# “Impact of the Global Financial Crisis on Sub-Saharan Africa”

*March 25, 2009*

*Export-Import Bank of the United States*


Participants in the panel discussion included: Joe Grandmaison, member, Board of Directors, Ex-Im Bank; Wayne Raymus, Chair, sub-Saharan Africa Advisory Committee; Harry Broadman, Managing Director and Chief Economist, Albright Capital Management LLC; John Chambers, Managing Director and Chairman, Sovereign Rating Committee, Standard & Poor’s; Ambassador Phillip Carter III, Acting Secretary of State for African Affairs.

**THE IMPACT IN AFRICA OF THE INTERNATIONAL FINANCIAL CRISIS**
**March 25, 2009**

**Panel Discussion prior to the Meeting of the sub-Saharan Africa Advisory Committee (SAAC) of the Export-Import Bank of the United States (Ex-Im Bank)**

On March 25, 2009, Ex-Im Bank organized a panel discussion with the theme "The Impact in Africa of the International Financial Crisis" in conjunction with the Bank's SAAC meeting.

Three experts on African economic and political issues participated in the panel: Harry G. Broadman, Managing Director and Chief Economist, Albright Capital; John Chambers, Managing Director and Chairman, Sovereign Rating Committee, Standard & Poor's Management LLC; and Phillip Carter III, Acting Assistant Secretary of State for African Affairs.

This paper highlights their analyses of current economic conditions in Africa, the future outlook, and steps needed to address economic challenges.

**Henry Broadman – Managing Director and Chief Economist, Albright Capital**

**Impact of Global Economic Crisis on Africa Would Have Been Stronger if African Economies Had Not Been Growing So Fast. Appropriate Policy Responses Are Critical To Address Continuing Economic Risks: Sound Principles, Transparency, and Putting African Countries in the Driver's Seat.**

What we have been seeing in the global economy is unprecedented in the last 60 years. On a global basis, gross domestic product (GDP) growth is contracting. The greatest declines in global GDP growth are happening in the industrialized economies. They have been the most pronounced in Japan (13% decline in the fourth quarter of 2008), and in the United States (U.S.) and the European Union (EU) (6% decline each in the fourth quarter of 2008). Growth in GDP also has been declining in the emerging economies for four reasons:

1) weak external demand from industrialized economies
2) lower commodity prices
3) tightened financing constraints
4) remittances (workers from emerging economies working in the industrialized economies)

Looking across a spectrum of emerging economies, we have seen Eastern Europe and the countries of the former Soviet Union being hardest hit. They were running large current account deficits heading into the crisis. In Latin America and in East Asia including China, the story is more mixed. Some of the economies have withstood this crisis well while others, such as Brazil and Mexico, have been hit harder.

In the Middle East and in Africa the economies have, on average, been more resilient than in Eastern Europe, the former Soviet Union, Latin America and East Asia. Most of the international financial institutions, including the World Bank and the International Monetary Fund (IMF), are predicting that in 2009 global GDP in real terms will decline 1.5 to 1 percent. They expect that 2010 will see a gradual uptick in GDP in the United States and EU countries and China.

It is important to think about why the current recession has been so prolonged compared with other post-war recessions. I believe that it can be traced to two reasons:

1) To date, there has been limited progress in relieving the stress of the financial markets in developed countries. Credit is still frozen, and there has been relatively little progress in the deleveraging process.

2) Policy mistakes and a lack of confidence in dealing with the financial sector crisis led to contagion in the real sector (agricultural and manufacturing) last year. This caused real spending habits to decline, imbalances to build up in the real sector, and a serious feedback effect between the real and financial sectors.

One year ago, the economic outlook for Africa was quite bright. Most of the sub-Saharan Africa continent was exhibiting growth on par with the developing world, except China and India. Sixty-four percent of the population of sub-Saharan Africa was living in countries where growth over the past two decades registered between 6 and 8 percent. If you look at just the non-oil producing countries between 1997 and 2007, one third of the population was experiencing growth of about 5.5 percent. There were some genuine economic success stories in Africa.

