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Qiao Yu:

Good afternoon everyone. On behalf of the Brookings-Tsinghua Center for Public Policy, we are very pleased to invite Mr. Roger Nord and his party to come over here again. They visited us a year ago to deliver a presentation on the economic outlook of Sub-Saharan Africa. We know that Sub-Saharan African countries are very important economies and they are major trading partners of China and also very important divestment targets of China's foreign direct investment. Currently, Sub-Saharan African countries face some problems and they will face these problems and analyze the factors and the macroeconomic impact of these economies. So I would like to invite Ms. Antoinette Monsio Sayeh to share a few words on what will be presented today.

Antoinette Monsio Sayeh:

Thank you very much. We're very pleased to be here to join you today. Roger Nord and Celine Allard will be making presentations today and it's been a year since we were last here. I am the Director of the African Department of the IMF. We have worked to continue to deepen our relationship with China on Sub-Saharan Africa issues, given what you have just said as the importance of China as a partner for Sub-Saharan Africa and as we say, the region has had a difficult patch given the declining commodity prices, oil prices, and other commodities as well. The heightened financial conditions that countries are facing and the drought that is affecting countries in Eastern Southern Africa are factors as well. With all of those difficulties, we still believe that the overall picture for Sub-Saharan Africa in the medium term is a relatively good one, provided that countries work hard and quickly to put in place those policy responses that they need to navigate the headwinds. And you will see from the presentation that both of my colleagues will make that by and large we think countries are behind the curve in that regard and very much want to encourage them to do better by that. Thank you for giving us the opportunity to share our work with you and hopefully the copies and summary of the report will also wake your appetite for more IMF analytic work on Sub-Saharan Africa. Thank you.

Qiao Yu:

Okay thank you very much Ms. Sayeh. Next we would like to invite Mr. Roger Nord, the Deputy Director of the Africa Department at the IMF to make a presentation first and then followed by Celine Allard.

Roger Nord:

Thank you very much Professor Yu. So we're going to do a presentation in two parts. The first part will be an overview of the economic outlook for Sub-Saharan Africa and then the second part will be a

deeper look at the commodity price shock. Here's the general background. You have a general background of a global economy where both remains moderate, modest, sluggish, choose your adjective. Not a very fast growing global economy. And against that background, you see Sub-Saharan Africa is slowing down compared to the growth rates in the past over the last 15 or 20 years on average of about 5-6% growth, some countries even faster than that. The IMF now estimates that in 2015 growth was about 3.5% in Sub-Saharan Africa and our outlook for 2016 is at most 3%, so definitely a much weaker outlook. What I'm going to do today is a presentation in three parts. I'm going to talk about why it is that growth has slowed down. I'm going to talk a little bit about what countries have done to react to that. And then I'm going to turn to what is the title of our current report, which is 'Time for Policy Reset'. As Ms. Sayeh said, I'm going to talk a little bit about why we think that those countries most affected by the downturn have not yet taken the necessary policy steps to respond.

This should be quite a familiar picture to you. Natural resource producers, oil exporters in particular are experiencing a significant slowdown. You can see in this chart these are the eight countries in Africa that are large oil exporters. You see the black line is the average growth rates achieved between 2010 and 2014; the red bars are what they are likely to reach in 2016. You can see that with the exception of Cameroon, everyone is growing more slowly than they did over the last four to five years.

This shows you that the same is true for other commodity exporters with very few exceptions, Tanzania being one of the exceptions, but you can see across the board, metal exporters also are significantly affected by this slowdown. But I should underline that it's a tale of two Africa's- you have the commodity exporters that are facing serious issues and I'll come back to that later. But you also have a significant group of countries that continue to grow quite robustly. Here you see that for those other countries, growth is often more or less where it was over the last 4 years in some countries, even stronger than where it used to be. So keep that in mind as we go through this. Africa is a heterogeneous continent. You have a sharp slowdown in some countries, big countries like Nigeria, Angola, South Africa, for other reasons but you also have a large number of countries that continue to grow quite robustly like Senegal and Cote D'Ivoire in West Africa to Kenya and Tanzania, Uganda, Rwanda, in the east.

