Henry A Kofi Wampah: Ghana – macroeconomic developments and outlook for 2015

Address by Mr Henry A Kofi Wampah, Governor of the Bank of Ghana, at the 2014 Chartered Institute of Bankers (GH) Annual Bankers' Dinner, Accra, 29 November 2014.

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Mr. Chairman,

The President of the Chartered Institute of Bankers, Ghana,

The Deputy Governor,

CEOs of Banks,

Distinguished Bankers,

Distinguished Guests,

Members of the Press,

Ladies and Gentlemen,

It gives me great pleasure to be in the midst of esteemed bankers and colleagues to exchange views and information on the banking system and to share with you some perspectives on monetary policy and banking sector developments over the past year as well as the Bank of Ghana's policy vision for the coming year. I feel particularly honoured and thankful for your kindness in naming this evening's event ***Governor's Day***.

Mr. Chairman, it is not an understatement to say that 2014 has been a very challenging year with external sector shocks and domestic macroeconomic imbalances, which reflected in a steep depreciation of the cedi and rising inflation. As bankers, I know you faced your own challenges and had to dig deep into your arsenal of knowledge and experience to navigate the turbulent waters. I believe that as a country, we came to the edge of the precipice, but through our collective efforts, enterprise, and determination we have pulled through and would turn the tide and restore this economy to a sustainable growth path as we continue to work together on the remaining challenges. Even though the challenges are not over, I believe that at least the level of despair has diminished and confidence is rebounding.

Before I move on to give you a sense of the policy direction for 2015, let me quickly review the macroeconomic landscape and developments in the banking sector in the year that is fast drawing to a close.

Macroeconomic developments

Growth and inflation

Several factors, both global and local, have contributed to lower than expected growth for the review year. The Bank of Ghana's assessments of growth in the first three quarters of 2014 show that energy sector challenges, in particular, have lingered and adversely impacted economic activity in Ghana.

The latest release of GDP figures by the Ghana Statistical Service showed some moderation in economic activity. Real GDP growth declined to 5.3 percent in the second quarter of 2014, compared with 10.8 percent recorded in the same period last year. The major subsectors contributing to the drag on growth were manufacturing, electricity production, and hotels and restaurants.

In the third quarter, indicators of economic activity reflected by the Bank's Composite Index of Economic Activity (CIEA) declined to 7.8 percent compared with 9.6 percent in the third quarter of 2013.

On a positive note, however, the latest business and consumer surveys, point to improvements in both business and consumer sentiments, as economic conditions turned around in the later part of the third quarter.

Consumer price inflation has trended upwards steadily since the beginning of the year. From 13.1 percent (year-on-year) in October 2013, inflation increased to 16.9 percent in October 2014. The rising inflation rate was on account of fiscal imbalances that generated abundant liquidity that fed demand pressures, the pass- through effects of a rapidly depreciating Ghana cedi, and upward adjustments of petroleum and utility prices. Together, these factors fuelled a surge in prices. The first- and second-round effects of these elevated the inflation profile relative to the Bank of Ghana's medium-term target of 8±2 percent.

Consequently, the Bank's Monetary Policy Committee (MPC) has maintained a tight monetary policy stance in 2014 to reduce inflation and re-anchor inflation expectations. To this effect, the MPC has raised the monetary policy rate by a cumulative 500 basis points during the year to 21 percent in November 2014. This was done in concert with other macro-prudential measures to address liquidity problems in both the money and foreign exchange markets.

Exchange rates and external sector developments

The foreign exchange market experienced increased volatility in the first half of the year, as demand pressures mounted alongside softening of international commodity prices and a decline in BOG's international reserves. The cedi's depreciation has slowed considerably since April and particularly from May, with an appreciation recorded in October – a development which has improved the sentiments of foreign exchange market participants as well as business confidence according to the latest market surveys.

The slower paced cedi depreciation observed in recent times has been largely due to the policy measures taken to reduce volatility in the foreign exchange market amidst easing supply constraints on the back of inflows from the cocoa pre-finance facility and the Eurobond issue. In addition, the on-going negotiations with the IMF have to a large extent calmed market sentiments.

