

Ghana Market Update – September 2011



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Policy

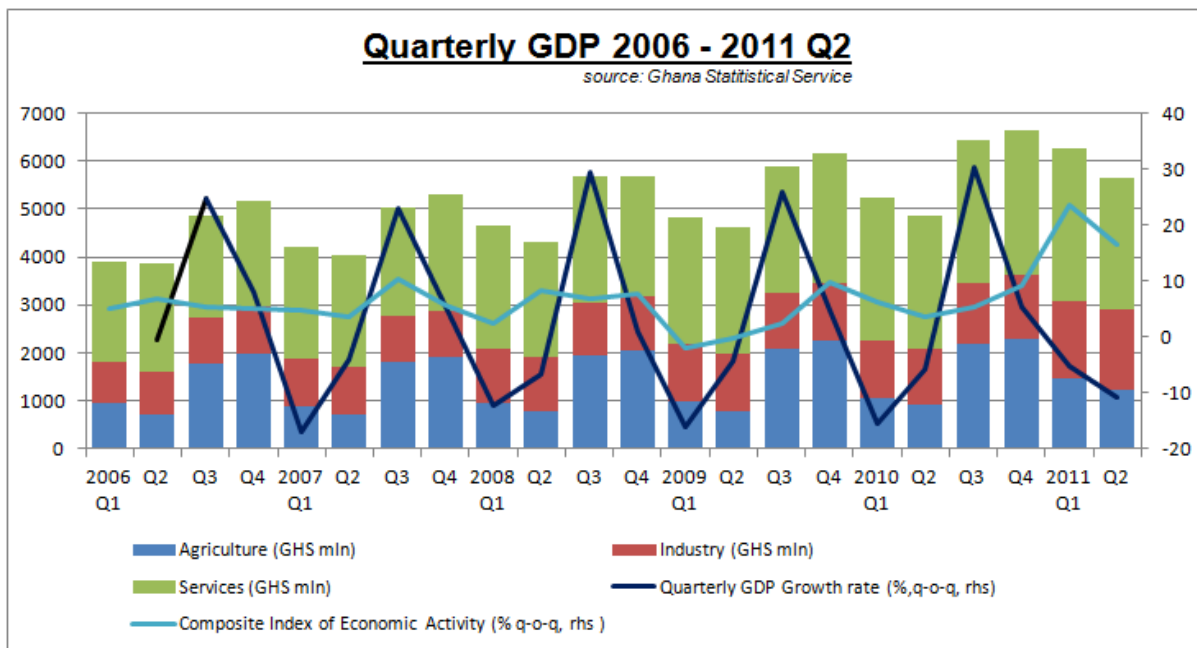
With vibrant economic growth, prospects look increasingly favourable for the Presidential incumbent John Atta Mills in next year's election. Indeed the President secured over-whelming endorsement in the ruling National Democratic Congress (NDC) primary, receiving over 96% of the votes cast. In decisively rejecting the candidature of Nana Kunadu Agyeman Rawlings, the wife of the party's founder, Jerry Rawlings, the NDC has implicitly decided against policy experimentation. It is now likely that Mills will be challenged by Nana Akufo-Addo of the opposition New Patriotic Party. In the previous 2008 election Mills narrowly defeated Addo by 50.23% to 49.77% in a run-off vote; given the favourable economic indicators the President's position should be more secure.

Popular expectations are however understandably rising, fuelled not only by the commencement of oil production but the major upward revision to GDP. While the change in GDP calculation has taken the country into the ranks of lower middle income economies, as per capita income has notionally risen, actual real incomes have remained substantially the same.

Economic Trends

A combination of surging gold prices, insecure global supplies of cocoa as well as the commencement of commercial oil production will contribute to extremely rapid growth this year. Official sources expect output growth to reach 14% in real terms this year, although some commentators are forecasting growth closer to 20%, based on a more rapid oil impact. Notwithstanding the strength of overall performance, the economy is still confronted with a number of issues, not least the vulnerability of fiscal performance to increases in expenditure commitments associated with next year's Presidential election campaign. However the GDP revisions provide some considerable leeway and the inflationary pressure continues to moderate. Consumer price inflation has been in single digits since the second half of last year, and although it remains stubbornly above 8%, it is a significant turnaround from the recent peak close to 21% recorded in June 2009, largely fuelled by the collapse of fiscal discipline associated with the previous Presidential election.

Although the July supplementary budget focused on growth, the government aims to reduce the fiscal deficit to below 5.5% of GDP, compared to the outturn of 6.8% of GDP last year. However, given the evident strength of economic expansion, this aspiration of growth may be directed more towards growth of employment opportunities, infrastructure provision and social welfare, than to accelerate already vibrant overall output performance.



The commercial exploitation of oil resources is expected to lead to a step change in the trajectory of growth, already robust as a result of global demand for the economy's current principal exports: cocoa and gold. Oil production from the offshore Jubilee field started flowing last December, with output expected to rise from the current 70,000 bpd to 120,000 bpd in the second half of the year. The economy recorded growth of 7.7% (revised series) last year, perhaps closer to trend, than the 4% recorded in 2009. Moreover, while last year's GDP revision has emphasised the contribution of the services sector, logistics (including transportation), construction and industry are all expected to record more respectable expansion. Notwithstanding the accelerated nature of growth, the BoG forecasts that current monetary policy will remain on track, especially given the continued easing of price pressures. Indeed, the BoG was able to reduce its key lending rate by 50 bps in both its May and July meeting to bring it down to 12.5% where it remains, having previously left it unchanged at 13.5% since July last year.