Here's a chart that tries to put the oil shock into context. And the context here is the bar all the way on the left. This is the largest decline over an 18 month period that we've seen in recent history. So it's been a very severe shock for the oil exporters in Africa. Just as an illustration, this has also affected Sub-Saharan Africa's trade relationship with China because of lower oil prices and the rebalancing of

economic growth in China. Sub-Saharan Africa's trade bounds with China have turned into a deficit for the first time in many years. Now that's one shock that Sub-Saharan Africa is facing, lower commodity prices. But there is a second shock that also weighs heavily on prospects and that is that external financing has become more expensive. You can see in this chart, the red line is the frontier markets in Sub-Saharan Africa- the Ghanas and Zambias and Nigerias of the continent for example. And you have the black line; those are the emerging markets outside of Africa. And you can see that in 2014, 2015, spreads were rising for both of them but since then, it has been much more severe in Sub-Saharan Africa, and that affects the access that frontier economies have to global financial markets. Access that had increased quite rapidly in recent years and now at minimum the cost and probably the access itself is going to be much more difficult. Now on top of all of that, in our view the risks are still on the downside. Some of the global risks could lead to a decline in commodity prices despite the slight rebound that we've been seeing in recent months. Second, there could be more volatility in global financial markets for many reasons- Brexit next week would be case in point. And further slowdown in Europe is certainly not excluded either. And then you have domestic risks that are very much centered on the African continent like projected policy adjustment, by which we mean that the policy adjustment is not actually happening, at least not yet. A more prolonged drought, we have a severe drought that is affecting a number of countries particularly in eastern and southern Africa. And of course you have security challenges across the Sahel belt but also over in Kenya. You have a number of risks that could affect prospects quite significantly.

Now how have countries responded? This tries to illustrate one response in the fiscal policy. The black dots are the changes in revenue, so you have a significant change in revenue- notably for oil exporters- and the red triangles are the changes in expenditures. And you can see in most countries that expenditures have not yet adjusted fully to the fall in revenue. Of course as a result, deficits have widened and the next chart, which looks at debt, illustrates that again. You have widening fiscal deficits, you have rising debt. But fortunately for oil exporters you have a reasonably strong starting position starting with reasonably low levels of debt, some reserves, sometimes significant levels of reserves. There was a little bit of time but as I'm going to illustrate in a moment, we think that that time is running out. This chart shows that not only are deficits rising, debt is rising, and the financing costs of these deficits is also rising. The size of the bubble here corresponds to the increase in domestic interest rates to finance the deficit so you can see that in many countries, that has gone up significantly. Zambia and Angola are cases in point. And then on the two axes you can see that the fiscal balance has worsened.

Those are the countries below the horizontal access in many countries. So financing costs are rising, fiscal balances are worsening, and of course that poses significant challenges for many countries.

How have countries dealt with this? In some cases it's been increased resources to central bank financing. As you can see here, the fixed exchange rate regime, which has many exporters, has been increasing costs to central bank financing and we know from experience that that can pose inflationary risks down the line. Countries that have had the opportunity to do so have let their exchange rates adjust, Angola, Mozambique, Zambia are cases in point, which is probably the appropriate response in terms of trade, deterioration, permanent shock. An adjustment in the exchange rate makes a lot of sense but you could also see that this adjustment has been quite uneven across countries although they've been facing the same shock. The adjustment in Nigeria for example has been far less than in Angola. And of course some countries do not have an exchange rate estimate, which puts an additional burden on fiscal policy.

Countries that have monetary policy independence and flexible exchange rates have used monetary policy to try to offset some of the inflationary risks so you can see that in many countries on the left hand panel here, the central bank has tightened monetary policy which is the right response to try to stem inflationary pressures, but of course it does also mean drag on growth. It also means a slowdown in private sector borrowing. We've seen in many countries that a slowdown in the private sector translates into a slowdown in growth. Similarly, it also puts pressure on banks and the financial system more broadly as the economy slows down, as interest rates go up, the nonperforming loans that many banks have started to creep up will increase so banking sector risks are rising in a number of countries in Sub-Saharan Africa. So against this rather bleak picture I guess the question you could ask is, is Africa still rising? What does this mean? Is this a rough patch? A weak period that is going to be overcome or is it in fact a more fundamental change in the growth model? Is what we've seen over the last 15-20 years something of the past? Many are asking themselves. The answer we present here is that underlying drivers remain strong. The fundamentals remain strong. We discussed it a little bit last year for those of you who were here.

