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
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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

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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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

TRADE AND TERMS OF TRADE

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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
# 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.)

## 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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

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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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

LAND ACQUISITION BY FOREIGN BUYERS

• Special FDI Case

• Other countries seeking food security purchase cheap land

• 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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

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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
IMPACT ON SUB-SAHARAN AFRICA INDIRECT

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OUTCOME

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

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<th>Low</th>
<th>Medium</th>
<th>High</th>
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Note: countries belonging to the operational definition of fragile countries are in bold.

POSSIBLE RESPONSES

INCREASING RESILIENCE

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

Highly country specific