Despite the size and scope of the services sector, overall GDP growth tends to be highly seasonal, with growth consistently more vibrant in the last two quarters of the year than in the first two. While this reflects the impact of agriculture, notably cocoa exports, the increased importance of non-seasonal exports, namely gold and oil, will tend to reduce this seasonality, and is already reflected in the data for the first quarter of this year.

Economic growth continued to expand dramatically, albeit at a comparatively more moderate 16% in the second quarter, largely a result of the impact of oil production coming on-stream. This builds on the impressive performance recorded in the first quarter, although this has been revised downwards to 23%. The total value of goods and services in the second quarter was valued at GHS 7.2 bln (US\$ 4.6 bln), with expansion was led by the mining and quarrying sub- sector, of which grew by 211%. The contribution of mining and quarrying has more than quadrupled in the second quarter, with industry overall expanding by 40% to GHS1.7 bln. Agricultural crops, including cocoa, expanded 37% in the second quarter, easing from the 39% in the quarter before.

Compared to the first quarter, GDP declined at a seasonally adjusted quarter-on-quarter rate of -3.1% in the quarter ending in June. In contrast q-o-q growth in the first quarter was close to 13%. There is, however, concern that local business, deficient in capacity, capital and expertise, may fail to take advantage of the opportunities available in the energy sector. Thus, whilst there is significant growth at the macro-level, this has yet to filter through on a micro-level as job creation.



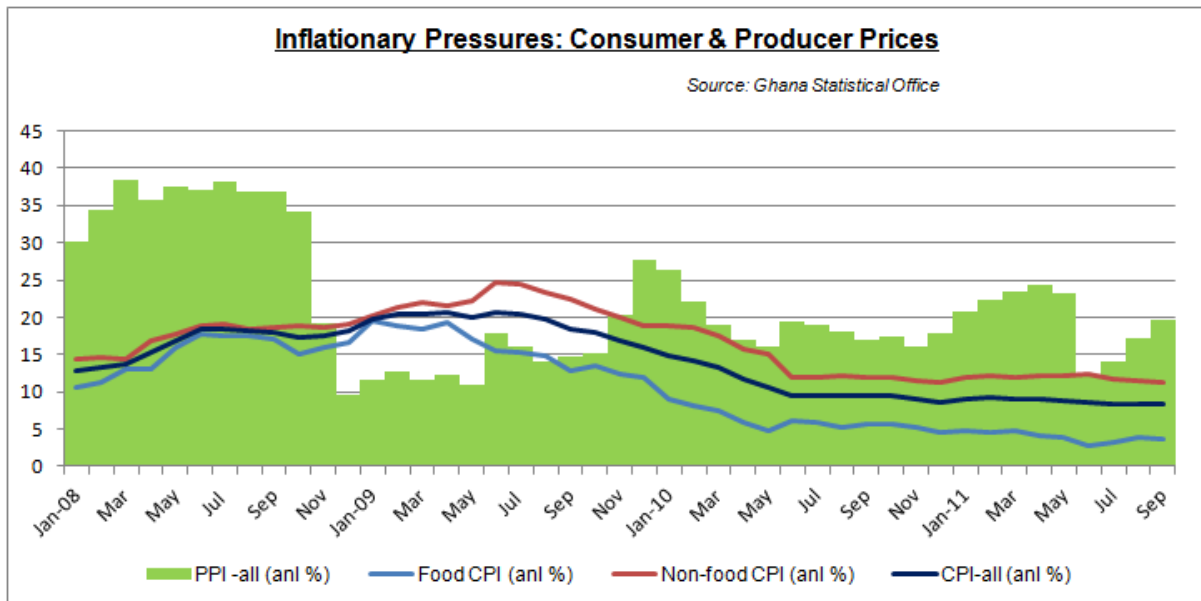
Inflation, Monetary and Foreign Exchange Rate Policy

Inflationary pressures have hovered close to 8.4% in both August and September, slightly above the July figure (8.39%), the lowest recorded rate in almost two decades. While principal cause of inflation is the continued strength of non-food prices, although the general trend in the sector has been easing - falling to 11.30% in September from 12.44% in June, an uptick in food prices was the cause of the recent firming. Average inflation rate for the food and non-alcoholic beverages group jumped another half a percentage point, in both July and August to reach 3.79% from 2.78% recorded in June this year, and remained at 3.74% in September. From June 2009 when it reached a peak of 20.74%, the inflation rate has progressively eased over an eighteen month period to 8.58% in December 2010. Even though inflation rate increased marginally to 9.08% and 9.16% in January and February 2011 respectively, it began to decline again starting from March 2011 pushing the inflation rate down to 8.39% in July 2011. While price pressures have been in single digits since June last year, it held in a range above 9% until April, since then it has progressively eased over the three months since to 8.4% in July.

