

Kwesi Bekoe Amissah-Arthur: Challenges to the Ghanaian economy

Address by Mr Kwesi Bekoe Amissah-Arthur, Governor of the Bank of Ghana, at the annual dinner of the Chartered Institute of Bankers, Accra, 27 November 2010.

* * *

Mr. Chairman,
President of the Chartered Institute of Bankers,
Fellows and Members of the Institute,
Distinguished Guests,
Ladies and Gentlemen

1. Thank you for inviting me to dinner again. I am, of course, delighted to be here and to share with you, members of the Chartered Institute of Bankers, my views on topical issues on the economy generally and the particular challenges confronting the financial and banking sector.

2. Forgive me if I exceed the mandate of the Central Bank has been assigned, but the banking sector operates within the economy and is very sensitive to developments in it. Therefore it is appropriate to review some important developments in the economy and how they impact on the banking system.

3. Last year, I spoke on the challenges, lessons and opportunities for the banking system and the Ghanaian economy posed by the global financial crisis. I enumerated a number of challenges and systemic risks that confronted the economy and the banking system and the need to introduce measures to mitigate the impact on our economy of what were essentially external shocks.

4. Having put in measures to halt the decline, the economy has witnessed an appreciable level of macroeconomic stability, reflected in stable prices, stable exchange rates and increasing foreign reserves. However a number of new challenges confront us. In the mean time, the Ghana Statistical Service (GSS) has undertaken a rebasing of the national accounts and many people still wonder how to interpret the results and what the implications are.

5. The fundamental dilemma of policy is how to strike a proper balance in sharing the costs of the fiscal consolidation process? How do we assure the sustainability of the gains we have made in achieving macroeconomic stability? How best do we manage the expected revenue from petroleum exports and avert the worst manifestations of the resource curse.

6. My address tonight will therefore attempt to examine the challenges confronting the Ghanaian economy; the state of the banking system and our future concerns about its progress.

Mr Chairman, let me start with the state of the economy:

7. It really does not need repeating that at the beginning of 2009 the Ghanaian economy was confronted with macroeconomic imbalances that contributed to high fiscal deficits, high inflation, high interest rates, currency depreciation and loss of international reserves. While the global financial crisis was a contributory factor, the economy reflected a highly expansionary fiscal policy which was partly accommodated by monetary policy, adversely impacting on the external current account.

8. Mr. Chairman, in the last two years or so, the economy has achieved a commendable level of stability, reflected in a declining rate of inflation, lower interest rates and stable exchange rates. From 16 per cent in December last year, the rate of inflation has declined to 9.4 percent at the end of October this year. All indications are that inflation will remain in single digits by the end of the year. The cedi has remained broadly stable throughout 2010

appreciating by 0.1 percent against the US dollar. Ghana's external position, that is, the trade and current account balance has improved with strong export receipts and private capital inflows helping to boost international reserves to over US\$4 billion at the end of October 2010. The challenge therefore is how to sustain these positive developments and create an environment that fosters faster growth.

9. Despite these successes, there is one specific area, the fiscal deficit, where efforts at containment have not been as successful. Various attempts to rein-in the expenditure plan have failed and as the scope for enhancing taxation seems limited, an unsustainable level of public expenditure could worsen the deficits to a level where they exceed the national capacity to finance.

10. It has been suggested that the long-term problem with the public expenditure programme are the earmarking of revenues. Because the legislations creating these interventions are not time-bound, funding of the programmes may survive long after the justification for their existence has lapsed. Let me give an example of the problem using the 2011 Budget proposals. If the total domestic revenue for the Government is 100, allocations to statutory funds (that is GetFund, NHIS, and District Assembly Common Fund (DACF)) constitute approximately 24 percent. Interest payments are another 26 per cent of revenues. When we add Government's contractual obligations to its current and past employees, that is wages and salaries, social security contributions, pensions and gratuities, another 72 per cent of revenues are used up. Together, the contractual obligations of Government consume over 120 per cent of total domestic revenues. Therefore when the Finance Minister presented his budget to Parliament, he had in effect, already exceeded his revenues by 20 per cent.

