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**Africa Rebounding:
When and How to Exit from Crisis
Intervention Policies**

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1. Background

After a sharp decline in growth in 2009, Africa's recovery now seems well underway. Africa has exhibited substantial resilience during this global recession, relative to most other developing regions and its own past record. While some factors driving Africa's recovery have been external, the positive outcome to date has been mostly due to the good policies that countries implemented before and during the crisis.

Nevertheless, substantial risks remain and have been only exacerbated by the recent European turmoil, while the challenge of bringing African countries on a path of high growth and poverty reduction has become even more pressing. This note discusses policies that would help make the continent's recovery more robust and help achieve high longer-term growth.

2. Africa: Moderate recovery under way but risks remain

While the global financial crisis hit Africa later than other regions, the continent has not emerged unscathed. The output growth fell from average of 5.6 percent during 2001-08 to 2.5 percent in 2009, while working poverty and unemployment, especially among the youth, escalated.

However, the continent has shown resilience. Defying expectations, Africa has emerged from the crisis faster and more robustly than in the past and than most other regions. Growth will reach 4.5 percent in 2010 and increase further to 5.2 percent in 2011 (Figure 1). As usual though, the aggregate numbers mask substantial differences across countries and regions. Economies most open to trade (e.g., commodity exporters), which slowed markedly in 2009, are expected to benefit from the revived commodity prices and trade, and thus record a relatively sharp V-shaped recovery (Figure 2).¹ Due to continued slowdown in remittances and FDI as well as possibly aid inflows, many low income and fragile countries are projected to grow at more sluggish rates. Overall, in 2010 about 60 percent of African countries are projected to grow at lower rates than on average during 2001-08.

The other key macroeconomic variables are also projected to improve. Africa's inflation is expected to be gradually returning towards mid-single digits in 2010 and 2011, as the impact of high commodity prices has waned and the aggregate demand remains subdued. Disinflation is faster among oil importing countries, due to cheaper imports and more subdued aggregate demand. The fiscal and current account balances of oil exporters are projected to strengthen in 2010 and 2011 due to increased prices and demand. As a result of stimulus policies, oil importers will continue to post deficits well above the pre-crisis levels (Figure 3).

Drivers of the continent's recovery

Sources of the continent's recovery have also differed across countries. In addition to the global recovery, driven by developing Asia and expansionary policies in advanced countries, strong commodity demand and prices have played a key role in the revival of continent's exports. Private capital flows are also projected to increase and some African frontier markets (e.g.,

¹ Oil (e.g. Angola) and commodity (e.g. Botswana) exporters, which were most adversely affected in 2009, are experiencing a relatively quick rebound, while growth of low income countries is subdued.

Ghana, Kenya) will benefit from improved access to international bond markets. In a number of countries (e.g. Mauritius, South Africa, Tanzania, Uganda, and others), the rebound was helped by stimulus packages. Prudent macroeconomic policies prior to the crisis, especially fiscal consolidation, as well as improved institutions of macroeconomic management provided space for fiscal stimulus initiatives. The financial support from IFIs, including the Bank, also played an important role in preventing large pro-cyclical fiscal cuts. In some countries improvements to business environments helped relieve structural bottlenecks. In others, government interventions stimulated agriculture and the overall private domestic demand (e.g., subsidy program in Malawi, distribution of inputs in Sierra Leone, and ICT use in Kenya). In East Africa, increased regional trade in part compensated for the slump in the global demand.

However, the projected growth for 2010 and 2011 remains below the trend in most countries, as increased trade and financial linkages with Asia will not compensate for subdued demand from the advanced economies and increased cost of credit. In the EU and the US, the demand for African imports will not reach its pre-recession level in the short term due to deleveraging and fiscal consolidation. The ongoing debt problems in Europe have only heightened the uncertainties surrounding the global recovery.

