

## Monetary Policy, Exchange Rate Stability, and the Lessons from Ghana's 2025 Rebound

Ghana's economy experienced a notable rebound in 2025, supported by multiple indicators of macroeconomic stability. Inflation declined sharply and the cedi recorded one of its strongest performances in recent history. Yet public discussion has focused overwhelmingly on the exchange rate. This is understandably so, because the exchange rate is the macroeconomic variable most immediately felt and most easily related to by Ghanaians, especially in an economy that depends heavily on imported goods and services.

While several factors contributed to the appreciation of the cedi, including a more accommodative monetary policy stance in advanced economies, favorable terms of trade driven by high gold prices, and Ghana's domestic gold purchase initiatives, **this policy note argues that the dominant drivers of both inflation and exchange rate performance in 2025 were domestic monetary policy decisions. In this regard, the Bank of Ghana (BoG) had the final say.**

The central lesson from 2025 is therefore not whether the Bank of Ghana can stabilize inflation and the exchange rate, but whether it is willing to deploy its tools decisively and consistently. On this score, the experience of 2025 has renewed confidence in the effectiveness of monetary policy in Ghana.

### Inflation and the Exchange Rate: Monetary Policy Outcomes, Not Accidents

The two macroeconomic variables dominating public discourse, inflation and the exchange rate, are not exogenous outcomes. They are explicit (in the case of inflation) and implicit (exchange rate) targets of monetary policy, shaped by deliberate policy actions.

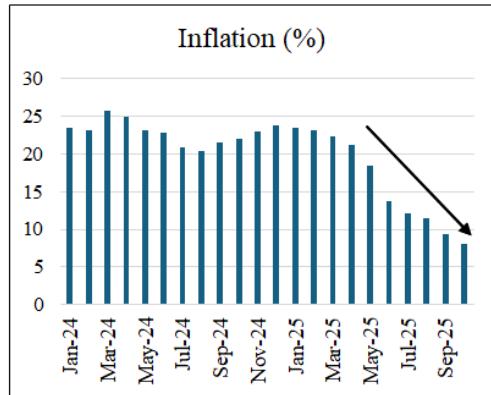
Figure 1 places this relationship in sharp focus. Inflation (Panel A) declined steadily through 2025, while the cedi shifted decisively from depreciation to appreciation beginning around May 2025 (Panel B). At the same time, policy variables moved forcefully in the background: growth in total liquidity (M2+) slowed sharply (Panel C), and commercial banks' reserves with the Bank of Ghana contracted significantly (Panel D).

These patterns are not coincidental. They reflect a clear tightening of monetary conditions.

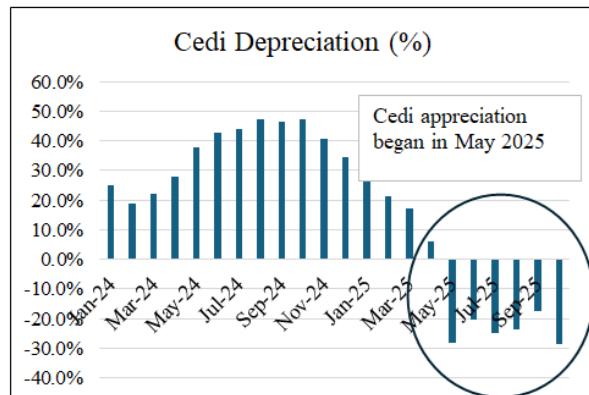
Figure 2 reinforces this point by directly linking the exchange rate to banks' reserves at the central bank. The sharp appreciation of the cedi, from about 15.8 cedis per dollar in early 2025 to around 10.8 by May, coincided precisely with a collapse in the growth rate of reserves held at the Bank of Ghana. In other words, as cedi liquidity was withdrawn from the system, pressure on the foreign exchange market eased and the currency strengthened.

