

Policy Briefs on the Financial Crisis

N° 7 / 2009

An Update on the Impact of the Financial Crisis on African Economies



African Development Bank

Editorial Committee

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the Chief Economist with contribution from other departments of the African Development Bank. The PBFC are intended to present analyses of experiences and lessons emerging from the Financial Crisis, so as to encourage policy debate that guides the search for sustainable solutions to the crisis.

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AFRICAN DEVELOPMENT BANK GROUP

An Update on the Impact of the Financial Crisis on African Economies

**Meeting of the Committee of Finance Ministers
and Central Bank Governors**

**Dar Es-Salaam, Tanzania
March 11, 2009**

1. Introduction

1.1 When this Committee met in January 2009 in Cape Town, it rightly stressed the need to monitor the impact of the economic crisis which is still unfolding. Evidence available now points to a deteriorating economic outlook on the continent as trade declines and key sectors such as mining, manufacturing and tourism are hit by plummeting commodity prices and a continuous decline in global demand.

1.2 The latest key features of the crisis since the last meeting include :

- A slowdown in the downward trend of commodity prices. For example, a barrel of crude oil was trading at USD 45 at the end of February 2009.
- A continued fall of most African stock markets and a depreciation of most currencies.
- Rising unemployment and activity shutdowns. The collapse of commodity prices has forced a number of international mining companies to close. The worst case may be in the Democratic Republic of Congo where more than 350,000 jobs are estimated to have been lost in the Katanga Province.
- Worsening of fiscal and current account balances of most African countries.

1.3 African governments are doing their best to mitigate the impact of the crisis, especially its effect on the poor. However, since the last meeting, the leeway has continued to shrink. Budget deficits have widened and foreign exchange reserves contracted. Public spending on infrastructure and basic needs is increasingly threatened, with dire consequences on the poor. While our development partners have committed to meeting their aid pledges, and some are intervening in African countries both through emergency grants and to prevent a worsening of the impact, we are concerned that traditional mechanisms will delay disbursements with detrimental consequences on the implementation of rescue and recovery initiatives. It is therefore critical to increase both speed and flexibility in development assistance processes.

1.4 This note is a brief update on the impact of the crisis on Africa and on growth outlook in the medium term (Section 2). It highlights key issues that deserve special attention as the continent attempts to weather the storm in view of the G20 summit (Section 3). Section 4 concludes on the role of the African Development Bank.

2. Update on the Outlook

Economic Prospects

2.1 In light of this fast evolving context, all projections for economic indicators for

Africa were reviewed since the first C-10 meeting. Africa is now expected to grow at a rate of 2.8 percent in 2009, down from 5.7 percent in 2008 and 6.1 percent in 2007 (Table 1 and Figure 1). In 2009, growth rates for oil-exporting and non-oil-exporting countries are expected to fall by 4.2 and 1.3 percentage points, respectively. Macro-economic balances have also deteriorated. First, from an overall current account surplus of 3.5 percent of GDP in 2008, the continent will face a 3.8 percent deficit in 2009 (Table 2). Second, Africa will move from a budgetary surplus, accounting for 2.3 percent of GDP in 2008 to a 5.4 percent deficit in 2009. In particular, budgetary deficit by oil exporters are forecasted to reach 7.7 percent of GDP in 2009, down from a surplus of 5.1 percent in 2008 (Table 3). Lower economic activity, oil and food prices are expected to contribute to lower inflation in 2009 (Table 4).

2.2 Foreign exchange reserves have continued to shrink over the period. Indeed, the decline in export-oriented activities (mining, tourism, textile, and manufacturing sectors) due to falling prices and demand, have led to losses in export revenues. Today, some countries have gone from months of import cover to just a few weeks.

