

## Exchange Rate Management In Ghana

Towards An Appreciation Of The Role Of The Exchange Rate In A Competitive Export-led Growth Strategy

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## Introduction (1)

- The exchange rate is:
  - Important economic policy instrument to address key economic objectives
  - But very controversial with ramifications for incentives and distortions
  - Consequently, much analysis is required to have an informed basis for an exchange rate regime and strategy

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## Introduction (2)

- Exchange rate policies have contributed to both economic and political instability in Ghana, notably:
  - increased inflationary pressures
  - collapse of domestic industries dependent on imported inputs
  - Unemployment
  - Change in government
- Politicization of Exchange rate policies
  - governments use the nominal stability of the exchange rate as measure of economic achievement
  - Yet, nominal exchange rate stability may not be the best policy option

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## Discussion Framework

- Critical issue: What does a country expect of its exchange rate regime and strategy?
  - We look at Ghana's currency and exchange rate history
  - The choices available to the policy makers
  - Some analytical basis for the trade-offs
  - Critical challenges to current exchange rate regime

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## Ghana's Currency and Exchange Rate History (1)

- Mechanics of the Sterling Exchange System
  - Ghana pound, £G, exchanged at par with the pound sterling of the United Kingdom, and was equivalent to US\$2.80
  - External value of Ghana £ depended on sterling
  - Ghana £ had no applicable rates of exchange of its own against other international currencies
  - Tied to BOP and considered to have adverse implications for internal development

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## Ghana's Currency and Exchange Rate History (2)

- "The colonial sterling exchange standard does not adapt itself easily to internal economic development and its introduction in the form that it took in West Africa may have created obstacles to internal development at the same time as it assisted the export sector, as it was designed to do." (Hawkins, E.K. 1958, "The Growth of a Money Economy in Nigeria and Ghana" in Oxford Economic Papers, October, p.354)
- This was one major reason why Nkrumah quickly left the WACB and initiated monetary programmes and policies with fiduciary implications

### Currency And Exchange Rate History (3)

- Ghana initiated action to break the one to one mapping of the Ghana £ with the £ sterling.
- July 19, 1965 Cedi was decimalized and made equivalent to 100 old pennies or the equivalent of US\$1.17
- Feb 23, 1967 Cedi was again decimalized, and referred to as *new cedi*, which exchanged for the old cedi at a rate of N¢1 = ¢1.20.
- Redenomination From First July 2007

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### The New Ghana Cedi (1)

- From July 1st, 2007, the existing note regime will be re- denominated
  - Ten thousand existing cedis (¢10,000) will be one new Ghana cedi (GH¢1)
  - The new currency, which is to be officially called *Ghana Cedi*, (GH ¢) would also be equivalent to 100 Ghana Pesewas (Gp)
  - By this, the new note regime will set the new currency unit at  $¢10,000 = GH¢1 = 100Gp$

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### Old And New Notes Have Same External Value (1)

- Assume the day's exchange rate between the cedi and the dollar is  $\$1 = \text{¢}9,200$ , then the exchange rate of the Ghana Cedi (GH¢) is:
  - $\text{¢}9200 = GH¢0.9200 = 92p = \$1$
- Expressed in domestic currency terms,  $GH¢1 = \text{¢}10,000 = \$1.087$ .
- Thus ¢1,000,000 Forex Bureau transaction at the exchange rate of  $\$1 = \text{¢}9200$  will yield \$108.70
- With the re-denomination,  $\text{¢}1,000,000 = GH¢100$ , which will also yield \$108.70

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### Phases of Exchange Rate Management

- Era of fixed exchange rate: 1967- 1982
- Era of crawling peg: 1983 -1990
- Inter-bank market transactions introduced in 1992
- Exchange rate management in constitutional era

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### Era Of Fixed Exchange Rate: 1967- 1982

- Cedi pegged to the US dollar within a controlled regime. Key features included:
  - Infrequent devaluations
  - Surrender requirements under various laws
  - Exchange controls with currency rationing
  - Removal of convertibility of the cedi with fiduciary issues.

