GHANA ASSOCIATION OF BANKS

POLICY BRIEF

Tiered CRR Review: Banking and Economic Implications

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TIERED CRR REVIEW: BANKING AND ECONOMIC IMPLICATIONS

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Introduction

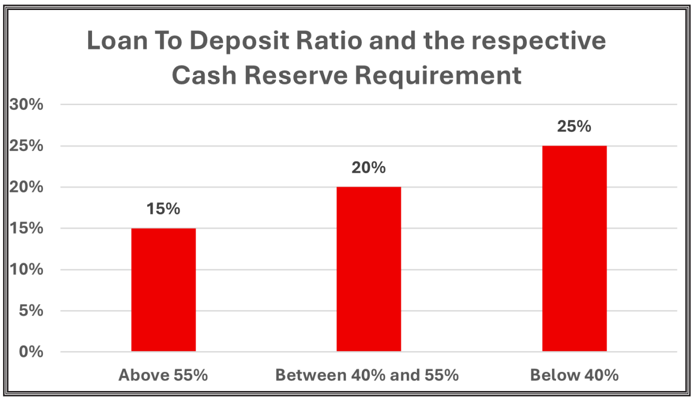
The Cash Reserve Ratio (CRR) has long served as a vital monetary policy instrument for the Bank of Ghana (BoG), playing a central role in liquidity management, money supply and the stabilization of the financial sector and general price level. Over time, the CRR has been modified in response to shifting economic landscape and emerging challenges.

In more recent years, the CRR has been adjusted to tackle inflation and liquidity challenges. In September 2022, the BoG announced a phased increase from 12% to 15%, executed in three stages: 13% in September, 14% in October, and 15% in November. However, in December 2022, the CRR was reduced to 12% as part of measures to cushion banks during the domestic debt exchange program. By April 2023, the BoG reset the CRR to 14% to manage excess liquidity while supporting economic recovery.

The key objective for the increase in the CRR was to mop-up excess liquidity within the banking system by deploying it as an inflation targeting tool. Over the period of its implementation, inflationary pressures have persisted, and the targeted inflation rate was missed by a wide margin. The policy does not do much to mop up liquidity in the informal sector, hence the failure to significantly impact inflation.

In April 2024, the BoG implemented a tiered CRR regime, whereby banks with higher loan-to-deposit (L/D) ratios are subject to lower reserve requirements, whereas banks with lower L/D ratios must maintain higher reserves.This structure was devised to mitigate inflationary pressures while simultaneously encouraging banks to increase the expansion of credit to the private sector - an essential driver of economic growth and employment. Though the aforesaid policy position was strategic, it creates a complex dilemma for banks; it is either they continue to lend in a highly risky environment, which is reflected in the high non-performing loan profile of the industry, currently at 21.8%, or choose to uncomfortably remain reluctant in extending credit, leading to low loan to deposit ratio, and its attendant cost in the form of high cash reserve ratio.

Loan to Deposit Ratio	Cash Reserve Requirement
Above 55%	15%
Between 40% and 55%	20%
Below 40%	25%



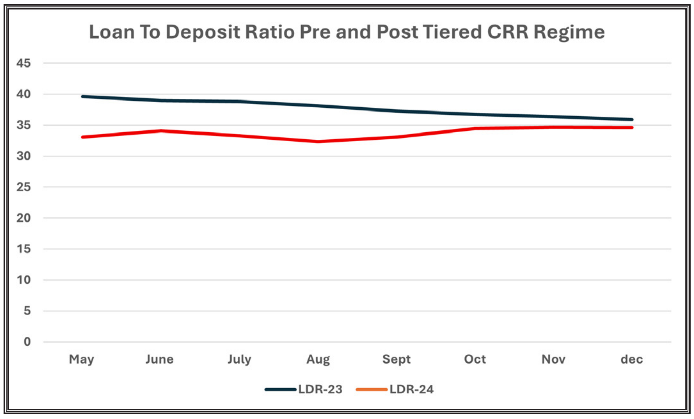
Source: Bank of Ghana, Monetary policy press release, March 2024

The tiered CRR regime, by design, mandates that a larger proportion of bank deposits be held in noninterest-bearing reserve accounts since the credit risk exposure remains high. This practice not only restricts banks' capacity to engage in alternative, potentially more profitable investment activities but also exerts downward pressure on overall profitability and unduly increases the cost of banking services. Funds sequestered in reserve accounts do not generate returns, thereby limiting the banks' ability to reinvest in growth-oriented or revenue-generating opportunities. The consequent reduction in profitability further disincentivizes banks from pursuing aggressive lending strategies.

