THE EFFECTS OF THE FINANCIAL CRISIS ON SUB-SAHARAN AFRICA

Franklin Allen, Giorgia Giovannetti (2011)

Presented by Michael Hobson

AGENDA

1. The Economies of Sub-Saharan Africa
2. Brief Overview of the Financial Crisis
3. Impact on Sub-Saharan Africa
   I. Direct
   II. Indirect
4. Fragility and Capacity to Cope in Crisis
5. Possible Responses

THE ECONOMIES OF SUB-SAHARAN AFRICA

HISTORY

- “Lost decades” – 1980’s, 90’s
  - Very low growth ~1% annually
- 2000’s: growth acceleration
  - Annualized growth of 8%
- Production and exports focused in raw materials, commodities

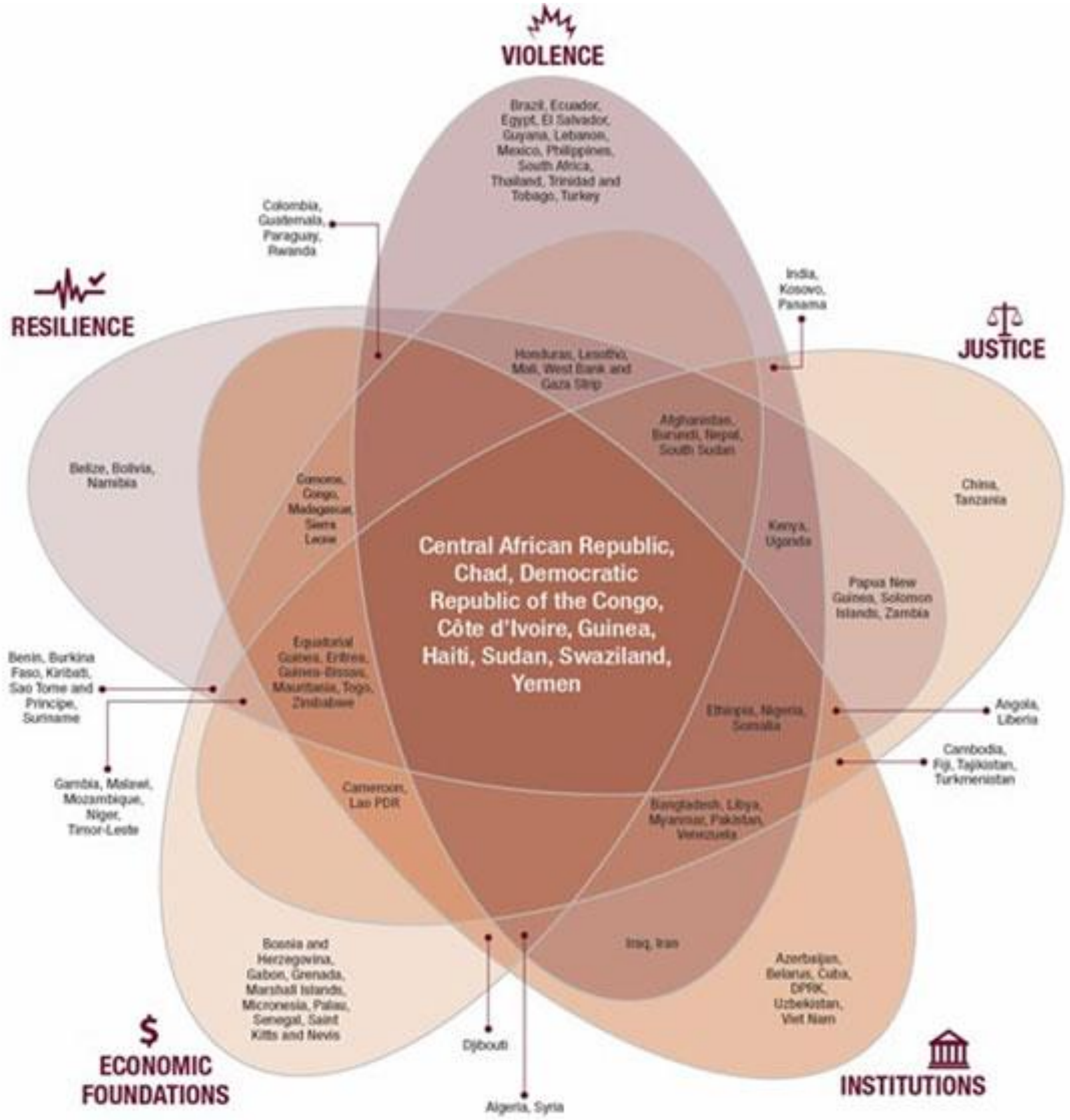
THE ECONOMIES OF SUB-SAHARAN AFRICA

FRAGILE

- Concentrated exports
- Low export/GDP
- Limited banking, finance
- Low foreign direct investment

