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GHANA: PROJECTIONS CLOUDED BY HIGH PUBLIC DEBT VULNERABILITIES

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Event

Ghana's economic activity has bounced back since 2021 and thanks to strong global commodity markets, GDP growth is expected to reach 5.2% this year, while current account revenues are set to remain rather elevated. Nevertheless, the government is likely to face stress to finance its government budget because debt vulnerabilities have further deteriorated since early 2022. In May, the IMF confirmed that the Ghanaian government did not make a programme request to help fund its immediate financing needs.

Impact

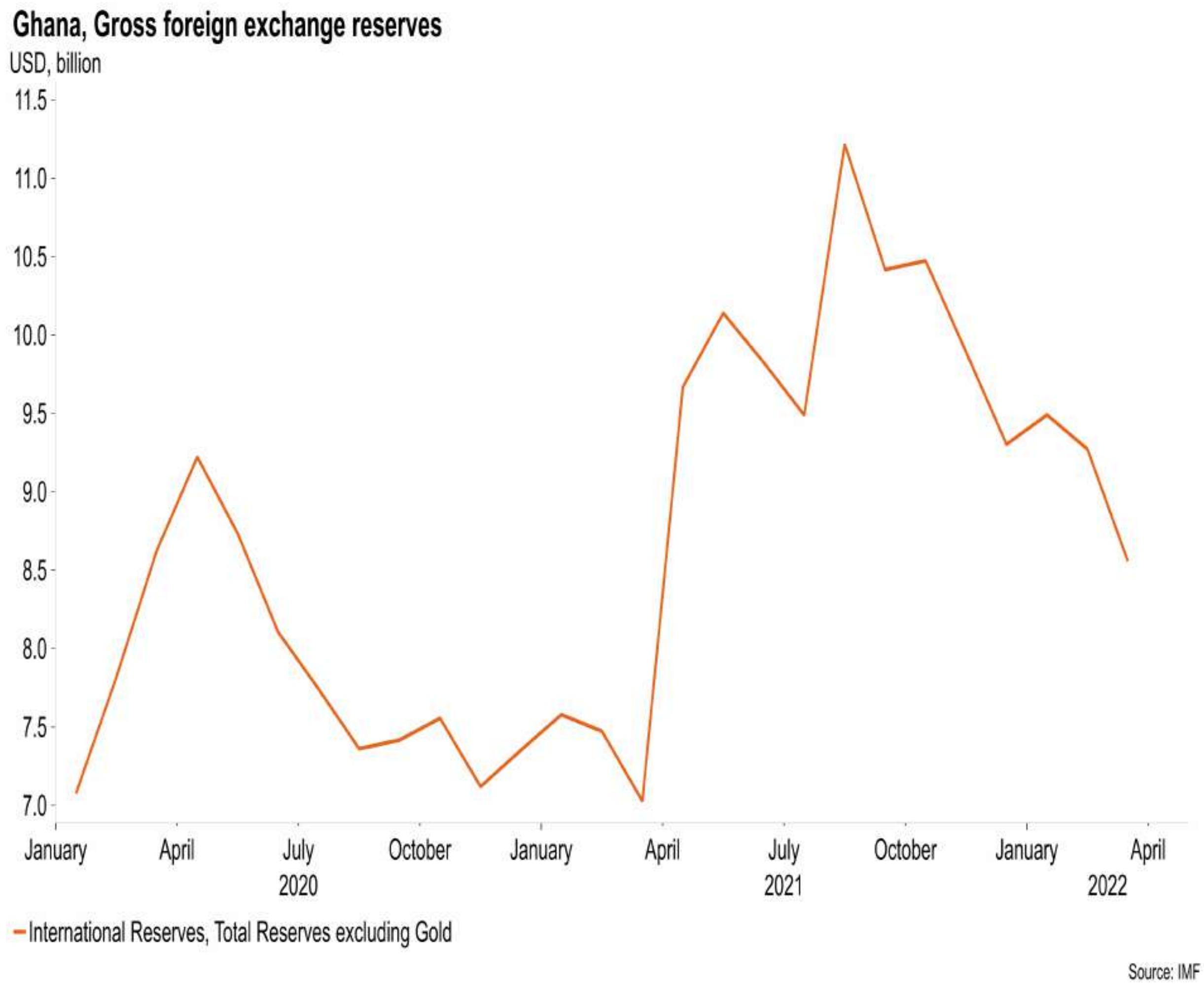
Ever since the birth of its multi-party democracy in the early 1990s, Ghana has remained one of the most stable countries in the region. However, an important weakness of Ghana's democratic process is the loose election spending and costly campaigns, which have been major culprits to periods of outsized budget deficits. Ghana's public finances have gradually worsened over the years, following election-related fiscal slippages, the end of the commodity price boom in 2014 and a serious energy crisis. In 2020, decisive actions to mitigate the impact of the Covid-19 pandemic helped the business environment and households, but came with a major fiscal cost. Public interest payments in 2020 absorbed half of that year's total public revenues, while the fiscal deficit amounted to more than 15% of GDP, further aggravating concerns over Ghana's public debt sustainability, which has been at 'high risk of debt distress' according to the IMF's Debt Sustainability Analysis (DSA) for years. In 2021, the budget deficit reached double digits again, pushing the gross public debt stock to 81.8% of GDP (567.9% of public revenue) while the interest burden reached more than 50% of public revenues, the second highest ratio in the world following Sri Lanka. Without a significant increase in revenues, the burden of these interest payments could spark a debt crisis in the near term.

