Rethinking African Economic Policy in Light of the Global Economic and Financial Crisis Conference

Global Economic and Financial Crisis: Transmission Channels and Impacts on Sub-Saharan African Economies

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Abstract

In the last decade, sub-Saharan Africa has made remarkable gains in promoting growth with economic stability. Real GDP growth averaged 5.9 percent over the past five years; inflation had fallen to single-digit levels before the fuel and food prices shock of 2008 and reserves were accumulated. However, with the outbreak of the financial and economic crisis in advanced economies, will these hard-won economic gains in the region be threatened? In this paper, I will provide an overview of how sub-Saharan African countries are exposed to the crisis through both financial and real transmission channels, and critically assess the impacts on different economies with recent data. The first part of this paper gives an overview of the recent economic development of sub-Saharan African countries, and a brief discussion of the origin and development of the crisis. I then proceed to the financial transmission channels and impacts on sub-Saharan African countries. Since the financial systems in the region are so heterogeneous that their exposure to the crisis varies greatly, my focus is more on highlighting those countries being mostly affected by a particular channel. The third section of the paper discusses the spillover effects of the crisis from the financial sector to the real sector. The impacts of real transmission channels on different economies will also be evaluated. The final section concludes on the impacts brought by the different transmission channels and also provides an economic outlook for sub-Saharan Africa.

1. Introduction

The global economic and financial crisis that started with the bursting of the housing bubble in the United States led to general concern about credit quality in the advanced economies, unanticipated contagion to other financial assets and a sharp retrenchment of credit. The crisis affected advanced economies, emerging markets and low-income countries in very different ways. Advanced economies were first hit mainly by the systemic banking crisis in the United States and Europe. Emerging markets with well-developed financial systems were initially mostly affected by cross-border financial linkages through capital flows and exchange rates. In financially developing countries in which most of the sub Saharan African countries belong to, the effects on real economies such as trade and workers' remittances dominated.

In the last decade sub-Saharan Africa has made remarkable gains in promoting growth with economic stability. Real GDP growth averaged 5.9 percent over the past five years; inflation had fallen to single-digit levels before the fuel and food prices shock of 2008 and reserves were accumulated. These positive developments relied on effective economic policies, a favourable external environment, debt relief and foreign aid. However, these hard-won economic gains are being threatened. Relatively weak financial linkages with advanced economies have not shielded African countries from the global economic storm. Demand for African exports has fallen, commodity prices have declined and workers' remittance flows are weakening. The tightening of global credit conditions is reducing foreign direct investment (FDI) and reversing portfolio flows, making trade finance more costly. The economic slowdown also increases credit risk and non-performing assets, weakening the balance sheets of financial institutions and corporations.

In the following sections, I will provide an overview of how sub-Saharan African countries are exposed to the crisis through both financial and real transmission channels, and critically assess the impacts on different economies with recent data. Since the financial systems in the region are so heterogeneous that their exposure to the crisis varies greatly, my focus is more on highlighting those countries being mostly affected by a particular channel.

2. Financial transmission channels and impacts on sub-Saharan African economies

Financial systems in sub-Saharan African countries have so far been resilient to the global economic and financial crisis. Although the crisis has exerted significant pressure on capital, foreign exchange and money markets and financial institutions, they have continued to function properly without emergency support from monetary authorities. The relative stability is due to the limited integration with global financial markets, minimal exposure to complex financial instruments, relatively high liquidity in banking systems, limited reliance on foreign funding, low leverage in financial institutions and strict controls of banking regulations and foreign exchange.

However, pressures have intensified and sub-Saharan African countries are being hard hit as the global crisis has deepened and broadened. There are a number of important channels through which the crisis might affect these countries. They include effects through financial markets (equity markets, bonds markets, foreign exchange markets and money markets), banking sector and non-bank financial institutions, portfolio inflows and foreign direct investment.

Financial markets

Sub-Saharan African countries are so heterogeneous that their exposure to the crisis varies greatly. In terms of financial depth and the degree of capital and financial market development, there are three distinct groups. These are:

- "emerging market" group which only consists of South Africa. It is vulnerable to changes in market sentiments and to contagion and hence subject to potential pressures in financial markets despite her strengthened supervision of banks and enhanced risk management. Pressure in South Africa's financial system could also have implications since several of its financial institutions (banks and insurance companies) have operations elsewhere in the region.

- "frontier market" group consists of 12 countries[1]. They have relatively limited integration of financial systems with global markets, small size of financial systems and weak linkages within the system. All these suggest that financial stress might be localized or spread more slowly. Foreign investors account for a relatively small share of local debt and equity market in those countries. However, given that the markets are relatively shallow, any changes in foreign investor sentiment might exert pressure on their debt, equity, currency and money markets.

- "financially developing" group consist of other 31 sub-Saharan African countries which have a narrow range of financial institutions in relatively small size and limited access of credit[2]. For these countries, the direct impact of the crisis is limited. The crisis is likely to arrive through other real channels.

Equity markets

After yielding double digit returns over two years, the equity markets across the region experienced a sharp correction in the wake of the Lehman Brothers collapse (Figure 1). Stocks indices for Botswana, Kenya, Namibia, Nigeria, South Africa, Uganda and Zambia registered large declines in dollar terms in 2008 and only three markets (Ghana, Malawi and Tanzania) closed in 2008 with positive returns. For some countries like Kenya and Nigeria, the stock market decline was complicated by their domestic factors.

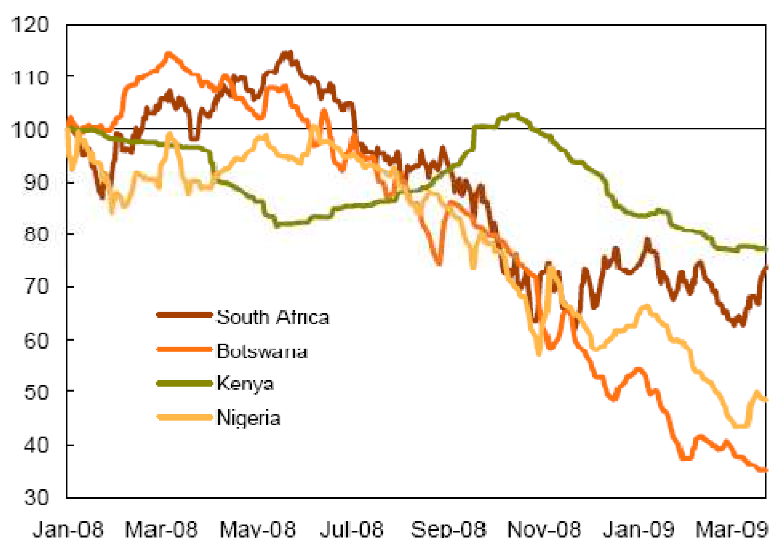
The impact of the stock market declines on the financial system and on wealth has been limited, largely because of the relatively small size of stock markets and the prudent regulations which limit the direct exposure of banks to equities. Only a few countries including Kenya, Nigeria, South Africa and Uganda that the banking sectors have been affected by the stock market declines. The impact has been more pronounced in Nigeria, where banks increased their reliance

[1] Frontier market countries include Botswana, Cape Verde, Mauritius, Namibia, Seychelles, Ghana, Kenya, Mozambique, Nigeria, Tanzania, Uganda and Zambia.