Striking a great balance between thinning profitability margins and erosion of asset quality ends of this dilemma remains a headache for the industry that would require collaborative effort in finding innovative solutions underscored by a strong case to the regulator for a review, to bolster growth in credit to the private sector, while the banking sector remains sound, resilient and profitable. In tandem, the following discussion provides a comprehensive review of the tiered CRR regime, its effectiveness in influencing loan to deposit ratio, and the challenges it faces, culminating in policy recommendations for a more robust credit-enhancement framework.

Assessment of the Tiered CRR Regime

In this paper, a critical analysis is made on how effective this regime has been in influencing lending by banks to the private sector. In attempt, a month-to-month comparison of the loan to deposit ratio of the banking industry before and after the implementation of tiered CRR regime has been accessed and analyzed. A month-on-month comparison, over a 10-month period, reveals that the average loan-to-deposit ratio was notably higher prior to the implementation of the tiered CRR regime than in the subsequent period.

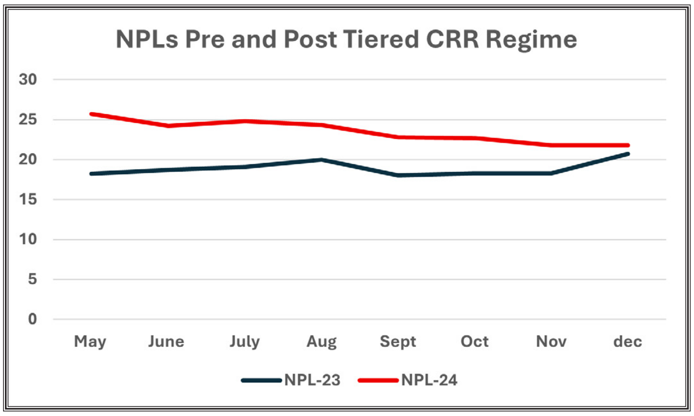


Source: Bank of Ghana, Summary of Economic and Financial Data, January 2024 & 2025

This finding suggests that the anticipated boost in lending activity has not materialized as expected. Several interrelated factors could contribute to this underperformance. This includes,

Elevated Non-Performing Loan (NPL) Ratios

Banks in Ghana have experienced persistently high levels of non-performing loans, which have significantly heightened risk aversion. Currently, the NPL of the industry remains significantly high at 21.8% as reported in the summary of financial and Economic data released by the Bank of Ghana in January 2025. This elevated NPL ratio compels banks to exercise caution, often leading them to limit their lending activities regardless of the CRR regime.

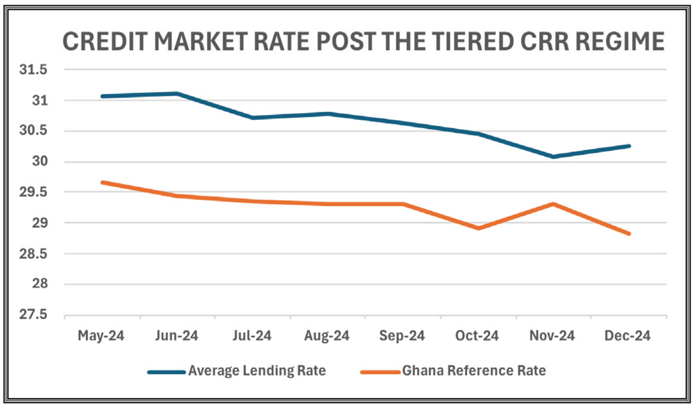


Source: Bank of Ghana, Summary of Economic and Financial Data, January 2024 & 2025

The inherent risk associated with high NPLs undermines the incentive for banks to exploit lower reserve requirements, as the potential returns on new loans are clouded by the increased probability of default.

High Cost of Borrowing

Despite the regulatory modifications, the prevailing environment of elevated lending rates continues to stifle credit demand. With the Ghana Reference rate significantly high, currently at 29.96%, we have seen the average lending rate also remain significantly high for both businesses and individual borrowers. As observed, the price of credit is a key factor in determining its demand, high borrowing costs diminishes the attractiveness of taking on new loans, as potential borrowers are deterred by the steep interest obligations. Even though banks are willing to



Source: Bank of Ghana, Summary of Economic and Financial Data, January 2024

extend credit as part of their core functions, the high cost of credit remains a deterrent to the demand side.