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### Upshot Of Pegged Exchange-Rate Regime

- Currency overvaluation and intractably high rates of inflation
- Fixed exchange rates do not necessarily lead to lower inflation
- Trade-offs are critical, especially as inflation could be precipitated by exogenous factors

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### Era Of Crawling Peg: 1983 -1990

- Characterized by adjustable pegs, and partial removal or restrictions on capital account transactions
  - Foreign exchange auction within a two-tier system
  - Two-tiers unified in 1987 and all transactions carried out using weekly-determined auction rate
  - In 1990, weekly auction replaced by the wholesale auction
  - Foreign exchange bureaux system introduced in 1988 fuse formal and black market

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### Exchange Rate Management in a Constitutional Era

- Third phase: inter-bank market transactions introduced in 1992
- Bank of Ghana committed to maintaining a managed floating exchange rate regime with no pre-announced path for the exchange rate
- BOG Intervenes only to smooth short-term exchange rate fluctuations to achieve inflation target within defined balance of payments and/or gross international reserve targets
- Yet, at least since 2002, the exchange rate has shown significant degrees of appreciation, even in nominal terms.

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### Currency Appreciation (2)

- IMF'S "Fourth and Fifth Reviews Under the Three-Year Arrangement Under the Poverty Reduction and Growth Facility and Request for Waiver of Nonobservance of Performance Criteria" Para 28 reads as follows:  
"The authorities describe their exchange rate regime as a managed float, with no pre-announced path for the exchange rate. Under this regime, intervention in the foreign exchange market is to be limited to short-term smoothing and achievement of the international reserves objective. However, as noted earlier, there has been relative stability of the nominal exchange rate vis-à-vis the U.S. dollar over a long period. The staff considered that in the face of strong inflows some nominal appreciation would have been expected, which would have supported the process of disinflation (*italics mine*). The authorities expressed some concern about the possible impact on competitiveness of the real exchange rate appreciation in such a scenario. However, they agreed with the staff that in the context of relative macroeconomic stability, the reliance should be on gains in productivity to maintain and improve competitiveness. In such a scenario, therefore, efforts to remove structural impediments to lower costs and diversify the economy should be intensified. In any event, the authorities agreed not to undertake actions—beyond short-term smoothing and achievement of the international reserve target—that would inhibit changes to the exchange rate for the cedi in response to market forces".

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### Currency Appreciation (1)

- BOG May 2006 MPC Report on the External Sector
  - In trade-weighted terms, the cedi appreciated, cumulatively, by 2.9 percentage points in January-February 2006, as compared with an appreciation of 6.8 percentage points over the first two months of 2005.
  - In terms of the foreign exchange transactions weighted index, the cedi appreciated cumulatively by 2.0 percentage points in January-February 2006, as compared with 7.8 percentage points over same period in 2005.

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### Currency Appreciation (3)

- Appreciation lauded by both government and the IMF e.g. Ghana: Letter of Intent and Technical Memorandum of Understanding May 25, 2006, Para 17
- "We believe that this regime has served Ghana well. Recent real effective appreciation has not harmed Ghana's international competitiveness, as indicated by the continued expansion of nontraditional exports and continued strong net private inflows. We have also experienced relative stability of the cedi nominal exchange rate with respect to the U.S. dollar. Under the circumstances, the central bank does not intend to undertake any action that would inhibit changes to the exchange rate as determined by the fundamentals of market forces"

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### Currency Appreciation (4)

- Exchange Rate and Inflation
  - Stand of BOG and IMF stems from their position on inflation targeting, namely:
    - transmission of exchange rate effects through prices is rather strong in Ghana.
- IMF accordingly urged BOG to remain concerned about the potential for sharp fluctuations in the cedi's external value

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## Exchange Rate Depreciation And Inflation Link

