



How the financial crisis is affecting Sub Saharan Africa

Sophie Chauvin and Marc Lantéri

Introduction

- **I.** The crisis has been transmitted to SSA mainly through the impact of the global economic slowdown
- **II.** How SSA countries have reacted ?
- **III.** Swift IFIs action

I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

1.1. Direct transmission of the financial crisis through the financial sector in SSA is limited

- Weak integration to global markets and limited exposure to toxic assets have limited the contagion to SSA countries.
- Fund raising in international markets remains limited for most of SSA countries.
- Structural characteristics of SSA banking system have been protective

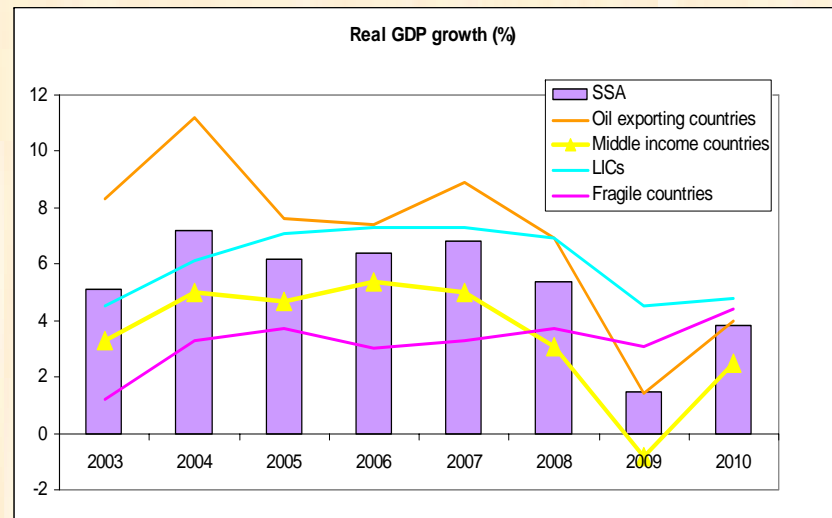
I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

- Several countries remain nevertheless exposed to a tightening of international financial conditions (Kenya and Ghana have postponed bond offering and are expected to rely more on domestic financing);
- So far, concerns that subsidiaries of foreign banks might face reduction of capital or that credit lines would be tightened / reduced (especially trade credit lines), have not been confirmed.
- Nevertheless, non performing loans could increase. Banks are particularly vulnerable to crop financing (Tanzania) and debt services problems faced by sectors hardly hit by the crisis (forestry in CEMAC, Côte d'Ivoire, Ghana). This can lead banks to limit their risk exposure by tightening lending standards.

I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

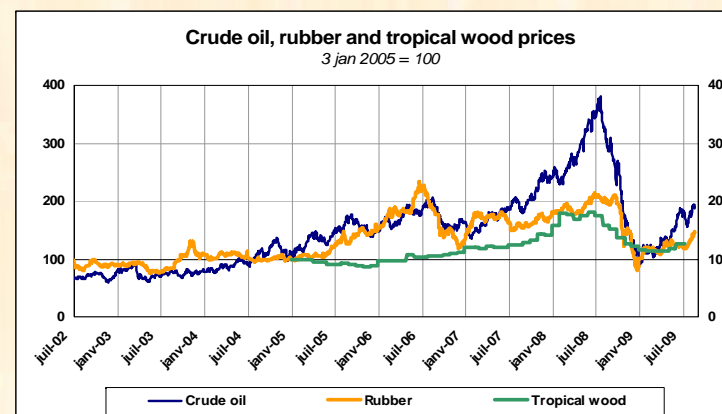
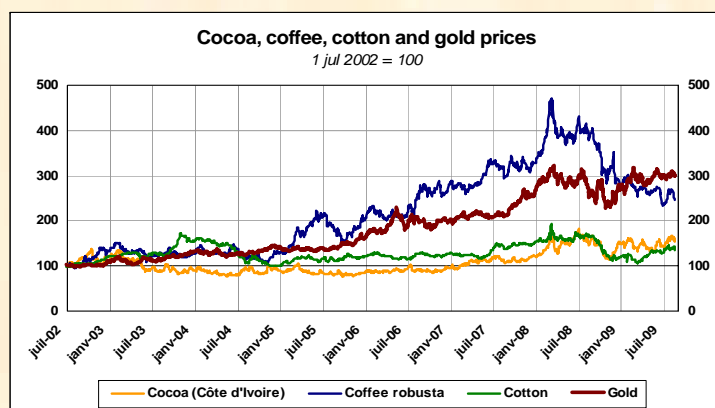
1.2. Reduction of growth and exports receipts

- SSA affected by the slowdown of the world economy :
 - SSA accounts for only 2% of world trade but with trade openness amounting to 79% in 2008;
 - A 1% decrease of world growth is expected to reduce SSA growth by 0.3% to 0.5% (IMF);
 - Growth expectations have been revised downward.



