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Ghana: Implications of the Rising Interest Costs to Government

Introduction

One important feature of fiscal management in Ghana in the last few years has been the rapid rise in government borrowing, not just a rise in real debt but also a rise in debt/GDP ratio, pushing the country into a debt trap. With the country posting double-digit fiscal deficits in three consecutive years since 2012 and financed through increased indebtedness, the government is now confronted with a huge and increasing interest payment burden. Interest costs to the government are now higher than capital expenditure and threatening to equal or even overtake wages and salaries if public borrowing is not slowed down. Interest payment has become a major factor behind the country's fiscal deterioration besides wages and salaries, requiring serious attention. This paper looks at the trends in interest costs to the government, causes, and what needs to be done to ensure an efficient management of the country's debt.

Interest Costs: Trends and Dynamics

Total interest payment, which stood at GH₵1.03 billion or 2.8 percent of GDP in 2009 had by 2012 reached GH₵2.44 billion or 3.2 percent of GDP and GH₵4.40 billion or 4.7 percent of GDP in 2013. The outturn of total interest payment in 2014 was GH₵7.08 billion, equivalent to 6.2 percent of GDP. The projected outturn of interest payment in 2015 is GH₵9.35 billion, equivalent to 7.0 percent of GDP, and GH₵10.49 billion in 2016, equivalent to 6.6 percent of GDP. This means that between 2009 and 2012, interest payments increased by GH₵1.41 billion or 137 percent and between 2012 and 2016, it is projected to increase by GH₵8.05 billion or 330 percent.

Interest payments accounted for an average of 18.4 percent of domestic revenue in 2009-2010, dropped to an average of 14.8 percent in 2011-2012, but rose to an average of 30.3 percent in 2014-2015. In 2016, interest payment is projected to absorb 28.8 percent of total domestic revenue (Table 1[1]). This means that for every GH₵1.00 to be collected as domestic revenue, GH₵0.29 would go into interest payment, leaving the rest for other recurrent expenditures, including wages and salaries, other statutory demands such as transfers to government units, and the much needed capital expenditure. In fact, the 6.2 percent of GDP interest payments in 2014, the projected 7.0 percent in 2015, and 6.6 percent in 2016 will be three successive years since 2000 that total interest payments would be larger than total capital expenditure.

Interest payments for the first five months of the year totaled GH₵3.3 billion, reflecting 8.7 percent lower than the budget estimate of GH₵3.6 billion. According to the government, the lower interest payment was partly due to the lower than estimated domestic borrowing to finance the budget during the period. In the 2016 Budget, interest payments are estimated at GH₵10.5 billion compared to the projected GH₵11.7 billion wages and salaries costs. The estimated interest payments in 2016 is equal to 28.8 percent of the projected domestic revenue in the year, 24.1 percent of total expenditure, and 57.1 percent more than the projected capital expenditure which is at the center of economic growth and development (Table 1). Ghana seems to have fallen into a debt trap as real interest rates continue to surpass GDP growth rates, suggesting that interest payments will probably be financed through additions to public debt or at the expense of other key government operations. In fact, if government continues to contract loans at prevailing high interest rates, interest payments on them could be equal to or outstrip the public sector wage bill. Total interest payment for this year is projected at GH₵9.6 billion.

According to Fitch Ratings (2015), the country's interest burden is the highest amongst its rated sub-Saharan African countries. Other analysts describe as worrying the escalating interest on the country's debts. The situation is also alarming because very soon the country will have to use nearly one-third of the domestic revenues it generates to pay interest on loans. This points to the need to slow down public borrowing unless such debts are used to finance projects that can generate income within a reasonable period to pay off the debts. The decision to implement an interest rate hedging to allow for enhanced predictability of debt-service is long overdue.

Causes of the Rising Interest Costs

Interest costs have risen astronomically in recent years in Ghana due to the large budget deficits registered over the

1 See Tables on Pages 5 and 6

years, especially since 2012, which were financed by borrowed funds from both domestic and foreign sources at high interest rates. In addition to increases in the debt stock itself, rising interest costs are the result of interest rates hikes and exchange rate depreciation.

