ECONOMIC OUTLOOK FOR AFRICA

BANKING ON TOMORROW CONFERENCE

GLOBAL MACRO & MARKET RESEARCH

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A Fragmented World – Changing Expectations and New Rules

Old “Order” Put Into Questions

- Post Second World War and post Cold War eras may be ending, Moving away from multilateralism
- Emergence of populism - questioning the established order (political, economic) - protectionism
- Developing world as a major source of growth but also volatility
- China's growing international role

New nodes of power, influence and demand

- China / Russia / US / Europe all want to have their own sphere of influence
- Nigeria, Turkey, Indonesia, Brazil, India as new regional actors?
- Disruptive entities: ISIS, criminal organizations
  - MACRO (multi-polar geopolitics) is back!

Multipolarity of Demographics

- From 7 billion people to more than 8 billion in 10 years!
  - Ageing societies where entitlements will be a struggle to fund
  - Young societies that need to generate jobs (Africa)
  - Young and Ageing societies emerging each with policy challenges but also market opportunities (Education/Health care)

Middle classes in EMs are rising and influencing the political and economic dialogue

- Large and growing middle class – 1 billion people have been joining the middle class between 2014 and 30
- Large markets – increasingly multinationals produce locally to cater to their needs, emergence of regional players
- Source of scrutiny – vocal and connected – articulate views on reforms, Government, clean air…
Synchronized Good News
In the 1980’s and 1990’s, DM accounted for up to 58% of global GDP growth. In the 2010’s, DM’s contribution has declined to 21% - EM now account for most global growth.
A Synchronized Expansion(2): Industrial Production

After 2014-2015 slowdown, a raising tide lifts almost all boats
Trade rebounding but ST indicators need monitoring

- Trade has started to recover after the GFC in late 2016, driven by better European, US and Chinese growth. This helped to stabilize commodity prices which positively impacted the value of global trade.

- On a long-term basis, services have been holding up better than goods, having grown at an annual average of 3.6% from 2010 and 2016 (as opposed to 0.6% for nominal goods trade).
Markets are Discounting Smooth Sailing Ahead…

BULL? MORE LIKE MOUNTAIN GOAT.
Taking Stock:

Africa Macro Turning Around?
Deterioration driven by growth & external and fiscal imbalances

- Between 2011 and 2015, the inflation index improved significantly, but dropped sharply in 2016
- The overall macro condition index in Africa deteriorated after 2014, in line with other EMs. The weak index performance has been mainly driven by fiscal and external imbalances, which have been deteriorated almost continuously for the last 10 years
- In 2016 the growth index fell to levels below those observed during GFC, mainly due to recession in Nigeria as well as anemic growth in South Africa, Guinea, and DRC
- Forecasts point to a recovery in macro conditions in coming years as growth prospects and inflation rates are likely to improve. However, both the fiscal and external accounts are expected to drag the overall index performance
Real GDP Growth Falls to 1.4% in 2016

Lowest GDP growth since 1994 – driven by contraction in Nigeria and flat growth in S. Africa

- Real GDP growth in Africa declined to only 1.4% in 2016, mainly due to contractions in Nigeria and almost no growth in South Africa.
- As Nigeria’s economy returns to positive growth, Ghana’s growth accelerates due to new oil fields, and South Africa’s growth picks-up mildly, the region will accelerate to 2.6% in 2017, also supported by countries such as Liberia, Congo, and Chad, which are coming out of recession.
- Africa average growth used to outperform most regions other than Asia over the last 15 years, but is now is only above LAC.
Headwinds (1): Commodities Tumbled, Now Stabilized at Lower Level

- **Real trade** (the actual amount of goods crossing borders) **has actually increased by 20% since 2010**, while the **value of these goods declined by 6.5% over the same period**

- Stabilization and increases in commodity prices benefit fiscal accounts for commodity exporters and support trade (imports)

### Trade Volumes vs Trade Values

**Monthly data, Jan 2000 - May 2017, indices: 2000=100**

![Trade Volumes vs Trade Values Graph](Source: CPB World Trade Monitor)

### World Commodity Price Evolution

**Rebased, 2000 = 100**

![World Commodity Price Evolution Graph](Source: Thomson Reuters – Datastream)
Deficit driven by reliance on imported goods and, lately, by lower commodity prices

- Even before the recent decline in commodity prices, the current account deficit in the region had already deteriorated significantly, driven by capital imports for infrastructure projects, higher consumption trends as growth accelerated, and a chronic reliance on imported goods across the region.
- The decline in commodity prices widened the gap to the largest levels on record – CA deficit dropped to around 6% of GDP in 2015. The situation improved in 2016 due to recession/no growth in many major countries.
- Net FDI flows, at around 2% of regional GDP in 2015-16, are not enough to cover the external deficit.
Headwinds (2): Reduced Fiscal Space

