

# The implications of the global economic slowdown for Africa: a synthesis

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**“The Credit Crunch- Implications for Africa”**

**28th of July, 2009, Hilton Hotel, Addis Ababa, 9:00am -13:00pm**

**Organized by the Institute for Security Studies**

# Outline

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- Visible and expected impacts of the financial crisis
  - Financial market linkages
  - Transmission channels to the real sector
  - Macro effects
  - Social effects
- Actual and potential policy strategies
  - Currently adopted strategies
  - Potential policy options
- Conclusion

# Introduction

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- The severity of the global financial crisis on African countries varies depending on:
  - level of integration into the global economy (finance & trade)
  - economic structure (diversification, productive capacity, development, socio-economic aspects)
- General trends in the transmission channels are observed in the African continent
- The scope of the impact, spillover effects and policy strategies vary across countries

# Impact of the global financial crisis on Africa

## **Effects through financial market linkages**

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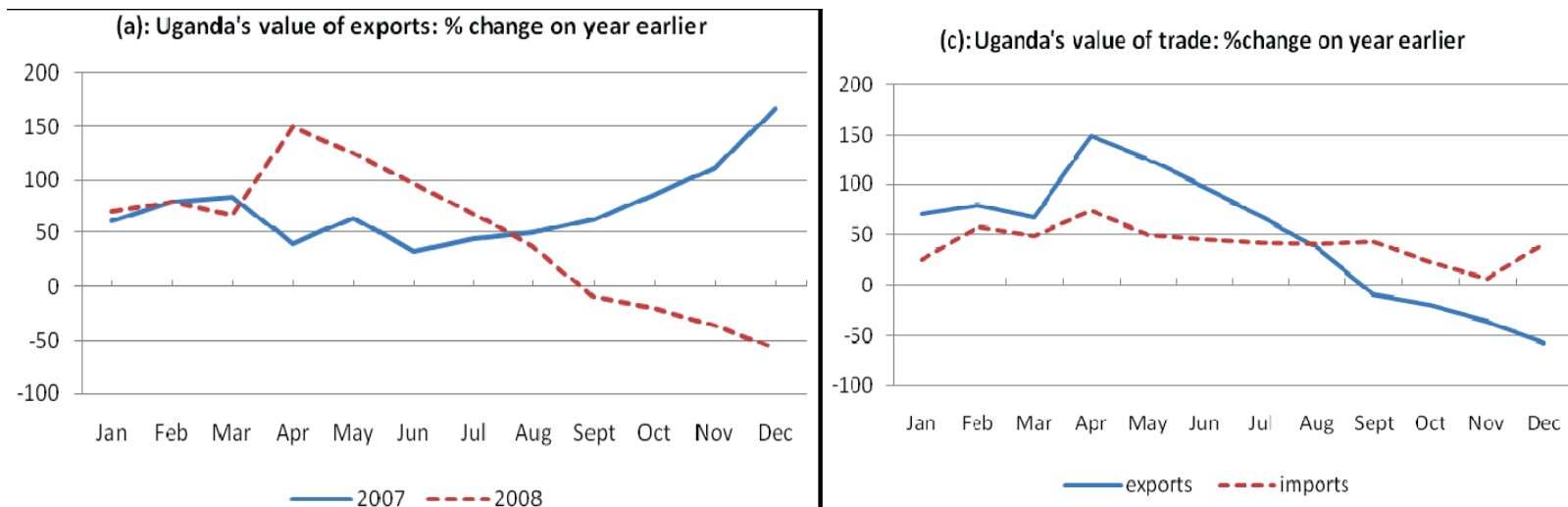
- Banking sector
  - Increase in non-performing loans
  - Drop in demand for government securities (investors retreat to safer destinations)
  - Risk of outflow of funds to support operations abroad (level of foreign ownership)
- Capital market
  - Effect on stock exchange through a retreat of investors
  - Drop in value of index (Uganda, the all share index of the USE fell by 39% from July to October 2008; Kenya, substantial outflow of portfolio capital in the Nairobi SE of 47 and 11,5 million USD in June and October 2008)
  - Panic sales by local investors in Uganda
  - Market capitalization fell by 45.8% in 2008 in Nigeria
  - Efforts to raise long term finance through sovereign bond issues have failed, been cancelled or delayed
- Amplitude of effect depends on the development and integration levels of the financial market