In the external sector, provisional estimates point to improvements in the trade deficit to US$681.3 million in the first nine months of 2014, compared to a deficit of US$2.7 billion in the same period in 2013. The improvement was due to a sharp decline in total imports (by US$2.3 billion), which more than offset the reduction in total export receipts (by US$293.3 million). Gross international reserves increased to US$5.9 billion at end-October 2014, a build-up of US$314.2 million since end- December 2013. These positive developments have provided some support to the current stability observed in the foreign exchange markets.

Banking sector developments

Mr Chairman, Ladies and Gentlemen, let me now turn to some developments in the banking sector.

The banking industry grew strongly and exhibited some resilience in the past year. At end-September 2014, total assets of the industry was GH₵47.8 billion or 51.0 percent of GDP. Credit to the private sector continued to expand, growing by 52.0 percent year-to-date to GH₵21.7 billion or 18.9 percent of GDP. The industry also continued to show a strong capital position, with the capital adequacy ratio averaging 17.0 percent – well above the minimum 10-percent requirement. The liquidity position of the industry was comfortable, although the upward adjustment of the cash reserve ratio put some stress on a few banks. The recent downward revision of the ratio should minimize the pressure on these banks. As at September 2014, the combined net profits of banks was GH₵1.51 billion which translated into an annualised 34-percent return on equity.

Despite the impressive industry-level performance, pockets of challenges remain in the banking industry that need to be addressed. A number of banks have high and growing non-performing loans (NPLs), thin capital buffers for risk absorption, and have manifested liquidity challenges and thus resorted to frequent inter-bank borrowing. The 2009–12 recapitalizations helped to shore up banks' capital, enabling them contain these difficulties. However, inflation and the cedi's depreciation over the period meant some capital erosion. This, combined with growing demands for liquidity as a result of oil business, implies that banks must grow their capital buffers to increase their relevance in the industry. Already a number of banks have taken steps to attain, and even exceed, the new minimum capital level of GH¢120 million set for new entrants into the banking industry, and this is commendable.

Mr. Chairman, in order to provide a transparent framework and level playing field for loan write-offs, the Bank of Ghana issued a notice to all banks on 12th September 2014. In essence, the notice requires banks to apply to the central bank for approval to write off loans that have been non-performing for a period. Let me emphasize that a write-off of a loan does not automatically confer forgiveness to the obligor and the notice was clear on this by requiring that the banks provide evidence of structures put in place for recovering such loans, including periodic reporting on recovery efforts. Further, in line with existing guidelines, loans written off are to be reported to the credit reference bureaux so that prospective lenders are forewarned of such delinquent borrowers when they search the bureaux data base for information to aid their credit decisions. It is expected that the blacklisting of such borrowers by the credit reference bureaux would discourage such behaviour and minimize loan delinquency.

Outlook for 2015

Monetary and exchange rate initiatives

Mr. Chairman, the central bank has noted the rather challenging economic conditions under which commercial banks have operated within the first three quarters. Although developments indicate some gains on the foreign exchange front, there are still risks to the inflation outlook amid continued macroeconomic pressures. We will continue to vigilantly monitor and take the needed steps to sustain macroeconomic stability and strengthen financial stability.

Since the last quarter of 2013, fiscal pressures, the pass-through effects of fuel adjustments, and exchange rate depreciation steadily pushed up inflation further away from the medium-term target band of 8±2 percent. Going forward, the main monetary policy objective for the Bank would be to lower inflation, re-anchor inflation expectations and restore the effectiveness of the IT framework and bring back inflation into the medium-term target band. The central bank will continue to primarily use its monetary policy rate to signal the monetary stance, supported by other instruments as needed. The disinflation process would be supported by fiscal consolidation and a lower financing of government budget deficit by the central bank. Fiscal consolidation will be strengthened and enhanced by the IMF supported programme which will bring in additional resources to support both the budget and the balance of payments. For 2015, the Bank of Ghana will aim for a progressive convergence to the medium-term inflation target range, with inflation projected to decline to an end period rate of 11.5 percent by end-2015.

