BANK OF GHANA
Banking Sector Report

November 2019

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1. PREFACE

The Bank of Ghana's Banking Sector Report is published after each Monetary Policy Committee (MPC) meetings. The report highlights developments in the banking sector which were deliberated on during the policy making process. The aim of publishing the report is to provide the public with information on performance of the banking sector which served as inputs for the MPC meetings. Through the publication of this document, Bank of Ghana aims to promote accountability for its decision making and promote transparency in the monetary policy formulation process.

Monetary Policy in Ghana

The primary objective of the Bank of Ghana is to pursue sound monetary policies aimed at price stability and creating an enabling environment for sustainable economic growth. Price stability in this context is defined as a medium-term inflation target of 8 percent with a symmetric band of ±2 percent. This target band is consistent with the objective of attaining the desired long-term average rate of growth for the economy. Other objectives spelt out in the amended Bank of Ghana Act include promoting and maintaining a sound financial sector and payment systems through effective regulation and supervision. This is important for financial intermediation and to ensure that risks associated with financial markets are considered during the monetary policy formulation process.

Monetary Policy Strategy

To achieve the objective of price stability, Bank of Ghana was granted operational independence to employ the appropriate policy tools needed to stabilise inflation around the medium-term target. The Bank of Ghana's framework for conducting monetary policy is based on Inflation Targeting (IT) Framework, which entails the use of the Monetary Policy Rate (MPR) as the key policy tool that provides guidance on the monetary policy stance and also helps anchor inflation expectations.

The MPC Process and Operational Arrangements

The MPC is a statutorily constituted body under the Bank of Ghana Act 2016 (Act 918, *as amended*) to formulate monetary policy. The MPC consists of seven members — five members from the Bank of Ghana, including the Governor who acts as the Chairman of the Committee, and two external members. The MPC meets bi-monthly in the course of the year to assess economic conditions and risks to the inflation and growth outlook. The Committee, after assessing recent economic conditions and taking a forward-looking view of the evolution of key macroeconomic indicators, then votes to position the MPR through a process of consensus-building with each member assigning reasons for the stated or preferred direction of the policy rate. Each interest rate decision provides a signalling of the stance of monetary policy. The MPC meeting dates are determined well in advance and published on the Bank's website at the beginning of each year. In line with the transparency aspects of the framework, an MPC policy statement is published via a press release and a press conference is held after each MPC meeting to communicate and explain the Committee's decisions to the financial markets and the general public.

2. SUMMARY

This report discusses developments in, and performance of, the banking sector using the October 2019 prudential data of the twenty-three (23) banks.

The industry's balance sheet posted a strong performance reflected by robust growth in total assets funded by sustained growth in deposits and increased capital levels relative to last year. Similarly, the industry's income statement recorded an impressive year-on-year increase in profit-after-tax on the back of stronger growth in revenue lines (net interest income and fee and commission income) compared to operating expenses. Private sector credit growth rebounded during the period under review, enhancing financial intermediation.

The improved performance of the industry's balance sheet and profitability also reflected in the key financial soundness indicators. Profitability indicators improved amidst efficiency gains. The liquidity and solvency positions of the industry were enhanced by the recapitalisation. A measure of the industry's solvency, the Capital Adequacy Ratio (CAR) remained well above the regulatory 13 percent buffer under Basel II/III. This points to a more stable and resilient industry, with the capacity to deepen financial intermediation and also absorb risks. In the same vein, the industry's main asset quality measure, the Non-Performing Loans (NPL) ratio also improved during the period. Asset quality is expected to further improve as banks intensify loan recovery efforts and strengthen credit risk assessment while expanding their loan books.

In summary, the positive dividends from the clean-up and recapitalisation reforms have remained broadly sustained reflecting in a sound, solvent, profitable and resilient banking sector. The outlook for the industry is positive and there is potential for further credit growth and financial deepening on the back of the higher capital levels and sustained growth in deposits.

3. BANKING SECTOR DEVELOPMENTS

3.1 Banks' Balance Sheet

Total assets of the banking sector grew by 13.8 percent to GH¢121.03 billion in October 2019. Of this, the stock of domestic assets increased by 16.1 percent to GH¢111.54 billion in October 2019, while foreign assets contracted by 7.7 percent from the reduction in banks' placements abroad [See Table 1]. Domestic assets remained the largest component in total assets with the share increasing to 92.2 percent in October 2019 from 90.3 percent in October 2018, while the share of foreign assets declined to 7.8 percent from 9.7 percent over the same comparative period.

The banking sector's investments in bills, securities and equity increased by 10.8 percent to GH¢47.47 billion in October 2019. This represents a more normalised growth compared with the 62.9 percent growth recorded for the same period in 2018. The sharp increase in total industry investments as at October 2018 was largely due to the special (long-term) resolution bonds held by Consolidated Bank Ghana (CBG). Following this development, the growth in long-term investments (securities) slowed to 10.6 percent (GH¢30.99 billion) in October 2019 from 218.3 percent (GH¢28.03 billion) in October 2018 [See Table 1]. Investments in short-term instruments picked up, increasing by 11.2 percent year-on-year to GH¢16.47 billion as at end-October 2019, after recording the 15.3 percent contraction a year earlier.

Industry's credit portfolio rebounded with a 17.2 percent growth in gross loans and advances to GH¢41.59 billion as at October 2019, from the 7.5 percent contraction recorded a year earlier. Similarly, net advances (gross loans adjusted for provisions and interest in suspense) expanded by 19.4 percent to GH¢36.48 billion after declining by 4.0 percent to GH¢30.55 billion in October 2018. The foreign currency component of net advances recorded a higher growth of 27.4 percent in October 2019, from GH¢9.3 billion (3.5% y/y growth) in October 2018 to GH¢11.79 billion, due in part to the depreciation of the Ghana Cedi over the period.

The non-earning assets of banks (comprising both fixed assets and other assets) grew by 15.6 percent in October 2019 compared with a contraction of 8.5 percent a year ago. This was due to the sharp increase in the growth of other assets by 19.1 percent from a contraction of 23.1 percent, while fixed assets moderated in growth by 12.1 percent from 12.6 percent during the period under review. The share of non-earning assets in total assets however did not change significantly.

Deposits, the main source of funding for the banking industry, grew by 17.1 percent in October 2019, marginally lower than the 20.7 percent increase in the previous year. Total banking sector deposits increased to GH¢78.90 billion by GH¢11.51 billion in October 2019 from GH¢67.38 billion in October 2018 pointing to renewed confidence in the banking sector following the reforms. Domestic deposits grew at the same pace as total deposits to GH¢78.50 billion in October 2019 from GH¢67.04 billion in the previous year, while deposits of non-residents remained small at GH¢397.70 million from GH¢342.10 million. The foreign currency component (denominated in Ghana Cedis) of total deposits, on the other hand recorded a higher growth of 22.4 percent in October 2019 to GH¢20.79 billion compared with a growth of 13.7 percent a year ago. [See Table 1].

Total borrowing by banks declined by 5.7 percent from GH¢18.08 billion in October 2018 to GH¢17.05 billion on the back of contraction in domestic borrowings and a slowdown in the growth of foreign borrowings. Short-term domestic borrowings contracted by 13.8 percent while long-term domestic borrowing contracted by 55.1 percent during the period. Growth in short-term and long-term foreign borrowings moderated to 23.4 percent and 7.5 percent respectively during the period under review, compared with 170.3 percent and 48.4 percent growth during the same period last year. The slowdown in borrowings by banks reflect both the increased capitalisation and sustained growth in deposits.