Although Ghana was DSSI-eligible, 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 in early 2021. Although the country has tapped international markets extensively – which seriously increased public debt and debt service ratios – investor appetite has remained strong over the years. However, since March 2022, the perception of the markets regarding Ghana's sovereign debt sustainability has turned very negative. Credit agencies started downgrading Ghana to levels reflecting a substantial risk of default. Ghana's sovereign spreads increased significantly and the cedi has lost about 27% since the start of the year. As a result (and amid high commodity prices and Central Bank financing of public deficit), inflation soared to 23.6% in April 2022.

The Russian invasion in Ukraine made things worse quickly, indirectly, with global food prices jumping up, and directly, as Ghana imports a quarter of its wheats from Russia. The Central Bank of Ghana reacted aggressively with the highest rate hike in its history, raising the policy rate to 19%. Higher domestic interest rates will further worsen the government's debt service burden, as about 40% of Ghana's government debt is held domestically. Moreover, Ghana been trying to expand its revenue base through intensified audits on tax evasion while touchy energy contracts are being renegotiated. Moreover, recently, a very controversial 1.5% levy on digital transactions has been introduced, including on mobile payments. It is expected to modestly improve public revenues but also generate significant popular discontent and possibly weaken domestic consumption and digital innovation.

In the coming years, the IMF does not expect a turnaround and the gross public debt stock would further increase. Even though the primary balance (fiscal balance excluding interest payments) is expected to improve, a substantial fiscal gap will further derail public finances, which are already in unsustainable territories. It will be vital for Ghana to regain access to financial markets to refinance large bonds coming due. Although no request has been introduced so far, lacking financial access could drive Ghana to the IMF for liquidity support and to its external creditors for debt retreatment. Moreover, the majority of the external public debt is denominated in foreign currency, creating a significant exchange rate risk, while today's global financial volatility and rising interest rates worldwide could bring about further currency depreciation, capital flight and higher refinancing costs. Indeed, with US interest rates rising, Ghana could become one of the countries no longer able to service its debts, with borrowing costs too high to roll-over the debt.

Its relatively well diversified export base (services, gold, fuel, food) has helped Ghana keep its current account balance deficit under control, balancing around 3% of GDP since 2017. In 2020, the Covid-19 pandemic caused a dip of 10% in current account receipts, but a drop in payments kept the deficit under control. Moreover, high commodity prices and rising fuel and gold production are expected to support Ghana's export revenues. Moreover, the 2022 current account deficit would be fully financed thanks to significant FDI inflows, although portfolio and other investment inflows could turn negative. With foreign exchange reserves still amounting to more than USD 8 billion (3.5 months of import cover in December 2021), the liquidity position should be strong enough to cover a temporary dip in financial inflows. However, foreign exchange reserves were artificially propped up by the Eurobond sales and SDR allocation last year. The Ghanaian cedi is not fully free floating, but floating with a margin against the USD exchange rate, requiring Central Bank interventions. Given the serious pressure on the cedi, foreign exchange reserves are expected to drop if no additional exchange rate flexibility is allowed. In fact, we do see a falling trend in foreign exchange reserves since last summer.



On the positive side, the total external debt level (the vast majority being public) remains in maintainable territories but large bonds due in the coming years could seriously raise debt servicing pressure at that time. All in all, we could say that the major risks are concentrated on Ghana's public finances with a terribly high interest burden. The solvency position of the entire economy seems to be in a much better state when looking at the total external debt ratios, the current account balance and high FDI inflows. Nevertheless, should the Ghanaian sovereign default, this would have a negative spillover effect on the entire economy. With regard to the risk for political destabilisation, stalled anti-corruption reforms and rising costs of living have been leading to a growing anti-government sentiment and protest risk. Moreover, jihadist groups in the Sahel continue to expand their operations into coastal West African nations. Besides Mali, Burkina Faso is the foremost concern due to its large shared borders with Ghana, Benin, Togo and Côte d'Ivoire. We can conclude that Credendo's political risk outlook for Ghana is negative.

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