High Budget Deficits

Ghana has experienced budget deficits for many years, but double digit fiscal deficits have been posted since 2012. The fiscal deficit in 2012 was GH₵8.6 billion, equivalent to 11.5 percent of GDP. In 2013, the fiscal deficit increased to GH₵9.5 billion, equivalent to 10.1 percent of GDP, despite the number of revenue and expenditure measures introduced in the year. Adverse developments in the global commodity prices and overruns in the wage bill, energy subsidies, and rising interest costs made it impossible for the fiscal deficit target of 9.0 percent for the year to be achieved (Government of Ghana, 2015). In 2014, the deficit stood at GH₵10.6 billion also equivalent to 10.2 percent of GDP, despite the modest fiscal consolidation efforts achieved since mid-2013. These efforts were however undermined by policy slippages, increasing debt-service and external shocks. And despite higher oil revenue, improved tax collection and some containment of the wage bill, delays in implementing some adjustment measures and unbudgeted wage allowances resulted in the higher-than-budgeted fiscal deficit in 2014. Additional domestic arrears were also accumulated and the overall fiscal deficit on a commitment basis remained close to 10.0 percent of GDP. In addition, the government started facing financing difficulties which led it to resort increasingly to short-term domestic debt, carrying interest rates of around 25-26 percent and significant monetary financing. A US$1 billion Eurobond was successfully issued in September 2013 and another US$1.0 billion issued in September 2014, but all at significantly higher interest rates than other issuers in sub-Saharan Africa due to the high risks associated with the country's fiscal imbalances (IMF, April 2015). The fiscal deficit (on cash basis) during the first five months of 2015 dropped to 2.2 percent of GDP against a target of 3.4 percent of GDP as revenue and grants rose in the face of declining expenditure. Despite the improved fiscal performance during this period, the government revised the budget, citing developments in both the domestic and global economic environment as the main reason. This resulted in a new overall fiscal deficit target of 7.3 percent of GDP against the original estimate of 6.5 percent of GDP (Table 2).

Rising Public Debt

Total public debt more than doubled to GH₵35.1 billion between 2010 and 2012, causing the public debt-GDP ratio to increase to 48.4 percent and making the country to face a high risk of debt distress and increased overall debt vulnerability. By end-2014, total public debt had risen to GH₵76.1 billion, equivalent to 67.1 percent of GDP, and representing an increase of 116.8 percent from 2012. By June 2015, the total public debt stock had reached a high of GH₵96.9 billion, representing 72.7 percent of GDP. Ghana's public debt stock thus increased by GH₵4.9 billion in 2007-2008, GH₵25.3 billion in 2009-2012, and GH₵61.8 billion in 2013-June 2015. The provisional public debt stock as at September 2015 was GH₵92.2 billion, which was equivalent to 69.1 percent of GDP. This figure comprised GH₵54.5 billion external debt and GH₵37.7 billion domestic debt (Table 3). This means that between 2007 and September 2015, the net increase in the public debt stock was GH₵87.3 billion (Table 4).

The stark reality is that Ghana's public debt-GDP ratio has not only risen astronomically in the last few years, but has reached a level considered to be above the sustainability threshold. Assuming no roll-overs and refinancing of existing debt, US$8.5 billion is required to service the country's external and domestic public debt this year. In 2016-2020, a total of US$12.7 billion will be required to service the country's debt and another US$7.7 billion will be required in 2021-2025 to service debt. Together it is projected that Ghana will need about US$28.8 billion to service its debt between this year and 2025. Interest payments alone will amount to US$2.4 billion in 2015, US$4.4 billion in 2016-2020, and US$2.6 billion in 2021-2025, bringing to a total of US$9.4 billion in 2015-2025, with the bulk of it amounting to 63.4 percent being interest on domestic debt (Table 5).

Table 6 shows that, debt service absorbed 38.4 percent of domestic revenue in 2006, dropping to 16.8 percent in 2008. Thereafter, the proportion of domestic revenue absorbed by debt service rose sharply, reaching 78.8 percent in 2014. In relation to exports, however, debt service experienced large swings during the review period. It increased from 84.1 percent in 2006 to 91.5 percent in 2007 before dropping steadily to 60.2 percent in 2011. Thereafter, the debt-exports ratio increased to 88.2 percent in 2013 but dropped to 78.7 percent in 2014 (Table 6).

Rising Interest Rates

Government borrowing to finance large budget deficits in recent years has been one of the major factors that have caused interest rates in the country to rise significantly, increasing the cost of borrowing or debt interest costs. As borrowing increases, the government has to pay higher interest rates to the holders of its bonds. In Ghana's case, increased borrowings by the government have pushed up interest rates because the market fears that there is a high chance of default on the part of the government, and therefore demands higher interest rates in return for the greater risk. Meanwhile, the higher interest rates on government bonds tend to push up other interest rates in the economy, increasing cost of credit with negative implications for investment and economic growth. As Table 7 shows, interest rates, including the monetary policy rate dropped sharply between 2009 and 2011 but assumed an increasing trend thereafter to reach 25 percent in September 2015. The average lending rate showed similar trend as the policy rate, but at a much higher rate. The 91-day rate, 182-day rate and 1-year note all dropped between 2009 and 2011 but rose significantly between 2012 and 2014 (Table 7).