Region	Regional CPI (% change y-o-y)					
	Sep-06	Sep-07	Sep-08	Sep-09	Sep-10	Sep-11
Eastern	11.9	13.5	22.7	14.1	7.5	7.8
Greater Accra	13.9	11.1	15.2	15.2	15.1	9.9
Ashanti	11.1	9	14	20.8	8	8.8
Northern	12.4	9.4	24	16.2	10.1	6.8
Western	11.1	7.8	19.8	18	6.8	8.4
Volta	8.6	9.9	21.7	20.2	5.6	5.7
Upper East & West	16	13.1	20.7	26.4	11.5	5.8
Central	8	10.8	19.6	27.6	8.1	9.9
Brong Ahafo	13.7	8.9	17.7	17	7.5	7.8
National	11.67	10.19	17.89	18.37	9.38	8.4
Source: GSS		above National rate			below National rate	

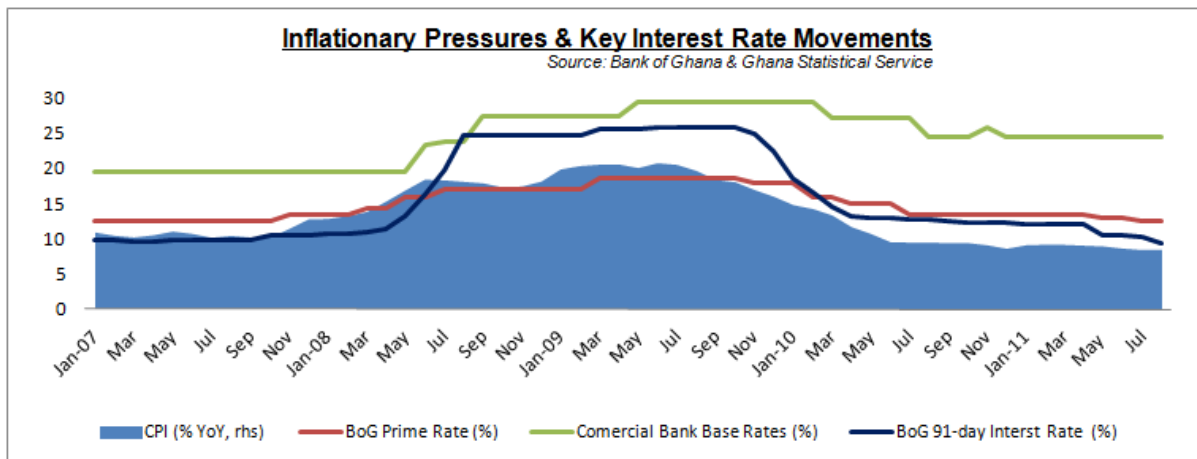
Regionally price movements have been much more volatile, although there seems to be two distinct periods, perhaps reflecting change in the structure of the economy. Prior to 2009, price variations tended to largely reflect the inadequacies of the transport and logistics infrastructure (prices higher the greater the distance from the ports), coupled with shifts in agricultural prices and the impact of government expenditure associated with electoral cycles. However, since then, there seems to

be stronger price pressures in the regions most closely associated with the exploitation of oil, namely, Western and Central, and the capital Greater Accra. Favourable climatic conditions appear to have dampened price pressures in other regions, with the notable exception of the Upper West and Upper East regions where poor climatic conditions have been compounded by extended distances from the principal ports.



While producer prices dropped dramatically according in June, to 12.5% y-o-y from 23.2% in the month previous, producer prices increased 14.01% y-o-y in July, an increase of 1.97% relative to June. While PPI has been easing over recent months, the significant shift in June was largely the result of the impact of previous utility PPI increases falling out of the index. The June data recorded a year-on-year price increase of 0.27%, compared to the y-o-y increase of 72% registered in the month previous. The Manufacturing PPI eased further to 12.1%, from 12.46% in May, and for the Mining sector, PPI data eased from 32.6% to 30.24% in June. The general easing of prices pressures probably reflects that at this stage much of the oil sector developments are of an enclave nature and that the fiscal side has yet to benefit from substantially enhanced oil-related revenue flows. Inflationary risks associated with a rapid expansion of the oil sector, are likely to remain a concern for the authorities. Indeed by September, these gains had largely evaporated as robust price pressures in the mining sector (primarily oil) increased by 51%, contributing to an overall strengthening of produce price pressures of 19.59%.

Additionally, the stability of the currency has been a significant factor in constraining inflationary pressures, supported by the strengthening balance of payments position. The cedi has also benefitted by increased confidence in the economy, which in recent trading appreciating to close to US\$1.50. This follows weaken at the beginning of the year when the cedi fell to its lowest for 17 years, and has since gained 4.2%. More recently, the cedi has strengthened recently as the BoG awaited an influx of the foreign currency as a result of the completion of the US\$1.75 billion trade-finance loan for next season's cocoa purchases, providing a boost to liquidity in the foreign exchange market. The next cocoa crop is harvested between October and September 2012, the borrowings acquired before the start of each harvest to fund purchases of beans from farmers.



Monetary policy has also been carefully moderated to support macroeconomic stability and provide a solid basis to enhance economic growth. While, the deceleration of price pressures has enabled the authorities to ease monetary policy in recent months, the BoG's decision to keep the policy rate on hold in September probably reflects concerns regarding higher utility prices and pay increases for public sector workers may add pressure on the inflation rate. However, although the BoG has reduced the prime rate to 12.5%, credit market conditions remain tight, with commercial bank prime lending rates still stuck in a range of 18-26%.