The impact of the debt crisis in Europe

The ongoing global recovery remains fragile; risk of a double dip or slower-than-expected recovery in the EU or the US remains high. The “Greek debt crisis” could have the following impacts on Africa: (i) higher cost of capital for emerging market economies (e.g., South Africa) due to the public debt problems and the associated heightened sovereign risk; (ii) derailed European recovery because of large spending cuts; (iii) reduced export price competitiveness due to weakening euro. The re-priced risk, which will hamper access of many African countries to trade credit, reflects markets’ concerns about additional fiscal fallouts in Europe. Concerns about political instability fueled by the budget consolidation measures (reduced expenditures, increased taxes) may also take a toll. The increased cost of financing would reduce further the post-crisis trend growth.²

In the post-crisis economic environment, investors’ attention to economic policies and anxieties regarding “market failures” are likely to increase. This renewed emphasis on credibility and prudence of policies will require that African countries not only pursue prudent policies, but also communicate their stances more effectively to the public and the outside world.

² For discussion of how the global financial crisis and other developments (climate change) may affect Africa’s trend growth, see Brixiova, Z.; Kamara, A. B.; and Ndikumana, L. (2010), “Containing the impact of the crisis and paving the way to strong recovery in Africa,” *AfDB Policy Brief No. 2*, February 2010.

3. Exit strategies from stimulus package

Stimulus packages in place

Fiscal stimulus

While substantial differences among countries emerged – based on their fiscal spaces and inflationary pressures – African countries have responded better to this crisis than in the past. Their fiscal measures also constituted a clear break from the pro-cyclical policies during the past crises and the pre-crisis boom. The scope for counter-cyclical measures varied with the level of income though, as richer countries have had a greater space for maneuver.

As a part of their stimulus packages, a number of governments boosted investment (infrastructure in particular) and consumption (social spending) outlays, acting as “consumer of last resort”.³ For example, South Africa implemented fiscal package to stimulate domestic demand that had also positive impact on other African countries, especially in the region. In absolute terms, South Africa’s package was the largest in Africa in 2009, while the one adopted by Tanzania was the largest as a share of GDP. Timely and effective measures that even low income countries were able to adopt (e.g. Uganda, Tanzania) demonstrated the strengthened quality of their institutions. With prudent packages, many African countries have emerged from the crisis with markedly stronger fiscal positions and lower public debts than advanced economies.

Monetary and financial sector policy

In 2009 a number of countries lowered their policy rates (e.g., WAEMU, CEMAC, South Africa, Mauritius, Botswana) and/or increased monetary bases (Tanzania) with a view to stabilize output. South Africa has even temporarily deviated from its inflation target. While the longer term impact remains to be seen, the easing of monetary policy stance contributed to preventing a large fall in GDP growth and even greater escalation of unemployment.

However, despite the expansionary monetary policy, credit to the private sector declined in a number of countries, especially in oil exporters due to reduced deposit bases (Figure 4).⁴ Commercial banks have invested in government securities, causing yields to decline and making these investments less attractive. Moreover, some low income countries (e.g., Kenya and Ghana) and especially fragile states (e.g., Sierra Leone) faced heightened inflationary pressures and were not able to lower their rates and expand money supply or even opted for monetary tightening.

As African financial sectors were largely shielded from the impact of the crisis, direct government interventions in the banking sector were rare. Nigeria was the exception, where in August 2009 the Central Bank of Nigeria had to inject funds into the banking system, after five

³ For discussion of stimulus packages adopted by various African countries, see Kasekende, L.; Brixiova, Z. and Ndikumana, L. (2010), “Africa: Africa’s Counter-cyclical Responses to the Crisis,” *Journal of Globalization and Development*, Vol. 1 (1).

⁴ The pro-cyclicality of liquidity in oil exporting countries is related to movements in both exports and the accompanying capital flows.

leading banks (40 percent of the banking sector) posted losses from non-performing loans due to excessive lending to the energy sector and the bursting of the stock market bubble. In Tanzania, the government set aside a part of the stimulus package for banks that have experienced rising non-performing loans.

