

**WEST AFRICAN MONETARY AGENCY  
(WAMA)**



**ECOWAS MONETARY COOPERATION PROGRAMME**

**MACROECONOMIC CONVERGENCE REPORT  
2007 GHANA**

**FREETOWN, JUNE 2008**

The country's 2007 macroeconomic policy focused on accelerating growth through poverty reduction while preserving macro-stability. The growth strategy centered on public sector investments, large infrastructural projects as well as the removal of supply bottlenecks in the energy sector and private sector development. These objectives were underpinned by prudent fiscal management and a monetary policy flexible enough to respond to external shocks, ensure price stability and maintain positive real interest rates to promote international trade.

Against this background, the 2007 macroeconomic framework was anchored on the following targets:

- real GDP growth rate of at least 6.5 percent;
- an end-period single digit inflation rate between 7.0–9.0 percent;
- an overall budget deficit of 5.7 percent of GDP;
- accumulation of international reserves to at least three months of import cover and a stable exchange rate.

In 2007, Ghana continued to experience shocks from the escalating crude oil prices on the international market and energy crisis on the domestic front. Notwithstanding these challenges, the economy responded positively to the macroeconomic policies. The provisional macroeconomic indicators show that the economy remained buoyant with moderate inflationary pressures. Underpinned by rising foreign exchange reserves, the exchange rate remained relatively stable against the major international currencies. Interest rates also trended downwards reflecting an increasing availability of loanable funds.

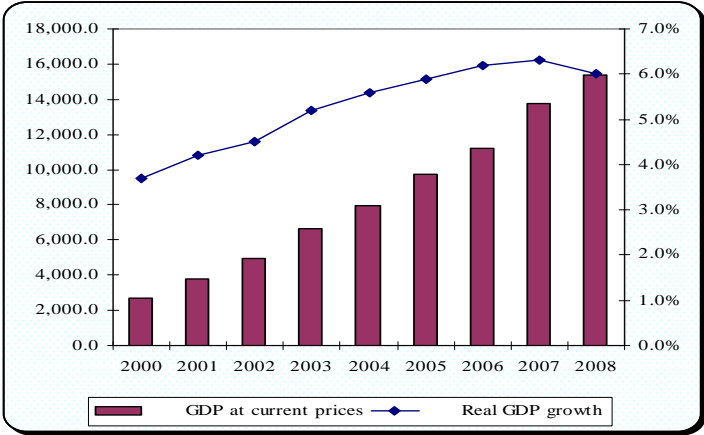
**1 Sector Analyses**

**1.1 Real Sector**

The available data indicates that the economy remained buoyant in 2007 with a real GDP growth rate of 6.2 percent<sup>1</sup>, albeit the outcome was marginally below the projected rate of 6.5 percent. The lesser-than anticipated performance was attributed to erratic rainfall patterns and the energy crisis that adversely affected the agricultural and industrial sub-sectors respectively.

The agricultural sector grew by 3.1 percent against 4.5 percent in 2006. Cocoa production dwindled whilst the fishing industry underperformed as a result of inadequate fisheries resources.

**Graph 3.37 : Trends in Nominal GDP and Real Growth Rate**



<sup>1</sup> Real GDP growth in 2006 was 6.4 percent.

Industry grew by 6.6 percent compared to 9.5 percent in the preceding year. The mining and quarrying industry recorded a significant growth rate of 30.0 percent, due mainly increases in gold and bauxite production. The construction industry also contributed moderately as the government invested heavily in infrastructure (roads, schools, stadia and others). However, the electricity and water sub-sector recorded a negative growth of 15.0 percent and manufacturing activities slowed down due to inadequate power supply.

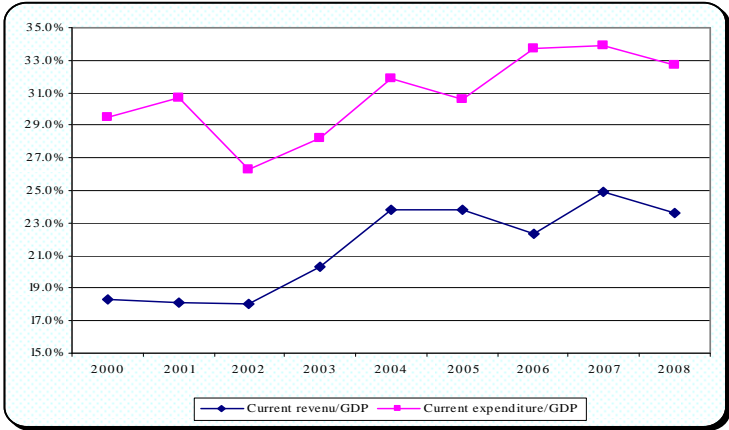
Economic activities in the services sector accelerated by 10.0 percent compared to 6.7 percent in 2006. The deepening of reforms in the financial sector led to robust growth in this sub-sector. Transport, communication, trade and the hospitality services also contributed to the favourable performance in the services sector.