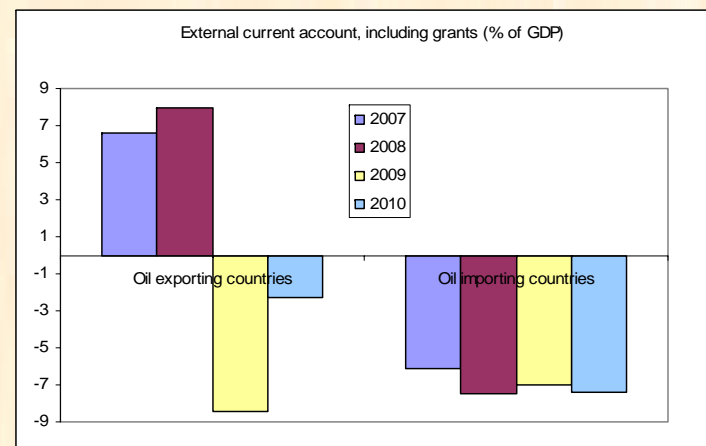
I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

- The high concentration in commodities makes SSA highly vulnerable to terms of trade shocks :



I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

- Impact of the crisis and the magnitude of the exogenous shock are different among SSA countries given their economic structures.
 - Oil exporting countries more exposed to price effects. Also exporters of commodity used as input in sectors (building, automobile) hit by the crisis are more exposed to price and volume effects;
 - Volume effects more difficult to gauge for rent products such as cocoa, coffee or cotton. Depends on supply elasticity to diminishing price. Cocoa prices have not declined significantly.
- Impact on current account balance will also vary among countries.
 - Oil exporters are expected to register a sharp deterioration of their external position.
 - Reserve accumulation will slowdown.

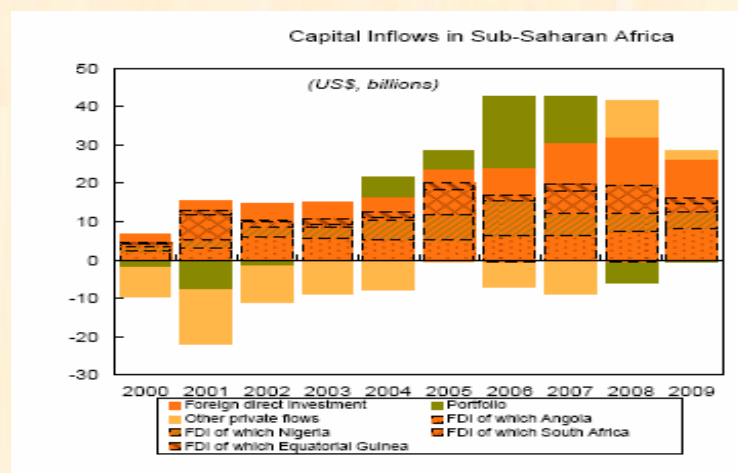


I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

1.3. Risks on balance of payments financing flows

➤ FDI likely to be postponed

- Recent survey undertaken by UNCTAD shows that SSA has been less affected by the global downturn in FDI flows but will remain marginal in TNCs FDI plans for the next three years.
- Countries with high degree of dependency on mineral exports are affected as increasing numbers of mines are being closed or suspended by foreign investors (Botswana, DRC, Zambia).



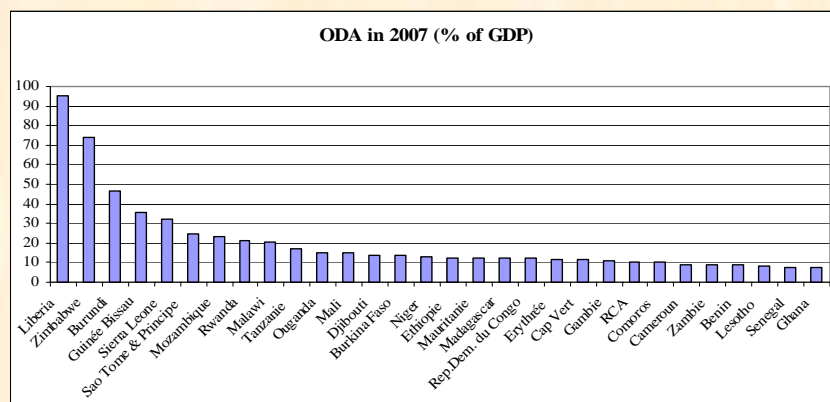
I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

➤ Risk that remittances will dampen.

