



AFRICAN DEVELOPMENT BANK GROUP

Meeting of the Committee of Finance Ministers and Central Bank Governors

***THE CRISIS AND AFRICA:
PREVENTING A DEVELOPMENT CRISIS AND GEARING UP FOR RECOVERY***

Abuja, 14 July 2009

1. **Introduction**

The global financial and economic crisis has had profound effects throughout Africa, and its effects continue to spread and deepen. It took only months to see the growth of African economies being cut by half. The hard-won reform dividends in terms of macroeconomic stability, debt management, and improved investment climate are now at great risk.

What can be done to shield African economies and the millions of the continent's poor from the adverse effects of the economic slowdown and prepare for a speedy recovery? Most African countries lack the resources to launch adequate countercyclical interventions. Hence, domestic efforts have to be complemented by determined and coordinated support from the international community. Speedy and targeted responses are urgently needed to prevent a growth crisis from turning into a deeper development and social crisis across the continent.

This brief takes stock of the impact of the crisis over the past months and highlights domestic and global responses to the crisis. It discusses opportunities and limitations of recent global initiatives in support of developing countries, especially in the case of African low-income countries. The brief also identifies areas that require further attention from policy makers to mitigate the impact of the crisis while preparing African countries for a robust recovery after the crisis.

2. **Deep, diverse and fast-evolving impact of the crisis**

Growth deceleration and even contraction in some countries

The global economic crisis has quickly been transmitted to Africa and has resulted in a marked slowdown in African economies. Several countries are expected to even experience contractions. The most recent forecasts by the African Development Bank estimate that Africa's growth will not exceed 2.3% in 2009, down from pre-crisis growth of 5.8%. The continent as a whole will experience negative per capita growth for the first time since 1994.

The crisis has hit the major drivers of recent African growth, especially trade, capital flows, and tourism. In February this year, the continent's exports were USD 16.3 billion lower than the same month last year, and USD 21 billion lower compared to the pre-crisis level in August 2008 (Figures 1 and 2). Oil exporters have recorded a larger decline in export revenue compared to mineral commodity exporters, in line with the relatively lower decline in the prices of most mineral commodities compared to oil. Agricultural commodity exporters have fared much better. Nonetheless, the dominance of oil exporters in the continent's overall growth accounts for the meager growth performance and the gloomy growth prospects for the medium term. The crisis has demonstrated the high risk of concentration, especially the dependence on primary commodities.

Commodity dependent countries, especially those with weak fundamentals have been hit faster and more by the crisis (Figure 3).

The current global economic crisis has also come at the back of rising prices for food, mainly staples such as rice, wheat and maize and energy mainly oil. Between 2008 and 2000, prices of these three key food items have tripled. Although they have fallen in the first quarter of 2009, food prices are still much higher than in 2000. In 2009, price indices of rice, wheat and maize are on the average 2 times the 2000 level. Net food importers are thus struggling to cope with both the economic crisis and a heavy import bill.

Growth deceleration will have detrimental effects on African countries' efforts to reduce poverty and achieve other development goals. As incomes decline and jobs are lost, the continent may see millions of Africans fall into poverty. With limited fiscal space, few African governments are able to finance adequate social safety net programs to shield the poor against the impact of the crisis. Attempts to increase social expenditures run against the risk of widening fiscal deficits. Widening current account deficits will result in shortages of basic commodity imports such as medication and educational equipment and supplies. Hence, there is a genuine risk that some countries may backslide in their progress towards the MDGs and other development goals.

Middle-income countries and growth engines

Middle-income countries (MICs) and large open economies in general (e.g., Nigeria) were the first to be hit by the crisis, with substantial losses on their equity markets. In relative terms, some African stock markets have experienced larger losses in market capitalization than those in the US and Europe (Table 1). The effects of the crisis have now spread to the real sector. Here again, countries that are most dependent on natural resources have suffered relatively larger growth deceleration and bigger losses in trade revenue and fiscal balances.

