



The Impact of the Global Financial Crisis in Africa

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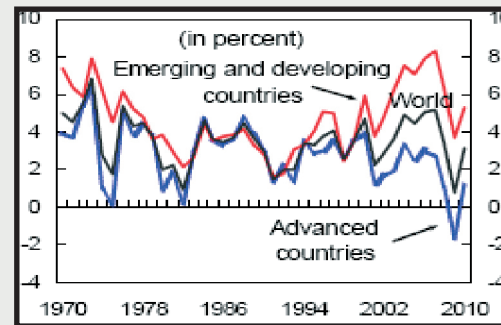
INTRODUCTION

On the back of the fallout from the current global financial crisis, world growth in 2009 is expected to decline to its lowest rate in 60 years. In 2008, the collapse in demand stemming from the financial crisis, coupled with synchronised falls in manufacturing and industrial production, trade credit financing problems and low consumer confidence, triggered a fall in world trade growth to just 4 percent. According to the United Nations Conference on Trade and Development (UNCTAD) Trade and Development Report 2008, the global economy is teetering on the brink of recession.

Initially, many commentators believed that the world's emerging economies, particularly those in Africa, would be relatively 'decoupled' from the effects of the crisis that originated from the most advanced industrialised economies. However, in the developing world the knock-on effects from the financial instability and uncertainty in industrialised nations are starting to take hold. Emerging markets' access to trade and investment is likely to shrink. Indeed, UNCTAD estimates that exports from the developing world could decline by 9.2 percent in 2009. The sharp fall in commodity prices that has accompanied the slowdown is particularly concerning for African economies, many of which are heavily dependent on commodity exports as their primary source of export revenue. Moreover, the market for trade finance has deteriorated severely in the past six months as the crisis has exacerbated a shortage of liquidity to finance trade credit. The emerging economies are also likely to suffer from direct financial contagion, notably in the form of capital flight and reduced capital flows.

Despite these potentially debilitating effects, predictions from the Group of 20 (G20) leaders' summit held in Washington in November 2008 suggested that more than 80 percent of the future growth of the global economy will depend on emerging market countries. Similarly, while the International Monetary Fund (IMF) has forecast that developing countries will grow by 3.3 percent in 2009, expectations are that the advanced economies will shrink by close to 2 percent.

GDP Growth by Country Group



Within this context, the extent of the impact of the crisis on African economies, and the availability and suitability of measures to mitigate the effects of the crisis on the continent, are critically important considerations for Africa's future growth prospects.

THE IMPACT OF THE CRISIS ON AFRICAN ECONOMIES

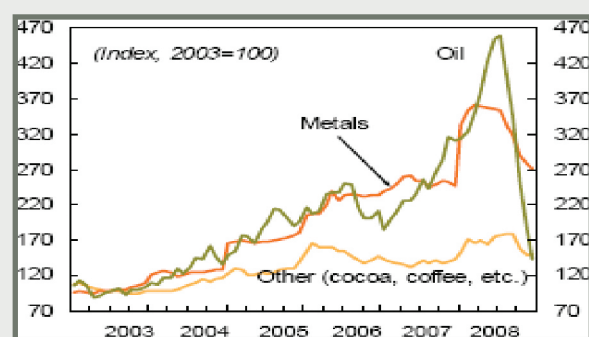
The impact of the global financial crisis is likely to vary across African countries depending on their exposure to the international financial system, their production and export structure, and their capacity to use policy tools to cushion its adverse effects. In general terms, the short-term effects on many African countries are likely to be mitigated by the fact that most countries on the continent are relatively de-linked from the global financial system. Moreover, the nascent banking systems in many African countries, typically characterised by simplistic structures, conservatism, prudent financial management regulations, controls on foreign exchange and very limited exposure to subprime loans and credit default swaps, have shielded the continent's financial structures from the full effects of the crisis. Indeed, Benedicte Christensen, deputy director of the IMF's African Department, went as far as to state in late 2008 that there is "no systemic risk that we can see in any African country in terms of banking".

This is not to say that Africa is immune from the effects of the crisis. It is in the medium to long-term that the full effects of

the crisis on African economies will be realised. Slowing global growth linked to the crisis may push millions of Africans over the poverty line. This possibility was emphasised in the IMF'S World Economic Outlook report in April 2008, which stated that a fall in world growth of just one percent could result in a 0.5 percentage point decline in Africa's gross domestic product (GDP). Already, the IMF is predicting that growth in sub-Saharan Africa will slow from close to 5.25 percent in 2008 to approximately 3.25 percent in 2009.