The need for orderly and gradual exits from stimulus policies

While the macroeconomic policies adopted by African countries prior to the crisis served them overall well, governments still need to maintain healthy balance between short run stabilization and achieving high long-term growth.⁵ Now that the stimulus packages have been put in place, the key questions are for how long to maintain them, at what speed to withdraw them, and how to coordinate exits across policies and countries.

Fiscal policy: medium term consolidation

In 2009, in many countries the actual fiscal deficits exceeded projections, pointing to more accommodative policies than initially expected (Figure 5). About 40 percent of African countries are projected to raise their fiscal deficits further this year relative to 2009, suggesting that African governments do not plan rushed exits from stimulus packages. Given the gradual revival of revenues that comes with higher growth, the widening deficits will be mostly caused by higher expenditures.⁶

Given uncertainties about the robustness of the global recovery and likely negative spillovers from the Greek debt crisis, where feasible, African governments could consider maintaining accommodative fiscal stance in 2011 as well. Such stance, while not sustainable over the longer term, would in the current circumstances increase predictability of policies, help gain public confidence and prevent “stop-go” patterns. As was the case until now, the increased (or maintained) expenditures should aim mainly at removing infrastructure bottlenecks, and establishing social safety nets.

At the same time, in most countries the current fiscal trends are not sustainable over the medium term, and if not reversed, they would jeopardize hard won debt sustainability once again. They would also negatively impact longer term growth through higher interest payments, crowding out of the private sector, and reducing investors’ confidence. Fiscal consolidation to get public finance on sustainable path and refocus it on growth and development, rather than output stabilization, will be thus needed.

To return to fiscal balance, African countries need to strengthen domestic revenue mobilization. At the same time, governments need to strengthen their expenditure management, protecting

⁵ A number of African low-income countries had inflation rates below 5 percent during 2001-08, but very few posted high enough growth to reach MDGs. Empirical literature shows that bringing inflation to very low levels in low income countries may come at the expense of growth rates. See, for example, International Monetary Fund (2005), *Monetary and Fiscal Policy Design Issues in Low Income Countries*, Washington D. C.: IMF.

⁶ In most of the countries where 2010 expenditures would decline relative to 2009, they would remain above the 2008 levels.

social and capital outlays while maximizing efficiency on the wage bills and other current expenditures.⁷

Coordination of monetary and fiscal policies

At the country levels, given the relatively low inflation rates, credible commitments to medium term fiscal consolidations should precede tightening of monetary stance for several reasons. First, in low-income countries, central banks are often not fully independent from the government. In the absence of external financing, loose fiscal policy would then undermine the aim of low inflation and the credibility of monetary policy.⁸ Second, even though transmission mechanisms are undoubtedly more complex in developing than advanced countries, monetary policy is still technically and politically easier to implement than fiscal consolidation.⁹ Third, increased interest rates that would result from tightened monetary policy would raise costs of debt repayment, thus making the fiscal consolidation more challenging. Finally, successful fiscal consolidation would slow down aggregate demand expansion, allowing for continued accommodative monetary stance without fueling inflation.

Another reason against fast tightening of the monetary stance is the inflation-growth trade-off. In most countries inflation is already in single digits; the current accommodative stance should stay in place until high growth returns. Inevitably, such stance will be reversed as recovery takes firm hold, growth accelerates, and inflationary pressures reemerge. Among various options, a flexible inflation targeting, already officially practiced in South Africa and Ghana, may provide an appropriate framework for emerging and frontier market economies that aim at achieving low inflation while preventing undue output volatility.¹⁰

International and regional considerations also suggest that monetary tightening should come after the fiscal one, as fiscal policy has fewer international spillovers. Specifically, as tighter monetary policy will raise interest rates, it could attract extra private capital flows, also away from countries with slower recovery. This could start a vicious circle of retaliation and protectionism (including barriers on capital outflows) that may hamper the continent's recovery. Moreover, in Africa's regions that weathered the crisis particularly well due to enhanced regional trade (e.g.,

⁷ For discussion of conditions under which fiscal tightening may have expansionary effect see Alesina, A. and Ardagna, S. (1998), "Tales of Fiscal Adjustment," *Economic Policy*, 27, 487–545.