Some examples are worth highlighting to illustrate these developments among MICs. The South African economy officially entered a recession in the first quarter of this year, following contraction over two consecutive terms. Manufacturing output declined by a record 21.6% year-on-year in April, settling at its lowest level in 6 years. Retail sales declined by 6.7% in April, reflecting weak consumer confidence. The country saw its trade deficit climb to USD 6.6 billion in the first quarter from USD 2.4 billion at the end of 2008. The decline in production in mining and manufacturing sectors accounts for the rising unemployment rates (23.9% in the first quarter, up from 21.9%).

Botswana, the continent's stellar performer for decades before the crisis is likely to see its economy contract by 4.7%. Diamond production has plummeted and unemployment is rising. In Mauritius, tourism has been hit by the crisis, and was 9.9% lower in the first quarter compared to last year. Unemployment is also rising, at 8% in the first quarter, up from 6.2%. Indeed, while still positive, growth rates will also decelerate substantially in other middle-income countries.

Non-resource-based middle income countries are doing relatively better. In Tunisia growth for 2009 will be around 3%. Tourism revenue was up 3 percent (USD 900 million) in the first five months of the year, with a 1.3% increase in tourist arrivals. In contrast, tourism receipts and arrivals are declining in both Egypt and Morocco.

The impact of the crisis on large middle income economies has drastic implications for neighboring smaller economies. The recession in South Africa and the retrenchment of labor in the mining sector have pushed thousands of migrant workers from neighboring countries into unemployment. Worker remittances in these countries have declined substantially. The cooling of the South African economy means lower demand for imports from neighboring economies and overall lower revenues in the SACU area. The same applies for Nigeria's neighbors.

The weakening of large MICs will also delay both the bottoming out of the downturn as well as post-crisis recovery.

Low-income countries – vulnerability and risk of delayed recovery

Non-resource-rich low-income countries were relatively shielded from the initial impact of the crisis as a result of their limited integration in global financial markets. In fact, low-income non-resource-rich rich countries are expected to grow faster than their resource-rich counterparts and middle income countries. The former group includes countries that are benefiting from relatively upbeat prices and demand for agricultural exports (Ethiopia, Kenya, Uganda, Rwanda). Uganda recorded a trade surplus of USD 37.8 million in April compared to a deficit of USD 81 million in the same month last year, thanks to substantial increase in cotton exports, among others. Likewise, Rwanda has enjoyed a rise in tourism receipts in addition to agricultural exports.

However, the key question for low-income countries is how long they can sustain this relatively good performance. The group includes countries that entered the crisis with poor initial conditions and high vulnerability to external shocks such as the Democratic Republic of Congo, the Central African Republic, and others... Vulnerability to external shocks mainly depends on three factors: (1) the country's dependence on primary commodity exports; (2) the country's dependence on external financing (capital flows including aid, FDI, and remittances); and (3) the country's capacity to respond to shocks as measured by its fundamentals, gauged by external balance position (reserves and current account balance) and its fiscal balance. As can be seen on Figure 4, all low-income countries face at least one the three vulnerability threats, and many face two, four countries face all three threats.

As the crisis deepens, government capacity to respond in these low income countries will further deteriorate. Many of them are already below or near their statutory levels of foreign exchange reserves. In the Democratic Republic of Congo, reserves are down to a couple weeks of import cover. Current account deficits and fiscal deficits are widening, further eroding the fiscal space. The Bank estimates that for this group of countries alone, it would take up to USD 27 billion to fill the saving-investment gap in order to reach the

pre-crisis growth rate. Raising the growth rate to the 7 percent MDG-consistent rate would require up to USD 51 billion (Table 2).

