Managing Capital Flows: Lessons from Emerging Markets for Frontier Economies: Policy Responses to Capital Inflows in Ghana

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Introduction

- There have been active debates on the economic benefits of un-bridled capital flows and financial account liberalization

- Financial inflows to Ghana have been on the continuous increase since 2006, but have also come with some challenges.

- The policy responses have been wide ranging, depending on the nature of the challenge

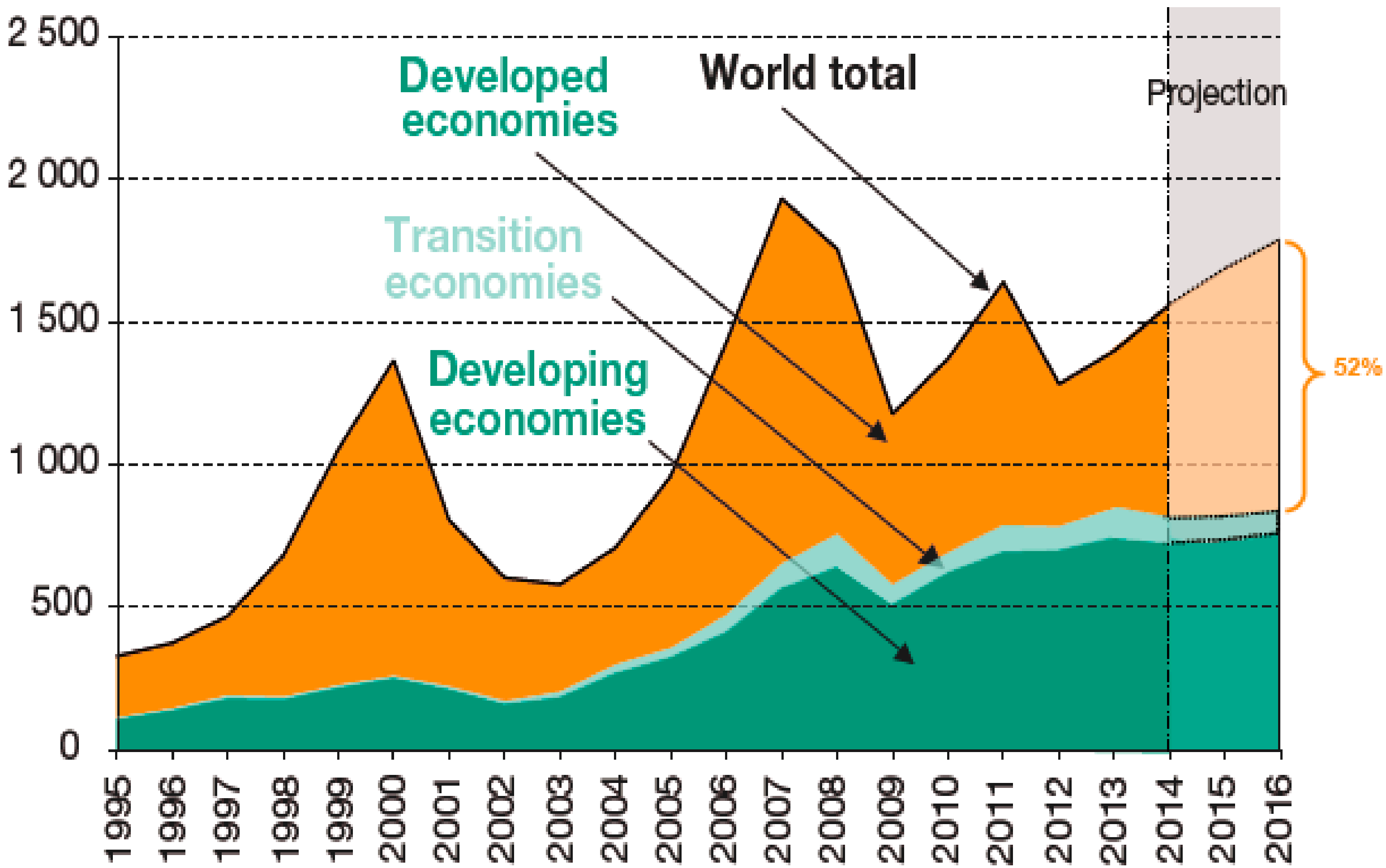
Trends In Capital Flows

FDI flows, by region, 2011–2013 (Billions of dollars)