As the Bank of Ghana maintains a tight policy stance to achieve the inflation target, we anticipate that our efforts would be fully complemented by yours in responding appropriately to the policy signals.

Treasury initiatives

Allow me now, Mr. Chairman, to share some thoughts on policies and measures to be implemented from the treasury perspective in the ensuing year.

In 2015, our preoccupation will be to ensure that a vibrant foreign exchange market is well established to facilitate a well-referenced exchange rate determination. To this end, the Reuters trading – the information and dealing tracking platform that has been established – will be enhanced further to accommodate all significant foreign exchange transactions to help in determining the reference exchange rate for the market. The strict cooperation of all authorized dealer banks and traders in meeting reporting requirements in a timely manner is expected to ensure that the foreign exchange market is well-deepened and anchored.

The Bank is also considering other measures to help deepen liquidity of the foreign exchange market. Some of the surrender receipts that currently flow to the Bank of Ghana are likely to be gradually redirected to the authorized dealer banks. This measure will only be introduced after full consultations with the banks to minimize any adverse effects.

Another area of policy focus of the Bank in the coming year relates to the development of appropriate monetary instruments and tools to make liquidity management more effective. To this end, the Bank will revise its monetary operations by introducing a 2-Week Fixed Rate BOG-bill linked to the Monetary Policy Rate and 56-day BOG-bill issued as a complementary sterilization instrument with the same features as the existing 56-day instrument. As usual, we expect your maximum cooperation in patronizing these instruments and also getting all the other policy measures carried through.

Payments systems initiatives

On payments systems – Mr. Chairman, as you are aware – the Bank launched a Payment System Strategy in August this year to drive the development of the country's payments system over the next seven years. The strategy comprises initiatives such as the Divestiture of GhIPSS, Instant Pay Facility, and Electronic Money Issuers/Agent Guidelines.

It is the Bank's intention to allow banks to be shareholders of GhIPSS to enable them participate more meaningfully in the running of the institution and partner the central bank better in developing the payments system.

On Instant Pay Facility, Mr. Chairman, at a meeting with heads of banks early this year, I noted that an Instant Pay Product was needed in Ghana. GhIPSS took the matter up and has put in place the necessary structures for this product to be deployed. We are looking to going live early next year. I will, therefore, urge you to get your systems ready for the take-off. Even if three or four banks finalize their developments, we will go live and that will give those banks a competitive edge over the rest.

Mr. Chairman, two guidelines on Electronic Money have been finalized. These are Guidelines for E-Money Issuers and Agent Guidelines. These guidelines are to promote electronic money as a retail payment medium with the potential to increase financial inclusion. They also specify necessary safeguards and controls to mitigate risks associated with e-money business and ensure consumer protection safeguards. The two guidelines will come into effect in December 2014.

Banking sector initiatives

Mr. Chairman, a critical review of our banking sector indicates that while banks have weathered the recent macroeconomic challenges well, there are some red flags appearing in the horizon. The non-performing loans ratio of the banking industry has stagnated around 12 percent over the last one year in spite of loan write-offs and banks undertaking a number of loan re-structuring/re-scheduling. The results of stress tests conducted by our Financial Stability Department, which was recently discussed with banks, also show that credit delinquency is a major threat to banking sector solvency. In the absence of an explicit recapitalization program steps have to be taken to conserve internally generated capital by minimizing the distribution of profits, improving risk management and efficiency of resource use.

Mr. Chairman, in order to build the buffers that will cushion banks against the likely deterioration in bank's solvency position, the central bank encourages all banks to observe the prudential capital adequacy buffer ratio of 13 percent in making their dividend pay-out decisions. Banks whose CARs are below 13 percent must ensure that in addition to making the appropriate statutory provisions and full provision for non-performing loans, they restrict their dividend payments to no more than 50 percent of distributable profits in the year. This is to allow them build the necessary buffers to contain any unanticipated shocks to the banks' capital. Furthermore, banks that currently benefit from single obligor waivers, implying they do not have sufficient capital for the risks they underwrite, should also restrict dividend payments to no more than 50 percent of distributable profits in the year and this policy shall apply until the waivers are withdrawn.