### Macroeconomic Outcomes

Panel A: Annual Inflation

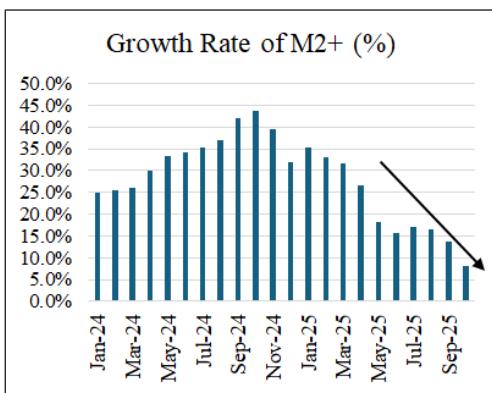


Panel B: YoY Cedi Depreciation

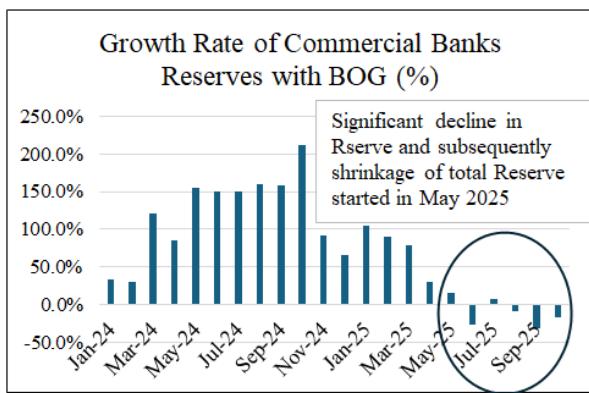


### Policy Variables

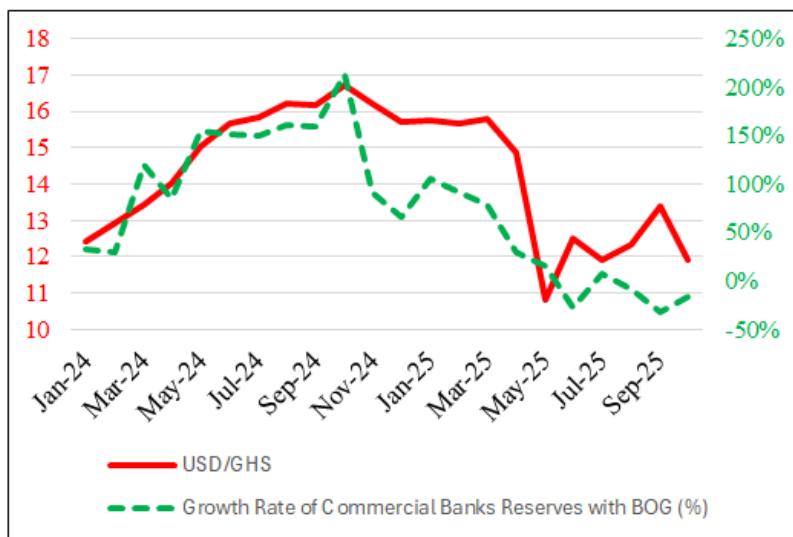
Panel C: Annual Growth Rate of Total Liquidity



Panel D: Annual Growth Rate of Reserves



**Figure 1: Compares the two key monetary policy outcomes to the main monetary policy variables.** The figure shows that the sharp appreciation of the cedi from around May 2025 coincided with a marked tightening of liquidity. As Panels C and D indicate, growth in total liquidity ( $M2+$ ) and commercial banks' reserves with the Bank of Ghana declined significantly during this period. This contraction in cedi liquidity reduced private demand for foreign exchange, reinforcing disinflation (Panel A) and driving the observed shift from cedi depreciation to appreciation (Panel B).



**Figure 2: Compares the Exchange Rate to the Growth Rate of Commercial Banks Reserves with Bank of Ghana:** The figure shows that the Exchange rate moved from 15.77 Cedis per Dollar in March 2025 to 10.83 Cedis per Dollar in May 2025. This coincided with the sharp decline in growth rate of Reserve held at the Bank of Ghana. Beginning from an annual growth rate of 78% in March 2025 to 30% in April and 15.6% in May before finally shrinking by 26.9% in June 2025.

