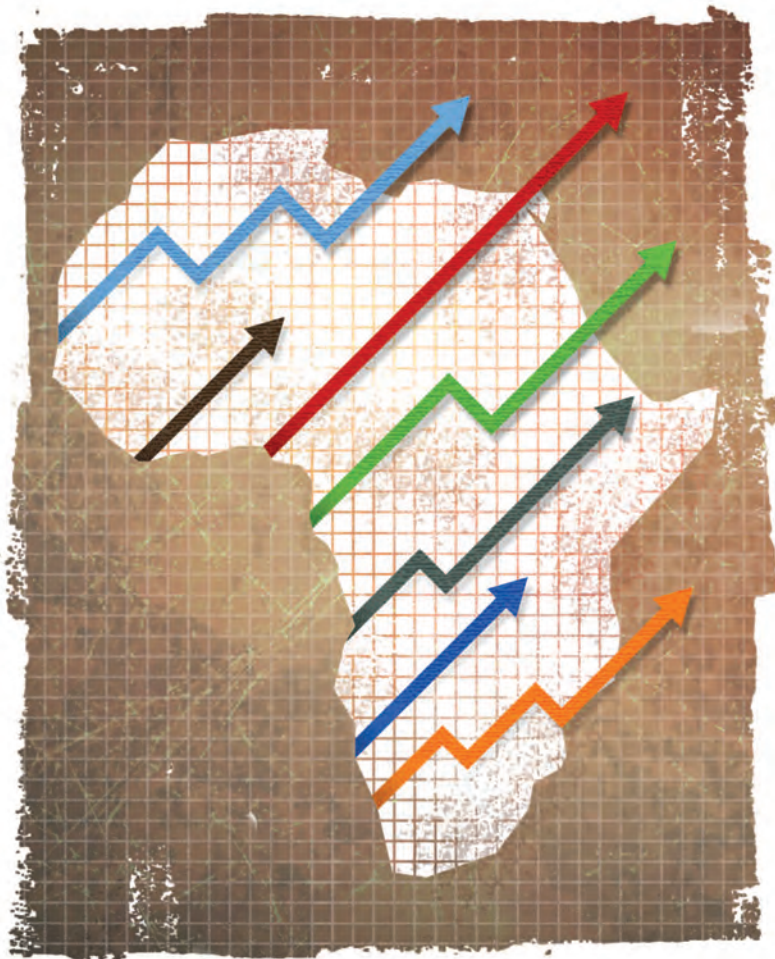


# Africa's Pulse

*An analysis of issues shaping Africa's economic future*



- ▶ Sub-Saharan Africa's growth will decelerate in 2015 amid weak global economic conditions. Some countries, however, will continue posting solid growth.
- ▶ Policy buffers are low in several countries, constraining the response to the current environment and underscoring the need for African countries to improve domestic resource mobilization and enhance public expenditure efficiency.
- ▶ Progress in reducing income poverty in Sub-Saharan Africa may have been faster than we thought but poverty remains high. The region's growth deceleration challenges efforts to reduce poverty.

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## Summary

- ▶ External headwinds and domestic difficulties are impacting economic activity in Sub-Saharan Africa. On the external side, the end of the commodity price super cycle, the slowdown of growth in China, and tightening global financial conditions are weighing on growth. Compounding these challenges, domestic impediments, notably electricity supply bottlenecks, have come to the fore more acutely in several countries.
- ▶ Against this backdrop, growth is projected to slow from 4.6 percent in 2014 to 3.7 percent in 2015, the lowest since 2009. Although many commodity exporters are seeing sharply lower rates of expansion, several other countries such as Côte d'Ivoire, Ethiopia, Mozambique, Rwanda, and Tanzania are continuing to post solid growth. Overall, however, the region's economic performance in the aftermath of the global financial crisis remains below that of the pre-crisis period: annual growth in gross domestic product of 4.5 percent in 2009-14 compared with 6.5 percent in 2003-08.
- ▶ Sub-Saharan Africa is entering a period of tightening borrowing conditions amid growing domestic and external vulnerabilities. Weaker terms of trade have worsened the external imbalances of commodity exporters, and current account deficits remain large in other countries. Fiscal positions have deteriorated significantly in many countries. Rising wage bills and lower revenues, especially among oil producers, have led to a widening of fiscal deficits. In some countries, large infrastructure expenditures are driving the deterioration in fiscal balances. As a result, fiscal deficits across the region are now larger than they were at the onset of the global financial crisis.
- ▶ Reflecting the widening fiscal deficits, government debt has continued to rise in many countries. Although government debt-to-gross domestic product ratios look manageable in most countries, they have increased rapidly in several frontier market economies (Ghana and Zambia), driven by non-concessional borrowing. External debt has increased notably in Ghana and South Africa. Rising sovereign bond spreads and higher yields on recent bond issuances point to investors' concerns about growing external and fiscal vulnerabilities in the region.
- ▶ Weak fundamentals, combined with the strong appreciation of the U.S. dollar, have kept currencies across the region under pressure throughout the year. By end-September, the Ghanaian cedi and South African rand had depreciated by more than 25 percent against the U.S. dollar (compared with their June 2014 levels), while the Angolan kwanza fell 38 percent. The Ugandan shilling and Zambian kwacha weakened the most by depreciating 45 and 80 percent, respectively.

- ▶ Policy buffers are low in several countries, constraining the response to the current situation. Where macroeconomic vulnerabilities are exacerbated, the focus will need to be on reducing macroeconomic imbalances. Overall, the changing global economic environment underscores the need for African countries to improve domestic resource mobilization, as well as enhance the efficiency of public expenditures to create fiscal space, including through better prioritization of key public services and infrastructure. Complementing these efforts, focus must also be on speeding up structural reforms to alleviate the domestic impediments to growth.
- ▶ Sub-Saharan Africa is facing a challenging outlook. After slowing to 3.7 percent in 2015, economic activity will pick up gradually to 4.4 percent in 2016 and 4.8 percent in 2017, as commodity prices make a slow recovery, fiscal consolidation eases, and governments take steps to alleviate power supply and transport constraints. More broadly, domestic demand through investment, private consumption, and government spending, will support growth in the region. The balance of risks to the outlook remains tilted to the downside, however.
- ▶ Weaker growth complicates the task of accelerating poverty reduction. Although progress in reducing poverty in Sub-Saharan Africa may have been faster than we thought, the region will fall short of achieving the Millennium Development Goal of halving the share of the population living in poverty between 1990 and 2015. Fragile countries have lagged behind the most in reducing poverty. Despite progress, non-income measures of well-being are also lagging.