This is a continent that was, and still is, on the move. Importantly, growth on the sub-Saharan African continent was not due to luck. Non-oil economies were not growing because of commodity prices; the growth was the result of difficult policy choices, hard work and the skill of the economic policy makers in key countries. The policies included: reduction in spending, investment in health systems, privatization of state-owned enterprises, trade policies, flexibility in the interest rate policy and private foreign direct investment.

What has been the impact of the global financial crisis on sub-Saharan Africa now? The initial impact about nine to eleven months ago, when the financial crisis was largely a subprime crisis in the United States and the EU, was felt by a few sub-Saharan African economies like Nigeria with relatively well developed financial systems. The rest of Africa was untouched, but still dealing with the food crisis. As the economic crisis broadened and spilled over to the real sector, the impact on sub-Saharan Africa also began to broaden. Disturbances were noted in stock markets beyond South Africa and Nigeria (for example in Uganda and Kenya). There were delays in sovereign bond offerings (Kenya and Ghana).

There are primarily three channels through which the impact of the economic crisis affecting advanced countries reaches sub-Saharan Africa:

1) A shift in demand for African products - almost 60 percent of African exports go to the U.S. and the EU combined. These are precisely the economies that have been hit by the crisis. There has been a decline in import volumes in 2009 of 2 percent in the U.S. and 5 percent in the EU.

2) Global decline in commodity prices – in the last year oil has declined about 15 percent and copper has declined about 15 percent. In addition, there have been recent declines in the prices of coffee, cocoa and cotton.

3) Reallocation of financing flows to Africa - portfolio or passive foreign investment has been curtailed. Remittances will begin to decline as workers who had been employed in developed countries lose their jobs and therefore do not send as much money back in 2009.

In 2007 and 2008, GDP growth was 6.1 percent and 5.1 percent, respectively. These are strong numbers. For 2009, the Fund, the Bank and others are forecasting growth rates in the 3 percent range. Should this forecast be accurate, it speaks to the resilience in the African non-oil producing economies. However, there are major risks to this outlook:

1) Inflation – the food crisis a year-and-a-half ago significantly contributed to inflation, and food importing countries are still experiencing a high inflation rate.

2) Commodity prices – the decline in commodity prices means virtually every country is now experiencing fiscal budget deficits. This has implications for public expenditures.

3) Current account surpluses have begun to shift to deficits.

4) Foreign exchange reserves have been challenged as governments attempt to prop up their currencies. While reserves are currently adequate, they could be subject to great risk.

Appropriate policy responses are critical to address these economic risks. This is where the most talented African policymakers will shine. They need to make the same kinds of difficult policy choices that they made during the past two decades. Certain principles must be followed:

1) Leaders need to engage in open dialogue with business and civil society about the risks to the economy. They must be as open as possible about what is buffeting the economy.

2) Leaders need to maintain sound principles in public finance, and to design strong social safety nets targeted at the most vulnerable. There will be tremendous temptation to put in place protectionist measures. While politically appealing, such actions will only make the vulnerable more vulnerable after the recession clears. It is not a question of regulation or deregulation. There will be regulation, but the question is what kind of regulations should be put in place. The IMF and World Bank are providing advice for reform and the African leaders should take advantage of this information.

Finally, the international community should keep African countries – not external advisors -- in the driver's seat. We also must ensure that our commitment to the Millennium Development Goals is not shaken, live up to the 'Gleneagles' commitments, work on jump-starting the Doha Round or some facsimile, and ward off global protectionism. We also need to work with the G-20 to overhaul the overall global financial architecture.

**John Chambers - Managing Director and Chairman, Sovereign Rating Committee, Standard & Poor's Management LLC**

**Global Economic Slowdown Is Expected to Affect All Sub-Saharan African Countries. Government Measures Can Raise Growth Trend in Region.**

This study will cover the credit outlook for 15 sub-Saharan African sovereign governments, and the key drivers of the credit ratings for these countries made by Standard & Poor's (S&P) Sovereign Rating Committee. The countries are: Republic of South Africa, Republic of Senegal, Republic of Botswana, Republic of Ghana, Republic of Cameroon, Republic of Benin, Burkina Faso, Republic of Madagascar, Republic of Mozambique, Federal Republic of Nigeria, Republic of Kenya, Seychelles, Gabonese Republic, Uganda, and Cape Verde.