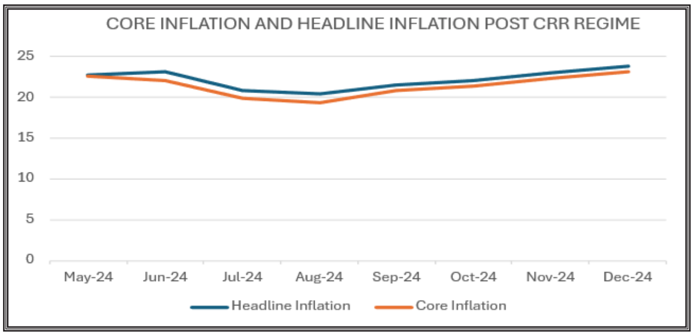
Consequently, even though the tiered CRR regime is intended to promote increased lending, the high cost of capital effectively neutralizes its stimulatory impact.

Lack of reliable and well-integrated credit information access system

This cautious stance is largely driven by concerns over credit risk and the potential for increased NPLs. The non-existence of credit status verifying integrated systems (other than the credit reference bureau) to easily identify good credit risk in the market makes it difficult for the banking industry to make informed risk adjusted lending decisions. This issue of asymmetrical information remains a significant challenge, posing a high risk of adverse selection in the banking space. This is largely data availability and integration issue that would require relentless but collaborative effort. Therefore, in spite of the size of liquidity in the system, deployment into productive credit remains a challenge due to these underlying risk considerations.

Inflation Remains Significantly high

Inflation remains significant post the tiered CRR regime, despite control of inflationary pressures being a key policy objective for the increase in CRR. Headline Inflation fluctuates, starting at 22.8% in May 2024, dropping to a low of 20.4% in August, and then rising again to 23.8% in December in the same year. This suggests a period of temporary price stability followed by renewed inflationary pressures.



Source: Bank of Ghana, Database portal

Core Inflation, which excludes volatile price components, follows a similar pattern, declining from 22.6% in May 2024 to 19.4% in August, before increasing to 23.1% in December of the same year. The resurgence in core inflation signals underlying price pressures remain strong.

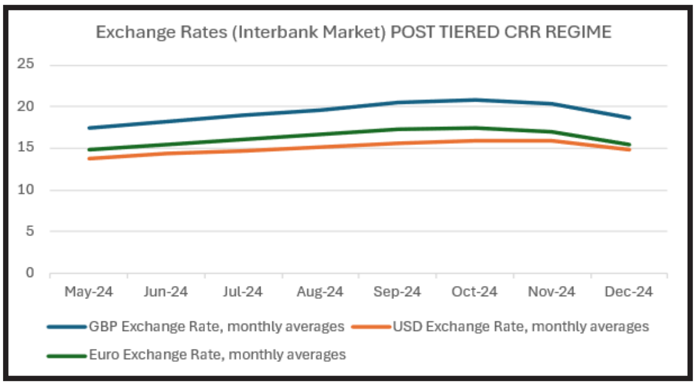
Implications for Credit Risk

Rising Credit Risk:

The rebound in inflation increases the cost of living and operational expenses for businesses and households, potentially reducing borrowers' ability to service debt. This raises the risk of loan defaults.

Continuous Depreciation of the Cedi against major trading currencies:

The depreciation of the Ghanaian cedi remains a significant economic challenge. In 2024, the Ghanaian cedi experienced significant depreciation against major currencies, including the US dollar, British pound, and the Euro. From January to November, the



Source: Bank of Ghana, Database portal cedi depreciated by 34% against the US dollar, while its value against the British pound and euro declined by 23.6% and 33.9%, respectively."

Inflationary Impact on Borrowers:

A weaker cedi raises import costs, fueling inflation and reducing disposable income, which can lead to higher loan defaults. Moreover, exchange rate instability may force banks to tighten lending policies, increasing borrowing costs and reducing credit availability. While the late-year recovery signals stabilization efforts, the overall depreciation heightens credit risks, necessitating stronger monetary and fiscal policies to ensure financial stability. As of the end of 2024, the exchange rate of the cedi against major trading currencies stood at 18.6876 per British pound, 14.7805 per US dollar, and 15.4741 per euro. By 25th of February 2025, these rates had increased marginally to 19.6726, 15.53, and 16.31, respectively, reflecting a depreciation of 5.01% against the British pound, 4.83% against the US dollar, and 5.17% against the euro. This moderate decline in the cedi's performance underscores the need for sustained macroprudential policies to enhance exchange rate stability and mitigate further depreciation

Policy Recommendations

Considering the challenges identified, it is imperative that the BoG reconsiders the current tiered CRR framework while multifaceted collaborative approach is adopted to address these structural impediments and stimulate sustainable lending growth. Below are some suggested innovative approaches that would help address challenges hindering credit expansion as identified.