Exchange Rate Depreciation

Ghana's public debt stock denominated in cedis has grown significantly partly as a result of the cedi depreciation over the years. Anytime the domestic currency depreciates, it affects the external debt component of the country's debt stock by the extent of the depreciation. An appreciation of the domestic currency has the opposite effect. Ghana's total external public debt stood at US$2.2 billion in 2006. At the 2006 exchange rate of GH₵0.91=US$1.00, the debt counted in cedis was GH₵2.0 billion in 2006. If the debt was not paid until September 2015 and the exchange rate remained the same, the debt would still stand at US$2.2 billion or GH₵2.0 billion. But with the cedi exchange rate depreciating to GH₵3.79=US$1.00 in September 2015, the debt stock in dollars would still be 2.2 billion but in cedi terms, it would be GH₵8.34 billion, reflecting an increase of 317 percent in cedi terms. The interest cost will similarly increase by 317 percent in cedi terms between 2006 and September 2015. The difference in the increase of the external debt counted in cedis reflects the extent of the depreciation of the cedi relative to the dollar over the period. This indicates that any time the cedi depreciates, the country's external debt component will increase by the rate of the depreciation, commonly referred to as the "exchange valuation effect".

The Ghanaian cedi has experienced significant volatility since its redenomination in 2007. As mentioned above, the exchange rate of the cedi increased from GH₵0.91=US$1.00 in 2006 to GH₵3.79=US$1.00 in September 2015. After depreciating against the Dollar by 23.5 percent cumulatively from January to June 2009, the Cedi strengthened from July 2009 to December 2009 when it appreciated against the dollar by 2.7 percent cumulatively. At end December 2010, the exchange rate of the cedi against the dollar stood at GH₵1.47=US$1.00 and by September 2011 the cedi to the dollar rate had increased to GH1.52. By January 2012, the rate had shot up to GH₵1.65=US$1.00 and continued to rise to GH₵1.78=US$1.00 in March 2012. The fear was that the rate would reach GH₵2.00=US$1.00 before the end of the year if nothing was done to stem the sharp depreciation. The government undertook measures to stabilize the cedi so that by end-2012 the exchange rate had settled at GH₵1.88=US$1.00. The cedi however resumed its downswing so that by end-2013, the dollar was selling at GH₵2.20 (Table 7).

At the beginning of 2014, the cedi lost value against the major foreign currencies, due to shortage of foreign exchange on the market, especially the US dollar. The US dollar sold at GH₵2.20 on the local foreign exchange market in December 2013 but was sold at GH₵2.60 in February 2014. This compelled the Bank of Ghana to announce new measures to salvage the downswing in the value of the cedi. The impact of the measures was short-lived so by end-June 2014, the cedi was trading at GH₵3.00 to the dollar, significantly increasing the total public debt denominated in cedis. In the first half of 2015, the cedi depreciated rapidly again, reaching GH₵4.33=US$1.00 by end-June. According to the government, among the factors that fueled the cedi depreciation were the outflows of foreign exchange from a higher-than projected trade deficit resulting from the oil price decline and lower production levels of cocoa and gold. The depreciation was also exacerbated by speculative activities on the foreign exchange market, following similar depreciation trends during the same period in 2014 (Government of Ghana, July 2015).

Managing the Public Debt

To slow down interest costs to government will require a slowdown in government borrowing. The surge in government borrowing to finance the fiscal deficits was driven by a variety of factors, including the rapid growth and better economic policies pursued in the country in 2010-2012, low global interest rates, and continued economic stress in many major advanced economies, especially in Europe. It appears that cheaper external debt than domestic debt has also been a major contributory factor behind the country's increased borrowing from the international capital market. Although the 2015 Budget calls for a continuation of cost-effective access to international and domestic capital markets to meet the country's development financing needs, no strategy is introduced to manage the high and rising public debt and the associated debt-servicing burden.

The current IMF program is also not too strong on the approach to the country's debt management. The program only requires the government to limit its borrowing plans to loans with a minimum grant element of 35 percent, with possible exceptions in line with the debt limits set. Despite this, the Fund approved for the government to issue a US$1.5 billion Eurobond in 2015. Second, with the Fund program limiting Bank of Ghana's gross financing of the budget deficit in 2015 to only 5 percent of previous year's revenue using only marketable financial instruments, the rest of the domestic financing of the fiscal deficit will have to come from the deposit money banks and non-bank institutions through the issuance of Treasury bills and bonds. Despite this, the fiscal outlook still poses serious challenges for debt sustainability and the country is likely to continue to be at a high risk of debt distress on account of unfavorable trends in the country's debt service relative to domestic revenues and export earnings. This calls for additional measures and strategies to contain the rise in the public debt stock and the resulting high interest costs (see IFS, 2015).

