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Ghana Macro View

The Cedi Crash Of 2012: It's The Same, But Different

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- **The fiscal Achilles Heel** — As we have argued in successive pieces of research on Ghana, the incumbent government often faces a fiscal crisis around election times: we have referred to this as the country's economic policy Achilles heel.

- **The impact on the cedi** — The most obvious sign of this fiscal indiscipline is on the cedi which depreciated significantly around both the 2000 and 2008 elections and has been under pressure for most of 2012 (elections are due this December). However, while it is easy to make this broad generalisation about the interaction of politics and economics in Ghana on the cedi, history rarely repeats itself exactly.

- **Understanding the differences is key** — In fact, more important than being surprised by a loss of fiscal discipline around closely fought elections in a democratic country is the need to try and understand the slightly different circumstances under which it happens as this has an influence on the overall economic outturn, and especially the outlook for the cedi. In particular, it is possible to indentify relatively clear patterns in rising capital and recurrent spending which can help explain the timing of any cedi weakness.

- **The twin deficits** — While the focus on Ghana and the cedi around elections is usually on the fiscal deficit, the reality is that currency weakness in Sub-Saharan Africa (SSA) is more typically driven by a combination of internal and external imbalance. Not only was there a balance of payments deficit in Ghana in 1999-2000 and then again in 2008, but the balance of payments has also been under pressure in 2012. This also impacts our outlook for the cedi.

- **Monetary policy** – The final point to make about events in 2012 is that monetary policy so far this year seems to have been much tighter than in either 2000 or 2008. Coupled with trends in domestic food production and base effects, this may help explain why inflation has not picked up substantially in 2012 despite cedi weakness.

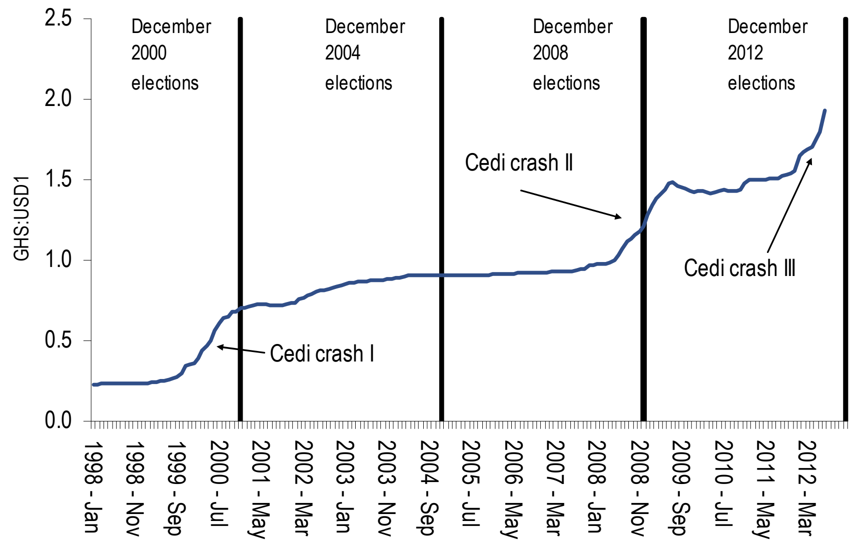
- **The Cedi Crash III** — Putting these elements together it does seem that the current cedi crash has more parallels with the deprecation in 2000, which had virtually run its course by the time of the December elections, whereas the December 2008 elections came in the middle of the crash. But if cedi stability is to be restored in 2013, much will depend on whoever wins the December 2012 election firmly seeking to restore fiscal discipline.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Understanding cedi collapses

As we have argued in successive pieces of research on Ghana[1], the incumbent government often faces a fiscal crisis around election time: we have referred to this as the country's economic policy Achilles heel. As Figure 1 shows, around both the 2000 and 2008 elections this has eventually played out in periods of cedi weakness.

Figure 1. The three cedi collapses to date



Source: Reuters and Citi Research

However, while it is easy to make this broad generalisation about the interaction of politics and economics in Ghana, history rarely repeats itself exactly. The most obvious difference in the two main historical bouts of cedi depreciation was that in 2000 it had virtually run its course when the December 2000 poll was held, whereas the December 2008 election was held at roughly the mid-point of the next major collapse. In this respect, the current cedi collapse in the run up to the December 2012 poll seems to fit more into the 2000 pattern.

Looking in more detail at all three incidents of cedi weakness additional differences emerge: the different nature of the loss of fiscal discipline, and the fact that the impact of a weakening currency on inflation seems to be changing over time. Understanding these similarities and differences is important when thinking about the outlook for the cedi.

Fiscal follies

Fiscal discipline has historically been an issue in Ghana

Over the last decade plus a bit, successive Ghanaian governments of all political persuasions have managed to lose control over the fiscal deficit in the run-up to various elections. But contrary to popular perceptions it does not happen every time there is an election. The two main times were in 2000 and 2008. In sharp contrast, the pattern was not repeated around the December 2004 elections. Instead, between the 2000 and 2008 elections a large degree fiscal discipline was restored: according to IMF data the deficit averaged only 2.9% of GDP in 2004-05, effectively the years prior to and after the poll.

[1] See Citi Ghana Macro Views: Tougher Times on the Horizon (June 2008); Cedi, Ghana Cedi, Petro-Cedi (November 2009); and Is the Glass Half Full, or Half Empty? (August 2011).

But perhaps more important than being surprised by a loss of fiscal discipline around closely fought elections in a democratic country, is the need to try and understand the slightly different circumstances under which it happened in each case, as this does have an influence on the overall economic outturn and in particular, the outlook for the currency, the cedi.