⁸ Specifically, in countries with underdeveloped financial markets and in the absence of foreign aid, the central banks may need to finance budget deficits directly, which means they would not be able to pursue their intended monetary tightening anyway. Moreover, high domestic debts that resulted from deficits (e.g. Ghana) are likely to increase pressures on central banks to "inflate these debt burdens away."

⁹ The important caveat here is that in low income countries, the transmission channels of monetary policy are more blurred than in developed countries. Moreover, there is a long lag between adoption of monetary policy and its actual impact on real economy.

¹⁰ Balance between flexibility, while anchoring inflationary expectations, is a prerequisite for success of this regime. Several institutional preconditions also need to be in place, including a flexible exchange rate regime and well functioning and adequately supervised financial sector. See Heintz, J. and Ndikumana, L. (2010), "Is there a case for formal inflation targeting in Sub-Saharan Africa?," *AfDB Working Paper No. 107*, for a comprehensive coverage of suitability of this framework for sub-Saharan African countries.

East Africa), measures that would undermine recovery of any single country would only backfire to the region as a whole.

4. Growth-oriented medium-term policies

A key issue for Africa's longer term growth is financial sector development. In this area Africa has been lagging other regions, but the speed of financial deepening picked up prior to the crisis. While selective short term government interventions to provide liquidity during the crisis have been helpful (e.g. Nigeria), fiscal policy need to stay focused on competition and efficiency in this sector.

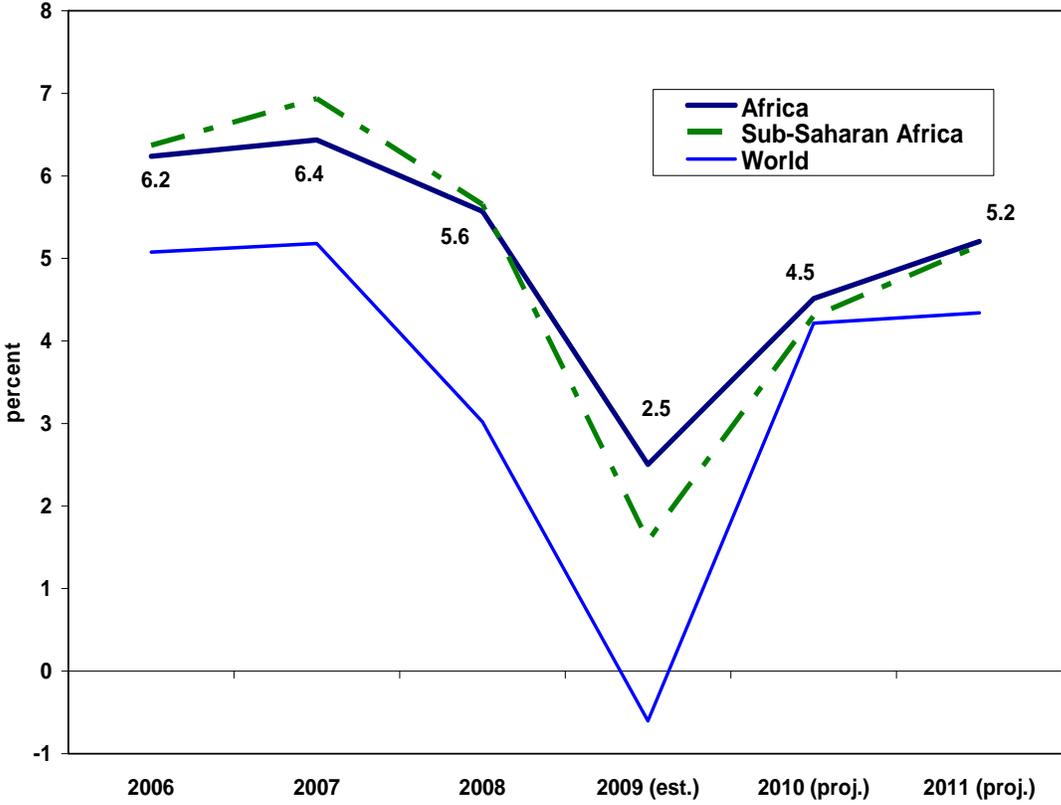
One of the key lessons of the financial crisis for Africa is that capital account liberalization needs to be implemented gradually to prevent occurrences of "sudden stops" of capital flows. This requires capital account management notably through: (i) a flexible nominal exchange rate; (ii) sterilized interventions by the central bank, and (iii) controls on capital in- and outflows. Indeed, countries that have maintained some flexibility in their macroeconomic policies fared markedly better during the crisis.

