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GHANA FLASH-NOTE [REV.]

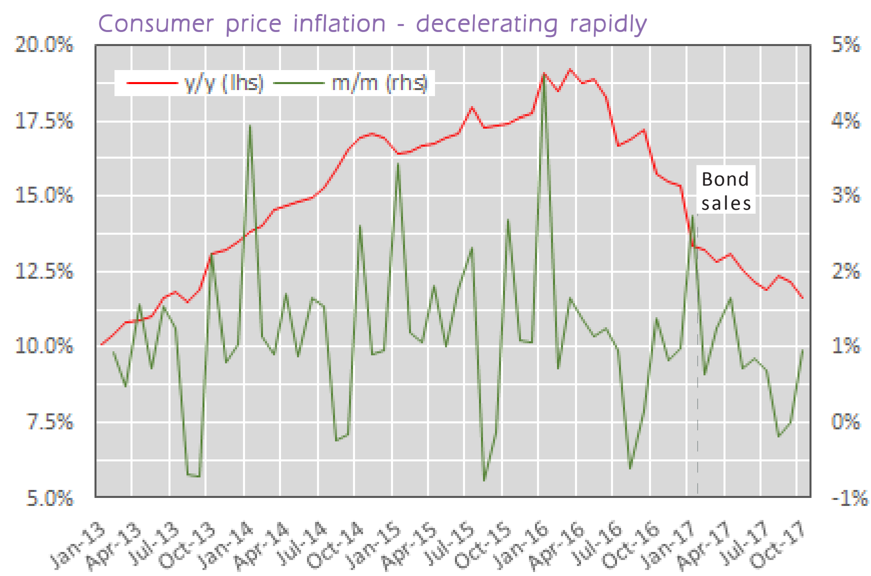
A costly manoeuvre - in the name of liability management

Touted as a landmark in terms of both duration and size, the massive bond sales of March 31st violated a cardinal rule of liability management and so are ***bound to aggravate, rather than alleviate, Ghana's debt-service burden****.*

1) On March 31st, Ghana issued the local-currency equivalent of USD 2.25 billion in bonds, of which the 10- and 15-year maturities accounted for more than 72% of the total issued[1]. Approximately 95% of the paper was bought by offshore investors[2], a fact **trumpeted by the incoming Akufo-Addo administration as a vote of confidence in its supply-side economic agenda**.

2) Such triumphalism clearly struck a raw nerve with the NDC, still smarting from its drubbing in the general election. This was the motivation behind the party's baseless allegation that the transactions had been tainted by a 'conflict of interest'[3]. However, one accusation that the Opposition might legitimately have levelled against the government – but did not - was the **charge of financial mismanagement**.

3) The landmark bond sale took place in **a context of rapid disinflation** that had seen the CPI rate drop by 400 b.p., over the previous four months, to 13.25%[4]. The rate has since declined to 11.66%[5], which puts it within striking distance of the central bank's 8 ± 2% target range.



4) Herein lies the problem. Market interest rates will begin ratcheting lower as the return to macroeconomic stability encourages BoG to relax its policy stance. The **91-day T-bill rate has already declined to 13.33%** - from 17.39% on March 31.

On this basis, we project that, by the end of 2018/Q2, **yields on 2-3 year GoG paper will have dropped to as low at 12-13%**.

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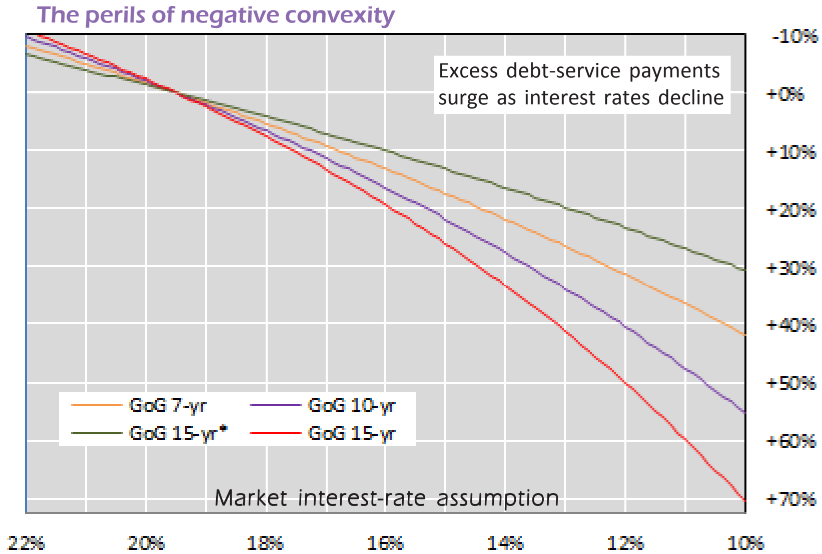
[1] I.e. GHS 7.06 billion of the GHS 9.72 billion issued that day.
[2] Reportedly, Franklin Templeton accounted for the lion's share of foreign investor participation.
[3] The molehill from which the NDC was trying to create this mountain was the fact that the board chairman of the Enterprise Group, an insurer founded by the finance minister, is also a non-executive director of Franklin Templeton.
[4] And yet, determined to wring inflation out of the system, the Bank of Ghana had kept its policy rate at a hawkish 25.50% p.a.
[5] I.e. the year/year print for October.

5) Such an outcome would have dire implications for Ghana's debt-service. Locked into a coupon rate of 19.75%, on GHC 4.87 billion of its long-term debt, **the Treasury will find itself paying an excess of GHC 705 million in annual debt service**[6] over the level warranted by contemporaneous yields.

As illustrated in the chart alongside, the level of excess debt-service is highly sensitive to declines in the level of market rates. In the vernacular of fixed-income mathematics, **the Treasury is "short convexity"**, the equivalent of a mortal sin.



6) The truth is that the real issue driving the finance minister's exercise in so-called liability management was a concern with **roll-over risk**.

Clearly, that challenge has now been **resolved – but at a potentially exorbitant cost to the Treasury**. It will therefore be interesting to see how the subject is addressed during the presentation of the 2018 budget, later this week.

[6] As measured in present-value terms. Excess debt-service is calculated as the difference in interest expense between the contractual rate of 19.5% and the coupon rate implied by the significantly lower market yields we are projecting for the end of 2018/H1 .

* The asterisked GoG 15-yr curve is based on a discounted cash-flow analysis through the first call date – i.e. Apr. 2022.