The fiscal story leading into 2000 and 2008 were very different

The first major difference between 2000 and 2008 is that the loss of fiscal discipline in the run-up to the December 2000 elections was not really specifically attached to the elections. Instead, there where clear indications that fiscal discipline had already slipped significantly for a number of years prior to the polls. The bottom line is that although the fiscal deficit reached at 9.5% of GDP in 2000 according to IMF data, the reality is that the deficit averaged 8.9% of GDP over the four year period from 1998-2001 as the incumbent National Democratic Congress (NDC) party spent heavily for a prolonged period prior to the election.

In contrast, the 2008 slippage came after a period when the National Patriotic Party (NPP) government elected in December 2000 had made real and substantial progress in restoring fiscal discipline. It had reduced the fiscal deficit to only 3% of GDP in 2004, the year it secured re-election, and it was even lower in the subsequent year at 2.8% of GDP.

The scale of fiscal slippage in 2008 was not immediately apparent

For the NPP government re-elected in December 2004, it was only in 2007 that real signs of fiscal slippage started to become apparent once again. But while this is now much clearer with the benefit of hindsight, even in early 2008 the full scale of the fiscal slippage that was underway was not immediately obvious from the published fiscal data. Instead, the full scale of the slippage only really became clear after the election when data on the outstanding level of arrears became fully available (although there was some anecdotal evidence of this available from companies etc).

The story of this loss of fiscal discipline can be seen in the June 2007, June 2008 and June 2009 Article IV reports produced by the IMF. These initially projected the fiscal deficit for 2008 at 6.1% of GDP, but by 2008 this had risen to 10.3% of GDP, and then by 2009 it was estimated at 14.5% of GDP. But even this latter estimate was to prove too low, with the scale of the slippage only fully apparent as the newly elected NDC government moved onto a new ECF programme after the poll. In the first and second review of this, the IMF estimated that while the cash based budget deficit was 14.5% of GDP in 2008, the commitment-based deficit was actually 20.1% of GDP as arrears were included. While this was subsequently revised down as the arrears data was tidied up and clarified, the revisions only brought the overall deficit down to around 18-19% of GDP in various IMF reports.

The GDP revision in 2010 made the fiscal slippage seem less dramatic

Bringing a fiscal deficit of this scale down to a reasonable level within a four year election cycle was always going to be Hurculean task for whoever won the poll. But for the new NDC government elected in December 2008 there was a relatively easy way to massage the deficit down to more acceptable levels with the substantial revision made to Ghana's GDP numbers in 2010. This increased the nominal size of GDP by around 60% and using the new GDP numbers in its June 2011 Article IV Review, the IMF data now puts the deficit for 2008 at only 8.5% of GDP, although in nominal cedi terms, at GHS2,558m, it was largely unchanged.

But, being able to reduce your fiscal deficit by around 10 percentage points of GDP with arguably little more than the stroke of a pen also seems to have had a major side effect, in that it also seems to have reduced the pressure on the government to really bring the deficit back under control since its election. In many ways this is unsurprising. Whereas a deficit of nearly 20% of GDP needs urgent addressing - its sheer scale is arguably sufficient to clarify thinking in the Ministry of Finance - one of 8.5% of GDP is large, but much less of a problem and also a more manageable one.

The rapid approach of oil production also impacted on fiscal calculations

Moreover, this lack of urgency about the need to tackle the fiscal deficit seems to have been compounded by the advent of oil production in December 2010, and the subsequent boost to revenue provided by this from 2011 onwards, although in fiscal terms the impact should perhaps not be overstated. In 2011, the first full year of production, oil revenue was an estimated GHS666m, compared to non-oil revenue of GHS9,654m, although in 2012 oil revenue should easily cross the GHS1,000m level.

But perhaps the biggest problem with the advent of oil production and the promise of additional revenue was not that it led to excessive and unrealistic temptations to boost capital spending (long one of the curses of oil producers[2]). Instead, the problem was that it encouraged the government to push ahead with the implementation of the long proposed, but often delayed, Single Spine Salary Structure (SSSS) (as well as making the decision to raise the minimum wage by 20% in 2012 to GHS4.48 a day).

The cost of the SSSS has proved highly significant

While it is hard to argue with the logic of the SSSS, and its overall goal of creating a more just and logical pay structure for the civil service which eliminates the anomalies that have arisen over time, the reality is that its overall cost escalated substantially over time. To give some idea of the escalating total cost, as recently as 2010 the IMF was estimating that wages and salaries would account for 7.3% of GDP in 2012 as the SSSS was introduced. But its current estimate is that this will be 8.1% of GDP in 2012, and this figure could ultimately turn out higher.

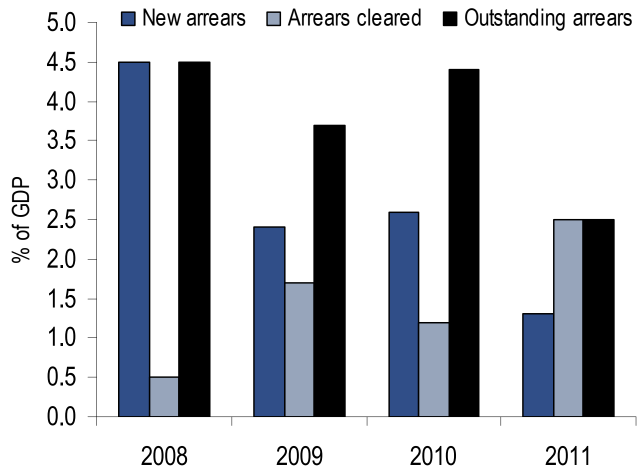
The other issue hanging over the implementation of the SSSS is that delays to the proposed timetable for implementation have meant that the government has made a series of back payments in salaries. These deferred wage payments cost the government around 0.6% of GDP in 2011, and even more crucially 1.4% of GDP in 2012 according to the most recent IMF estimates. With elections rapidly approaching, we think that most of these payments were actually made in the first half of the year, so have already been paid, hence the need for the government to pass a Supplementary Budget in July 2012.