Introducing automatic stabilizers through developing well-functioning social safety nets (so far mostly absent in Africa, except for pilot cases) into to the government budgets should be a priority before the next crisis strikes. This is important as multiplier effects from discretionary fiscal measures in emerging and developing countries are smaller and hence less effective than in advanced economies. Moreover, when used in less than extraordinary circumstances, they undermine credibility of the fiscal stance and the entire macroeconomic policy.

Now that Africa's rebound is under way, reaching quickly high and sustainable growth path is the key challenge. To be sustainable, growth in Africa needs to be driven by the vibrant private sector. In this regard, macroeconomic policies will play an important role, as stability is a precondition for private sector growth and development. At the same time, overly tight monetary stance can crowd out credit to the private sector and conservative fiscal policy can dampen the public infrastructure spending that provides the basis for private sector expansion. When choosing post-crisis macroeconomic targets, African countries will need to strike a right balance between stability and growth.

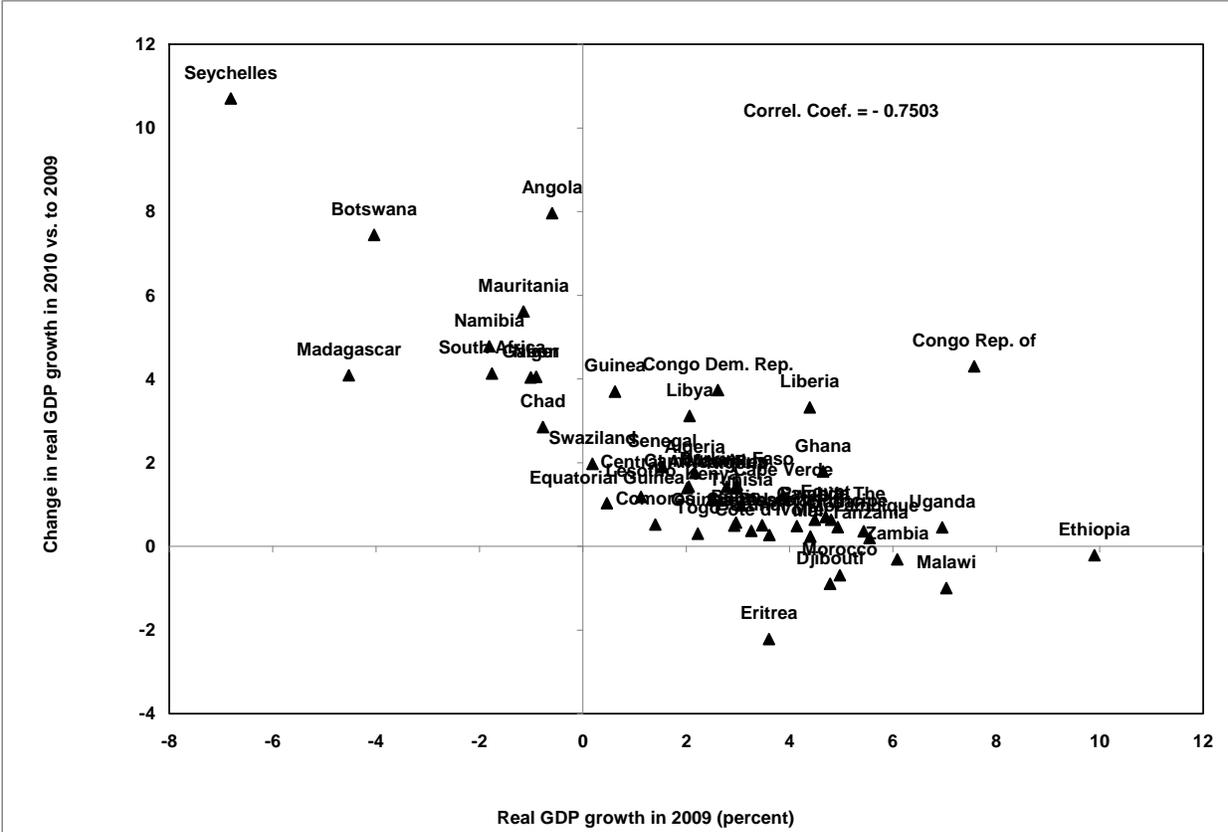
However, appropriate macroeconomic policies are only necessary but not sufficient for growth. Reaching this objective will also hinge on structural transformation and reforms such as removing remaining barriers to competition, strengthening governance and business environment, and progressing with the regional integration.

