
# PBBS 206: Economy of Ghana

## Lecture 9

## Monetary (Financial) Sector

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# Preamble

- One cannot talk about economic activities taking place in an economy without talking about how money changes hands in modern economics
- In other words, money is the medium of exchange and a means of payments for any given modern society
- It is this important role money plays in the economy that motivates us to discuss the financial and monetary sectors of the economy

# Monetary Developments

- Monetary policy entails the control of the level of money supply by the Central Bank using various instruments in order to achieve economic goals
- Monetary policy consists of the set of government measures aimed at regulating credit, and for that matter, the money supply in the economy, and are implemented through the Bank of Ghana
- The primary objectives of monetary control include:
- To achieve price stability
- To achieve external stability
- To achieve economic growth and

# Monetary Developments cont…

- To help mobilize savings for development
- Achieving price stability means reducing the rate of inflation (that is the rate at which overall prices of goods and services increase)
- Achieving external stability means minimizing the rate at which the Cedi depreciates, so as to reduce the country's external trade deficits
- Achieving economic growth means ensuring that there is continuous increase or expansion in economic or productive activities in the country

# Monetary Developments cont…

- Instruments used to control money supply in the country include:
- Open market operations (OMO)
- The rediscount rate/prime rate
- Reserve requirement
- Direct credit control
- Moral suasion etc.
- The open market operation refers to buying and selling of treasury bills and bonds by the Bank of Ghana. BoG selling bills and bonds to public – possibility of decreasing inflation

# Monetary Developments cont…

BoG buying bills and bonds from public – possibility of increasing inflation

- The rediscount/prime rate refers to the interest rate set by the Bank of Ghana on loans made available to its customers. A rise in rediscount rate will lead to a reduction in money supply and a fall in the rediscount rate will lead to an increase in money supply
- Another instrument in controlling money supply is the reserve requirements. Increasing RR implies a reduction in the money supply and reducing the RR implies a rise in the money supply

# The Bank of Ghana (The Central Bank)

- The Central Bank is at the very heart of Ghana's financial system and its activities in relation to the supervision of private sector financial institutions (especially those in the banking sector) are thought to be vital to the maintenance of confidence in the integrity and stability of the system and hence its continued effective and efficient operation.
- The BoG by virtue of its position as The Central Bank confers on it the overall responsibilities for the implementation of monetary and financial policy controls, which are explicitly designed by the government of Ghana to influence the behaviour of the

# The Bank of Ghana (The Central Bank) cont…

private sector financial institutions in relation to their money creation or intermediation activities.

- The organizational and institutional structure of Central Banks may vary from one country to another
- The Bank of Ghana was organized on the basis of the state of India. Its operations are however closely related to those of the Bank of England
- The precise function of Central Banks differs between nations and overtime within one country

# The Bank of Ghana (The Central Bank) cont…

- The functions depend on such factors as:
- The overall economic and financial climate in the country
- The government stance towards economic policy and
- Political persuasion of the government

# The Broad Function of the Central Bank

- The functions and operations of the Bank of Ghana are covered under the Bank of Ghana Law 1992 PNDCL 291
- For organizational purposes, The Bank's activities are divided into three (3) broad categories:

1. Banking
2. Financial regulation and supervision
3. Implementation of monetary policy

# 1. Banking Role of Bank of Ghana

- The Bank of Ghana offers a wide range of conventional banking services to its customers.
- However, the composition of its customer base is markedly different from that of the typical commercial bank
- While the commercial banks are opened to the public, the Central bank opens its doors only to
- Certain private customers
- Foreign central banks and international organizations
- Domestic Banks and some financial institutions
- The government of the country

# 1. Banking Role of Bank of Ghana cont…

**Private Customers**

- The Central Bank's private-customer base is relatively few in number and comprises mainly the Bank's staffs as well as some privileged domestic institutions and private individuals. The BoG maintain this clientele to have a feel of the day-to-day banking problems faced by the banking sector at large

**Foreign Central Banks & International Organizations**

- The BoG maintains or keeps account for a number of foreign central banks and certain international organizations, including the Bank for Reconstruction

# 1. Banking Role of Bank of Ghana cont…

and Development (World Bank), the Bank for International Settlements and International Monetary Fund (IMF). These accounts are kept for the purpose of managing the international payment arising from foreign exchange market intervention

**Domestic Banks and Some Financial Institutions**

- One of the extremely important functions performed by the Central Bank is serving as a banker to banker. The BoG thus provides banking to the banks and other financial institutions. The BoG maintains operational and non-operational accounts for commercial banks

# 1. Banking Role of Bank of Ghana cont…

**Banker to the Government of the Country**

With respect to government of Ghana, the Central Bank performs the following functions:

a) Financing of Government Debt
b) Manager of National Debt
c) Government’s Agent in Foreign Exchange Market Operations
d) Advisor to the Government
e) The Production and Distribution of Currency

# 2. Financial Regulation and Supervision Role of the Central Bank

- This is the most extremely important function of the Central Bank. The Banking Act, 1970, section 2, placed the responsibility for the regulation and supervision of the banking system on the Bank of Ghana
- To provide a legal backing for the regulatory and supervisory role of the Bank in the 1980s, The Banking Law, PNDCL 225, 1989, was promulgated. The Banking Law places on the Central Bank the overall supervisory authority in all matters relating to business of banking in Ghana.

