Responses to Issues Raised by Togbe Afede XIV (TAXIV) on High Interest Rates in Ghana

Response from the Research Department, Bank of Ghana

The Bank of Ghana's attention has been drawn to a recent article published on JOY FM online platform (myjoyonline.com) with the caption: **"Bank of Ghana has lost focus",** and which has since been republished by other media houses and circulated widely on social media. In the said article, Togbe Afede XIV is reported to have raised several issues about Bank of Ghana's conduct of monetary policy and its governance structure. While the Bank of Ghana rarely comments on general media discussions with the understanding that different stakeholders will have different views on the conduct of monetary policy, and also has a strong commitment not to be distracted by such discussions but rather remain focused on its primary mandate of controlling inflation, we have found it very important to respond to the facts (or the lack thereof) in the said article, in particular, given the profile of Togbe Afede XIV in the society.

To begin addressing the issues he raised, we will put in perspective where we have come from as far as macroeconomic management is concerned. Achieving and maintaining macroeconomic stability has been one of the major challenges to public policy making in Ghana. Its evolution is intertwined with the development history of Ghana. More recently, the current Management of the Bank of Ghana has worked very closely with other key stakeholders to achieve significant stability in the last four (4) years. Inflation which was 15.4 percent at the end of 2016 was brought down significantly to 7.9 percent in 2019, until the disinflation process was dislodged with the onset of the covid pandemic, which saw inflation rising again in 2020 and currently estimated at 12.2 percent at the end of November 2021. The gains from this disinflation process has been passed on to the market as the Central Bank reduced the Monetary Policy Rate, which stood at 25.5 percent at the end of 2016 to 13.5 percent at the September 2021, and lending rates have dropped from 28.1 percent at the end of 2016 to 20.2 percent at the end of September 2021. This was only raised recently by 100 basis points in November 2021 to address rising underlying inflationary pressures which was becoming embedded. In the process, we have seen growth rebound strongly in the last four years. The ultimate impact has been a relatively stable currency in the last four years, a stability that has not been observed in the last two decades.

For the Central Bank, the above context provides the basis for understanding the conduct of monetary policy in a developing country on a disinflation path and how that can be starkly different from the conduct of monetary policy in jurisdictions where inflation is in its steady state. For a good part of our history, inflation in Ghana has been in double digits whereas in the UK inflation is below 2 percent and even dipped to negative territories at some point. The conduct of monetary policy under these two settings are very different and the UK is a very poor comparator choice for Ghana. The assertion that the UK Government is more indebted than the Government of Ghana using metrics such as debt-to-GDP ratio and debt per capita and yet, the rate at which the Bank of England lends to banks is 0.1 percent, while the rate at which the Bank of Ghana lends to banks in Ghana is 13.5 percent again amplifies the point of a poor choice of comparator, and also demonstrates the oversimplification of the relationship between debt and interest rates. The headline debt-to-GDP number completely misses the fine details unless we look at other debt indicators such as the debt service costs. In fact, it is the debt service cost that

determines the immediate impact of high debt on the fiscal and it's ultimate crowding out effect. And in this case, let us draw the author's attention to the difference between the UK and Ghana. While the Overall General Government Gross debt to GDP ratio is 108.5 percent in UK and 83.5 percent in Ghana, the debt service cost in UK is about 5 percent of total fiscal revenues and translates to about 2 percent of GDP. In Ghana, our debt service costs is about 79 percent of total revenue and about 10 percent of GDP. This is where the incidence on the fiscal is critical and why the Government of Ghana will have to pay a higher interest rate to borrow to service debt compared to the UK. The interst rate floor of the policy corridor are completely different for the two economies. And for that reason, the rate at which the Bank of Ghana's Monetary Policy rate will be effective in helping manage liquidity and achieve the price stability objective, is constrained by the debt service cost and public sector borrowing requirement dynamics on interest rates. It is therefore completely erroneous and misleading and spurious analysis to simplify the monetary policy stances comparison with just the overall debt-to-GDP comaprsion of two completely different economies with different fundamentals.

It is important to bring other perspectives in context to show why the analysis in the said article can at best be generously described as spurious . It is also important to note that the UK debt is highly printable. The Pound Sterling, as we all know, is a reserve currency. This means that other sovereigns and central banks are keen on holding such assets as part of their reserves. For this very reason, the UK Government is able to issue debt at a lower cost to support monetary policy conduct. This argument does not hold for only the Pounds Sterling but for all SDR basket of currencies like the USD, JPY, the Euro etc etc. The Ghana Cedi is not yet convertible even in the sub region and let alone considered as a reserve currency. What this means is that in order to attract inflows Ghana will have to pay a premium, resulting in the issuance of debt at a higher cost.