[2] Financially developing countries include Angola, Benin, Burkina Faso, Burundi, Cameroon, Central African Republic, Chad, Comoros, Congo, Dem. Rep. of, Congo, Rep. of, Côte d'Ivoire, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Gambia, Guinea, Guinea-Bissau, Lesotho, Liberia, Madagascar, Malawi, Mali, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Swaziland, Togo, Zimbabwe.

on equity markets to raise capital and engaged in lending for share purchase. The poor performance of equity markets might slow the expansion plans of Nigerian banks. The impact has been modest in Kenya and Uganda, where some banks reported balance sheet losses due to nonperforming loans associated with the practice of lending for stock purchases. In South Africa, two banks reported losses due to the inability of some investors to meet margin calls on equity derivatives. The unfavourable performance of equity markets might also undermine the performance of large domestic institutional investors like pension funds and life insurance companies.

Figure1: Selected African countries: stock market index, (Jan 1, 2008 = 100)



Source: Bloomberg

Bonds Markets

The bonds markets of several sub-Saharan African countries came under intense pressure as the liquidity in global credit markets declined. Nigeria, South Africa, Uganda and Zambia registered significant outflows from their domestic debt markets. Unfavourable capital market condition has led several countries to postpone their bond issuance plans (Table 1). South Africa, although not heavily relying on international borrowing, is affected by the increase in sovereign spreads, reflecting investor liquidity needs and flights to higher quality assets (Figure 2).

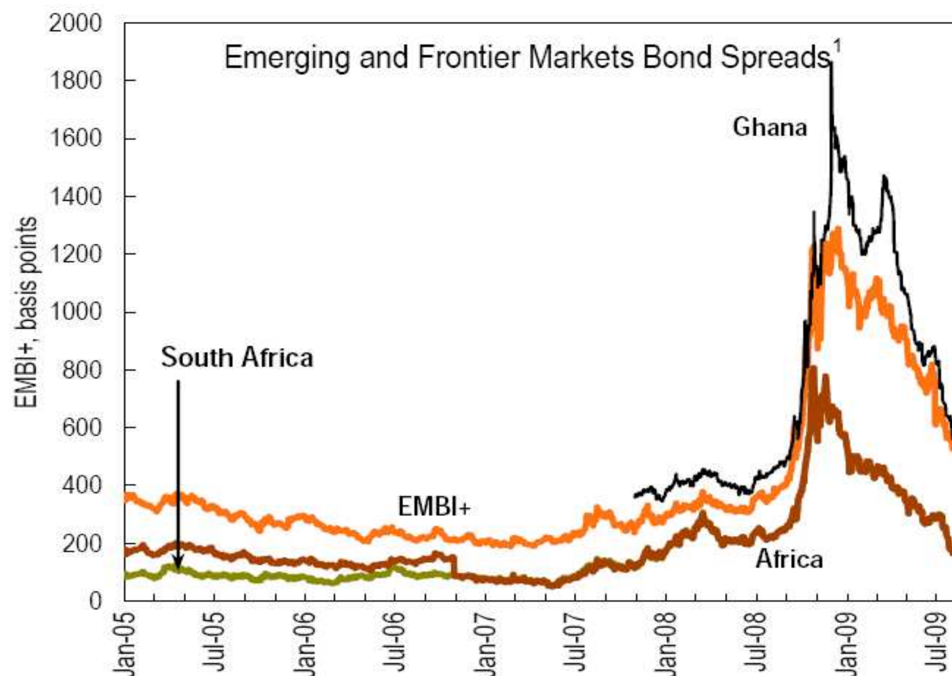
Table 1: SSA: Issuance of international bonds, 2004-08
(Millions of US dollars)

	2004	2005	2006	2007	2008
Total	1,697	2,681	4,899	12,396	1,533
Gabon	0	0	0	1,000	0
Ghana	0	0	0	950	0
Nigeria	0	0	0	525	0
Seychelles	0	0	200	107	0
South Africa	1,697	2,681	4,699	9,814	1,533

Source: IMF, Global Financial Stability Report database

In some countries, portfolio outflows may have been limited by capital controls. In Nigeria, foreign participation in local debt markets is restricted to long-term bonds, which may limit rollover risk and capital flight. Uganda and Zambia have fully liberalised their capital accounts but other countries like Nigeria and Ghana have residual capital controls.

Figure 2: Emerging markets CDS spreads (Basis points)



Source: Bloomberg

Note: Africa, South Africa and Ghana data are components of J.P. Morgan Emerging Markets Bond Index Plus (EMBI+).

Foreign Exchange Markets

Portfolio outflows triggered by increased risk aversion and deleveraging, sharp declines in FDI and the unwinding of commodity trade put pressure on the exchange rate in the region[3]. The currencies of the relatively open economies like Kenya, Mauritius, South Africa, Uganda and Zambia have come under some pressure and depreciated against the dollar (Figure 3).

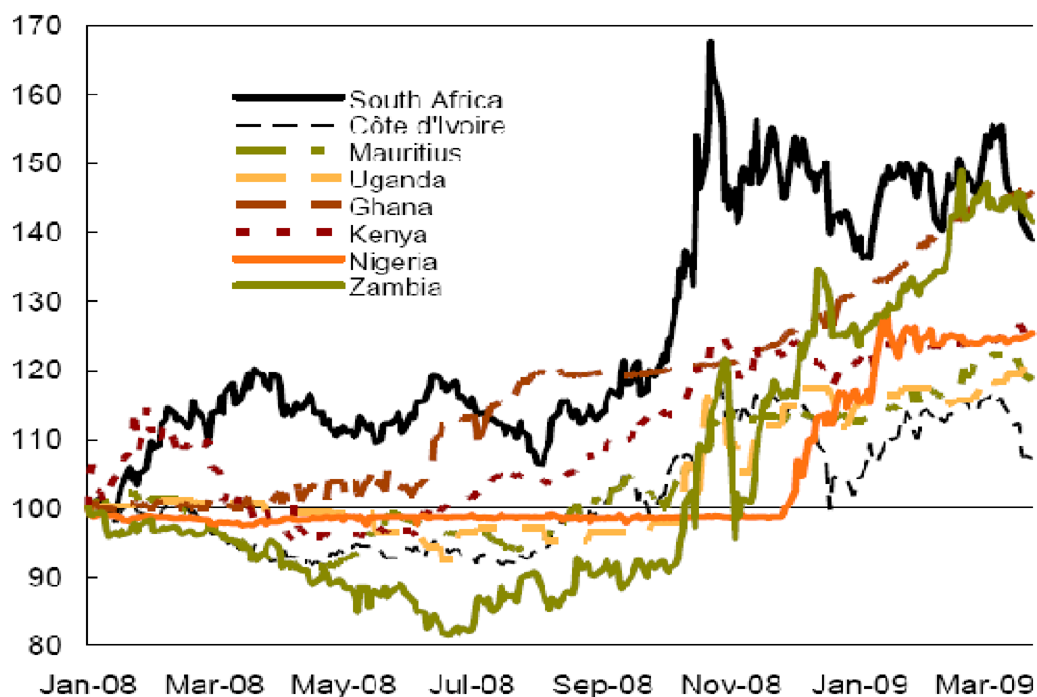
African economies can expect exchange rate pressures and volatility to persist for some time. Given the highly uncertain pace of global recovery, the geographical rebalancing of trade flows and volatility in the exchange rate of the main currencies, portfolio outflow are likely to continue. The continued exchange rate volatility posts particular challenges for countries seeking to integrate with international capital markets. Financial integration acts as a catalyst for African growth, which facilitates more rapid investment in infrastructure and private sector development, enhances competition and encourages foreign direct investment and technology

[3] CFA zone countries have been insulated due to their pegged regime and more restrictive capital account framework.

transfer. However, increased exchange rate volatility could hinder financial integration, skewing capital flows from longer-term to short-term investment.