LESS FRAGILE

- Diverse Exports
- Moderate export/GDP
- Credit origination, market access
- Foreign direct investment


VIOLENCE
Brazil, Ecuador, Egypt, El Salvador, Guyana, Lebanon, Mexico, Philippines, South Africa, Thailand, Trinidad and Tobago, Turkey
Colombia, Guatemala, Paraguay, Rwanda
India, Kosovo, Panama
RESILIENCE
JUSTICE
Honduras, Lesotho, Mali, West Bank and Gaza Strip
Afghanistan, Burundi, Nepal, South Sudan
Belize, Bolivia, Namibia
Comoros, Congo, Madagascar, Sierra Leone
China, Tanzania
Kenya, Uganda
Central African Republic, Chad, Democratic Republic of the Congo, Côte d'Ivoire, Guinea, Haiti, Sudan, Swaziland, Yemen
Papua New Guinea, Solomon Islands, Zambia
Equatorial Guinea, Eritrea, Guinea-Bissau, Mauritania, Togo, Zimbabwe
Benin, Burkina Faso, Kiribati, Sao Tome and Principe, Suriname
Ethiopia, Nigeria, Somalia
Angola, Liberia
Cambodia, Fiji, Tajikistan, Turkmenistan
Gambia, Malawi, Mozambique, Niger, Timor-Leste
Cameroon, Lao PDR
Bangladesh, Libya, Myanmar, Pakistan, Venezuela
Iraq, Iran
Bosnia and Herzegovina, Gabon, Grenada, Marshall Islands, Micronesia, Palau, Senegal, Saint Kitts and Nevis
Azerbaijan, Belarus, Cuba, DPRK, Uzbekistan, Viet Nam
Djibouti
ECONOMIC FOUNDATIONS
INSTITUTIONS
Algeria, Syria

Credit: OECD

THE ECONOMIES OF SUB-SAHARAN AFRICA

- Balance of trade
- Tourism
- Foreign aid receipts
- Remittances
- Land acquisition by foreign buyers

BRIEF OVERVIEW OF THE FINANCIAL CRISIS

- Preceded by real estate bubble, inflation of commodity prices
- Originated in the US sub-prime mortgage market
- Demand for US debt drew risk internationally
- Induced exchange rate volatility
  - Euro/Dollar fell 21.9%
- International credit crunch

IMPACT ON SUB-SAHARAN AFRICA

DIRECT

- Transmission of crisis through financial systems

INDIRECT

- Trade and Terms of Trade
- Tourism
- Foreign direct investment
- Land Acquisition by Foreign Buyers
- Remittances
- Foreign Aid

