BANK OF GHANA HAS FAILED US

Togbe Afede XIV - December 26, 2023

INTRODUCTION

It was interesting to hear Bank of Ghana (BOG) officials pat themselves on the back because year-on-year inflation had dropped to 26.4% in November 2023, from 35.2% in October 2023 and 54.1% in December 2022. This trend should have been expected, I thought, because of the massive price increases and exchange rate depreciation that were recorded during the corresponding periods in 2022. It is a **fallacy of year-on-year inflation numbers -** they tend to be influenced a lot by what happened one year ago. That is why year-on-year inflation may rise in a particular month even when the general price level has fallen in that month, and vice versa.

You cannot describe what happened to prices and exchange rates towards the end 2022 as "a blip" when the effects are still with us. The markets simply adjusted to the rot in the system. A return to the relatively lower inflation rates of the past does not mean prices have become lower. Year-on-year inflation rate of 26.4% in November 2023 is not worthy of celebration. Zambia and Kenya, exposed to the same global shocks, recorded 12.9% and 6.8%, respectively. And the US dollar is currently trading at more than 150% of its price (cedis) in June 2022.

But I am glad that **Bank of Ghana (BOG) has finally bitten the bullet**, accepting that it does not have to set its policy rate above "past inflation". After decades of insisting that its policy rate must be fixed above year-on-year changes in the consumer price index (CPI) to ensure "positive real returns" to investors, BOG had over the past several months, following the collapse of our economy, kept their policy rate below the year-on-year changes in the CPI. Maybe it was the case that they just could not set the policy rate above the recent hyperinflation rates.

In my December 2022 article, "Our Self-Inflicted Monumental Economic Crisis", I presented my thoughts on the reasons why we, Ghanaians, find ourselves in this undeserved economic mess, given our massive human and material resource endowments.

The Ghana we have today is obviously not what our founding fathers dreamt of. We have failed woefully but have pretended otherwise. Instead of giving hope, our leaders have created a frightening sense of helplessness among the populace, especially the youth.

As I said earlier in December 2021, during a courtesy call by the Speaker of Parliament, **Ghana would have filed for bankruptcy if it were a company**. This was effectively what we did when we went back to the IMF for bailout and implemented the Domestic Debt Exchange Programme (DDEP). We eventually defaulted on our debts. Holders of Government bonds suffered massive losses, and the outlook remains dim.

We have been brought to the brink by despicably dishonest, corrupt, reckless, arrogant, and divisive leadership. We are also victims of bad fiscal and monetary policies. We owe our relative peace and stability to the resilience and patience of Ghanaians, and I pray that we remain so. I know what suffering is like, and that is why I will continue to share my thoughts on our development challenges.

AN ECONOMY IN SHAMBLES

Very alarming, as I wrote in my December 2022 article, is the fact that we have piled on so much debt, and are **now Africa's most indebted country**, yet we still lack the basic socio-economic infrastructure required for development – good roads, hospitals, schools, etc. Making matters worse, are the massive judgment debts, the results of greed and recklessness, staring us in the face.

The dollar had been on the loose, gaining almost 200% over the cedi since 2017. The cedi is still under pressure notwithstanding our positive trade surplus in recent times. Total exports at the end of October 2023 stood at USD13.4 billion. Compared to total imports value of USD11.3 billion, the result was a positive trade balance of about USD2.1 billion.

Inflation, as I have already said, is still high, at 26.4%, and **business failures, joblessness and poverty levels are worse than ever**. That is why too many of our younger compatriots are desperately on the lookout for ways out of our potentially rich but poor country.

We are victims of **predatory economics**, where policies or decisions were presented to us well-packaged, only for us to realise during implementation that they were designed to benefit a privileged few, as we saw with some of the COVID-19 initiatives and in the ill-fated award of Electricity Company of Ghana to PDS Ghana Ltd. We are also **victims of a constitution that protects even our worst leaders**. The result is the annoying and arrogant display of "conspicuous consumption" by our leaders and their cronies.

I hold the view that poverty is not God's desire for man. So, **I remain optimistic that we can turn our fortunes around** and make a paradise out of our beautiful country, maximise the welfare and happiness of every Ghanaian, so that we can enjoy genuine sustainable peace and unity and make it unnecessary for the youth to embark on hazardous journeys in search for greener pastures.

But we need, first, to identify and understand the causes of our predicament. So much has been said about corruption at a scale we could never have imagined, our battered reputation, bad fiscal policy, lawlessness, divisive tribal politics, our weak institutions, our attitudes, etc. But, as I have said many times, one segment of economic policy that has escaped scrutiny over the years is Bank of Ghana's monetary policy.

