Ghana: The 2015 Mid-Year Budget Review

31 July 2015

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Introduction

On July 12, 2015, the government tabled in Parliament for discussion and approval a mid-year review of the 2015 Budget and supplementary estimates for the 2015 financial year. Prior to that, on June 30, 2015, the IMF had issued its first review press statement on Ghana's Extended Credit Facility (ECF) program. This brief reviews the mid-year budget and assesses the basis for the government's revision of the 2015 Budget.

Economic Performance: January-May 2015

Provisional GDP figures show that the economy grew by 4.1 percent year-on-year in the first quarter of 2015, driven by agriculture and services while industry performed poorly. Inflation rose steadily from 16.4 percent in January to 16.9 percent in May due to the cedi's depreciation and other cost-push factors. The fiscal performance was encouraging as total revenue and grants was 5.5 percent above target and total expenditure was 9.1 percent below target. The budget deficit of GH₵2,524.7 million was 1.9 percent of GDP against a target of 3.4 percent. External sector performance was weak as exports decreased by 17.8 percent year-on-year in May to US$4,816.7 million and imports fell by 11.0 percent to US$5,487.4 million, yielding a trade deficit of US$670.7 million. Gross international reserves dropped by US$1,925.0 million to US$3,536 million, covering 2.3 months of imports. The cedi weakened in the interbank market against the dollar by 19.9 percent as foreign exchange demand outweighed supply.

Revisions to the 2015 Budget and New Policy Initiatives

The government revised the 2015 macroeconomic and fiscal targets, citing developments in both the domestic and global economic environments as the cause. The real GDP growth target was revised from 3.9 percent to 3.5 percent; non-oil real GDP from 2.7 percent to 2.3 percent; end-year inflation from 11.5 percent to 13.7 percent; and the overall budget deficit from 6.5 percent to 7.3 percent of GDP. Total revenue and grants was cut by GH₵1,879.9 million from GH₵32,406.2 million to GH₵30,526.0 million on account of lower oil revenue projections and lower-than-expected non-tax revenues. Total expenditure and arrears clearance was also cut by GH₵968.4 million or 2.3 percent from GH₵41,222.0 million to GH₵40,253.6 million. The downward revision affected all the expenditure items except for compensation, foreign-financed capital expenditure and arrears payment.

The government also envisages implementation of a number of policy initiatives to achieve its transformation agenda. These include short- and medium-term measures to address the energy crisis; public financial and performance management reforms; deregulation of the petroleum sector downstream activities; debt management initiatives; and export promotion strategies.

Evaluation of the Revised 2015 Budget

Despite the impressive fiscal performance in the first five months of 2015 and the government's expectation that the macroeconomic situation will improve significantly in the rest of the year, it moved to revise the 2015 Budget.

First, the reason stated, that it was due to lower oil revenue projections, does not seem to support the reality of the situation because the government itself said that crude oil prices have been rising gradually above the price projection of US$52.8 per barrel used in assessing the implications of the fall in crude oil prices on the 2015 budget in March. Why then did it sharply cut its oil revenue projection when it expects an even better crude oil price of US$57.0 per barrel in the remaining seven months of the year? Normally, adjustments to budgets during the fiscal year are warranted for two key reasons, viz. to seek legal approval to use new revenue that has been mobilized or will be mobilized during the year but was not appropriated in the original budget and/or revise expenditure

upwards to deal with shocks or unforeseen events. In this case, however, one cannot claim that the crude oil price fall since July 2014 was an unforeseen global shock for which the associated risks could not have been mitigated.

Second, the grants shortfall of 44.8 percent in January-May confirms our observation that the IMF deal does not guarantee the release of funds frozen by development partners since there are other conditions that influence disbursement. This shortfall notwithstanding, the target for grants in the remainder of 2015 has been raised by 74.5 percent to GH₵1,676.7 million, which we feel is overly optimistic and may not be achieved.

Third, significant expenditure undershoots were recorded in employees' social benefits, transfers to government agencies, interest payments, and arrears clearance. These unpaid potential arrears amounted to GH₵1,251.8 million and together were the major cause of the expenditure containment and improved fiscal deficit during the period.