Enhancing Risk Management Measures to address High NPL Ratios

Banks should implement robust measures to address non-performing loans, including the development of more sophisticated credit risk assessment tools, and stringent enforcement of loan recovery processes by calling on our judicial systems to highly consider implementing special legal provisions to support loan default and recovery cases. These initiatives would help reduce the overall NPL ratio and restore confidence in the lending environment. The regulator should encourage investments in predictive credit score platforms (like MyCreditscore which was launched recently) to serve as effective guides towards concrete risk profiling of borrowers

Reducing the Cost of Borrowing in Ghana Through Coordinated Monetary and Fiscal Policies

From a fiscal policy perspective, the government must work to comply with current IMF measures to contain budget deficits within agreed targets, as excessive domestic borrowing crowds out private sector credit and drives up interest rates. The central bank must continue to develop and implement innovative measures to drive inflation downwards, more importantly toward the optimum in the medium term. Moreover, effort to significantly stabilize and improve the performance of the Ghanaian cedi against its major trading currencies would be laudable, and that will collectively lead to further monetary policy easing which would automatically feed into the credit market rates.

Establishing and Enhancing Partial Credit Guarantee Schemes

A collective call on the government to enhance the capacity and operational efficiency of GIRSAL will catalyze increase lending to the Ghanaian agriculture sector. By design, GIRSAL credit risk guarantee scheme is meant to provide participating financial institutions with up to 70% credit risk guarantee on agricultural loans. This provides a safety net for banks, particularly when lending to small and medium-sized enterprises (SMEs) in our agriculture sector with high growth potential but limited credit. By mitigating the risk of default and depoliticizing the scheme can encourage banks to extend credit more freely as they would always wish.

Moreover, introducing and establishing a similar scheme in light manufacturing to substitute imports and other critical sectors will be a step in the right direction.

Strengthening Credit Infrastructure

Improved Credit Reporting and Collateral Systems through collaborative efforts to invest in the enhancement of credit reporting systems and the modernization and expansion of the collateral registration frameworks will help reduce information asymmetry and enhance the recoverability of loans, thereby bolstering the overall health of the banking sector. Moreover, leveraging the Ghana identification card penetration and efforts to integrate information across various sectors of the economy will provide and enhance the availability credit information on potential borrowers which will facilitate lending decisions by the banks.

Reassessing the CRR Structure by implementing Uniform and Flexible CRR Framework:

It is highly suggested that the Bank of Ghana should consider reverting to a uniform CRR structure or developing a more flexible system that does not unduly penalize banks. A good starting point could be immediate reversion of CRR to reserve in currency -for-currency to be followed by gradual reduction in the CRR percentage to prudential confines. Such a recalibration would realign regulatory incentives with the operational realities of the banking sector, fostering a more conducive environment for voluntary credit expansion.

Exploring complementary financing options for critical sectors

The growing need for affordable and sustainable financing in Ghana calls for the adoption of alternative financing mechanisms such as green bonds, corporate bonds, and Islamic finance to complement conventional banking. Enhancing financial inclusion and supporting critical sectors such as infrastructure, energy, and agriculture, these financing options present viable solutions

Conclusion

The tiered CRR regime was introduced with the laudable objective of managing inflationary pressures while promoting private sector lending. However, empirical evidence suggests that the regime has not succeeded in enhancing lending activity, primarily due to structural challenges such as high NPL ratios, elevated borrowing costs, and constrained investment capacities. To achieve a more robust credit environment, it is essential for the BoG to reconsider the tiered CRR framework and adopt a more nuanced set of policies that address these underlying issues. By recalibrating the cash reserve requirement structure, enhancing risk management practices, making efforts to reduce the cost of borrowing, and bolstering credit infrastructure, Ghana can pave the way for a more dynamic and sustainable banking sector that effectively supports economic growth and employment through effective credit allocation to the private sector.

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