# 2. Financial Regulation and Supervision Role of the Central Bank cont…

- The BoG under the Law undertakes the following:

i. Supervises the maintenance of liquid assets of banks
ii. Specifies the offences in connection with holding of liquid assets
iii. Requires particulars of loans granted
iv. Exercises special powers over the banks
v. Issues guidelines and rules

- This is done in accordance with the economic policy of the government of the day. The BoG is responsible for ensuring the stability and dev't of financial system and maintenance of high standards of banking

# 3. Implementation of Monetary Policy

- The Central Bank serves as the executor of monetary policy
- The BoG therefore has the responsibility for the day-to-day control of the growth of the money supply and for influencing the rates of interest in the various financial markets.
- In accordance with the economic policy of the government, the Central Bank administers, regulates and directs the currency system
- Additionally, the BoG controls the availability and use of foreign exchange in the country

# 3. Implementation of Monetary Policy cont…

- It is duty bound for the Bank to maintain certain assets as the cover for the currency in circulation
- Some of the assets include gold, foreign bills and foreign currencies, Special Drawing Rights (SDRs) of IMF, domestic securities, loans and advances of the government, banks and others, and other investments

# The workings of The Monetary Policy Committee (MPC)

- The Bank seeks to achieve government's inflation target by setting an interest rate (prime rate)
- The level of interest rate (prime rate) is decided by MPC
- The MPC consists of seven members – five from Bank of Ghana and two external members appointed by the Minister of Finance
- The meetings are chaired by the Governor of Bank of Ghana (BoG)
- The MPC meets bi-monthly for a three-day meeting, usually beginning on the third Tuesday of the month in which the meetings have been scheduled, ending on the

# The workings of The Monetary Policy Committee (MPC) cont….

Thursday of the same week

- The meeting dates for each year are determined well in advance at the beginning of each year.
- Decisions are made by a vote of the Committee on a one-person one-vote basis with each member stating clearly with reasons why a particular rate decision
- These reasons are based on global and domestic economic development
- In the last emergency meeting of the MPC on February 5, 2014 to address the rapid depreciation of the Cedi, the prime rate was increased from 16% to 18%

# Inflation Targeting

- Inflation targeting is an economic policy in which a Central Bank estimates and makes public a projected or 'target' inflation rate and then attempts to steer actual inflation towards the target through the use of interest rate (prime rate) changes and other monetary tools
- Ghana have targeted a single digit inflation rate in recent years
- The desired inflation target of below 10% is expressed in terms of an annual rate of inflation based on the Consumer Price Index (CPI)

# Reasons a/cing for Ghana missing its Inflation Target

- Inconsistency in policy to achieve said target
- External shocks – cruel oil price increase/global crisis
- Increase in utility prices/unreliable supply of utilities
- Unrealistic targets/overly optimist
- Real factors e.g. food production and transportation not addressed by policy
- Increase in government spending
- High lending rates
- Currency depreciation

# The non-traditional Role of the Central Bank

- Aside the traditional functions, the Central Bank also performs certain non-traditional functions to propel economic development
- The BoG provides direct capital for the establishment of specialized financial and economic organizations. Serving as a catalyst in the development process, the BoG performs the following:

# The non-traditional Role of the Central Bank cont…

i. Establishment of development banks
ii. Participating in setting up specific projects with the private sectors
iii. Providing credit guarantee schemes to approved commercial banks to cover loans and advances to small borrowers in agricultural and industrial sectors
iv. Promoting financial infrastructure and certain other important enterprises where no entrepreneur is willing or able to enter

# Commercial Bank in Ghana

- A commercial bank is a financial institution whose prime or major function is to receive deposits from the public and to make short-term loans to its customers
- Commercial banks lend money by creating current account overdrafts facilities and retire loans by cancelling them
- CB also compete with other financial institutions in the provision of services such as time deposits facilities and the safekeeping of valuables.
- Ghana Commercial Bank (GCB) is the largest commercial bank in Ghana with the widest branch network

# Functions of Commercial Bank

- The following are the major functions CB performs:
- Provision of short-term credits to industry, commercial and other economic enterprises
- Offer international financial transfer, traveler's cheque and foreign currency
- Provide different types of saving accounts, mortgage loans, secured and unsecured loans and overdraft facilities for its personal customers
- Compete with other financial institutions in the provision of services such as time deposit facilities and safekeeping of valuables, thus providing executor and

# Functions of Commercial Bank cont…

trustee facilities to personal customers

- Investment in subsidiaries and associated companies and trade investment (holding shares in another company)

# Development Banks in Ghana

- Development banks are generally long-term financial institutions established to finance and promote specific spheres of the economy, example agriculture, building, industry etc
- The two development banks in Ghana comprise the Agricultural Development (ADB) and the National Investment Bank (NIB)
- The activities of these two major development banks appear highly important in the development  of directly productive sectors in Ghana