11. So what happens to the other operations of Government, including the administrative function and capital spending? In effect, these are made possible by foreign grants and domestic borrowing. Thus, the priorities of Government in the national budget were established years ago and are not those determined by the current Parliament. Those relationships established long ago continue to dominate the national budget. As the years go by therefore, the budget addresses less and less the current priorities of the Government.

12. The result of this arrangement is the accumulation of arrears, a systemic problem created by the everlasting earmarking which monopolize resources and reduce the ability of the authorities to fully finance their priorities. The problems thereby created have negative implications for capital spending, private sector growth, stability of the banking system and hence overall economic growth. The problem cannot be postponed indefinitely and it needs to be urgently confronted in a resolute and bi-partisan manner.

13. Mr. Chairman, let me now quickly deal with two developments which are seen as heralding great economic prospects. The recent re-basing of the GDP and the imminent production of petroleum.

14. As the Ghana Statistical Service has explained, re-basing is an exercise that needs to be undertaken regularly to maintain a realistic measure of economic developments. The new base year selected for this purpose is 2006, thirteen years since the last one. In the 17 years since the base year was last revised, the GSS is saying that we underestimated the expansion in our national output by about 4 per cent per annum. On the surface of it, the rebased numbers give us much concern than comfort. It shows that we need to do more to really consolidate our position as a middle income country. Our revenue/GDP ratio for instance now suggests that a lot more effort would have to be directed at revenue mobilization if we need to maintain a high level of public expenditure.

15. Now to Petroleum. It was a privilege to observe the diligence and rigour with which the joint session of the Parliamentary Committees on Finance and Energy examined proposals for the management of petroleum export revenues in Koforidua a few weeks ago. The 2011 budget statement projects that Ghana's share of oil revenues will be GH¢584 million (or 1.9 per cent of GDP). This is just a third of the anticipated VAT collection

and definitely not the sort of resource that the huge expectation of economic transformation can be built. It is obvious that the Government has to explore other sources of revenues to meet any ambitious spending plans.

16. Mr. Chairman, the point I am trying to make is that the fiscal challenges need to be addressed as a matter of urgency to ensure that the current macroeconomic stability is sustained. An improved macroeconomic environment is crucial for a thriving banking sector.

Mr Chairman, let me now switch the focus of my address to developments in the banking sector, which is of the utmost interest to you.

17. Over the past few years, we have all watched, with varying degrees of apprehension, as big, respected and global banks that dominated the advanced economies weakened or simply collapsed. To help them survive, staggering amounts of capital have been injected into “ailing” banks in the advanced economies.

18. Much closer home, Nigeria had to prop up some banks with injections of about N600 billion (or approximately US\$4.0 billion) to shore up their capital bases. As we recount these experiences, the question to ask is what if the Ghanaian banking sector had been adversely affected by the global crisis? Could we have been in a position to inject capital, of such magnitude, into the sector given the limited resources at our disposal, for which a number of infrastructural needs compete?

19. Thankfully, banks in Ghana emerged from the global crisis substantially unscathed partially because of lower global integration, but also due to the strong reliance on domestic deposits to fund banking activities and a regulatory and supervisory framework that limits risky behaviour. Nonetheless, the effect of challenges in the domestic macroeconomic environment since 2008 has given rise to non-performing loans and impaired assets, weakening the balance sheets of some of our banks.

20. Looking at what has transpired in the global financial system, there is no doubt that the banking sector is crucial to the economy; hence instability within the industry would have negative consequences on the economy. This is the basis for safeguarding the sector to ensure equitable, fair and strong business practices, giving no room for complacency. Poor performance or non-compliance with regulations by individual banks can introduce systemic risks and jeopardize the entire banking sector.

21. Mr. Chairman, The Ghanaian banking system has undergone significant transformation and continues to improve with new regulations and guidelines seeking to maintain stability. This has made the sector more efficient, innovative, competitive and profitable. Currently, we have a fairly well-diversified banking and financial system, with 26 banks in operation (soon to be 27), half of which are foreign controlled and the remainder Ghanaian controlled.