The industry remained well-capitalized with paid-up capital up by 38.4 percent to GH¢9.26 billion in October 2019 from GH¢6.69 billion in October 2018. The industry's shareholder funds also went up by 24.7 percent in October 2019 to GH¢17.34 billion from GH¢13.90 billion in October 2018, due to the pickup in banks' reserves following improved industry profitability and the strong growth in paid-up capital. Growth in other liabilities (other than deposits, borrowings and shareholders' funds) increased by 11.2 percent to GH¢7.75 billion during the period under review compared with 9.1 percent a year earlier. The industry's balance sheet performance remained strong during the first ten months of 2019 supported by strong growth in assets and deposits reflecting sustained confidence in the banking sector post-reforms and recapitalization.

Table 1: Key Developments in DMBs' Balance Sheet

	GH¢ million				Y-on-Y Growth (%)			Shares (%)		
	Oct-17	Oct-18	Aug-19	Oct-19	Oct-18	Aug-19	Oct-19	Oct-18	Aug-19	Oct-19
TOTAL ASSETS	**88,914.4**	**106,339.5**	**115,181.7**	**121,033.3**	**19.6**	***10.1***	***13.8***	***100.0***	***100.0***	***100.0***
A. Foreign Assets	8,292.3	10,288.0	9,418.1	9,494.0	24.1	*(14.0)*	*(7.7)*	*9.7*	*8.2*	*7.8*
B. Domestic Assets	80,622.2	96,051.6	105,763.6	111,539.3	19.1	*12.9*	*16.1*	*90.3*	*91.8*	*92.2*
Investments	26,292.8	42,839.9	45,922.0	47,466.7	62.9	*13.2*	*10.8*	*40.3*	*39.9*	*39.2*
i. Bills	17,487.2	14,812.3	15,063.9	16,472.3	(15.3)	*(5.2)*	*11.2*	*13.9*	*13.1*	*13.6*
ii. Securities	8,805.6	28,027.6	30,432.2	30,994.4	218.3	*25.6*	*10.6*	*26.4*	*26.4*	*25.6*
Advances (Net)	31,823.5	30,551.1	34,086.3	36,479.9	(4.0)	*19.8*	*19.4*	*28.7*	*29.6*	*30.1*
of which Foreign Currency	8,944.6	9,259.6	11,943.5	11,792.2	3.5	*18.2*	*27.4*	*8.7*	*10.4*	*9.7*
Gross Advances	38,364.5	35,480.0	38,852.0	41,594.8	(7.5)	*15.0*	*17.2*	*33.4*	*33.7*	*34.4*
Other Assets	4,931.8	3,793.7	4,162.0	4,519.8	(23.1)	*(6.3)*	*19.1*	*3.6*	*3.6*	*3.7*
Fixed Assets	3,426.1	3,857.0	4,074.8	4,324.9	12.6	*3.4*	*12.1*	*3.6*	*3.5*	*3.6*
TOTAL LIABILITIES AND CAPITAL	**88,914.4**	**106,339.5**	**115,181.7**	**121,033.3**	**19.6**	***10.1***	***13.8***	***100.0***	***100.0***	***100.0***
Total Deposits	55,831.7	67,382.3	76,023.0	78,897.2	20.7	*12.2*	*17.1*	*63.4*	*66.0*	*65.2*
of which Foreign Currency	14,942.3	16,984.9	21,210.4	20,784.6	13.7	*26.3*	*22.4*	*16.0*	*18.4*	*17.2*
Total Borrowings	15,084.7	18,082.7	15,931.6	17,053.1	19.9	*(5.0)*	*(5.7)*	*17.0*	*13.8*	*14.1*
Foreign Liabilities	4,164.0	8,288.1	9,086.6	9,741.5	99.0	*10.3*	*17.5*	*7.8*	*7.9*	*8.0*
i. Short-term borrowings	1,871.6	5,058.9	6,088.2	6,240.8	170.3	*24.4*	*23.4*	*4.8*	*5.3*	*5.2*
ii. Long-term borrowings	1,945.3	2,887.1	2,667.9	3,103.0	48.4	*(5.8)*	*7.5*	*2.7*	*2.3*	*2.6*
iii. Deposits of non-residents	347.2	342.1	330.6	397.7	(1.5)	*(35.6)*	*16.3*	*0.3*	*0.3*	*0.3*
Domestic Liabilities	73,119.1	83,983.0	89,376.8	93,956.5	14.9	*8.1*	*11.9*	*79.0*	*77.6*	*77.6*
i. Short-term borrowing	9,898.7	7,642.1	5,890.9	6,588.6	(22.8)	*(23.0)*	*(13.8)*	*7.2*	*5.1*	*5.4*
ii. Long-term Borrowings	1,369.1	2,494.5	1,284.6	1,120.7	82.2	*(8.2)*	*(55.1)*	*2.3*	*1.1*	*0.9*
iii. Domestic Deposits	55,484.5	67,040.2	75,692.4	78,499.4	20.8	*12.6*	*17.1*	*63.0*	*65.7*	*64.9*
Other Liabilities	6,388.6	6,969.7	6,508.9	7,747.8	9.1	*0.4*	*11.2*	*6.6*	*5.7*	*6.4*
Paid-up capital	4,452.8	6,687.7	9,257.5	9,257.5	50.2	*39.5*	*38.4*	*6.3*	*8.0*	*7.6*
Shareholders' Funds	11,604.8	13,899.8	16,718.2	17,335.2	**19.8**	*22.8*	***24.7***	*13.1*	*14.5*	*14.3*

Source: Bank of Ghana

3.1.1 Asset and Liability Structure

Broadly, the asset and liability structure of the banks' balance sheet remains unchanged. Investments dominated the asset mix followed by loans and advances. The share of investments (bills and securities) in banks' assets however declined marginally from 40.3 percent to 39.2 percent during the period under review, while that of net advances inched up from 28.7 percent to 30.1 percent. The share of Cash and Due from Banks remained the third largest component of assets at 23.3 percent in October 2019, reflecting a marginal decline from the 23.7 percent share in October 2018. In total, the industry's earning assets (investments, net advances and Cash and Due from Banks) accounted for 92.3 percent of total assets as at end-October 2019. The share of non-earning assets (fixed assets and other assets) remained broadly unchanged in October 2019 compared with the same period last year, constituting a total of 7.3 percent of total assets [See Annexes Table 1].

On the liability side, the funding mix of banks remained dominated by deposits. The share of deposits in banks' pool of funds increased from 63.4 percent in October 2018 to 65.2 percent in October 2019. Shareholders' funds replaced total borrowings as the second largest source of funds, its share increasing from 13.1 percent to 14.3 percent while the share of total borrowings declined from 17.0 percent to 14.1 percent reflecting less reliance on borrowings with the equity injection from the recapitalization exercise. The share of other liabilities recorded a marginal decline from 6.6 percent to 6.4 percent [See Annexes Table 1].

3.1.2 Share of Banks' Investments

The composition of investments experienced only minimal changes between the two periods. The share of investments in securities was broadly unchanged at 64.4 percent in October 2019 while the share of short-term bills remained almost flat at 34.7 percent. The size of banks' investments in shares and other equities remained negligible at less than 1.0 percent as it is a non-core investment activity for banks [See Figure 1].