Debt comparisons will also have to be done taking into consideration the components of the debt. Here are some facts. About 18.1 percent of the domestic debt stock is held by non-residents, while the total non-resident holdings of the public debt constitutes about 57.3 percent of total public debt. As at September 2021, the foreign currency denominated debt component of the total debt stock stood at 48.7 percent. Given these facts, the profile of our public debt stock is highly sensitive to movements of the exchange rate and would require higher interest rates to maintain exchange rate stability to guarantee debt sustainability.

To conclude on this first point, one would have thought that by assessing the performance of an Inflation Targeting Central Bank, inflation would have been the basis of this assessment. Inflation is a "cancerous animal" that hurts the poor the most. Nowhere in the said article was inflation mentioned as a key factor of determining the level of interest rate in the economy. The simple theory underpinning finance suggests that investors will always have to be compensated for inflation and that investors always factor in real interest rates in making decisions. With an inflation rate of 11 percent, the central banks policy rate of 13.5 percent implies a real interest rate of 2.5 percent. I think the fact remains that once we are able to get inflation under control and in a stable macroeconomic environment, interest rates will obviously come down. This is the reason why the Bank of Ghana's focus has been on disinflation. This has been achieved

largely and for the first time in decades, inflation reached single digits and stayed within single digit for over [36 months] until the covid-19 pandemic hit the global economy in early 2020. That notwithstanding, the Bank of Ghana has worked hard to manage the impact of the pandemic on inflation.

The article also tried to compare the balance sheet of the Bank of Ghana and that of the United Kingdom. Clearly, if one digs deep, there is the quick realization that the comparisons of the balance sheet of the central banks of UK and Ghana also lacks context and shows clearly the lack of appreciation of balance sheet analysis. It is important to first note that the Bank of Ghana, like all other Central Banks, has price stability as its primary objective. A first principle analysis of the components of the balance sheet of the two central banks will show that the drivers are not the same and hence extremely errorneous to compare their profitability and use that as an assessment of their conduct of monetary policy. Of course a stronger balance sheet is needed for the conduct of monetary policy of an operationally independent central bank. The assessment that the Bank of England made a profit of $76 million in 2020, whereas in a relatively smaller-sized Ghanaian economy, the Bank of Ghana made a profit of $270 million, stemming mainly from its lending activities which was conducted at a rate of 13.5 percent, is borne out of flawed balance sheet analysis.

A quick reference to page 101 of the Bank of England Annual Report for 2020 **https://www.bankofengland.co.uk/-/media/boe/files/annual-report/2020/boe-2020.pdf?la=en&hash=2E9658E006FC1AA89E39415B9833BAE0BA753877),** shows a net operating income of £738 million (equivalent to some US$1.01 billion). This is obviously different from the US$76 million profit indicated in the circulated article. In the Financial Accounts published by the Bank of England, Income from securities issued stood at £200 million while income from regulatory activities was reported at £271 million. It is not yet clear where the author of the article and the one such an assertion is claimed to have come from got the 2020 Bank of England profit of $76 million from. Now, on the substantive case of the profit level of the Bank of Ghana, basic level accounting and balance sheet analysis will require identification of the drivers of such profitability. A careful look at the financial statement of the Bank of Ghana, pages 65 & 89 (**https://www.bog.gov.gh/wp-content/uploads/2021/09/Annual-Report-2020_Electronic-Print-Version_BOG_NOV-2021.pdf** **)** shows that an amount of GHC 1.1 billion in the reported profit level is as a result of revaluation of property, plant and machinery. This is not driven by income derived from the banks 'lending activities, but rather largely the result of revaluation gains from exchange rate movements. Accounting for exchange rate movements within the year gives a true profit level of around US$82 million.

The article further cites the profit levels of Ecobank and Standard Chartered Bank for the first nine-months of 2021, at GHC 468 million and GHC 385 million respectively. These profit levels are high and wondered how banks could be making such profits in a difficult economic environment with high operating costs. In the view of the writer, this has been made possible because of the high lending rates. To make matters worse, banks are not sharing these huge profits with depositors as deposit rates remain very low. On this basis there is no justification to continue keeping interest rates at very high levels as we have in Ghana.

With regards to the profit levels of commercial banks, it is worth noting that Ecobank and Standard Chartered Bank are the two large banks in Ghana by asset size. Such banks are able to leverage on the strong branch network, superior technology and efficient banking practices to support their operations and financial performance. While it is not prudent as a regulator to discuss individual bank performances, it is fair to note that most banks improved on their profitability performance in 2021 due to cost controls, increased digitisation, lower travel costs due to a shift to online training, and slowdown in loan provisions in 2021 compared with 2020. It is important to note that, the performance of Ecobank and Stanchart are not reflective of the entire industry. Other banks operating in the same industry recorded lower profit levels, while others made losses in 2021.