22. The size of the balance sheet of the banking system continues to expand. Total assets increased by 35.2 percent in October 2010 on a year on year basis to GH¢16.3 billion while total deposits rose by 37.2 percent on an annual basis to GH¢10.8 billion at the end of October 2010. The banking industry’s branch network continues to expand, and currently exceed 700 nationwide.

23. It is interesting to note however, that the growth in total asset was driven largely by the relatively new banks in the system. Asset concentration in the few big banks has continuously declined, reflecting the intense competitive environment under which banks are operating. The industry also recorded a capital adequacy ratio (CAR) of 25.6 per cent in October, comfortably above the minimum requirement of 10 percent.

24. We believe that the banking sector is growing at a fast pace alongside deepening financial intermediation. However, recomputed financial sector indicators using the rebased GDP figures show that there is substantial room for improvement. For instance, as at end October 2010, total assets of the industry constituted about 64 percent of “old” GDP, but only

36 per cent of new GDP indicating that our financial sector is not as deep as we imagined. Similarly, other indicators of the banking industry in terms of GDP may turn out to be lower than previously estimated meaning that collectively, we must intensify efforts to deepen the financial sector to match the status of a middle income country.

25. One critical issue that has proved rather challenging for the banking industry and the broader economy this year has been high bank lending rates and its effect on access to credit. Traditionally, a low inflation and low interest rate environment is expected to ease credit conditions and stimulate economic growth. Contrary to this expectation, the response of lending rates within the banking sector to the monetary easing by the Bank of Ghana has been sluggish.

26. The Annual Percentage Rates (APRs) which reveal actual lending rates in the financial sector indicates that the average base rate charged on borrowing by enterprises ranged between 27.5 percent and 38 percent at the end of August. By all standards, these rates are high and have instigated tight credit conditions in the economy for most part of this year. Some of the underpinning factors that the banks claim to have contributed to this situation include the high non-performing loan ratios and high loan loss provisioning driven mainly by Government's lack of fiscal capacity to honour its obligations to contractors and service providers. This is an aspect of what I have characterised earlier as the unsustainability of the Government's spending plans.

27. Indeed, the quality of the banks' aggregated loan book remains a source of financial sector vulnerability. High levels of non-performing assets in the balance sheets of banks have the potential to lower profitability and erode the capital base. Indicators of asset quality, measured by the Non-performing loan (NPL) ratios hit a peak of 20 percent in February 2010, declining to 16.5 percent in September and 16.9 percent by end October.

28. The declining trend in the aggregate NPL ratios has given rise to a gradual easing in credit conditions since August. By end September 2010, gross credit in the banking industry grew by 14.8 percent to GH¢7.37 billion. It is to improve the quality of lending that we request banks to collaborate with the new Credit Reference bureau for access to information on prospective borrowers to reduce the challenges of adverse selection in lending. Also, increased use of the Collateral Registry to secure "collateralized" loan contracts will remove some of the constraints on effective loan recovery in the event of default.

29. Other financial soundness indicators measured in terms of profitability continue to improve. The liquidity position of the industry is also strong and banks are encouraged to make additional efforts towards building strong contingency plans to mitigate any unforeseen liquidity crisis. Although aggregated indicators point to stability and strength in the banking system, individual performance indicators show weaknesses in a few banks. To make the system more efficient, I wish to draw your attention to some potential threats within the industry that need to be addressed in the way forward to building a strong financial sector.

30. Mr. Chairman, In 2007 the Bank of Ghana took steps to increase the minimum capital requirements of banks. All the foreign controlled banks have complied with the new capital base of GH¢60 million, substantially improving their solvency. However, we observe that the longer dispensation granted domestically controlled banks to comply with the minimum requirement has rather placed them at a competitive disadvantage.

31. I must report that most domestic banks have achieved the first phase of attaining the GH¢25 million before next month's deadline; however, the transition from GH¢25 million to GH¢60 million in two years is expected to remain a major challenge. To achieve the next stage of capitalization therefore, domestic banks have to seriously consider their options and consolidate their positions through mergers or open up for acquisitions. These will be necessary to enhance their competitiveness and thereby improve their ability to participate in high value transactions.