Paying off arrears has been a major burden

The final point to bear in mind is that even if the government was fully committed to reducing the deficit, the reality is that the scale of the arrears it inherited was substantial. In fact, there is an argument that one of the reasons why it has struggled to bring spending under control is that it has continued to pay down the high burden of arrears it inherited when it took office in early 2009. Moreover, this has taken longer than originally planned as the government has struggled to verify and then pay all the outstanding claims on it.

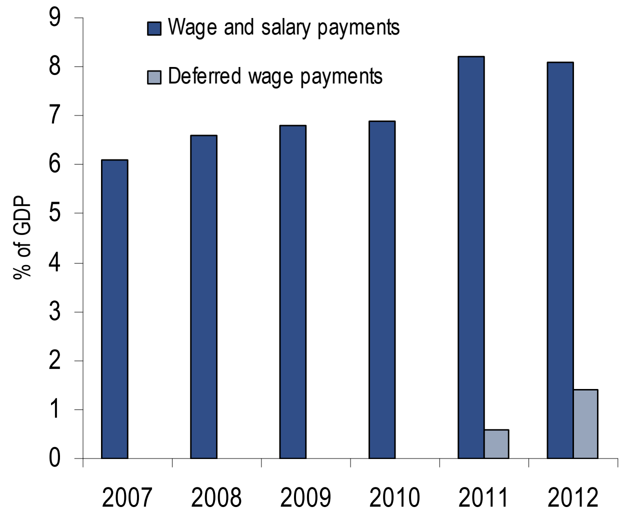
[2] In fact, arguably the biggest problem is captured in the rather ugly statement, the problem for oil producers is often the "recurrent spending implications of development spending" which means that when oil prices are high capital spending rises, but poor budget planning means that when oil prices fall back the recurrent spending costs associated with the capital spending are the real issue.

Figure 2. Battling to clear arrears



Source: IMF Article IV Reports

Figure 3. Rising wage and salary costs



Source: IMF Article IV Reports. 2012 data are estimates.

The bottom line: only limited fiscal consolidation since 2008

However valid or invalid the reasons are, the bottom line is that there has arguably been very little real fiscal consolidation since the 2008 elections. Under the revised GDP data, although the deficit fell to 5.8% of GDP in 2009, it rose back up to 7.2% in 2010, or over GHS3,000m in nominal terms, before dropping back to 5.4% of GDP in 2011. But with rising salary commitments and lower-than-expected oil revenues, we estimate that it will jump back towards the 7% level for this year.

Post election, fiscal consolidation should prove easier

Where does this leave the prospects of fiscal consolidation post election? As long as the government does not accumulate a new set of arrears during 2H 2012, we think that fiscal consolidation is possible after the election for several reasons:

- First, the reality is that having paid off arrears in recent years, these costs will not return after the elections. Or the stock of outstanding arrears has now been removed.
- Second, in a similar vein, the SSSS exercise is also a one-off event designed to correct salary imbalances that have built up over time within the civil service. As such we think that pressures to raise government wages in the short term will be more limited on whichever government wins the December 2012 elections.

In fact, with further robust GDP growth and a steady rise in oil revenue as oil production eventually starts to move towards its potential of 120,000b/d from 2013 onwards, as long as the government seeks to hold the wage bill constant at its new high level in nominal terms and does not build up new arrears, it should be able to shrink the deficit in relation to GDP and that post-election fiscal consolidation is achievable, although not inevitable, in the next parliament.

The twin deficits cannot be ignored

Fiscal and BoP deficits usually equal currency woes in SSA

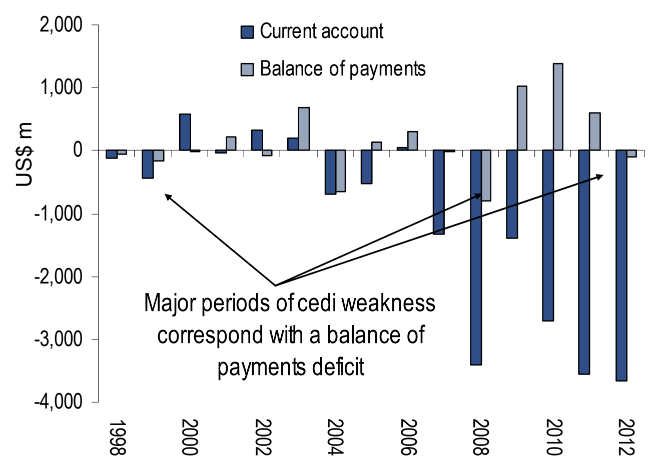
While the focus on Ghana and the cedi around elections is usually on the fiscal deficit, in broad terms, as with most countries in Sub-Saharan Africa (SSA), the reality is that currency weakness is more typically driven by a combination of internal and external imbalances, or the combination of a fiscal and balance of payments deficit. As shown in Figure 4, there was a balance of payments deficit in Ghana in 1999-2000 and then again in 2008. Perhaps the interesting exception is 2004, although in this case although there was a balance of payments deficit, the fiscal deficit was much more modest than in 2000 and 2008.

But the problem of looking at the external balance is that the pattern has become more complicated in recent years because despite the significant rise in export earnings since 2008, driven not only by the advent of oil production, but crucially also rising cocoa and gold exports, the current account has actually moved into a large and persistent current account deficit in recent years (more so than at any point in Ghana's recent economic history).