3.2 Credit Risk

Asset quality of the banking industry broadly improved evidenced by a decline in the NPL ratio during the review period. Intensified loan recovery, write-offs and credit risk management are some of the on-going measures expected to sustain the gains made in the industry to prevent deterioration and safeguard the quality of the new capital.

3.2.1 Credit Portfolio Analysis

Credit growth rebounded in October 2019 compared to the contraction a year ago. Gross loans and advances (excluding the loans under receivership) increased by 17.2 percent to GH¢41.65 billion in October 2019 from GH¢35.53 billion (-7.6% y/y growth) in October 2018. Private sector credit also recorded a rebound in growth by 13.1 percent to GH¢37.13 billion during the review period after contracting by 3.1 percent in October 2018 to GH¢32.82 billion. Credit to households however declined from GH¢8.64 billion representing 47.2 percent annual growth to GH¢8.48 billion representing a contraction of 1.8 percent during the period under review, partly reflecting base drift effects [See Annexes Table 2].

The share of public sector credit in total credit increased to 10.8 percent in October 2019 from 7.6 percent in October 2018, stepping down the share of loans to the private sector to 89.2 percent from 92.4 percent during the same period. Of the loans to the private sector, the share to indigenous enterprises was 56.5 percent in October 2019 marginally down from 56.9 percent in October 2018 while that of foreign enterprises increased marginally to 9.6 percent from 9.3 percent during the same review period. Over the same reference period, households' share in total credit declined to 20.4 percent from 24.3 percent on account of declining stock of loans to households [See Annexes Table 4].

The rise in the share of the industry's credit to the public sector was on the back of increases in all the sub-components, namely, credit to the government, public institutions and public enterprises. In particular, the share of loans to central government increased to 3.8 percent from 2.6 percent, while that of public enterprises increased to 4.5 percent from 4.2 percent. Lastly, the share of public institutions also increased to 2.5 percent from 0.8 percent during the same comparative period [See Annexes Table 4].

The share of loans to the services sector was 22.7 percent in October 2019, closely followed by the commerce and finance sector with a share of 22.3 percent. These compare with 21.0 percent and 24.6 percent for the services and commerce and finance sectors respectively in the same period last year. The manufacturing sector held a share of 11.5 percent of the banking industry's credit, up from a share of 10.5 percent a year earlier constituting the third largest recipient, while the construction sector's share was 8.7 percent from 8.0 percent share recorded last year.

The lowest recipient of industry credit remained the mining and quarrying sector although with an increased share of 3.2 percent in October 2019 from 2.6 percent a year ago. The top three recipients of the industry's credit (services, commerce and finance, manufacturing sectors) accounted for 56.5 percent share in bank credit in October 2019 while the lowest three recipients (mining &

quarrying, agriculture, forestry & fishing, transport, storage & communication sectors) held a combined share of 16.5 percent of the industry's credit during the same period [See Figure 1].

3.2.2 Off-Balance Sheet Activities

Banks' off-balance sheet transactions (largely comprising trade finance and guarantees) increased in October 2019, compared with the same period last year. The industry recorded contingent liabilities amounting to GH¢10.62 billion as at end-October 2019 compared with GH¢9.35 billion in October 2018, representing a higher year-on-year growth of 11.9 percent compared with the prior year's 6.1 percent. The ratio of banks' contingent liabilities to total liabilities also recorded a marginal increase to 10.2 percent from 10.1 percent during the period under review [See Annexes Table 3].

3.2.3 Asset Quality

The industry's asset quality broadly improved during the period under review due to the implementation of loan write-offs and intensified recoveries. The stock of the industry's Non-Performing Loans (NPLs) edged up marginally to GH¢¢7.19 billion in October 2019 from GH¢7.14 billion a year ago. The marginal increase in the stock of NPLs in October 2019 vis-à-vis the higher growth in total loans contributed to the lower NPL ratio of 17.3 percent from 20.1 percent for the same comparative period last year.

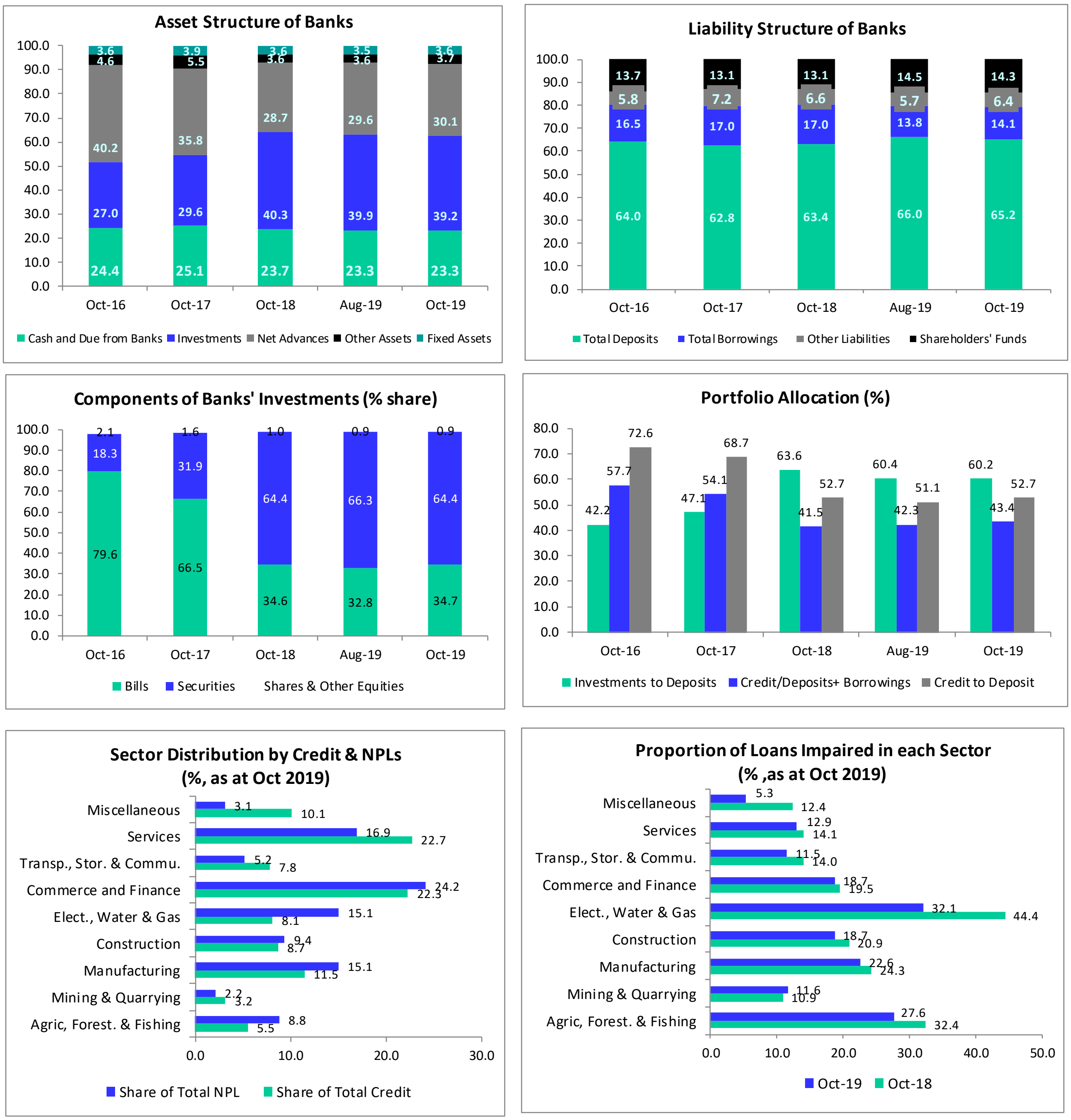
The industry's NPL ratio adjusted for the fully provisioned loss loan category improved to 8.1 percent in October 2019 from 11.4 percent in October 2018. This points to the fact that the industry's stock of NPLs could be reduced further with implementation of the loan write-off policy, intensified loan recoveries, and stronger credit risk management practises.