Vulnerability

2.3 In low-income countries and fragile states, the ability of governments to

respond to the crisis is severely constrained by the erosion of their fiscal space as revenues fall. In these vulnerable countries (Table 5), development achievements are now threatened by potential decreases in government expenditures (in social services in particular) and unsustainable macroeconomic imbalances. This situation is especially acute in countries which have been severely hit by the food and oil crisis. Ultimately, some countries could default on their debt payments which would, in turn, jeopardize their access to external financing.

2.4 In better-off countries, the economic downturn could be mitigated by implementing policies to boost demand. However, it is now acknowledged that, even in those countries, the fiscal space remains at risk should the crisis deepen and/or last longer. It is therefore time to seriously consider establishing well designed social safety nets with clear targets and financing mechanisms. They should be designed for easy scaling up in times of crisis to respond to expanding needs.

3. G20 and MDBs

Coordination

3.1 An international coordination policy is critical. The G20 can support Africa's efforts in mitigating the crisis through four channels. First, the G20 can galvanize

donor commitments to increase official development assistance to Africa. Second, the G20 can raise awareness of the detrimental impacts of trade protectionism and severe constraints on credit access. In particular, the G20 should encourage members to avoid any measure that inadvertently induces a bias against lending and investing in African countries. Third, the G20 can call for an increase in development resources allocated to Africa, notably through its regional development banks. Finally, the G20 can provide strong support towards the conclusion of the *Doha Development Round* and an advancement of the *Aid for Trade* agenda.

3.2 As far as Multilateral Development Banks (MDBs) are concerned; they can support African governments in reforming and building capacity through devising innovative instruments. This will require scaling up resources for MDBs to allow them to meet increased demand from Regional Member Countries.

Financial Regulation, Supervision, and Surveillance

3.3 Since the beginning of 2009, the governance and regulation of financial institutions and markets have been in the spotlights. Within the current financial system framework, some transactions (e.g., off-balance sheet operations) are not sub-

ject to scrutiny by regulators. These off-balance sheet operations can be a source of systemic risk and should be subject to appropriate regulation.

Trade

3.4 Aid-for-Trade is becoming critically important as poor infrastructure is imposing a heavy burden on Africa's ability to trade, and makes African trade uncompetitive in global markets. A long-term strategy to promote trade must therefore address supply bottlenecks and Africa's connectivity to global markets. Such a strategy needs to involve long-term assistance programmes, especially, predictable aid flows which can be fed into budgeting processes.

3.5 As banks in developed countries have cut lines of credit to African banks and companies, a severe shortage of credit to finance trade has arisen. The global shortfall of trade credit is currently estimated at around US\$ 25 billion. Efforts to inject liquidity in financial institutions in developed countries have not yet resolved this shortage. Initiatives at global and regional levels to facilitate access to trade finance are therefore urgently needed.

3.6 Since January 2009, governments have implemented various interventions to preserve jobs and livelihoods that could undermine global trade. Creeping protec-

tionism particularly threatens some sectors, including agriculture, which is the mainstay of many African economies. However, glaring trade protectionist measures still remain limited, as advised during the G20 November 2008 Summit. The challenge in 2009 is for developed and emerging economies to fulfil their promises of trade liberalization. In this regard, the G20 can promote (i) the restoration of access to financing for African countries; and (ii) the reduction of the continent's exposure to systemic risk, especially in relation to increased cross-border banking.

3.7 African countries need to design short-term and long-term strategies that boost trade, and domestic resource mobilization, to build more resilience to shocks. On the trade front, countries need to pursue domestic trade policy reforms that support international rules setting (simplification, harmonization and standardization of rules, procedures and processes), unlocking trade opportunities in the regional agenda, and increasing their voice and participation in the Doha Development Round.

4. The Role of the Bank and the Need to Scale up Resources

4.1 The African Development Bank is facing the challenge of meeting rising

demand for assistance from its Regional Member Countries (RMCs) since the crisis resulted in a deteriorating credit environment marked by a downgrade of counterparties and negative watch listing of some borrowers. While the Bank's financial capacity is currently strong and can support projected lending in line with its Medium Term Strategy (MTS) up to 2012, it will be severely strained by rising demand beyond the MTS projections. It is, therefore, important that measures be taken in a timely manner to provide additional capacity to ensure sustainable, long-term assistance to its RMCs.