Fiscal Policy

In July, Parliament approved a supplementary budget totalling GHS1.46 bln providing additional expenditure for the 2011 financial year. The new spending is targeted at the creation of jobs and youth employment opportunities, provision of economic and social infrastructure as well as improvement in sanitation. The rationale for the supplementary appropriation was attributed to shifts in the domestic and global environment not assumed in the original budget approved in November last year.

Additionally, according to the MoF, the new Petroleum Revenue Management Act alters the assumptions underlying Benchmark Revenue, the Annual Budget Funding Amount and the transfer of funds into the Ghana Petroleum Funds Account. However, these adjustments reflect the beneficial impact of increases in crude oil production volumes and high oil prices, which entailed upward adjustment in revenue projections. The revenue account had also been bolstered by World Bank inflows, the sale of AngloGold Ashanti shares in lieu of royalties with enhanced tax as well as increased revenue collections from the Ghana Revenue Authority through enhanced administration measures. Furthermore, as a result of an accumulation of domestic debt stocks, related higher borrowing costs, as well as the need to reduce outstanding arrears and commitments, projected payments exceeded initial 2011 estimates, thereby requiring additional resources to meet those additional payments.

Sustaining fiscal discipline continues to prove problematic, and could provoke increasing interest as the election approaches. While the current Mills administration has enjoyed considerable success in restoring order to the fiscal process, there continues to be some slippage in both attaining projected budget targets and clearing accumulated arrears. The commitment to fiscal consolidation saw the overall budget deficit brought down to 5.7% and 5.9% of GDP (rebased) respectively in 2009 and 2010. The capacity of the state to absorb the scale of revenues coming into the state's coffers, also raises scepticism about fiscal discipline, given past experience. The fiscal deficit widened to 14.5% of GDP in 2008, and was close to a quarter of GDP if arrears were included. While the spending gap narrowed last year, the target for 2011 has been raised to 5.1% in July from the initial forecast of 4.1%. The government has already announced that public-sector workers will receive a 20% rise in base salaries, retroactive to January.



The end-year data for 2010, indicates that cash and domestic financing targets were missed. The fiscal deficit exceeded the adjusted programme ceilings by 0.8% of GDP. Tax revenues exceeded projections, however non-tax revenues and grants fell short, which coupled with the greater than anticipated expenditure, largely a result of higher capital spending, weakened fiscal performance. 2010 also saw further accumulation of expenditure arrears by the equivalent of almost 2% of GDP, in contrast to the projected reduction equal to 0.2% of GDP. As a result, on a commitment basis, adjusting the cash deficit for accumulated arrears, increased to 8.4% of GDP last year, almost 3% of GDP. Accordingly, and despite the revisions to GDP, total public debt increased to 39% of GDP at the close of 2010, 3% higher than the equivalent figure a year earlier. While the bulk of the debt increase was financed through domestic issues, debt held and arrears owed by State Owned Enterprises is estimated to be equal to an additional 9% of GDP.

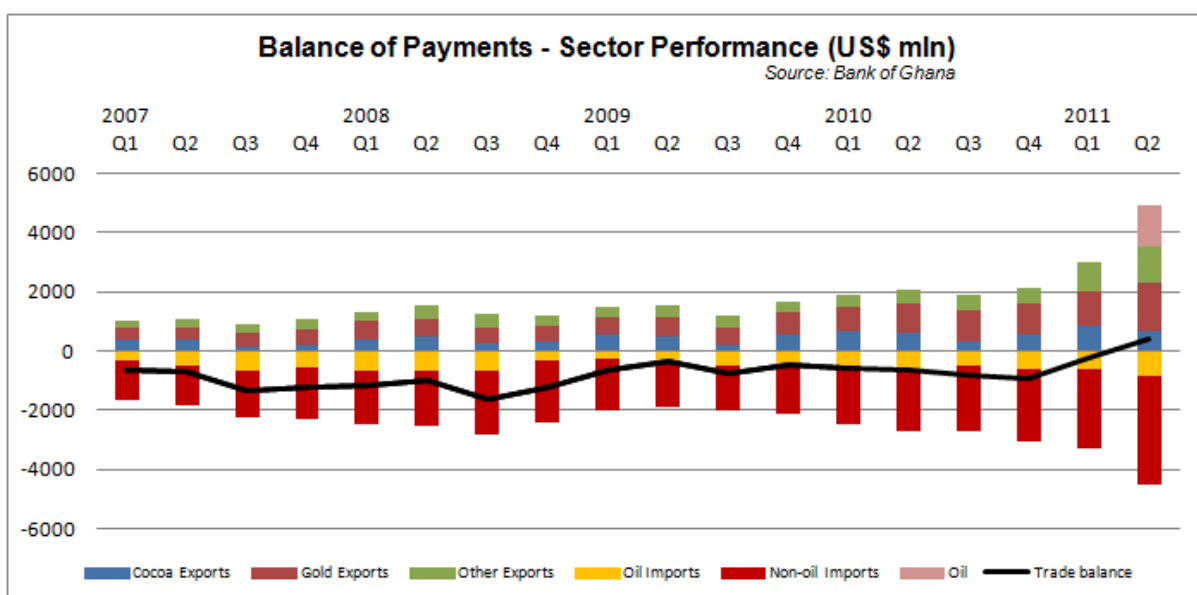
The projected 2011 budget was based on forecast expenditure of GHS 12.7 bln (US\$ 8.4 bln), enabling the budget deficit to be brought into a range of 5% and 5.5% of GDP. Total revenue (including grants) in the first quarter reached GHS 1.9 bln, equivalent to 3.5% of GDP, representing a growth rate of 19%, up from 18% in the equivalent period last year and a fifth of the anticipated budget. This robust performance was officially attributed to improvements in tax collection, notably with respect to imports (both VAT and duties) and Petroleum taxes. First quarter expenditure however increased by some 43% in annual terms, a similar rate to that sustained at the beginning of 2010. At GHS 2.8 bln, expenditure was equivalent to 5.2% of GDP and represented realisation of 30% of the government's annual spending programme, excluding accumulated arrears. A noticeable feature was the growth in the public sector wage bill by almost a quarter in the first quarter, representing 1.6% of GDP.