IMPACT ON SUB-SAHARAN AFRICA: DIRECT

Transmission of crisis through financial systems

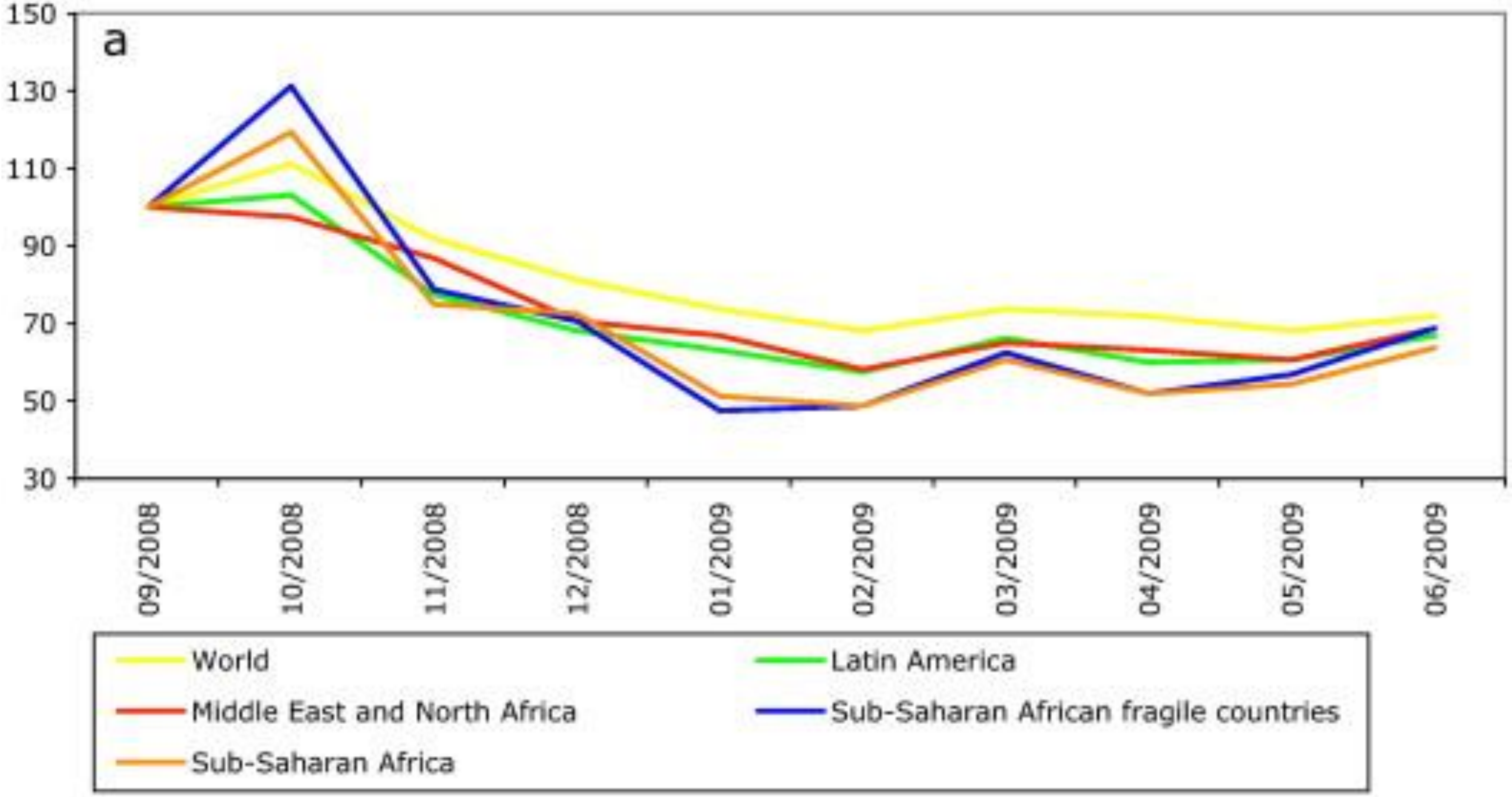
- Systems mostly underdeveloped, especially in fragile economies
  - African capitalization is 2.09% of world capitalization
- Exposed African markets "at the border of the crisis".
- Short-term portfolios too small for serious affect
- Overall risk aversion, credit tightening, and volatility decreased (already low) inflows
  - Bond issuances put on hold