Figure 1. Real GDP growth, 2006 – 2011: Africa in synch with the global recovery



Source: African Economic Outlook (May 2010) and WEO database (2010).

Figure 2. Least growing countries in 2009 rebounded the most in 2010



Source: African Economic Outlook (May 2010).

Figure 3a. Fiscal and current account balances of oil exporters

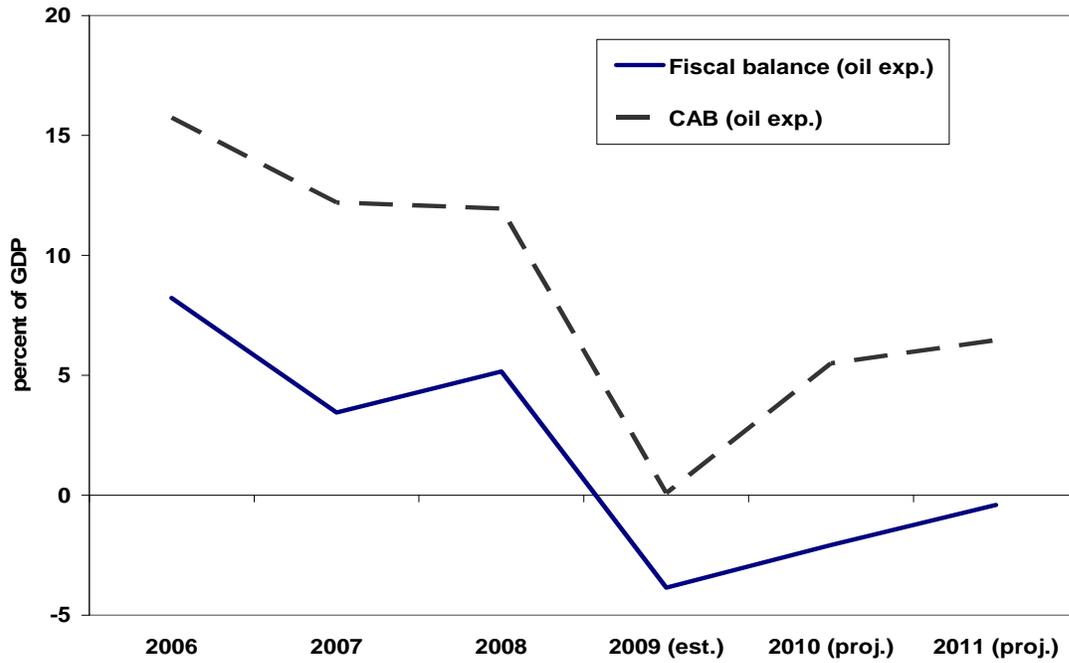
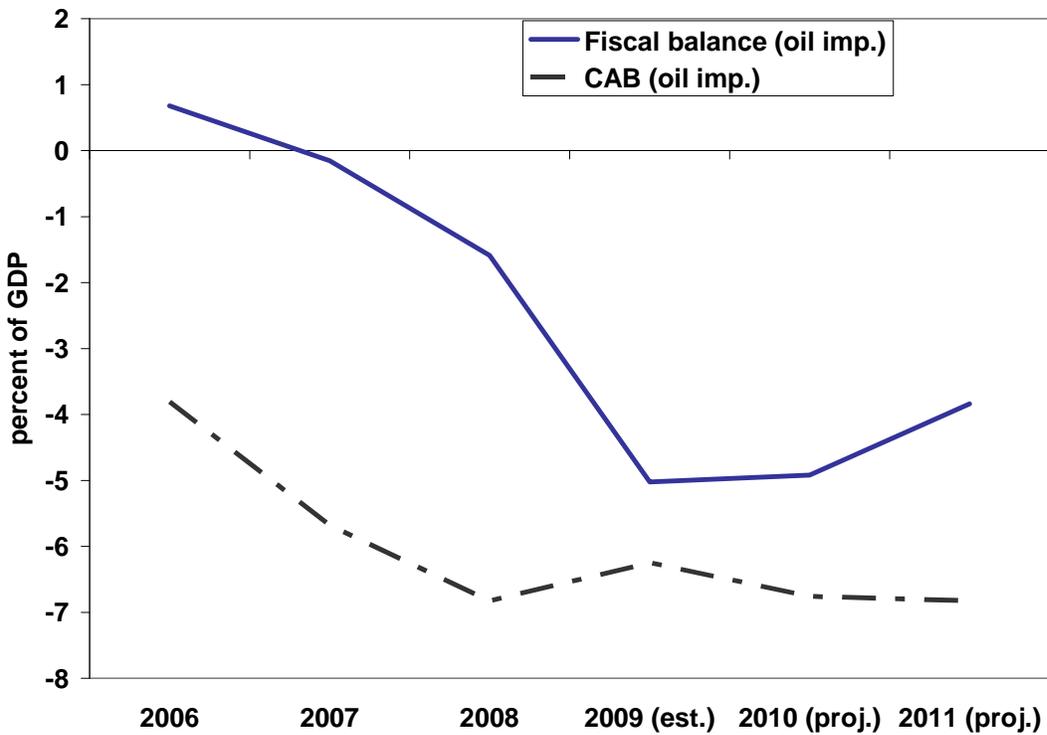
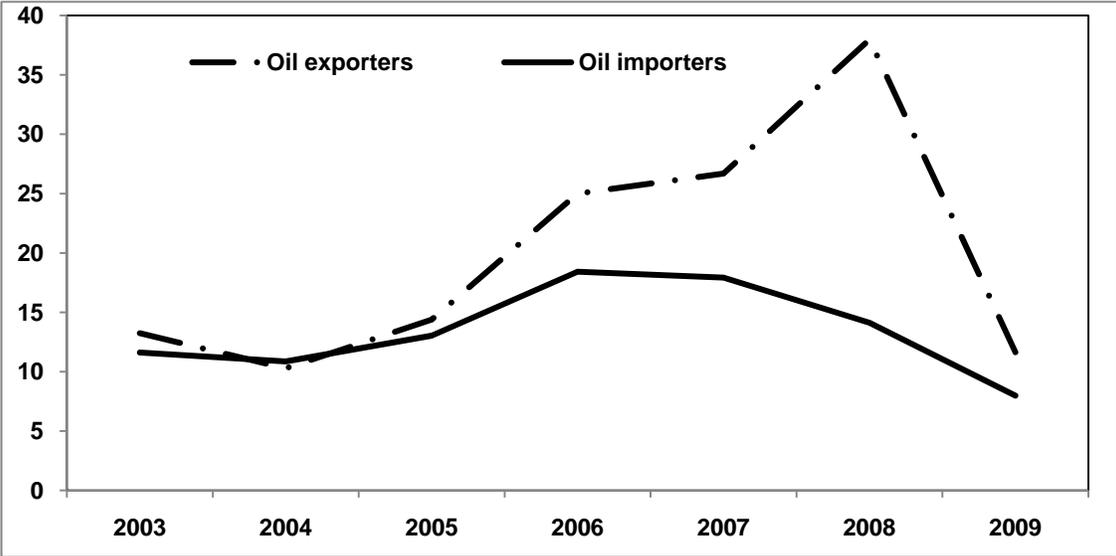