Region	FDI inflows			FDI outflows		
	2011	2012	2013	2011	2012	2013
World	**1 700**	**1 330**	**1 452**	**1 712**	**1 347**	**1 411**
Developed economies	880	517	566	1 216	853	857
European Union	490	216	246	585	238	250
North America	263	204	250	439	422	381
Developing economies	725	729	778	423	440	454
Africa	48	55	57	7	12	12
Asia	431	415	426	304	302	326
East and South-East Asia	333	334	347	270	274	293
South Asia	44	32	36	13	9	2
West Asia	53	48	44	22	19	31
Latin America and the Caribbean	244	256	292	111	124	115
Oceania	2	3	3	1	2	1
Transition economies	95	84	108	73	54	99

- In 2013, FDI flows returned to an upward trend. Global FDI inflows rose by 5 per cent to US$1.41 trillion in 2013. FDI inflows increased in all major economic groupings − developed, developing, and transition economies. Global FDI stock rose by 9 per cent, reaching US$25.5 trillion.

FDI INFLOWS, GLOBAL AND BY GROUP OF ECONOMIES, 1995–2013 AND PROJECTIONS, 2014-2016 (BILLIONS OF DOLLARS)



- UNCTAD projects that global FDI flows was about US$1.6 trillion in 2014, and would rise to US$1.75 trillion in 2015 and US$1.85 trillion in 2016.
- The rise will be mainly driven by investments in developed economies as their economic recovery starts to take hold and spread wider.
- The fragility in some emerging markets and risks related to policy uncertainty and regional conflict could still derail the expected upturn in FDI flows.

EMERGING ECONOMIES

- In the aftermath of the 2008 global financial and economic crisis, capital flows to emerging countries surged again. There had been similar episodes in the past three decades, including one that culminated in the 1997–98 East Asian financial crisis.
- What differs in each episode of surges in capital flows are the circumstances facing a particular economy. What would be similar is that policymakers in each country would consider capital controls.

Regional Trends

Both push and pull factors contributed to the surge in portfolio private capital flows to sub-Saharan African frontier markets between 2011 and 2013.

- Push factors included weak economic growth, excess liquidity, and low bond yields in advanced economies.
- Pull factors include the better economic prospects in sub-Saharan African frontier markets. Improved macroeconomic policy management, low debt levels, and structural reforms, including the development of capital and securities markets have encouraged foreign investment.

Regional Trends cont'd

- One important factor—investor risk aversion—is highly volatile, and can change abruptly in response to political as well as economic events.
- FDI inflows to Africa rose by 4 per cent to US$57 billion in 2013, driven by international and regional market-seeking and infrastructure investments. Expectations for sustained growth of an emerging middle class attracted FDI in consumer-oriented industries, including food, IT, tourism, finance and retail.

- Over the last three years, the frontier market economies of sub-Saharan Africa have received growing amounts of portfolio capital flows.
- Since 2010, continued positive macroeconomic performance, coupled with unprecedented accommodative monetary policies in advanced economies, renewed foreign investors’ interest on a much larger scale, resulting in sub-Saharan African frontier markets becoming more integrated with international capital markets.

- The number of sub-Saharan African countries with international credit ratings has increased, a large number of countries have issued sovereign bonds—many of them for the first time—and foreign investors have become active players in some domestic bond and equity markets.

Capital Flows –Ghana

Measures to Attract FDIs

- The passage of the Ghana Investment Promotion Council Act in 1994 established the legal framework for investment inflows
- Tax holidays, import duty exemptions for foreign investors, improved remittances of dividends and profits abroad and improved judicial processes are some of the other measures put in place to attract capital.
- In 2005, Ghana obtained its first sovereign rating and then gained access to international capital markets

- Security of investment is also provided by the national constitution, as well as by agreements such as the Multilateral Investment Guarantee and the Investment Promotion Protection Agreements.