External Sector

The increasing stabilisation of the cedi is in part a result of the considerable improvement in external sector performance since 2008. The current account deficit, on the balance decreased, from US\$3.5 bln in 2008 to US\$1.6 bln and US\$2.6 bln in 2009 and 2010 respectively. Furthermore, the overall balance of the balance of payment improved from a deficit equivalent to US\$941 mln in 2008 to surpluses of US\$1.2 bln and US\$1.5 bln in 2009 and 2010 respectively. The first seven months of 2011 has again seen a robust performance, with merchandise exports expanding by 63% to US\$ 5.2 bln, as a result strong growth of gold, cocoa beans and crude oil exports. Nevertheless, the vulnerability of the external sector was highlighted by the fact that merchandise imports growth of 45.4 per cent for the same period.

As the world's second largest cocoa producer, second only to South Africa in terms of the continent's gold production, as Africa's newest oil exporter, the immediate and indeed medium-term prospects for exports are extremely favourable, and provided import demand is constrained, the prospects for the balance of payments must be similarly posed. In the first five months of this year, 8.6 million barrels of oil were exported, equivalent to US\$955 mln, while gold exports amounted to US\$2 bln, and cocoa earnings were US\$1.4 bln. Foreign exchange reserves moderately fluctuated over the first part of the year, from the equivalent of US\$ 4.7 bln at the year-end, reserves peaked at US\$44.8 bln in February, and then fell to US\$4.5 bln in March, before recovering to \$4.7bln in May.





Banks

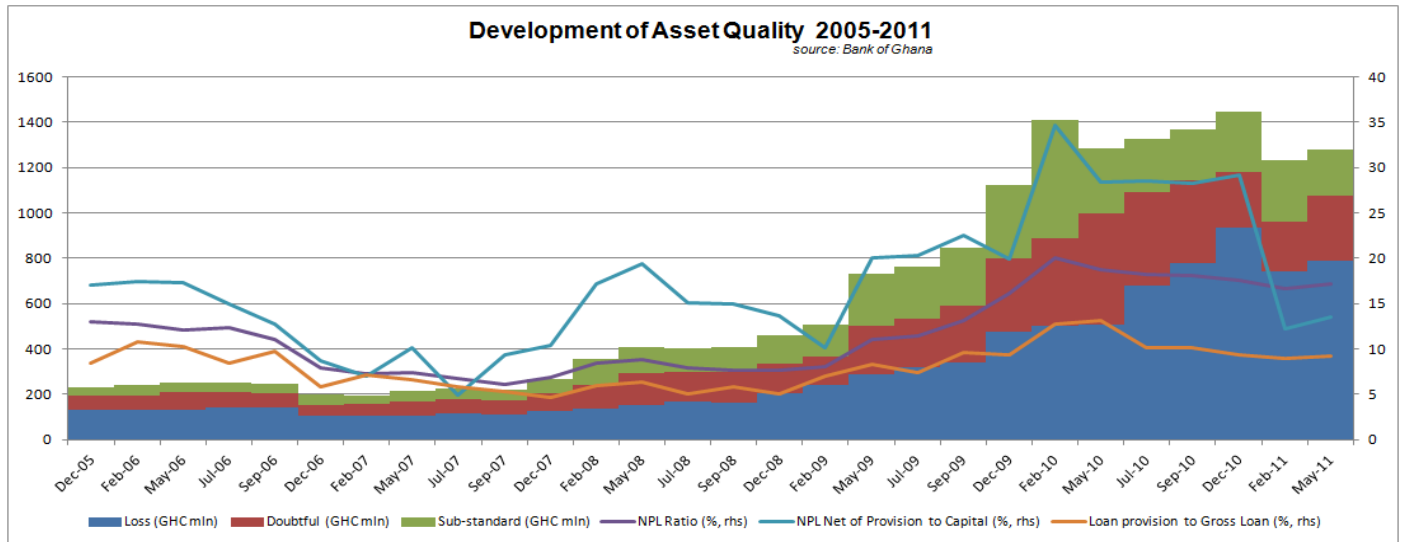
While credit demand has recovered, expanding 8.8% in May compared with a 3.4% contraction in the same period the year previously ago. The BoG remains concerned of the willingness and capacity of the commercial banks to finance the real economy. In particular, the setting of commercial bank lending rates will be subject to a review by a BoG established committee.