First, government will need to adopt a debt management strategy that puts caps on the levels of gross concessional and non-concessional borrowing. Limits should also be placed on contracting and/or guaranteeing of non-concessional loans that can become liabilities to the government. To effectively monitor the public debt stance, strict measures and quantitative targets would have to be set to guide the efficient delivery of cash and debt management, suggesting that the plan to review and strengthen the Financial Administration Law and the accompanying Regulations is in order.

Second, as the international derivative markets have grown in sophistication, the possibilities of hedging risks associated with borrowing in foreign currencies have to be explored. Similarly, the government may consider using the interest rate swap market to manage the maturity structure of the country's external debt. Lowering currency risk does not preclude the country from tapping international markets to broaden its investor base, lengthen the maturity profiles, or develop benchmark debt instruments. Rather, it implies that unless the government has access to foreign currency revenues, the country's foreign currency borrowing should, as far as possible, be hedged against currency risks to stop interest costs from rising (see IFS, 2015).

Third, as debt sustainability depends on both the costs and risks of debt service, an effective strategy must choose between domestic debt and foreign debt that strikes the optimal balance between cost and risk. The government will have to assess whether the higher interest rate on domestic debt represents a fair compensation for insurance or a premium for the illiquidity of the domestic market or the exchange rate depreciation that could occur on the foreign currency debt, and whether such expectation is justified or reflects the lack of credibility of the monetary/exchange rate policy. The need to ensure macroeconomic stability is also important to bring down inflation and interest rates to help ease the pressure on interest costs to the government..

Fourth, the decision of the government to deepen the domestic capital market is laudable as this will help broaden the investor base and enable the government to issue fixed-rate long-term bonds denominated in domestic currency, which will provide budget insurance against both supply and external shocks.

Conclusion

A greater access to international capital markets bestowed on Ghana and indeed many developing countries has also exposed the countries to the vicissitudes of these markets. Already, the international capital markets conditions have become harsher for Ghana, both raising borrowing costs and reducing investor interest, and together with the current slowdown of economic growth, this makes it difficult for the country to service its debts without refinancing and roll-overs. The sizable external foreign currency debt of the country also makes it vulnerable to swings in international exchange rates and speculative currency attacks. Although Ghana has some flexibility in managing its borrowing on commercial terms, what is needed is to manage new debts carefully so that rollovers remain manageable. The decision to migrate some commercially viable projects and their associated investment requirements to the Ghana Infrastructure Fund (GIF) is also a good idea as it will help reduce the government's debt stock and the associated interest costs.

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Table 1. Ghana: Interest Payments on Public Debt, 2009-2016

	2009	2010	2011	2012	2013	2014	2015*	2016*
In Billion Cedis	1.03	1.44	1.61	2.44	4.40	7.08	9.35	10.49
As % of Total Expenditure	12.3	12.48	12.0	11.6	16.0	22.2	23.8	24.1
As % of Domestic Revenue	18.2	18.6	13.7	15.7	23.5	29.6	31.0	28.8
As % of GDP	2.8	3.1	2.7	3.2	4.7	6.2	7.0	6.6

Source: Government of Ghana, Budget Statements (various sources)*projected

Table 2. Ghana: Fiscal Deficits (including divestiture proceeds and discrepancy), 2009-2015

Indicator	2009	2010	2011	2012	2013	2014	2015*
In GH billion)							
Overall Fiscal Deficit	2.1	3.0	2.4	8.6	9.5	11.6	9.7
As Percentage of GDP							
Overall Deficit	5.8	6.5	4.0	11.5	10.1	10.2	7.3

Source: Government of Ghana, Budget Statements (various issues); *projected

Table 3. Ghana: Total Public Debt, 2006-2015

Item	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015*
In billions of Cedis										
External Debt	2.0	3.5	4.9	7.2	9.2	11.9	16.7	25.2	41.5	54.5
Domestic Debt	2.9	3.7	4.9	6.1	8.3	11.8	18.4	26.7	34.6	37.7
Total Public Debt	4.9	7.2	9.8	13.3	17.5	23.7	35.1	51.9	76.1	92.2
As % of Total Public Debt	41.0	48.5	49.9	53.8	52.6	50.1	47.5	48.6	54.5	59.1
External Debt	59.0	51.5	50.1	46.2	47.4	49.9	52.5	51.4	45.5	40.9
Domestic Debt										
As % of GDP										
Total Public Debt	26.2	31.0	34.8	36.0	38.9	41.6	48.4	55.3	67.1	69.1
External Debt	10.7	15.0	17.4	19.4	20.3	20.8	23.1	26.9	36.6	40.9
Domestic Debt	15.5	16.0	17.4	16.6	18.6	20.8	25.3	28.4	30.5	28.2

