TECHNICAL SUPPORT MISSION ON INTERNATIONAL CREDIT RATINGS: REPUBLIC OF GHANA

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APRM
African Peer Review Mechanism

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1. INTRODUCTION

This report presents findings from a technical support mission (hereafter called 'mission') to the Republic of Ghana to assess capacities and challenges faced in engaging international credit rating agencies (CRAs), in periodic reviews and in implementing recommendations. The mission further aimed to identify gaps that could weigh down the country's credit rating as well as key success factors that could lead to positive rating outcomes and good practices to be shared with peers. This report thus makes recommendations for implementation by relevant stakeholders in Ghana.

The mission was undertaken in line with Decision Assembly/AU/Dec.631(XXVII) of the 28th Ordinary Session of the African Union (AU) Assembly of Heads of State and Government. The mission comprised teams from the African Peer Review Mechanism (APRM), an autonomous entity of the AU, mandated to support Member States to improve their credit ratings. The mission team also comprised teams from the United Nations Economic Commission for Africa (UNECA) and the Collaborative Africa Budget Reform Initiative (CABRI)

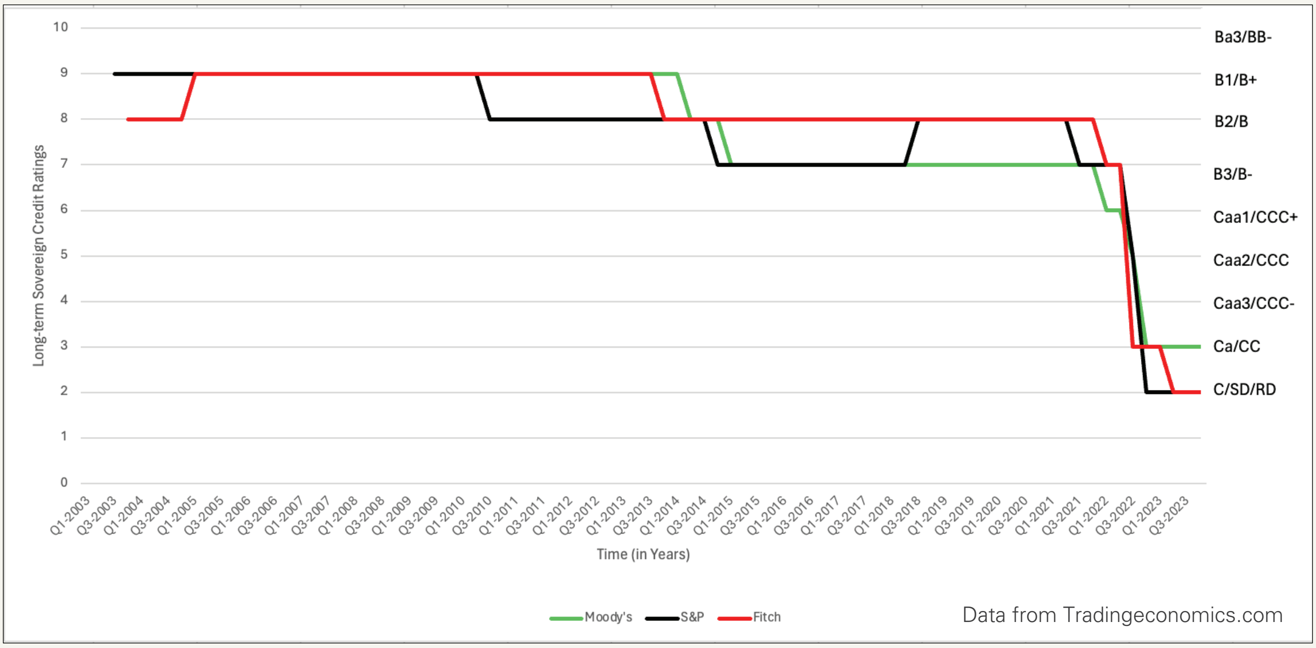
The APRM technical support mission team, held from the 11th to the 15th of March 2024, undertook a series of consultations with key institutions of the state and the financial services sector. These include the Ministry of Finance, Securities Exchange Commission (SEC), Institute of Directors (IoD), United Nations (UN) Resident Coordinator in Ghana, Bank of Ghana (BoG), Ghana National Chamber of Commerce and Industry (GNCCI), Ghana Union of Traders Association (GUTA) amongst other stakeholders.