This particular group of low income countries, therefore, poses a critical and urgent challenge to the development community. With swift and sizeable external financial support, the majority of these economies can avert a deterioration of living standards. Indeed, the evidence demonstrates that without rapid and adequate external funding, these countries face a serious threat of a deep recession, followed by a long and painful recovery, a scenario that can degenerate into a development and social crisis.

The private sector hit by the shortage of liquidity

Before the crisis many African countries had experienced substantial expansion of private sector activity, notably tourism and the information communication technology. Private sector expansion has supported growth and employment creation. The crisis has taken the wind out of this trend, especially because of the shortage of financing. Private operators continue to struggle to secure credit for investment and trade. Lines of credit have closed and pre-crisis promises have been withdrawn in some cases. Investors and private banks have resorted increasingly to regional banks such as the African Development Bank both for direct funding and participation into joint funding arrangements to fill the gaps left by the withdrawal of international financiers.

Building resilient African economies will require concerted efforts by governments and their development partners to support a vibrant private sector. Hence, the Bank's new financing instruments such as the Trade Financing Initiative that are tailored to the private sector are much welcome. But it is also clear that the current provisions under these programs are still inadequate to meet the rising demand. Therefore, it is important that the new global pledges for new resources translate into scaled-up funding for the private sector.

3. Domestic response to the crisis

Since the beginning of the crisis, African governments have been doing their best to counter the impact of the crisis on the economy and alleviate hardships on households. In many countries, 2009 budgets have provided for substantial increases in public spending on growth stimulating and job creation programs. In Rwanda for example, the 2009 budget is 24 percent higher than the year before and it includes USD 330 million of spending on infrastructure and USD 152 million on various programs aimed at increasing productive capacity. In Tanzania, the government has raised its budget by 31 percent relative to last year, allocating nearly half of the expenditure to farming, schools, health and infrastructure to ease the strain from the global economic slowdown.

Various other African governments have also undertaken measures to support key sectors that are most hit by the global recession. The South African government for instance, has designed a rescue plan for the textile industry, including granting loans at preferential rates to textile firms for equipment upgrade, cracking down on illegal imports of cheap

textiles, and cutting import duties on imports of inputs for textile production. In Morocco, the government has pledged funds to support tourism marketing. It also unveiled a loan guarantee plan in favor of the textile and automobile parts sectors.

Nonetheless, few African countries are able to initiate and sustain meaningful rescue plans in the face of declining government revenues and dwindling foreign exchange reserves. The capacity to respond is very limited for most African governments. A solution to the crisis must involve the helping hand of development partners.

4. Global pledges in response to the crisis – good but inadequate for Africa

The April G-20 Summit reached a consensus that the global crisis requires a globally coordinated solution. This was reiterated by the G8 Development Ministers meeting on 11-12 June in Rome who resolved to “act in a coordinated manner to prevent the economic crisis from turning into a deeper social crisis” (Chair’s Summary, 12 June). The G20 countries agreed to a plan of recovery of unprecedented scale, making ambitious commitments to take action to restore the flow of credit through the scaling up of resources of the IMF and the World Bank.

However, for African countries concerns remain as to how exactly these global initiatives will translate into resources that can be utilized for both supporting crisis-prevention programs and meeting long-term development needs. For low-income countries, a key concern is that they are not eligible for the bulk of new resources, which are in the form of loans. For middle-income countries, the concern is the risk of debt build up, which would undermine their growth prospects and their ability to take advantage of global recovery. Moreover, given that the resources availed to the IMF are mostly short-term, these cannot be relied upon to meet African countries’ needs for long-term financing, especially for infrastructure. A further concern is the lack of flexibility in the traditional financing mechanisms which limit responsiveness and adaptation to country specific circumstances.

It is clear that more needs to be done to meet the financing needs of African countries in the context of the crisis. In particular, it is critical to increase the pool of concessional resources and grants for low income countries. To improve crisis response effectiveness, it is advisable for the IMF to channel its recently approved short-term resources into long-term development financing, mainly through regional and multilateral development Banks. Moreover, greater flexibility is imperative to increase effectiveness in responding to the needs of African countries in the context of the global crisis. In this context, it is critical to ensure a speedy review of the debt sustainability framework.