**1.2 Public Finances**

Given the recent excesses in fiscal policy, the government introduced a number of reforms in 2007 that aimed at preserving macroeconomic stability. These included the cutting of nonessential capital expenditure, curbing of expenditure overruns, containment of domestic debt and a combination of other measures to strengthen revenue collection and administration.<sup>2</sup>

In spite of the above stringent policies, fiscal performance continued to deteriorate in 2007. The provisional outturn indicates that the overall budget deficit (on commitment basis including grants) increased further from 7.1 percent of GDP in 2006 to 8.5 percent<sup>3</sup>. The overall budget deficit balance on commitment basis excluding grants increased from 12.6 percent to 14.7 percent in 2007. The domestic primary balance (excluding interest payments) also enhanced from a deficit of 4.9 percent of GDP to 6.1 percent.

**Graph 3.38** : Trends in Current Revenue and Expenditure



The fiscal operations resulted in a borrowing requirement of GH¢132.2 million, 63.0 percent of which was financed from domestic sources, particularly through money creation and borrowings from the private sector. About 14.0 percent was financed from external sources by way of project and programme loans whilst the rest was financed from amounts accruing from the HIPC and MDRI initiatives and non-concessional borrowing.

<sup>2</sup> The government created a National Audit Team and Large Tax Payers Unit, introduced a cash-based budgetary system, revised the VAT rate from 10.0 percent to 12.5 percent and introduced a 5.0 percent imports duty on previously zero-rated items and 10.0 percent withholding tax on rental income.

<sup>3</sup> The overall budget deficit (on commitment basis) in 2005 was 1.7 %.

The provisional outturn further indicates that revenue mobilization continued to improve during the year under review. Total domestic revenue increased by 43.0 percent over the outturn in 2006 to GH¢ 3,651.0 million, representing 26.0 percent of GDP. Tax revenue represented 23.6 percent of GDP compared with 20.2 percent in the preceding year. On the other hand, non-tax revenue represented 2.4 percent of GDP against 0.8 percent in 2006.

Total grant disbursements from the country's development partners amounted to GH¢ 857.2 million, representing 6.1 percent of GDP. This outturn reflects a 35.0 percent increase over the level received in 2006.

On the other hand, total expenditure (including net lending) rose from 34.9 percent of GDP to 40.6 percent in 2007. The fiscal excesses encountered in 2007 were attributed to a number of factors, including significant outlays made to address the lingering energy crisis that started in 2006 and improve electricity generation and transmission. In addition, the government expended extensively on the celebration of the country's fiftieth anniversary, AU Summit, 2008 African Cup of Nations, AGOA conference, educational reforms and a decentralization programme that resulted in the creation of more district assemblies during the year.

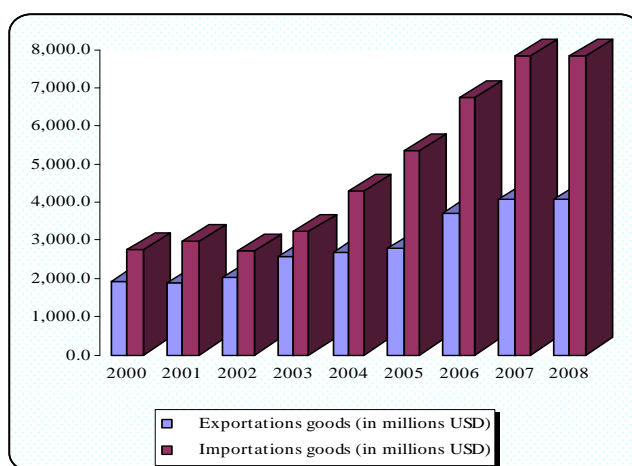
Recurrent expenditure, which represented 64.6 percent of total expenditure, increased by 43.9 percent to GH¢ 3,684.3 million (equivalent to 26.4 percent of GDP) in 2007. The discretionary component of recurrent expenditure continued to thwart government's effort in expenditure control. Salaries and wages increased by 24.8 percent to GH¢ 1,418.8 million, representing 38.5 percent of recurrent expenditure, whilst goods and services (including outlays on education and health) represented 15.5 percent of recurrent expenditure. On the other hand, statutory payments in respect of transfers (comprising pensions, gratuities, social security, national health fund, subsidies to utility companies and others) constituted 29.0 percent of recurrent expenditure. Statutory interest payments on both domestic and external debts also continued to decline from 3.4 percent of GDP to 3.1 percent in 2007.