The private sector's share of the banking industry's NPLs increased to 97.7 percent in October 2019 from 95.5 percent in October 2018, while the share of NPLs contributed by the public sector declined to 2.3 percent from 4.5 percent over the same period. This shows that the pick-up in the banking sector's loans to the public sector has not been associated with deterioration in the quality of loans to that sector. [See Annexes Table 4].

The breakdown of the industry's NPLs by economic sectors revealed broad improvement in the NPL ratios across most of the sectors with the exception of mining and quarrying. The distribution further showed that the electricity, water and gas sector had the highest NPL ratio (impaired loans to the sector/total loans to the sector) of 32.1 percent as at October 2019, an improvement over the 44.4 percent a year ago, while the agriculture, fishing and forestry sector had an NPL ratio of 27.6 percent, also an improvement over the 32.4 percent recorded during the same comparative period. The largest recipient of the industry's credit, the services sector, recorded an NPL ratio of 12.9 percent in October 2019 compared with 14.1 percent in the prior year. Broadly, these trends show improvement in the industry's asset quality.

A review of the contribution of the various sectors to the industry's NPLs showed that the top three industry credit recipients constituted the top three contributors to the industry's NPLs with commerce and finance sector leading with 24.2 percent, followed by the services sector with 16.9 percent and manufacturing sector with 15.1 percent. These top three industry recipients jointly accounted for 56.2 percent of the industry's NPLs as at October 2019 while the lowest three recipients of credit (mining & quarrying, agriculture, forestry & fishing, transport, storage & communication) accounted for 16.2 percent during the same review period [See Figure 1].

Figure 1: Developments in Banks' Balance Sheet & Asset Quality



3.3 Financial Soundness Indicators

The financial soundness of the banking industry was enhanced during the period, evidenced by the improved key financial soundness indicators.

3.3.1 Liquidity Indicators

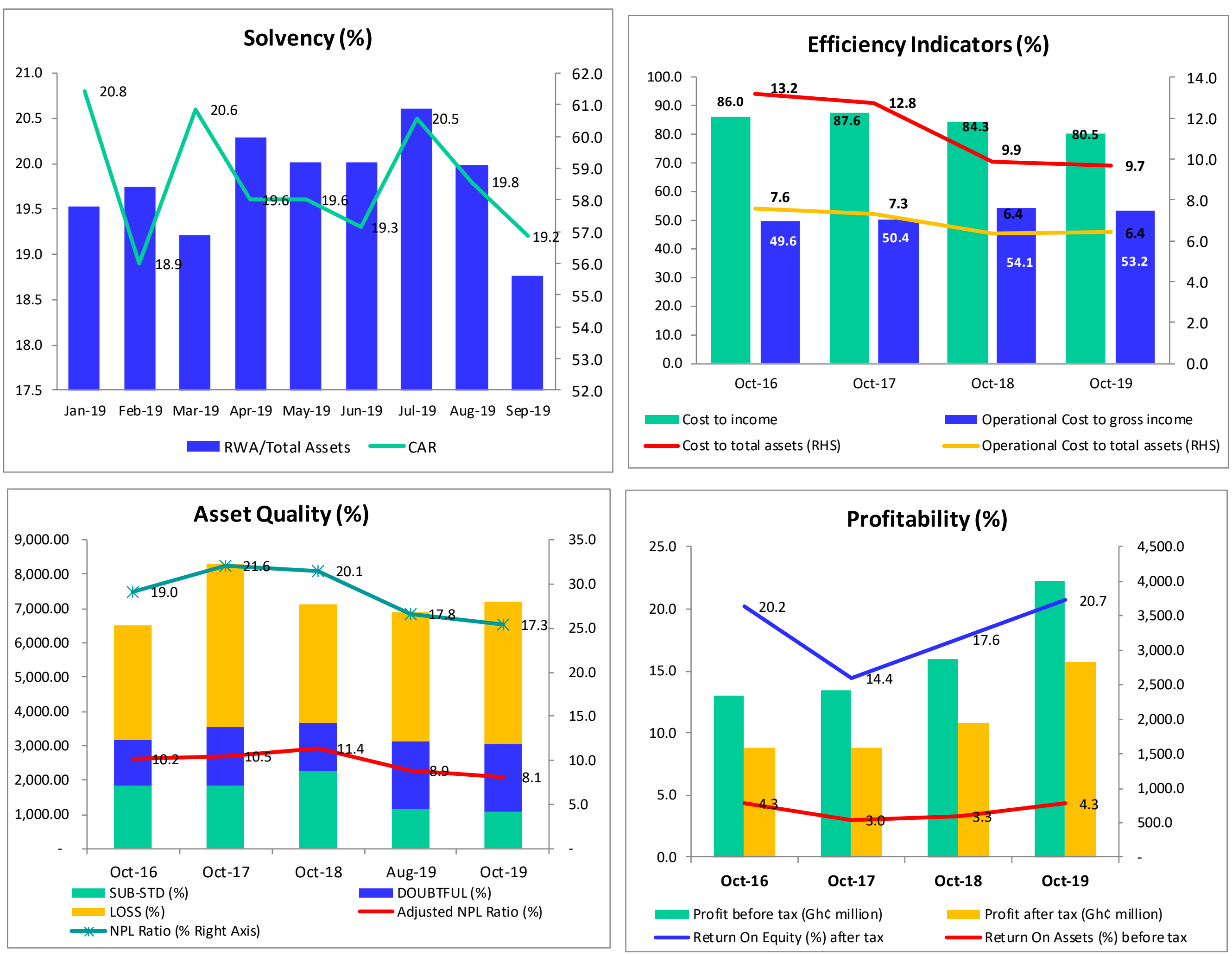
The industry continued to maintain adequate liquidity though some moderations were recorded in the main operational liquidity indicators. The industry's ratio of core liquid assets (mainly cash and due from banks) to total deposits declined slightly from 37.4 percent in October 2018 to 35.7 percent in October 2019 due to the increase in the industry's total deposits which were channelled into new advances other than cash and due from banks or short term investments [see Annexes Table 1]. Similarly, the ratio of broad liquid assets to total deposits also declined marginally from 100.4 percent to 95.3 percent during the same comparative period.

The expansion in banks' total assets in favour of net advances in October 2019 was associated with a marginal decline in the ratio of core liquid assets to total assets to 23.3 percent from 23.7 percent, similar to the decline in the ratio of broad liquid assets to total assets to 62.1 percent from 63.6 percent during the review period. The marginal declines notwithstanding, the liquidity indicators remain adequate [See Annexes Table 5].