5. Vigorous and coordinated response needed to avert a development crisis and prepare the continent for a speedy recovery

A comprehensive response to the crisis will require coordination of actions by African governments and those of their development counterparts to maximize effectiveness. Within Africa, success will require strengthening partnerships between government and

the private sector in leveraging the potential of human and financial resources to build competitive and resilient economies.

The policy responses must be forward-looking and follow a two-pronged approach. On the one hand, it is important to sustain livelihoods through protection of employment and spending on social sectors (education, health, and sanitation). On the other hand, it is critical to support domestic growth drivers to ensure a speedy recovery after the crisis. This notably requires maintaining high levels of investment in infrastructure and supporting the private sector, especially by facilitating financing for investment and trade.

The developed economies can help Africa recover by:

- Pursuing strategies that boost demand for African exports. Indeed, recovery in the developed and emerging markets will help Africa out of the crisis by increasing African exports and capital inflows.
- Discouraging protectionist practices in trade and finance. Protectionism would have the lamentable effect of curtailing trade and capital flows.
- Supporting increased provision of concessional financing and grants to African countries through bilateral and multilateral mechanisms.
- Providing adequate funding for African low income countries as well as supporting funding for programs aimed at enhancing response to vulnerability.
- Honoring pledged funding for Africa.

But much of the effort must come from the continent: African countries with strong macroeconomic fundamentals and a good business environment will benefit from inward investments induced by global recovery. High return public investments are central to a recovery. Moreover, strategic partnerships between government and private actors are critical for building resilient economies, notably via joint funding of large public infrastructure projects.

Thus, African countries need to:

- Strike a balance between crisis response and alleviation of structural constraints to long term growth;
- Rebalance between external and domestic sources of growth;
- Accord priority to infrastructure, trade logistics and regional integration;
- Accelerate institutional reforms;
- Balance between the role of the state and the role market mechanisms; they must not quit markets nor disengage from the global economy.

6. Conclusion

The crisis has affected African countries severely, although the impact has varied across countries and sectors. The decline in export revenue, shrinking capital inflows, and reduced fiscal revenues are threatening a return of unsustainable “twin deficits”. In the absence of a vigorous response by the international community, there is a genuine risk that the growth crisis may degenerate into a development crisis.

In light of the disparity of the impact of the crisis across African economies, the African Development Bank has adopted a tailor-made approach to assisting regional member countries. For low-income countries the Bank is accelerating the transfer of existing resources to help fill gaps on the fiscal and current account balances. For middle-income countries the Bank has established emergency response instruments that are flexible and fast-disbursing, including a trade financing initiative of USD 1 billion and an emergency liquidity facility of USD 1.5 billion. However, it is clear that the Bank's current resource envelope will soon fall short of the rising demand for financing as the crisis deepens. This calls for immediate scaling up of resources availed to the Bank.

Ultimately, the solution to the crisis will require the collective efforts to stimulate global demand and avoid deep recessions. On the policy front, it is imperative for Africa to be engaged in global debates. Thus, it is critical to ensure that the continent is effectively represented in key global institutions such as the IMF and the World Bank and that its voice is heard in major bodies such as the G20.