Figure 3: Selected African countries' exchange rates

(Jan. 1, 2008 = 100; National currency per US dollar)



Source: DataStream

Money Markets

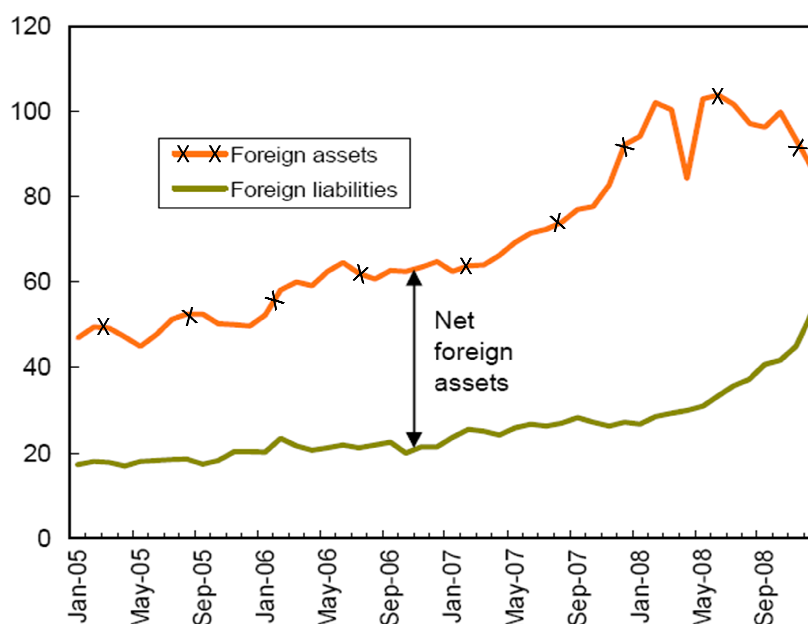
Money markets continued to function normally without generalized liquidity pressures. This was due to lack of a developed interbank market where contagion could spread, limited foreign funding, and large share of treasury bills and other liquid assets on the balance sheets of banks before the crisis. In recent years, high commodity prices, increased workers' remittance, FDI and portfolio inflows together with limited lending opportunities allowed the banking systems in the region to accumulate substantial liquidity buffers, which are usually in the form of foreign assets. However, there are indications that the net foreign assets have declined (Figure 4). The pressures in money markets is mainly reflected in increased interbank rates and shortening of maturities. To manage the potential impact, several countries adopted expansionary monetary policy and made net liquidity injections through monetary operations (Uganda) or lowering the reserve requirements (Nigeria).

Banking systems and non-bank financial institutions

Financial institutions in sub-Saharan African countries have been relatively resilient. The existence of capital control in several countries and structural factors have helped to moderate the direct and indirect effects of the crisis on the sub-Saharan African countries' banking systems. Banking systems have limited exposure to complex financial instruments. This has

resulted in fewer exposures and risks of potential losses. The banking systems in the region are also characterised by abundant low-cost domestic deposits and liquidity. This has allowed banks to finance themselves with domestic funds. Many banks are highly liquid and due to weak competition, have high profit margins contributing to accumulation of capital buffers.

Figure 4: Total foreign assets and foreign liabilities of deposit money banks in the African region, 2005-08
(Billions of US dollars)



Source: IMF, International Financial Statistics

However, the spillover of the financial crisis to the real sector has increased the risk of adverse feedback loop between the real economy and the financial sector. The current crisis might affect the region by deteriorating the quality of banks asset portfolios. Credit risks will also reflect the projected fall in commodity prices, affecting particularly oil and metal exporters. The potential deterioration in asset quality is magnified by substantial risk concentration that prevails in the region. In the case of Central African Economic and Monetary Community (CEMAC) and West African Economic and Monetary Union (WAEMU), the large exposure limits are substantially breached[4]. Any sectoral development caused by a change in commodity prices could therefore have serious implication for the soundness of financial system.

Countries where foreign banks have large claims on domestic banks are also vulnerable. The region has net claim on banks reporting to the Bank for International Settlements (BIS), but few countries have significant outstanding liabilities to banks abroad (Figure 5). Concerning the rollover of these liabilities, those countries may find it difficult to refinance or may be charged at higher interest rates.

[4] According to IMF (2006), in November 2005, nearly three-fourth of the banks did not comply with the limits on large exposures.

The foreign banking ownership might adversely affect sub-Saharan African banking systems in threefold: (1) parent banks might be less willing to provide liquidity to their African subsidiaries; (2) parent banks might be tempted to withdraw funds from their African subsidiaries in order to offset losses in home countries; and (3) parent banks might be unwilling or unable to inject additional needed capital into African subsidiaries. All these will increase African banks' chances for bankruptcy.

The prevalence of foreign-owned banks in sub-Saharan African financial systems exposes the region to capital withdrawal if these banks start to deleverage or close their local operations. In about 20 countries in the region, the majority of banking assets are foreign-owned whereas in countries like Nigeria and South Africa, foreign-owned banks account for a small percentage of bank assets (Table 2).

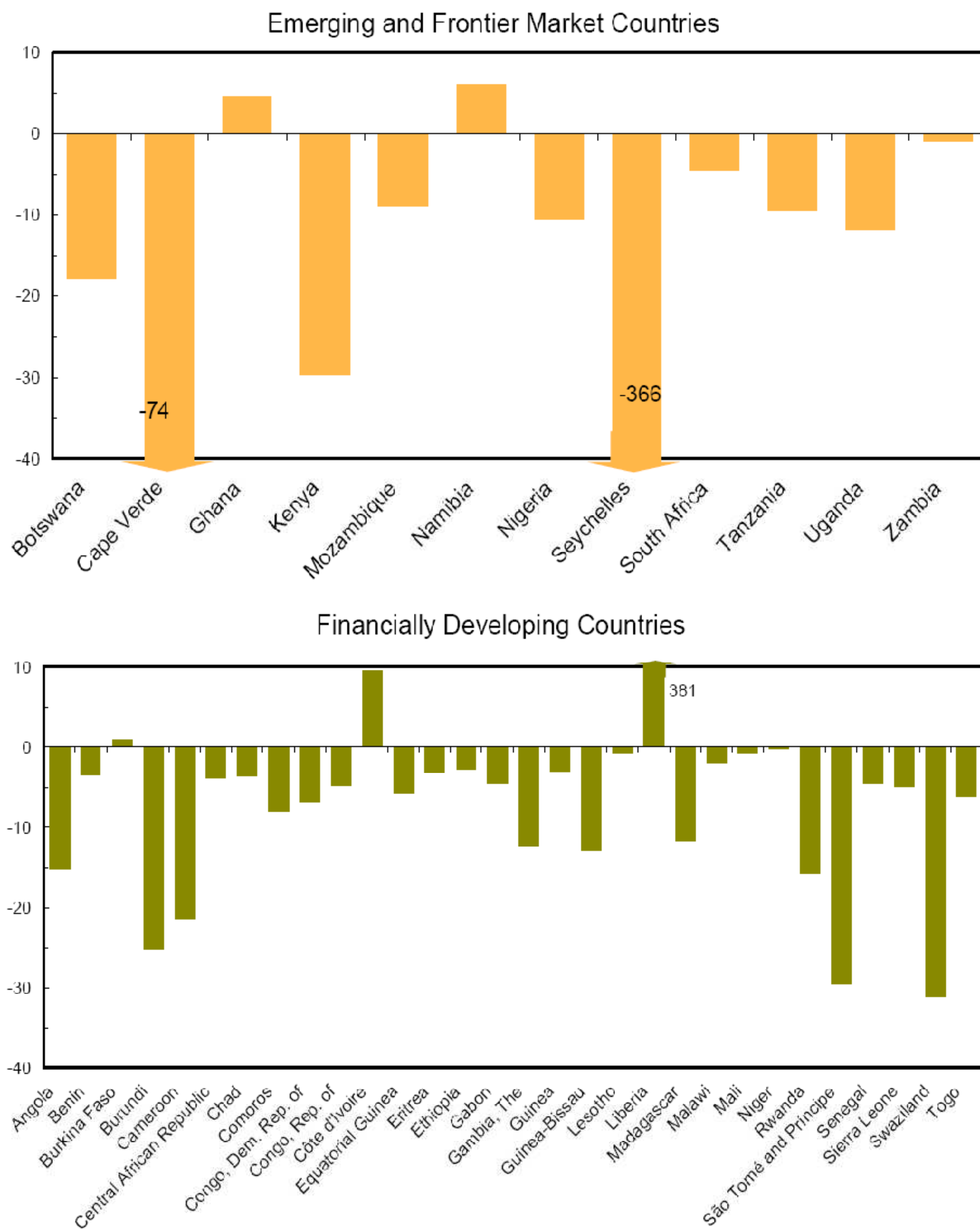
In some countries, banking systems may be increasingly exposed to market volatility due to increasing interlinkages between banks and local capital markets as well as weaknesses in banks' risk management. Countries like Kenya, Nigeria and Uganda, where high equity returns had encouraged borrowing for investing in the stock markets, are at greatest risk. At the same time, as prices of banks' own share have fallen, their cost of capital has gone up, which will constraint their ability to expand.