The analysis that we've done in recent years shows that a lot of this growth, the 15-20 years of growth was not driven by natural resources alone, but by strong economic policies and stronger institutions that played an important part and those are not necessarily gone. Those are still in place or can indeed be reinforced. So our view is that Africa's medium term prospects remain strong but in the short term for

sure, a policy reset is required. So these are the kind of short-term policy responses that we have been urging countries to take on fiscal policy. Fiscal adjustment is urgently needed for oil exporters. There is just no way around it. A country like Angola, lower oil prices have led government revenue to fall by 20% of GDP. There is no alternative than to adjust to such a shock. On the oil importers side, many countries continue to enjoy strong growth rates and that is certainly a positive thing. It is also an opportunity to build buffers, an opportunity to ensure against future shocks I mentioned global financial markets being one constraint that all countries are starting to face in Africa. One the monetary exchange rate policy, those who have the space and opportunity to do so should use the exchange rates as a buffer to adjust to the terms of trade shock and monetary policy should accompany that to make sure that the exchange rate adjustments does not translate into runaway inflation. Central banks should be careful not to overextend themselves and limit the amount of government financing that central banks engage in.

For Africa to return to growth rates of the past, I would like to mention three areas for policy action in the medium term. A lot of this draws. On some of the analytical work that we've done over the last couple years. Revenue mobilization is very important and a big theme that came out of recent conferences for obvious reasons, because if you are less able to raise financing either for markets or for development partners, building stronger domestic revenue bases is important. The need to reinforce resilience- buffers is very important for countries that are susceptible to shocks. An increasing competitiveness is particularly important for countries that have a less diversified export structure. And then the third policy priority is to make growth more inclusive and I'll come back on that in a moment. This is a chart from a report six months ago where we did some analytical work to look at revenue potential and using some econometric estimates said on average, there are still significant potential for more domestic revenue in a number of countries. On average, about 3-3.5% of GDP could still be raised on domestic revenue. This is all the more important given expenditure needs that these countries are facing. This complicated chart comes from an analysis of Sub-Saharan Africa's integration and global value chain that we also did last year.

What it shows is that a lot of Sub-Saharan Africa is below the curve and less integrated in global value chains than would be needed to have sustainable growth, but you can also see that varies. I think we have in our report some examples of countries that have been able to integrate more into global value chains like Ethiopia, Kenya, Tanzania, etc. There is some progress that has been made but overall there is still a lot of need to do better on the competitiveness front. Competitiveness is not only about global value chains, but a lot of micro aspects to it starting with infrastructure development for example. This is

the third area that I mentioned- reducing inequality. This comes from the report we did also about six months ago. What we tried to do was look at both income inequalities and gender inequalities and estimated that if Sub-Saharan Africa was able to reduce inequalities to levels seen in Asia, you could gain at least 1% in growth per year. This is research that fits pretty well with research we've done beyond Sub-Saharan Africa over the last couple of years at the IMF. Sub-Saharan Africa has very large inequalities, particularly gender inequalities. There is quite a lot of scope for gaining growth that can be shared better than it is today.

That's all I'm going to tell you. I know that it's a snapshot but there are two things that I would like you two remember that are- yes, in our view it is a rough patch but it is a rough patch that requires countries to take action- particularly those that have been heavily hit, particularly the oil exporters. And it is also a rough patch that, in our view, can be followed by a return to the growth rates of the past. But again, that is not automatic. It requires putting in place medium-term policies. Three of which I embedded here and I am happy to talk more about it in a moment. So with that, Professor Yu, I will pass it back to you and Celine can take over.

Qiao Yu:

Okay thank you very much Roger. You've given us a very clear picture of Sub-Saharan Africa's economic situation. So next we would like to invite Celine Allard to make a presentation about commodity prices.

Celine Allard:

Thank you very much Professor Yu. The topic itself I think deserves very little motivation and as Roger's presentation was very clear for about half of the countries in the region, those countries which are considered vulnerable one way or another to fluctuations in commodity prices. However, to what extent it would be effective remains debated. So this chapter tries to shed light on that topic and I will try to respond to these questions through three different aspects. First, I will look and show how much the dependency on commodities has changed over time and how it compares to other regions in the world. The second I will try to answer is to what extent those fluctuations affect microeconomic performance in the region and in particular by looking at past episodes of commodity price decline and try to draw some lessons of how the region will be affected in the next two years. And then building on those lessons, we will try to draw some lessons about how those countries can best react with policies.

One element that is very important to realize is that unlike many other regions in the world like Asia or Latin America, over the last 30 years, the regions have actually become more and not less dependent on commodities. Here, if you look at the exports for the region as a whole, it has grown from about 2% of GDP in the 80s to about 6% nowadays. And not too surprisingly, this has affected more oil exporters in the region. If you look here on the left hand side, you can see that next exports for countries such as Angola, Equatorial Guinea, Gabon, and the Republic of Congo, net exports of oil for those countries corresponds to about 45-85% of GDP. And then when you look at net oil exporters, which was the eight oil exporters- account for about 20 countries out of the 45 countries in Sub-Saharan Africa. Those countries tend to have slightly less net exports but still fairly significant from about 10-30% of GDP. Those tend to be the largest, like Zambia, Ghana, or South Africa.