## Section 1: Recent Developments and Trends

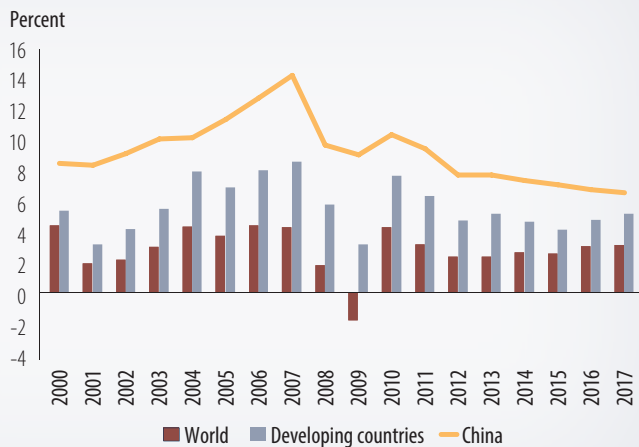
- ▶ Global growth is softening amid deceleration of growth in China and weaker economic performance in a range of countries. The pace of global expansion is expected to be 2.5 percent in 2015, slightly below the 2.6 percent rate of 2014, and strengthening to 3.0 percent in 2016-17.
- ▶ A less favorable global environment is presenting a challenge to Sub-Saharan Africa's growth performance and prospects. After decelerating in 2015, output growth is expected to recover in 2016-17, but the pace of expansion will remain below that of 2003-08. This underscores the need for governments in the region to improve domestic revenue mobilization, enhance the efficiency of public expenditures, and redouble efforts to implement structural reforms.

### GLOBAL ECONOMY

Global growth appears set for another disappointing year (figure 1.1). It struggled to gather momentum in the second quarter (Q2) of 2015, with activity in the Euro Area and Japan slowing, growth in China continuing to decelerate, the economies of Brazil and the Russian Federation contracting, and those of other major commodity exporters weakening. Looking forward, Purchasing Managers Index surveys are still firmly in expansionary territory in high-income countries, but point to contraction in low- and middle-income countries.

The slowdown in global growth in 2015 is partly driven by a deceleration in growth in China and weaker growth in many emerging market countries

**FIGURE 1.1:** Trends in GDP growth



Source: World Bank.

The recovery in the United States remains on track. U.S. growth rebounded from a temporary setback in the first quarter of 2015, to an upwardly revised 3.9 percent in Q2 (seasonally adjusted annual rate, SAAR), and has shown further signs of improvement since then. The U.S. Federal Reserve left the federal funds rate unchanged at the current 0-0.25 percent target range in September, citing dampening effects on the U.S. economy from recent global economic and financial developments. Meanwhile, growth in the Euro Area slowed to 1.4 percent (SAAR) in Q2, down from 2.1 percent in Q1. Domestic

demand and trade have picked up in 2015, while inflation remains far below the European Central Bank's 2 percent target. Germany, Ireland, and Spain are on track for above-trend growth in 2015, while growth remains fragile in France and Italy.

Growth in China was reported to be 7 percent year-on-year in 2015Q2, supported by stimulus measures. High-frequency indicators for Q3 are mixed, pointing to a continued slowdown in manufacturing activity, including contractions in exports and imports and slowing growth of industrial production. Domestic demand-related indicators show greater resilience, with rising services Purchasing Managers Index and retail sales growth. In August, a change in the calculation of the renminbi reference rate resulted in a 4.5 percent depreciation of the renminbi against the U.S. dollar, the largest two-day drop since the mid-1990s.

In addition to the uncertainty about the growth path of the largest economies in the world, commodity prices have remained persistently low (figure 1.2). After dropping more than 50 percent from June 2014 to January 2015, there was a slight recovery in the international price of crude oil (figure 1.2). However, recent demand shocks (for instance, the Chinese growth slowdown) and an oil production glut lowered the price of crude again. The price retreated about 25 percent during May to August 2015. Oil prices have finally caught up with the steady decline in international prices of agricultural goods and metals and minerals. Robust supplies and lower demand have generally explained the decline in commodity prices across the board. For instance, the drop in the prices of natural gas, iron ore, platinum, and coffee has exceeded 25 percent since June 2014. Given the shocks underlying the plunge in commodity prices, it might be expected that lower and volatile commodity prices are here to stay for a while.

Emerging and frontier market economies are showing more signs of slowing growth. High-frequency indicators suggest that weak growth in 2015Q1 among major emerging market countries (Brazil, Nigeria, Russia, and South Africa) extended into Q2, and is likely to disappoint yet again in 2015. With the exception of India and countries in Eastern Europe, among others, a majority of developing countries could see weaker growth in 2015 compared with 2014, as subdued external demand weighs on exports. Oil exporters (Colombia, Malaysia, Nigeria, República Bolivariana de Venezuela, and Russia) are under

acute pressure from deteriorating terms of trade, while countries reliant on export revenues from metals and other non-energy commodities (Argentina, Chile, Indonesia, Peru, South Africa, and Zambia) also face significant headwinds. Q2 growth releases show steep contractions in Brazil and Russia, and a further slowdown in Indonesia, Malaysia, Nigeria, and South Africa. In contrast, the recovery in India appears to remain robust. For now, growth prospects in 2015 for low-income countries remain above 6 percent.

Against the backdrop of disappointing data outcomes, continuing weakness in global trade, and bouts of turbulence in global financial markets, there is now a likelihood that even the modest pick-up in global growth that was forecasted earlier for 2015 will not materialize, and projections are being revised downward.

Global growth is now expected to slow from 2.6 percent in 2014 to 2.5 percent in 2015 before strengthening somewhat to 3 percent in 2016-17, driven in part by an expected rebound in emerging and low- and middle-income economies.