**Credit ratings of 15 Countries*:**

| Sovereign | Credit Ratings | Date Assigned | Issued |
|---|---|---|---|
| South Africa (Republic of) | BBB+/Negative/A-2 | Oct-94 | Yes |
| Senegal (Republic of) | B+/Negative/B | Dec-00 | No |
| Botswana (Republic of) | A/Negative/A-1 | Apr-01 | No |
| Ghana (Republic of) | B+/Negative/B | Sep-03 | Yes |
| Cameroon (Republic of) | B/Stable/B | Nov-03 | No |
| Benin (Republic of) | B/Positive/B | Dec-03 | No |
| Burkina Faso | B/Stable/B | Mar-04 | No |
| Madagascar (Republic of) | B-/Negative/B | May-04 | No |
| Mozambique (Republic of) | B+/Stable/B | Jul-04 | No |
| Nigeria (Federal Republic of) | BB-/Stable/B | Feb-06 | No |
| Kenya (Republic of) | B/Positive/B | Sep-06 | No |
| Seychelles | SD | Oct-06 | Yes |
| Gabonese Republic | BB-/Stable/B | Nov-07 | Yes |
| Uganda | B+/Stable/B | Dec-08 | No |
| Cape Verde | B+/Stable/B | March-09 | No |

*Standard & Poor's

## Overview of Credit Ratings

A sovereign credit rating is a forward-looking opinion of a government's capacity or willingness to pay its debt in full and on time. It is not a recommendation to buy a security. It is not a view on whether a security is liquid, or whether it is appropriate for a particular portfolio. It is an opinion on default risk. Default risk means payment default on commercial debt and exchanges.

The opinion is reached by looking at qualitative and quantitative factors and by comparing one sovereign government to another. Raters examine political factors, income and economic structure, growth prospects, fiscal accounts, monetary and financial system, the balance of payments, and the international investment position. The opinion is determined by the S&P Sovereign Rating Committee comprised of senior analysts who work on credits throughout the world. Decisions are made by vote, with simple majority ruling.

**Political Risk**

The most subjective category examined by raters is political risk. The objective is to determine the likelihood that a particular set of policies will be maintained into the future for better, or for worse. Fortunately, the 15 sub-Saharan countries in this study lacked the greatest risk -- war. Nothing debilitates a government's credit standing more than war. There are several past examples of this in Africa, but a current example is the still-simmering conflict in the Democratic Republic of Congo. Depending on the estimates used, this has caused anywhere from three to four million deaths, many of them civilians, in the past decade.

Another calamitous aspect of political risk is an extra-constitutional change in government. The outcome in Madagascar is yet to be seen, although the heightened uncertainty has led the S&P Sovereign Rating Committee to lower the government's rating one notch to a B minus. Although other Committee-rated sub-Saharan countries also have had such incidents in their history since independence, the Committee thinks the future likelihood of a coup d'état now for those countries is remote.

On the other hand, succession risk is more of an issue for our rated sub-Saharan African countries than it would be for countries like Egypt, Tunisia, or Oman. Cameroon, Gabon and Burkina Faso have had long-standing leaders. Our base case is that these governments have sufficient resilience to make a transition without economic dislocation. However the level of uncertainty is higher in countries like these than in a country that already has been able to make a political transition of power.

The most dramatic, powerful and inspiring example is South Africa's transition away from apartheid. Others, such as Nigeria, Benin and Mozambique, have made less dramatic but still notable transitions. Although expected, it was gratifying to see Ghana -- which made a successful transition to pluralistic democracy over a decade ago -- undergo a very tight election just over a month ago that was quickly accepted by the losing incumbent party.

Part of the evaluation of political risk is trying to gauge the strength of the 'social contract.' The riots last year in Cameroon and Senegal, or the banditry in the Delta region of Nigeria, may speak to that issue. More alarming was the aftermath of the Kenyan elections in which over a thousand people died and 300,000 people were displaced. Fortunately, most of the time we are not confronted with analyzing such tragic events, but rather transitions where the changes will be at the margin. A good example would be the recent change in leadership of the African National Congress (ANC), where our view is that the prudent policies that have characterized governments for the past decade will be preserved.