4.2 As a response to the crisis, the Bank is proposing several initiatives to provide funding to its regional member states, notably through the *Emergency Liquidity Facility (ELF)*, the *Trade Financing Facility (TFF)* and accelerated transfers to ADF countries. The USD 1.5 billion ELF will provide financial support to AfDB eligible countries and non-sovereign operations in member countries that are suffering from lack of liquidity due to the global financial crisis. The USD 1 billion Trade Finance Initiative (TFI) will allow African commercial banks and Development Finance Institutions (DFI) to use AfDB resources to support trade finance operations. The Accelerated Resource Transfer to ADF Countries will support the Bank's low-income concessional borrowers through an accelerated use of currently available

concessional resources. In addition, budget support and balance of payments support are needed as short-term instruments in addressing resource constraints on African Countries. Although such initiatives are useful in mitigating negative

shocks, more resources and instruments will be needed to meet the needs of African countries. These can also complement more structural measures to increase the Bank's resource pool through the general capital increase.

5. Questions for consideration

1. Should fiscal targets used in the context of lending/assistance agreements be revised upward in the short term to allow countries to implement counter-cyclical demand stimulus? By how much should the targets be adjusted and for how long?
2. Are any countries facing any risk of insolvency vis-à-vis their external debt due to declines in export revenues and foreign exchange reserves?
3. What measures can be used to assist countries that face this situation to achieve fiscal stability in the short run while preserving credibility vis-à-vis international markets?
4. What are the country-specific needs for crisis response in terms of external financing? This is important to allow donors to plan their aid budgets and make a case for scaling up resources for regional development banks and other global development assistance initiatives.

Appendix

Appendix 1: Tables

Table 1: Africa's Real GDP Growth (%)

Table 2: Africa's External Current Account, including grants (% GDP)

Table 3: Africa's Overall Fiscal Balance, including grants (% GDP)

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Figure 1: Africa: Real GDP Growth

Figure 2: Africa: Fiscal Balance as % of GDP

Appendix 1: Tables

Table 1: Africa's Real GDP Growth (%)

	2004-04	2005	2006	2007	2008(e)	2009(p)	2010(p)
Central	5.7	5.3	3.4	4.0	5.0	2.8	3.6
East	4.9	7.1	7.6	8.8	7.3	5.5	5.7
North	4.1	4.9	5.6	5.3	5.8	3.3	4.1
South	4.1	6.3	6.8	7.0	5.2	0.2	4.6
West	7.1	5.7	5.1	5.4	5.4	4.2	4.6
Africa	4.8	5.7	6.0	6.1	5.7	2.8	4.5
<i>Memorandum items</i>							
<i>North Africa (including Sudan)</i>	4.2	5.0	6.1	5.7	6.0	3.5	4.2
<i>Sub-Saharan Africa</i>	5.2	6.2	5.9	6.4	5.5	2.4	4.7
<i>Oil-exporting countries</i>	5.4	6.3	6.1	6.8	6.6	2.4	4.5
<i>Oil importing countries</i>	4.1	5.0	5.8	5.4	4.6	3.3	4.5

Source: African Economic Outlook 2009 (*preliminary estimates*), AfDB, 2009

Note: (e) denotes an estimate and (p) a projection

Table 2: Africa's External Current Account, including grants (% GDP)