Portfolio inflows

The number of stock markets in sub-Saharan Africa has increased significantly though it is still small. There were only five stock markets in 1989, but it increased to 16 currently including those recently established in Ghana, Malawi, Swaziland, Uganda and Zambia. Some stock exchanges in the region like Ghana, Uganda, Kenya, Nigeria and Mauritius have experienced an extraordinary performance over the past few years, hence attracting increasing share of portfolio inflows.

However, the global crisis has put these portfolio inflows at risk. The heightened risk aversion of investors together with the tightening of global credit conditions, the deterioration of the macroeconomic environment in the region, increased volatility of capital markets and exchange rates have led to a reduction of portfolio inflows to sub-Saharan Africa (Figure 6). The country which is mostly affected by this phenomenon is South Africa. About US$5.7 billion in portfolio investment left the country during the fourth quarter of 2008, up from a US$ 1 billion outflow in the third quarter. In Uganda, the outflow was US$119 million, with a sharp contrast of a US$ 9 million inflow in the third quarter of 2008. However, lower portfolio inflows may result in a limited number of countries with developed stock markets.

Figure 5: SSA net claims of BIS reporting banks (percent of GDP), Sept 2008



Source: Bank for International Settlements and International Monetary Fund

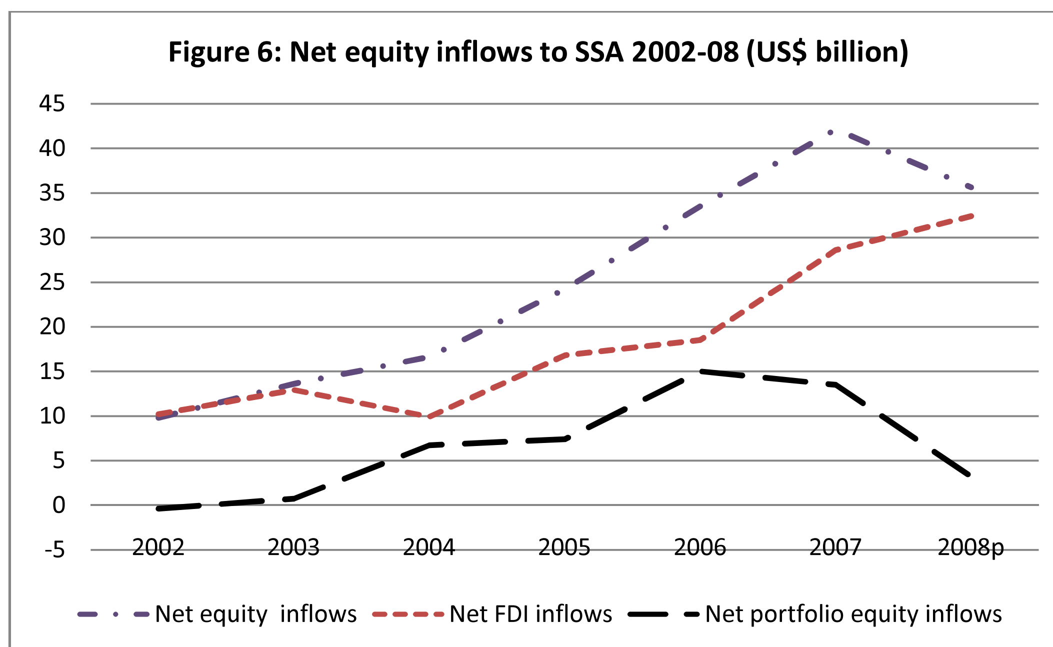
Note: “Net claims” is defined as BIS reporting bank claims on minus liabilities to individual countries.

Table 2: SSA countries with concentrated foreign banking assets, 2008[1]

Host Country	Assets Held by Foreign Banks (percent)	Largest Foreign Banks	Home Countries of the Largest Foreign Banks
Angola	68	Angolan Development Bank	Portugal
		Espiritu Santo Bank of Angola (BESA)	Portugal
		Totta Angola Bank (BTA)	Portugal
Botswana	99	Barclays Bank of Botswana	United Kingdom
		Standard Chartered Bank Botswana	United Kingdom
		First National Bank of Botswana	South Africa
Cameroon	70	BICEC	France
		Société Générale	France
		Attijariwafa Bank	Morocco
Cape Verde	74	Banco Comercial Atlantico	Portugal
		Banco Interatlantico	Portugal
		Banco Caboverdiano de negocios	Portugal
Chad	75	Société Générale Tchadienne de Banque (SGTB)	France
		Ecobank	Togo
		Commercial Bank Tchad	Cameroon
Comoros	92	Banque pour l'Industrie et le Commerce (BIC)	France
		EXIM Bank Tanzania	Tanzania
Congo, Dem. Rep. of	90	Banque Congolaise	United States
		Banque Commericale du Congo (BCDC)	Belgium
		Rawbank	Luxemburg
Congo, Republic of	57	BGFI – Congo	Gabon
		Banque Marocaine du Commerce Exterieur (BMCE)	Morocco
		Crédit Agricole	France
Côte d'Ivoire	56	Société Générale	France
		Banque Internationale pour le Commerce & I'Industrie en Côte d'Ivoire (BICICI)	Belgium
		Ecobank	Togo
Ghana	55	Barclays Bank	United Kingdom
		Standard Chartered Bank	United Kingdom
		SSB Bank	France
Lesotho	97	Standard Bank	South Africa
Madagascar	71	Mauritius Commercial Bank (MCB)	Mauritius
		Banque Malgache de L'Océan Indien (BMOI)	France
		BFV- Société Générale (SG)	France
Mauritius	72	Barclays Bank	United Kingdom
		Hong Kong and Shanghai Banking Corporation (HSBC) Mauritius Ltd.	United Kingdom
		Standard Chartered Bank	United Kingdom
Mozambique	100	Banco Internacional de Mocambique (BIM)	Portugal
		BCI-Fomento	Portugal
		Standard Bank	South Africa
Namibia	73	Standard Bank Namibia	South Africa
		First National Bank	South Africa
São Tomé and Príncipe	100	Banco Internacional de STP (BISTP)	Portugal
		Afriland First Bank	Cameroon
		Island Bank	Nigeria
Senegal	65	SGBS	France
		B.I.C.I.S.	France
		Attijariwafa Bank	Morocco
Seychelles	56	Barclays Bank	United Kingdom
		Mauritius Commercial Bank (MCB)	Mauritius
		Bank of Baroda	India
Swaziland	70	Standard Chartered Bank of Swaziland Ltd.	United Kingdom
		NedBank Swaziland Ltd.	South Africa
		First National Bank Swaziland Ltd.	South Africa
Tanzania	52	NBC Ltd.	United Kingdom
		Stanchart	United Kingdom
		Barclays Bank	United Kingdom

