POLICY BRIEF

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Current Monetary Policies and their Implications for Doing Business in Ghana

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Summary
This policy brief is a synthesis from a policy symposium organized by the CSIR-Science and Technology Policy Research Institute (STEPRI) in collaboration with the Ministry of Trade and Industry. Research evidence from the presentations indicates that an upward adjustment in monetary policy rate will lead to substantial adjustments in lending rates. This ultimately causes the growth rate of sectors and sub-sectors to decline. For instance, exchange rate volatility translates itself into high lending rates, increased costs of importing raw materials and high import tariffs. These scenarios impair the growth and development of Small and Medium Enterprises (SMEs), resulting from high input/production cost which sometimes forces them out of business. There should therefore be policies that will make the cost of foreign currencies less severe to SMEs. Policies must also aim to build the capacity of SMEs to penetrate global markets.

Introduction
Monetary policies are pursued together with fiscal policies to ensure that economic progress is achieved while fiscal and other macroeconomic challenges are addressed. A component of a broad stabilization programme of government is monetary policy. Among other things, the objectives of monetary policy includes: price stability, exchange rate stability, output stabilization and financial stability, of which price stability is the dominant policy goal among modern central banks. Thus, successes or failures of monetary policy are based on their impact on prices, output, exchange rate and financial stability. This suggests that unguided or uninformed monetary policies can have damaging effects on the economy.

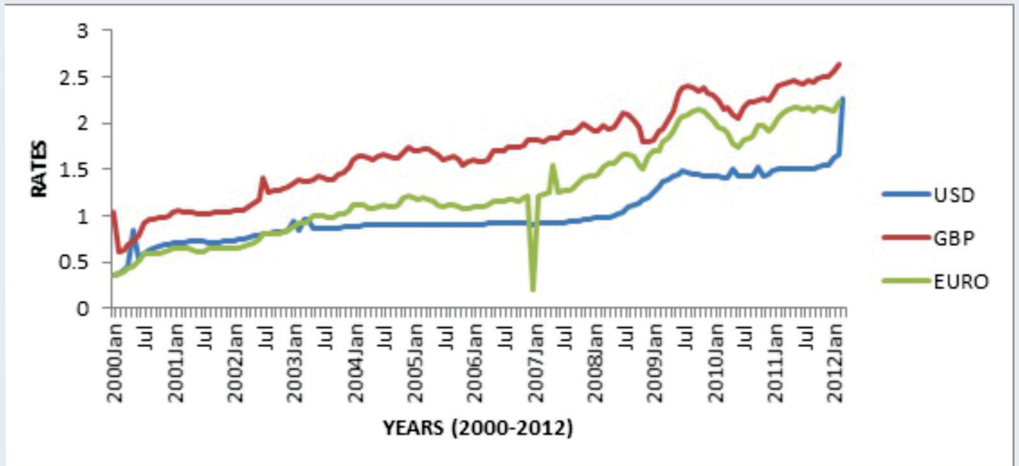
Ghana has come a long way since independence in institutionalizing a system for delivering price stability to the economy. The system has evolved from a monetary-targeting framework, which firstly involved the use of credit controls and then quantitative open market operations to the current inflation-targeting framework. When Ghana obtained its own monetary policy after 1957, the country has had higher inflation rates and lending rates than some of her peers in Sub-Saharan Africa. Evidence also suggests that in recent times exchange rates have not been stable and lending rates are above the policy rates. This seems to be affecting both small and large businesses especially those in the manufacturing sector. Hence it is important that the effects of monetary policies on business and sectoral growth in general be looked at.

Exchange rate volatility in Ghana: Implications for SMEs
Exchange rate volatility captures the degree to which exchange rate changes over time and its impact on economic activities. The larger the magnitude of exchange rate volatility, the greater the level of risk that businesses are faced with. From figure 1, it can be depicted that the country has been going through a huge exchange rate volatility and hence currency depreciation over the years. SMEs in Ghana are usually small and lack economies of scale, having limited access to working capital and export finance, among others. There is also poor demand for locally made products which has resulted in increased imports and higher exchange rates.

The implications for exchange rate volatility includes the continuous depreciation of the

Ghana cedi which translates itself into high lending rates, increasing costs of importing raw materials and high import tariffs. This ultimately impairs the growth and development of these SMEs resulting from high input/production cost which sometimes forces them out of business.

Figure 1: Exchange rate volatility (2000-2012)



Source: ISSER 2013 The State of the Ghanaian Economy

Policies must therefore be put in place to support SMEs to produce and export value added commodities that will earn foreign exchange. Greater commitment is also needed on the part of government to remove supply side constraints facing SMEs in their efforts to export.

Sectoral and Sub-Sectoral Effects of Monetary Policy in Ghana

It has been revealed that an upward adjustment in monetary policy rate leads to substantial adjustments in lending rates which ultimately cause the growth rate of sectoral and sub-sectoral outputs to decline. The size and timing of responses are heterogeneous. The construction sector has the largest response, whiles transport, storage and communications sub-sector has the least responses as shown in Table 1. A way for policy makers to counter this behavior is to target and reduce the size of the pass-through effects of the policy rate to market rate by dealing with asymmetric information.

Table 1: Maximum response of sectoral output growth to nominal disturbances

SECTORAL OUTPUT GROWTH	MAXIMUM RESPONSE TO SHOCKS					
	Monetary Policy Shock		*Inflation Shock*		*Exchange Rate Shock*	
	Maximum impact (%)	Quarter	Maximum impact (%)	Quarter	Maximum Impact (%)	Quarter
Real GDP	-5	4				
Industrial	-4	1	-4	2	0.3	2
Manufacturing	-5	1	-3	3	0.7	3
Mining, manufacturing and utilities	-0.7	1	-4	3	0.5	3
Construction	-20	4	-5	3	0.5	1
Services	-9	4	-1	2	0.5	4
Wholesale, retail trade, restaurants and hotels	-7	4	-2.5	2	1	4
Transport, storage and communications	-2	4	-1	2	0.7	3

Source: Theme Speaker's compilation

Conclusion and Policy Recommendations

The key driver to the poor performance of Ghana's monetary policies has been identified to be fiscal indiscipline as well as poor demand for locally made products which has resulted in increased imports and hence higher exchange rates. The growth of SMEs is at risk if these persist.

The following policy recommendations have therefore been suggested to help in that direction.

- Exchange rate risk must be managed especially for export and import oriented SMEs;
- The use of forward contracts to hedge in the forex market should be pursued;
- Policy makers should target and reduce the size of the pass-through effects of the policy rate to market rate by dealing with asymmetric information;
- SMEs need to come together and work so that they can take advantage of syndicated loans in accessing financial support;
- There should be policies that will support SMEs to produce and export;
- Deepening policy implementation strategies is an important key to economic growth;
- Efforts should be focused on pursuing policies that would stabilize the cedi and make the dollar irrelevant in doing business transactions; and
- SMEs need to be equipped with exchange rate risk management skills.

References

Adu G (2015) Sectoral and Sub-Sectoral Effects of Monetary Policies in Ghana. Proceedings of Policy Symposium Organised by CSIR-STEPRI in Collaboration with Ministry of Trade and Industry, 28th April 2015, Accra-Ghana.