Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 25-Jan-2024 | Report No: PID307

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Operation ID	Operation Name	
Ghana	P180719	Ghana Financial Stability Project	
Region WESTERN AND CENTRAL AFRICA	Estimated Appraisal Date 19-Mar-2024	Estimated Approval Date 28-Mar-2024	Practice Area (Lead) Finance, Competitiveness and Innovation
Financing Instrument Investment Project Financing (IPF)	Borrower(s) THE REPUBLIC OF GHANA	Implementing Agency Ministry of Finance	

Proposed Development Objective(s)

To build capital buffers of viable deposit-taking institutions to contribute to financial stability.

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)? Yes

Is this project Private Capital Enabling (PCE)? Yes

SUMMARY

Total Operation Cost	**250.00**
Total Financing	**250.00**
of which IBRD/IDA	**250.00**
Financing Gap	**0.00**

DETAILS

World Bank Group Financing

International Development Association (IDA)	250.00
IDA Shorter Maturity Loan (SML)	250.00

Environmental and Social Risk Classification	Concept Review Decision
Moderate	The review did authorize the preparation to continue

Other Decision (as needed)

B. Introduction and Context

Country Context

1. **In 2022, a confluence of pre-existing vulnerabilities and external shocks brought Ghana into a macroeconomic crisis.** Before the COVID pandemic, Ghana maintained a loose fiscal stance, covered in large part by expensive commercial (external and domestic) debt and made worse by significant energy and financial sector costs. The COVID pandemic and the war in Ukraine, combined with the tightening of global financial conditions, exacerbated these macroeconomic vulnerabilities. In 2022, the combination of tightening financial conditions, rapidly rising debt levels, high inflation, steep depreciation of the exchange rate, and the dwindling foreign international reserves led to a full macro-financial crisis where the country lost access to the Eurobond markets.

2. **The loss of access to the Eurobond market, combined with high levels of uncertainty and loss of investor confidence, led to large capital outflows, which in turn added to the pressures on the exchange rate and created a negative feedback loop with inflation.** Inflation eroded the purchasing power of Ghanian consumers. As the Government of Ghana (GoG) turned increasingly to the domestic financial sector for funding, interest rates became a hindrance for the private sector, and banks built very high levels of exposure to the sovereign. These developments severely curtailed the post COVID-19 economic recovery as growth slowed down to 3.1 percent in 2022. As growth slowed and inflationary pressures continued to build, tax revenues plummeted, and investors began to lose confidence in Ghana's public debt sustainability.

3. **Fiscal pressures forced Ghana to announce a restructuring of its domestic debt.** On December 19, 2022, Ghana announced a moratorium on all official bilateral and commercial external debt repayments and requested debt treatment under the G20 Common Framework to the Paris Club. Additionally, the government started negotiations with commercial creditors and Eurobond holders. On December 5, 2022, Ghana announced the first phase of its Domestic Debt Exchange Programme (DDEP).

4. **Spillover effect on the financial sector emerged as Ghana exchanged its domestic debt, the largest share of which was held by banks**. The first phase of the DDEP covered domestic bonds issued by the government and select SOEs/Special Purpose Vehicles and was completed on February 21, 2023. The total amount exchanged was GHS82.9 billion ($US7.2 billion) or 85 percent of the GHS97.7 billion (US$8.5 billion) eligible bonds. Financial institutions tendered 73 percent of the total exchanged. The second phase was completed in August 2023 and covered locally issued US$ government bonds, cocoa bills issued by the Cocoa Marketing Board (COCOBOD), and bonds held by pension funds. Investors were offered new bonds with lower-coupons and longer maturities. Because banks held material levels of domestic debt on their balance sheets, they recorded large impairments and saw a significant deterioration of their solvency position in 2022.

5. **In this context, urgent policy priorities for the GoG include restoring fiscal and debt sustainability, lifting long-**

term growth, significantly lowering inflation, rebuilding external buffers, buttressing financial sector stability, and the successful conclusion of the GoG's ongoing negotiations with external debt creditors. The authorities have sought support from development partners for this policy agenda.

Sectoral and Institutional Context

6. **The banking system plays a critical role for the functioning of the Ghanaian economy.** With banking assets representing 39 percent of GDP in 2022, the financial sector remains dominated by banks which provide critical services to households, firms, government, and, most importantly, support economic growth. Two thirds of the banking system is composed of foreign-owned banks (with a market share close to two thirds) belonging to international banking groups, including large pan-African banking groups mostly from South Africa, Nigeria, and Togo. The rest of the market is split evenly between privately owned and state-owned domestic banks. Assets of specialized deposit taking institutions (SDIs) account for one percent of GDP. SDIs play an important role as the only institutions often serving low-income households, including in rural areas.