Total capital outlays, which represented 11.7 percent of GDP, amounted to GH¢ 1,630.2 million, out of which 54.5 percent was financed from domestic sources. The outturn for capital expenditure shows a 42.3 percent increase over the amount expended during the preceding year. About 42.8 percent of the domestic capital outlays were financed from amounts accruing from the HIPC and MDRI initiatives.

### 1.3 External Sector

The provisional data indicates that the balance of payments experienced some constraints in 2007 as the overall surplus balance declined from of USD 415.1 million in 2006 to USD 413.1 million, representing 5.1 percent of GDP.

**Graph 3.39:** Trends in Exports and Imports



The deficit balance on the current account widened from 21.5 percent of GDP to 28.7 percent in 2007, mainly due to unfavourable developments in merchandise trade. Exports increased moderately by 12.6 percent as both the output level and value of the country's traditional and non-traditional exports improved. Imports rose significantly by 19.5 percent, driven by the importation of equipments for the construction industry, energy crises and other goods for the Ghana @50 celebrations.

Current transfers, comprising private inflows rebounded during the year, increasing by 16.2 percent to USD 2,075.4 million, compared with the 5.7 percent growth recorded in 2006. These inflows helped to mitigate the constraints on the current account. Net services in respect of freight and investment income also enhanced moderately.

The capital and financial account remained buoyant in spite of a relative decline in official capital inflows. Direct and other investments more than doubled to USD 2,346.9 million. The financial transactions on the balance of payments led to an increase in the stock of external reserves from USD 2,266.7 million to USD 2,836.7 million, which was equivalent to 4.5 months of imports cover.

Trends in exchange rate developments in 2007 indicate that the cedi maintained its relative stability against the major international currencies. It depreciated marginally by 1.9 percent against the US dollar, by 5.6 percent against the pound sterling and by 8.0 percent against the euro.<sup>4</sup> The relatively higher depreciation of the domestic currency against the pound and euro may be explained by their appreciation against the US dollar on the international foreign exchange market.

The external debt position of Ghana stood at USD 3,586.7 million at end-2007 compared to USD 2,177.2 million in the preceding year. Debts owed to multilateral agencies (IMF, World Bank and others) constituted about 47.7 percent of the debt stock. The rest were borrowings from bilateral development partners, international capital market and other concessional loans. About 94.6 percent of the

<sup>4</sup> In 2006, the cedi depreciated by 13.4%, 1.1% and 10.9 percent against the pound sterling, US dollar and euro respectively.

outstanding debts are long-term loans. The analysis shows that the external debt position of Ghana is currently sustainable.<sup>5</sup>

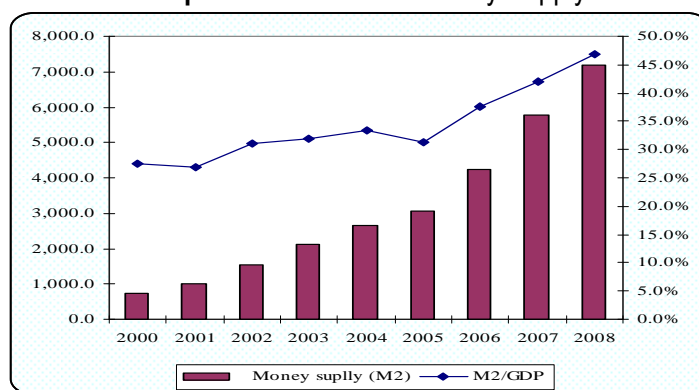
#### GHANA: EXTERNAL DEBT SUSTAINABILITY DATA

	2003	2004	2005	2006	2007
External Debt Position (USD)	8,034.6	6,367.9	6,749.8	2,177.2	3,586.7
External Debt/GDP (%)	72.2	63.5	22.3	24.6	26.7
Debt Service Payments/Exports (%)	4.4	5.5	7.5	4.5	4.6
Debt Service Payments/GDP (%)	1.7	2.2	2.0	1.3	1.3

#### 1.4 Monetary Sector

A major development in the financial sector was the re-denomination of the domestic currency by setting ten thousand cedis to one Ghana cedi (¢10000 = GH¢ 1) on July 1, 2007. According to the Bank of Ghana, this policy decision was intended to remove the dead weight burden that the old cedi regime placed on the economy and enhance efficiency gains in business.<sup>6</sup> The Bank of Ghana continued its inflation-targeting policy which aimed at achieving single digit inflation and maintaining exchange rate stability.