Now the first step to go and understand the magnitude of the impact of commodity price fluctuations on those economies, the first step is to understand how the terms of trade of those countries are affected. And by 'terms of trade', I mean the fluctuation of net export income for those countries as a percent of GDP. Here you see those fluctuations over a period of 25 years and especially since the turn of the century, what we see is that the oil exporters have experienced very dramatic fluctuations of their terms of trade. In fact, they experience very dramatic increase in terms of trade from 2000 to 2014, but also an equally dramatic decline since mid 2014. And this decline has been much larger, both compared to oil exporters outside the region and to other commodity exporters in the region. The solid green line shows you the terms of trade fluctuations for the metal exporters in Sub-Saharan Africa and as you can see its much more stable than what we see for the solid red line. Which are both Sub-Saharan African oil exporters.

Now looking a little bit more in detail at the country circumstances, what we see here is that those terms of trade have declined the most for the countries that are the most with production. Production is so much more concentrated into oil. So Congo, Equatorial Guinea, and Angola have seen terms of trade decline ranging from 25 to 45 percent of GDP. If you think about it, those countries have lost about 20% of GDP of export income in a matter of 18 months. Those changes are more muted for metal exporters but are still being quite significant for countries like Zambia, Sierra Leone, and the Democratic Republic of Congo, which has lost about 5-10% of terms of trade over that period, owing to the sharp decline of copper and iron ore prices.

So now given the very sharp fluctuations, it's legitimate to ask how these countries have been affected in terms of microeconomic outcome. So at first sight, if you look at the past and the period of very strong increase in terms of trade, the correlation between those very large increases in terms of trade and the growth rate seems to be only accurate for oil exporters. But it doesn't mean that for the metal exporters that the decline of prices that they've experienced since 2011 or 2012 would not have effected their economy. And the reason is that for those countries they have very discrete moments that can affect the economy very strongly. And this is when there's the decision to actually close mines where it was a very negative impact on jobs and activity and we've actually seen that happening recently in countries such as Zambia and South Africa, to name a few. And this can actually introduce some non-linearity and a very strong impact on the economy.

So one first way of looking at the impact those terms of trade shocks have on the economies is to do advanced study. So basically look at past shocks of similar magnitude and how they have continued to affect the economy. So that's what we show here when we look at the growth rates of those economies prior and after commodity price shocks that have happened in the past. So in general, we find that in Sub-Saharan African countries we tend to see a decline of about 1% of GDP in terms of growth when this happens which is quite similar to what we see in other emerging and developing countries around the world. Not to mention more of an effect than elsewhere in the world. However, for Sub-Saharan Africa's oil exporters, this situation is very different. You will find a much larger impact on the economy at more or less a decline of 3 percentage points of gross after commodity shocks, so a very large impact. And actually, when we look at what has happened already since 2014, Sub-Saharan Africa's oil exporters grew by about 6% in 2014. That growth rate was only 2.6% in 2015, so this is very much the order of magnitude that we have already seen in this current oil price shock.

Those very large impacts on growth are also very apparent on other macroeconomic variables. As you can see here, in those episodes, the very substantial current account surplus that those countries have very quickly turned into a deficit, save for the fiscal balance, and we also a very large draw down on reserves. The study doesn't take into account other elements that can affect growth for commodity exposures at the time of a price slump. For example, the growth rate of the trade partners or political factors domestically. So to complement the events, we have also learned from econometric analysis that the control for this other exogenous factors. And this analysis pretty much confirmed what we found on the very strong headwinds of oil exporters. If you look on the left hand side, basically what the analysis shows is that at 1% decline in the commodity terms of trade shock, countries in Sub-Saharan Africa tend

to have accumulated an impact of loss of GDP of about 0.75%. So knowing that oil exporters have experienced 20% decline in terms of trade, this also corresponds to a declining growth of about 3-3.5% of GDP for consecutive years for the region. So again, very much in line with the order of magnitude we've seen already, but what this study shows is that this effect is very attractive. The negative impact peaks after 4 years so it means that those countries are not yet out of the woods even if those prices started to rebound a little bit.