**Income and Economic Structure**

Looking at the real economy, a starting point would be per capita GDP. Although initial resource endowment and geography can help, they do not explain all that much. Otherwise Gabon, Nigeria, and Cameroon would have similar results, since oil predominates in all three of economies. Or if being landlocked condemned a country to underdevelopment, Botswana would not be as prosperous as it is. Rather, per capita GDP can give an initial impression.

Of course, it is necessary to judge whether a government's policy mix will enable that level of wealth to be maintained. Part of our Committee's work is identifying the 'bottleneck,' or where the misallocations are in the real economy. Think of electricity generation in Nigeria, South Africa or Cameroon, or the state of the ports. Benin's progress in developing the port of Cotonou is encouraging. Senegal's agricultural reform has sharply boosted fields under cultivation. On the other hand, state ownership of land in Mozambique hampers growth.

With these structural features in mind, our Committee tries to get a bead on growth. The slowdown in the global economy is going to hurt all sub-Saharan countries. We try to look through economic cycles, even in a deep recession like the one we are in now. Our analysis tries to take a more medium-term perspective, looking at total-factor productivity growth rather than simply growth in labor and investment inputs.

Our Committee tries to identify government measures that may raise the trend of growth, for example Botswana's initiative to go down the value-added chain to conduct diamond cutting locally. Or we look closely at the results posted annually in the World Bank's "Doing Business" surveys. We also look at savings rates because the higher the savings rate, the more flexibility a country has to adjust to shocks.

**Monetary Policy**

Inflation had been an issue in Africa although it is moderating as the externally generated portion of Africa's inflation -- oil and food -- fades away or is reversed. However, a portion of the consumer price index (CPI) story in the 15 governments under study is home-grown, with the oil exporters' inflows not being adequately sterilized in many states. Throughout the continent, interest rates are negative in real terms. It is important to keep inflation in check so that the private sector has one less uncertainty when making investment decisions, and to protect the population's purchasing power, particularly the poor.

Regarding exchange rate regimes, our Committee does not have any *a priori* opinions. The fifteen countries in question represent a wide range of regimes: Cape Verde is a pegged exchange rate; Senegal, Cameroon, Burkina Faso, Benin and Gabon are all in a monetary union with a pegged exchange rate; South Africa freely floats; Botswana has a crawling peg; Nigeria has imposed exchange controls and operates basically with two exchange rates; the rest have floats, or with the central bank intervening from time to time.

What matters most is whether the surrounding policies support the foreign exchange regime. Certainly the fourteen members of the two CFA franc zones have benefitted by pulling reserves and through institutional arrangements with the French treasury. Also, South Africa has been served by its freely floating exchange rate and Nigeria has taken a step back by imposing capital controls.

**Financial Sector**

The financial sector touches on every category of the Committee's analysis. It is through this sector that monetary policy is transmitted. When the financial sector has problems, it can create dislocations in the real economy, fiscal costs for the government, and balance of payments pressures for the central government.

South Africa has not only the best financial system in Africa, but also one of the best financial systems in emerging markets overall. With the banking consolidation and reform in Nigeria, banks have improved. But recent regulations capping lending rates create needless dislocations and impair the nation's growth prospects.

In rating debt, S&P delves into a government's fiscal accounts to see where the vulnerabilities are on the revenue side and where the flexibility is on the expenditure side. We look at the government's primary fiscal balance, which is its fiscal balance before interest payments. Most of the 15 governments under study had a poor 2008, and some will have a very poor 2009. When S&P looks at deficits, it counts privatization receipts below the line. For example, when Burkina Faso sells a majority stake in Onetel to MorocTelecom, we count that as revenue rather than as a financing item.