3.3.2 Capital Adequacy Ratio (CAR)

The banking industry remained resilient and robust evidenced by its improved solvency even under the more stringent Basel II/III framework. The industry's Capital Adequacy Ratio (CAR) under the Capital Risk Directive (CRD) of the Basel II/III framework has remained well above the 13 percent buffer level since its introduction in January 2019 and was at 18.9 percent in October 2019 pointing to the industry's improved ability to withstand losses following the reforms and the recapitalization [See Figure 2].

Figure 2: Key Financial Soundness Indicators (FSIs)



3.3.3 Profitability

The banking industry posted stronger profits during the first ten months of 2019 which translated into improved profitability indicators. The industry's net income (profit-after-tax) recorded a yearly growth of 45.3 percent to GH¢2.83 billion in October 2019 compared with the 22.3 percent growth amounting to GH¢1.59 billion recorded during the same period last year. The increase in the net income was on the back of significant increases in net interest income and fee and commission income, while operating cost was contained.

The industry's net interest income grew by 23.9 percent to GH¢7.56 billion compared with the 0.3 percent contraction to GH¢6.10 billion recorded in the same period a year ago. The increase in the net interest income was as due to a stronger growth in interest income (16.8% y/y) which more than offset the growth in interest expense (5.2% y/y). This contributed to the 33.0 percent growth in net operating income as all the revenue sources grew faster than operating expenses.

On a year-to date basis, net fees and commissions was GH¢1.79 billion in October representing a slower year-on-year growth of 12.3 percent compared with GH¢1.59 billion in October 2018. Growth in operating expenses however picked up on account of staff costs and other operating expenses. The industry's staff cost of GH¢2.85 billion during the first ten months of 2019 was 15.5 percent higher than the GH¢2.47 billion recorded during the same period in 2018. Similarly, banks' other operating expenses (largely comprising administrative expenses) went up by 6.9 percent to GH¢2.38 billion in October 2019 compared with the 1.7 percent growth which amounted to GH¢2.23 billion during the same comparative period a year ago.

Total provisions (comprising loan losses, depreciation & others) increased by 16.7 percent to GH¢1.34 billion compared with GH¢1.15 billion (-7.7% y/y growth) during the period under review. Overall, the industry's total income or gross income was stronger at a growth of 16.5 percent to GH¢14.55 billion during the current review period compared with the 3.5 percent contraction to GH¢12.49 billion during the same review period last year [See Annexes Table 7].

(a) Return on Assets and Return on Equity

The industry's main profitability indicators were positive during the period. The ratio of profit-after-tax to average shareholders' funds, termed after-tax Return on Equity (ROE) increased to 20.7 percent in October 2019 from 17.6 percent in October 2018. This points to a higher earning on each unit of average shareholders' funds used. The ratio of profit-before-tax to average total assets, termed before-tax Return on Assets (ROA) increased to 4.3 percent from 3.3 percent during the same comparative period, reflecting more efficient assets utilisation to generate profits [See Figure 2 and Annexes Table 6].

(b) Interest Margin and Spread

The spread between gross yield and interest payable widened during October 2019 to 9.8 percent from 8.1 percent a year earlier. The increase in the spread was on the back of the increase in the gross yield to 14.9 percent from 13.1 percent while interest payable increased marginally to 5.1 percent from 5.0 percent during the same comparative periods. The increased spreads continue to reflect low rates on deposits while the yields on particularly longer-dated instruments edged up. [See Box 1 for discussion on Net Interest Margin].

The industry's asset utilisation which is measured by the ratio of gross income to total assets also increased marginally to 12.0 percent from 11.7 percent during the period under review, indicating improvement in revenue for every unit of asset utilized. Interest margin to total assets was 6.2 percent as at October 2019 compared with 5.7 percent during the same period last year, while interest margin to gross income ratio increased to 52.0 percent from 48.9 percent during the same review period. The developments in the income statement culminated into an appreciable rise in the industry's profitability ratio, measured by the ratio of net income to gross income, from 15.6 percent in October 2018 to 19.5 percent in October 2019. [See Annexes Table 6].

(c) Composition of Banks' Income

The components of the banking industry's income largely reflected its assets composition. Hence, investments, the largest share of the industry's assets, contributed the most to the industry's income in the form of interest income, followed by interest income from loans, the second largest share of the industry's assets. The share of the industry's income from investments increased to 44.8 percent in October 2019 from 42.9 percent in October 2018, while that of income from loans declined to 34.5 percent from 36.1 percent during the same review period. The third largest income source for the banking industry were fees and commissions which accounted for 12.3 percent of total income in October 2019 compared with 12.7 percent during the same period a year ago, while the residual, the other income category, increased marginally to 8.5 percent from 8.2 percent during the period under review [See Figure 3].

3.3.4 Operational Efficiency

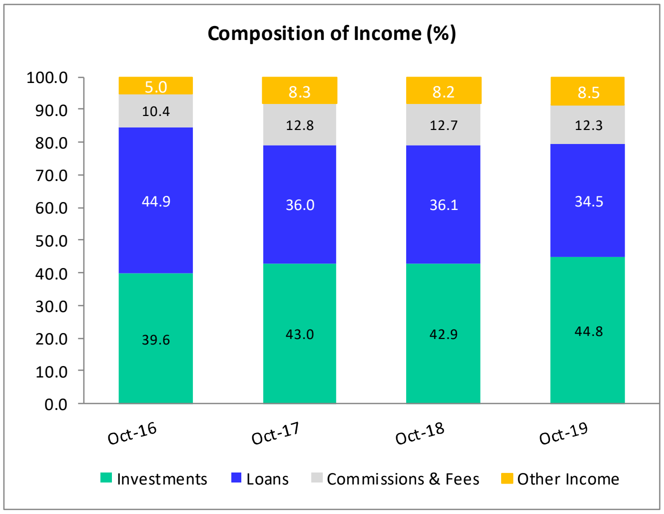
The banking industry remained efficient during the period under review with significant improvement in key efficiency indicators. The industry's cost to income ratio improved to 80.5 percent in October 2019 from 84.3 percent during the same period last year, while cost to total assets also improved marginally to 9.7 percent from 9.9 percent. Despite the higher growth in operational cost in October 2019, the ratio of operational cost to gross income declined to 53.2 percent from 54.1 percent due to the higher growth in gross income which constitutes the denominator. The ratio of operational cost to total assets however remained unchanged at 6.4 percent during the period under review. The improved income performance of the industry has reinforced its overall efficiency [See Figure 2].