7. **Ghana's debt restructuring has negatively impacted the banking sector.** According to Bank of Ghana (BoG) [1], based on audited financial statements, banks recorded a DDEP-related impairment charge of GHS16.3 billion (US$1.5 billion) in 2022[2] which has eroded capital buffers. However, some banks posted strong profits in 2023, mainly thanks to high interest rate on short-term securities. Once these profits are audited and capitalized, some banks are expected to offset their capital shortfalls by end-2023. Non-performing loans have increased from 14.8 percent in December 2022 to 18.3 percent in October 2023. Nominal credit growth to the private sector slowed dramatically in 2023 amid low demand and banks' reluctance to lend because of high credit risk and efforts to conserve scarce capital.

8. **In consultation with the World Bank and IMF, the authorities developed and approved a Financial Sector Strengthening Strategy (FSSS) to preserve financial stability post-DDEP.** Among others, the FSSS outlines the key features of the Ghana Financial Stability Funding (GFSF), including its mandate, eligibility criteria, and governance; and describes the authorities' approach to resolve non-viable banks. The GFSF is expected to provide solvency and liquidity support to financial institutions impacted by the DDEP, with the goal of mitigating the most severe impacts of the sovereign stress on financial stability. It will be capitalized with GoG resources up to 2.6 percent of GDP (~ GHS22.8 billion or US$2.0 billion) as contemplated in the IMF Extended Credit Facility (ECF) program macro framework.

9. **The GFSF will comprise a solvency window (Fund A) and a liquidity window (Fund B)**. The solvency window (Fund A) is split into Fund A1 and Fund A2. Fund A1 would be capitalized using cash proceeds from this proposed IDA project and will only support eligible viable banks and SDIs. It would provide non-dilutive Additional Tier 1 Capital (AT1) by purchasing capital-eligible debt securities issued by banks and SDIs (alongside injection of new capital by shareholders). Fund A2 will be capitalized by the GoG. It will prioritize the recapitalization of viable banks (through purchase of common equity or preference shares) in which the state has equity interest. Additionally, Fund A2 will be open to support:(i) viable private banks and SDIs that are not eligible to access support from Fund A1; and (ii) systemically important insurance companies and SEC-regulated entities.

Relationship to CPF

10. **The proposed Project is closely aligned with the World Bank Group's (WBG) FY22-26 Country Partnership**

[1] Bank of Ghana. 2023. "Financial Stability Review 2022." https://www.bog.gov.gh/news/financial-stability-review-2022/b

[2] This impairment included GHS12.3 billion (US$1.1. billion) on DDEP phase 1 bonds and GHS4 billion (US$348 million) in on other GoG exposures including cocoa-bills, locally issued US$ bonds, and Eurobonds.

Framework's (CPF), as it strives to balance emergency economic crisis response with creating the conditions for long term resilient recovery. Consistent with the WBG COVID-19 Response Framework, the CPF seeks to support the government in managing the impact of the COVID-19 crisis through preserving critical human capital and capabilities while taking the opportunity to build back better for a dynamic and diversified economy, creating job opportunities for a greener, more resilient, and inclusive society. The three focus areas of the CPF are: (1) Enhancing Conditions for Private Sector Development with Quality Job Growth; (2) Improving Inclusive Service Delivery; and (3) Promoting Sustainable Resilient Development. The proposed Project will support focus area 1 through Pillar 2, via greater financial sector stability, which is critical for objective 1.2 (increased access to finance).

11. **The proposed project is also fully aligned with the WBG's Global Crisis Response Framework and Ghana's Paris Agreement commitments.** As stated in the Framework, "the WBG's objective is to provide mutually re-enforcing support by addressing short-term shocks to improve prospects for long-term sustainable development, while developing long-term resilience to help prepare for future shocks." Pillar II calls for Protecting People and Preserving Jobs to help mitigate the medium- to long-term impact of crises, including through promotion of financial market stability.

C. Proposed Development Objective(s)

12. **To build capital buffers of viable deposit-taking institutions to contribute to financial stability.**

Key Results (From PCN)

13. **Proposed indicators to be used to measure project's achievement of the proposed development objective:**

- Percentage of bank assets held by adequately capitalized banks.
- Percentage of banks adequately capitalized.