Figure 3b. Fiscal and current account balances of oil importers



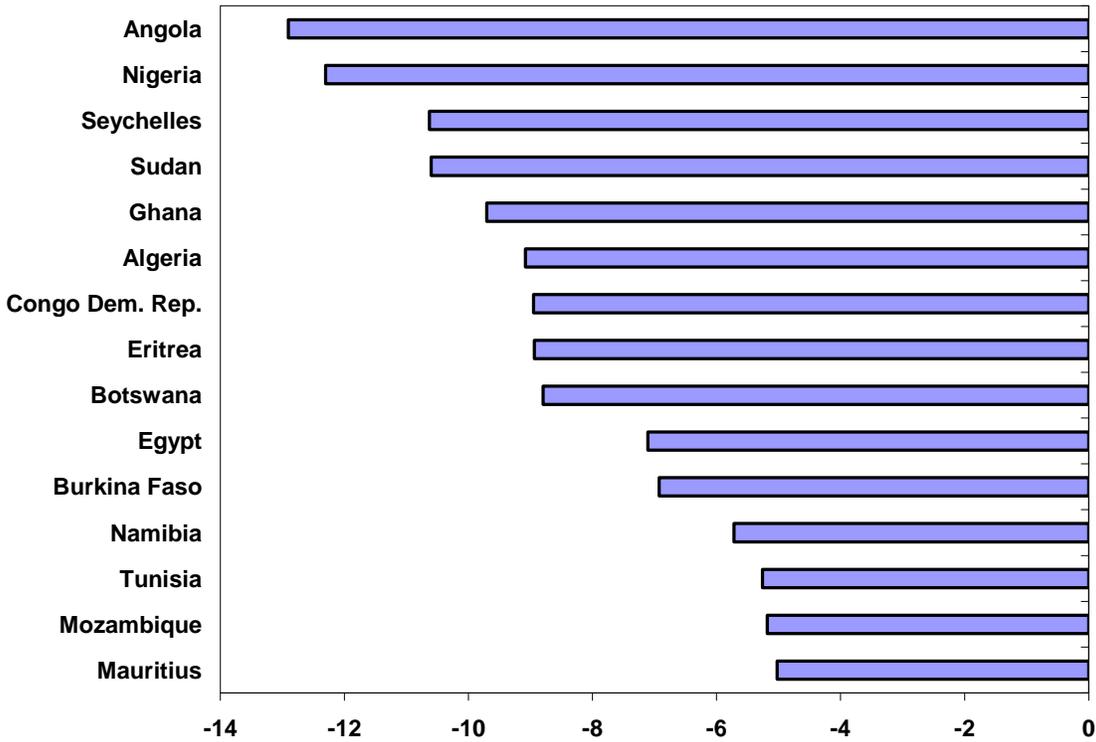
Source: African Economic Outlook (May 2010).

Figure 4. Credit to the private sector, annual flows, 2003 – 2009 (% of GDP) 1/



Source: IMF Regional Economic Outlook database (2010). 1/ Sub-Saharan Africa.

Figure 5. Differences between projected and actual fiscal balances, 2009 (% of GDP) 1/



Source: African Economic Outlooks (May 2009 and May 2010. 1/ Negative number indicates greater deficit or smaller balance than initially projected. Projections are taken from May 2009 African Economic Outlook database, while the actual figures are from May 2010.



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