2. OVERVIEW OF INTERNATIONAL CREDIT RATINGS IN GHANA

Ghana first received a B+ and B sovereign credit rating in 2003, from S&P Global and Fitch Ratings, respectively. It was assigned a B+ equivalent of a B1 rating by Moody's in 2012, which was downgraded to B2 and B3, consecutively in 2014 and 2015. Since then, Ghana's sovereign credit ratings have been on a downward trend, with a steep decline in 2022, when the country's rating was downgraded a combined total of 10 times by all three international CRAs. The government grappled with increasingly costly debt and limited policy levers to address the high inflation, depreciating local currency and rising debt. These fiscal and monetary challenges were induced by significant external headwinds, largely on account of COVID-19 and Russia-Ukraine conflict, which exacerbated domestic vulnerabilities. Ghana was further downgraded to its current rating of Selective Default (SD)[1] and Restricted Default (RD) by S&P and Fitch, respectively, after the country announced a suspension of debt service on its commercial foreign currency debt. Figure 1 below shows the historical trend of Ghana's sovereign credit ratings since 2003, when S&P and Fitch first assigned the country a sovereign rating.

1 The Government of Ghana suspended payments on most of its external debt.

Figure 1: Trend of Ghana's Sovereign Credit ratings



In September 2020, Ghana publicly disagreed with international CRAs following the rating downgrade by S&P Global and Fitch Ratings, in which the government raised objection[2] to the downgrade, indicating that it does not agree with it. The Government of Ghana was of the view that *"rating agencies were punishing it for choosing to prioritize saving lives and livelihoods through once-off expenditures in response to Covid-19 shocks and temporary economic adjustments over saving the economy through expenditure cuts"*. In the view of President Nana Akufo-Addo, "the government's priority of saving lives was more justifiable as an economy could later be revived". In addition, the government contested that the temporary expenditure adjustments had not significantly weighed on the country's economic fundamentals, which remained strong with high growth prospects. The government of Ghana also criticized the timing of the rating downgrade, citing that it increased the impact of Covid-19 on its economy.

2 https://mofep.gov.gh/press-release/2020-09-14/global-ratings-lowers-ghanas-long-term-rating-to-b-with-a-stable-outlook

3. GHANA'S ECONOMY

Stakeholders consulted during the mission and reports by CRAs have cited fundamental structural problems constraining Ghana's economy despite progress made in the last decades. These challenges can be summarized as follows:

3.1 **Dependency on primary commodity exports:** heavy reliance on primary commodities such as raw agricultural products, minerals (gold), cocoa, and crude oil, together contributing more than 80% of the country's total exports. This dependency makes the economy vulnerable to price fluctuations in global markets[3].

3.2 **Infrastructure deficit:** Ghana faces significant challenges in infrastructure development, including transportation, energy and telecommunications. Infrastructure deficit hampers economic growth by increasing transaction costs, hindering productivity and deterring investment. The estimated investment gap in the infrastructure sector is $45 billion until 2040[4].

3.3 **Fiscal imbalance:** Ghana has struggled with fiscal deficits and high levels of public debt. Fiscal challenges such as excessive government spending, subsidies and borrowing, have contributed to these imbalances. High debt levels crowd out private investment, reduce fiscal space for providing essential public services and expose the economy to external shocks.

3.4 **Inefficient tax system:** overreliance on Value Added Tax (VAT) and other indirect taxes on goods and imports. These taxes have disproportionately burden existing taxpayers, who argue that the current multiple taxes are discouraging small enterprises from formalizing their businesses and hindering their growth.

3.5 **Informal sector dominance:** the informal sector is estimated at 65.3% of the economy[5], which limits government revenue generation and undermines labour rights. Informal enterprises face strained access to credit and when they have access to finance, the borrowing cost is unsustainably high, which still constrains their growth potential.

3.6 **Weak industrial base:** Ghana's industrial sector remains underdeveloped, with limited value addition and overreliance on imported intermediate and finished goods. The World Bank statistics indicate that manufacturing value added as a percentage of GDP in Ghana stood at 11.56% in 2022[6]. Weak industrialization has hampered economic diversification, job creation, and export competitiveness.

3.7 **High Interest Rate:** interest rate in Ghana has been on an upward trend reaching an all-time high of 30% in July 2023. This surge has significantly increased the cost of borrowing, thereby hampering private sector growth.

