

**MEMORANDUM TO PARLIAMENT**

**BY**

**HON. SETH E. TERKPER  
MINISTER OF FINANCE**

**ON THE INTEREST RATE RISK MANAGEMENT  
TRANSACTIONS**

**15<sup>th</sup> JULY, 2013**

## **1.0 ACTION REQUIRED**

Honorable Members of Parliament are kindly invited to consider and approve the Government's Interest Rate Risk Management Transactions.

Cabinet at its 2<sup>nd</sup> meeting, held on Tuesday, April 2<sup>nd</sup>, 2013 granted approval for this memorandum to be laid before parliament.

## **2.0 BACKGROUND INFORMATION**

Ghana in 2010 officially became a lower middle income country. Paradoxically, our enhanced status comes with two broadly intertwined challenges: the first being the challenge of raising up the level of the country's infrastructure and related amenities commensurate with standards in middle income economies; the second is the decreasing access to concessionary financing making it necessary to use market sources of funding to finance the requisite infrastructural upgrade. Having a borrowing mix more tilted commercially translates into higher interest payments and therefore the need to astutely manage such a risk.

The volatility of interest rates presents a major risk management challenge. As a country firmly anchored on the path of accelerated growth, Ghana faces increased market exposure of its debt portfolios from the country's expanded access to international capital markets as well as business cycle risk often linked to changing global economic climate. The Government's finances could be affected by adverse movements in interest rates. The risk, if not managed properly, could affect the country's smooth operations and potentially put the country under debt stress. A proper debt management framework should therefore be used to insure against shocks to interest rates.

The Government pioneered the adoption of risk management solutions with the Cabinet approval of a Petroleum Price Risk Management Program on March 11, 2010. In the 2012 Budget Statement and Economic Policy, the potential dangers of having a sizeable portion of the country's external debt stock on a floating interest rate basis (at a time when LIBOR rates have begun to rise), was identified. To address this concern, Government indicated its intention to adopt a hedging solution to deal with the problem.

## **3.0. OBJECTIVES OF THE PROPOSED TRANSACTIONS**

MoF desires to hedge against the risk of a hike in 6m USD Libor (floating rates) in order to seek protection from future rises in interest rates. The objective therefore is to take advantage of this current era of historically low interest rates in order to forestall the possibility of having to incur more debt-servicing costs in future.

The programme entails the use of risk management instruments to lock in the interest rates on Ghana's longer-dated external debt stock. Analysis of the GoG's external debt portfolio reveals that at the end of First Quarter 2013, an amount of US\$1,390.28 million representing 14.69 percent of the country's total external debt stock of US\$9, 997.2

million had variable or floating rates of interest. This figure includes a disbursement of US\$192 million under the CDB facility. With the addition of the bulk of the CDB facility, the variable or floating rates component increases to nearly 42 percent. Given that interest rates have been at historic lows since the onset of global financial crises in 2007, the benchmark rates on Ghana's external borrowings been equally low by historical comparison.

However, once global economic conditions strengthen, the consequential impact on the country's debt servicing could be worrisome. There is a high probability that interest rates (e.g. LIBOR) will increase, with serious adverse effects on our debt servicing obligations. Over the past couple of months, interest rates have gone up. Yields on 10-year US Treasury notes have spiked significantly to two-year highs of 2.6pc on (June 24 2013).

Over the lives of the GoG loans in consideration and with inflationary pressures, mounting US fiscal deficit and heightened bank funding concerns, there is a potential likelihood of a further spike in rates going forward. GoG is therefore exposed to upward movements in interest rates.

To address this anticipated problem, Cabinet at its sitting on April 2, 2013 approved a risk management solution. This solution involves converting the interest rates applicable on Ghana's external debt stock from floating to fixed rate liabilities. The instruments available for this purpose are the following:

- ✓ **Swaps** – an agreement between MoF and a counterparty (bank) under which the bank would pay MoF the floating rate on our outstanding loan notional amount in exchange for the fixed rate that MoF is obliged to pay.
- ✓ **Cap**- MoF agrees with a counterparty to set a threshold for floating interest rates (known as "Cap") and so accordingly receives payments at the end of each period in which the interest rate exceeds the threshold. MoF makes an upfront premium payment.
- ✓ **Zero Cost Interest Rate Collar**- here, the floating interest rate payable by MoF is subject to both a **Cap** (an upper limit) and a **Floor** (a lower limit). This is a **zero cost structure**; hence MoF will pay no up-front premium.

#### 4.0. BENEFITS/ JUSTIFICATION

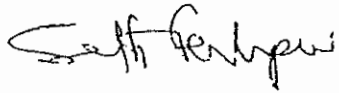
##### BENEFITS

Swapping to fixed rates would give MoF full certainty at the outset on its interest payments by locking in our interest payments and thereby ensure a predictable and sustainable interest payment burden.

#### 5.0. CONCLUSION

Honourable Members are kindly requested to consider and grant approval to the Ministry of Finance to undertake risk management transactions of a notional value of USD 5 billion using

appropriate instruments in order to convert floating rates into fixed rates public debt. The approval, if granted, will be in effect for the next three years.



**HON. SETH E. TERKPER**  
**MINISTER OF FINANCE**

DATED 15<sup>th</sup> July, 2013

In case of reply the number and date of this letter should be quoted.



OFFICE OF THE PRESIDENT

P.O. BOX 1627

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Your Ref. No.....

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REPUBLIC OF GHANA

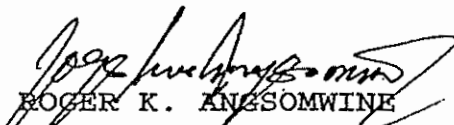
**CONFIDENTIAL**

4<sup>TH</sup> APRIL, 2013

INTEREST RATES RISK MANAGEMENT SOLUTIONS

At its 2<sup>nd</sup> meeting, held on Tuesday, 2<sup>nd</sup> April, 2013 Cabinet considered a memorandum submitted by the Minister for Finance on the above subjects.

2. The memorandum respectfully requested Cabinet to consider and approve the adoption of an Interest Rate Risk Management Programme to be implemented by the Ministry of Finance to cover the country's external debt.
3. After the ensuing discussion, Cabinet granted approval to the request noting that an Executive approval had been granted earlier. It however directed the composition of a Team under the Chair of H.E Vice President to further interrogate issues raised before the memorandum is laid in Parliament.
4. It would be appreciated if you could take necessary action on the decision.

  
ROGER K. ANSOMWINE  
SECRETARY TO THE CABINET

HON. MINISTER FOR FINANCE

cc: Executive Secretary To H.E.  
The President

Secretary To H.E. The Vice  
President

Chief of Staff