The advent of oil production has driven the rise in the current account deficit

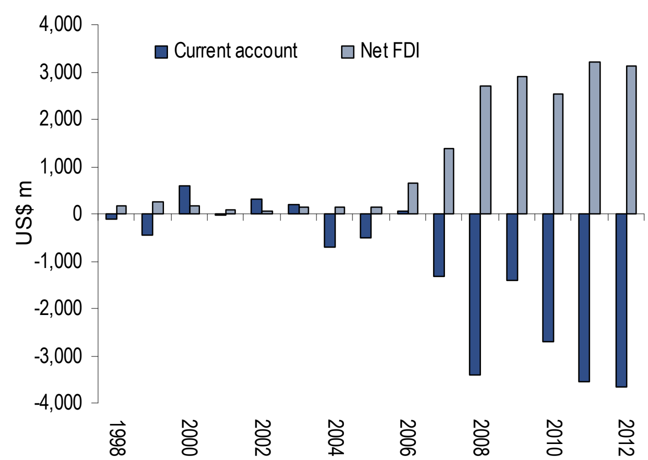
On the one hand, this trend on the current account in recent years is not surprising. Bringing on-stream a major new oil field, in this case the Jubilee field, in a country with no prior history of production is expensive. In particular, the importation of much of the heavy equipment, led by the oil platform, has pushed up imports. Services to develop the field also have to be paid for. In the early stages of the development, many of these costs were actually paid for by the developers of the field, so there was also a large rise in FDI inflows into the country. Taken at face value from the balance of payments data, net FDI inflows into Ghana averaged US$2,838m from 2008-11 compared to US$562m from 2004-07. As shown in Figure 5, this sharp increase has acted as an offsetting force to the cost of developing the oil field, leaving the balance of payments, by and large, balanced.

Figure 4. The balance of payments and current account deficits



Source: Citi Research and IMF Article IV Reports. 2012 data are Citi Research and IMF estimates.

Figure 5. A rising current account deficit, but rising FDI



Source: Citi Research and IMF Article IV Reports. 2012 data are Citi Research and IMF estimates.

Net other flows are important in understanding the move into a BoP deficit

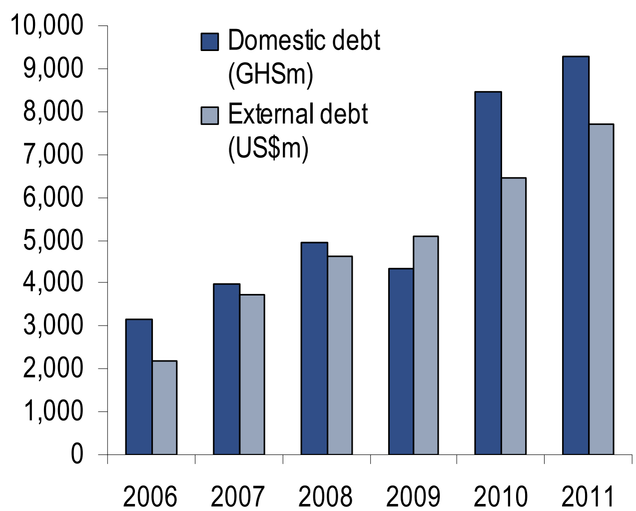
But a more detailed inspection of the financing of the current account around election times tends to show that the main flows on the financial account which help push the country into a balance of payments deficit or surplus are classified as "net other flows". These include inflows from donors, which tend to be relatively constant over time: from 2008-11 total donor support averaged US$1,623m a year.

But also, and crucially, they include net private flows and short-term flows. Although details on these flows are not always fully available, and the actual amounts are relatively small compared to FDI and official donor support, they tend to move into deficit in or around elections, probably indicating a modest degree of capital flight, but still significant enough to push the overall balance of payments into a deficit.

The debt stock has risen in recent years

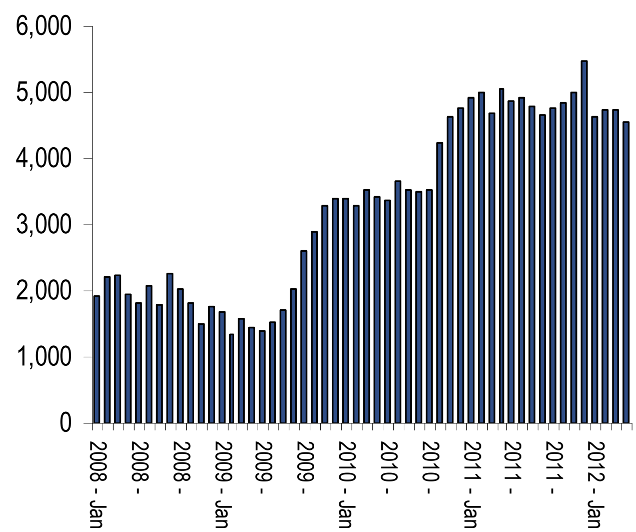
The final point of note about the impact of the twin deficits on the economic outlook for Ghana in recent years is that they have also driven a sharp rise in government debt, although the overall debt picture in Ghana in recent years is complicated first by the HIPC/MDRI write-off of external debt and then the revision to the GDP series. But the bottom line is that since 2008, using the revised GDP data, the IMF shows that the total debt stock has risen from 33.6% of GDP in 2008 to 46.3% of GDP in 2011, driven by both rising domestic and external debt. Not that Ghana's debt levels are close to critical, but the overall trend in the debt stock has been sharply upwards in the last few years.