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

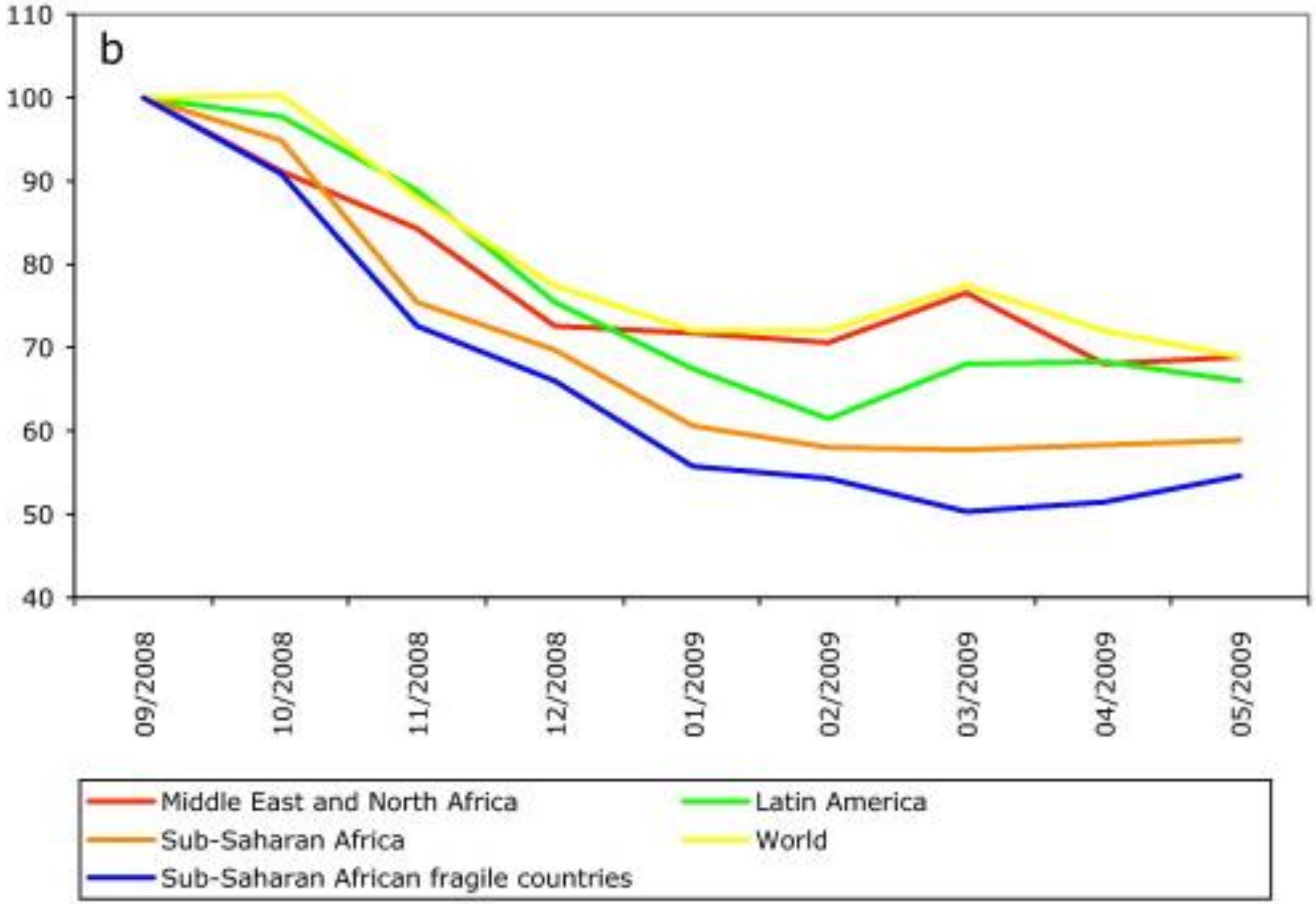
TRADE AND TERMS OF TRADE

- Growth driven by export market growth (Europe, US, China)
  - Fell sharply through mid-2009