Table 1: Stock Markets: changes in capitalization index, July 2008-June 2009

Region/Country	Index Name	Index Code	Benchmark* (31/07/2008)	Value at end of previous Week (19/06/2009)	Value at end of current Week (26/06/2009)	% change (on 26-06- 2009)	
						from previous week	from Benchmark
African markets							
Côte d'Ivoire	BRVM Composite Index	BRVM CI	242.54	135.4	145.52	7.47	-40.0
Egypt	CASE 30 Index	CASE30	9251.19	6163.26	5479.51	-11.09	-40.8
Kenya	Kenya Stock Index	NSE	4868.27	3279.67	3266.45	-0.40	-32.9
Mauritius	Mauritius AllShares	SEMDEX	1735.77	1458.04	1454.18	-0.26	-16.2
Morocco	Casa All Share Index	MASI	14134.7	11637.39	11615.08	-0.19	-17.8
Nigeria	NSE All Share Index	NSE	52916.66	28910.19	25813.55	-10.71	-51.2
South Africa	All Share Index	JALSH	27552.65	22399.18	22308.28	-0.41	-19.0
Tunisia	Tunis se Tnse Index STK	TUNINDEX	3036.87	3604.90	3661.35	1.57	20.6
Other markets							
USA	Dow Jones Industrial	DJ Index	11378.02	8539.73	8438.39	-1.19	-25.8
France	CAC 40 Index	CAC40	4392.36	3221.27	3129.73	-2.84	-28.7
Japan	Nikkei 225 Index	N225	13376.81	9786.26	9877.39	0.93	-26.2

*Benchmark as at 31/07/2008 except for Zimbabwe at 31/08/2008

Sources: ADB Statistics Department; Oanda Foreign Exchange Rates Online Database June 2009.

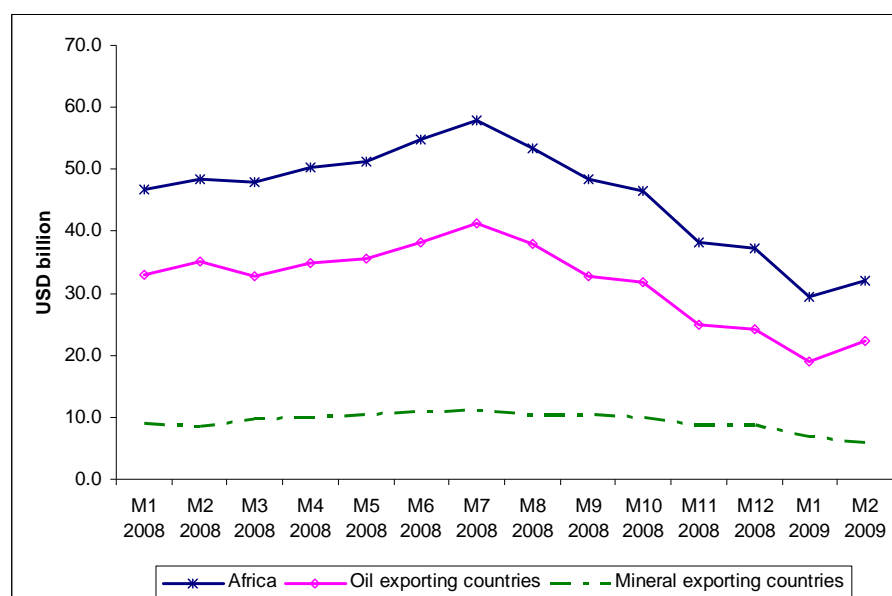
Table 2: Financing gaps for low-income African countries*

To achieve MDG-consistent growth rate						
Funding gap in bn USD			Funding gap as % of GDP			
	Oil exporters	Mineral exporters	Other LICs	Oil exporters	Mineral exporters	Other LICs
2009	22.7	11.5	17.0	15.7	23.2	34.4
2010	25.2	12.5	18.3	16.8	23.9	35.0
To achieve pre-crisis growth rate						
Funding gap in bn USD			Funding gap as % of GDP			
	Oil exporters	Mineral exporters	Other LICs	Oil exporters	Mineral exporters	Other LICs
2009	5.3	8.8	12.9	11.2	20.4	24.9
2010	6.8	9.4	13.7	13.6	20.5	24.9

Note: Here LICs are all the 38 countries that are eligible to Bank's ADF window ; this includes countries that are not classified as LICs according to the World Bank's definition.