Figure 6. A rising debt stock



Source: Haver Analytics and IMF Article IV Reports

Figure 7. Total foreign exchange reserves (minus gold in US$m)



Source: Haver Analytics

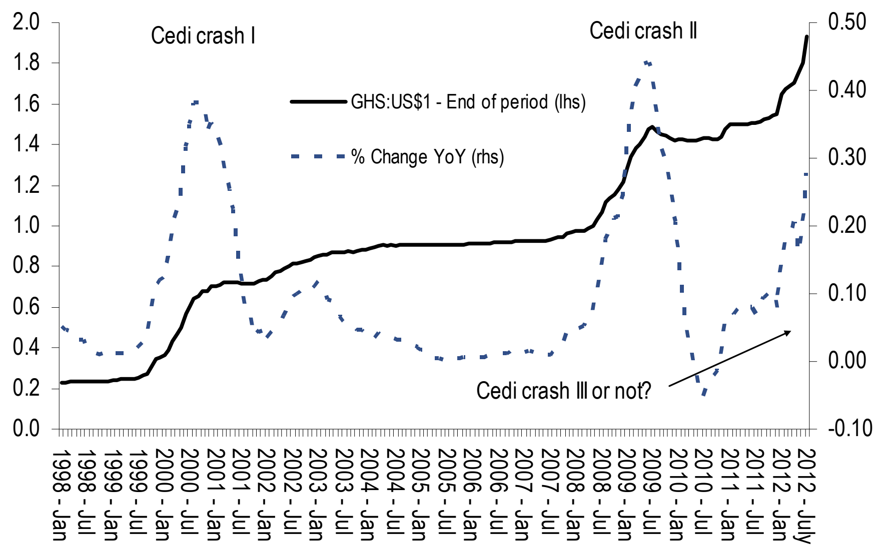
"Cedi Crash III", or is it?

Twin deficits and currency weakness are not surprising

Unsurprisingly in a country in SSA running both a fiscal and balance of payments deficit, the currency usually comes under pressure, and this has been the pattern with the cedi in 2000, 2008 and 2012. Perhaps what is more interesting this time around is whether the cedi weakening has already run its course in the run-up to the December 2012 elections, a pattern with more similarity to the situation in 2000, or we are just at the mid-point, as in December 2008.

A second point to bear in mind is that the scale of the slippage in the cedi seen so far in 2012 does, at least so far, seem less substantial, and arguably more gradual, than in 2000 and 2008. This is clearest looking at the YoY change in the value of the cedi against the US dollar, as shown in Figure 8. One way to interpret this graph would be that after an initial period of stabilisation in late 2009 and early 2010, the cedi has actually been under steady pressure, despite a change in expectations about its future value.

Figure 8. Cedi crashes: 1 to III?



Source: Haver Analytics and Citi Research

Cedi stability following the advent of oil production was the expectation

This change in expectations about the outlook for the cedi is also another important difference between this crisis and previous ones. In particular, expectations about the future value of the cedi were altered substantially as a result of Ghana becoming an oil producer. The best way to understand this is to look back at the forecast for the cedi provided by Consensus Economics. These show that in November 2010, the month before oil production was started, the spot exchange rate for the cedi was GHS1.43:USD1, with the average forecast for its value in 12 months time at GHS1.39, with further stability expected with an average forecast of GHS1.40:USD1 in 24 months time.

The difficult part of the equation in understanding the current bout of cedi weakness is the next step: to try and link the identified developments in the fiscal and balance of payments to the weakness and compare this to the same events in 2000 and 2008 to see if they provide any insights. This, at least partially, depends on the expected transmission channel from government spending to the cedi. In this respect, it is possible to make some broad observations.

- First, the pattern of the fiscal deficit is much more similar to 2000 than 2008, with the deficit having been substantial for a prolonged period of time prior to the collapse of the cedi.

- Second, although we think that the balance of payments has moved into a deficit in 2012, it is still unlikely to be a substantial deficit unlike in 2008, which again arguably makes the current episode more similar to 2000.

In 2008 a key feature of the fiscal problem was the build-up of arrears which continued after the election

In fact, it is possible to argue that the 2008 and 2012 pre-election spending patterns of the government are the mirror image of each other. Yes, in both cases government spending on wages and capital projects rose, but in 2008 the emphasis was on the latter, not the former, while in 2012 the emphasis has been on the former not the latter. Both translate into rising imports, but the big difference was that in 2008 the government failed to fully pay contractors completing the capital projects for them, which then built up arrears. As these were paid off after the election, this kept demand for foreign exchange high, maintaining pressure on the cedi and driving further depreciation.

In 2012 a key feature of the fiscal problem was the paying of deferred wage arrears prior to the election

In contrast, the 2012 fiscal deterioration has been driven by rising capital spending and wages, but also crucially the back-dated pay settlements which have also translated into demand for imports[3]. Unlike in 2008 when the arrears post-dated the election, this time the deferred wage payments have pre-dated the poll. These were on promised wage rises since October 2011 and looking at the IMF and the government projections for these, we think these deferred payments are worth an estimated 1.4% of GDP in 2012 alone. As far as can be ascertained, this has not been accompanied by a build-up in arrears. In fact, the pass through of the current and back-dated pay rises into import demand has now probably run its course.

The final problem for the government of Ghana is that the recent weakening of the currency in the run-up to various elections has in itself created a self fulfilling prophecy. The rise in demand for foreign exchange created by rising government spending, and the weakening exchange rate, encourages a general dollarisation as elections approach as ordinary Ghanaians also seek to hold foreign currency as a hedge against cedi weakness. Breaking this vicious cycle may well prove to be one of the hardest for future governments.