D. Concept Description

14. **This proposed US$250-million project would include three complementary components:** (a) Capitalization of Fund A1 of the GFSF (Capital Buffers Scheme); (b) Technical assistance; and (c) Project management, monitoring and evaluation (M&E).

15. **Component 1: Capitalization of Fund A1 of Ghana Financial Stability Fund.** This component would capitalize Fund A1 of the GFSF to strengthen capital positions of viable institutions so that they can support the recovery and withstand possible new shocks. Fund 1 would acquire Additional Tier 1 securities issued by banks and specialized deposit-taking institutions (SDIs). Fund A1 would provide cash to banks and SDIs in exchange for securities that qualify as capital. As a result, Fund A1 would help banks and SDIs meet the minimum capital requirements stipulated by Bank of Ghana (BoG).

16. **Component 2: Technical Assistance.** This component would finance technical assistance to improve BoG's assessment of banking sector risks and inform the development of appropriate remedies, enhance Ghana Deposit Protection Corporation's (GDPC's) preparedness, and build the capacity of BoG, GDPC, and beneficiary financial institutions. Specifically, this component would finance an asset quality review for banks, technical assistance to upgrade the depositor payout system of the GDPC, and the upgrade/establishment of beneficiary banks and SDIs' Environmental and Social Management Systems (ESMSs).

17. **Component 3: Project management, monitoring and evaluation.** Project implementation would be mainstreamed into the institutional structure of the MoF. Thus, the MoF—through its Financial Sector Division (FSD) —

will be the responsible government counterpart and coordinating agency. This component will cover project implementation costs, including the compensation of an Investment Advisor, coordination, procurement, financial management, monitoring and evaluation, and other related costs.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Area OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

18. **The potential environmental risks of the proposed Project are expected to be moderate since the environmental risks are anticipated to be limited and would require awareness-raising and capacity building which is included in the project structure.** The proposed Project – through the GFSF – would provide solvency support to beneficiary banks and SDIs impacted by the DDEP, and ultimately the banks and SDIs will use the funds to support their operations (hold cash reserves, make loans, buy securities, etc.). The environmental risk management of the World Bank will apply to the entire portfolio of beneficiary banks and SDIs, including when banks and SDIs support individuals or MSMEs borrowers in sectors like agriculture, manufacturing, and services. These borrowers' operations might directly or indirectly impact the environment, with risks including land and forest degradation, habitat destruction, destruction and threat to native biodiversity, soil and water pollution and poisoning of non-target organisms associated with the use of pesticides. Specific concerns include the use of agrochemicals in agriculture and pollution from manufacturing processes, highlighting the need for effective risk management and environmental protection measures.

19. **The potential social risks of the proposed Project are expected to be moderate since the risks are anticipated to be limited and would require awareness-raising and capacity building which is expected to be provided under through this Project.** Given that borrowers of the beneficiary banks and SDIs are mostly individuals and MSMEs engaged in sectors such as agriculture, wholesale/retail, manufacturing, and services, the proposed Project could potentially generate various social risks based on their operations. These risks include displacement of communities, labor issues like poor working conditions and exploitation, child labor, health hazards due to inadequate safety measures, conflicts over resource access, and impacts on cultural heritage. The Project also risks exacerbating gender and income inequalities, as well as poor inclusion, if economic benefits are unevenly distributed. The country's weak grievance management systems need strengthening, particularly for handling sensitive issues like sexual exploitation and abuse (SEA), sexual harassment (SEA/SH), and child labor cases. Furthermore, the proposed Project could significantly impact food security in local areas. These challenges necessitate effective management strategies to mitigate potential negative social impacts.

20. **The integration of environmental and social risk management measures into the activities of the MoF and beneficiaries of Fund A1 will be governed by ESS9.** ESS9 requires that MoF and the beneficiary financial institutions, establish and maintain effective environmental and social policies, systems, procedure, and capacity for assessing, managing, and monitoring risks and impacts of subprojects, as well as managing overall portfolio risk in a responsible manner, through an ESMS. The ESMSs will include: (i) an environmental and social policy; (ii) clearly defined procedures for the identification, assessment and management of the environmental and social risks and impacts of sub-projects;

(iii) organizational capacity and competency; (iv) monitoring and review of environmental and social risks of banks and SDIs and their portfolios; and (v) external communications mechanism.

21. **The MoF has prepared a draft Environmental and Social Commitment Plan (ESCP).** The final ESCP will be cleared by the World Bank and will be disclosed prior to appraisal.

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APPROVAL

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