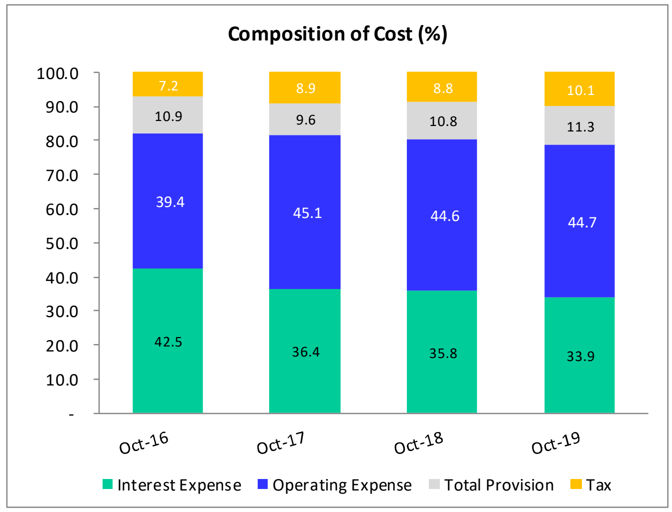
3.4 Banks' Counterparty Relationships

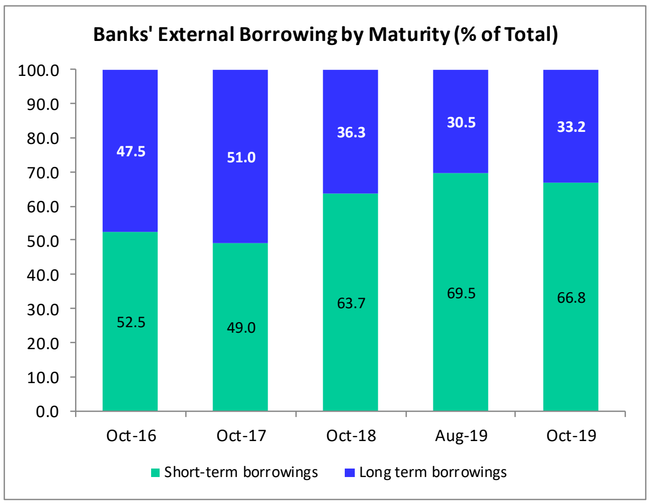
The banking industry's exposure to cross border risks moderated during the period under review. The stock of balances with foreign counterparties contracted by 9.0 percent in October 2019 to GH¢8.82 billion from GH¢9.70 billion (25.2% y/y growth) in October 2018. The contraction in banks' offshore balances was attributable to the 21.8 percent contraction in placements abroad in October 2019 following a 59.4 percent growth a year earlier, while nostro balances recorded a 7.0 percent growth compared to 1.2 percent contraction during the same period a year earlier. The ratio of offshore balances to net worth declined to 50.9 percent in October 2019 compared to 69.8 percent a year ago due to the decline in the offshore balances as well as the increase in banks' net worth following the recapitalization [See Annexes Table 8].

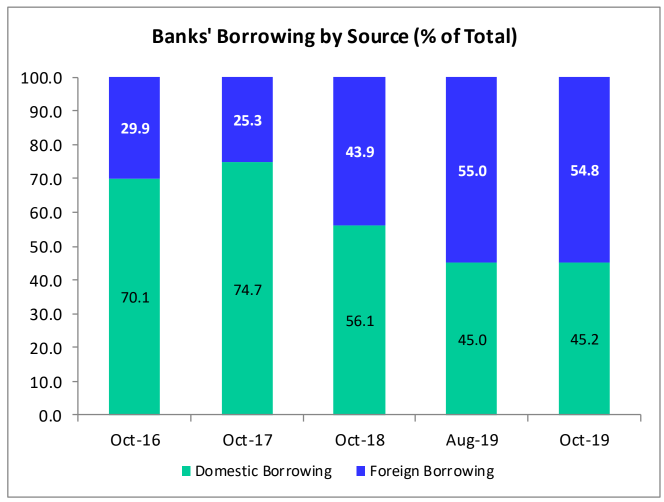
The contraction in domestic borrowing by the banking sector resulted in a decline in its share of total borrowing from 56.1 percent in October 2018 to 45.2 percent in October 2019, while the share of foreign borrowing increased from 43.9 percent to 54.8 percent during the same review period. A breakdown of the banks' external borrowings also revealed an increase in the share of short-term funds to 66.8 percent in October 2019 from 63.7 percent in October 2018, while that of long-term borrowing declined 33.2 percent from 36.3 percent to during the same review period [See Figure 3].

Figure 3: Composition of Income, Cost and Borrowings









4. CREDIT CONDITIONS SURVEY

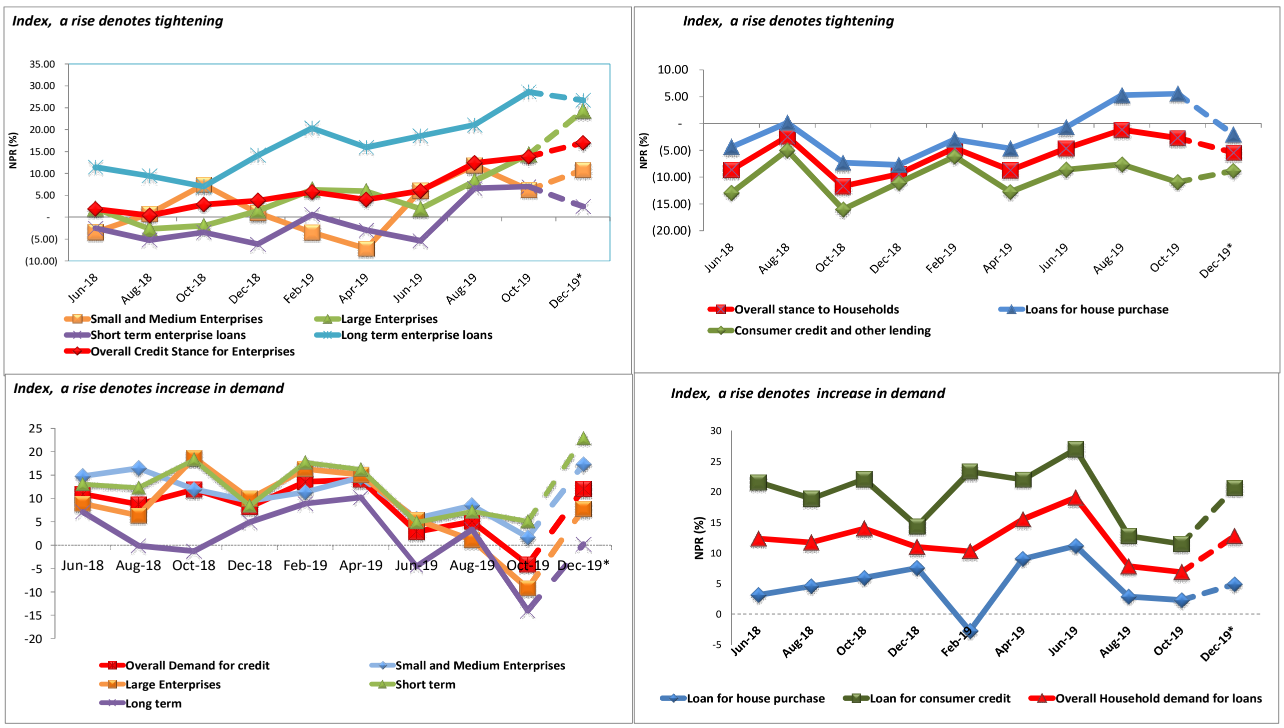
Banks reported net tightening in the overall credit stance on loans to enterprises credit conditions survey conducted by the Bank in the October 2019. This followed a net tightening in the credit stance on loans to large enterprises, short-term and long-term enterprise loans. There was however a net ease in banks' credit stance on loans to Small and Medium Enterprises (SMEs). Banks projected further tightening in the overall credit stance on loans to enterprises between November 2019 and December 2019 on the back of net tightening in the credit stance on large enterprise loans as well as SME loans.