- World Bank (July 2009) estimates that flows of migrants' remittances to SSA which amounted to an estimated USD 20 billion in 2008, will fall in 2009 by between 8.3% under a “base case” scenario and nearly 11.6% in "pessimistic" scenario.
- Could be problematic for countries where remittances remain a major source of capital inflows (Lesotho 24.5% of GDP, Gambia 12.5%, Togo 9%, Sénégal 7%).

I. The crisis has transmitted to SSA mainly through the impact of the global economic slowdown

- **Concerns that ODA could diminish due to revised budgetary priorities in donor countries though international aid often represents more than 10% of GDP in SSA economies.**
- Currently, however, fears of an aid shortfall must be placed firmly into perspective because the G-20 confirmed its aid commitments to Africa at its April 2009 meeting in London.



II. What strategies have been put in place by SSA countries?

3.1. Which scope for accommodative monetary policy?

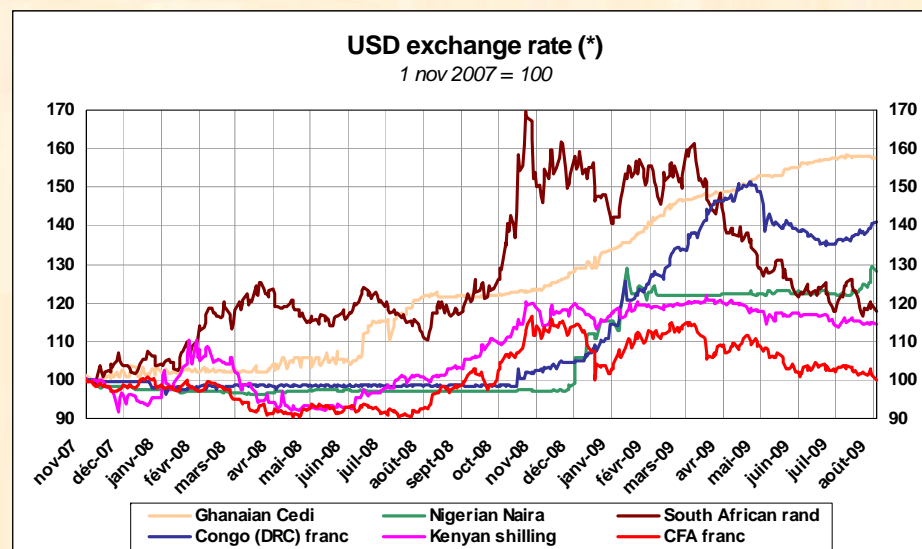
- In face of the crisis, the scope for accommodative monetary policy to support economic recovery depends on countries monetary and exchange rate framework.
- In WAEMU, the BCEAO intervenes, since 2007, by injecting liquidity through open market operations (weekly liquidity provision) to limit tension on interest rates. Since the second quarter of 2009, the BCEAO has increased its intervention through a one-month facility and a reduction of reserve requirements. It has also reduced its main refinancing rate by 50 basis points at 4,25 %.
- In CEMAC, between December 2008 and July 2009, the BEAC has decreased three times its main refinancing interest rates, the global reduction totalling 125 basis points.
- In September 2008, the Central bank of Nigeria decreased its main policy rate (MPR) to 9,75%. A second decrease of 175 basis points was decided in April 2009.

II. What strategies have been put in place by SSA countries?

- Dilemma for countries like Ghana where inflation remains high:
 - o Increase of key policy rate from 13,5% to 17% between november 2007 and 2008 in response to the consequences of the food crisis. In March 2009, the Central Bank of Ghana increased its main interest rate by 1,5 percentage point to 18,5%.
 - o High inflation (20,7% in june 2009) results from two factors: (i) an increase in the price of petroleum products which pushed up transaction costs with spillover effects on the price of most goods and services; (ii) the pass through to domestic prices of exchange rate depreciations.

II. What strategies have been put in place by SSA countries?

- Despite pressures on some countries' currency, no exchange rate crisis have erupted so far



II. What strategies have been put in place by SSA countries?

3.2. The scope to implement fiscal countercyclical policies is limited by fiscal deficits and overindebtedness risks.

- MDRI and HIPC initiative, together with improvement of macroeconomic fundamentals, have contributed to reduce debt burden;
- Due to good macro economic policies, SSA countries have resisted relatively well to the crisis
- Nevertheless, risks of overindebtedness remain in several countries: oil countries already record high non oil fiscal deficits while oil importers have been particularly hit by the commodities price shock last year (though some countries could scale back the subsidies put in place in 2007-08);

II. What strategies have been put in place by SSA countries?

- Risks on debt sustainability also limit the capacity of further indebtedness
 - Among the 35 SSA countries potentially eligible to a PRGF, 16 have a moderate or high risk of debt distress;
 - Despite debt relief, LICs remain particularly at risk as out of 20 SSA countries having reached the completion point, 10 countries still have a moderate or high risk of debt distress.