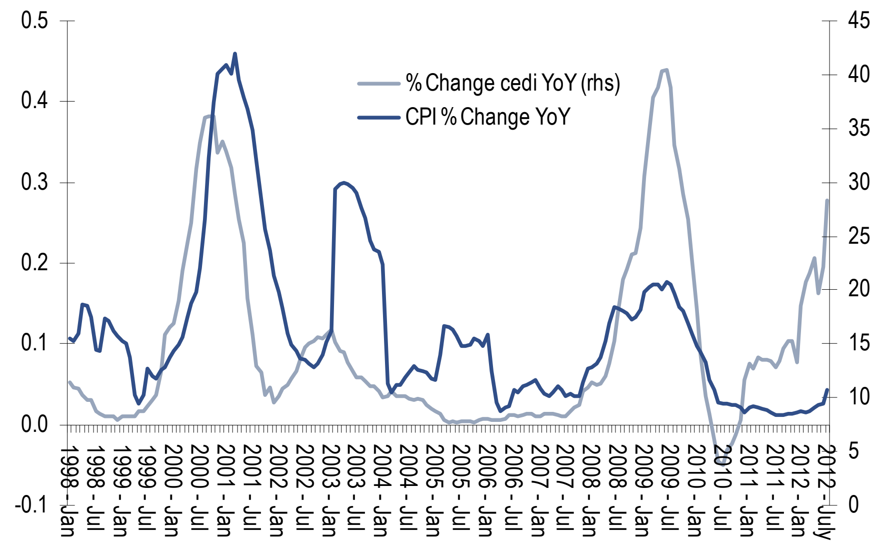
[3] The logic of this is that providing civil servants with both a pay rise and a lump sum of up to six months back-dated pay is likely to lead them to go and make significant one-off purchases, from anything from a new television to a new car. Most of these items are imported in Ghana.

The inflation question

The link between cedi weakness and inflation was pronounced

Historically, cedi weakness has also been accompanied by a rise in inflation. In fact, a quick look at Figure 9 seems to shows that historically the pass through from cedi weakness to rising prices is relatively quick in Ghana. However, understanding inflation developments in a country like Ghana is compounded by a number of additional factors.

Figure 9. The cedi and inflation



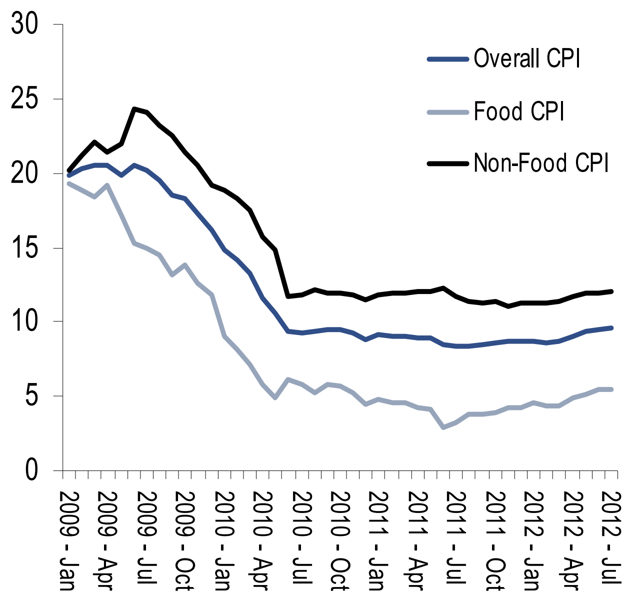
Source: Citi Research

Food and base effects are important

Probably the most important of these, as in many countries in SSA, is the high level of domestically produced food in the basket of goods used to calculate the Consumer Price Index (CPI), which can make inflation volatile. This trend is clear in Ghana for example, where even though food imports are substantial, there is a very pronounced seasonal effect caused by the harvest on food prices. This "saw-toothed" effect is clearly shown in Figure 11, which also highlights that inflation regularly becomes negative on a MoM basis in the August to October period.

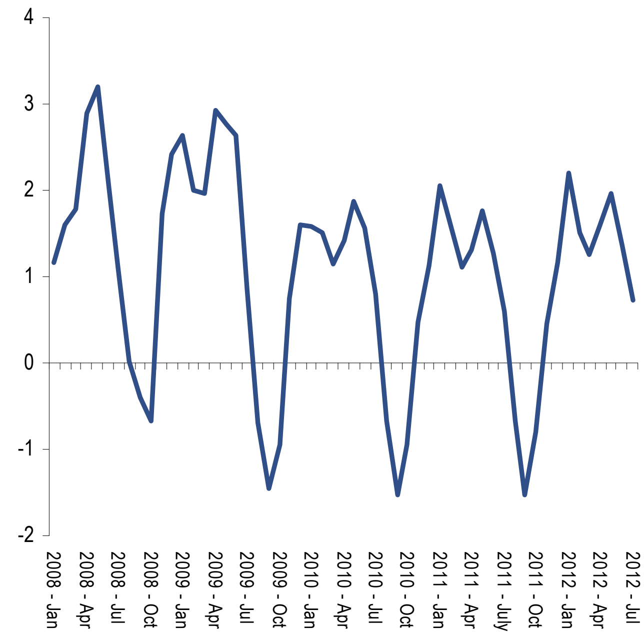
The other point to bear in mind in a country like Ghana, which has experienced considerable spikes in inflation, is that current inflation trends can, at times, be quite heavily influenced by base effects. On a positive note, looking at Figure 9, it is clear that the inflationary spikes experienced in Ghana have become less pronounced than in the late 1990s and early 2000s. In some ways this is unsurprising, as the food component of the CPI basic has fallen and greater competition in the economy has probably helped to make prices a little less volatile (even the shift from predominantly shopping in open-air markets to buying more in supermarkets should help reduce price volatility, as supermarket prices tend to be more sticky).