Trade Balance, Current Transfers and Net Capital Flows to Ghana (in million USD)

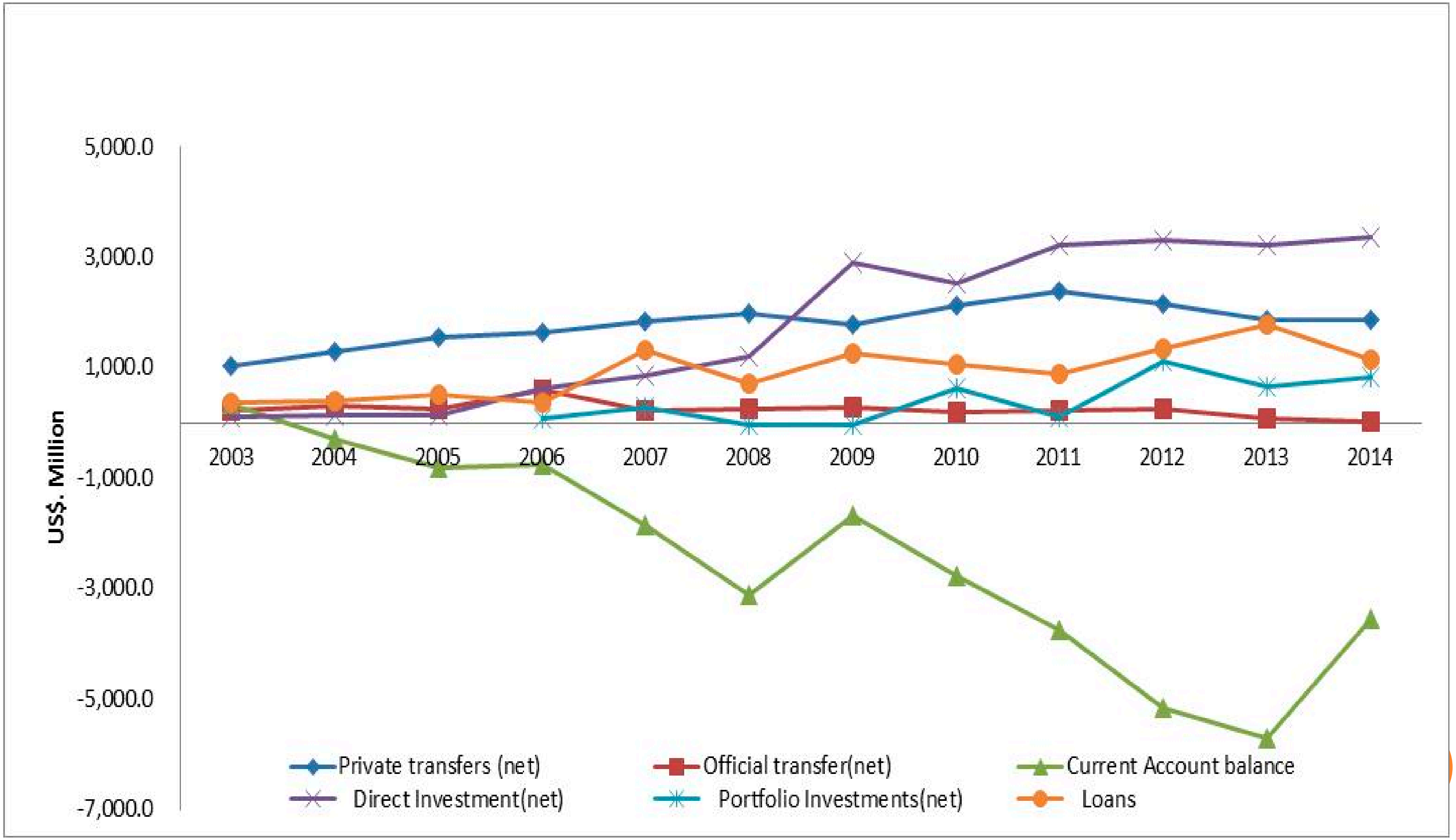
	US$. Million											
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Current Transfers	1,244.9	1,579.9	1,794.2	2,248.3	2,043.2	2,211.5	2,078.0	2,322.4	2,597.4	2,405.3	1,939.4	1,878.4
Private transfers (net)	1,017.2	1,287.1	1,549.8	1,644.6	1,833.8	1,970.4	1,788.4	2,122.7	2,368.8	2,147.5	1,859.2	1,868.8
Official transfer(net)	227.7	292.9	244.5	603.7	209.4	241.1	289.6	199.7	228.7	257.8	80.3	9.6
Current Account balance	325.4	-303.3	-831.0	-768.7	- 1,843.4	- 3,113.3	- 1,687.7	- 2,769.7	- 3,770.1	- 5,168.5	- 5,704.1	-3,564.7
Capital and Finance Account	494.7	452.6	1,165.7	1,484.9	2,866.6	2,943.3	4,327.6	4,289.5	4,479.3	3,651.3	5,368.2	3,270.1
Financial Account	340.4	201.6	834.5	1,255.0	2,678.5	2,480.0	3,763.8	3,952.1	4,034.3	3,367.9	5,018.9	3,250.2
Direct Investment(net)	110.0	139.3	145.0	636.0	855.4	1,211.6	2,890.2	2,527.4	3,222.2	3,293.4	3,226.3	3,363.4
Portfolio Investments(net)				65.8	289.3	-49.01	-43.64	620.5	117.6	1,121.8	658.9	835.9
Loans	369.8	402.3	501.3	351.2	1,305.8	717.9	1,246.2	1,057.9	888.8	1,341.7	1,765.4	1,151.6