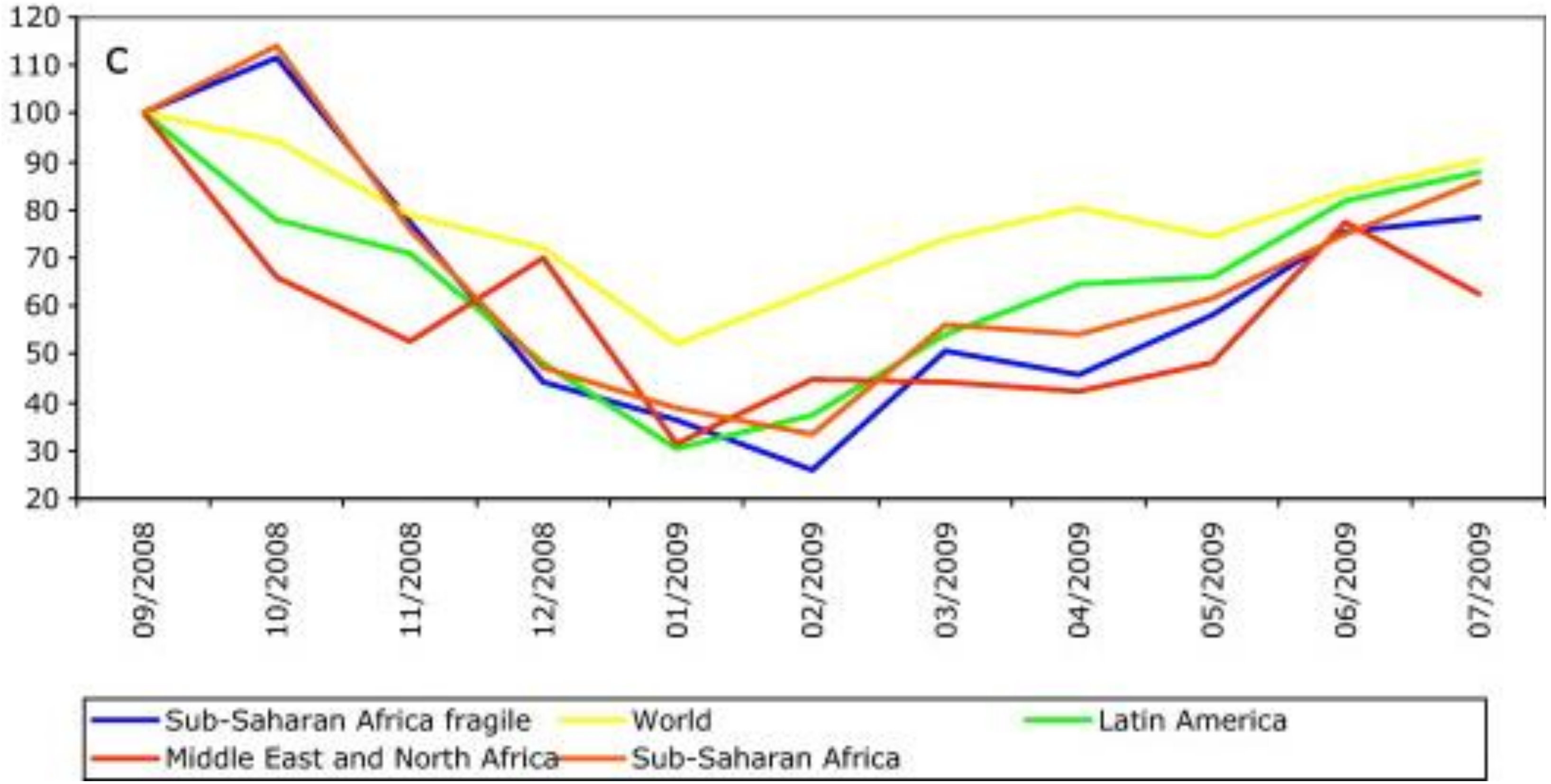
Indexed US Imports



Indexed Eurozone Imports



Indexed Chinese Imports



IMPACT ON SUB-SAHARAN AFRICA INDIRECT

TRADE AND TERMS OF TRADE

- Growth driven by export market growth (Europe, US, China)