Source: IMF, African Department financial sector survey questionnaires

1. Based on most recent data that are available (2008 or earlier). Only those countries for which the share of banking system assets held by foreign banks that exceed 50 percent are shown.



Source: World Bank
Note: p = projected
Net equity inflows = net FDI inflows + net portfolio equity inflows

Foreign direct investment (FDI)

In 2007, net foreign direct investment inflows to sub-Saharan Africa amounted to about US$ 29 billion , which is a 35 percent growth, and they have continued to grow during 2008 (Figure 6). The FDI growth has been mainly due to the fact that investment in the region have offered diversification opportunities and relatively higher return rates than those in mature economies. However, the current global crisis and the consequent multinationals' reduced profit margins, combined with difficult financing conditions and volatile commodity prices (FDI in the region is heavily concentrated in natural resource sectors) are likely to make foreign investors reducing their investments in the region. Comparing with other low-income countries, the impact of reduced FDI in 2009 in sub-Saharan African countries is expected to be mild, due to FDI concentration in natural resource sectors, where new projects may be delayed but most ongoing projects are likely to be continued. Given the sizable up-front capital investment required for such investment and losses associated with withdrawing from natural resource projects prior to their completion, the likelihood of FDI withdrawal is reduced.

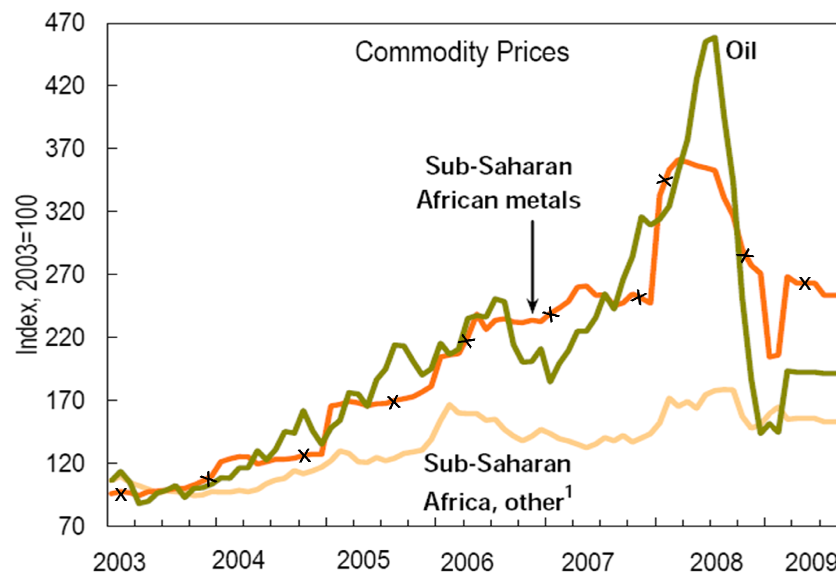
3. Real transmission channels and impacts on sub-Saharan African economies

The crisis spilled over from the financial economies to the real economies. There are a number of important transmission channels which the global financial crisis might affect sub-Saharan African countries. They include effects through exports and imports of goods and services, terms of trade, workers' remittances, official development aid and the economic slowdown of China and India.

Trade in goods and terms of trade

Before the outbreak of the crisis, sub-Saharan African countries, who are oil rich and agriculture net exporters, benefited from increase in fuel and food prices[5]. The continuous demand for natural resources caused terms of trade improve steadily throughout the region since 2003. However, the crisis and lower global growth dampened demand for the region's exports with consequent fall in export prices. There was a sharp adjustment in prices of oil, metals and other commodities in 2008. The prices stabilised in 2009 (Figure 7).

Figure 7: Sub-Saharan African commodity prices



Sources: IMF, Commodity Prices, and UN Comtrade

[1] Composite of cocoa, coffee, sugar, tea and wood, weighted by sub-Saharan African exports

The rapid drop in global demand for industrial products accelerated the decline in global commodity prices which affects the sub-Saharan countries in different ways. For African commodity exporters, the lower prices represented a significant loss in incomes and caused a sharp deterioration in their current account positions. For oil importers, however, lower fuel prices represented a favourable terms-of-trade development. Overall, the terms of trade deteriorated in 19 of 44 countries in the region between July 2008 and May 2009, with income losses of more than 10 percent of GDP in 7 of them (Figure 8). Another 26 countries recorded improved terms of trade, largely because of lower fuel prices. The improvement is more pronounced in Cape Verde, Eritrea, Seychelles and Togo where they rely heavily on oil imports (Figure 9).

[5] The group of oil-exporting countries includes Angola, Cameroon, Chad, Republic of Congo, Equatorial Guinea, Gabon and Nigeria. The group of non-oil resource-rich countries includes Botswana, Côte d'lvoire, Guinea, Namibia, São Tomé and Príncipe, Sierra Leone, Zambia. Countries are classified as resource-rich if their primary commodity rents exceed 10 percent of GDP. The group of non-resource-rich countries are Benin, Burkina Faso, Burundi, Cape Verde, Central African Republic, Comoros, Congo, Dem. Rep. of, Ethiopia, Gambia, Ghana, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mali, Mauritius, Mozambique, Niger, Rwanda, Senegal, Seychelles, South Africa, Swaziland, Tanzania, Togo, Uganda and Zimbabwe.

Figure 8: Large terms of trade losses expected in countries exporting minerals and oil