The slowdown in global growth, coupled with a sharp decline in global industrial production, has reduced demand for African exports, reflected most notably in the downward spiral of both prices and demand for commodity exports. This is most alarming given the fact that commodity exports represent the primary source of export receipts for the majority of African countries. Furthermore, the fall in export revenues is likely to have negative spillover effects in terms of reducing government revenues, thereby worsening the already tenuous fiscal position in many African countries.

Commodity Prices for Sub-Saharan Africa

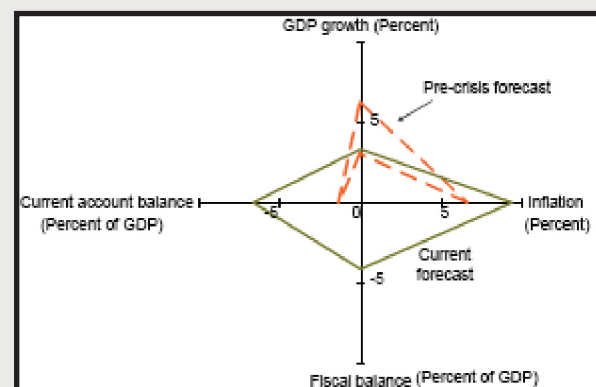


The tightening of global credit as a result of the crisis has also led to an enormous reduction in private investment flows and bank financing, resulting in reduced capital flows and a curtailment of the availability of trade finance. This is likely to be reflected in a substantial decline in international funding flows to African countries, most prominently in the form of reduced foreign direct investment, portfolio flows and remittances from the diasporas resident in the developed world. In terms of the latter, any long term reduction in remittances from Africans living abroad is likely to be particularly hard felt, given that these funding flows currently contribute an estimated \$10 billion annually across the continent.

The effects of a decline in foreign investment in Africa for countries that are currently financing large current account deficits could be particularly devastating. For instance, South Africa is heavily reliant, at least in the short run, on private capital flows

to finance its extremely large current account deficit – which amounts to approximately 8 percent of the country's total GDP. The predicted reduction in capital flows will mean that South Africa will have to contract its current account deficit appreciably. Other African countries running relatively large current account deficits, such as Uganda and Tanzania, are likely to be similarly affected. These problems are likely to be compounded by the prospect of widening deficits brought about by the crisis itself. Indeed, the IMF has predicted that the current account deficit for the entire sub-Saharan African region will widen by more than 4 percent of GDP to reach 6.75 percent of GDP in 2009.

Sub-Saharan Africa: Current versus Pre-crisis Growth Forecasts, 2009



The projected decline in private capital flows may also have a longer-term impact on infrastructure investment projects in African states, many of which may face shortfalls in financing. Given that many African capital markets are small in size, even comparatively limited withdrawals of foreign investment may have a potentially significant impact.

Furthermore, African countries may face increasing pressure for debt repayment as international institutions and western banks not only tighten their lending policies but seek to shore up their reserves. Allied to this is the prospect that the global financial crisis will result in a slowdown in foreign aid and development funding to African countries due to the tightening of global credit.

AFRICAN RESPONSES TO THE FINANCIAL CRISIS

In light of these potentially debilitating effects, it is critical for both African and world leaders and policy makers to consider potential responses to mitigate the impact of the crisis on the continent.

One way of responding effectively to the crisis is to prioritise the building of African markets. Specifically, policies to strengthen African markets and institutions are necessary to encourage growth and ensure that African economies are more resilient to external shocks. In addition, there is a need for more stringent

regulation of African financial markets. Moreover, creating a more conducive business environment by reducing the costs and constraints associated with doing business in African economies will raise their profile as less expensive, less risky and more profitable business destinations, thereby helping to attract greater foreign capital flows and investment in the context of a market for capital that has become considerably more risk-averse in the wake of the onset of the financial crisis. Reforms that encourage foreign direct investment and portfolio flows and measures that raise the level of trust in African financial systems are likely to have a similarly positive impact.

Expanding trade with other developing countries represents another potential means to soften the severity of the negative impact of the crisis on African economies. Global trade statistics suggest that trade between developing countries as a share of both total world trade and global commerce has already been on the increase for quite some time. Indeed, merchandise trade between developing countries grew at an average annual rate of 13 percent between 1995 and 2007 and, in 2007, accounted for one fifth of total world trade flows. It is critically important for the African continent to increase its share within this South-South trade nexus in order to offset some of the effects from the anticipated decline in demand for its commodity exports. Allied to this is the need to increase regional trade and intra-African trade flows in order to lessen the dependency of African economies on overseas markets.