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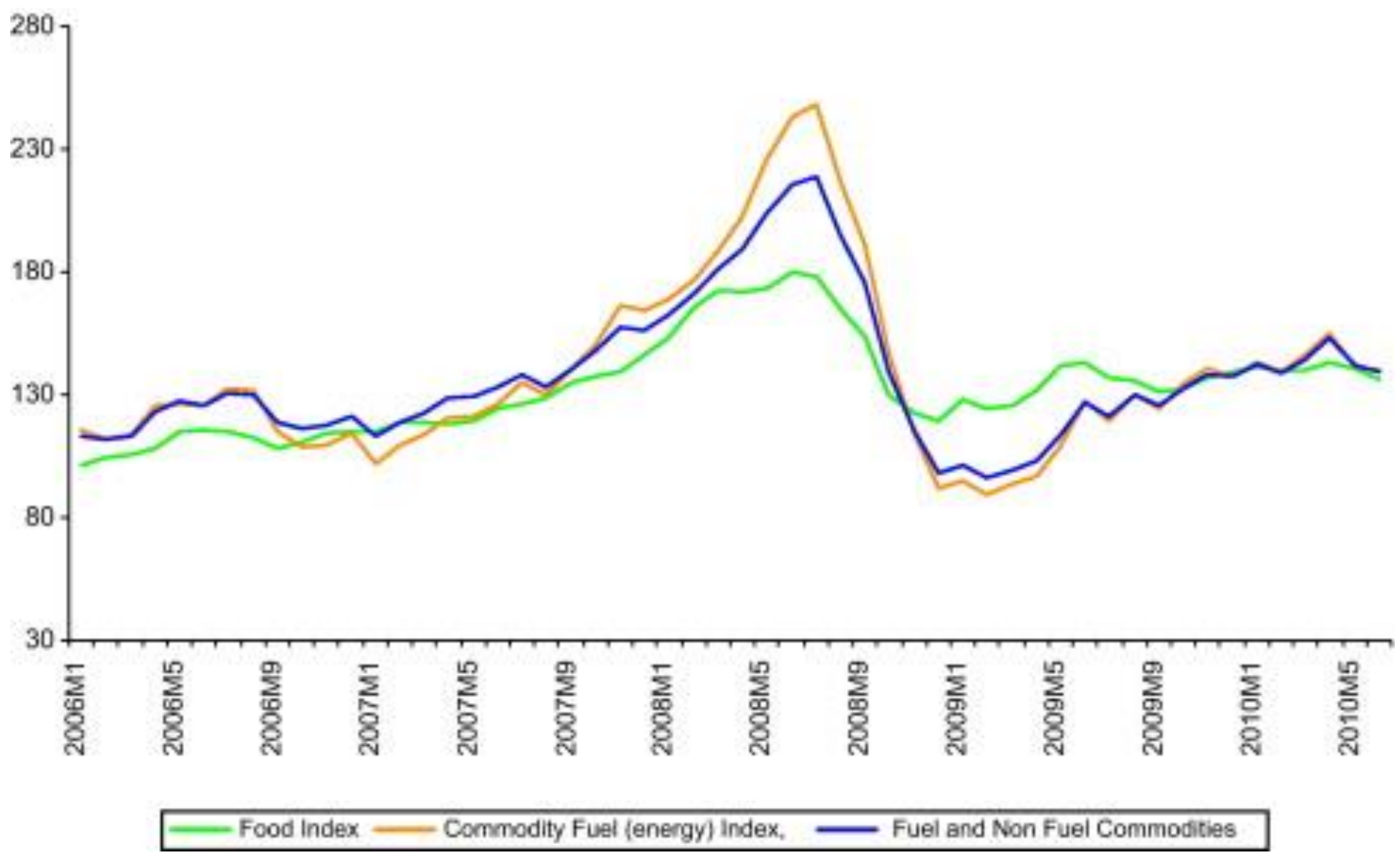
- Exchange-rate volatility increased uncertainty, costs of trade
  - Special case: CFA zone countries
- Short-term credit crunched