General Trends

- Ghana, like many emerging and frontier economies, has witnessed some substantial inflow of capital in recent past.

- It experienced a surge in capital flows from 2009 after the 2008 global financial crisis. The country also relies heavily on remittances from overseas workers
- Ghana also benefitted from FDI inflows when prices of minerals rose in the period up to 2013. It has also benefited from rising investment since the 2007 discovery of oil.

Trade Balance, Current Transfers and Capital Flows to Ghana (in million USD)



Foreign Direct Investment

- FDI has risen from a few hundred million US dollars annually to over US$3.0 billion a year since 2009.

Sector Distribution of Foreign Direct Investment (US$ Millions)

	2010	2011	2012
	Stock	Stock	Stock
Book value of equity as at 31st December	**4,987.22**	**5,870.96**	**13,262.94**
Administrative and Support Service Activities	0.72	0.76	0.07
Agriculture, Forestry and Fishing	19.86	17.89	70.43
Arts, Entertainment and Creation	0.01	0.02	0.05
Construction	23.90	24.50	64.90
Electricity, Gas and Air Conditioning Supply	69.30	87.51	245.96
Finance and Insurance Activities	917.05	1,091.02	1,396.12
Information and Communication	370.17	-267.16	638.87
Manufacturing	366.08	417.63	590.68
Mining and Quarrying	3,115.15	4,381.08	9,919.02
Others	0.50	0.42	31.36
Professional, Scientific and Technical Activities	0.01	0.01	0.03
Real Estate Activities	0.79	0.74	0.66
Transportation and Storage	4.63	3.23	3.24
Wholesales & Retail Trade	99.03	113.28	301.55

- The major recipient sectors of FDI during the period were mining and quarrying (which includes the oil sector), Finance and Insurance (which includes banking), Information &Telecommunications and the Manufacturing sectors.

- At the end of 2012, the stock of FDI in the mining and quarrying sector was US$9,919.02 million as a result of the oil discovery, Finance and Insurance (includes banking) received US$1,396.12 million and the Wholesale and Retail sector was US$301.55 million.

Top 10 Foreign Direct Investments Source Countries (US$ Millions)

FDI Source Country	2011	2012
	Stocks	Stocks
United Kingdom	2,750.88	2,442.52
Ireland	2,315.84	1,684.15
Cayman Islands	1,837.92	1,304.91
Bermuda	949.12	1,225.52
Bahrain	1,012.91	1,224.04
Canada	740.37	981.42
British Indian Ocean Territory	769.51	785.01
China, P.R	486.76	549.91
Belgium	234.37	443.72
Cameroon	460.46	418.14
FDI from Top 10 Countries	**11,558.14**	**11,059.36**
Total FDI	**13,845.95**	**13,262.94**

- The main sources of FDI in 2012 were United Kingdom, Ireland, Cayman Islands, Bermuda and Bahrain etc. The top ten countries jointly accounted for 83.48 per cent and 83.39 per cent of FDI transactions and stocks in 2012, respectively

Portfolio Investments (Equities)

Portfolio investment in resident enterprises is comprised of total equity (based on the value of individual shareholding of less than 10 percent).

