


Speeches & Presentations

 **Ghana: The State Of The Economy** Speech Delivered by Hon. Dr. Kwabena Duffuor, Minister of Finance and Economic Planning at a Working Lunch with Association Of Ghana Industries on the topic Ghana: The State Of The Economy - June 17, 2009

**SPEECH DELIVERED BY HON. DR. KWABENA
DUFFUOR, MINISTER OF FINANCE AND ECONOMIC
PLANNING AT A WORKING LUNCH WITH
ASSOCIATION OF GHANA INDUSTRIES ON THE
TOPIC GHANA: THE STATE OF THE ECONOMY ON
16TH APRIL, 2009 AT 12:30 NOON**

Mr. President

Members of the Association of Ghanaian Industries (AGI),

Distinguished Guests of the Business Community,

Ministers present,

Colleagues from our MDAs,

Friends from the Media Fraternity,

Distinguished Guests,

Ladies and Gentlemen,

I want to take the opportunity to thank the President of AGI and Members of the Association for the platform created for me to interact with you and your guests. Indeed, I am very pleased to be here this afternoon to share with you the performance of the economy since we took over the administration of the country.

Mr President, I will like to open my address with the economic difficulties we were confronted with when we entered into office in January this year.

THE LEGACY OF 2008

As some of you may know, the Ghanaian economy at end-2008 was characterised by severe imbalances, reflected in the fiscal deficit which widened from 9% of GDP in 2007 to 14.5% of GDP in 2008. The 2008 deficit does not include expenditure arrears running into millions of cedis we are currently uncovering. The deficit was largely driven by a lack of prudence in public spending and misplaced priorities.

Although the economy registered an estimated growth of 7.3% 2008, this was largely caused by the massive injection of funds, including the 2007 sovereign Eurobond, sale of majority stake in Ghana telecom, and draw-down of the foreign currency reserves.

The expansionary fiscal stance of the Government caused inflation to rise significantly, reaching 18.1% at end-2008. Although the strong public spending was the major factor behind the inflationary

pressures, rapid increases in private sector demand, fuelled by strong credit expansion was also a contributory factor.

The demand pressures also weakened the balance of payments and the cedi exchange rate. Non-oil imports rose by 33% in dollar terms in 2008, causing a significant increase in the current account deficit to nearly 20% of GDP. With insufficient financing, the official foreign reserves were heavily drawn down, even as the cedi was depreciating sharply. The result was that by December 2008 the balance of payments had recorded a huge deficit of USD941 million; the cedi had depreciated by over 25% against the dollar; and the country's gross foreign reserves dropped to USD1,896 million equivalent to 2.1 months of import cover for goods and services. The overall total outstanding national debt at the end-December 2008 had also reached USD8.1 billion.

RESPONSE

Ladies and Gentlemen, the challenge for economic management when we took over the administration was to address the economic imbalances inherited from 2008, namely weakened public finances, high inflation, depleted official

foreign currency reserve position, and depreciating exchange rate. The Government's strategy to respond to the crisis is centred on the implementation of an austerity budget for the 2009 fiscal year. The focus of the budget is to lay a firm base for the gradual adjustment and consolidation of public finances over the medium term to reduce pressures on inflation, the exchange rate, and the balance of payments, and also reverse the deterioration in the public debt. The restoration of fiscal sustainability and macro-stability are expected to pave the way for the resumption of sustainable economic growth to support poverty alleviation. The results since January this year have been very encouraging.

FISCAL PERFORMANCE

Ladies and Gentlemen, let me start with the fiscal performance. Provisional data on the implementation of the 2009 budget shows that the government's fiscal stabilization strategy is on track. The overall balance shows a deficit of GH¢608.9 million (excluding payment of some 2008 arrears of GH¢225 million), equivalent to 2.8% of GDP. This shows that the deficit target of 2.8% of GDP for the first five months of 2009 was successfully achieved.

Total revenue and grants amounted to GH¢2.4 billion in the first five months of this year, reflecting an increase of 13.6% over the outturn for the same period in 2008. Domestic revenue totalled some GH¢2.0 billion in January-May period of this year. Compared to the GH¢1.7 billion collected in the same period of 2008 shows an increase of 17.4%. Tax revenue was also 17.8% higher than the corresponding figure in the same period of 2008.

Total expenditure during the first five months of this year, amounting to GH¢2.9 billion, was 4% more than total expenditure during the same period of 2008. Non-interest expenditure during the first five months of 2009 was also more than the corresponding expenditure in the same period in 2008 by 8.4%. As a result, the domestic primary balance of 1.2% of GDP for the first five months of the year was much higher than the corresponding balance of 0.5% in the same period of 2008.

MONETARY AND FINANCIAL SECTOR PERFORMANCE

In the monetary and financial sector, the performance in the first quarter of the year has been very encouraging, as reflected in the slowdown in the growth of the key monetary indicators. This has contributed to the easing up of

the inflation pressures currently being witnessed. Growth in broad money supply in the first quarter of 2009 has slowed down considerably due to the general tightening of credit conditions for all categories of borrowers.