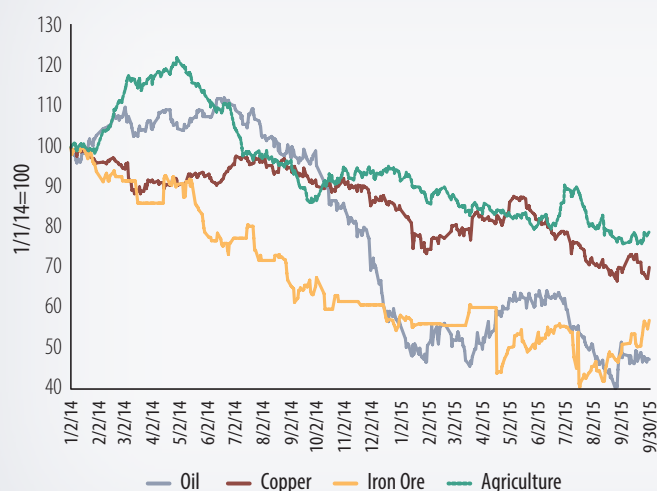
Risks to the global outlook remain tilted to the downside. Major downside risks are centered on the prospects in emerging and low- and middle-income countries, which could be significantly affected by a further slowdown in China and a disorderly increase in borrowing costs as the U.S. Federal Reserve embarks on a gradual tightening cycle. Meanwhile, deflation concerns remain, with actual and expected inflation staying below policy objectives in an increasingly large number of advanced economies and emerging and low- and middle-income countries amid declining commodity prices.

## SUB-SAHARAN AFRICA

### *Recent Developments*

After rising 4.6 percent in 2014, economic expansion in Sub-Saharan Africa (SSA) is set to decelerate markedly in 2015, reflecting the combined effects of difficult global conditions and domestic challenges (figure 1.3). The region's commodity exporters—especially oil producers such as Angola, Equatorial Guinea, Nigeria, and the Republic of Congo, but also producers of minerals and metals, such as Botswana and Mauritania—are seeing setbacks to growth. In some cases, growth woes, such as in South Africa and Zambia, are compounded by domestic factors, notably electricity supply bottlenecks. In other cases, political and social tensions are taking a toll on economic activity (Burundi and South Sudan). Nonetheless, several countries, such as Côte d'Ivoire, Ethiopia, Mozambique, Rwanda, and Tanzania, are bucking the weakening regional trend and continuing to post robust growth.

FIGURE 1.2: Evolution of commodity prices, 2014-15

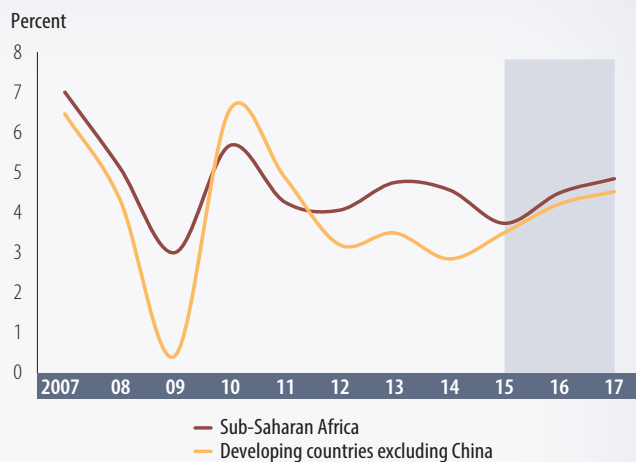


Source: World Bank.

Commodity prices have remained persistently low, mostly due to robust supplies and lower demand

Growth in Sub-Saharan Africa is projected to decelerate in 2015 amid difficult global conditions and domestic challenges

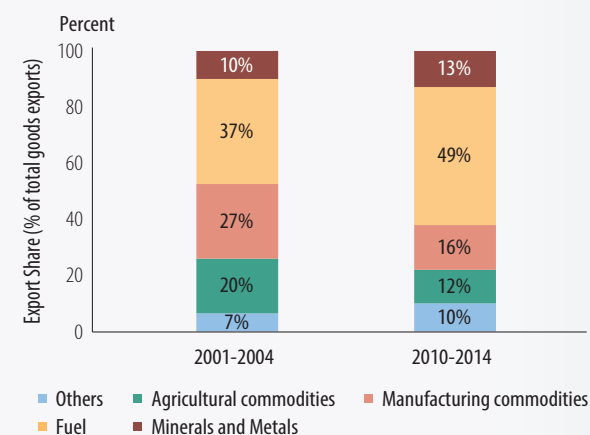
**FIGURE 1.3:** GDP growth



Source: World Bank.

Fuel exports alone accounted for nearly half of all exports in 2010-14

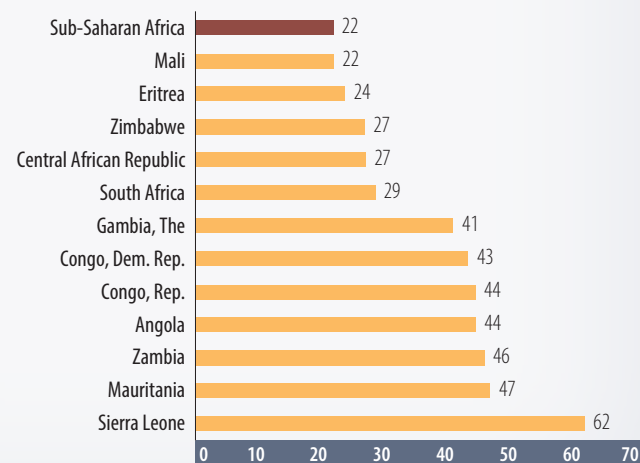
**FIGURE 1.4a:** Share of key exports in total exports of Sub-Saharan Africa, 2001-14



Source: World Trade Integrated Solutions (WITS) database.

China is the largest individual trading partner for Sub-Saharan Africa. In many countries, exports to China account for over 40 percent of country's exports

**FIGURE 1.4b:** China's share of exports, average for 2010-14



Source: World Trade Integrated Solutions (WITS) database.