In the 12-months up until May, the banking sector aggregate balance sheet increased 30% compared with the corresponding period in 2010. While the domestic asset base increased by a similar margin and at a similar rate to the equivalent previous period (29.7% compared to 29.9%), international assets increase by a third, compared to much more moderate growth last year (3.8%). As of May, overall net loans and advances reached GHS6.5 bln, equal to growth of close to 9%, compared to the 2% contraction sustained in the year previous. In contrast, the aggregate investment portfolio registered growth of 61%, as bills and securities held reached GHS6.1 bln, compared to the more robust growth of 134% in year up until May 2010. The banks continue to largely fund themselves via deposits, which expanded by 37% from GHS9.6 bln in May last year to GHS13.2 bln in May this year. Total borrowing also increased by 17.3%, increasing to GHS1.84 bln, from GHS1.56 bln in the period up to the previous May.

There was a marginal improvement in asset quality as of the end of May, compared to the previous May, with the Non-Performing Loan (NPL) ratio easing from 18.7% to 17.2%. The bulk of NPLs, however comprised loan losses, some 61.6% of the impaired assets, whilst substandard and doubtful categories accounted for 15.7% and 22.7% respectively. In the equivalent period last year, loss loans accounted for 39.3%, substandard loans 22.5% and doubtful loans 38.2%. Nevertheless, the NPL position, net of provision to capital recorded a substantial improvement at 13.5% at end May, compared to 28.4% previous. Additionally, loan loss provisions to gross loans ratio recorded a similar improvement, falling from 13.1% to 9.2%. Significantly, NPLs were concentrated in the private sector, some 92% of the total NPLs. In order to tackle the NPL issue, the BoG is advocating greater use of credit bureau information, as part of the process of assessing loan applications, and calling for banks to adopt enhance risk management systems and recoveries. Overall, the



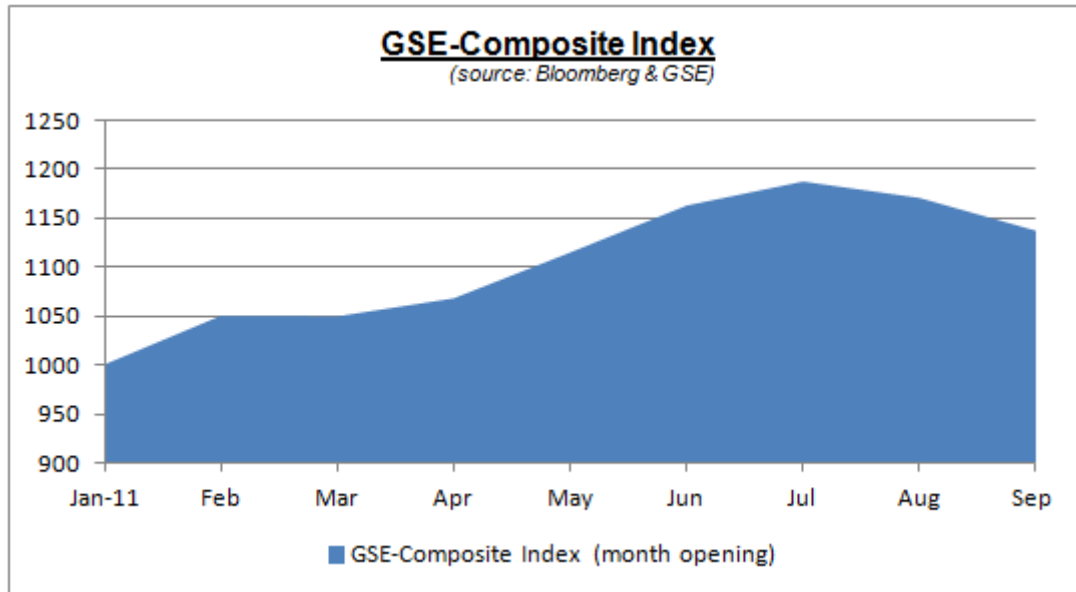
BoG in its most recent comment, has stated that the sector is adequately capitalised, liquid and profitable. While generally, the banking sector aggregate ratios in terms of earnings, portfolio quality, liquidity, and capital adequacy are sound, NPLs remain high and concentrated in some banks and sectors.



Capital Markets

Following the July listing of Tullow Oil, developer of the Jubilee field, the Ghana Stock Exchange (GSE) is now the third largest capital market in sub-Saharan Africa, after South Africa and Nigeria. The GSE composite index has now climbed 14% this year. With Tullow valued at GHS 28.5 bln, their listing raised the GSE's market capitalisation from close to GHS 20 bln to almost GHS 49 bln. However the structure of the Tullow listing, with only 3.5 million shares traded locally, and the bulk, 900 million shares, held internationally by institutional investors, the potential for deepening market liquidity will be only limited. Tullow is not only the first oil company to list on the Ghana Stock Exchange but also the company to have undertaken its all-time largest primary offer on the exchange.

The GSE plans to distribute stock to members before selling shares to the public by 2013, as part of the longer-term plan to open ownership to the public. Demutualization will make the bourse a profit-seeking entity for its shareholders, shares will first be offered to brokerage firms, listed companies and associate members before they are opened to the public. In addition, the bourse will introduce an exchange-traded fund, linked to the price of gold, by the end of the year, as part of the process of repositioning the GSE by bringing new products and instruments to trade.



