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PRELIMINARY OBSERVATIONS OF THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON THE GHANAIAN ECONOMY

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Introduction

The global financial crisis that emanated from the United States is the worst financial crisis since the Great Depression of the 1930s. This crisis started in late 2007 and intensified throughout 2008. From early 2008 onwards, the value of shares in major markets around the world dropped significantly compared to previous years' levels.

A major underlying cause of the crisis was the collapse of the sub-prime mortgage loans market in the United States of America (USA). Sub-prime lending is designed for borrowers who normally do not qualify for access to bank loans due to poor credit worthiness and poor credit records. As such, these borrowers pay higher than normal interest rates. Many big banks were attracted to the sub-prime loans market due to their lucrative returns. In the second part of 2008, two major players in the sub-prime loans market, Fannie Mae and Freddie Mac failed, due to massive loan defaults and were taken over by the United States Government on the 8th of September 2008. The loan defaults in the sub-prime loans market led to the collapse of the US housing market which quickly spread throughout the US financial sector (banks and stock markets) as well as global markets. Consequently, there was a credit squeeze which led to reduced consumer demand and a fall in general economic activity, particularly in the manufacturing sector

of the economy. The automobile industry was hard hit and a special Government package was prepared to help them survive.

Another underlying cause of the global financial crisis emanated from the use of complex financial instruments called derivatives in the banking sector of the United States. An example of such derivatives is the credit default swap that permits lenders to transfer their credit risks, for example, mortgage defaults, to third parties such as hedge funds. It is now clear that the financial institutions misjudged the extent of risks associated with such complex financial innovations.

Overall, the financial crisis has led to a recession in several Western countries in the third and fourth quarters of 2008. The global financial crisis has now spread to most parts of the world including China, Russia and East Asian countries such as South Korea and Singapore. The main objective of this Paper is to report on the preliminary observations of the global financial crisis. The rest of this Paper is organised as follows: the next section is devoted to a brief discussion of the possible impacts of the global financial crisis on Ghana. This is followed by suggested steps that the Government of Ghana can take to alleviate the negative impacts of the financial crisis. The last section concludes the Paper.

Possible Impacts of the Global Financial Crisis on Ghana

The global financial crisis is likely to have some serious repercussions on developing countries including Sub-Saharan African countries such as Ghana. However, the impacts of the crisis will vary by country depending on the exposure of the country to the global banking system and its related structures. The degree of trade activities that a country engages in with the rest of the world will determine the severity of the impact of the crisis on a country. For instance, developing countries that trade extensively with Western countries will suffer more than countries that are more dependent on domestic and regional trade. Further, countries that are dependent on remittances, foreign aid, and are bedeviled with current account and budget deficits are more vulnerable to the crisis.

Ghana is expected to be adversely affected by the global financial crisis and the ensuing recession in Western countries through a number of channels. These channels which include capital inflows, aid, and trade (and trade prices) are linked and depend on the structure of the Ghanaian economy. The current concerns about the economy of Ghana are linked to the rapid deterioration in all three major deficits - Government budget, balance of trade and balance of payment deficits over the last two years. Further, the cover for imports of goods and services that is sustained by the country's international reserves has now declined to about two months - less than the minimum required three months, considered prudent by international lending agencies such as the International Monetary Agency.

With a severe recession expected in Western countries in 2009, the demand for Ghana's traditional export commodities such as cocoa, gold and timber is likely to fall with relatively lower levels of world market prices of these commodities. The country is therefore likely to experience continuously high trade deficits even with the fall in the international prices of oil of which Ghana imports substantial quantities. The three traditional export commodities of Ghana (gold, cocoa; and timber) account for about 70 per cent of total exports earnings of the country.

The remaining 30 per cent earnings are attributed to several non-traditional export commodities such as processed and semi-processed products, other agricultural products, and handicrafts. The European Union (EU) absorbs over 40 per cent of Ghana's exports while the USA receives around 10 per cent of Ghana's exports. Severe recession in both EU and USA in 2009 will affect the demand for Ghana's exports and worsen the balance of trade position of the country.