SSA has faced an across-the-board weakening in commodity prices in 2015 (figure 1.2). Following some recovery in the second quarter, oil prices plunged again, dropping below US\$40 per barrel. Prices of copper and iron ore, two of the region's main metal exports, fell by about 25 percent and 40 percent, respectively, while prices of agricultural goods remained depressed. SSA's pattern of exports makes the region vulnerable to commodity price shocks. The region is a net exporter of fuel, minerals and metals, and agricultural commodities. The combined share of energy and minerals and metals has grown, and now accounts for about two-thirds of the region's exports (figure 1.4a). By contrast, manufacturing exports have seen a sharp decline in share, as have agricultural commodities.

China is an increasingly important trading partner for the region and has a strong participation in world commodity markets. China's demand for crude oil represents 11 percent of world demand. It also consumes 57 percent of the world copper demand and 2/3 of the world iron ore demand. The growth of SSA's exports to China has outpaced that of exports to other regions. In 2011, China became the largest individual trading partner for the region, with the share of the region's trade with China reaching 17 percent, from negligible amounts in the 1990s. At the same time, traditional trading partners' shares have fallen steadily. The share of the European Union countries has decreased from over 55 percent in 1990 to 26 percent in 2014—the same as that of China. In many countries—including Angola, The Gambia, Democratic Republic of Congo, Mauritania, Republic of Congo, Sierra Leone, and Zambia—China accounts for over 40 percent of the country's exports (figure 1.4b).

The region's exports to China are heavily concentrated in resource products: In 2011-14, nearly 60 percent of the region's exports to China were minerals and metals (39 percent) and fuel (21 percent).

Signs of an economic slowdown in the world's second largest economy have potential spillovers for SSA, given the region's tight linkages built up with China in recent years. First, countries in the region have raised their trade intensity with China. Foreign trade between the region and China grew more than three-fold between 2007 and 2014, from around US\$60 billion to nearly US\$200 billion, a level comparable to the total trade with the European Union and about four times the total trade with the United States. Second, the impact of a Chinese slowdown may also affect Africa's foreign trade through third-party effects. Third, intra-regional trade effects may also affect countries in the region. For example, South Africa's economy has been affected by lower Chinese demand for the country's gold, platinum, iron ore, and coal, among others. South Africa's growth prospects are likely to have an impact on the country members of the Southern African Customs Union and Mozambique (about a third of their exports are sent to South Africa).

China's rebalancing of growth away from raw material-intensive sectors will have direct implications for SSA. A recent study estimates that from a long-term perspective these effects could be sizeable (box 1.1).

China's economy is undergoing significant changes. The country's Third Party Plenum reform blueprint calls for a slower but safer growth path: a "new normal." Apart from putting the brakes on fast growth, Chinese authorities aim to rebalance the economy toward consumption and away from investment. As SSA's largest trading partner, including the single largest export market, developments in China have implications for the region.

A recent study applies the global dynamic computable general equilibrium (CGE) LINKAGE model (van der Mensbrugghe 2011) along with the Global Income Distribution Dynamics microsimulation tool (Bussolo et al. 2010) to study the impact of slowdown and rebalancing in China on economic growth, trade, and poverty reduction in the rest of the world. This methodology combines a consistent set of price and volume changes from the CGE model with household surveys at the global level. The analysis mainly focuses on the trade and relative prices channels to capture the impact of China's transition on SSA.<sup>b</sup>

In line with the assumptions in World Bank (2014), the study analyzes a slowdown and rebalancing scenario consistent with the transition to the "new normal." To illustrate various channels operating in this transition, the results are grouped as follows:

- 1) *Slowdown*: China's gross domestic product (GDP) growth slows down to an average of 6 percent per year over 2016-30 and 4.6 percent in 2030.
- 2) *Rebalancing*: the share of investment in total GDP gradually falls from 46.7 percent in 2015 to 35.5 percent in 2030, with a corresponding increase in household consumption. The services sector grows to 61 percent of value added by 2030 from 50 percent in 2015 (World Bank 2014).
- 3) *Combined impact*: combination of channels 1 and 2.

**BOX 1.1:**  
China's  
Slowdown and  
Rebalancing:  
Potential  
Growth Impacts  
on Sub-Saharan  
Africa<sup>a</sup>

<sup>1</sup> Intra-regional trade linkages in the rest of the region as not as deep but there are some standouts —e.g. Kenya sells 13 percent of their exports to Uganda and 9 percent to Tanzania while Côte d'Ivoire ships 9 percent of their exports to Ghana, and 8.5 percent to Nigeria.