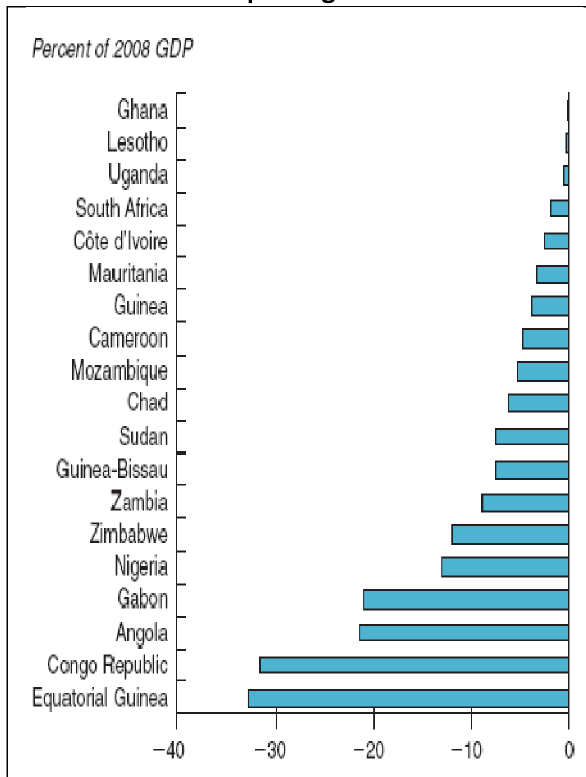
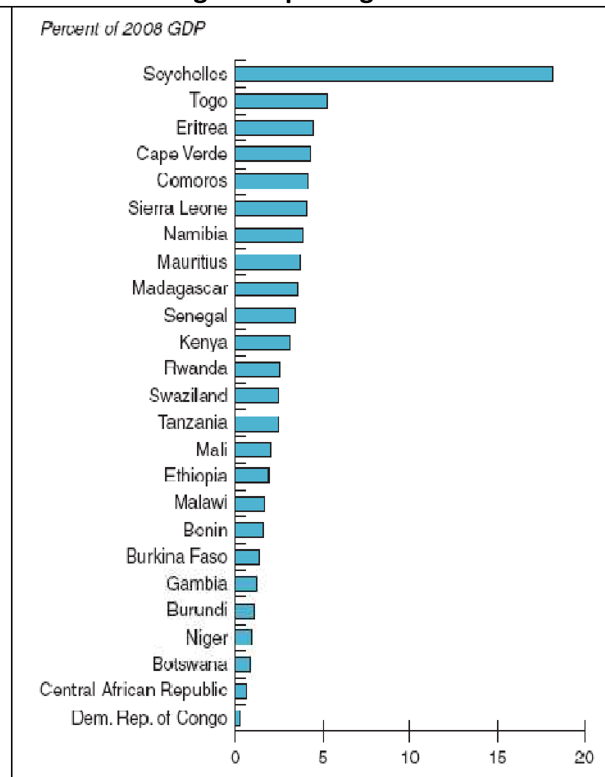


Figure 9: Terms of trade gains expected among oil-importing countries



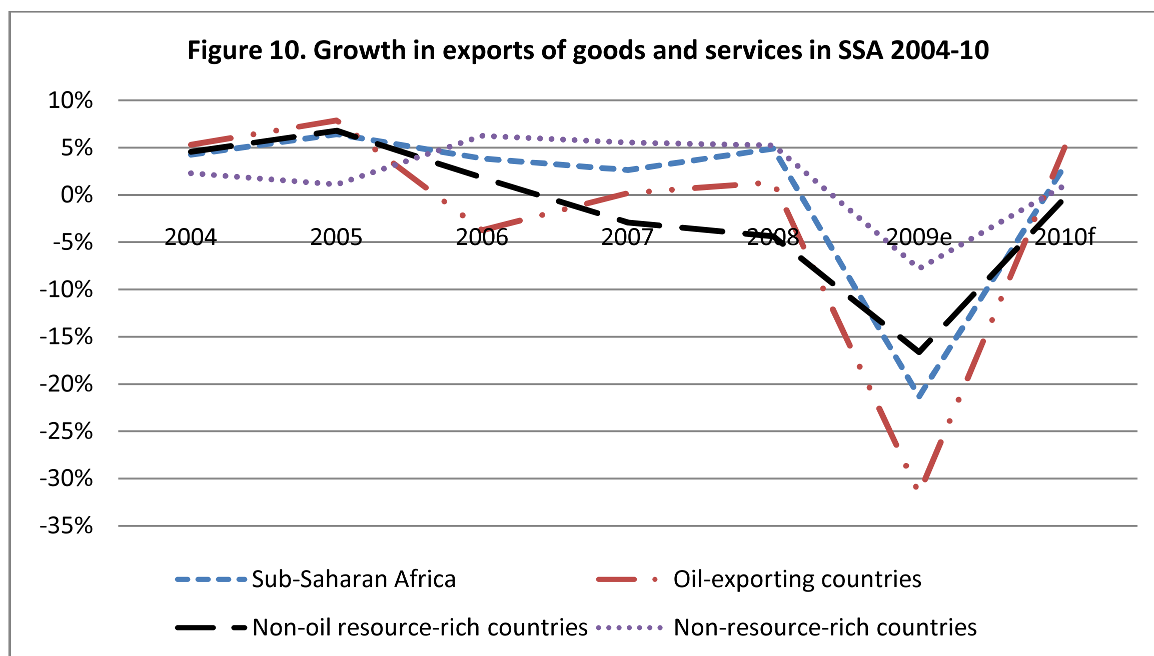
Estimated terms of trade from changes in international prices between 2008 and 2009
Source: World Bank

Services

Commodities are essential for sub-Saharan African economic growth. However, the growth is also being contributed by service sectors like financial, tourism and real estate services. It is estimated that the improved services have contributed more than half of its growth in the last decade, with the share of services in incomes increasing by 5 percentage points over the last 15 years. Hence, while the region is expected to feel the impact of global financial crisis, it may go beyond the effects through lower commodity prices.

The high price of oil and later on global economic and financial crisis squeezed travel budgets. The UNWTO suggests that Africa's growth in year 2008 was 4%, which is half the level achieved in 2007. International tourism receipts amounted to US$ 31 billion, signifying a decrease of 1% in real terms. And this is largely due to growth in North Africa while sub-Saharan African's average growth may decline significantly compared with the growth rate of 2007.

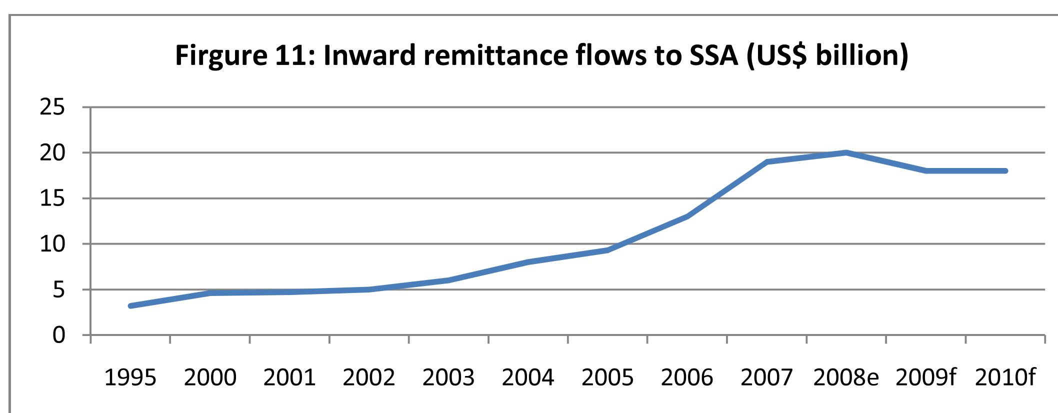
The sub-Saharan African countries are severely affected by the fall in exports both in commodities and services. The growth of exports of goods and services were expected to decline from an average of 4% over the past 5 years to -21% in 2009. It suggests that the oil exporter may suffer the most from the crisis with 32% decline in export growth (Figure 10).



Source: IMF's Regional Economic Outlook on sub-Saharan African, April 2009.
Notes e = expected, f = forecast.