Lower Earnings From Commodity Exports Increased Financing Needs

- **African public investment is a share of GDP increased until 2014** - in contrast to other EMs, which saw a decline in capital public spending in the aftermath of GFC
- Many African countries have been scaling up public investment to meet large infrastructure, energy, health and other critical sectors’ needs
- **This is challenging to achieve as countries requiring public investment are also those where fiscal space is limited**

Source: IMF (Low-Income Developing Countries), World Bank, Datastream
Debt level increase driven by Mozambique, Ghana, Gabon, Zambia among many others

- On the fiscal side, the situation in the region has been deteriorating over the last few years – the deficit increased to over 2% of GDP in 2016 due to the collapse in commodity prices. Public sector inefficiencies and an important wage bill also contribute

- This led to a sharp increase in government debt levels from around 25% of GDP in 2009 to over 40% in 2016
Headwinds (3): Labor Productivity Gaps

- **EMs have a larger variation in labor productivity levels** across all sectors than most advanced markets.
- **Agriculture in SSA has a particularly low labor productivity level due to high employment (~60%) and low value-added. Boosting productivity levels in that sector provides economy-wide growth opportunities.**
- Inter-sectoral productivity gaps signal potential for productivity increases across the economy through further diversification.

*Source: ILO, UN*
Issue 1:

How the Chinese Economy and Import Demand Growth Affect Africa?
EM regions directly and indirectly linked to Commodities and through EM value chains

- The super cycle in commodities of the early 2000s:
  - Benefited pure commodity exporters
  - Spurred growth of exports by multinational companies catering to the energy complex and
  - Helped the outperformance of domestic demand plays in commodity producing economies

- How will the demand for commodities evolve?

- In fact, China has become one of the largest exports markets for many EMs – East Asia, Africa and LAC
What Products do EMs Export to China?

Raw materials constitute major product category in EM exports to China (SSA), followed by intermediate and capital goods, particularly for EAP

Key takeaways

- For most Emerging Markets, raw materials constitute the main export to China

- EAP and SA however are noticeable exceptions as they either do not rely on raw material exports (8% of SA’s global exports are in raw materials, compared to 46% in SSA)

- A decline in Chinese import demand will certainly impact Emerging Markets in line with their current sectoral exposure
Issue 2:

What Drives Growth in FCS?
SSA macroeconomic weaknesses emphasized for FCS countries

- The overall macro conditions index points to severe weakness in SSA FCS countries over the last years, in particular as growth rates kept declining after the post-crisis rebound, and the fiscal position is at historical lows given a deterioration since 2011.
- The current account balance index has declined since 2011, even after a significant improvement as commodity prices started to recover.
- Forecasts point to a mild improvement in the macro condition over the next few years, driven by higher growth. However, inflation, fiscal and external accounts will remain a drag and the overall macro condition will remain on a weak level.
Agriculture value added is significant in FCS countries, manufacturing and business services contribute smaller shares to the overall economy

- Most fragile and conflict-affected states reflect strong similarities with low-income countries, especially with respect to their sectoral composition of their GDP
- The higher a country’s fragility index, the more reliant it is on Agriculture or Mining
- Higher value added sectors, such as manufacturing are negatively correlated with fragility
- A similar message if we look at financial intermediation or business services which are negatively correlated with fragility
Resource extraction and agriculture dominate in FCS countries

- **Reliance on resource extraction** is often a legacy of an early focus on natural resources and lack of diversification, a situation which reinforces inequality and creates a potential for conflict.

- **The share of Agriculture (the most labor-intensive sector) has increased.** Compared to FCS countries, the EM aggregate reflects a much higher contribution to value added from more productive sectors such as business services and financial intermediation.

- **A lack of sectoral diversification may increase the risk of conflict** if the misappropriation of natural resources exacerbates inequalities and government capacity (e.g. rule of law, control of corruption) is low.
Issue 3:

Getting Insights for Growth Potential of Economies
Gauging EMs Potential Productivity

Institutional strength and higher propensity to produce more diverse and sophisticated products are key for future sustainable development. **Potential productivity = Economic complexity + institutional strength**

- **Economic complexity** is a proxy for a country’s ability to produce more diverse and sophisticated goods - via of productive knowledge and networks that enable their people to share knowledge and collectively build more complex goods. The ability to produce more complex goods is positively correlated with innovative capacity.

- **Institutional strength** measures the weighted quality of institutions in EMs and ranks countries from best (100) to worst (0).

- The respective scores include both current state and changes over time.

Source: Atlas of Economic Complexity, WB, IFC Global Macro and Market Research
Focus on SSA Countries

FCS countries in SSA either lack economic complexity or have deficiencies in their institutional strength.

- FCS countries in SSA either rank low on institutional strength (Mozambique) or economic complexity (Congo, Zimbabwe), highlighting the relevance of both indicators for stability and economic growth.
- Côte d’Ivoire is a notable exception in that it fares better on both scores, driven by the country’s positive developments in institutional quality and economic complexity over recent years.

