



**Ghana – EU Business Forum**

SPEAKING NOTES:

**The Challenges on Monetary Policy and Markets  
Development in Ghana**

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**H.E. Dr. Mahamudu Bawumia**, Vice-President of the Republic of Ghana

**Jyrki Katainen**, Vice-President of European Commission

**H.E. Diana Acconcia**, EU Ambassador to Ghana

**Honourable Ken Ofori-Atta**, Minister of Finance of the Republic of Ghana

**Honourable Robert Ahomka-Lindsay**, Deputy Minister of Trade and Industry, Ghana

**CEOs and Representatives** from the Financial Sector and Business Community

**Distinguished Ladies and Gentlemen**

## Background

1. Let me start by expressing our appreciation to the organisers of the Ghana – EU Business Forum. Ghana has had very good economic, trade and social relations with the European Union (EU) over the years, and we believe there are even greater opportunities for further socio-economic and trade cooperation in the medium to long term.
2. This Forum provides a unique platform for policymakers, financial sector participants and the business community to share ideas to help facilitate business promotion but also, on a larger scale, to shape the economic and structural transformation agenda we aspire for under the *Ghana Beyond Aid* agenda.

## Let me provide a Brief Overview of Monetary Policy Implementation in Ghana

3. **Monetary policy remains and will continue to remain crucial in the macroeconomic management process. The quest to** achieve macroeconomic stability, a necessary condition for sustained growth, cannot be overemphasised.
4. In line with the Bank's primary mandate of price stability, the key goal of the Central **Bank's monetary policy strategy seeks to pursue policies geared towards bringing down inflation to within the targeted bank. Currently, the band is set at  $8\pm 2\%$  with a future possibility of reviewing the band target range**



**based on prevailing economic circumstances.** With improving macroeconomic fundamentals, the Central Bank has lowered consistently its key policy rate, in line with the disinflation process, from a high rate of 25.5 percent at the end of 2016 to the current level of 16 percent as at May 2019. The Bank has done this by carefully balancing the need to lower rates to help foster vibrancy in economic activity and at the same maintain relatively higher real interest rates to sustain investor interest in the economy.

5. Headline inflation has declined from 15.4% at end 2016 to 9.0% in January 2019, before edging up to 9.5% in April on the back of pass-through effects of the exchange rate depreciation in the first quarter of the year.
6. While there is full commitment on the part of the Central Bank to achieve its price stability mandate, we need to recognize that monetary policy will have to act in concert with other economic parameters for full realization of the desired effects.. In this regards, the **transmission mechanism** through which policy decisions are channelled to the rest of the economy matters. In the context of the transmission mechanism, the role of banks and financial institutions remain important as they are the primary conduit through which monetary policy decisions impact on the final objectives of price stability and growth.
7. Monetary policy effectiveness therefore requires an **efficient financial market system** to ensure that monetary policy actions have the desired impact on the economy.
8. Appreciating the role of an efficient financial system, in discussions of monetary policy and market development is very important. Under **the Bank's inflation-targeting framework of monetary policy**, short-term interest rates, including the rates at which banks lend to each other are expected to responded to changes in the Monetary



Policy Rate (MPR) . This then serves to influence other rates in the financial markets and then finally with impact effects on inflation and output.

## **MP Implementation Challenges**

9. As simple as the transmission process may seem, , there are challenges. Key challenges to effective monetary policy and markets development, in our experience, have centred mostly on the following:

### ***Weak and uncompetitive banking sector***

- The critical role of banks as the primary conduit for monetary policy suggests that the transmission mechanism is more effective in a competitive banking sector environment. In a weak and uncompetitive banking sector, monetary policy becomes less ineffective because banks become less responsive to changes in monetary policy stance.
- To address some of these challenges in the Ghanaian economy, the Bank of Ghana, over the past two years, has taken steps to recapitalise and undertaken significant reforms in the banking sector to strengthen the industry's capacity to effectively intermediate. The implementation of new and wide-ranging regulatory reforms should also serve to provide a good-enough basis for enhancing competition and efficiency in the sector.
- Fostering banking competition, efficiency and stability therefore remains key policy objectives that the Bank of Ghana will continue to pursue to facilitate effective monetary policy transmission.