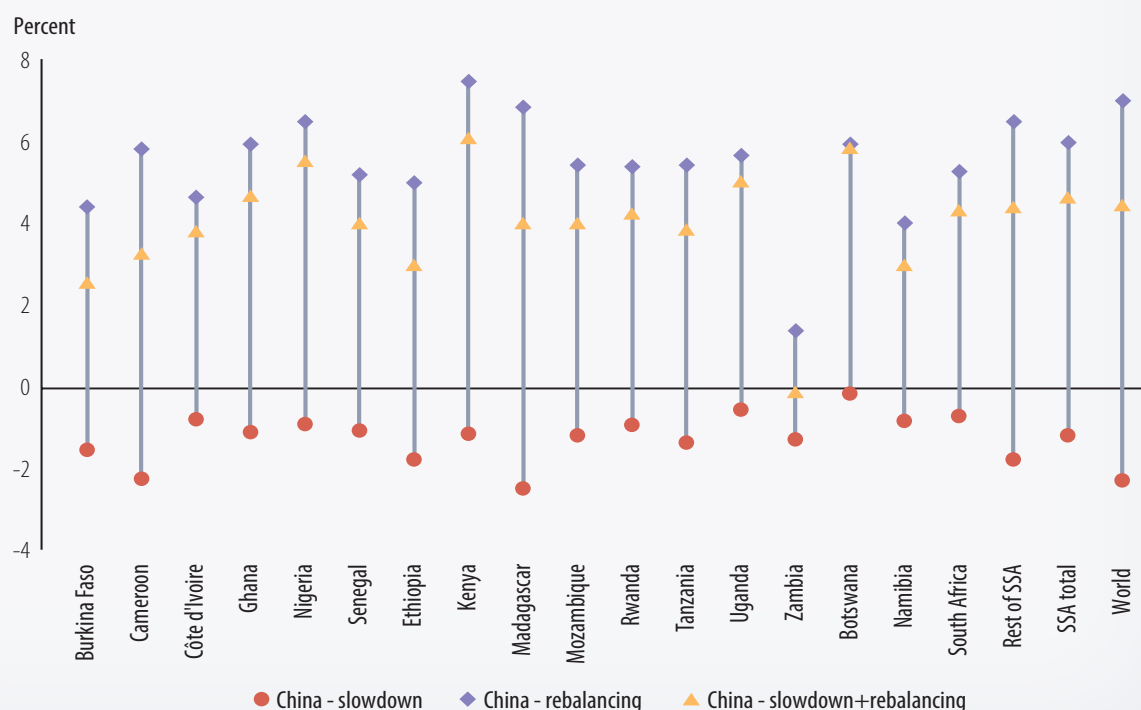
**BOX 1.1**  
Continued

The results are presented against the baseline (or business as usual) scenario, which assumes no rebalancing and constant growth in China of 7 percent during 2016-30.

**Slowdown.** The slowdown channel is expected to result in a GDP loss in Sub-Saharan Africa of 1.1 percent, or about \$42 billion compared with the baseline by 2030 (figure B1.1.1). Slower growth in China significantly impacts demand for SSA's exports, suggesting a decline of 11 percent (\$25 billion). China's slowdown is expected to contribute to further downward pressure on world prices of commodities—the world prices of agricultural, food, and natural resources commodities are estimated to fall by 2.9, 1, and 0.3 percent, respectively, by 2030 relative to the baseline. The countries that have the most to lose from China's slowdown are Madagascar, Cameroon, and Ethiopia, with an expected GDP loss of 2.4, 2.2, and 1.7 percent, respectively, compared with the baseline in 2030, mostly because of terms of trade losses.

**Rebalancing.** Rebalancing alone lifts GDP in SSA by 6.1 percent (\$232 billion) above baseline by 2030. It boosts China's private consumption and implicitly its demand for imported products. It boosts private consumption and implicitly demand for imported products. This demand is biased toward services, driving up the prices of nontradables relative to tradables and leading to a faster increase in wages in nontradable sectors and real exchange rate appreciation by 15 percent up to 2030 (Balassa-Samuelson effect). As a result, SSA's exports to China are expected to increase by 13.21 percent (\$30.6 billion) by 2030 compared with the baseline. The countries in SSA that are expected to benefit the most from China's rebalancing are Kenya, Madagascar, and Nigeria, with additional GDP gains of 7.5, 6.9, and 6.5 percent, respectively, compared with the baseline by 2030. The higher than average gains result from the prevalence of products more linked to China's consumption demand as a share of their exports.

**FIGURE B1.1.1: GDP**  
(changes relative to the baseline)



Source: LINKAGE simulations.



**Combined impact.** The negative effects of China’s slowdown are outweighed by the positive changes caused by rebalancing. The combined scenario implies higher overall imports by China and positive terms of trade effects for exporters of agricultural commodities. This is expected to lead to overall GDP gains for the SSA region of 4.7 percent (US\$181 billion) by 2030 relative to the baseline. The countries that benefit the most are the ones that enjoy the highest relative gains from China’s rebalancing, that is, Kenya, Botswana, and Nigeria, with 6.2, 5.8, and 5.5 percent increase in GDP, respectively, by 2030. Zambia—a large copper exporter—is shown to be the only SSA country that experiences small overall losses from China’s transition. As the world price of these products declines as a result of China’s switch from an investment- to a consumption-based growth model, terms of trade and GDP gains for Zambia are small in the rebalancing scenario.

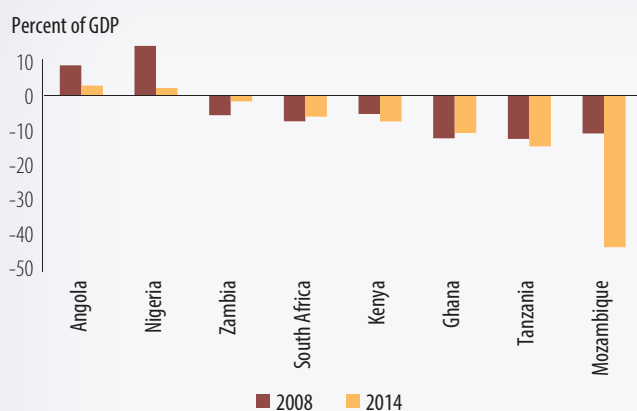
These scenarios also have important implications for poverty reduction, but these are not presented here (see Lakatos, Maliszewska, and Osorio-Rodarte 2015 for details).

a. Based on research funded by the PSIA TF018287 and conducted by Csilla Lakatos, Maryla Maliszewska, and Israel Osorio-Rodarte.  
b. Key channels of interaction between China and the rest of the world are the bilateral trade flows based on COMTRADE data from 2011 and updated to 2015. The results are sensitive to the initial data, closure rules, functional forms, and underlying parameters.

**External imbalances widened in many countries, amid falling commodity prices.**

Not surprisingly, commodity exporters have been hit hard by the worsening terms of trade (figure 1.5). Oil exporters such as Angola, Nigeria, and Republic of Congo are particularly affected because of their heavy dependence on oil exports. The current account balance is expected to turn sharply negative in Angola and Nigeria, and to remain large among oil importers as non-oil imports continue to rise in these countries. In Nigeria, the current account deficit widened to an estimated 3.6 percent of GDP in 2015Q1, from 0.6 percent of GDP in 2014Q4. In Kenya, the current account deficit has remained large (9 percent of GDP), despite the decline in the price of oil, as the downturn in tourism caused by security concerns continued to weigh on export earnings. On the other hand, South Africa’s current account deficit narrowed to 3.1 percent in 2015Q2 from a deficit of 4.7 percent in 2015Q1 due to larger exports and subdued growth of imports.