Banks maintained credit stance easing on loans to households during the October 2019 survey round, with a net ease in the credit stance on loans for house purchases and consumer credit following relative tighter stance during the previous two survey rounds. Banks' stance on loans to households is expected to ease further over the next two months to December 2019, supported by a net ease in loans for house purchases or mortgages.

Results of the October 2019 survey round indicated a decline in overall demand for loans by both corporates and households between August and October 2019. The decline in demand in both sections of the credit market was driven by declines in the various components of enterprise and household loans. Banks however anticipated a pickup in demand for loans by corporates and households in anticipation of increased business activities during the year end.

Bank's inflation expectations remained well-anchored depicted by the October 2019 survey results. The survey indicated a 100 basis points decline in the six-month inflation expectations index to 9.2 percent during the October 2019 survey from 10.2 percent in August 2019. Banks' expectations for lending rates, six-months from the reporting date also declined to 21.6 percent in October 2019.from 22.7 percent in August 2019. The decline in NPL ratio over the previous two months partly accounted for the downward revision in banks' lending rate expectations.

Figure 4: Credit Conditions Survey Results



5. CONCLUSION AND OUTLOOK

The performance of the banking industry during the review period shows that a stronger banking sector has emerged, with improved solvency, liquidity and profitability. Further, asset quality is improving and banks' resilience to shocks has been strengthened. The key financial soundness indicators remained positive throughout 2019 as banks adhered to sound banking practices following the reforms. The banking industry continues to exhibit strong prospects in the medium term with projected improvement in credit growth on the back of the higher capital levels and improving asset quality. It is envisaged that the recently announced policy measures, including the setting aside of 2 percent of banks' primary reserve to support targeted lending to Small and Medium Enterprises (SMEs) would give further impetus to credit growth. These measures alongside the strengthening of credit underwriting practices and loan recovery efforts would help deepen financial intermediation without impairing asset quality over the near to medium term.

Box 1: Decomposition of Net Interest Margin of Ghana's Banking Sector

In this Box, we analyse the decomposition of Net Interest Margin (NIM) of Ghana's banking sector, using a model developed by Randall (1998)[1]. As broadly defined, Net Interest Margin (NIM) is the difference between lending and deposit rates which also serves as accepted measures for the cost of bank intermediation and banking competition[2]. The Randall model is however based on an accounting framework using income statement and balance sheet items of banks.

The persistence of high NIMs are viewed as symptomatic of a number of issues, including lack of competition, perceived market and credit risks, scale diseconomies constrained by small markets, high operating costs due to low efficiency or an unfavourable institutional environment. Sub-Saharan African (SSA) countries are seen to have relatively higher NIMs compared to other regional blocks (Beck & Cull, 2013; Calice & Zhou, 2018)[3]. Such high financial intermediation costs constitute a serious impediment for financial deepening in SSA countries.

Using the Income statement accounting identity:

P= II-IE+NII-OC-Prov. ------------------------------ **(eqtn 1)**

Where,

P = Profit before tax; **II**= Interest Income; **IE**= Interest Expense; **NII**= Non Interest Income
OC = Operating Cost (Staff Cost + Admin Expenses + Other Operational Expenses); **Prov** = Provisions

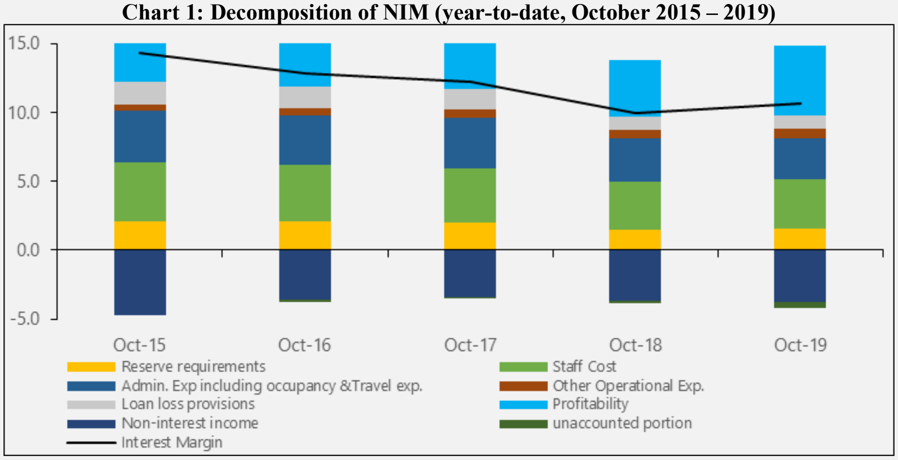
Re-writing (eqtn 1) by making **II-IE** (the spread) the subject of the equation, dividing the resultant expression by the interest bearing liabilities (D) as a scaling factor, and defining interest margin as the difference between implicit lending rate ($II/L=i_L$) and implicit deposit rate ($IE/D=i_D$), the equation can be written as:

$$i_L - i_D = \rho i_L + \frac{OC+}{D}\frac{PROV}{D} + \frac{ROA\,(A)}{D} - \frac{NII}{D} + \varepsilon \text{ --------} \qquad \textbf{(eqtn 2)}$$

Where,

ρi_L is the opportunity cost of the primary reserve,
ε is the residual term (or unaccounted portion) emanating from combining stock and flow variables, and making the simplifying assumption that all interest bearing liabilities (excluding reserve requirements) are channelled into interest earning assets.

Chart 1: Decomposition of NIM (year-to-date, October 2015 – 2019)



Based on eqtn 2, we compute the NIM and its components on a year-to-date basis (in October) over the past five years. Chart 1 shows the trend and components driving NIM for the period 2015-2019. As seen from the Chart, the key drivers of NIM in Ghana's banking sector are bank staff costs and administrative expenses. High profit margins of banks are also important in explaining changes in NIM. These notwithstanding, the net interest margin in the banking industry has been on a steady decline since October 2015, partly reflecting the comprehensive reforms undertaken since 2017.

Based on the key drivers of NIM, addressing the high operating cost and high profit margins of banks would go a long way to help reduce the relatively high levels in the banking sector. It is against this backdrop that some policy measures were announced in the Monetary Policy Committee (MPC) Press Release[4] to scale up market efficiency in the pricing of loans and other policy measures to foster competition, deepen financial intermediation and further enhance economic growth.