Fourth, expenditure was cut by GH₵1.2 billion or 3.1 percent relative to the original budget estimate. The interesting aspect is that the projected interest payment is one-and-a-half times bigger than the capital expenditure target— just as it was in the first five months of the year. Since public investment serves as an important catalyst for economic growth, the strong containment of capital expenditure relative to recurrent expenditure is not good for the economy. Cutting down budgets too abruptly, including much-needed capital expenditure, will impede overall economic recovery, remembering that if the economy slows down, revenues will be impaired, deficits will rise and so will government debt. What the country needs is a steady but gradual fiscal adjustment.

Macroeconomic Performance and Outlook

The macroeconomic performance in the first five months of 2015 was not impressive, requiring a strengthening of policies to achieve a strong recovery in the rest of the year and 2016.

Although the cedi rallied in July, stability has not been restored, suggesting that the short-term efforts to support the currency must be complemented by medium- to long-term measures to increase and conserve foreign exchange, such as modernizing agriculture, expanding exports (both traditional and non-traditional), and reducing imports of goods that can be competitively produced in the country.

The decision to also open up the short-term securities market (one- and two-year notes) to foreign participants may support the cedi, but has serious downside implications such as the risk of capital flow reversals, which need to be carefully monitored.

Prices of Ghana's three key export commodities have also been declining in recent months, indicating potential loss of foreign exchange and government revenue. In the face of this development, the country remains a huge importer of both intermediate goods and household consumables, with very little to offer in local manufacturing. This constrains the ability to accumulate and conserve foreign exchange and exposes the cedi to depreciation. What Ghana needs is a complete overhaul of its trade policy through the introduction of targeted demand-side measures aimed at reining in excessive and unproductive import demand while contemporaneously reallocating the fiscal resource envelope away from ballooning recurrent wage and interest outlays towards long-term, growth-propelling capital investment.

It also observed that despite the rising central bank policy rate, inflation has risen steadily from January due mainly to factors that are beyond the central bank's control. As such, the sustained high interest rates, which have contributed to the increase in cost of doing business need to be contained.

Another major challenge which continues to confront the country is that the debt-to-GDP ratio is not only rising astronomically but has already reached a level considered to be above the sustainability threshold, posing serious headwinds to economic growth. Domestic public debt is also concentrated at the short-term end of the market, putting pressure on the budget from the high rate and cost of refinancing. This underscores the need to lengthen maturities and slow down borrowing unless the borrowed funds are used for projects that can generate returns within a reasonable time period to pay off the loans.

On the energy crisis, it is encouraging to hear the various initiatives underway to resolve it as well as secure the country's energy future. The Atuabo gas processing plant, the Tweneboa-Enyenra-Ntomme (TEN) fields development, and the Sankofa gas project are strategic investments that will help achieve this objective. The government has also made good progress with the deregulation of the petroleum downstream sector. With the current global oil supply glut, which is driven by record production in the US that has dampened crude oil prices, we think that Ghana's fortunes do not lie in its oil production, whose contribution to fiscal revenues is less than 10 percent, but rather in gas production, which has the capacity to transform the country's energy sector and increase both industrial and household activities. The gas projects being undertaken are therefore in the right direction and should be pursued relentlessly.

IMF Review Mission's Observations

According to the IMF's Review Mission, Ghana's program is on track, with all performance criteria met except for the ceiling on central bank financing to the government, which was technically missed by a small margin. The Fund noted that the success of the program critically hinges on continued spending moderation and renewed efforts to improve revenue collection. It also cited a number of challenges that have to be addressed to advance the program's success, including fixing the electricity shortages, reducing inflation, improving grants disbursement by donors, and taking measures to rebuild external reserves. It is important that the Fund's observations are taken seriously to ensure the success of the program.

Conclusion

Although some progress has no doubt been made on the fiscal front during the first five months of the year, there are still some challenges relating to the fiscal and macroeconomic outlook which need to be addressed. Revenue mobilization needs to be strengthened through broadening the tax base, further enhancing tax administration, and eliminating tax exemptions. This should be supported by spending moderation, especially on recurrent items. Structural reforms to improve agricultural production and increase both traditional and non-traditional exports should play an essential role in building confidence and supporting growth. The real challenge however is whether the government will be able to demonstrate fiscal prudence in the run-up to the 2016 elections.