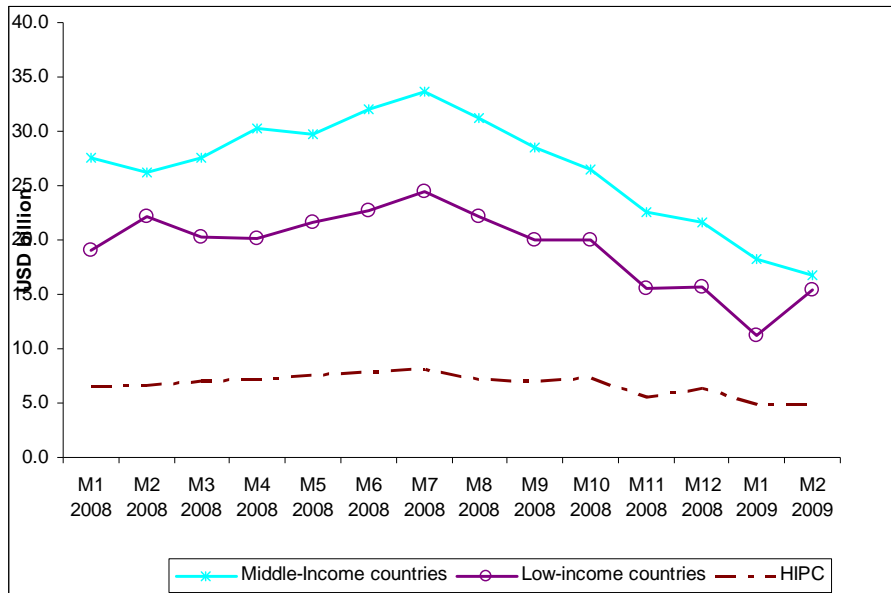
Source: Computed using AfDB database and models

Figure 1: Africa's exports by resource endowment category, January 2008 to February 2009 (USD bn)



Source: IMF, DOT database

Figure 2: Africa's exports by income category, January 2008 to February 2009 (USD bn)



Source: IMF, DOT database

Figure 3: Fundamentals, vulnerability and staggered impacts of economic the crisis