THE CHICKENS HAVE COME HOME TO ROOST

Recent events, including the Government's inability to service its debt obligations, have finally exposed BOG. Over the past several months, BOG maintained its policy rate below the year-on-year inflation rate, departing from its previous approach. And the Bank recently announced massive losses in 2022, totaling GHS60 billion, and year-end negative net worth of GHS55 billion, making it technically bankrupt. This is unprecedented in our history. The loss, equal to 10 % of our 2022 GDP of GHS606.82 billion (USD72.24 billion at the average 2022 cedi-dollar exchange rate of 8.4:1), is one of the largest one-year losses ever recorded by a central bank.

It is an irony that **BOG finds itself in this mess** after it only recently aided the collapse of several "poorly managed" local banks, savings and loans companies, microfinance institutions, finance

houses, and fund management companies, at a cost of GHS20 billion, when an estimated GHS9 billion could have kept them in operation. Such wasteful approach to cleaning up the financial sector could only have been pursued by an organization that thought it had too much money.

In the competitive world of private enterprise, where standards and consequences of failure are exacting, BOG would have gone under. Details of the 2022 annual report reveal budgeted and actual expenditures that do not look like those of a struggling country's central bank: USD250 million for a new head office, equivalent to 0.35% of our GDP; GHS97.4 million for travel; GHS131 million for motor vehicle maintenance/running; GHS32 million for communication; GHS67 million for computers; GHS336.9 million for currency issue expenses (currency in circulation amounted to GHS40.73 billion); and GHS8.6 million for directors.

And they rewarded themselves very well, increasing their salaries by a whopping 68%! Personnel costs amounted to GHS1.6 billion. With a total of 2,203 employees, this means an average of a colossal GHS726,282 per annum or GHS60,523 per month per employee. Staff loans amounted to GHS1.247 billion, an average of GHS566,818 per employee. I still cannot believe BOG staff are living in a different world. Unlike in the case of Bank of England (BOE), with a labour force of 4,793, BOG's financial statements do not disclose the remuneration of individual executives.

BOG, guilty of the poor business practices it had accused the collapsed banks of, had obviously been misled by the **spurious profits** it reported in previous years to embark on the recklessness depicted above. I call them "spurious profits" because they included revenues (interest payments due from the Government) that were never going to be realised. The Bank reported a profit of GHS1.57 billion (USD270 million) in 2020. Comparatively, Bank of England (BOE) made a profit of only GBP57 million (USD76 million) in 2020/21. The size of the Ghanaian economy was USD72 billion, and that of the UK was USD2.7 trillion. Thus, BOG reported almost 4 times as much profit as BOE, even though the UK economy was 40 times that of Ghana.

It is surprising that the BOG, the Government's bankers, had been oblivious to the obvious possibility of the Government defaulting on its obligations, and failed to make appropriate provisions. It is also surprising that the external auditors appeared not to have noticed the poor quality of debt owed to BOG by the Government. The BOG directors were similarly unaware. The impairment did not happen suddenly. In effect, BOG was monitoring the quality of the assets of the financial institutions it regulates but forgot to examine its own.

BOG's huge "profits" were largely the result of unnecessarily high interest rates which have been detrimental to the real sectors. These profits supported their unnecessarily high operating costs, including the abnormally high remunerations paid to staff and directors. The **commercial banks** also benefitted from the high interest rates. But, like BOG, their debtors (Government and other loan customers) could not bear these abnormally high lending rates, hence the massive debt losses these banks also reported in 2022.

We are not out of the woods yet because the impact of all this on the economy means defaults by borrowers will continue for some time. Just a few months before our economy run into trouble, BOG was praising the banking sector, claiming, "The banking industry's performance has defied the general economic downturn with strong growth across key metrics including total assets and

deposits, as well as sustained improvement in profitability within the industry during the first half of 2022." And that, "The sector's total assets increased by 22.8 percent to GHS200billion at the end of the period. The domestic component of total assets recorded a higher growth rate of 23.5 percent in June 2022 compared to a growth of 18 percent in June 2021". They added further that "…the higher growth in the industry's assets by mid-year was primarily on the back of an upsurge in deposits and borrowings during the review period".

But as I pointed out, the undeniable truth is that all **these "growths" were fueled by high interest rates and were, effectively, a transfer of assets from government, the public, and the real sectors to the banking sector**. BOG and the commercial banks' huge parasitic profits put a lot of stress not only on the private sector, but on the public sector as well. They imposed a huge burden on those outside the banking sector and frustrated the realisation of the structural changes needed in the economy.

POLICY RATE, INTEREST RATES AND INFLATION

BOG's monetary policy has *escaped scrutiny over the years* because many of us had assumed that the ladies and gentlemen at BOG were infallible professionals. We have been wrong, at least so says the evidence.

