MINIMIZING THE IMPACT OF THE GLOBAL ECONOMIC SLOWDOWN ON AFRICA

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The Priority

By all indications, 2011 was a challenging year for the global economy. GDP growth in the advanced economies—notably, the United States, the United Kingdom and the eurozone countries—stagnated at 1.6 percent and only marginal growth improvements are expected in 2012. Emerging economies and low-income countries on the other hand experienced robust growth of 6.4 percent in 2011.

The global macroeconomic environment continues to be dominated by the effects of the 2007–2009 Great Recession, the eurozone sovereign debt crisis and the ongoing turmoil in global financial markets. These events have largely contributed to the growth slowdown being experienced by the OECD countries and emerging market economies. Of particular concern is the magnitude and depth of the eurozone debt crisis. With the Greek debt crisis yet to be resolved and Italy now also experiencing its own sovereign debt problem, global markets are responding to fears that neither the European Union nor the International Monetary Fund will be able to bail out European countries in the event of a default. Even in event of a successful Greek and Italian debt restructuring, investors will still be concerned about highly indebted countries in recession—a situation that could jeopardize the stability of banks not only in Europe but also in the U.S. and Asia.

Why Is It Important?

The anticipated growth slowdown in both OECD and emerging market countries, coupled with growing uncertainties in global financial markets, is expected to negatively impact Sub-Saharan African economies both directly and indirectly. First, with a slowing world economy and uncertainty in global financial markets, investors around the world will respond by withholding investment decisions. This in turn will directly hurt African economies because it will reduce exports from the continent, tourism from abroad, capital inflows and remittances. For example, during the recent global economic crisis, overall export revenues for all African countries dwindled by $251 billion and $277 billion in 2009 and 2010 respectively. Capital inflows also fell considerably, especially for countries like Kenya where remittances dropped steadily from $61 million in October 2008 to $39 million in January 2009. Likewise, compared to the fourth quarter of 2007, tourism receipts for Kenya in 2008 were 13 percent lower.

Second, as observed in 2011, uncertainties within the European financial system led to a massive shift by investors away from euro-denominated assets to dollar-denominated assets, thereby triggering sharp depreciations in the currencies of most of the non-oil-exporting emerging countries in Africa, notably South Africa, Kenya, Tanzania and Uganda. For instance, between May and December 2011, the Ugandan, Kenyan and Tanzanian shillings depreciated against the dollar by 18, 13 and 7 percent respectively. While these depreciations offered a potential export competitiveness dividend, the increased exchange rate volatility associated with these currency declines have instead magnified the downside returns as their import bills and foreign debt holdings rose, foreign reserves plummeted and trade deficits widened. To curb domestic inflation and stabilize the exchange rate, central banks in the African economies concerned have largely tightened monetary policy with unintended consequences on domestic demand and growth.

If the experience of the recent crisis in Africa that swept away firms, mines, jobs, revenues and livelihoods is anything to go by, then one should realistically expect the growth slowdown in OECD economies to have adverse consequences on the well-being of Africans. Without appropriate measures to counter these negative effects, the gains in poverty reduction and progress toward the Millennium Development Goals could be undermined.

What Needs to Happen in 2012?

In 2012, financial markets will be watching the European Union as it moves toward closer integration. With Britain's veto of the proposed changes to the EU's Founding Treaty—which would have given EU institutions more enforcement authority and member countries less control over their national budgets—the remaining 26 EU member countries must pursue more restrictive budget deficit rules. Though this will not achieve the desired level of fiscal integration, it will nonetheless inspire markets to renew trust in eurozone bonds, which could stabilize the European banking system and global financial markets. In turn, African economies might see renewed capital inflows, which could shore up their foreign exchange reserves and diminish the volatility associated with the rapid depreciation in their currencies. Another factor that might contribute to a restoration of investor confidence in global financial markets is the announcement in December 2011 by the U.S. Federal Reserve that it would substantially implement all of the Basel III rules reforming the global financial architecture. Although pundits argue that increased regulation of the financial system will hurt growth, markets need assurance that the system will not default. Finally, markets will be looking forward to the implementation of a credible medium-term fiscal consolidation plan in the United States—a move that would restore consumer and investor confidence, and thus spending in the largest economy in the world. This would certainly have positive economic spillovers to the rest of the world, including Africa.

In light of the forgoing, and in order to reap any potential benefits from the global macroeconomic environment in 2012, Sub-Saharan African countries first need to protect their macroeconomic balance sheets by controlling inflation, restraining spending and ensuring that debt-to-GDP ratios are sustainable. Additionally, African governments need to maintain political stability, which is a crucial element to improving the business environment and attracting foreign investors.

Furthermore, considering the potential risks associated with trading with only a few OECD countries, African countries must seek to diversify their trading partners. For example, forging strategic trading relationships with emerging economies in Asia and Latin America would help sustain African economies in the event of further economic slowdowns in the advanced economies. In addition, African governments must implement policies to diversify their economies away from oil, gas and minerals into higher value-added activities, such as agro-industries, manufacturing and services. More diversified economies are more resilient to wide demand swings caused by fluctuating commodity prices. Likewise, African countries must accelerate the pace of regional integration in order to expand intra-Africa trade. Expanding trade within Africa is crucial to supporting growth especially when economic conditions will probably continue to be dismal in advanced economies in 2012.