The global financial crisis is also likely to lead to less capital inflows to Ghana in the short-term period, especially for 2009. There are three major sources of capital inflows that are likely to be affected. First, the growth of private remittances from Ghanaian expatriates to Ghana is likely to decrease further in 2009 if the current trend in recession in Western countries continues. Evidence over the past few years already suggests that growth of this type of capital inflows is lower than the growth of earlier years. The slowdown of growth of private remittances from Ghanaian expatriates is due to severe contraction and recession of overseas economies that they work in which in turn will affect their disposable incomes. Ghanaian migrants, like those from developing countries, are more likely to be laid off during a recession in Western countries.

Secondly, commercial and business capital inflows which appear to be declining will decline further in 2009 if flow of credit does not resume on a reasonable level. Commercial borrowers have in the recent past come under severe pressure in developed countries where the financial crisis hit harder and this necessitated various forms of government bail-out worth trillions of dollars. Some of these banks have been nationalised (wholly and or partially), imposing restriction on their borrowing activities. The Ghanaian economy will therefore not be able to secure sufficient capital inflows particularly in terms of loans. And this is also likely to have a negative impact on the economy of Ghana. The plan of the Government of Ghana to secure money on the international commercial markets through bonds for the finance of public infrastructure will be suspended.

Furthermore, pledged Government donor funds in 2009 are still likely to be lower than the levels of earlier years. This is irrespective of the assurances by the World Bank, the International Monetary Fund and the EU to deliver on their promises of foreign aid. Even in this decade's good times, pledged foreign aid funds have not been fully released to recipient developing countries. It is worth noting here that promises that developed countries made to increase aid and grants to developing countries at the Gleneagles Summit of the eight leading industrialised countries in 2005 have not been fully implemented. We should therefore expect that with many Western donor countries in dire economic straits, international donor funds are likely to be reduced and/or their release delayed as foreign governments would pay more attention to the needs of their citizens. This situation is more likely to occur in countries that win be holding national elections in 2009 and 2010.

Another likely casualty of the global financial crisis is the construction industry. The construction industry is one of the fastest growing industries in Ghana and its growth is likely to slow down in 2009. We should expect lower growth of the construction industry in 2009 partly due to the expected slow down of private remittance inflows into Ghana. Private remittances have been a major driving force of the recent construction industry boom. However, due to large-sized commitments made in the industry, the growth of the construction industry is likely to remain positive. Overseas-based Ghanaians with investments in housing are likely to continue to complete these investments if they are in their final stages of completion. However many expatriate Ghanaians may postpone the acquisition of new housing assets. Other industries likely to be adversely impacted by the financial crisis are the mining and tourism industries.

The impact of the crisis on the banking sector in Ghana has so far been limited, though the stock market has not shown appreciable performance. The large spread between savings rates and borrowing rates of local banks has allowed for healthy profits for banks in the country. Also,

Banks in Ghana do not have the type of exposure to those risks that have devastated banks and other financial institutions in the developed world, especially in North America and Europe. However, the rapid expansion of banks in Ghana seen over the last few years is likely to be curtailed in this year as the Bank of Ghana increases capital requirements on one side and managers adopt a more cautious attitude and watch the impact of overseas developments on their business in Ghana. Some foreign Banks in Ghana have had their overseas-based banking businesses impacted by the global financial crisis and will obviously exercise more caution with expansionary activities in Ghana. Nonetheless, there are some aspects of the global recession that would cushion the Ghanaian economy in this year and the next. This regards the declining trends in the prices for imported fuel and food products, two major sources of Ghana's sizeable import bill leading to some moderation in the inflation rate of the country.

What can the Government do to Alleviate Negative Impacts of Financial Crisis?