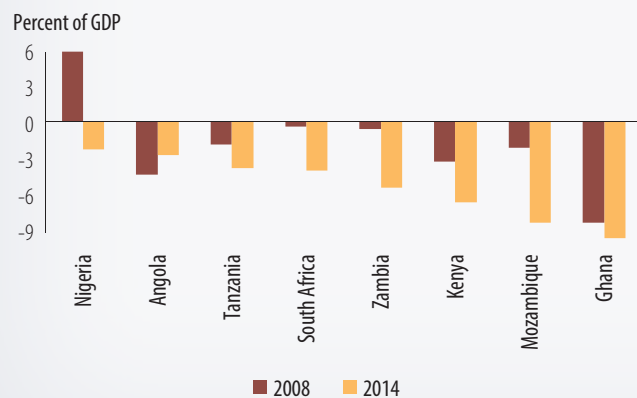
FIGURE 1.5: Current account balances, 2008 and 2014



Source: World Bank.

Heavy reliance on commodity exports has contributed to the weakening of current account balances, especially among oil exporters

FIGURE 1.6: Fiscal deficits, 2008 and 2014



Source: World Bank.

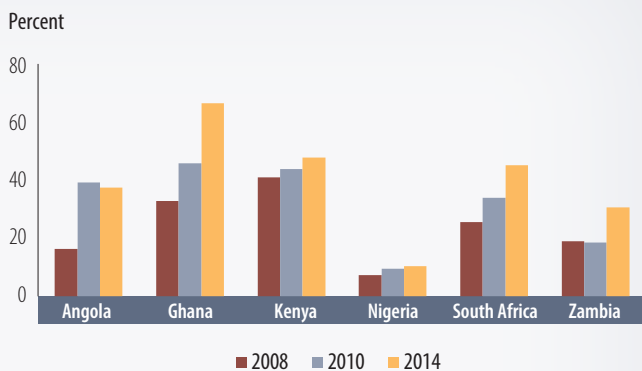
Fiscal deficits are now larger than they were at the onset of the global financial crisis

**Deteriorating fiscal positions.** Heavy dependence of fiscal revenues on commodity exports, in turn, contributed to the weakening of fiscal balances. The fiscal positions of oil exporters such as

Angola, Nigeria, and Republic of Congo were particularly affected. In Nigeria, distributable revenues to the federal and state budgets fell by about 40 percent between January and June 2015, triggering a severe tightening of public spending. Salary arrears emerged in several states, and state and federal governments implemented sharp cuts in capital expenditures. Similarly, in Angola, the oil price plunge induced a sharp retrenchment in public sector investment projects. In the Republic of Congo, where oil revenues account for over 70 percent of fiscal revenues, recurrent expenditures have been cut, while infrastructure spending remains strong. In Mauritania, the sharp decline in iron ore prices combined with delays in expansion of mining sector production capacity are presenting a fiscal challenge. And because of weak revenue performance associated with the mining sector, Botswana is expected to see a fiscal deficit for the first time in three years.

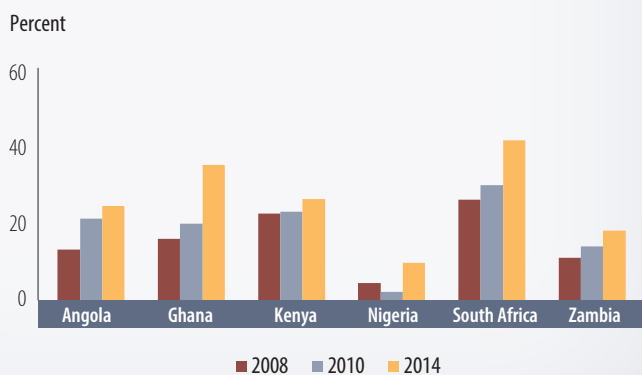
The size of government debt relative to GDP is rising. Meanwhile, the external debt of Ghana and South Africa has notably increased

**FIGURE 1.7: Government debt (percent of GDP)**



Source: World Economic Outlook, IMF.

**FIGURE 1.8: External debt (percent of GDP)**



Source: World Economic Outlook, IMF.

Fiscal positions were already deteriorating in many countries, and fiscal deficits across the region are now larger than they were at the onset of the global financial crisis (figure 1.6). Rising wage bills, higher military spending, and lower revenues, especially among oil producers, led to a widening of fiscal deficits. In some countries, the deficit was driven by large infrastructure expenditures, which could help boost growth. Reflecting the widening fiscal deficits, government debt continued to rise in many countries (figure 1.7). While government debt-to-GDP ratios look manageable in most countries, they rose rapidly in several frontier markets (Ghana and Zambia), driven by non-concessional borrowing. External debt increased notably in Ghana and South Africa (figure 1.8). By contrast, Nigeria's sovereign debt position has remained at a modest level. The rising sovereign bond spreads and higher yields on recent bond issuances point to investors' concerns about growing fiscal vulnerabilities in the region.

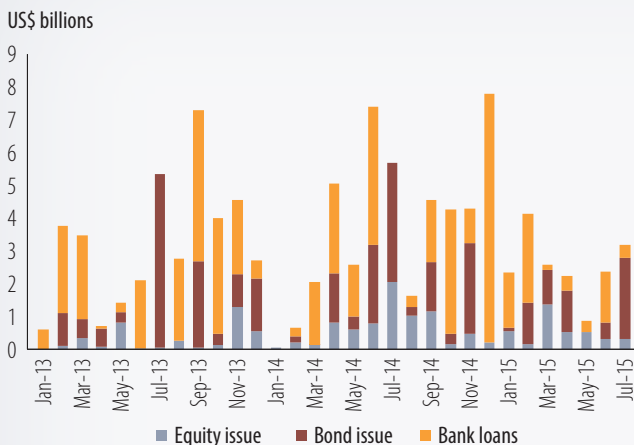
Meanwhile, capital flows to the region slowed in 2015 (figure 1.9). After reaching record levels in 2013 and 2014, bond issuance in the region decelerated. To date, fewer countries have tapped the international bond market. Côte d'Ivoire's sovereign bond issuance in February was followed by that of two countries—

Gabon (June) and Zambia (July). Bond issuance activity was not only reduced, yields were also higher than in previous issuances, exceeding 9 percent in the case of Zambia. In this environment, sovereign spreads rose across the region (figure 1.10), indicating a reassessment of risk among sovereign debt investors as global headwinds channeled through slowing Chinese growth, weak commodity prices, and a strong U.S. dollar weigh on the region. Many of SSA's frontier market economies are entering a period of tightening borrowing conditions amid growing domestic and external vulnerabilities.