We also do not deem it expedient to compare individual banks performances with the profit levels of UK banks as they operate in different markets. However, it is worth noting that the profit after tax for three relatively large banks (HSBC, Barclays Bank plc, and Standard Chartered) in the UK registered extraordinary growth of 120 percent, 145 percent and 196 percent respectively for the first nine months of 2021. This overshadows the growth rates of 19 percent and 22 percent by the two banks in Ghana cited for the same period in 2021.

Touching on the role of the Bank of Ghana during this pandemic, the Bank is being criticized for not doing enough to support the private sector. While I will not want to belabour this point, as anyone who has followed the Bank of Ghana's leadership in this area will attest to the critical role the raft of macroprudential measures outlined by the Bank of Ghana in a policy-time-consistent manner, helped weather the socio-economic impact of the pandemic on the economy. I will take the liberty, and for the avoidance of doubt, highlight below a summary of raft of measures introduced by the Bank to support the economy during the pandemic.

The Bank of Ghana immediately steered its policy stance to accommodate and absorb any aggregate demand shocks and complemented this with macro-prudential policies to support the commercial banks as they provided reliefs to the real sector, similar to the policy support extended elsewhere by other Central Banks in Advanced and Emerging Markets Economies. The Bank of Ghana in particular:

- Lowered the monetary policy rate by 150 basis points to 14.5% in March 2020, and again by another 100 basis points a year later in May 2021 to 13.5%. The essence of the rate reductions was to support growth, prevent an immement collapse of the economy and allow the private sector to borrow at relatively cheap rates to support a recovery.
- Reduced the Cash Reserve Requirement (CRR) from 10percent to 8percent for Banks – *to make about GHC 2 billion liquidity available for banks to on-lend to critical sectors of the economy;*
- Reduced CRR from 8 percent to 6 percent for RCBs, S&Ls, Finance Houses; and from 10percent to 8 percent for microfinance companies – *to make liquidity available to low-income households and small and medium-sized enterprises;*

- Reduced the Capital Conservation Buffer (CCB) from 3 percent to 1.5 percent *to sustain lending activities in the midst of COVID. This policy measure release total liquidity of GHC 1.15 billion to the banks;*
- Reduced provisioning from 10 percent to 5 percent for loans in the OLEM category for banks *to support banks' loan provisioning in the OLEM category for businesses hard hit by the pandemic;*
- Restricted payments of dividends and other capital distributions for the financial years 2019 & 2020 *to preserve liquidity and capital buffers*;
- Extended the new capital requirements deadline for SDIs (MFIs and RCBs) to December 2021 from the February 28, 2020 deadline *to provide temporary relief to SDIs, given current economic conditions*.
- Introduced a 6-month moratorium on principal payments for *customers in the worst pandemic-hit sectors – Airline and Hospitality Industries*
    - Provided various intervention within the Mobile Money Space (e.g. temporarily suspended transaction fees on minimum transactions (GHC100) and increased wallet limits) *to promote electronic transactions as part of COVID protocols;*
- Activated Section 46A of the BOG Act 2002 (Act 612); *to provide liquidity support to savings and loans and finance house companies facing temporary liquidity challenges in line with the BoG liquidity support framework.*
- Triggered the Bank of Ghana Asset Purchase Programme, in line with provisions of the BOG Act 2002 (Act 612), as amended Act 918, to provide Government with GH¢10 billion through the purchase of Government of Ghana COVID-19 relief bond; *to complement government's efforts at closing the widened financing gap.*

These measures instituted by the Bank, complemented the Government's COVID fiscal policy response measures and acted together to prevented a total collapse of the economy. These measures have indeed supported the recovery process. At the end of 2020, the Ghanaian economy had recorded a real GDP growth of 0.4 percent, compared with economic contraction in peer economies across the sub-region.

And lastly, the article touched on Governance issues at the Bank of Ghana and called for a review of the Bank of Ghana Act which will seek to separate the Chairmanship of the Board of the Bank from Governorship. The drafters of the Bank of Ghana Act clearly understood the important role central banks play in all economies, and more so in developing countries that are in the process of building stronger institutions. Modern central banking have focused on the primacy of price stability as the overall objective and the underlying importance of operational independence of central banks in achieving this objective. In Section 8 of the Bank of Ghana Act 2002 (Act 612) clearly states that the Governor of the Bank of Ghana shall be the Chairman of the Board of Directors. Obviously, the drafters had reasons for locking in such a structure for such a sensitive institution. This governance arrangement has supported the conduct of monetary policy and regulation and supervision of the financial system well and the evidence is there for all to see.

Based on the above, we believe it is disingenuous on the part of anyone who tries to shift the focus away from the real structural issues that have challenged the lowering of lending rates in

Ghana and the progress the Bank of Ghana has made and continues to make in this particular area, and rather use biased analysis to shift the blame to the central bank and the commercial banks. This is doing a huge disservice to the policy discourse that is currently ongoing to find a way to address these structural bottlenecks and the legacy of years of macroeconomic mismanagement, as we try to build back better from the impact of the pandemic.

Research Department
Bank of Ghana

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