The years, 2009 and 2010, will be difficult years for the country due to the likely reduction in foreign aid inflows, foreign direct investment and private individual remittances. As a first step, the Government should cut down on its budget deficit by postponing several programmes that are not urgently needed. The Government should urgently cut down on its waste by eliminating non-urgent travels and the size of its staff sent on overseas trips. With modest oil revenues expected to be available to the Government in 2011 and beyond, austerity measures undertaken by the government in 2009 and 2010 may yield positive dividends as the economy can be expected to grow modestly in those two years (2009 and 2010) based on sound macroeconomic management. Due to likely lower levels of foreign aid inflows, the Government should explore additional means of generating internal revenues through taxes and enforcement of existing tax laws.

The new National Democratic Congress (NDC) Government should use its maiden national budget to push for enhanced food production in the country to reduce food imports and help to

reduce the high current account deficit. Food production bottlenecks, which are well known, should be urgently tackled. For example, special efforts need to be made by the Government to improve food storage. This can be done with the expansion of existing publicly-owned silos. Post-harvest losses can be minimised with more government efforts at enhancing food processing. The Government should pay special attention towards preparations geared at withstanding other types of shocks such as severe droughts, bush fires and climate-related natural disasters. Given the impact of the global financial crisis, the Government needs to anticipate and adequately prepare for other disasters to avoid the repetition of the near-collapse of the economy that occurred during the 1975 to 1983 period.

The near-collapse of the economy over the 1975-83 period, was due to among other factors: (1) political instability caused by three successful military coups and several unsuccessful armed rebellions, (2) the quadrupling of world market oil prices from 1973 benchmark levels to levels in early 1980s, primarily due to geopolitical tensions such as the Arab-Israeli conflict of October 1973 and the Islamic Revolution in Iran in 1979/80, (3) the severe droughts and related bush fires of 1977 and 1983 which led to record levels of inflation, (4) the expulsion of over one million Ghanaians in Nigeria in 1982/83 by the Government of Nigeria in retaliation for an earlier expulsion of Nigerian workers initiated by the Government of Ghana in October 1969 and (5) excessive printing of money by various military Governments in the mid-1970s in response to continuous wage demands by public sector workers in response to very high inflation. The country is currently prone to some of these above-mentioned factors that led to the near-collapse of the economy and the government should take pre-emptive actions to safeguard the country. In particular, it must desist from the populist action of expelling non-Ghanaian citizens and workers legally resident in the country and must avoid the course of confrontational governance that alienates large sections of the population and contributes to political instability.

Another area the Government needs to look at is the maintenance of a certain level of public employment. In this regard, the National Youth Employment Scheme of the previous Government needs to be maintained and strengthened. Efforts at relaxing the constraints facing the private sector especially the manufacturing industry need to be continued to increase employment opportunities for the youth. Further, access to public health care through the National Health Insurance Scheme needs to be maintained with a more realistic public-private financing scheme. In this regard, it is suggested that the NDC pre-election manifesto promise concerning the one-time payment of health insurance premium be modified to a system of one-time life-time payment of health insurance premium for every four years, during the life-time of the existing Government. A one-time life-time insurance premium is not realistic as the level of payment that can sustain the financial viability of NHIS would be too high for most people especially low-income earners.

Lastly, District Assemblies should be encouraged to raise more revenues from local sources through innovative schemes. Ideally the proposal for the direct election of District Chief Executives and Mayors starting in the District Assembly elections to be held next year (2010), if implemented, can offer a major outlet to mobilise internally generated funds for the development of Districts and reduce their dependence on national government funds.

Conclusions

This brief has provided a summary of the causes of the current global financial crisis and its likely impacts on the economy of Ghana. A few suggestions have been made to the Government to implement to reduce the negative impacts of the crisis on the economy. Given the rapidly changing dynamics of the global financial crisis, it is important to monitor the developments of the crisis around the world and its impacts on Ghana. The Government of Ghana may need to set up a broad-based working group with members from both public and private sectors to monitor and analyse the developments and impacts concerning this crisis.

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