Not since 2003 when I complained about monetary policy in this country has there been any open debate about how monetary policy has been conducted. The arguments I made in 2003, more than 20 years ago, are still valid today. **BOG had virtually indexed its policy rate to year-on-year inflation**, a self-fulfilling prophesy, with predictably adverse consequences for inflation, the value of the cedi, and the economy at large. I believe many of us have now realised that the failure of monetary policy has been a key part of our problems.

By this dogmatic interest rate policy, BOG tried to keep its policy rate above year-on-year inflation. In their December 2021 article in response to my concerns, BOG argued that "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 bank's policy rate of 13.5 percent implies a real interest rate of 2.5 percent". That is poor economics, sadly supported by some "eminent African economists in their comment on the concerns I raised, thus, "..it should be noted that 13.5% lending rate is nominal. Ghana's current inflation rate is about 10.5%, and hence the real rate is 3%".

Now that the economy has taken a nosedive, the BOG suddenly became happy to keep its policy rate below the year-on-year inflation rate over several months, when they had always argued for the opposite.

It is important to appreciate that **year-on-year inflation is a historical concept**, and that, it is not past price changes that interest rates must seek to compensate for. The relevant inflation rate for fixing the policy rate is *expected inflation,* adjusted for seasonality, etc. Expected inflation is what astute investors are interested in, much the same way they look at forward price-earnings (P/E) ratios as opposed to trailing P/E ratios in evaluating shares for investment purposes.

Future price trends are measured more accurately by the annualised latest average changes in the CPI, say 3-month average, adjusted for food and energy prices, etc. (Core CPI), which would give better real-time information for fine tuning monetary policy.

The Fisher effect, named after Irving Fisher, defines the link between inflation, nominal interest rate, and real interest rate, and explains the tendency for interest rates to rise when expected inflation is high and fall when expected inflation is low. Thus, a fall in expected inflation, if the expected real interest rate is unchanged, should cause an equal fall in the nominal interest rate. In our current context, the expected inflation is BOG's 8% target. So, 8% plus the expected real interest rate should give us an acceptable nominal interest rate. The current policy rate of 30% translates into an expected real interest rate of 22%!

It is sad that our economists have failed to realise **the fallacy in comparing the current interest rate to *past* year-on-year inflation to determine the real interest rate**. BOG's fixation of its policy rate based on year-on-year inflation, with little or no interest in recent month-on-month changes, has been a self-fulfilling prophesy that has only succeeded in importing past inflation into the future, trapping us in a vicious circle of *high inflation→ high interest rate→ high inflation*, and making Ghana's inflation rate one of the worst on the continent over the past two decades.

POOR VS RICH COUNTRY; COST-PUSH VS DEMAND-PULL INFLATION

BOG's persistence in **trying to fight inflation in Ghana using high interest rates does not make logical sense**, and especially when it is indexed to (historical) year-on-year inflation. Raising interest rates to fight inflation often works in a rich country like the UK. The minimum wage in the UK is GBP9.50 an hour or GBP76 for an 8-hour workday. In Ghana, the minimum wage is GHS14.88 per day, less than GBP1. The average cost of a litre of petrol currently is about GBP1.57 in the UK, that is, 2% of the daily minimum wage. In Ghana, the average cost of petrol is about GHS14, that is, 94% of the daily minimum wage.

The relativities are similar with regard to other necessities of life. So, unlike in the UK, increasing interest rates will only increase cost of living in Ghana, but will not encourage the average Ghanaian, who can hardly make ends meet, to spend less and save more.

Also, it is **difficult to see how policy rate increases can fight cost-pushed inflation** resulting from factors like food or crude oil price increases or increased taxes on petroleum products. Sadly, even at the height of the COVID-19 pandemic, when income levels had fallen worldwide, and stimulus packages were being implemented everywhere to boost economic activity, BOG still ensured that we suffered under strangulating high interest rates.

EFFECTS OF BOG'S INFLATION TARGETING MONETARY POLICY APPROACH

BOG's monetary policy over the years has succeeded in **creating one of the most profitable banking sectors in Africa** per the accounting reports, while ensuring a growth-stifling *high inflation→ high interest rate→ high inflation* environment, with disastrous consequences for the cedi and the economy.

Inflation

BOG's approach to **inflation targeting** has not worked. In December 2021 BOE increased its prime rate from 0.1% to 0.25%, to meet a 2% *inflation target*. BOG's policy rate, on the other hand, had no relationship with its target inflation of 8%. BOG raised its policy rate from 13.5% to 14.5%, focusing more on the reported year-on-year (past) inflation of 12.2%, in a bid to maintain a "positive real interest rate" based on their awkward understanding of *real interest rate*.

It is worth noting that Zambia's November 2021 inflation rate was 19.3%, but the Central Bank of Zambia's (CBZ's) prime rate was as low as 9%. Zambia recorded 12.9% inflation in November 2023, while Ghana's current inflation rate is 26.4%. Today, CBZ's prime rate is 11%. But BOG, which is still targeting inflation of 8%, maintains a policy rate of 30.0%. BOG's perennial inflation target of 8±2% thus appears to be at best an expression of desire which has become a template in their monetary policy releases.