We also look at debt burden. Gabon has been able to cut its debt burden by asset liability operations. Most of the low income countries have received debt relief through the Highly Indebted Poor Countries (HIPC) program and the Multilateral Debt Relief Initiative (MDRI), although Kenya has not received such assistance. In evaluating their fiscal position, we look not only at actual debt outstanding but contingent fiscal risks. These contingent fiscal risks emanate mostly from the banking sector. The banking crisis in the CFA franc zones after the 1994 devaluation would be one example. Contingent fiscal risks also emanate from public enterprises. So when Senegal has to recapitalize Senelec, SAR the refinery, or ICS the refertilizer company, these are contingent fiscal risks that crystallize on the government's books.

**External Accounts**

Lastly, S&P's Committee considers external accounts -- how vulnerable a country is to terms-of-trade shocks, now being felt by most of the African nations. We look at supply disruptions like those suffered by Benin when Nigeria closed the border two years ago, or sudden stops in international finance, experienced by the Seychelles. Many of the African countries' current accounts will deteriorate in 2009. Commodity exporters will see oil, mineral and agricultural prices decline. Those with robust tourism products, such as Kenya or Cape Verde, will see fewer arrivals. Remittances from the industrialized countries will fall, foreign direct investment (FDI) will taper off; commercial/external financing will become expensive or non-existent. As a result, official creditors like the export credit agencies will need to step into the breach lest reserves decline to dangerous levels.

**Ambassador Phillip Carter III - Acting Assistant Secretary of State for African Affairs**

**New U.S. Government Policies Will Help African Countries Address the Global Financial Crisis; Key is African Countries' Ownership of Process, so that they Become Part of Global Economy.**

Initially, analysts thought that Africa would be insulated from the global financial crisis because of the region's lack of development or isolation from the global marketplace. This turned out not to be true, as seen in figures for remittances and commodity prices, the unavailability of credit and the impact this has on credit ratings, and Standard & Poor's view that Africa faces real challenges.

To help Africa move through this crisis, and at the same time introduce itself to a market considerably changed by global recession, we must look at the policy matrices we can put forward throughout the continent.

## The U.S. policy towards Africa in this administration

We are still shaping our Africa policy, and there are significant reviews underway, for example how to engage Sudan and Somalia. We are reviewing our entire overarching policy. At the same time, on a bilateral level, each State Department desk officer is reviewing where we stand with each country in Africa -- where can we learn from new innovations, what are the lessons learned, and how can we move forward. It is a deep, broad study and will take some time. However, four basic policy review elements are being used to formulate the U.S. outlook towards Africa:

1) Economic Assistance Obligations: We will continue to meet our economic assistance obligations as enunciated in the past. We, too, will continue to see the Millennium Development Goals as guideposts for implementing our assistance program.

2) Security: We need security to focus on the other elements. Without stability founded on protection of nationals and property, issues of health and development and economic growth are set to the side. We will continue to provide significant support to the governments to help them help themselves. For example, we have offered extensive programs to train African peace keepers to participate in peace-keeping operations throughout the continent and globally. To date, our programs have trained about 50,000 peace keepers. Globally, if the "train the trainer" results are included, we have trained in excess of 100,000 peace keepers participating in the DRC, Somalia, Sudan, and outside the continent as well.

    a. In addition, we will look at the professionalization of the African military forces. That will continue through our well-known programs of military training, and also through exchanges.
    b. AFRICOM -- the African Command is a positive development. It blends three combatant commands into one, adds better coherence to our strategy, allows the military to support our foreign policies even more closely and, more importantly, allows for more direct attention to African security.

3) Economic growth: Food security is critical to economic growth. The recent commodity crisis brought on by rising costs of oil, transportation and other products were crippling for some African countries. The U.S. government had to redesign, reinvigorate and restructure its response to these issues through an extensive interagency group. We attacked the food crisis from two viewpoints -- humanitarian and agricultural productivity. From the humanitarian perspective, we are one of the largest, if not the largest, contributor to the World Food Program. We realize that that is not sufficient. To address sustainable economic development on the African continent, we must look at agricultural productivity broadly and in depth. There are efforts now to address this through improved infrastructure, better types of seeds, technology transfers, and other means. But there is a long way to go. Resources need to be put in place extensively, and managed well.