Figure 10. Food and non-food price inflation in Ghana (YoY % change)



Source: Haver Analytics

Figure 11. A regular cycle to inflation (% change in MoM inflation)



Source: Haver Analytics

The impact of cedi weakness on inflation has diminished over time

As also illustrated in Figure 9, one interesting trend over the years has been that the link between inflationary spikes and cedi weakness seems to have reduced since the early 2000s. The current bout of cedi weakness seems to have had only a minimal impact on the inflation rate in 2012 to date. While it is unlikely that the weakening link between cedi weakness and inflation can explain this completely, putting all the observations on Ghanaian inflation together it is possible to argue that inflation has stayed low in 2012 by Ghanaian standards, despite the fall in the currency, not only because of the declining importance of cedi weakness on inflation, but also positive base and food price effects.

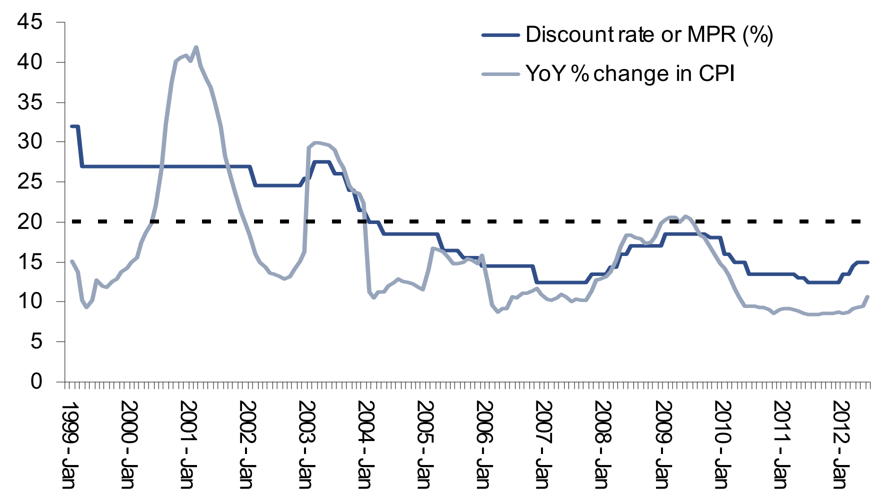
Monetary policy has been fairly tight despite fiscal laxity recently

On the other hand, even with base effects, it does still seem somewhat surprising that non-food price inflation has not picked up more sharply since 2011, driven by a combination of loose fiscal policy, strong GDP growth helped by the start of oil production and the weakening of the cedi pushing up the price of imports.

Although the link between monetary policy and inflation is often uncertain in many SSA countries, taking a long-run view of monetary policy in Ghana, as indicated by the difference between the inflation rate and the Bank of Ghana's (BoG) discount rate or more recently by the Monetary Policy Rate (MPR), Figure 12 would indicate since the middle of 2010 monetary policy has been tight when compared to recent historical standards.

The other time in recent history when monetary policy was relatively tight for a prolonged period of time was in the mid-2000s, but this was accompanied by a period of fiscal consolidation. This time, it has been accompanied by a much looser fiscal policy. But this, at least, may also help explain, why non-food price inflation pressures have been more muted than perhaps initially expected in the light of the oil boom in the country in recent years and cedi weakness.

Figure 12. Inflation and the monetary policy rate



Source: Haver Analytics

Where do we think inflation will go?

The next question is where does Ghanaian inflation go from here? On the one hand food prices are likely to continue to remain muted for some months, as the impact of a strong local harvest continues. Even if this is partially offset by rising global food prices, the impact tends to be minimal. So the key driver of inflation, at least for most of the rest of 2012 should be non-food price inflation. But, with food price impacts dominating in the coming months, we would be surprised if inflation rose sharply.

Moreover, with greater cedi stability moving forward, this would mean that even if inflation does pick up in late 2012 and into early 2013, we think that there is unlikely to be a significant pick-up, with the rate reaching mid-double digits at the most. Even if it does reach this level, it is unlikely that the rises will be sufficient to push the Bank of Ghana (BoG) into raising rates all that much further than we have already seen this year.

Interest rates and the cedi

One clear lesson for central banks in Sub-Saharan Africa (SSA) in 2011 and so far in 2012 has been that raising interest rates can be a significant factor in helping stabilise currencies. Nowhere was this more evident than in East Africa where high rates in Uganda and Kenya have had this effect. The same is also true closer to Ghana, in Nigeria, where the decision to raise rates in 2H 2011 has been an important factor in helping stabilise the naira. So the implication is that raising rates in Ghana should help stabilise the cedi.

But there may be some important differences between Ghana and these other countries. In particular, while the rate increases in the other three countries have all led to significant new inflows of portfolio investment, it is not clear the extent to which this has happened in Ghana. This is arguably for two reasons.

First, prior to raising rates, none of the countries had significant stocks of portfolio inflows, whereas Ghana did. Second, foreign investors into Ghana can only buy government securities with an initial issuance maturity of three years. In contrast, to encourage inflows in Nigeria, the authorities removed their one year lock-in from 1 July 2011 (restrictions are already much more limited in East Africa). What this means is that most foreign portfolio investors in Ghana's local government debt market bought three or five year bonds in 2009 when rates where last high and the general sentiment is now to exit the trade due to the cedi weakness experienced in

2012. The question in this case is has the rise in rates attracted sufficient new inflows to offset those leaving, or to create an overall net positive inflow.

Portfolio flows are the not the only factor that influences a SSA currency. But they do seem to be important in having a tipping effect in many cases. Instead, this means that the main impact of rate rises so far in 2012 will not be in attracting new foreign portfolio inflows, but in encouraging Ghanaians to hold cedi assets rather than to buy foreign currency. This should work, but the impact may be slower.