Similarly, measures to improve South-South economic cooperation, particularly in terms of investment, financial flows and joint efforts to stabilise currency exchange rates and debt, should be investigated. Specifically, several South-South coping measures are potentially available to African countries to address the worst effects of the global financial crisis. First, increased financing from regional development banks would compensate for the anticipated slowdown in international aid and donor funding to African economies. Second, regional stimulus packages could be implemented to help to sustain markets and maintain economic growth. Similarly, regional arrangements could be employed that are specifically designed to mitigate the impact of financial shocks through, for example, the provision of international financial liquidity via swap arrangements. Finally, in African countries saddled with high levels of foreign debt, measures to diversify foreign-exchange reserves could be adopted whereby other developing countries 'purchase' that debt.

On a global level, according to the World Trade Organisation Director-General, Pascal Lamy, reaching a global trade deal would represent a relatively simple way to ease the effects of the crisis. The promise of such a 'global deal' is particularly compelling for African economies, which are perhaps amongst the most

threatened by the prospect of increased protectionism stemming from the crisis. Specifically, new domestic protectionist measures, predominantly in the form of seemingly benign, crisis-linked policies such as government stimulus and bailout programmes, exchange rate devaluations, anti-dumping and countervailing duties and 'buy local' policies that discriminate against foreign firms and workers, may stifle Africa's export sectors even further. Consequently, it is critical for African policymakers to push for a global accord that maintains open markets and prevents an avalanche of new crisis-linked protectionist measures.

Furthermore, in the aftermath of the onset of the global financial crisis, it is clear that there is a pressing need to reform the multilateral financial architecture, particularly in terms of ensuring greater representation of African countries in international financial institutions. Even though the financial crisis did not originate in Africa, the continent has already been unduly exposed to its effects. This has sparked strident calls for a more inclusive approach to multilateral governance that affords a greater 'voice' to African countries in international financial institutions. It is important for developing countries, and African countries in particular, to play a more meaningful role in these institutions and in the management of economic shocks.

Domestic fiscal and monetary responses should also be explored by those African countries with the capacity to implement them. For instance, in African countries with relatively large foreign exchange reserves, it may be possible to utilise these reserves to cushion the worst effects of the crisis and finance any decline in capital flows. Alternatively, African countries operating under fixed exchange rate systems may have some scope to adopt more flexible exchange rate regimes in order to "allow the nominal exchange rate to absorb some of the impact of the external shock and reduce the real effects in the domestic economy." In terms of fiscal stimulus options, expansionary fiscal policies such as reducing taxes or increasing government expenditure may serve to boost demand and employment within African economies. The usual argument against expansionary fiscal policy – that it crowds out private sector investment – is unlikely to apply given the climate of declining credit and a drastically reduced appetite for risk among investors.

Finally, while Africa is undoubtedly feeling the effects of the global economic slowdown, the impact of which is likely to worsen even further, the tightening of credit in the world's most advanced economies may actually create opportunities in terms of movement of capital into emerging economies. For instance, sovereign wealth funds that previously targeted investment in the financial systems of the United States and Europe may now increasingly look to the developing world for possible locations for investment. However, for this to occur in Africa, countries on the continent

will need to implement measures to improve their investment risk ratings.

CONCLUSION

The fact that many African countries are relatively de-linked from the global financial system has cushioned the continent from some of the impact of the global financial crisis. Nevertheless, the initial view propounded by many commentators that Africa would be 'decoupled' from the effects of the financial crisis that originated in several of the world's advanced economies has proved to be unfounded. Prices and demand for African countries' commodity exports have declined significantly amid a sharp decrease in global industrial production. Furthermore, the climate of declining credit stemming from the crisis is likely to lead to a substantial decline in international funding flows to African countries, in the form of private investment and capital flows, trade credit, donor funding and remittances from Africans in the diaspora. These factors have prompted predictions of sharply plummeting growth within sub-Saharan Africa.

It is clear that African countries and their leaders must seek proactive economic policy measures and reforms to mitigate the effects of the crisis on African economies. These should include interventions to strengthen African markets and institutions, expand 'South-South' trade and economic cooperation, increase inter/intra-regional trade to lessen dependency on overseas markets, and implement expansionary monetary and fiscal policies to boost demand and employment. Furthermore, on a global level, African leaders must push for reform of the global financial architecture to include greater representation of African interests in the forum of international financial institutions. Moreover, it is critically important that the continent supports efforts to conclude a global trade accord that maintains open markets and safeguards against a proliferation of new crisis-linked protectionist measures.

ENDNOTES

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