	2004-04	2005	2006	2007	2008(e)	2009(p)	2010(p)
Central	-4.1	-0.8	1.9	-0.5	11.2	-4.6	-2.4
East	-5.5	-6.7	-9.3	-9.3	-6.2	-7.5	-8.1
North	5.6	12.6	15.2	12.9	12.0	2.9	2.8
South	-1.1	-1.8	-1.1	-3.3	-2.0	-6.8	-7.4
West	-2.4	2.6	4.4	-0.2	0.4	-8.3	-6.8
Africa	0.6	3.5	4.8	2.4	3.5	-3.8	-3.6
<i>Memorandum items</i>							
<i>North Africa (including Sudan)</i>	4.5	10.6	12.4	10.3	10.5	1.3	0.9
<i>Sub-Saharan Africa</i>	-2.0	-0.7	0.4	-2.3	-0.4	-6.8	-6.4
<i>Oil-exporting countries</i>	3.0	10.6	13.1	8.9	9.8	-3.9	-2.9
<i>Oil importing countries</i>	-1.6	-3.4	-4.0	-4.9	-5.3	-3.5	-4.7

Source: African Economic Outlook 2009 (*preliminary estimates*), AfDB, 2009

Note: (e) denotes an estimate and (p) a projection

Table 3: Africa's Overall Fiscal Balance, including grants (% GDP)

	2004-04	2005	2006	2007	2008(e)	2009(p)	2010(p)
Central	2.0	6.9	17.5	7.4	13.3	4.0	4.8
East	-2.2	-2.0	-3.9	-3.6	-2.3	-4.0	-5.2
North	-1.1	4.5	6.4	3.5	2.9	-6.1	-5.8
South	-2.5	0.4	3.2	2.3	1.9	-4.6	-3.6
West	-0.5	5.2	6.4	-0.4	-0.2	-8.8	-9.4
Africa	-1.4	2.8	5.0	1.9	2.3	-5.4	-5.1
<i>Memorandum items</i>							
<i>North Africa (including Sudan)</i>	-1.0	3.9	5.5	2.7	2.7	-6.6	-6.3
<i>Sub-Saharan Africa</i>	-1.7	2.1	4.7	1.4	1.8	-4.9	-4.7
<i>Oil-exporting countries</i>	0.3	7.3	8.6	4.0	5.1	-7.7	-7.4
<i>Oil importing countries</i>	-2.9	-1.7	1.1	-0.5	-2.0	-2.8	-2.5

Source: African Economic Outlook 2009 (*preliminary estimates*), AfDB, 2009

Note: (e) denotes an estimate and (p) a projection

Table 4: Africa's Consumer Prices (Inflation in %)

	2004-04	2005	2006	2007	2008(e)	2009(p)	2010(p)
Central	15.8	5.4	6.3	2.9	8.8	7.2	6.5
East	5.9	7.3	12.0	10.1	17.8	10.2	8.0
North	2.6	4.7	3.6	6.8	8.1	7.6	5.2
South	13.8	6.6	7.4	9.8	13.2	9.0	7.9
West	10.3	14.0	7.4	5.4	10.6	8.6	8.2
Africa	7.9	7.1	6.4	7.5	11.1	8.5	6.9
<i>Memorandum items</i>							
<i>North Africa (including Sudan)</i>	2.9	4.8	4.5	7.0	8.6	7.7	5.4
<i>Sub-Saharan Africa</i>	11.6	8.8	7.7	7.9	12.9	9.0	7.9
<i>Oil-exporting countries</i>	9.8	8.5	5.9	7.2	10.0	9.1	7.1
<i>Oil importing countries</i>	6.0	5.6	7.0	8.0	12.3	7.7	6.6

Source: African Economic Outlook 2009 (*preliminary estimates*), AfDB, 2009

Note: (e) denotes an estimate and (p) a projection

Table 5: Exposure to Economic Crisis – Vulnerability

Level of vulnerability	Countries
Very high high poverty and weak macro balances/ fiscal space	Burundi, Eritrea, Madagascar, Mozambique, Niger, Senegal, Sudan, Togo
High High poverty and moderately weak macro balances/fiscal space	Angola, Central Africa Republic, Congo Dem Rep, Côte d'Ivoire, Gambia, Kenya, Lesotho, Liberia, Malawi, Nigeria, Rwanda, Sao Tome & Principe, Sierra Leone, Zambia
Moderate: moderately weak balances and low or moderate poverty	Benin, Burkina Faso, Cape Verde, Chad, Djibouti, Ethiopia, Ghana, Guinea Bissau, Mauritania, Mauritius, Sychelles, Tanzania, Zimbabwe
Low Low poverty, positive macro balances	Tunisia, Morocco, Uganda, Cameroon, Swaziland, Equatorial Guinea
Very low: sound macro balances, very low poverty	Algeria, Botswana, Gabon, Lybia, Namibia