Workers' remittance

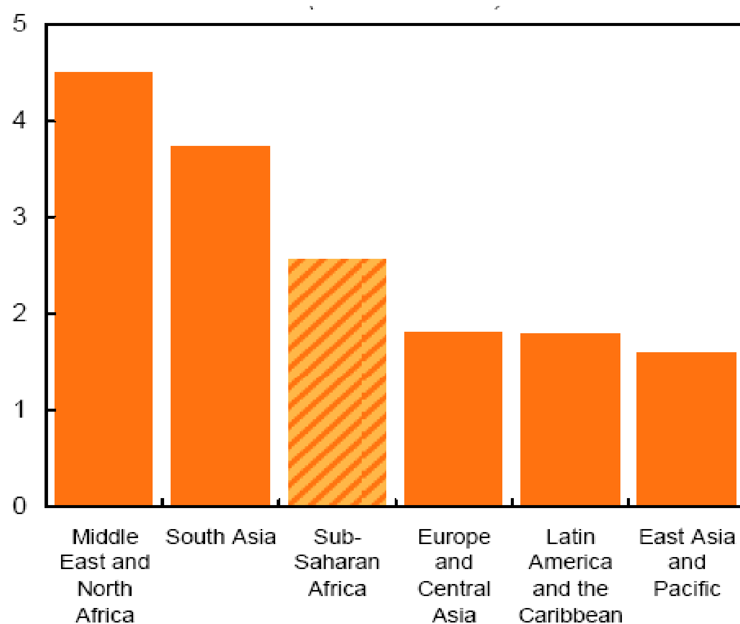
Remittance flows to sub-Sahara Africa have experienced a significant growth recently, increasing from a value of US$3.2 billion in 1995 to a value of US$19 billion in 2007, which is a powerful poverty reduction mechanism in the region (Figure 11). However, with about 80 percent of its remittances coming from advanced countries, the region would be vulnerable to an economic slowdown in the source countries. The remittance flows to the region slowed down to US$20 billion in 2008 and is expected to fall by 8.3 % in 2009 due to the global crisis.



Source: World Bank 2008.

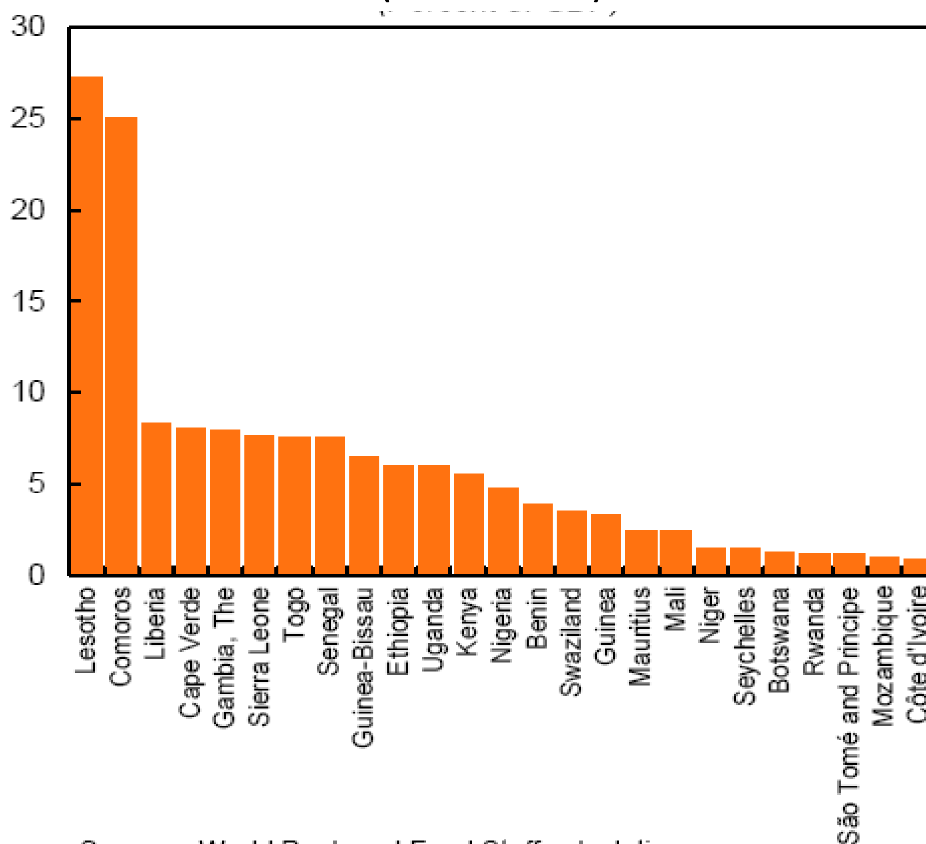
Sub-Saharan Africa is dependent on remittances - about 2.5 percent of regional GDP, and there are some countries that could be more exposed than others (Figure 12). In Comoros and Lesotho, remittances account for more than 20 percent of GDP and in ten other countries, they account for more than 5 percent of GDP (Figure 13).

Figure 12: Remittance by region, 2007
(Percent of GDP)



Sources: World Bank and Fund Staff calculations.

Figure 13: Sub-Saharan Africa: Top 25 recipients of remittances, 2008
(Percent of GDP)



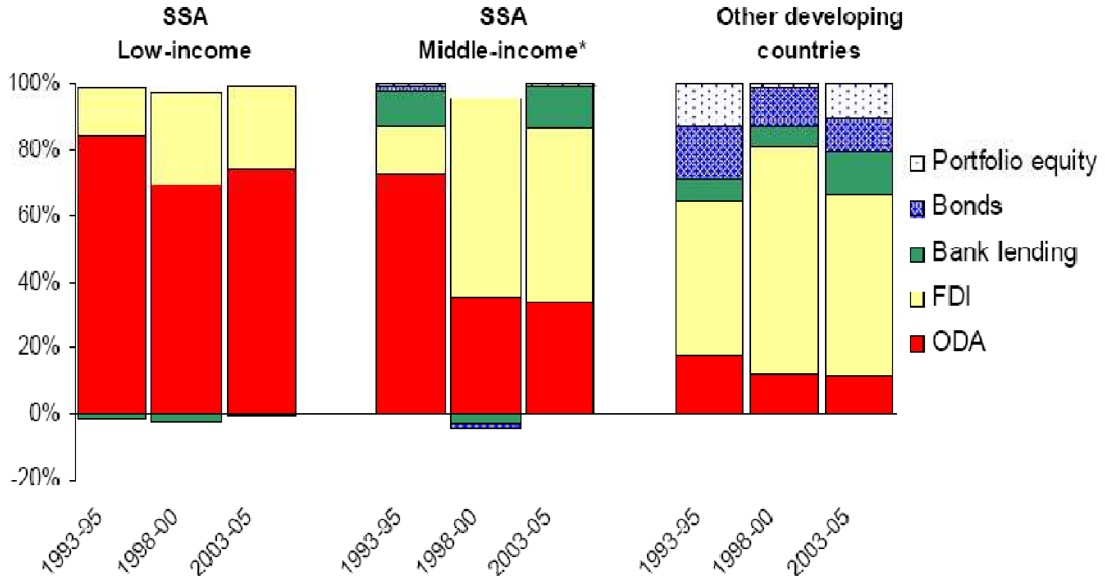
Sources: World Bank and Fund Staff calculations.

Official development assistance

Poverty-reducing initiatives across the world have led to sizable aid flows during this decade. Official development assistance to sub-Saharan Africa excluding South Africa has increased from US$13.3 billion in 2000 to US$35.4 billion in 2007. Sub-Saharan Africa continues to rely heavily on official aid flows compared with other regions. For the low-income SSA countries, official aid flows account for an average of 70% of resource flows over the past decade. It also accounts for an average of 30% of resource flows to the middle-income SSA countries[6] during the same period (Figure 14). Official aid flows is the largest source of external financing for SSA countries, both in dollar amount and as a share of gross domestic products. In 2006, aid flows to SSA countries other than South Africa was $37.5 billion, which is 8.2 percent of GDP, compared with 1 percent for all developing countries.