IMF debt sustainability risk analysis for PRGF-eligible African countries

Low risk	Moderate risk	High risk	Distressed
Cameroon , Cap Verde, Kenya, Madagascar, Mali, Mozambique, Nigeria , Senegal, Tanzania, Uganda, Zambia	Angola , <i>Benin</i> , <i>Ethiopia</i> , <i>Ghana</i> , Lesotho, <i>Malawi</i> , <i>Niger</i> , <i>Sierra Leone</i> , Chad , <i>Rwanda</i>	<i>Burkina-Faso</i> , Burundi, Congo, <i>Gambia</i> , Central African Republic, <i>Sao Tomé and Príncipe</i>	Comoros, DRC , Côte d'Ivoire, Guinea, Guinea-Bissau, Liberia, Togo, Zimbabwe

Source: IMF website, updated 5 June. 2009. The debt distress risk presentations of the IMF Board of Directors date from 2007, 2008 or 2009.

II. What strategies have been put in place by SSA countries?

- Countries with no policy room should focus on prioritizing spending;
- Also , the scope of relying on fiscal policy to stimulate the economic activity depends among other things on the availability of domestic and external financing on sustainable terms, which could be difficult given the limited stage of development of regional financial markets (or the lack of market as in CEMAC);
- Some success could nevertheless be mentionned as the development of WAEMU regional financial market;
- Also the crowding out effect of fiscal policy may be larger in SSA countries given less access to international capital markets and the limited size of the domestic financial markets.

III. Swift action of the IFIs

- The international community, through the IFIs, has set up several emergency measures to smooth the adverse effects of the crisis
 - The World Bank: may 2008, *Global Food Response Program* (USD 1,2 billion); december 2008, *Financial Crisis Facility* (USD 2 billion) to fast track funds to developing countries;
 - IFC has doubled its *Global Trade Finance Program* to USD 3 billion over three years. Also a Global Trade Liquidity Program mobilised more than USD 6 billion to support trade;
 - Actions also focus on fast disbursements, supplemental budget support operations, providing additional technical analysis and advice.

III. Swift action of the IFIs

- The IMF doubled its LIC access limits and ramped up its total concessional lending to these countries.
 - o Capacity of lending expected to reach USD 8 billion over 2009-10 and USD 17 billion through 2014. In addition, more than USD 20 billion of a planned USD 283 billion allocation of IMF SDRs will be directed to LICs. ;
- The IMF is also changing its lending instruments to make its financial support more flexible through three new concessional credit facilities;
 - o the extended credit facility (ECF) which replaces the PRGF. Compared to the PRGF it will offer more flexible timing requirements for countries to produce a formal PRSD;
 - o the stand credit facility (SCF), which replace the ESF's high access component, will be similar to the stand-by arrangement for middle-income countries;
 - o the rapid credit facility (RCF) which mainly provides limited financial support in a single, up-front payout for LIC facing urgent financing needs.
- Debt Sustainability Framework (DSF) also revised to provide for greater flexibility

Conclusion

1/ Impact of the crisis mainly through real channels

- For oil exporting countries, the recent increase of oil prices could improve expected results;
- For oil importing countries, concerns remain especially regarding the evolution of debt sustainability.
- In the short run, room of manoeuvre for contra cyclical policies are limited;

Conclusion

2/ Despite pre crisis macro economic progress, SSA was still in under developed and vulnerable situation.

- The crisis has exacerbated SSA vulnerabilities;
- Medium term development goals should not be left apart. Further strategy aiming at improving investment in infrastructures, business environment while insuring safety nets to the poorest should be followed;
- Difficult to dissociate short and medium term actions in the case of SSA (LICs) given development issues to deal with.

Conclusion

3/ IFIs interventions will not be sufficient if they are not backed up by national/regional policies that deal with structural issues

- Reform of IMF instruments and the increase of lending facilities heightened rooms of manoeuvre of SSA countries;
- Nevertheless, to raise the resilience of SSA countries to exogenous shocks, structural reforms focusing on infrastructure and economic diversification should be actively implemented;
- The financial crisis should not create doubt on the necessity to increase agricultural supply, which has been stressed again recently during the high summit on food security (27-29 January 2009) and World Forum on Water (16-22 March 2009).