Source: Calculations based on the AfDB Socio Economic database

Note: Vulnerability is assessed based on:

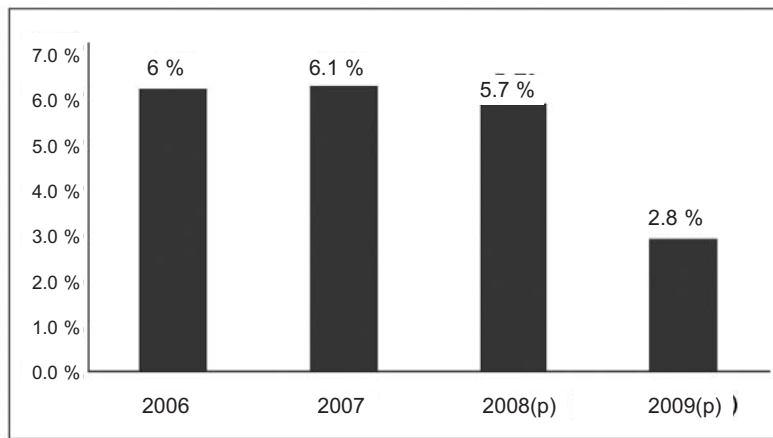
- (1) macroeconomic balances and fiscal space (current account deficit/surplus and fiscal deficit/surplus), and
- (2) poverty levels at \$1/day.

Cut off points are:

- Current account balance: $x < -7.7\%$, $-7.7\% < x < -4\%$, $-4\% < x < -2\%$, $-2\% < x < 0\%$, $x > 0\%$;
- Budget balance: $x < -3\%$, $-3\% < x < -2\%$, $-2\% < x < 0\%$, $x > 0\%$;
- Poverty: $x > 50\%$; $20\% < x < 50\%$; $x < 20\%$

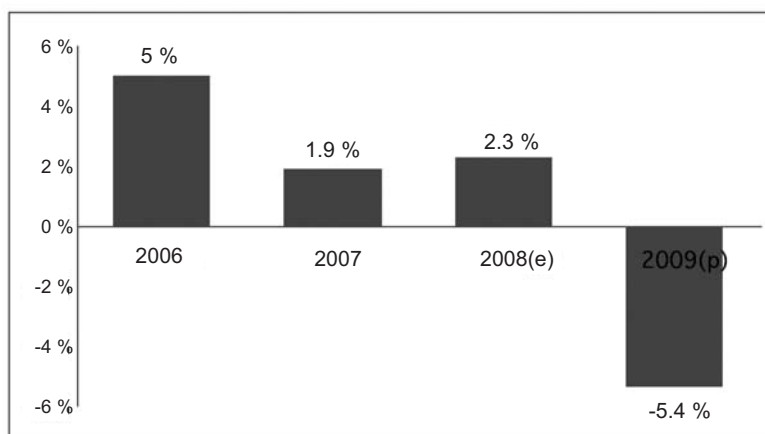
Appendix 2: Figures

Figure 1: Africa: Real GDP Growth



Source: *African Economic Outlook 2009 (preliminary estimates)*, AfDB, 2009
e: estimates and p: projection

Figure 2: Africa: Fiscal Balance as % of GDP



Source: *African Economic Outlook 2009 (preliminary estimates)*, AfDB, 2009
e: estimates and p: projection

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