# General Functions of Development Banks in Ghana

- The role of development banks is to fill the gap in the financial market where enterprises find it cumbersome to raise seed money. Dev't Banks performs ff. functions:
- Provide medium and long term or guarantee for loans from other sources
- Providing share capital for participation of joint-stock
- Developing local entrepreneurial skills through training and consultation services
- Making short term advances, where such facilities are unavailable elsewhere, and taking deposits and transfer money

# General Functions of Development Banks in Ghana cont…

- Identify productive investment opportunities, developing and promoting projects
- Receiving foreign loans on behalf of domestic enterprises

# Non-Bank Financial Institutions

- The Non-Bank Financial Institutions however, according to the PNDCL 328 of 1993, are any non-banking institution that carries on the business of or part of whose business is any of the following activities:
- Taking deposits
- Financing of any activity by way of making loans or advances or otherwise, other than its own
- Companies dealing in shares, bonds, debentures, or security issued by government or companies or other marketable securities

# Non-Bank Financial Institutions cont…

- Leasing, letting or delivering of goods to a hirer under a hire purchase agreement
- Carrying on by insurance companies of any business other than insurance

- These non-banking institutions are further classified into deposit taking and non-deposit taking non-banking financial institutions
- In spite of the section 265 of the companies' code, 1963 (Act 179), a deposit taking non-banking financial institution may make invitation to the public to deposit money with it for fixed periods

# Non-Bank Financial Institutions cont…

- They are obliged to summit quarterly returns to the Bank of Ghana showing their assets and liabilities
- Examples of such institutions by the PNDCL 328, 1993 include Discount Companies, Acceptance Houses, Credit Unions, Building societies, Savings and Loans companies, Finance Houses, Mortgage Financing Companies etc
- However, the Non-deposit taking non-banking financial institutions do not take deposits as a condition for rendering services

# Non-Bank Financial Institutions cont…

- They render services or sell facilities and, in the course of such operations, accumulate funds
- Examples of such institutions include Pension Funds, Investment trust, Unit trust, Insurance Companies and the Informal Credit Delivery System
- All the non-banking financial institutions do not offer chequeable accounts for their customers

# Monetary Policy Issues

- The basis of monetary policy is the classical or monetarist hypothesis, which is best seen in the quantity theory of money
- Monetary policy in Ghana has as its objectives price stability, economic growth and improvement in the balance of payment
- The main target of monetary policy is an attempt to control the amount and direction of credit flowing to the private sector of the economy
- Monetary policy is designed to take as much corrective action as possible against the non-government sector

# Monetary Policy Issues cont…

- Monetary policy involves the use of reserve requirement, quantitative credit guidelines, special deposit, interest rates, open market operations and moral suasion
- Monetary policy could be grouped into two:
- Instruments of monetary and credit control: that is, controlling the magnitude of money and credit
- Instruments of development policy: that is, controlling the direction of credit to the growth-generating sectors of the economy, the so called ‘priority sector’.

# Monetary and Financial Policies in 2006

- Policies in 2006 was aimed at developing the private sector which will translate into enhancement of job creation and economic growth acceleration
- The BoG used open market operations, repurchase agreements and adjustments in its prime rate as its key instruments
- The relative stability in inflation and other macroeconomic fundamentals persuaded the central bank's Monetary Policy Committee (MPC) to reduce the prime rate from 15.5% at the end of 2005 to 14.5% in January 2006

# Monetary and Financial Policies in 2006 cont…

- This level was maintained throughout the year until December 2006 when it was reduced to 12.5%

# Monetary and Financial Policies in 2007

- Monetary policy in 2007 continued to focus on anchoring inflation expectations and ensuring stable exchange rates, low inflation and low interest rates so as to reduce the cost of credit, promote business and consequently stimulate private sector activity
- The relative stability in inflation and other macroeconomic fundamentals convinced the central bank's Monetary Policy Committee (MPC) to maintain the prime rate at 12.5% in 2007

**Currency Redenomination in July 2007**

- Currency redenomination refers to the process of

# Monetary and Financial Policies in 2007 cont…

changing the currency value on a financial security

- In simple terms, redenomination means striking out some zeroes from a currency
- Redenomination is normally induced by high inflation and in such periods, the credibility of the country's currency is called to question
- For instance one of the key reasons for the redenomination of the Turkish lira was because the central bank recognized that the existence of a 20 million lira banknote had a negative effect on the credibility of the currency

# Monetary and Financial Policies in 2007 cont…

**Benefits of Redenomination**

- It helps citizens regain confidence in their currency since loss of confidence in currency will make citizens resort to the use of foreign currencies such as the dollar, pounds and euro
- Reduction in the transaction cost of handling many notes
- Reduction in the risk involved in carrying bundles of notes
- Easier use of accounting software
- More efficient use of ATMs

# Monetary and Financial Policies in 2007 cont…

**Negative Effects of Redenomination**

- For business community, redenomination will mean changing prices on labels, menus and catalogues, changing balance sheets and accounting records as well as changing or modifying software and any other equipment or procedures involved in recording monetary values.