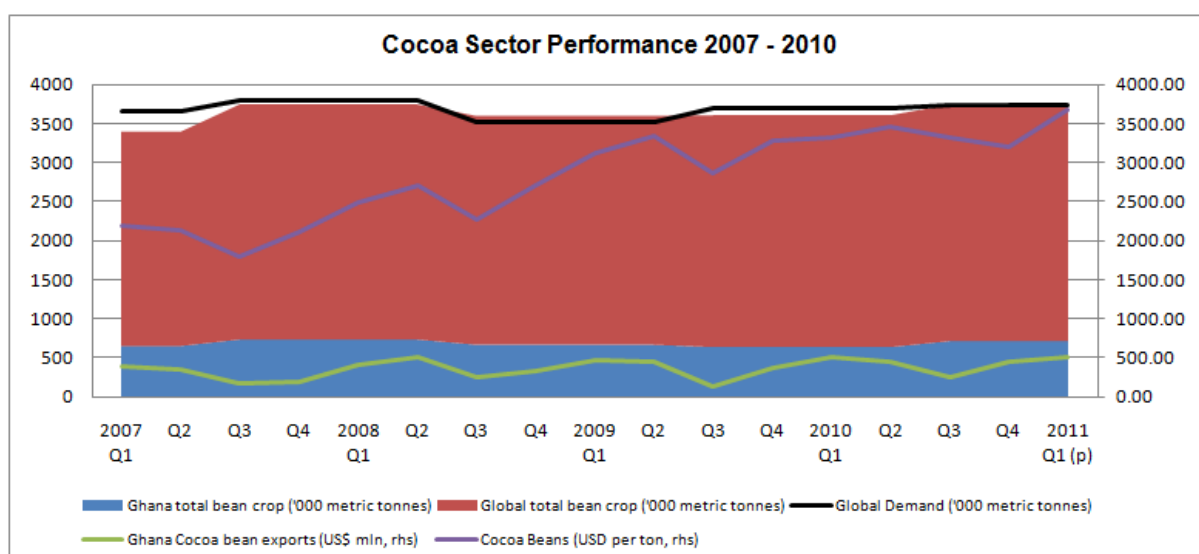
In July, the BoG is offered GHS 300 mln (US\$198 million) of notes due 2016, the first sale of five-year bonds in three and a half years 3 1/2 year on July 28. The West African nation's three-month borrowing costs have retreated to within 10 basis points of the lowest in at least four years as inflation slows.

Gridco, the state-owned power transmission company, is expected tap the markets for the equivalent of US\$230 million this year, with funding raised both locally and internationally for infrastructure investment. It is anticipated that Gridco will receive US\$115 mln from Coface and Societe Generale; US\$70 million from the Korean ExIm Bank; US\$25 million from Standard Chartered; and US\$13 million from Cal Bank of Ghana. While the World Bank is expected to make available a US\$150 mln grant to the agricultural sector – a technical support programme last year boosted the cotton harvest to 50,000 metric tons to compared to previous harvests, when cotton output averaged 5,000 tons a year.



Cocoa

The LIFFE weekly average price opened the year at £2,039.00 per metric tonne, while for the January-June period, the average price was £2,016.4, compared with the average of £2,275.7 over the corresponding period in 2010. The end-June 2010 price of £1,896.00 represented a decline by 21.7% y-o-y. The 2010-11 harvest exceeded 1 mln metric tonnes, according to latest data from the Cocoa Board, and a record according to the ICCO. The harvest was boosted by favourable weather, fertilisers and hybrid plantings, while smuggling from neighbouring countries may have also inflated the country's data. Globally, cocoa production may exceed demand for the current 2010-11 season by more than 350,000 metric tons, with crops in the Ivory Coast and Ghana at record highs. According to the latest data available the Ivory Coast, the world's largest grower, may produce about 1.6 million tons in the current season, while output in Indonesia, the third-largest producer, is forecast to be slightly above 500,000 tons. Collectively West African producers, Ivory Coast, Ghana, Nigeria and Cameroon, account for 68% of global output, which is expected to reach 4.025 million tons in 2010-11, according to the ICCO. The Cocoa Board intends to distribute 20 million free seedlings each year for five years to farmers as it seeks to exceed neighbouring Ivory Coast as the top grower of the chocolate ingredient. It aims to produce between 1.1 mln tons and 1.2 mln tons in the next harvest period.

