sustainability are a precondition for IMF financial support. However, in order to restore public debt sustainability more structurally, painful reforms and fiscal discipline will also be imposed by the IMF. That is a politically unpopular road that could encourage social unrest. In addition, stalled anti-corruption

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