DEGREE OF IMPACT

- Specialization and degree of export/import concentration
- Main export and import markets
- Dependence on forms of financing



280
230
180
130
80
30
2006M1
2006M5
2006M9
2007M1
2007M5
2007M9
2008M1
2008M5
2008M9
2009M1
2009M5
2009M9
2010M1
2010M5
Food Index
Commodity Fuel (energy) Index,
Fuel and Non Fuel Commodities

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OUTCOME

- Crisis hit hard, but the region recovered quickly
- Overall value of trade fell by 25.6% from 2008 to 2009, hitting 2007 levels
- By 2010, exports recouped all losses
- Imports fell by 17% from 2008 to 2009, recovered by 2010
- By 2011, as if nothing happened

Source: Worldbank

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

TOURISM

- Special exports case
- Highly elastic luxury good
- Important source of foreign currency earnings
- Affects industries more likely to employ domestic workers (Hotels, restaurants, etc.)

EFFECTED COUNTRIES

These countries had tourism accounting for more than 20% of exports as recently as 2006

- Cape Verde
- Ethiopia
- Gambia
- Madagascar
- Mauritius
- The Seychelles
- Tanzania
- Uganda

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OUTCOME

- 4.1% increase in 2008-09
- Growth slowed, still outpaced inflation
- Positive real growth
- Majority of travelers from EU
  - Real value of tourism fell during crisis

Source: Statistics South Africa, 2015

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

FOREIGN DIRECT INVESTMENT

- Present in few fragile countries
  - Angola, Chad, Nigeria, Sudan received 70% of FDI from 2000-2005
- Credit crunch reversed or delayed foreign investment plans
- Sub-Saharan Africa perceived as high risk

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OUTCOME

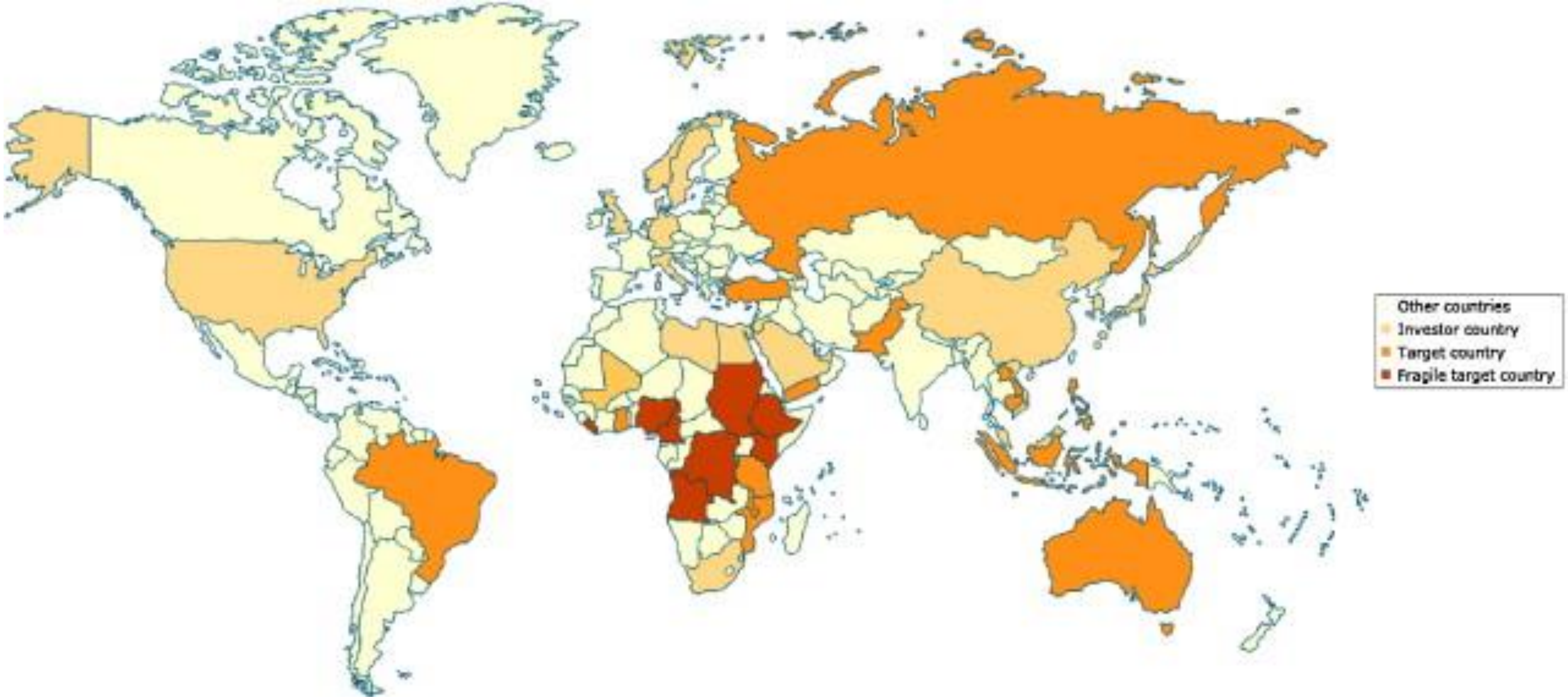
- Fell by 27% from 2008-2010
- Recovered to 2008 levels, then stagnated
- Dampened GDP growth in FDI countries