Graph. 3.40 : Trends in Money Supply



The provisional data indicates that monetary policy was rather expansionary as reserve money increased above 30.0 percent in both 2006 and 2007. Broad money supply ( $M_{2+}$ ) grew significantly by 36.3 percent, even though it was 2.5 percentage points below the growth rate recorded in 2006.

The increase in broad money supply in 2007 was attributed to a significant rise in net domestic assets through the money creation activities of the banking system. Net foreign assets also grew by 10.1 percent compared to 19.5 percent in the preceding year. The growth in broad money supply reflected significant increases in demand deposits and quasi-money (savings, time and certificate of deposits) whilst the growth in foreign currency deposits slowed down 10.0 percent.

<sup>5</sup> According to the IMF, a country is regarded as severely indebted if the ratio of scheduled debt service to export of goods and services is above 25.0%.

<sup>6</sup> The difficulties using the old currency related to high transaction costs at the teller points, the inconvenience and high risks in carrying large currency loads and increasing difficulties in bookkeeping, maintenance of statistical records and electronic data processing.

## GHANA: GROWTH IN KEY MONETARY AGGREGATES

	2002	2003	2004	2005	2006	2007
Reserve Money	42.6	33.4	18.5	1.2	32.3	30.6
Broad Money(M <sub>2+</sub> )	48.8	35.8	27.7	14.3	38.8	36.3
Narrow Money(M <sub>1</sub> )	60.5	34.8	31.7	6.3	35.1	40.7
Currency In Circulation	51.2	35.7	15.2	9.9	27.0	29.3
Demand Deposits	74.5	42.0	44.6	2.8	43.7	51.5
Quasi Money	30.7	45.3	22.5	30.6	47.5	48.1
Foreign Currency Deposits	49.7	28.8	24.1	16.1	36.8	10.0

Source: Bank of Ghana

Net credit extended by the banking system to government declined by 21.0 percent to GH¢ 1,162.7 million. The outstanding credits held by the private sector increased by 59.4 percent (compared to 42.6 % in 2006) to GH¢ 3,312.6 million, reflecting the high lending activities of the deposit money banks. Credits extended to public sector institutions also enhanced significantly by 88.1 percent to GH¢ 858.8 million. About GH¢ 44.0 million was also used to finance cocoa purchases during the year under review.

Notwithstanding the escalating international oil prices and energy constraints in the real sector, the level of inflation (end-period) upped moderately from 10.9 percent to 12.8 percent by December 2007. The average food inflation stood at 11.0 percent compared to 11.8 percent in the preceding year. The average inflation on non-food commodities also declined from 14.2 percent to 12.3 percent. Given the credit injections to the economy during the year, this outcome was attributed to the effective liquidity management by the Bank of Ghana.

The Bank of Ghana prime rate increased by 100.0 basis points to 13.5 percent, signalling a policy intention to address the liquidity problem amidst the inflationary pressures experienced, especially, during the last quarter of the year. In this regard, the discount rate on 91-day Government Treasury bills increased from 9.4 percent to 10.3 percent, albeit, the fixed rate on the medium term Treasury note continued to decline reflecting an increasing demand for short-term government borrowing. Interest rates in the money market continued to trend downwards. The average savings rate declined by 100.0 basis points to 4.6 percent whilst the average lending rate also dipped by 50.0 basis points, thereby, increasing the spread between the savings and lending rates. It should be underscored that the prevalence of negative real interest rates (measured as the difference between the minimum savings rate and inflation) and the increasing interest rate spread would adversely affect financial intermediation.

### 3 PERFORMANCE UNDER MACROECONOMIC CONVERGENCE

Performance under macroeconomic convergence rather deteriorated in 2007 as the country met none of the primary convergence criteria, having missed out on the budget deficit financing criterion. However, Ghana achieved three of the secondary criteria (domestic arrears, tax revenue and public investment).