The high fiscal and current account deficits, combined with the strong appreciation of the U.S. dollar, kept currencies across the region under pressure throughout the year (figure 1.11). By end-September, the Ghanaian cedi and South African rand had depreciated by more than 25 percent against the U.S. dollar (compared with their June 2014 levels), while the Angolan kwanza fell 38 percent and the Nigerian naira 23 percent. The Ugandan shilling and Zambian kwacha weakened the most, depreciating by 45 and 80 percent, respectively. In response, the Angolan and Nigerian authorities introduced a range of administrative measures to stem the demand for foreign currencies, which hampered private sector activities. A liquidity squeeze emerged in the interbank market in Nigeria, prompting the central bank to reduce the cash reserve ratio. In the CFA franc zone, depreciation of the currency against the U.S. dollar was more muted.

Currency weaknesses contributed to higher inflation in many countries. Consumer price inflation has continued to rise in Angola and Nigeria, exceeding the central bank's target in both countries; and it remained in high double digits in Ghana, despite easing in recent months. Concerns about exchange rate inflation pass-through led central banks in several countries to hike interest rates (Angola, Ghana, Kenya, South Africa, and Uganda), tightening monetary conditions (figure 1.12). Following the decision by the U.S. Federal Reserve to leave interest rates unchanged, central banks in the region opted for a pause in the tightening cycle at their September meetings (Kenya, Nigeria, and South Africa). Although interest rate increases may help preserve price stability, they are likely to lower private credit growth and affect activity.

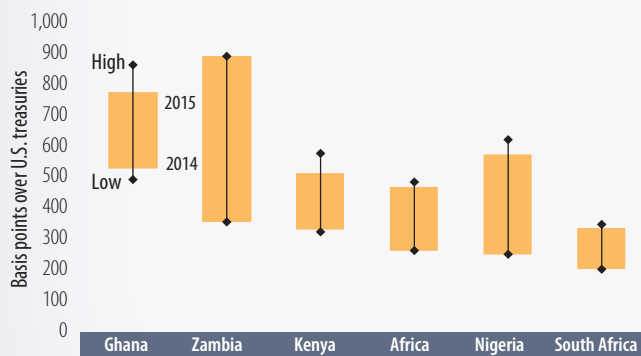
**FIGURE 1.9: Capital flows to SSA**



Source: Dealogic.

Capital flows to the region have slowed in 2015, partly due to a decline in bond issuances

**FIGURE 1.10: Sovereign spreads**



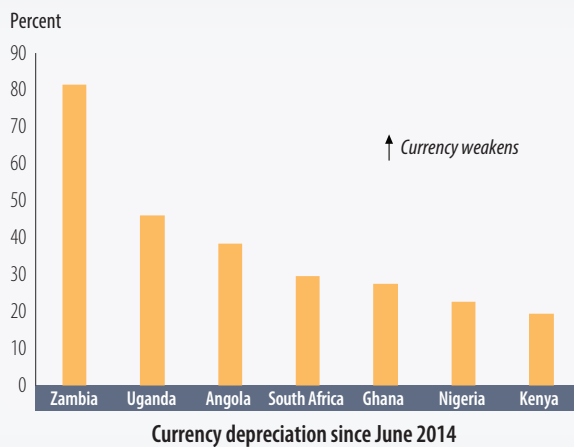
Source: Bloomberg.

Note: This figure shows the spread on September 9, 2015, the spread on September 9, 2014, as well as the highest and lowest points during that period.

Sovereign spreads rose across the region, indicating a reassessment of risk among sovereign debt investors

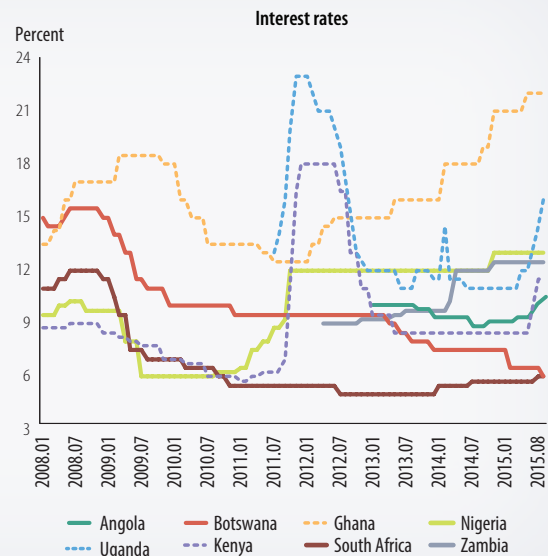
Sub-Saharan African countries' currencies have been under pressure since June 2014. Currency pressures, and concerns about inflation pass-through, led several central banks to hike interest rates

**FIGURE 1.11: Currency depreciation, June 2014 to September 2015**



Source: Bloomberg; International Finance Statistics, IMF.

**FIGURE 1.12: Policy interest rates**



Source: Bloomberg; International Finance Statistics, IMF.

### Economic Outlook

Growth is expected to decelerate in SSA to 3.7 percent in 2015, the lowest since 2009, because of low commodity prices and infrastructure (electricity supply and transport) constraints (figure 1.3). This is especially the case in the region's largest two economies: Nigeria and South Africa. The slowdown in Nigeria is driven by the non-oil sectors. Growth slowed notably in the manufacturing sector. Part of this slowdown was related to oil: oil refining, one of the key activities in the sector, recorded a sharp decline. However, the pronounced contraction of manufacturing production also reflected more acutely than before Nigeria's huge infrastructure and electricity deficits, which are impairing the ability of factories to operate. In South Africa, on-going power and infrastructure bottlenecks compounded by difficult labor relations weighed heavily on growth, although a drought in agriculture also contributed to the fall in output in the second quarter. Despite rising demand, electricity supply has remained broadly constant and power cuts are pervasive. Growth in unit labor cost has continued to outstrip growth in productivity, and prolonged strikes have set back mining production. Electricity shortages (in part driven by drought conditions) emerged as key structural impediments to growth in several countries in 2015, including Botswana, Namibia, and Zambia, where a power crisis severely hampered copper production. Availability of electricity was also a constraint in Ghana and Senegal.