Given that this macroeconomic impact is very large, especially for the oil exporters in the region, what is our recommendation and how best can the country cope with this shock? So the events have already provided some glimpse into what the best policy may be. On the left hand side you can see that when we look at the countries that have coped the best in the past episodes, what we see is that countries that have more flexible exchange rates have tended to be more resilient. Similarly, countries that entered the period of shock with a lower level of public debt are also tending to be more resilient. So to complement this first analysis, we also conducted a more comprehensive econometric analysis trying to identify the factor that determined the difference in growth before and after the shock. So here, the dependent variable is the difference in growth rate after and before the shock. So basically any significant positive variable here would indicate that the variable or policy in question would help mitigate the impact of the shock.

The first thing we find is that indeed a flexible exchange rate tends to help countries absorb and weather the shock. It also shows that the level of depreciation also helps. For every 10% depreciation over a period of two years after the shock tends to mitigate the loss in GDP by about 1.25% of GDP. However, what's important to notice is that for countries that experience very large depreciation, what we call an exchange rate collapse that tends to increase the negative impact on growth. Our interpretation of that result is that when countries tend to delay the exchange rate adjustment, this tends to have negative consequences because it gives time for imbalances to build. So much so that by the time the exchange rate depreciation happens, it cannot help any more to absorb the shock. In particular, we looked at the sample that experienced that kind of exchange rate collapse and in 75% of the sample, those were countries that up to then had a fixed exchange rate regime and it had come to a point where they could not sustain anymore which later lead to the exchange rate collapse. So basically the bottom line and the confirmation here of our prior is that the exchange rate, where it's available can be a tool to absorb the shock but it should not be delayed.

Now turning to the fiscal policy, we do find that counter-cyclical fiscal policy can help. And indeed when you look at the growth of government consumption after the shock, with more growth, you actually find less negative impact on the economy. However, this effect disappears when the stock of debt entering into the shock is too high. Here we have this when the external debt is above 40% we find that positive impact of counter-cyclical fiscal policy disappears so it means that when you have buffers you can use them, but if you don't have fiscal space then increasing government consumption can actually be counter productive. So what does that mean for Sub-Saharan African countries and commodity exposures at this juncture? As I said, the first takeaway is that indeed the exchange rate adjustment should not be delayed. The other element is that up until now, between mid-2014 and now, as Roger's presentation showed, countries have used all of their buffers. They've let the fiscal deficit widen, public debt has increased, and basically we're getting very close to that threshold where fiscal policy loses its power. So that's one reason why we feel that now fiscal adjustment is really called for, especially for the countries that do not have the exchange rate tool such as the central African monetary union.

That being said, it doesn't have to be through a very drastic adjustment that really kills growth. And in particular, we see two avenues where this can be done minimizing the negative impact on growth. The first one is really to work at domestic revenue optimization like Roger was saying, increasing the tax base from the non-commodity sectors as a sustainable social fiscal space. The other one is to really work more closely at prioritizing spending. In particular, there is one element where we feel that there is still room for some commodity exposures, which is in the area of huge subsidies, which still eat some fiscal space in some countries. As Roger also said, beyond the macro policy response, this is also an opportunity to reinvigorate the diversification of the agenda for those countries and I won't say more because Roger already elaborated quite a bit. Let me just say one thing is that in a sense this makes me sound very weak and that all of these exposures will continue to get hit very much, but I think one positive take away from this work is that policy really matters. Policies have a role to play for countries to adjust to this very abrupt patch. Now is the time to put these policies in place, otherwise the adjustment runs the risk of being disorderly. Thank you.

Qiao Yu:

Thank you very much Celine for your very insightful analysis for impact of commodity prices on the economy. I would like to invite Wenjie Chen, an economist of the Africa Department of the IMF.

Wenjie Chen:

Thank you for organizing this event. Last year I was here as well with David Dollar and it was such a great experience. In terms of the presentations as we can see with the commodity price decline, in the background we have China's rebalancing. A shift from investor led growth to consumption led. It's been playing a big role in terms of commodity prices coming down, particularly metal prices that have also been in decline on those airports. That's another venue going forward that's going to be very important in having consequences for the prospects of these countries. First in the near term it will be very negative and challenging to overcome but in the long run there also may be more positive implications such that non-commodity exporters end up being very attractive for Chinese investors. Some of my other research that I presented last year showed that a lot of [], regardless if a country was a commodity exporter or not. So I believe those trends going forward can address bottled issues such as infrastructure, having a better environment, conducting business, etc. And those will certainly be very important within global value chains and increasing trading.