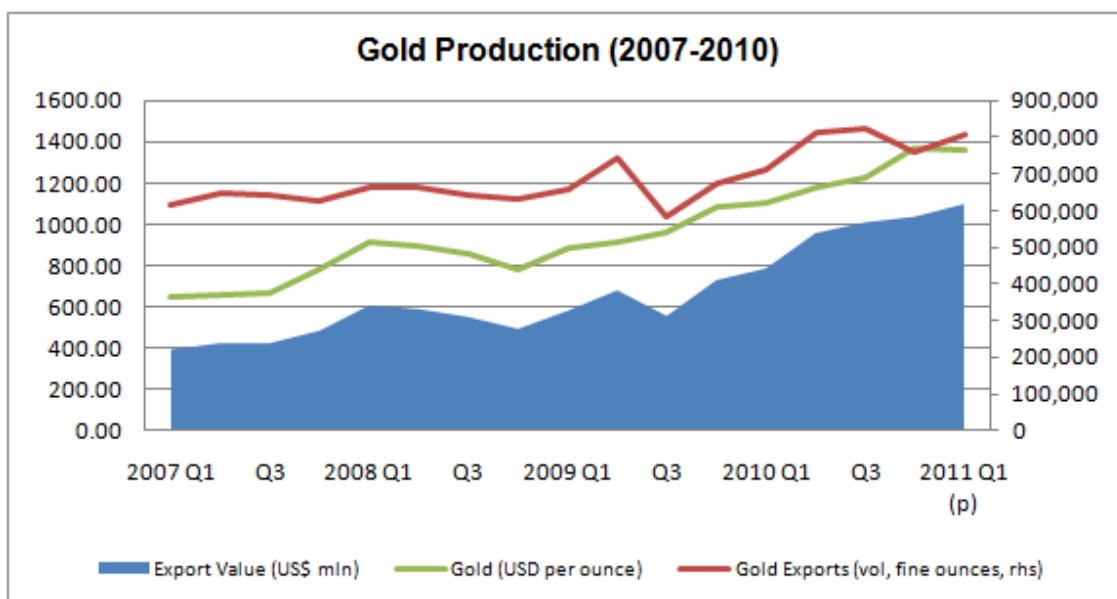


Source: ICCO & Ghana Statistical Service



Gold

Gold prices have remained buoyant in recent months, with continued buying by central banks and strong demand from Asia providing solid support on any pullbacks. The weaker macroeconomic backdrop has also helped, with poor US data putting the US dollar (USD) under downward pressure and raising fresh concerns about a potential further bout of monetary easing. So far this year, gold has outperformed cyclical markets like base metals, reflecting these worries. Over the January–June 2011 period, spot price of gold rallied 8.5 percent from \$1,384.7 to \$1,502.7 per ounce, with some fluctuations being registered over the period. The average weekly price in first half of 2011 was \$1,443.9 per oz, compared with \$1,151.8 in the first half of 2010. While the global gold price has come off recent peaks, it remains at record levels, trading over US\$ 1, 900 per oz in early September. The Chamber of Mines announced that production rose 14% for Q1 2011 compared to the same period last year, to 796.797 ounces, with revenues of \$ 1.19 bln. Gold production for the first half of 2011 hit 1,497,023 ounces, up from 1,455,234 ounces a year earlier, with revenues during the same period jumping to \$2.2 billion from \$1.68 billion. According to the Chamber of Mines, gold production fell by 12% q-o-q in the second quarter to 700,226 ounces from 796,797 ounces in the previous quarter. Standard Bank has signed a US\$60 million 3-year revolving loan with Gold Fields for fleet replacement at its Tarkwa and Abooso mines.



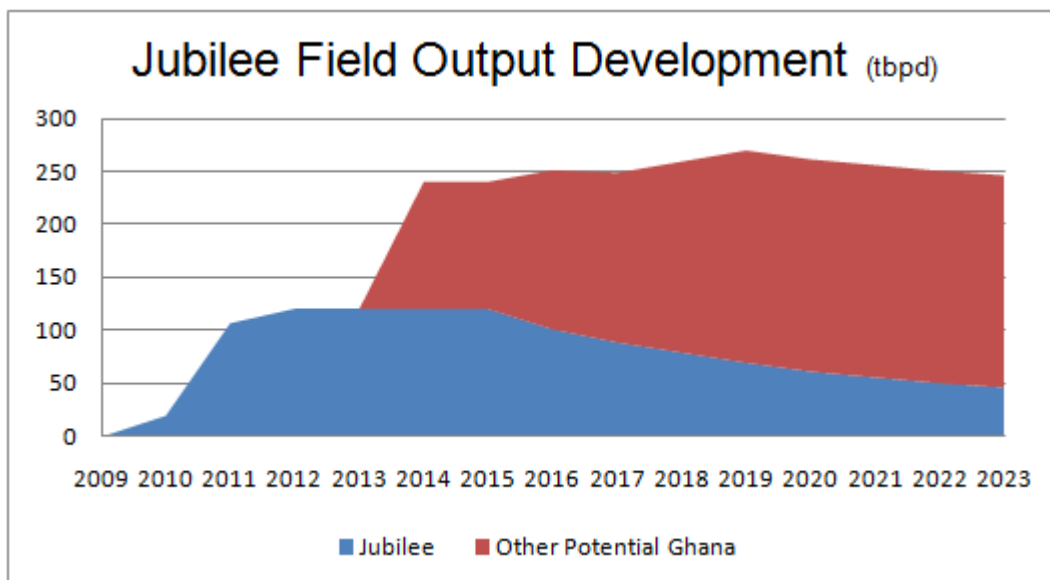


Hydrocarbons

It appears that the government is tightening its policy toward the oil sector, with the suggestion that it may require oil companies to secure official approval for borrowings, if a draft petroleum exploration and production bill is enacted. The requirement is intended to ensure that international oil companies procure only loans that are competitive.

Since becoming the continent's most recent oil exporter last December, oil production from the Jubilee field is expected to increase to 120,000 bpd by the year end. In September, three cargoes of Jubilee crude will be shipped, one more than in August, each shipment equivalent to 950,000 barrels. The Jubilee field is operated by Tullow Oil, producing a crude that is light and sweet, or low sulphur, suitable for the refining into the more profitable fuels such as gasoline and diesel. According to the operators, total output from the field to mid-June reached 10 million barrels.

The sensitivity surrounding development of oil sector, is highlighted by the fact that the opposition has attempted to include amendments to Petroleum legislation that would allocate specific percentages to regions. This was opposed by the government, whose strategy is to develop a Sovereign Wealth Fund.





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