Source: Worldbank

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

LAND ACQUISITION BY FOREIGN BUYERS

- Special FDI Case
- Other countries seeking food security purchase cheap land
  - China, US, Eurozone
- Pre-crisis, high food prices drove up land prices, no land acquisition
- During crisis, land prices fell with food prices, driving acquisition



Credit: UNCTAD World Investment Report

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

LAND ACQUISITION BY FOREIGN BUYERS

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- Land prices fell with food prices

OUTCOME

- 15-20 million hectares in developing countries, mainly in sub-Saharan Africa
- Poverty-reducing growth in rural areas
- Poor resource rights, contract enforcement has suppressed growth

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

REMITTANCES

- A primary system of transfer of FDI impacts to non-FDI countries
- Hard to observe specifically
- Linked to intra-African migration

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OUTCOME

- IMF estimates a 1% decrease in host country growth reduces remittances 4%
- "A more detailed, country-specific impact assessment is unfeasible"
- Expected effects on education and housing

IMPACT ON SUB-SAHARAN AFRICA INDIRECT

FOREIGN AID

- Mostly dedicated to achieving the Millennium Development Goals
- Two stages
  - Commitment
  - Payout
- Aid budgets reduce significantly during recessions

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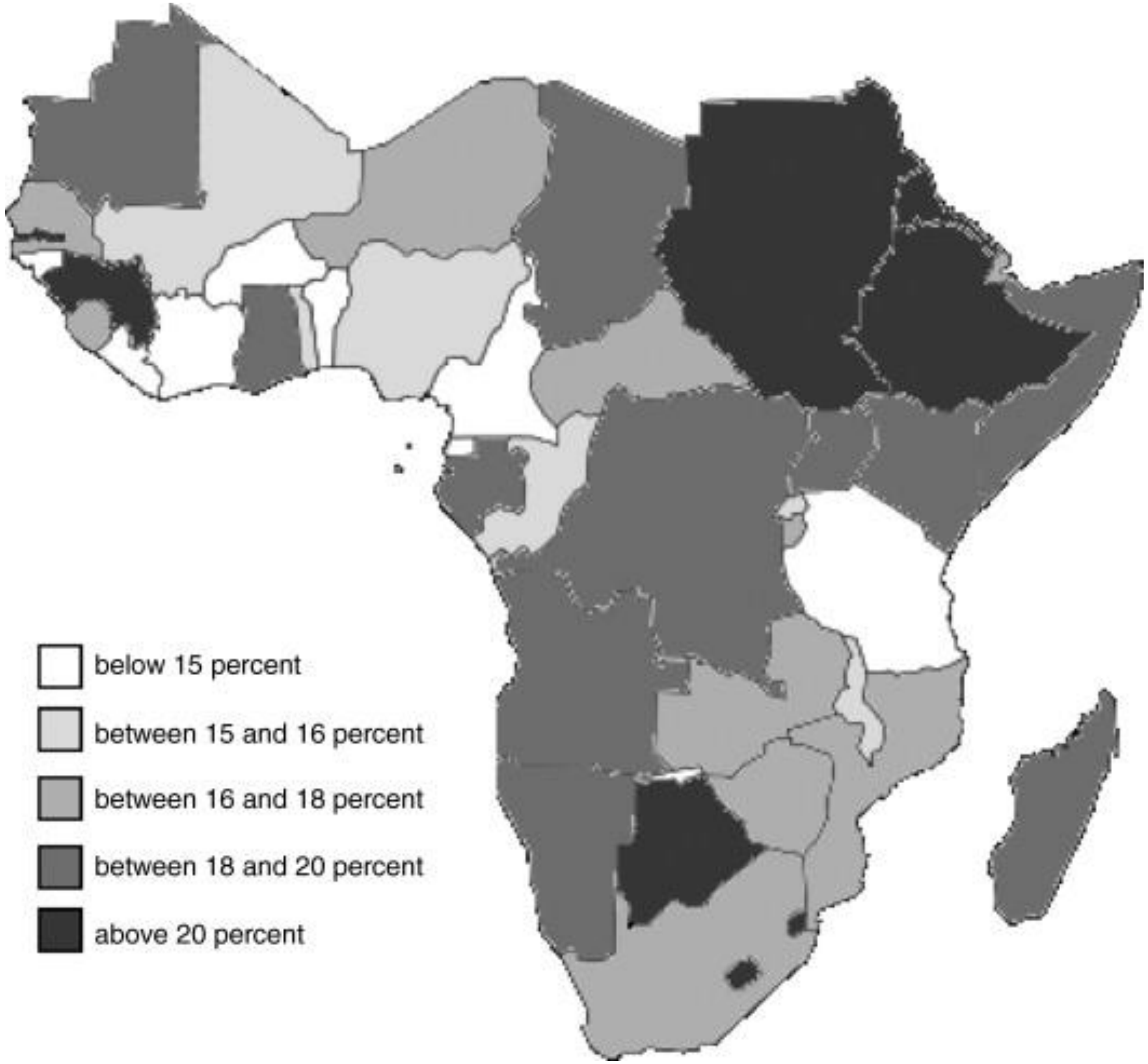
OUTCOME

- Total 2009 aid fell by 18.6% ($22B)
- Fragile countries more aid-dependent, highly susceptible to shock


below 15 percent
between 15 and 16 percent
between 16 and 18 percent
between 18 and 20 percent
above 20 percent

IMPACT ON SUB-SAHARAN AFRICA OVERALL

- Growth fell from 5.5% pre-crisis to 2.5% in 2009
  - Miguel et al. (2004) estimated a 5% reduction in the rate of growth doubles the risk of regional conflict
- Real GDP growth per capita was negative
- 12-15% reduction in financial inflows reduces annual resources by $50B
  - Reduction in industries requiring skilled labor, didn't translate to unemployment
- Unemployment ended downward trend, stabilized
  - Poverty reduction slowed

FRAGILITY AND CAPACITY TO COPE IN CRISIS

MEASURING RESILIENCE

- Openness, measured as the share of exports over GDP;
- Concentration of exports, measured as the Herfindahl–Hirschman Index – the more diversified the basket of exports, the less vulnerable the country;
- External indebtedness, measured as external debt as a share of GDP;
- Regulatory capital to risk-weighted assets;
- Cross-border liabilities;
- Growth of credit to the private sector.

Overall resilience rank – from low to high.

Low		Medium		High	
Congo, Dem. Rep. of	**1**	**Ethiopia**	**16**	Burkina Faso	31
Chad	**3**	**Sierra Leone**	**17**	**Togo**	**32**
Burundi	**4**	Zambia	18	Madagascar	33
Central African Republic	**5**	Malawi	19	Benin	34
Eritrea	**6**	**São Tomé and Príncipe**	**20**	Tanzania	35
Congo, Rep. of	**7**	**Cameroon**	**21**	Mozambique	36
Guinea-Bissau	**8**	Mali	22	Lesotho	37
Côte d'Ivoire	**9**	**Uganda**	**23**	Swaziland	38
Guinea	**10**	**Nigeria**	**24**	Seychelles, The	39
Niger	**11**	Ghana	25	Gabon	40
Kenya	**12**	Senegal	26	Namibia	41
Liberia	**13**	Cape Verde	27	South Africa	42
Angola	**14**	**Rwanda**	**28**	Mauritius	43
Comoros	**15**	**Equatorial Guinea**	**29**	Botswana	44
		Gambia, The	**30**		

Note: countries belonging to the operational definition of fragile countries are in bold.

Source: Naudé (2009).

POSSIBLE RESPONSES

INCREASING RESILIENCE

- Diversifying exports
  - Transition to long-term contracts
- Reduced aid dependency
- Build foreign exchange reserves

Highly country specific