*as at end- September 2015 (excluding the US$1.0 billion Eurobond)
Source: GoG Budget Statement, various sources; Bank of Ghana, Quarterly Economic Bulletin, various issues

Table 4. Ghana: Net Change to Total Public Debt, 2006-2015

	2007	2008	2009	2010	2011	2012	2013	2014	2015*
In millions of Cedis									
External Debt	1,474	1,402	2,275	2,032	2,673	4,783	8,567	16,282	13,000
Domestic Debt	81	1,197	1,241	2,137	3,561	6,590	8,235	7,955	3,100
Total Public Debt	2,285	2,599	3,516	4,169	6,234	11,373	16,802	24,237	16,100

*as at end- September 2015 (excluding the US$1.0 billion Eurobond)
Source: GoG Budget Statement, various sources; Bank of Ghana, Quarterly Economic Bulletin, various issues

Table 5. Ghana: Debt Service Projections, 2015-2025 (US$' million)

Item	2015	2016-2020	2021-2025	2015-2025
External Debt				
Principal Payment	836	5,798	5,093	11,727
Interest Payment	456	1,972	1,020	3,448
Total External Debt Service	1,292	7,770	6,113	15,175
Domestic Debt				
Principal Payment	5,193	2,512		7,705
Interest Payment	1,991	2,440	1,545	5,976
Total Domestic Debt Service	7,185	4,952	1,545	13,681
Total Public Debt				
Principal Payment	6,029	8,310	5,093	19,432
Interest Payment	2,447	4,412	2,565	9,424
Total Public Debt Service	8,476	12,722	7,658	28,856

Source: Government of Ghana (September 2015); *assuming no roll-overs and no refinancing of existing debt

Table 6. Ghana: Public Debt Sustainability Profile

Item	2006	2007	2008	2009	2010	2011	2012	2013	2014
As % of GDP									
Total Public Debt	26.2	31.0	34.8	36.0	38.9	41.6	48.4	55.3	67.1
External Debt	10.7	15.0	17.4	19.4	20.3	20.8	23.1	26.9	36.6
Domestic Debt	15.5	16.0	17.4	16.6	18.6	20.8	25.3	28.4	30.5
As % of Domestic Revenue									
Total Public Debt	191.8	196.9	203.8	234.5	226.0	203.0	280.2	277.0	318.1
External Debt	78.6	95.4	101.7	126.2	118.9	101.6	133.0	134.6	173.4
Domestic Debt	113.2	101.5	102.1	108.3	107.1	101.4	147.2	142.4	144.7
Debt service	38.4	24.5	16.8	20.1	27.6	44.5	43.2	54.4	78.8
As % of Exports									
Total Public Debt	142.5	177.6	153.2	159.3	150.0	120.1	141.6	171.5	173.1
External Debt	58.4	86.1	76.6	85.8	78.6	59.9	67.6	83.3	94.4
Domestic Debt	84.1	91.5	76.6	73.5	71.4	60.2	74.0	88.2	78.7

*as at end- September 2015

Source: Government of Ghana Budget Statement, various sources; Bank of Ghana, Quarterly Economic Bulletin, various issues

Table 7. Ghana: Interest and Exchange Rates, 2009-2015

Indicator	2009	2010	2011	2012	2013	2014	2015*
Interest Rates (end-period in %)							
Bank of Ghana Policy Rate	18.0	13.5	12.5	15.0	16.0	19.0	25.0
Interbank Rate	16.5	11.6	6.5	17.1	16.3	23.9	23.6
Average Lending Rate	32.8	27.6	27.0	25.7	25.6	29.0	29.0
91-day Treasury Bill	22.5	12.3	10.3	22.9	18.8	25.7	25.2
182-day Treasury Bill	25.3	12.7	11.1	22.9	18.8	26.4	25.9
1-year Note	20.0	12.7	11.3	22.9	17.0	22.5	22.5
Exchange rate (end period: GH₵1.00=US$1	1.43	1.47	1.55	1.88	2.20	3.20	3.79

Source: Bank of Ghana (2013; 2014; 2015); *September

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