- The stock of portfolio investments increased from US$209.18 million in 2011 to US$218.86 million in 2012, attracting net inflows of US$9.68 million during the period.
- The Finance and Insurance and Information and Communication sectors attracted net portfolio inflows of US$33.21 million and US$13.23 million respectively.
- These sectors attracted net inflows from Nigeria, Cayman Islands, France, Trinidad and Tobago and Luxembourg.

Portfolio Investments (Government Bonds)

- Ghana commenced the issue of medium term domestic sovereign bonds in 2006, which non-residents could participate in.
- Developments in the domestic government bonds market have been mixed. The highest net inflow from non-residents of US$620.50 million was in 2010.
- However, volatilities in the value of the domestic currency, the cedi, has kept non-residents' participation quite chequered, even though the relatively high yields remain a source of attraction.

PORTFOLIO INVESTMENTS (EUROBONDS)

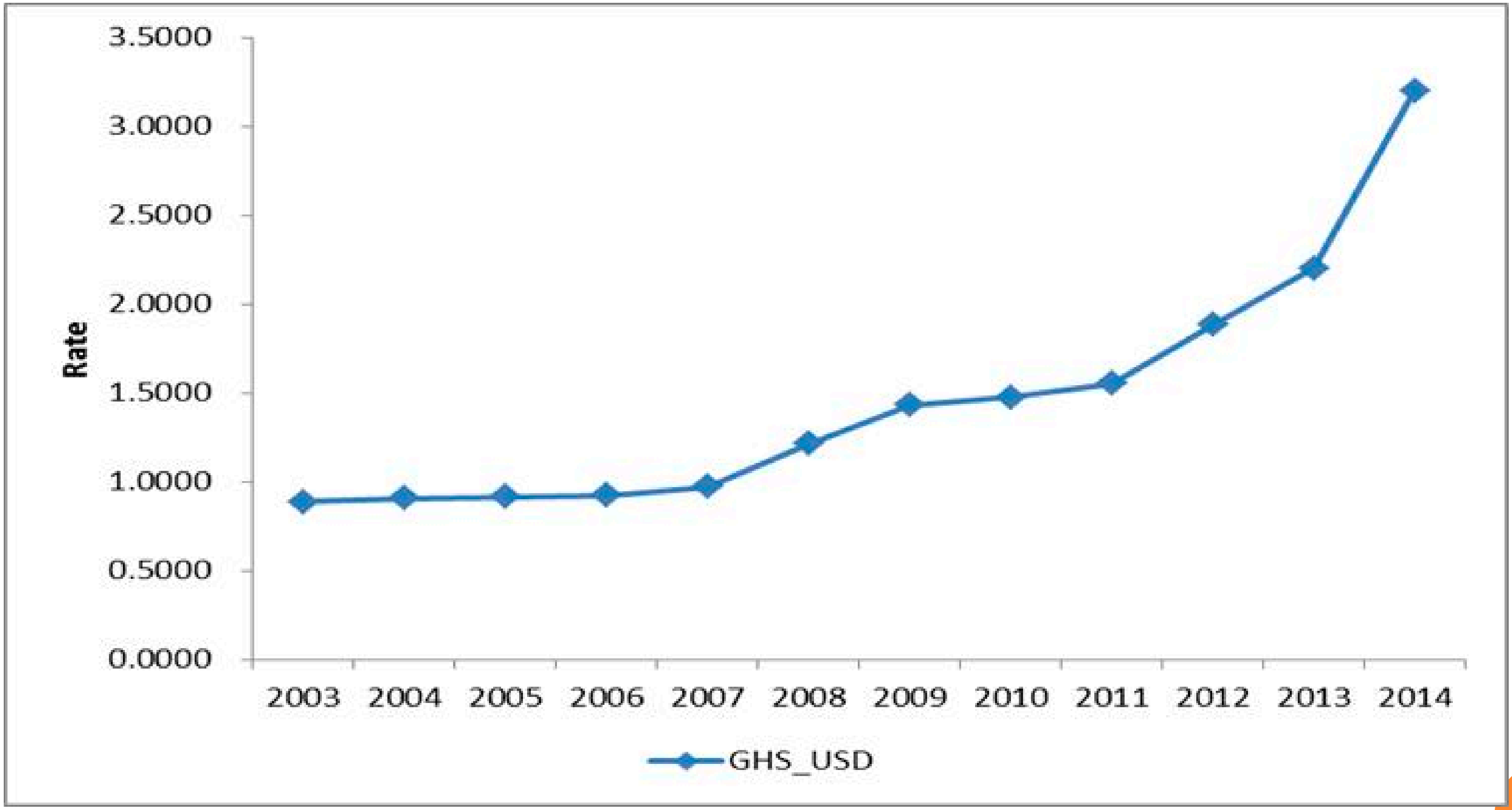
- Ghana issued its first Euro bond, a 10-year Eurobond in 2007. The issue, which raised US$750 million from investors at a coupon of 8.5 percent, made Ghana the first nation in sub-Saharan Africa after South Africa to borrow from international capital markets.
- In 2013, Government of Ghana floated its second Eurobond. The issue raised US$1 billion from the international bond market at 8% interest rate with maturity of 10 years.