Source: Atlas of Economic Complexity, WB, IFC Global Macro and Market Research

Indices: 0=Low, 100=High

Matching Institutional Strength with Economic Complexity

SSA FCS (IFC classification)
Other SSA Countries

Strong institutions and economic diversification drive prospects for FCS.

Source: Atlas of Economic Complexity, WB, IFC Global Macro and Market Research
Uneven Progress – Earlier Gains for Some are Evaporating

Some FCS countries have made considerable progress in either institutional strength (Zimbabwe), economic complexity (Mozambique) or both (Côte d’Ivoire)

Source: Atlas of Economic Complexity, WB, IFC Global Macro and Market Research
Combining Economic Complexity, Institutions and Demographics

Higher potential economic growth requires a growing working age population. Countries with higher economic complexity, robust institutions and a growing labor force have an advantage.

Demographics in FCS create prerequisites for future growth

- **Potential productivity score** is the combination of the economic complexity and institutional strength scores.

- In order to assess the future growth prospects, a country’s labor force has to provide a favorable demographic underpinning.

- **All FCS countries in SSA offer strong demographic dividends**, albeit lower potential productivity scores than EMs in other regions.

![Matching Potential Productivity with Demographics](image_url)

Indices: 0=Low, 100=High

Source: Atlas of Economic Complexity, WB, United Nations IFC Global Macro and Market Research
Will the commodity crisis be the catalyst for change?

Local and external challenges abound but the underlying drivers of medium-term growth prospects remain in place

- Improving business environment
- Favorable demographics
- Large infrastructure development programs should continue to support robust growth

Innovation, entrepreneurship, economic diversification, infrastructure all require capital… Not only through foreign sourced capital but also by investing domestic savings

Concerted actions by the government and the private sector to gradually correct issues will help unlock Africa’s potential

- For FCS, higher and sustained growth will require running substantial CAs deficits (import of capital and technology intensive goods) and larger foreign financing flows (mostly private). FDI will not be the only source…
- In this light, the development of local capital markets is essential to achieving growth levels that will generate jobs for a young and vibrant population
- For smaller FCS, capital markets may not be the answer in the short term. Instead blended finance, development of pooled vehicles to achieve the size necessary for institutional investors, more innovative financing vehicles will be key
- *AfDB and WB-IFC’s catalytic role will be crucial in the years ahead*
Thank you
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Flows are mainly driven by bank lending

- Following 5 years of continuous growth, gross capital flows to Africa peaked at $53bn in 2014. After a sharp decline in 2015 to $40bn, flows recovered to $51bn in 2016.
- In 2017 flows year to date are comparable to the record in the same period in 2014. Flows to the region are mainly driven by bank lending, contrary to other regions where bond issuance tends to dominate.
- A decrease in loans was the main driver behind the decline in 2015 relative to 2014 and we may witness another decline in 2017.
- Bond and equity issuance exceeding is at all time highs.
Natural resources, infrastructure, and financial services leading

- Over the last 3 years, the share of gross capital flows going to the private sector (rather than to sovereign and public sector companies) increased to around 2/3 of the total. While flows to the private sector increased from $26bn to $38bn between 2015 and 2016, flows to the sovereign/public sector declined from $14bn to $13bn, showing the dynamism of African private sector.

- Natural Resources, Infrastructure, and Financial Services have been the main destination of flows over the last years.

- Data for January-August 2017 shows a slight deterioration relative to the same period in 2016 ($21bn in 2017 vs. $222bn in 2016), driven by a decline in flows to the Services and Infrastructure sectors.
Fragility index points to almost no change in long run trends in Africa (FSI'06=89.3 vs FSI'17=88.9)

- Between 2016 and 2017, African states that experienced significant deterioration in their scores included Ethiopia (the largest increase in Fragility worldwide), South Africa (6th worst deterioration worldwide), Gabon (11th) and Zambia (16th). In Ethiopia all but two components of the index worsened; in South Africa state legitimacy deteriorated the most.

- Looking at the longer-term trends, the best improver in Africa over 2006-2017 period is Cote d’Ivoire, which moved from the 3rd most fragile country worldwide in 2006 to the 21st position in 2017 (mainly due to improved economic situation, security and state legitimacy). Some progress was also recorded in Zimbabwe, Liberia and Togo.

Source: Fund For Peace, Global Macro and Market Research
Due to currency depreciations, higher commodity prices, drought, and deficit financing

- Inflation increased significantly last year, from an average of 6.6% in 2013-15 to 11.4% in 2016 - the highest level since 2008 (food & fuel crisis)

- Angola’s inflation rate was over 32% in 2016 and expected to decline to around 27% in 2017. Inflation is also high in DRC, Mozambique, Zambia, Ghana, and Nigeria (between 15-22% in 2016), and above the regional average (11.4%)

- On the opposite side, several countries with a common monetary policy have quite low inflation rates (at or below 1%) – Côte d’Ivoire, Senegal, Cameroon among others