As I pointed out earlier, the reduction that we saw in the headline inflation rate recently was only a natural result of what happened to prices one year ago. It should be noted that, even though maintaining the current high policy rate will not help the fight against inflation, a reduction in BOG's policy rate from 30% to 20%, for example, should not produce inflationary consequences. There is therefore absolutely no need to maintain the current high policy rate of 30%.

Interest Rates

BOG is still pursuing the same, growth-stifling, demand-side approach to the inflation problem, and we find ourselves locked in the vicious circle of *high inflation→ high interest rate→ high inflation*. It is sad that the IMF has encouraged the use of the wrong monetary policy and inflation concept over the years. As our "advisors", they share the blame for the mess we are in and have an obligation to help. I suspect some other African countries outside the French block have suffered similarly.

So, after taking the difficult step to reduce domestic debt through the draconian DDEP, we are still piling up short term debt - 91 Day Bill at 29.35%, 182 Day Bill at 31.95% and 364 at 32.49%.

Currency Depreciation

BOG's astronomically high monetary policy rates have burdened our economy over the past 20-plus years. **It has not only fueled increases in money supply over the years, fueling price increases, but has also undermined the cedi**. Contrary to their claims, we cannot use "higher interest rates to maintain exchange rate stability", especially when they have failed to protect the cedi as the only legal tender in Ghana. High interest rates have not and will not help us "maintain exchange rate stability". Parity laws tell us the opposite.

On November 1, 2007, GHS1 was equivalent to USD1. GHS1 invested in Ghana Government's 91-day treasury bill on that day and rolled over for 15 years would grow to about GHS12 on October 31, 2022, at the height of our economic crisis. Coincidentally, the price of USD1 on October 31, 2022 was about GHS13! Obviously, this huge return on the cedi has been inflationary, and pulled with it the value of the dollar in cedi terms. Inflation was 40.4% in October 2022. Along with it, the dollar went up 141%, from average GHS6 in October 2021 to GHS14.47, implying cedi depreciation of 58.53%.

External Borrowing Costs

The unnecessarily high interest rate numbers have fed into **external market perception of our outlook.** We cannot through our policy rate give an impression of a high inflation risk outlook and expect the external financial markets to think differently. BOG's approach has been costly for us in the international financial markets, where it has created an exaggerated risk perception, with adverse implications for our credit rating and borrowing costs. COCOBOD is currently suffering the consequence, having to borrow at an unprecedented 8%.

Speaking during a press briefing on Friday, October 7, 2022, in Washington, DC, on the 2022 edition of the Babacar Ndiaye Lecture, Dr Hippolyte Fofack, Chief Economist and Director of Research at Afreximbank, elaborated on the importance of the year's theme, "The Developing World in a Turbulent Global Financial Architecture":

"Africa's total external debt is about USD726 billion. That makes it less than a third of Italy's debt estimated at about USUSD2.8 trillion. And expressed as a percentage of GDP, Africa's total external debt is 27%, compared to 130% in Europe. Yet African countries are more at a risk of debt distress than their European counterparts largely as a result of large spreads and default-driven borrowing rates assigned to African sovereign and corporate entities."

The Economy at Large

High interest rates have made the cost of capital excessive and made it difficult for businesses to borrow to invest in the real sectors of the economy, especially manufacturing, making it difficult to realise the value addition we crave. So, **we have remained exporters of primary products**.

They have also hurt our ability to expand production capacity generally and **perpetuated our import dependence.** Local entrepreneurs have suffered more, and their inability to borrow, invest and increase local ownership has **ensured the foreign domination of our economy.** These and other structural bottlenecks have had significant supply-side and cost-push effects on inflation.

Thus, BOG's policies have been a stumbling block to creating an enabling financial market and have inadvertently **frustrated the restructuring of the economy**, which they have often identified as the solution to our balance of payments deficit and currency depreciation problems.

BOG MANDATE, DIVIDENDS AND GOVERNANCE

We should remember that **price stability is not an end in itself**. Probably more important are growth and employment generation, in which the BOG must show interest. We need to clarify BOG's mandate and improve its governance to mitigate the profit motive.

In principle, BOG should have turned over its profit to its only shareholder, the Government, which should determine how much of the profit BOG can keep. **BOG should not be able to make decisions on profit distribution independently of the shareholder**. That is not part of Central Bank independence. But shareholder apathy has allowed BOG to keep and misuse its "profits".

It is also important to point out that no institution of state can claim absolute autonomy, and neither does the **independence of the BOG require that the Governor should be Chairman as well**. It will, at the very least, enhance internal check if the two roles are separated.