- Depreciation raises prices of imported goods when there are no suitable domestic substitutes
- Consumers end up with higher prices, translating into higher inflation pressures
- Cost push inflation is exacerbated as domestic producers use huge amounts of imported inputs
- Depreciation translates into higher costs of petroleum products, which in turn engender further inflationary pressures

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## Hence.....Fiscal Tightness And Inflation Targeting

- Singular most important objective now is disinflation
  - “The achievement of single-digit inflation is the primary goal of the Bank of Ghana. Recent refinements to available instruments and operating framework have facilitated progress toward this end” IMF PRGF Review Para 27, May 2006
- Probably single digit inflation of 5%????
- But what are the trade-offs??????

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## What Does Ghana Want Of Its Exchange Rate Regime ?

- General Objectives of Economic Policy Include:
  - stability in domestic price levels
  - equilibrium in the balance of payments
  - Employment creation economic growth with export led strategy in a global economy
  - Intensification of poverty reduction within an export-led growth framework

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## What Does Ghana Want Of Its Exchange Rate Regime ? (2)

- Role of exchange rate is critical in the trade-offs because it can be an incentive or disincentive to:
  - Inflation
  - international competitiveness
  - domestic import competing industry
  - non-traded goods

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## Exchange Rate Regime And Export-Led Growth Strategy

- A misaligned exchange rate can make imports cheaper than they should be, and *reduce the profitability of* exporters and domestic firms producing import competing products.
- But Ghana aspires to be a middle income country by 2015 using an export-led growth strategy.

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## Points To Note On International Competitiveness

- Measures of international competitiveness reflect changes in relative price of foreign traded goods relative to domestic tradable goods
- These are based on real exchange rate indicators on:
  - Consumer prices
  - Export unit values
  - Labour costs
  - Technical productivity indexes

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### Exchange Rate and Import Competing Industrialization

- For producers of import competing goods to remain competitive, tariff protection is often requested to cover the tax element in the exchange rate appreciation
- Call for tariff protection various manufactures
  - Is this due to tax and subsidy elements in either exports or imports, which make Ghana's exports uncompetitive and imports cheaper than those products made in Ghana?

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### Setting The Agenda For Discussion (1)

- Are we making the right choices to promote export led-growth which will lead to long term development for sustainable poverty reduction using the exchange rate as a policy instrument?
- Have we examined the nature of shocks, i.e. rapid, uncertain and unexpected changes that can impact the economy?
- External shocks exacerbate inflationary pressures, which in turn aggravate distortions in favour of imports while serving as disincentive to exports

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### Setting The Agenda For Discussion (2)

- **Exchange Rate and External Shocks**
  - Ghana's economy is largely vulnerable to external shocks, which are not easily amenable to managing the exchange rate regime to achieving a desired nominal exchange rate path
  - Such shocks derive from:
    - Intractable domestic inflationary pressures including weather conditions
    - Erratic Energy Supply
    - unstable export earnings
    - Volatile crude oil prices

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### Setting The Agenda For Discussion (3)

- Exchange Rate and External Shocks:
  - It is very critical for a country to evaluate the nature of shocks that face it and the expected duration of the shock in determining its exchange rate regime and strategy
  - Against this background, we pose the following question to guide the discussion

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### What Does Ghana Want Of Its Exchange Rate Strategy?

- Trade-offs in exchange rate policy instrument
  - incentive or disincentive to inflation
  - international competitiveness
  - promotion of domestic import-competing industries
  - non-traded goods
- How do we measure these trade-offs?
- Who are the winners and the losers?

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### Again, What Does Ghana Want Of Its Exchange Rate Strategy?

- This presentation is to:
  - set the agenda for discussion on exchange rate as an instrument of policy, focusing on the trade-offs so as to provide informed analysis for evidence-based policy

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THANKS FOR YOUR  
KIND ATTENTION!!

WISHING YOU  
VERY FRUITFULL  
DELIBERATIONS

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