Although there was no immediate requirements for existing banks to achieve the new capital level of GH¢120 million, we encourage banks not meeting this capital level to put in place plans to achieve this capital level. The need for ongoing capital build-up cannot be over-emphasized.

Mr. Chairman, regarding the legal and regulatory framework, you may recall that the central bank has kick-started a process to revise the Banking Act to better govern the conduct of banking business in Ghana. The Bank recently submitted a final draft of the Banks and Specialized Deposit-taking Institutions Bill and the Deposit Protection Bill together with the accompanying Memoranda to the Minister of Finance. We hope that these bills would be approved by Cabinet shortly and proceed to the lawmakers. The Bills benefited from comments from stakeholders such as banks, non-bank financial institutions, the Institute of Chartered Accountants, and the Ministry of Finance.

The new bills address a number of regulatory imperatives, including provisions on consolidated supervision, dealing with cross-border and cross-sector collaboration in banking, and outlining a clear framework for dealing with distressed banks. They also seek to strengthen the central bank's powers in licensing, dealing with illegal banking and providing a transparent procedure for regulatory issuances and handling of disagreements with the Bank's decisions. It is my hope that the Chartered Institute of Bankers, as a body of banking professionals, will take active interest in the process and make relevant inputs so as to give us a solid legal and regulatory framework for banking in Ghana.

The Bank of Ghana is also considering implementing Basel II/III accords. To this end, the Bank will begin consulting the banking industry on the transition in 2015. This will be in addition to a review of the implementation of IFRS, so as to ensure that we do not unduly dilute the Bank's prudential framework. In this regard, the Bank has secured the assistance of a long-term advisor to help the Banking Supervision Department strengthen its supervisory processes. The Bank of Ghana will continue to dialogue with both domestic and external stakeholders in these efforts to develop a well-functioning banking system to support the growth and development objectives of the country.

Mr. Chairman, the issue of request for waivers of the single obligor limit has persisted largely because no bank has the capacity to single-handedly finance most oil-related transactions. In the absence of a workable syndication system in the industry, the central bank has often had to flout its own rules in risk management.

This practice cannot continue. The new banking bill has eliminated the clause that allows the central bank to grant these waivers. Banks that want to undertake transactions that cannot be supported by their balance sheets must either seek syndication partners or begin to look for commensurate capital to support such transactions.

Allow me now, Mr. Chairman, to turn to a sector that has been the backbone of Ghana's economy for years but receives minimal bank credit – i.e. the agriculture sector. Mr. Chairman, I am happy to say that the banks, together with the Bank of Ghana, have agreed to set up an Equity Fund dedicated to developing this sector – particularly the rice, maize and poultry sub-sectors. We look forward to the Equity Fund becoming operational in 2015.

Conclusion

In conclusion, Mr. Chairman, the relatively unfriendly macroeconomic conditions that existed in the first half of the year is seeing a turnaround. On the real sector, even though energy sector challenges adversely impacted economic activity, the latest business and consumer surveys point to improvements in both business and consumer sentiments.

The banking industry has been resilient and profitable in the year, albeit amidst pockets of vulnerabilities. To address these vulnerabilities, the Bank of Ghana will continue to create the enabling business and regulatory environment for the industry to flourish to support economic growth and job creation.

In support of this process, Mr. Chairman, the Bank of Ghana will roll out the policies and initiatives outlined earlier, and others not mentioned here as we deem necessary. We count on your usual cooperation in getting the desired outcomes from these policies and initiatives. The BOG will also continue to regularly engage with you to share ideas on emerging trends, including on the regulatory landscape.

Ghana, as a member of international bodies such as the IMF, is committed to developing its financial sector in line with international standards. To this effect, the BOG will continue to require banks in Ghana to adopt international best practice in their operations and stop seeking regulatory forbearance at the earliest sign of distress.

I thank you all for listening. Enjoy your meal and I wish you a Merry Christmas and a Prosperous New Year in advance.