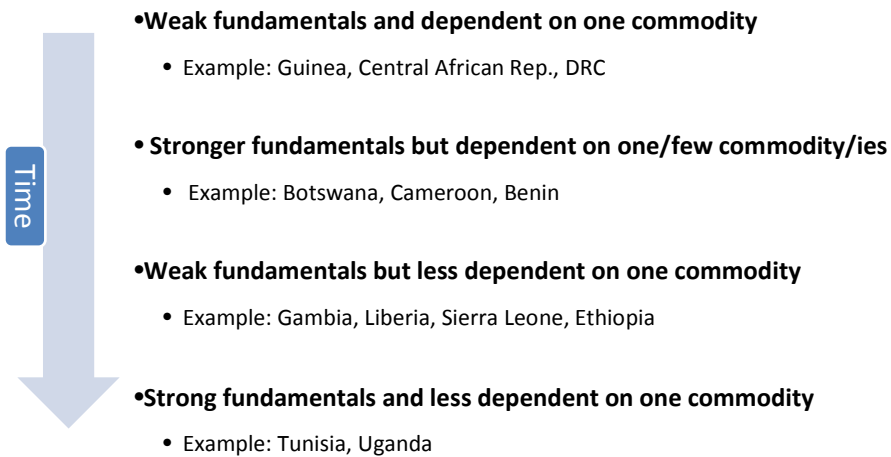
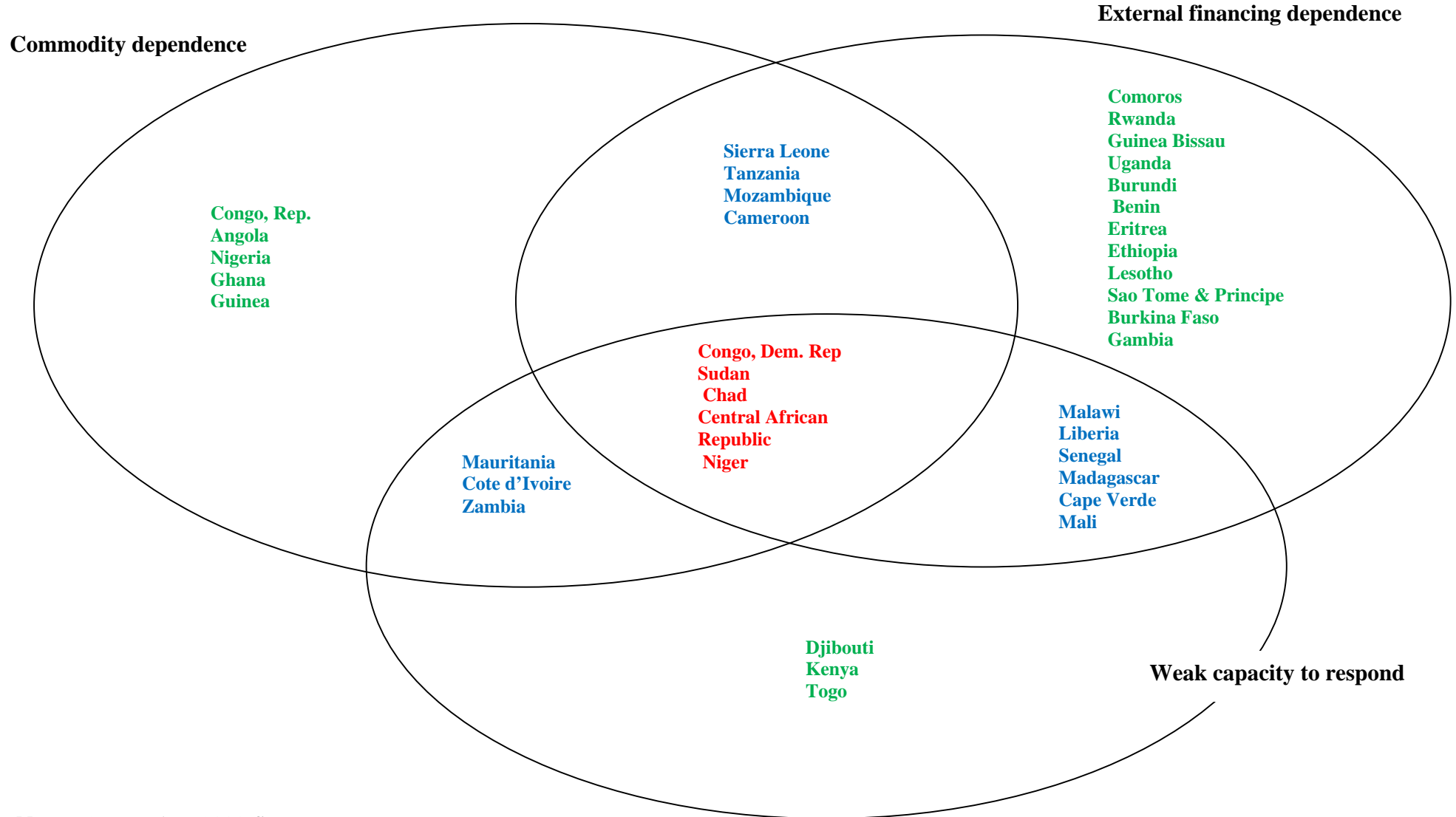


Figure 4: Typology of exposure to the crisis for LICs



- Notes:**
- 1) Based on 2008 figures
 - 2) -Commodity dependence: Oil and Minerals
 - External financing: OAD, FDI, Remittances
 - Capacity to respond: Reserves, Fiscal balance