# Impact of the global economic slowdown on Africa

## Transmission channels to the real economy

- Trade flows (lower demand and commodity prices)
  - Expected shortfall in African export revenue amounting USD 251 billion in 2009 and USD 277 billion in 2010 (AfDB, 2009)
  - Exports fell by 10,3% in September 2008/2007 in Uganda

Uganda's trade performance, 2007-2008 (% change on year earlier)



Source: Ssewanyana et al, 2009

# Impact of the global economic slowdown on Africa

## **Transmission channels to the real economy**

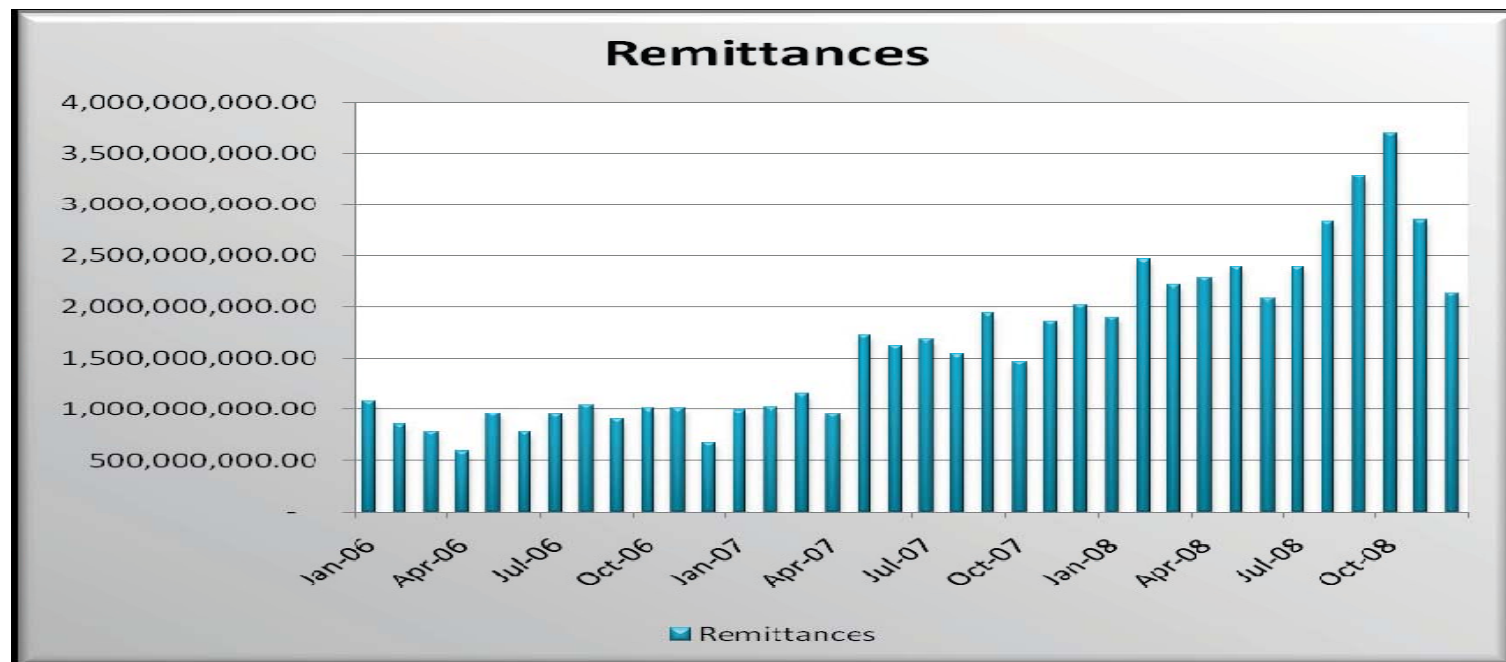
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- In Ethiopia, exports were projected to earn USD 2,6 billion between June 2008 and 2009 but only reached USD 1,4 billion
- Nigeria, reduction in demand for crude oil (80% of foreign earnings and 85% of gov. revenue) from 1,69 million barrels a day to 1,49 on a half-year basis between 2007 and 2008
- Export earnings from copper fell by 57% between May and December 2008 in Zambia
- Remittances
  - Important role in society (income and consumption of households) and economy (source of foreign exchange)
  - Decline of 27% in January 2009 relative to January 2008 in Kenya
  - Reduction in remittances in November and December 2008 in Nigeria