The banking sector also continued to remain sound, well capitalized, fairly liquid, and with improved profitability during the first quarter of 2009. Recent stress analysis confirms that the industry as a whole is quite robust to exogenous macroeconomic shocks given the current level of capital adequacy of banks. The raising of the minimum capital requirements of banks to GH¢60 million, effective from 2010, will further improve both the liquidity and solvency positions of banks to enable them deal effectively with any future unexpected shocks. The message however is that, although the domestic banking system may not have been impacted significantly by the first round effects of the global economic meltdown, we need to be prepared for the second round effects as the crisis prolongs.

THE CEDI EXCHANGE RATE

Ladies and Gentlemen, the cedi weakened against the major international currencies by 25.3% in 2008. During the first five months of this year, the

larger than expected twin deficits (fiscal deficit and current account deficit) of 2008, depletion of foreign reserves at the Central Bank, and uncertainties in the domestic and global financial markets continued to weigh heavily on the cedi, causing it to further depreciate by 15.5% against the dollar.

The rate of the cedi depreciation has, however, been declining since January, accompanied by a reduced volatility in the exchange market. The rate of depreciation of the dollar/cedi rate at the interbank market has declined steadily from 5.1% in January this year to 1.4% at end-May. The fall in the rate of depreciation of the dollar/cedi rate at the forex bureau was even sharper, from 6.8% in January 2009 to 0.8% in May 2009. We have also observed a gradual convergence of the interbank market and the forex bureau dollar/cedi rates in April-May period. This notable achievement has come about as a result of the prudent macroeconomic measures being pursued by the Government.

INFLATION

Inflationary pressures built up in 2008 continued to remain strong during the first three months of this

year, causing the inflation rate to rise from 18.1% in December 2008 to 19.9% in January and then gradually, reaching 20.5% in March. Nevertheless, the inflation rate has stabilized in the last two months, with a rate of 20.6% recorded in April and 20.1% in May. Thus, for the first time since December 2008, the rate of increase in the inflation rate has been negative due to the macroeconomic and fiscal stabilization measures being implemented in the country. Inflation may peak slightly in next month as a result of the adjustment in the petroleum prices, but we expect the rate to assume a downward trend thereafter.

EXTERNAL SECTOR

The performance of the external sector during the first five months of 2009 was equally encouraging. During the January-May period, the sector witnessed a firming up in the prices of the country's major export commodities in the international markets. The average realized price of cocoa bean exports increased by 17.8% in the first quarter of the year, and the average export price of gold by 12.4%.

Total merchandise exports (fob) during the first quarter of the year amounted to about USD1.5

billion against imports of some USD2 billion, giving a trade deficit of USD552 million. The corresponding trade deficit for the same period of 2008 was USD1.8 billion. As a result, the current account (including official transfers) recorded a deficit of USD429.5 million in the first quarter of 2009, compared with a deficit of USD801.1 million for the same period in 2008.

FOREIGN INVESTMENT

Available information from the Ghana Investment Promotion Centre (GIPC) shows that foreign direct investment in the country increased during the first quarter of this year. According to the GIPC, total new investments for the first quarter of this year amounted to USD372.32 million, comprising USD363.34 million worth of re-investments (capital goods imported) and USD8.98 million equity transfers for new projects registered. This reflects an increase of 45.1% over the total new investments for the corresponding quarter in 2008, and was a direct result of the efforts being made by the Government to restore stability and confidence in the economy.

ECONOMIC AND FISCAL RISKS

Despite the gains made since the beginning of the year, the Government recognises that there are a number of risks that continue to pose serious difficulties to the achievement of fiscal consolidation and macro-economic stability. First, is the inadequate delivery of basic public services, such as electricity, water, and sanitation, which tend to increase the cost of doing business, limit access to markets, and reduce efficiency, thereby undermining the opportunities for economic growth. The Government has engaged our development partners, such as the World Bank, Africa Development Bank, the European Union and others in serious discussions towards finding a lasting solution to this problem. To date, we have secured over USD400 million to fund water and sanitation projects across the country. Despite this, we still need injection of more resources in the water and sanitation sectors.

Second, is the weak public finance management capacity in the public sector, which makes it difficult to control, monitor and evaluate the effectiveness of government spending. To respond to this problem, the Ministry of Finance is in serious consultations with a number of our development partners, with the view to developing a comprehensive financial management capacity

building program for implementation in the second half of the year.

The third risk is related to the poor performance of state-owned enterprises (SOEs). Poor performance and inadequate monitoring of SOEs operations have led many SOEs to incur huge losses or accumulate excessive debt that pose significant risk to the fiscal consolidation. To address this problem, the Ministry of Finance will recommend that the Governing Boards of the SOEs be made to enter into performance agreements with the Government to ensure efficient and effective management and monitoring of the activities of the state enterprises.