Our final point is that while rising fiscal deficits have been a problem throughout SSA in 2010-12, fiscal issues are still more problematic in Ghana. A clear feature of policy in SSA since 2H 2011 has been the need for central banks to arguably "over-tighten" monetary policy to limit currency weakness given ongoing fiscal indiscipline. This has also arguably been the case of Ghana, but whereas inflation had trended down sharply in East Africa, in West Africa, notably Nigeria and Ghana, it has remained higher. How long both central banks will wish to retain this "over-tight" monetary policy therefore becomes an interesting, and open ended, question.

Political calculations: a blurring of the battle lines

The election race has taken an unexpected twist

The recent and largely unexpected death of Ghana's incumbent president, John Atta Mills, in late-July was a shock to most Ghanaians and to the international community. But it has also posed a significant re-think for the two main political parties, the ruling National Democratic Congress (NDC) and the opposition National Patriotic Party (NPP). Whereas until early July both parties had pretty clear ideas about their overall campaign strategies for the December 2012 presidential and parliamentary elections, these have now had to be quickly be re-thought.

For the NPP the decisions have arguably been easier to make. The party has settled on its candidate, Nana Akufo-Addo, and it has spent the four years since its 2008 election defeat thinking about where it wrong and rebuilding its party structures in rural areas, while avoiding a substantial part of the political in-fighting that has beset the ruling NDC. Moreover, although economic growth in Ghana has been strong, the NPP can highlight a number of important economic weaknesses on the campaign trail, notably that inflation, although having fallen, remains relatively high, and the sharp weakness of the cedi so far in 2012. It can also argue that with the fiscal deficit not having been brought under control, the government has at least partially squandered the potential economic benefits of the start of oil production. The rising debt stock is also an issue that it will likely raise. However, its ability to highlight the indecisiveness of Mr Atta Mills is no longer a policy option and this will have to be quickly re-thought.

The NDC falls in line with John Mahama, but its unity is still under question

For the NDC the options initially seemed more complicated, but seem to have quickly fallen together. The ex-vice president, John Mahama, assumed the role of the interim president, and the leadership of the NDC. Moreover, the party's National Executive Committee quickly endorsed him as its presidential candidate and this was overwhelming confirmed at a special party congress in late August. He has also announced that his running mate for the polls will be the governor of the Bank of Ghana, Kwesi Amissah-Arthur, which it is hoped will improve his economic credentials. In fact, both will now probably campaign on the grounds that that they spent the last four years resolving many of the economic problems that the NDC government inherited, while also passing legislation to ensure that some of the country's oil wealth is saved in a combination of the stabilisation fund and the heritage fund, and should be trusted to keep this work going.

The two-party system seems to be dominant

The problem for the NDC, which has been around for many years now, is how to accommodate the Rawlings faction within the party[4]. Although Mr Mahama won 99.5% of the ballots cast at the special NDC congress in Kumasi, speculation that the wife of the former president, Nana Rawlings, will announce she is leaving the NDC to run as the presidential candidate for the National Democratic Party (NDP) continues to float around in the local media (see various stories in the Herald and modernghana.com) Although she has significant ground roots support, and would probably be able to obtain some financial support for any campaign, the reality is still that in recent years a range of smaller parties have contested Ghana's elections over the years, with few having a significant impact on the current two party dominance of the election process in the last decade.

What voters think remains unclear

How any of this plays out with the voters remains unclear. A broadly united NDC would probably win some sympathy votes, and if past electoral history is a guide, the party may be given the benefit of the doubt about the economic state of the country by the electorate after the large government pay rises it has awarded recently. This is especially as the introduction of Mr Mahama as its new candidate, who is seen as relative young and dynamic, may be seen as offering new initiative to the incumbent government. However, a divided party, possibly facing rising inflation and further cedi weakening, could easily lose the poll.

A close run vote whatever

The bottom line, however, as shown in 2008 presidential run-off vote, when Mr Atta-Mills secured 50.2% of the vote compared with 49.8% for Mr Akufo-Addo, is that the winning and losing margins in Ghanaian elections are often very small, especially at uncertain political times. In this regard, much may simply depend on how the voters of Greater Accra, which now accounts for just under 20% of the population in the 2010 census and is arguably where most swing voters live, choose to cast their ballots.

Back to stability or on to Cedi Crash IV?

An open and uncertain poll looms at the end of the year

Ghanaian voters head to the polls in December at an uncertain time. Not only has the political situation changed significantly, and deeply unexpectedly, in the last few months, but the economic outlook also remains very uncertain. Although we expect growth to remain robust, the bigger questions on the minds of voters will likely be whether cedi weakness will continue, whether inflation will rise sharply in the coming months and can the fiscal deficit be brought under control?

We think that the answer to many of these questions is positive. In particular, the way the fiscal and current account story has played out so far means that the combination of the two has already impacted on the cedi, as was the case in 2000, so further significant weakening after the December poll, as in 2008, seems unlikely. This is especially the case as the ongoing tight monetary policy, coupled with a good harvest, helps keeps inflationary pressures under control.

Fiscal consolidation and cedi stability are very possible in 2013

The key question may well then prove to be whether either of the two presidential candidates has the will to impose greater fiscal discipline in 2013 and beyond. At present, current trends in the fiscal spending patterns indicate that they are in a relatively strong position to do so if they choose to on being elected. The question for the voters is who do they trust to do so? But for whoever is elected, fiscal consolidation could well usher in a new period of cedi stability, at least for a number of years.

[4] Mr Rawlings is the former military and elected civilian president of Ghana in the 1990s who continues to have a major influence in the party which he founded although not formally in office.

Appendix A-1

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