### ***High Non-Performing Loans (NPLs)***

- The prevalence of high non-performing loans can also limit banks' lending capacity and/or interfere with policy transmission and therefore impair the effectiveness of monetary policy. Although the banking sector's NPL ratio has declined from 23.5 percent in April 2018 to 18.9 percent in April 2019, the current ratio still remains very high. With such high NPL levels, transmission mechanism of monetary policy to lending rates is weakened and financial intermediation to support economic activity is constrained.



- To make effective the transmission channel through the NPL angle , the Bank of Ghana is engaging banks to improve their risk management frameworks while the loan loss write-off policy is on-going. We are also strengthening credit conditions through the collateral registry and the credit referencing bureaus.

### ***Market development to ease transmission mechanism***

- The need to broaden the scope of government financing needs without crowding out the private sector through the development of a liquid bond market is critical to effectively help manage debt without repercussions on macroeconomic stability. An efficient and liquid bond market provides some scope for effective transmission mechanism for monetary policy.
- With sound fiscal and monetary policies, improved regulatory environment and improved payments and settlement infrastructure, Government has lengthened the yield curve to 15-years on the domestic money market.
- Government re-profiling has supported the shift towards more medium-to-long term bonds to reduce re-financing risks, driving down interest rates at the short-end of the market and has helped correct the yield curve.

### ***External Vulnerabilities***

- Exchange rate movements are relatively important for a small open-economy with a flexible exchange rate mechanism, like Ghana. Exchange rate dynamics have significant effects on the ultimate goal of price stability and hence on monetary policy decisions.
- The impact effects of external vulnerabilities on the domestic economy are channelled through three main sources – first, with a commodity-dependent export base, the economy is highly vulnerable to negative terms of trade shocks. Second, the increased levels of outflows in the service and income accounts due to the dividends and profit repatriation by large multinational companies in the energy, mining and telecoms sectors pose significant risks to reserves and in the process constrains out ability to effectively deal with shocks. Third, the increased non-



resident participation in the domestic bond market has exposed the economy to vulnerabilities stemming from changes in sentiments of these investors. These sources of vulnerabilities, when they materialize, can distort external sector conditions and impact adversely on economic conditions.

- In other words, the provisioning of foreign exchange cover for repatriation of Multi-National Corporations (MNCs) dividends and non-resident investors' coupon payments, bond maturities and energy-related debt repayments exerts significant foreign exchange pressures. For instance, one of the triggers in the recent exchange rate volatility we experienced was the early redemption and coupon repayments of foreign denominated domestic bonds. These developments reinforce Ghana's external vulnerability conditions which invariably results in sharp currency movements which impacts inflation and remains a challenge to monetary policy formulation.
- The recent inflation uptick from 9% in January to 9.5% in April 2019 was largely attributed to the pass-through effects of the recent currency depreciation on non-food inflation.

### ***Structural rigidities and supply-side constraints***

- The external vulnerability issues highlight the issues of structural rigidities that would need to be addressed alongside ensuring sound macroeconomic condition to ensure exchange rate stability. Issues such as pursuing export diversification, increasing local content, stepping-up domestic production, managing services and income outflows by MNCs, will all have to be addressed head-on. Most of these structural issues are not in the domain of monetary policy, but could pose challenges for monetary policy conduct.
- Structural reforms such as the Government's industrialization drive under the '***Ghana beyond Aid***' agenda to improve the manufacturing base of the economy, diversify the structure of the economy and create employment opportunities to increase production should be vigorously pursued.
- Further, the on-going digitization of service delivery processes in the economy will help improve the business environment of the country. Other complementary reforms and institutional



arrangements to further improve the business environment and ease production bottlenecks should be pursued to facilitate growth.

## **Conclusion**

- 10.** Distinguished Ladies and Gentlemen, let me conclude by stating that the importance of maintaining macroeconomic stability and ensuring an efficient and robust banking sector are critical to our monetary policy implementation processes. The Bank of Ghana will continue to play its role in ensuring that the economic conditions are conducive to support private sector investment and business growth in the country.

**Thank you.**