#### GHANA: STATUS OF CONVERGENCE

	target	2002	2003	2004	2005	2006	2007	2008*
<b>Primary Criteria:</b>								
i) Budget Deficit/GDP	≤4%	5.2	7.5	9.1	6.9	12.6	14.7	8.9
ii) Inflation Rate	≤5	15.2	23.6	11.8	13.9	10.9	12.8	19.8
iii) Budget Deficit Financing	≤10%	12.1	0.0	1.6	0.0	0.0	15.6	5.0
iv) Gross External Reserves	≥6m	2.6	4.9	4.5	4.0	3.7	4.5	5.6
<b>Secondary Criteria:</b>								
i) Domestic Arrears	n/a	n/a	n/a	n/a	n/a	n/a	0.0	0.0
ii) Tax Revenue/GDP	≥20%	17.9	19.6	21.8	20.8	20.2	23.7	22.9
iii) Salary Mass/Tax Revenue	≤35%	52.0	47.6	42.8	44.1	53.1	46.8	50.1
iv) P. Invest/Tax Receipts	≥20%	13.6	18.8	20.0	18.8	26.5	27.3	34.3
v) Real Interest Rate	≥0	-2.2	-13.9	-2.3	-8.5	-3.5	-8.2	-12.9
vi) Real Exchange Rate**	±5%	3.7	0.7	-1.1	10.2	5.8	-8.4	1.4
<b>Total No. Of Criteria Met</b>		1	2	4	2	3	3	5

Source: WAMA

\*projected end-2008 data

#### 3.1 Primary Criteria

Performance under the primary criteria generally worsened during the year under review. In spite of the recent successes in revenue mobilization, performance on the budget deficit criterion (on commitment basis excluding grants) degenerated from 12.6 percent of GDP in 2006 to 14.7 percent, thus, missing the required target by a wide margin. As in the preceding year, this deteriorating performance was due to the massive infrastructural developments and excess budgetary expenditure incurred in 2007.

Contrary to the expectation for a single digit target, inflationary pressures increased moderately during the year under review. A combination of factors explained this phenomenon, including, the expansionary monetary policy, the relative shortfall in food production and the escalating crude oil prices that impacted negatively on the prices of all consumer commodities.

Due to the fiscal constraints experienced during the year, the government resorted to financing from the central bank, thus, exceeding the maximum limit of 10.0 percent of previous years' tax revenue. This development was an exception as the government has, in recent years, avoided deficit financing from the central bank.

Although Ghana was not able to meet the required target, performance on gross external reserves was very encouraging as the level increased from 3.7 months of imports cover to 4.5 months. Notwithstanding the increasing imports, the massive foreign exchange inflows from both private and official sources accounted for this rising trend.

#### 3.2 Secondary Criteria

The improvement under the secondary criteria was however encouraging. For the first time, Ghana met the criterion on domestic arrears in 2007 following indications from the fiscal authorities that it had liquidated its domestic arrears as at end-2007. This development was encouraging.

The volume of tax revenue relative to GDP was above the minimum target at 23.7 percent, signifying the success of the recent revenue enhancement measures adopted by the government. The data indicates that Ghana has been able to sustain this performance since 2004.

After achieving the required target in 2006, the country made further progress on public investments policy by surpassing the required target at 27.3 percent. Aided by the increasing domestic revenue, the commitment of the government of Ghana in pursuing its developmental strategy accounted for this achievement.

The recent improvement in revenue mobilization led to a moderate easing of the wage burden from 53.1 percent of tax revenue to 46.8 percent, albeit, it was still quite high above the required maximum limit of 35.0 percent. The high wage burden calls for further reforms to streamline the size of the public sector and enhance productivity.

As in recent years, real interest rates remained negative. The declining interest rates suggest an increasing availability of loanable funds which may influence investment positively in the short-run. However, the persistence of negative real interest rates may adversely affect financial intermediation in the long-run.

In spite of the relatively stable nominal exchange rate of the domestic currency, the country did not meet the required target on real exchange rate stability.