Fourth, ineffective management of the public sector wages is a major risk that has the potential to seriously derail the country's fiscal consolidation. This is because the growing wages and salaries bill is not linked to productivity, so while costs increase on one side, there is no commensurate increase in the services that the expenditure buys. The high wage bill also adds to the fiscal rigidity and makes the budget more vulnerable to shocks, as necessary adjustments become difficult.

To minimise the wage risks, the Government has taken a number of measures that seek to lay the basis for a comprehensive public sector reform. The key objective of the reform is to link public sector pay to productivity, position or level, and qualification; maintain the competitiveness of public sector incomes relative to the private sector so as to be able to attract competent and experience people into the civil service; and determine the optimal number of workers required to efficiently deliver public services.

The Ministry of Finance in conjunction with the Ministry of Employment will also undertake a skills audit in the civil service, with the view to identifying the skills gaps and developing a comprehensive capacity building and skills development program to address the gaps. This is required to ensure a smooth migration and placement of employees from the current wages and salaries structure which is unrelated to productivity to the proposed single spine salary structure which relates to productivity.

Fifth, there is the fiscal risk associated with the outstanding payment arrears from 2008 and commitments running into millions of cedis for which inadequate provision was made for in the 2009 budget. These include the 2008 expenditure

arrears and commitments for projects and services rendered; arrears related to fuel subsidies; monies owed to commercial banks; judgment debts (including local and foreign court and arbitration awards) for cancelled contracts; arrears of statutory payments; and other liabilities not disclosed to the Ministry of Finance at the time of preparing the 2009 budget. A program to liquidate these arrears will be put in place once the due diligence of the stock of expenditure arrears and the commitments currently underway is completed in September 2009.

Sixth, there is the fiscal risk emanating from the energy sector. This is related to the problem of unreliable power supply for industrial, commercial and other uses, resulting from deteriorated infrastructure and obsolete transmission and distribution networks. The unreliable power supply impacts adversely on economic growth, particularly from the industrial and commercial activities, and may undermine the achievement of our growth targets. To help address the energy supply problems, the Government is embarking on a zero gas flaring policy in order to utilize the associated gas from the Jubilee Fields. The gas from the Jubilee Fields will be the primary energy for

power generation to eliminate the irregular supply of electricity and reduce power costs to businesses. Finally, there is the potential risk of losing investor confidence in the local processing of cocoa beans due to the difficulty the COCOBOD faces in meeting the local demand for processing. The COCOBOD should reassure our local manufacturers of regular supply of cocoa beans so that the factories can operate effectively and efficiently. To this end, I have charged the new Governing Board of Ghana Cocoa Board to do everything possible to ensure that cocoa production is significantly stepped up in the next few years to enable the country to meet both its export requirements and domestic processing needs.

Ladies and Gentlemen, these are the major economic and fiscal risks that the country faces today, and the support from AGI and the business community, in general, to the Government will be timely and most welcomed. To this end, I am proposing that a formalised structure be set up between my Ministry and the business community through AGI to facilitate regular interactions to find solutions to minimize these risks.

RESTORING CONFIDENCE IN THE ECONOMY

Mr. President and Distinguished Guests, confidence in the economy is rapidly being restored due to the positive impact of the Government's fiscal consolidation and macroeconomic stability measures currently being implemented and the possible injection of significant external resources into the economy. The first five months of 2009 has witnessed a positive primary fiscal balance; gradual stabilization in the cedi exchange rate; sound, well capitalized and fairly liquid financial sector, accompanied with improved profitability; decline in the movement of the rate of inflation, and improvement in the trade balance, all as a result of the prudent fiscal and macroeconomic measures being implemented. This has raised confidence in the economy and paved the way for positive negotiations with our development partners for financial support.

Recent negotiations with the multilateral institutions will hopefully see an inflow of USD1.2 billion budgetary and project support from the World Bank, and possible USD1.0 billion from the IMF for balance of payments support. The COCOBOD is also planning to syndicate USD1.2 billion on the international capital market for the purchases of this year's cocoa production. Since the cocoa purchases are made in local currency, the whole of

the USD1.2 billion syndicated money will be available to the Bank of Ghana to strengthen the economy and improve the foreign reserve position of the country.

CONCLUSION

Ladies and Gentlemen, in conclusion it needs to be recognized that Ghana is a resource rich country, both in human and natural resources, and it is now blessed with oil which will provide further support to the realization of the economic and social goals. The fiscal deterioration we are trying to arrest began in 2006, and has been worsening since then, and made worse by the exceptionally huge expenditures in 2008. This needs correction through both immediate measures and institutional changes which will prevent these slippages re-occurring in future. It will also require that a stable macroeconomic foundation be put in place once and for all before the oil economy becomes a reality. With a solid macroeconomic foundation, the onset of the oil economy and improved overall economic management will set the stage for a higher shared growth phase in our economy. A rigorous implementation of the budget in the second half of the year will therefore be very

critical in propelling the economy into the take-off phase.