Mr Chairman, most of our banks rely on ICT Platforms for the delivery of financial services.

32. Following the global financial crisis, risk management has taken centre stage in bank regulation and supervision. Different kinds of risk have been identified; market, credit, operational and reputational risks. Operational risk has assumed great significance, due largely to the reliance on Information and Communication Technology, or ICT, platforms for the delivery of financial services.

33. The rapid pace of ICT usage in the banking sector requires continuous knowledge update by both operators and regulators. Indeed, regulators will have to acquire special expertise in IT auditing to ensure appropriate monitoring of ICT-related vulnerabilities in the banking sector. The Bank of Ghana will also insist that stakeholders in the industry improve corporate governance systems, especially the installation of an effective internal control system.

Mr Chairman, Broadening Financial Sector Regulation

34. One of the critical lessons that emerged from the global financial crisis is the need to tighten financial regulation. This was underscored by the inherent risks of diversifying into non-bank financial businesses. The argument for additional regulation has centred on the risk exposures and speculative activities as banks broadened their horizon to include non-core banking activities such as insurance and capital market activities financed with depositors' funds. In the global financial markets, these trends widened the boundaries of regulation beyond the banking sector and without effective oversight from other financial regulatory bodies, gave rise to what is now termed "shadow banking".

35. As part of restructuring the global architecture therefore, steps are being taken in a number of countries to limit banks from actively engaging in proprietary trading that was not instigated by clients, referred to as the Volcker Rule.

36. As the financial sector continues to grow in Ghana licensed universal banks have started to branch into areas such as providing bancassurance services or setting up subsidiaries to engage in capital market activities. There is need for effective collaboration between financial sector regulators; that is the Bank of Ghana, the National Insurance Commission and the Securities and Exchange Commission and the National Pensions Regulatory Commission. This approach of cross-sector supervision or consolidated supervision is necessary to ensure that emerging risks emanating from financial sector activities are identified and dealt with. Already, arrangements are underway to institutionalize collaboration between BOG, SEC, NPRC and NIC by ensuring regular interaction, information sharing and where possible carrying out joint examinations of common institutions.

37. With the growing number of regional banks in the domestic economy, cooperation with regional supervisors in the exchange of information on cross border financial activities will enhance oversight responsibilities and strengthen our banking systems. Bank of Ghana will pursue and formalize these arrangements and deepen and strengthen the work of the College of Supervisors in the sub-region to facilitate the process. Substantial progress has been made in this area and yesterday, the College of West African Supervisors concluded their second meeting in Accra.

Mr Chairman, Government dominance in the financial sector

38. In assessing the banking system, we have taken note of the dominance of Government and quasi-Government agencies in the ownership structure of a number of banks, but also as a major source of deposits, some of which are concentrated and contribute to weakening some of the banks.

39. To enhance competition and efficient operation of the banking sector therefore, we should encourage the broadening of the ownership of the banks by encouraging the offloading of shares on the stock market. However, the withdrawal of such large shareholders from the banking system has to be properly sequenced and managed. The control objective in the banking system must be balanced by objectives such as growth and

stability to ensure that the emerging banking system meets the nation's broad objectives of a stable, sound banking system.

40. As a final thought, let me note that in the coming years, Central bank policy will seek to consolidate the positive developments in the financial system. Tough decisions will be taken, particularly in addressing emerging challenges such as recapitalizing the banks. In exercising its regulatory and supervisory role, the Bank of Ghana will henceforth show least forbearance for non-compliant banks. This will ensure that confidence and trust in our financial system is not shaken.

41. In conclusion, Mr. Chairman, I wish to reiterate that a stable and efficient financial system is a pre-requisite for economic growth and development. Greater macroeconomic stability means that banks must reposition themselves in an increasingly competitive market in which innovation; efficiency and cost-containment have become important ingredients for success. I believe that as stakeholders, we can play invaluable roles as members of the banking fraternity in consolidating the gains made so far and recommit to the stability, efficiency and development of the Ghanaian banking sector.

42. Thank you once again for making me feel at home and for your kind attention tonight.