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[1] *Randall (1998), Interest Rate Spreads in the Eastern Caribbean, IMF Working Paper, WP/98/59.*
[2.] *NIM can be measured ex ante or ex post. The ex-ante measure of NIM is Lending Rate (i_L) - Deposit Rate (i_D). The ex-post measure (Balance Sheet and P&L proxies) of NIM is obtained as follows: NIM = interest income on earning assets/Average interest earning assets (proxy for i_L)* ***minus*** *interest expense/Average interest bearing liabilities (proxy for i_D)*
[3] *Beck, T., and R. Cull (2013), Banking in Africa. World Bank Policy Research Working Paper No. 6684;*
Calice, P., and N. Zhou (2018), Benchmarking Costs of Financial Intermediation around the World, World Bank, Policy Research Working Paper No. 8478.
[4.] *Bank of Ghana MPC Press Release, November 2019*

ANNEXES

Table 1: Asset and Liability Structure of the Banking Sector

	Oct-16	Oct-17	Oct-18	Aug-19	Oct-19
Components of Assets (% of Total)					
Cash and Due from Banks	24.4	25.1	23.7	23.3	23.3
Investments	27.0	29.6	40.3	39.9	39.2
Net Advances	40.2	35.8	28.7	29.6	30.1
Other Assets	4.6	5.5	3.6	3.6	3.7
Fixed Assets	3.6	3.9	3.6	3.5	3.6
Components of Liabilities and Shareholders' Funds (% of Total)					
Total Deposits	64.0	62.8	63.4	66.0	65.2
Total Borrowings	16.5	17.0	17.0	13.8	14.1
Other Liabilities	5.8	7.2	6.6	5.7	6.4
Shareholders' Funds	13.7	13.1	13.1	14.5	14.3

Table 2: Credit Growth

	Oct-16	Oct-17	Oct-18	Aug-19	Oct-19
Gross Loans and Advances (GH¢m)	34,359.77	38,455.04	35,525.98	38,902.69	41,646.00
Nominal Growth (y-o-y)	17.2	11.9	(7.6)	15.2	17.2
Private Sector Credit (GH¢m)	29,103.06	33,882.12	32,819.40	35,155.25	37,131.72
Nominal Growth (y-o-y)	7.3	16.4	(3.1)	11.5	13.1
Household Loans (GH¢m)	5,066.63	5,866.12	8,634.58	8,048.46	8,476.14
Nominal Growth (y-o-y)	18.3	15.8	47.2	23.9	(1.8)

Table 3: Contingent Liability

	Oct-16	Oct-17	Oct-18	Aug-19	Oct-19
Contingent Liabilities (GH¢)	6,754.7	8,904.7	9,347.7	10,001.4	10,620.9
Growth (y-o-y)	(7.3)	23.3	6.1	14.9	11.9
% of Total Liabilities	10.6	11.5	10.1	10.2	10.2

Table 4: Distribution of Loans and NPLs By Economic Sector (Percent)

	Oct-17		Oct-18		Aug-19		Oct-19	
	Share in Total Credit	Share in NPLs	Share in Total Credit	Share in NPLs	Share in Total Credit	Share in NPLs	Share in Total Credit	Share in NPLs
a. Public Sector	**11.9**	**5.3**	**7.6**	**4.5**	**9.6**	**2.4**	**10.8**	**2.3**
i. Government	1.5	0.9	2.6	0.8	3.7	0.3	3.8	0.2
ii. Public Institutions	3.5	0.1	0.8	0.3	1.5	0.3	2.5	0.2
iii. Public Enterprises	6.9	4.3	4.2	3.4	4.4	1.8	4.5	1.8
b. Private Sector	**88.1**	**94.7**	**92.4**	**95.5**	**90.4**	**97.6**	**89.2**	**97.7**
i. Private Enterprises	71.1	89.0	66.2	83.7	66.6	82.2	66.1	84.8
o/w Foreign	9.5	10.8	9.3	10.5	10.4	8.5	9.6	8.6
Indigeneous	61.6	78.2	56.9	73.2	56.2	73.7	56.5	76.2
ii. Households	15.3	5.3	24.3	11.3	20.7	10.9	20.4	8.2
iii. Others	1.8	0.5	1.9	0.6	3.1	4.5	2.7	4.8

Table 5: Liquidity Ratios

	Oct-16	Oct-17	Oct-18	Aug-19	Oct-19
Liquid Assets (Core) - (GH¢'million)	18,022.0	22,313.8	25,216.2	26,853.9	28,158.91
Liquid Assets (Broad) -(GH¢'million)	37,536.7	48,190.8	67,630.1	72,350.0	75,200.31
Liquid Assets to total deposits (Core)-%	38.2	40.0	37.4	35.3	35.7
Liquid Assets to total deposits (Broad)- %	79.5	86.3	100.4	95.2	95.3
Liquid assets to total assets (Core)- %	24.4	25.1	23.7	23.3	23.3
Liquid assets to total assets (Broad)- %	50.9	54.2	63.6	62.8	62.1

Table 6: Profitability Indicators (%)

	Oct-16	Oct-17	Oct-18	Oct-19
Gross Yield	22.4	17.0	13.1	14.9
Interest Payable	9.7	7.5	5.0	5.1
Spread	12.7	9.5	8.1	9.8
Asset Utilitisation	15.3	14.6	11.7	12.0
Interest Margin to Total Assets	7.3	6.9	5.7	6.2
Interest Margin to Gross income	47.8	47.3	48.9	52.0
Profitability Ratio	14.0	12.3	15.6	19.5
Return On Equity (%) after tax	20.2	14.4	17.6	20.7
Return On Assets (%) before tax	4.3	3.0	3.3	4.3

Table 7: DMBs' Income Statement Highlights

	Oct-16	Oct-17	Oct-18	Oct-19	Oct-17	Oct-18	Oct-19
		(GH ¢'million)				Y-on-y Growth (%)	
Interest Income	9,501.8	10,943.5	9,874.5	11,530.5	15.2	(9.8)	16.8
Interest Expenses	(4,107.3)	(4,819.7)	(3,770.7)	(3,966.1)	17.3	(21.8)	5.2
Net Interest Income	**5,394.6**	**6,123.8**	**6,103.8**	**7,564.4**	**13.5**	**(0.3)**	**23.9**
Fees and Commissions (Net)	1,218.8	1,346.6	1,590.2	1,785.7	10.5	18.1	12.3
Other Income	568.3	651.0	1,025.1	1,233.5	14.6	57.4	20.3
Operating Income	7,181.7	8,121.5	8,719.1	10,583.5	13.1	7.4	21.4
Operating Expenses	(3,784.7)	(4,465.7)	(4,697.0)	(5,233.7)	18.0	5.2	11.4
Staff Cost (deduct)	(2,012.4)	(2,276.2)	(2,470.7)	(2,853.9)	13.1	8.5	15.5
Other operating Expenses	(1,772.3)	(2,189.5)	(2,226.3)	(2,379.7)	23.5	1.7	6.9
Net Operating Income	**3,397.0**	**3,655.8**	**4,022.1**	**5,349.9**	**7.6**	**10.0**	**33.0**
Total Provision (Loan losses, Depreciation & others)	- 1,048.0	- 1,243.0	- 1,146.7	- 1,337.7	18.6	(7.7)	16.7
Income Before Tax	**2,349.0**	**2,412.8**	**2,875.4**	**4,012.1**	**2.7**	**19.2**	**39.5**
Tax	(771.3)	(819.8)	(927.5)	(1,182.2)	6.3	13.1	27.5
Net Income	**1,577.6**	**1,593.0**	**1,948.0**	**2,829.9**	**1.0**	**22.3**	**45.3**
Gross Income	11,288.9	12,941.2	12,489.8	14,549.6	14.6	(3.5)	16.5

Table 8: Developments in Offshore Balances

	Oct-16	Oct-17	Oct-18	Aug-19	Oct-19
Offshore balances as % to Networth	58.7	66.7	69.8	52.5	50.9
Annual Growth in Offshore balances (%)	29.7	30.0	25.2	-15.0	-9.0
Annual Growth in Nostro Balances (%)	-20.9	64.3	-1.2	-14.9	7.0
Annual Growth in Placement (%)	167.6	2.7	59.4	-15.3	-21.8