3 Ghana Statistical Service: Ghana 2022 Trade vulnerability Report, August 2023.

4 UNDP: Ghana Rising Sustainable Infrastructure Post COVID-19, Pipeline of Infrastructure Projects, SDG Investor Platform, 2021 SDG Investment Fair.

5 Good Governance Africa: Assessing Opportunities for the Sustainable Integration of Ghana's Informal Sector Contribution into Socio-Economic Development of Ghana, Research Report of Good Governance Africa, West Africa, March 2023

6 The World Bank: Manufacturing, value added (% of GDP), World Bank national accounts data, and OECD National Accounts data files: https://data.worldbank.org/indicator/NV.IND.MANF.ZS

4. SOVEREIGN CREDIT RATING RISK ANALYSIS

Ghana's sovereign credit rating is influenced by an interplay of economic, fiscal and political factors. In the second half of 2021, the country's fiscal challenges ballooned when lawmakers in Ghana's legislature strongly opposed the government's proposal to introduce a 1.75% levy on all digital transactions, including mobile-money payments. The opposition against the Electronic Transaction Levy proposal in parliament triggered panic[7] amongst Eurobond holders, sparking a huge sell-off. The capital flight was interpreted by CRAs as a key signal that the country's debt and fiscal deficit would be impossible to contain. This, together with the Covid-19 pandemic spending, blew the country's debt beyond the 70% of GDP mark, exacerbating Ghana's fiscal challenges.

International CRAs have identified renewed liquidity pressures as the leading risk factor that could result from delays in the external debt restructuring process and could increase the probability of further restructuring or default on local currency debt. In early 2023, Ghana officially requested a restructuring of its commercial debt after it defaulted on its overseas debt in December 2022. The domestic debt restructuring supported monetary levers introduced by the Central Bank to help stabilise the local currency and set inflation on a downward trajectory, although it remains relatively high. S&P Global raised Ghana's local currency sovereign credit ratings from selective default (SD) to 'CCC+/C' following the completion of the Domestic Debt Exchange Programme (DDEP), acknowledging the substantial curing of the selective default. However, the country has undertaken a range of structural reforms in tax policy, revenue administration and public financial management to address its fiscal challenges. To address some of these challenges, Ghana is on a US$3 billion 3-year International Monetary Fund (IMF) Extended Credit Facility arrangement. Under the program, the government is implementing a range of reforms to stabilise the economy, contain inflation, and improve fiscal and external positions.

5. IMPACT OF CREDIT RATINGS ON GHANA'S ECONOMY

Notwithstanding the fiscal challenges that Ghana has been facing, CRAs have contributed to magnifying these challenges. Rating agencies took negative speculative actions and drove 'negative noise' through their media statements, commentaries and research reports on Ghana in early 2022. Their speculative views, regrettably, were contrary to actual macroeconomic performance, projections and policy direction, diminishing investors' appetite and confidence in the Ghanaian economy. For instance, in February 2022, government bond data indicates a sharp spike in yield to maturity (YTM) on Ghana's 15-year Eurobond after the controversial sovereign downgrade by Moody's. International financial markets remained pessimistic despite macroeconomic indicators showing that Ghana's economy was on the rebound, posting a 5.4% annual growth rate and 7% fourth quarter rate for 2021, which was above the forecasts by the Central Bank of Ghana and the IMF.

It could be argued that the speculative commentary by Fitch's primary analyst[8] about Ghana's possible loss of access to international capital markets made it a reality. Investors immediately reacted to Fitch's comments by selling-off Ghana's bonds, causing an interest rate spike. This was contrary to the fact that, at the time, Ghana had sufficient liquidity and other available external financing options to cover near-term debt servicing without another Eurobond issuance. In addition, contrary optimism observed amongst Ghana Eurobond investors after engaging with government in the Non-deal Roadshow (NDR) in the beginning of 2022. The rebound of interest rates on the country's Eurobonds following the rating downgrades proves the impact of these speculative rating actions.