# Impact of the global economic slowdown on Africa

## Transmission channels to the real economy

Monthly remittances to Nigeria 2006-2008



Source: Olu Ajakaiye and Tayo Fakiyesi (2009)

# Impact of the global economic slowdown on Africa

## **Transmission channels to the real economy**

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### ■ Foreign investment

- Investors are relocating to lower risk countries
- Sharp decline in FDI in DRC and Central African Republic due to high economic and political uncertainty
- Sharp decline in portfolio investment in Uganda
- Financial inflows to Nigeria are predicted to reduce by 38.6% between 2008 and 2009

### ■ Aid

- 50% of Ghana's development budget
- Little evidence of aid pullout so far
- Foreign aid decreased from USD 223,29 million during Q4 2007 to USD 178,9 million in Q4 2008 in Uganda

### ■ Tourism

- Tourism receipts are down (effect on sector output and jobs)
- Kenya, average decline in tourism arrivals by 15,9% in 2007-2008

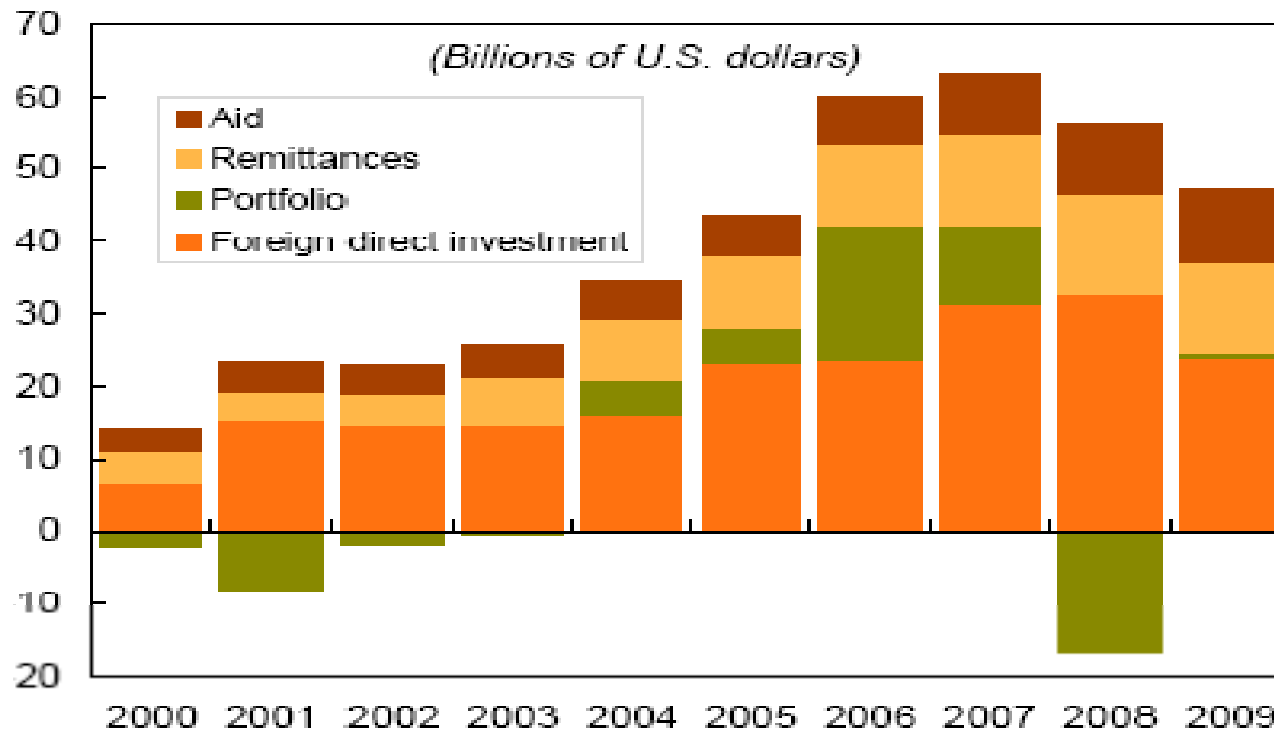
# Impact of the global economic slowdown on Africa