Portfolio Investments (Eurobonds) cont'd

- In August, 2014 a third Eurobond was successfully issued. Government issued 1 billion dollars with a coupon rate of 8.125%.

- The inflow of capital to Ghana has not brought in its wake the traditional Dutch disease and currency appreciations.
- Cocoa and gold continue to be very important export commodities despite the huge investments in the oil sector
- Capital inflows also coincided with increases in imports arising from oil production related activities, increased outflows of services and income and some amount of fiscal excesses linked to electoral cycles.

GHANA CEDI_ US DOLLAR EXCHANGE RATE



MEASURES AIMED AT MANAGING CAPITAL INFLOWS

1. Sterilization

- Cocoa syndicated loans of US$1.5 billion in 2012, US$1.2 billion in 2013, and US$1.7 billion in 2014 were mobilized to be used to fund cocoa purchases.

- To prevent the potential impact of such large amounts of inflows on the domestic currency, all these moneys were sterilized and the disbursements made in tranches to the board for onward payment for cocoa beans.

- Beyond serving as ready cash for the payment of cocoa purchased from farmers, the coming in of the loan is timely, as it helps shore up the country's reserves and consequently help stabilize the cedi. The loan also helps improve liquidity in the system.
- Similar treatment has also been given to the Eurobond issues.

2. Macroeconomic policies

- The promulgation of the Bank of Ghana Act by parliament in 2002.
- In 2005, Ghana obtained its first sovereign rating
- Ghana, the top reformer in Africa, in trade, tax, and property administration.

3. Macro prudential Policies

- The minimum capital of banks in Ghana has been raised twice.
- The central bank has extended its supervisory operations to micro finance institutions
- New mandatory reserve requirements of 9 per cent in domestic currency on both foreign and domestic currency deposits have been introduced.
- The reserve balance must be held with the Bank of Ghana.
- Daily single foreign currency exposure limit is reduced from 15 to 10 percent of the capital base.

MACRO PRUDENTIAL POLICIES CONT'D

- Banks are required to hold 100 per cent domestic currency reserves on their vostro accounts since they had started holding such monies for speculative purposes.
- The Central Bank has put in place mechanisms for improving financial operations with the setting up of a collateral registry, and credit reference bureaux.
- The Bank is in the process of putting in place a bank resolution framework to help in resolving issues of insolvent financial institutions.
- Pension funds regulations have also been reviewed to ensure that there is sufficient domestic capital in both the money and capital markets in the country.

4. Direct Policies

- In Ghana, there are restrictions limiting non -resident purchases of government securities to longer maturity instruments of three years or more.
- Efforts are also underway to make the secondary market for these securities more vibrant.
- The increased participation of foreigners in the government debt markets could be an additional source of vulnerability resulting from rollover risks.
- Though the secondary market is rather illiquid, an early redemption or purchase of not yet matured three-year and five-year bonds is possible.
- Foreign exchange measures to stabilize the cedi.

Conclusion

- The gradual opening up of the capital account has seen a remarkable increase in capital flows into the country and also improved the country’s financing options despite the drying up of official inflows.
- It has at the same time increased production related imports and also coincided with some amount of fiscal excesses.
- These developments have brought along current account and exchange rate pressures which have in turn slowed down the pace of liberalization.
- Going forward, the country hopes to reign in the fiscal excess, begin reaping the benefits of the inflows and then proceed to full capital account liberalization.

Thank you for your attention.