4) Democratization and good governance: We are trying to advance the political process through civil society participation, and through the media, to encourage the free-flow of information. We are looking at political party development and will continue working through USAID and through direct funding from the State Department. A cornerstone of mitigating the impacts of food insecurity is for countries to have transparent policy structures that everyone can understand. Countries that have put in place effective governance mechanisms to run their economies -- structures that are transparent and responsible -- are weathering the financial crisis better than countries that have not taken such steps. We are working with international financial institutions to provide support to countries that are facing what we call the “exogenous shock syndrome.” Resources are being put forward in a basic way to buttress their account balances. But our growing concern is that these resources must be provided in a way that reinforces good behavior rather than allowing funds to be used for continued inappropriate expenses.

5) Health and education: those two sectors have been priorities in the previous administration and they will likely be of continued importance in the present administration. Programs for HIV/Aids prevention and treatment will continue to grow, with an emphasis on how we can work with our African partners and make that process sustainable through their own health systems. As a result, development of health systems will be as important a factor for us as education. We will be looking at primary education, the benefits of secondary education systems, and ways to link those systems with the private sector. In that way, the education provided will be relevant to the needs of the society on an economic level as well as a social one. We are looking at expanding our exchanges at the tertiary education level and above. All of these elements will be developed on the policy level.

We hope to partner with Africa and continue to build on the foundation put into place over the past years which is seeing a tripling of economic aid to Africa. We want to emphasize that this is not a paternalistic relationship but a partnership. In looking at the Millennium Challenge, a framework of 18 indicators set up to see how countries can become eligible is extremely useful. This framework has been the centerpiece of economic reform with many governments and civil society. It is perhaps one of the most useful tools to spur dialogue on the social side, but also in the areas of corruption and governance because it is seen as completely objective, nonpartisan and nonpolitical. It provides a clear framework for what a country needs to do and where it needs to focus its attention. This program has helped feed growth rates of some countries on the continent.

In addition, we are continuing to work with the Overseas Private Investment Corporation (OPIC). Since 2004, we have provided about $1.2 billion to capitalize about 16 capital funds throughout Africa. These funds are expected to mobilize approximately $3.2 billion in private equity for a total of $4.4 billion to be invested in Africa. Although this may seem small, the expectation is for these numbers to increase over time.  In earlier discussions on this panel, I was struck to hear that Africa is gaining additional attention by investors.  This is because returns on investments on the African continent were seen as relatively competitive compared to other regions that are experiencing diminishing returns. One country's challenge may be an opportunity for an African country.

We also have such programs as the Africa Global Competitiveness Initiative (AGCI), a $200 million USAID-led, five-year program that looks at building up trade capacity and boosting the competitiveness of African exports.  The program examines trade and investment environments and policies, development of small and medium-sized enterprises, increasing access to finance, and leveraging $1 billion in critical infrastructure.

National Bank of Rwanda is a success story, where the automation of off-site surveillance of financial markets was introduced. This allowed the central bank to distill and determine what information is essential, to improve its data content, and to develop a more robust regulatory reporting process. This example refers back to the good governance and improvement of transparency in financial markets mentioned earlier. The National Bank of Rwanda was so pleased with the system that it has encouraged other central banks to ask for the same assistance.  As a result, we are beginning to work with the Central Bank of the Democratic Republic of the Congo, which requested the same type of assistance.  USAID is beginning to provide the help. These types of developments, while technical and difficult to implement, are critical to providing that foundation for economies that are trying to pull themselves out of a recession.

We need to push the Doha Round forward and pursue a global trade policy that avoids concerns of protectionism.  The issue for us is partnership. We need to partner with African countries and with the international financial community.  It also is a question of ownership.  These are African issues which need African ownership.  The issues are not imposed on Africa from external entities -- from donors or creditors.  But the U.S. government is committed to working with these countries. We have the G20 Summit coming up and there, Prime Minister Meles of Ethiopia representing the New Partnership for Africa's Development (NEPAD) as well as the Chairman of the African Union, Jean Ping. These are signals that Africa's future is part and parcel of the global economy and something that we shall not ignore.