Potential reduction in aid flows is a serious concern. Empirical evidence shows that aid is procyclical with both donor and recipient incomes (Bulíř and Hamann, 2006). In a sample of 18 donors, Pallage and Robe (2001) show that the co-movements of total aid disbursements with donors' output were positive for almost three-quarters of donors during 1969-95. Given the severe slowdown in growth of advanced economies, it is expected there will be a reduction in aid flows to the region from 9.2 percent of GDP to 5.2 percent of GDP. It is also highly unlikely that the G8 will honour their commitment to double official aid flows to Africa by 2010.

Figure 14: Composition of resource flows to SSA compared with other developing regions



* Excludes South Africa.

Source: World Bank 2007a; Calculation by Dilip Ratha, Sanket Mohapatra and Sonia Plaza

[6] Middle-income countries: Botswana, Cape Verde, Lesotho, Mauritius, Namibia, Seychelles and Swaziland

The economic slowdown of China and India

China and India have played an important role in sub-Saharan Africa recently in terms of aid, trade and investment. China has offered grants and loans to some oil and mineral rich countries like Angola, Gabon, Republic of Congo, Equatorial Guinea and Nigeria, and has planned to double aid to Africa by 2009. India has offered aid particularly in the IT and health sectors. China and India are also among the largest trading partners and foreign investors in the region: 10% of African exports (86% of which is oil) go to China and India, and Asian FDI inflows account for 10% of FDI in Africa. As a result, the economic slowdown in China and India will also have implications on the region. According to a projection made by the International Monetary Fund in October 2009, China is expected to slow down from 13% output growth in 2007 to 9% in 2010. India might slow down from 9.4% to 6.4%.

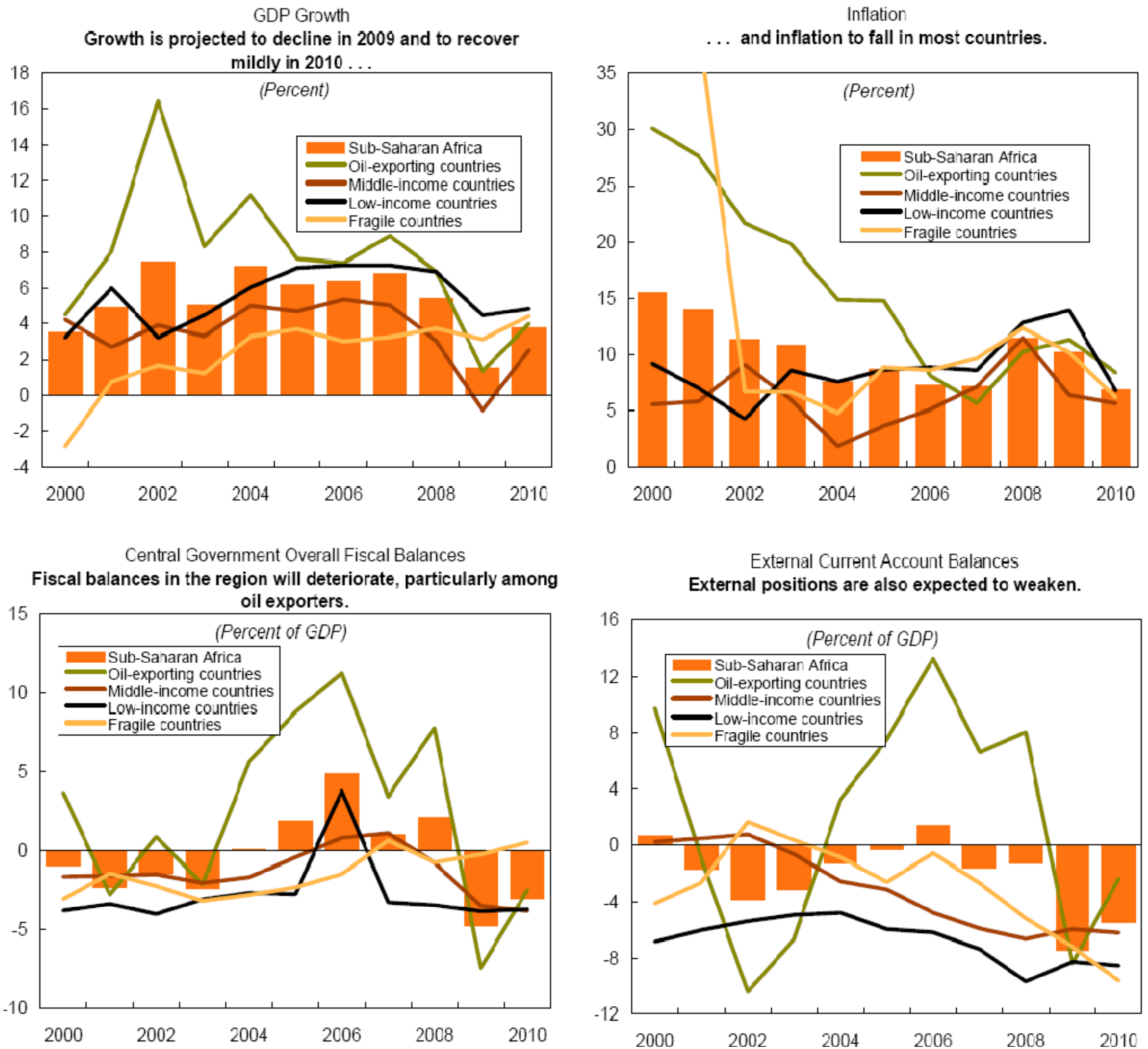
4. Conclusion: outlook for sub-Saharan Africa

The channels through which the global economic and financial turmoil affects sub-Saharan African countries may be classified into financial and real transmission channels. Financial channels include effects through financial markets (equity markets, bonds markets, foreign exchange markets and money markets), banking sector and non-bank financial institutions, portfolio inflows and foreign direct investment. Real transmission channels include effects through exports and imports of goods and services, terms of trade, workers' remittances, official development aid and the economic slowdown of China and India.

With the expectation of a more pronounced global downturn, lower commodity prices and pressure on capital inflows, growth projection in sub-Saharan Africa have been revised sharply downward compared with pre-crisis level. Growth is projected to decline from 5.5 percent in 2008 to 1.5 percent in 2009 before recovery to about 4 percent in 2010. Inflation is projected to decline from about 11.5 percent in 2008 to 10.5 percent in 2009 and about 7 percent in 2010. Although inflation has started to decline as commodity prices and global demand both decline, it remains high in many countries. This is largely because of the fuel and food prices increase through mid-2008 and currency depreciation in some countries that put upward pressure on prices. Fiscal balances are expected to deteriorate in many countries as tax revenues, particularly those are commodity related, come under pressure while governments face additional demand for social spending. The fiscal balance in the region is projected to decline from surplus in 2008 to deficit of 6.4 percent of GDP in 2009 and deficit of 4.6 percent of GDP in 2010, with oil exporters being particularly hard hit. The terms of trade shock to commodity exporters is also widening current account deficits in the region, by about 6 percentage points of GDP to 7.5 percent in 2009, though with significant divergence between groups of countries. Oil and other commodity exporters are particularly hard hit by the reversal in terms of trade (Figure 15).

While all the sub-Saharan African countries are affected by the crisis, the magnitude of the impact varies, depending on the development of financial system and the structure of the economy. It is clear that some countries are highly impacted either through real contagion or financial contagion. This group is dominated by oil exporters and countries with more financially developed markets.

Figure15: Sub-Saharan African: Economic outlook 2009-10



Sources: IMF, World Economic Outlook; and IMF, Africa Department database

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