7 https://tellimer.com/article/ghanas-eurobonds-trading-at-a-massive-risk-pr

8 https://www.fitchratings.com/research/sovereigns/ghanas-financing-challenges-set-to-rise-if-yields-remain-high-01-11-2021

6. MISSION FINDINGS

The mission finds that the Government of Ghana is yet to ensure coherent messaging about the objectives and outcomes of government policy across all key institutions and actors. A coherent message is critical because CRAs constantly check for consistency, not only in data reporting, but also in messaging about key policy issues across all key actors. The mission encourages the government to consider actions in the following areas, which could improve the country's credit ratings in the medium to long term if addressed.

6.1 Capacity to engage ICRAs

The mission established that, while the Ministry of Finance views its current internal technical capacity as sufficient, there is a need to strengthen the institutional arrangements that govern the dealings with credit rating agencies. The Ministry of Finance has a team of three experts responsible for the work of credit ratings, led by a Divisional Head. However this team has no Terms of Reference and is coordinated on adhoc basis, attending to specific enquiries by international CRAs on a need basis. This exercise commonly happens prior to routine credit rating reviews when requested to provide information and coordinate other stakeholders that may be relevant in gathering the necessary information. The mission learnt that these requests are often considered subordinate to other responsibilities. The team is not always available to proactively engage international CRAs on matters of fiscal development, especially during the off-rating calendar periods. The mission thus noted that the weaknesses in the institutional arrangements could cause delays in the provision and verification of information requests by international CRAs.

The mission also established the need to particularly improve coordination between the Ministry of Finance and the Bank of Ghana in dealing with international CRAs as there is no established formal institutional arrangement. Part of the challenge is that the Bank of Ghana does not have an established team responsible for credit rating matters. The rationale given was that, since the primary responsibility rests with the Ministry of Finance there is no need for such a dedicated team. Hence, the various departments within the Bank of Ghana are engaged directly by the ministry on an adhoc basis depending on the information requests from international CRAs. This widens the scope of responsibilities for the small team within the Ministry of Finance. Their other responsibilities include coordinating key stakeholders to prepare review meetings, consistently communicating government policy positions, issuing communiques, engaging investors on public media platforms and proactively reaching out to international CRAs to avert possible speculations, especially when there are significant fiscal developments. Due to the overwhelming responsibilities, the Ministry of Finance's credit rating liaison team is not able to either host prereview workshops, sit-in during international CRAs' stakeholder consultation meetings nor does it develop a comprehensive strategy for pitching for rating upgrades.

It is on this basis that the mission concluded that there are capacity challenges and inadequate structures within the Ministry of Finance. This is needed to comprehensively engage rating analysts and convince them of perceived risk factors whose threats are usually inaccurately overstated. It was further observed by the mission that the credit rating liaison team has a limited understanding of the granular details of the credit rating methodologies and process, which limits their chances of success in pitching for a rating upgrade. Consequently, a number of rating decisions may have gone against the country either under the assumption that the Ministry of Finance was non-cooperative or as a result of inadequate preparation by the Ministry of Finance's country liaison team.

Thus, the mission also established that it would be ideal for the Bank of Ghana to complement the Ministry of Finance in addressing the capacity challenges. The Bank maintains its own dedicated team of key contacts at a very senior level, most ideally under the auspice of the Research Directorate, to engage international CRAs on matters of monetary policy. A strong collaborative team in the Central Bank and the Ministry of Finance that proactively engages international CRAs through quarterly meetings to discuss monetary and fiscal developments. Developing a national strategy for dealing with international CRAs would impact the country's rating positively. A clear national strategy is necessary to guide all stakeholders in their responses to all issues raised by international CRAs in previous reviews and how relevant government departments and agencies are addressing them. It is crucial for governments to have on-going internal engagements in the Ministry of Finance, in collaboration with the Central Bank, to deliberate on risk exposures highlighted by rating agencies and develop strategies to mitigate them.

Evidence from South Africa, which has comprehensive institutional frameworks on sovereign credit ratings. This suggests that the absence of a structured Standing Committee/ Sub-Committee on Sovereign Credit Ratings that predominantly sits on sovereign credit rating issues may be the foremost factor in the rating outcomes. Having such a committee addresses any possible information asymmetries which can arise between operations of central banking that often affects the debt management, such as the impact of policy rates on Treasury bills being the main funding instrument of government. On the other hand, the Bank of Ghana holds in its monetary portfolio, bonds or financial instruments issued by the Ministry of Finance. Hence, the execution of government annual borrowing plan (strategy) may need to be well coordinated with Bank of Ghana monetary operations.