#### **4 Policy Prospects for 2008**

Prospects for 2008 are favourable. Output has been projected to accelerate by 7.0 percent. The government intends to achieve this feat by intensifying its wealth creation and sustainable poverty reduction strategies and scaling-up its investments in energy, roads, railways, information and communications technology. Fiscal policy, which is intended to maintain long-term financial and debt sustainability, focuses on increased revenue mobilization and continued strengthening of public expenditure management, including public sector wages and privatization of state owned enterprises.<sup>7</sup>

The main challenges of the facing the economy are the high oil prices in the international oil market and the lingering energy crisis which may thwart government efforts at maintaining macroeconomic stability. Available records indicated that the general price level increased by 4.6 percent during the first quarter of the year of the year, suggesting an annualized inflation rate of 19.8 percent. The increasing inflationary pressure may be attributable to the lagged effects of the excess liquidity crated in 2007, the escalating crude oil prices and energy crisis. However, the performance of the exchange rate during the same period shows that the domestic currency would remain resilient with estimated depreciations of 5.5 and 1.0 percent against the pound sterling and US dollar respectively. The exchange rate is also expected to remain stable given higher expected foreign exchange inflows from the private and donor community and a reduction in demand due to debt relief. The moderately increasing inflationary pressures and increasing demand for loanable funds and higher government borrowing from the private sector may reverse the recently declining trend in the general structure of interest rates, especially on short-term financial assets.

The projections indicate that the improvement in performance under macroeconomic convergence would be marginal. *Ceteris paribus*, the country will meet the budget deficit financing criterion and sustain the four secondary targets realized in 2007. Even though fiscal policy is expected to ease moderately in 2008, the budget deficit/GDP ratio would be high, given the continued labour agitations,

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<sup>7</sup> The government has instituted measures to broaden the tax base, computerizes the operations of the revenue collecting agencies and undertakes other enforcement actions.

the demand for higher investment in the energy and industrial sectors and the escalating crude oil prices. Inflation will remain a major challenge. However the level of external reserves in months of imports cover would continue to improve, albeit, the country would miss the required target of 6.0 months narrowly.<sup>8</sup> With regard to the secondary criteria the country would be expected to meet the required targets on tax revenue, public investment and real exchange rate stability. However, the authorities would continue to grapple with the wage burden and the persistent negative real interest rates.

## **5 CONCLUSION AND RECOMMENDATIONS**

Ghana faced significant challenges in 2007, relating to the high and ever-increasing crude oil prices, energy crisis and unfavourable weather conditions. Nevertheless, the economy of Ghana remained buoyant. Even though inflation remained above the programmed single-digit target for the year, the anticipated upward pressures were adequately controlled by the Bank of Ghana, aided by the relatively stable exchange rate.

Attempts to address the various challenges impacted negatively on fiscal policy, owing to numerous contingencies for extra-budgetary and un-programmed expenditure. In addition, the high wage burden, interest payments, government subsidies and transfers continued to thwart government's efforts in expenditure control, highlighting concerns for a bloated public sector and the granting of excessive subsidies to certain public sector institutions in a bid to address the energy crisis. These concerns underscore the need for government to encourage private sector participation in the energy sector in order to help control government expenditure.

Monetary policy fared creditably in containing inflation, given the liquidity created during the year by the banking system. The snag related to the persistence of negative real interest rates and the large spread between the savings and lending rates. The external sector experienced some constraints mainly due to a higher demand for both oil and non oil imports to address the energy crises. In spite of these difficulties, the country's external reserves enhanced, driven mainly by higher external inflows from both official and private sources. Performance under the convergence programme was not very encouraging as the country did not meet any of the primary targets.

However, the macroeconomic policies outlined in the 2008 budget statement are realistic and adequate to address the difficulties encountered in 2007, particularly, in respect of price stability, the fiscal excesses, the energy crises, the crude oil price shocks, negative real interest rates and the adverse gap on merchandise trade.

In addition to addressing the above problems, government policy for 2008 aims at enhancing output by increasing economic capacity and productivity and establishing adequate infrastructural base to facilitate private sector investment. In this regard, the following recommendations may be relevant in complimenting government policy:

1. support private sector participation in the energy sector;
2. undertake extensive irrigation projects relying on the availability of numerous water bodies throughout the country to forestall the country's over-reliance on rainfall for agricultural production;
3. minimize subsidies and ensure proper pricing of goods and services provided by public institutions;
4. strengthen liquidity management, moderate increases in money supply and avoid budget deficit financing through money creation;

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<sup>8</sup> The projections show that the constraints in the balance of payments would ease considerably in 2008 on account of an improving trade deficit and higher foreign exchange inflows from both official and private sources.

5. accelerate the programme for private sector development to support growth and employment while accelerating the public sector reforms.