## Transmission channels to the real economy

IMF, Regional Economic outlook: Sub Saharan Africa

Capital Inflows in Sub-Saharan Africa

... and capital inflows to decline.



Source: IMF, *World Economic Outlook*.

# Impact of the global financial crisis on Africa

## **Interrelations and spillover effects: macro approach**

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### ■ Inflation

- Remaining pressure from the food and oil crisis
- Depreciation of exchange rate (import dependent economies)

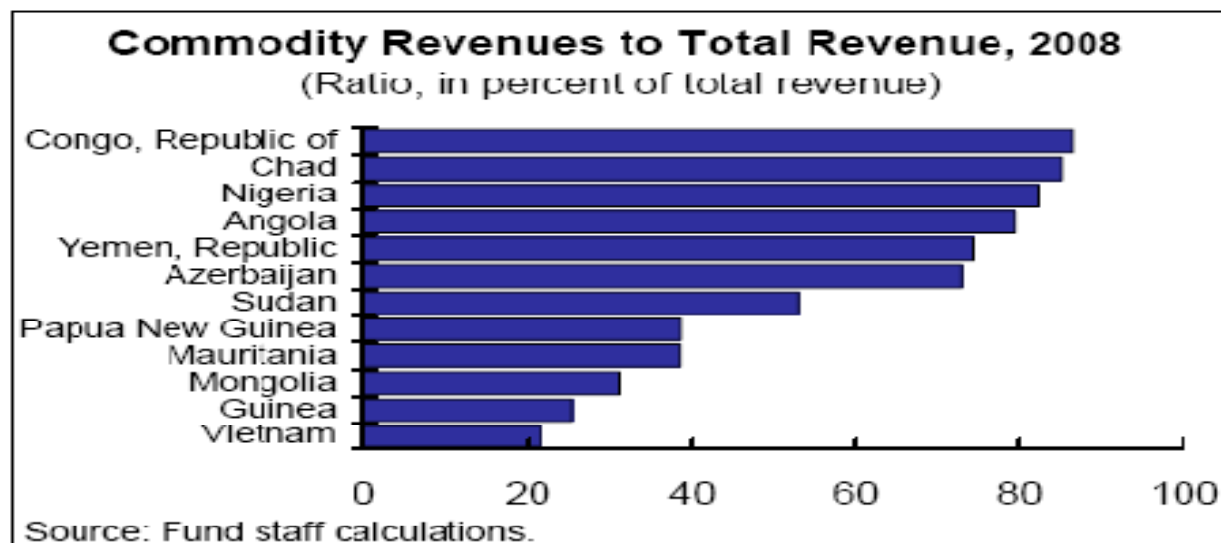
### ■ Government accounts

- Deterioration of external balance (exports are declining, high import bills, existing deficit of oil and food importers, decline in remittances and tourism).
- Kenya's current account deficit widened from USD 1,10 billion in 2007 to USD 2,12 billion in 2008 but declined in Q3 of 2008