The mission also established that, investors and other stakeholders are more concerned about the consistent and timely publication of reliable economic data, which is the basis for investor sentiments, a key input to credit ratings determination. Whilst monetary data from the Bank of Ghana is fairly up-to-date on the bank's website, the data on fiscal metrics that are issued by the Ministry of Finance are not published on time. Key information requisite for enhancing communication, data provision and increase transparency on reporting government debt and other fiscal data through various reports, such as the Quarterly Public Debt Statistics Bulletin, Annual Borrowing & Recovery Plan, stock of public debt and Periodic Public Debt Reports. These reports reports are either unavailable or largely outdated on the Ministry of Finance website.

The absence of important economic information often sends downside signals to investors, causing unnecessary market discomfort. Stakeholders value frequent communication from the Ministry of Finance and Bank of Ghana, disclosing detailed information on total nominal public and publicly guaranteed debt, debt service costs, debt structure (domestic and external), debt composition (by currency and creditors category) etc.

6.2 Implementition of ICRA review recommendations

CRAs have cited the outcomes of the ongoing external debt restructuring process as one of the key risk factors faced by Ghana. The CRAs assert that the outcome of the restructuring will increase the probability of further restructuring or a default on local currency debt. This, according to Fitch Ratings, will be critical in addressing the liquidity pressures to avoid further negative rating actions. Accordingly, one of the recommendations for Ghana suggested that the country should not delay the restructuring process. Once the government reaches an agreement with private creditors on the restructuring of its foreign-currency-denominated external debt and completes that restructuring process, its credit rating will be upgraded. Hence, the government is in extensive discussions with bondholder representatives to advance restructuring engagements, but no agreement has been reached yet.

6.3 Factors weighing in on Ghana's ratings

From the analysis of rating drivers, the mission concluded that among the main drivers of negative outlooks turning to downgrades are actions yet to be undertaken by the government. This includes addressing specific risk factors cited by rating agencies in previous rating reviews. Based on the findings of the mission, the following is a summary of areas that require urgent addressed:

i. **Developing a national strategy on credit ratings:** the government is yet to develop a Ministry of Finance/Central Bank's strategy for engaging with rating agencies on the downside risks raised in previous reviews and how relevant departments and agencies have addressed them. The Ministry is yet to develop focus areas and action plans to improve credit ratings and does not objectively monitor sovereign risk exposures.

ii. **Broaden and deepen participation in stakeholder consultations:** the Ministry of Finance credit rating liaison team currently does not participate in some of the stakeholder meetings of rating agencies – which are designated as 'private'. Hence, they do not have information on the topics discussed and outcomes. This is key to coordinating efforts inside and outside the government for a coherent interpretation of government policy.

iii. **Institute comprehensive and sustained engagements in public media:** the Ministry is yet to consistently issue official communications on the government's position on policy matters through public media interviews and verifying factual correctness on media queries that may impact investors' sentiments.

iv. **Initiate proactive engagements with CRAs and investors:** there is limited proactive engagements with international CRAs and investors on key macro-economic events – budget reviews and policy proposals – to address information asymmetries.

v. **Inadequate of preparation:** the Ministry may not be adequately prepared for rating reviews based on the theme of rating review, areas of international CRAs' concerns, discussion topics and industry experts or institution that the rating agencies want to interview.

6.4 Regulation of International CRAs in Ghana

The Securities Exchange Commission (SEC) of Ghana is responsible for the licensing and regulation of domestic CRAs operating in Ghana, established by the Securities Industry Act, 2016 (Act 929). The SEC regulates the activities of entities involved in the issuance, trading and management of securities such as stocks, bonds and mutual funds. The mission was briefed on the ongoing collaborative effort between the Securities and Exchange Commission (SEC) and three other institutions in Ghana to establish a domestic credit rating agency as part of the country's strategy to develop the domestic financial market. However, SEC does not regulate the operations of the three international CRAs, which do not need any approval nor license to operate in Ghana.

The mission further noted that under the current regulations in Ghana, debt instruments issued by government do not require approval from SEC before issuance. Any CRAs that assign ratings on such instruments do not require licensing in Ghana before conducting such business. This automatically puts the three international CRAs outside the umbrella of regulations by SEC, hence they are not subject to any form of regulation in Ghana, making accountability impossible. Thus, like in other African countries, Ghana is revising its regulatory framework to incorporate regulation of the three international CRAs to be at par with international standards. It's critical to develop regulatory capacities benchmarking with South Africa's Financial Sector Conduct Authority (FSCA), which has stringent regulatory requirements similar to the G20 standards.