## Why Monetary Policy Is Central: Theory Meets Evidence

This interpretation is firmly grounded in macroeconomic theory.

In the short run, exchange rates are explained by the financial asset approach, where monetary policy affects interest rates, portfolio choices, and capital flows under conditions of sticky prices. In the long run, exchange rates are governed by Purchasing Power Parity (PPP) and the Quantity Theory of Money, where relative money supplies and inflation differentials determine currency values.

Given Ghana's history of volatile inflation, the long-run framework is particularly instructive. According to PPP, if inflation in Ghana falls relative to inflation in the United States, the cedi should appreciate. Under the Quantity Theory of Money, this disinflation is achieved by reducing the growth of money in circulation.

This is exactly what occurred in 2025.

Figures 1 and 2 show a clear monetary contraction: liquidity growth slowed dramatically, reserves were drawn down, and inflation fell in tandem with exchange rate appreciation. With U.S. inflation broadly stable, the narrowing inflation differential favored cedi appreciation, precisely as theory predicts. While external factors and commodity prices may have supported this process, the dominant force was domestic monetary tightening.

## On the Criticism of “USD Injection” by the Bank of Ghana

In recent weeks, the Bank of Ghana has faced criticism for “pumping USD 10 billion” into the economy to stabilize the exchange rate. Critics argue that such actions are inefficient, unsustainable, and a misuse of scarce foreign reserves.

I respectfully disagree.

First, this is exactly what monetary policy tools are designed to do. In the long run, monetary policy cannot raise real output, but it can stabilize prices and the exchange rate. That stability is not an end in itself. It is the foundation upon which fiscal policy, investment, and structural reforms can operate effectively.

Second, the claim that the effects of such interventions are necessarily temporary misunderstands the mechanics of exchange rate intervention.

If dollar sales are accompanied by the reinjection of cedis through domestic asset purchases what (economists call sterilized intervention) then the exchange rate effects will indeed be short-lived. But the data from 2025 suggest the opposite. The Bank of Ghana did not re-expand liquidity following its FX operations. Instead, total money in circulation declined, compressing excess demand for foreign currency. This is unsterilized exchange rate intervention, and both theory and evidence show that it can have lasting effects on the exchange rate. Figures 1 and 2 clearly demonstrate this mechanism at work in Ghana.

## Conclusion: The Real Lesson from 2025

The experience of 2025 delivers a powerful message.

Many factors influence inflation and exchange rates, but monetary policy remains the decisive force. The Bank of Ghana’s actions — tightening liquidity, anchoring expectations, and allowing monetary conditions to bite — were central to Ghana’s macroeconomic stabilization.

Finally, if one is looking for an early warning signal of whether — and when — the exchange rate may return to episodes of sharp and disorderly depreciation, the key variable to monitor is not external shocks or speculative narratives, but a policy variable fully under the control of the Bank of Ghana: commercial banks’ reserves held at the Bank of Ghana.

The experience of 2025 shows that exchange rate stability coincided with the contraction or modest growth of bank reserves at the central bank. As long as reserves held with the Bank of Ghana are shrinking or growing only moderately, pressure on the foreign exchange market remains contained. However, if the growth rate of these reserves were to reverse course —returning to the 50 percent to triple-digit annual growth rates observed in earlier years — this would signal a renewed surge in cedi liquidity. History suggests that such an expansion would quickly translate into excess demand for foreign currency and a renewed phase of sharp cedi depreciation.

The discipline and decisiveness with which the Bank of Ghana deployed its monetary policy tools in 2025 deserve commendation. Going forward, sustaining exchange rate and price stability will depend on the Bank's continued resolve to use these tools decisively to achieve its desired macroeconomic outcomes.

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