# Impact of the global financial crisis on Africa

## Interrelations and spillover effects: macro approach

- Aggravation of budget deficit
  - Reduction in tax revenue due to decline in export growth (Angola, government revenue for 2009 is expected to be 24% lower relative to 2008)
  - Reduction in local fiscal revenues because of domestic activity contraction (sales tax, income tax, VAT)



Source: IMF (2009), The Implications of the Global Financial Crisis for Low-Income Countries

# Impact of the global financial crisis on Africa

## **Interrelations and spillover effects: macro approach**

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- Difficulty to maintain expenditure
  - increase taxes (demand), increase debt (crowding out), or cut expenditures
- Shortage of foreign currency reserves (increase in import value and decline in foreign capital inflows)
- Contraction in fiscal space for policy
  
- Exchange rate
  - Depreciation of national currencies (current account deficit and reduced capital inflow)
  - Export competitiveness
  - Imported inflation (industries that depend on imported raw materials by increasing the cost of production)
  - Debt payment

# Impact of the global financial crisis on Africa

## **Interrelations and spillover effects: macro approach**

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- Economic growth
  - Slowdown in domestic activity
    - Contraction of global demand
    - Delays and suspension in planned private and public sector projects
    - Difficulty to import raw materials due to shortage of reserves
  - Growth projections have been revised downwards
    - Angola: economy expected to contract by 7% in 2009 from 15,8% in 2008
    - Tunisia: growth projections for 2009 revised downwards by 1,5 percentage points
    - Kenya: 7% in 2007, 4% in 2008, and 3% in 2009

# Impact of the global financial crisis on Africa

## **Interrelations and spillover effects: macro approach**

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### ■ Poverty

- Negative correlation between economic growth and poverty
- High inflation (households' real income and purchasing power)
- Decline in remittances (households' income and consumption)
- Shortage of foreign exchange reserves (affect the ability to import basic commodities such as food, medicines, agricultural inputs, oil)
- Employment rates are declining (27% reduction in mining labor in Zambia) and no social protection schemes
- Reduction in prices and volume of export commodities affects households that produce them

# Impact of the global financial crisis on Africa

## **Interrelations and spillover effects: macro approach**

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- The social sector depends on donor support and government expenditure
  - cuts will have a dramatic effect on basic services (the 2009 budget proposal indicates a 16% cut in education allocations and 29% in health in Nigeria)
  - women and children will particularly be more affected
  - Considerable effect on human development

# Policies to address these shocks (actual and potential)

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- Reinforcing regional trade (Uganda)
- Promoting non-traditional exports which do not usually sell on international markets (maize, beans, cement in Uganda)
- Allow the exchange rate to adjust
- Short-term counter-cyclical monetary policy by cutting interest rates to stimulate demand and reduction in the cash reserve requirement for banks (Botswana, Egypt, Namibia, South Africa)  
→ low inflation
- Fiscal stimulus (increase in investment or tax reductions in some countries like Mauritius, Liberia, South Africa)
- Maintain budget and expenditure plans in priority areas essential to poverty reduction (basic services such as health, education, water and sanitation and agriculture)
- Export diversification (partners, products)
- Reduce wasteful public spending by channeling the limited resources into productive economy sectors and areas that ensure social protection of the poor and vulnerable

## Policies to address these shocks (actual and potential)

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- Support sectors that are key drivers of growth and that create employment (the Nigerian government injected money into the textile sector; and the government of Uganda provided assistance to the transport sector)
- Reduce production constraints by cutting costs (infrastructure, cost of capital, skilled labor)
- Explore alternative sources of financing for government
- Increased aid (the AfDB estimated that for the continent to maintain pre-crisis growth levels, additional resources of USD 50 billion for 2009 and USD of 130 billion is required for 2010)

## Conclusion

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- Effects of the crisis are more important than expected through the magnitude varies
- The crisis posed considerable challenge to policymakers because of its complex and interrelated effects as well as the uncertainty of its duration
- Timely country-specific measures are required to maintain the significant economic gains of the past decade
- Donor support is critical for countries with limited policy space

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Thank you