7. RECOMMENDATIONS

Although the Ministry of Finance had contracted the services of an external consultant firm to manage the government's affairs with CRAs, it has not been effective despite the high costs. It would therefore be in Ghana's interest to develop internal capacity, which will save the government significant financial resources that are unnecessarily being lost through inflated debt service costs driven by negative rating actions. The mission thus makes the following recommendations to the Government of Ghana.

i. **Institutionalise a framework for the Credit Rating Liaison team** – there is need for a structured country liaison team of at least two experts to function as the key contact office or person(s) in both the Ministry of Finance and the Bank of Ghana. At least 50% of this team's responsibilities are to be primary contacts in the ongoing engagements between the sovereign, investors and CRAs, as well as coordinating relevant stakeholders to ensure consistency and transparency [Ministry of Finance; Bank of Ghana].

ii. **Develop a communication strategy for dealings with rating agencies –** in collaboration with other key government institutions such as the Bank of Ghana, the Ministry of Finance should develop a strategy for communication with rating agencies. This is for the purpose of increasing the chances of a favourable credit review outcome. It is crucial to have on-going internal engagements in government to deliberate on risk exposures highlighted by rating agencies and develop strategies to mitigate them [Ministry of Finance; Bank of Ghana].

iii. **Participation in stakeholders' meetings** – it is recommended for the credit rating liaison team to participate in all meetings of CRAs in the country, with the public and private sector and to come up with a comprehensive outcomes report to be shared with responsible government officials. This is a basis for consistency and coherence in communicating government's position on policy matters to both investors and rating agencies [Ministry of Finance; Bank of Ghana].

iv. **Establish a formally recognised Credit Rating Liaison team –** the sovereign rating liaison team can be empowered through a Directive signed by the Chief Director requiring all Directors and/or Coordinating Director(s) to attend all meetings or conference calls organised by the credit rating liaison team. This is especially important after the tabling of the main budgets and the medium-term budgets [Ministry of Finance].

v. **Establish and maintain a government-wide Standing Committee on Sovereign Credit Ratings** – in line with best practices from other African countries. It will be beneficial for Ghana to establish a Standing Committee on Sovereign Credit Ratings, which should be co-chaired by the office of the Deputy Governor of the Bank of Ghana (or any Senior Director responsible for Research and Financial Markets) and the Chief Director (or Director responsible for public debt management). The Standing Committee need to be governed by clear Terms of Reference (TORs) and well constituted with representatives, both technical and policy-oriented, from both the Ministry and the Bank [Ministry of Finance; Bank of Ghana].

vi. **Conduct periodic methodology transparency meetings** – while credit rating methodologies are publicly available on websites of rating agencies, understanding the details of how analysts assign weights and scores to each risk factor is quite complex. Therefore, it is a necessity to schedule periodic meetings with all relevant experts on methodology transparency with analysts of the three international CRAs [Ministry of Finance; Bank of Ghana].

vii. **Proactively engage with CRAs** - The credit rating liaison team should ensure that there is constant sharing and exchange of information to international CRAs on any piece of information, from policy pronouncements, publication of key fiscal and monetary data metrics, budget reviews and policy proposals, including such basic information such as the state of the nation addresses. This is important to address information asymmetries in public media commentaries [Ministry of Finance; Bank of Ghana].

viii. **Establish official protocol for timely issuance of official communications** – it is critical for the government to consistently issue official communications on the government's position on policy matters through public media interviews and verify factual correctness on media queries that may impact investors' sentiments. In the absence of official communication from government, public media speculative analyses will drive investor sentiment. It is therefore to the government's advantage to initiate discussion topics with rating agencies to clarify and inform stakeholders on key risk areas such as budget reviews, policy proposals and other key macroeconomic events. [Ministry of Finance; Bank of Ghana].

ix. **Strengthen legislation of CRAs** – the current Act governing the services of credit ratings should be revised to include the regulation of international credit rating agencies. This should be in line with international requirements on regulation and accountability of credit rating agencies at a global level. SEC may also, through issuing Rules and Guidelines, provide for licensing and monitoring to include the three international credit rating agencies [Parliament of Ghana, Securities Exchange Commission].

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