A moderate rebound in growth is expected in 2016-17, as gradually rising commodity prices, easing of fiscal consolidation, and alleviation of electricity constraints provide some support for government spending and investment, especially in oil-exporting countries.

Consumption dynamics will continue to differ for oil exporters and importers. Private consumption growth is expected to remain soft in the oil exporters as the removal of subsidies to alleviate pressure on the budget results in higher fuel costs, sustained currency depreciation weighs on consumers' purchasing power, and salary arrears stemming from reduced fiscal revenues hold back household spending. By contrast, lower

inflation in the oil importers, owing in part to lower fuel prices, should help boost consumers' purchasing power and support domestic demand. Even so, the price level impact of currency depreciation combined with interest rate increases could offset some of these effects in many oil-importing countries.

A confluence of diverging factors will drive investment growth in the region. China's growth slowdown, low commodity prices, and challenging growth prospects among many commodity exporters are expected to result in lower FDI flows in the region. Fiscal consolidation efforts in oil-exporting countries are expected to result in sharp capital expenditure cuts, as governments seek to limit cuts in public sector wages and protect social spending. Meanwhile, an electricity crisis is reducing investment in some frontier market countries. However, in several countries, especially the low-income, non-oil commodity exporters, governments are expected to continue to invest heavily in energy and transport infrastructure in a bid to improve the operational environment for growth.

The fiscal policy stance in oil-exporting countries is expected to remain constrained (because of lower revenues) throughout 2015 before easing gradually in 2016 as oil prices begin to recover. However, with oil prices projected to remain below their recent peaks, fiscal revenues are not expected to recover to earlier levels in Angola and Nigeria. As a result, fiscal deficits are likely to remain substantial in these countries. Fiscal deficits are also expected to remain elevated in oil-importing countries as spending on goods and services and wages and the push to upgrade physical infrastructure continue to expand.

Net exports are projected to make a negative contribution to real GDP growth. Low commodity prices will depress export receipts, especially among oil exporters, even as export volumes rise in some countries. Among oil importers, current account imbalances are expected to remain large as import growth continues to be strong, driven by capital goods imports.

**Growth prospects for 2016-17.** In this context, growth is expected to slow considerably in the region's two largest economies this year, followed by a relatively subdued recovery in 2016. In several frontier markets, economic imbalances and weak industrial production will temper the rebound from the 2015 slowdown. However, most low-income countries are expected to continue to grow at a faster pace, supported by large-scale infrastructure investment and consumer spending. Overall, growth in the region is projected to average 4.4 percent in 2016, strengthening to 4.8 percent in 2017.

- In Nigeria, policy uncertainty, electric power shortages, fiscal consolidation, and high import costs are expected to gradually lessen, helping to support growth. In South Africa, the recovery is likely to be muted as the weak outlook for commodity prices, high rates of unemployment, on-going power and infrastructure constraints, difficult labor relations, and policy uncertainty weigh on activity. A modest recovery is also expected in Angola, despite an increase in oil production, as public spending remains constrained and elevated inflation weighs on household consumption.
- Among the region's frontier market economies, rising oil production, diminishing imbalances, and easing of the electric power crisis are expected to lift growth in Ghana in 2016-17. In Zambia, low copper prices will hold back investment in mining production and weigh on growth, limiting the rebound. Despite pressure on the shilling, Kenya is expected to continue to grow at a robust pace, supported by expenditure on large-scale infrastructure schemes, including a new railway system, which should help boost domestic trade, and a new port.

- The region's other countries, including low-income countries, are expected to continue to grow at a robust pace. Large-scale investment projects in energy and transport, consumer spending, and continued investment in the resource sector will help Côte d'Ivoire, Ethiopia, Mozambique, Rwanda, and Tanzania sustain growth at around 7 percent or more in 2016-17. However, in some countries (Mali and Sierra Leone), continued weaknesses in the prices of their main exports will offset the benefits of the decline in the price of oil. In some countries (Burundi and South Sudan), political instability will be a drag on growth.

### *Risks to the Outlook*

The balance of risks to the regional outlook remains tilted to the downside. On the domestic front, events in Burkina Faso, Burundi, and South Sudan suggest that political risks associated with the electoral process will remain a key issue for the region in 2015-16. Security risks tied to the Boko Haram insurgency are significant for Cameroon, Chad, Niger, and Nigeria; while terrorist threats remain a concern for Kenya and the East African subregion more generally. These events could generate greater instability in the region, with negative impacts on growth, if they were to escalate.

Many countries have macroeconomic weaknesses that leave them vulnerable to shocks. In these countries, fiscal and current account deficits are sizeable and debt levels are rising. If these conditions were to deteriorate significantly, shocks could manifest in extreme currency weakness, higher inflation, and lower consumer and business confidence, forcing a severe fiscal adjustment characterized by a sharp economic slowdown.

On the external front, the main risks are a sharper-than-expected slowdown in China, which would bring about a further decline in commodity prices; a further decline in oil prices, which would sharply reduce government spending in oil-producing countries; and a sudden deterioration in global liquidity conditions, which would push up financing costs for the emerging and frontier market economies.

### *Policy Challenges*

Recent developments suggest that the global economic environment will be less conducive to growth in SSA over the next several years than it has been in the recent past. Lower commodity prices and weak external demand will weigh on growth.

Efforts by policy makers to stimulate growth with macroeconomic policies could exacerbate existing domestic economic weaknesses. The low buffers with which some countries are confronting headwinds from the external environment suggest that the scope for counter-cyclical policies to support economic activity is limited. In most oil-exporters, lower oil revenues have induced sharp cuts in capital expenditures, with adverse consequences for growth prospects.

In this context, reforms to raise domestic resource mobilization should be high on the agenda of Sub-Saharan Africa's policy makers. These policies need to strike a balance between maintaining policy space to fund social and public investment programs and stimulate aggregate demand through countercyclical short-term policy responses. This issue has become even more important as the global

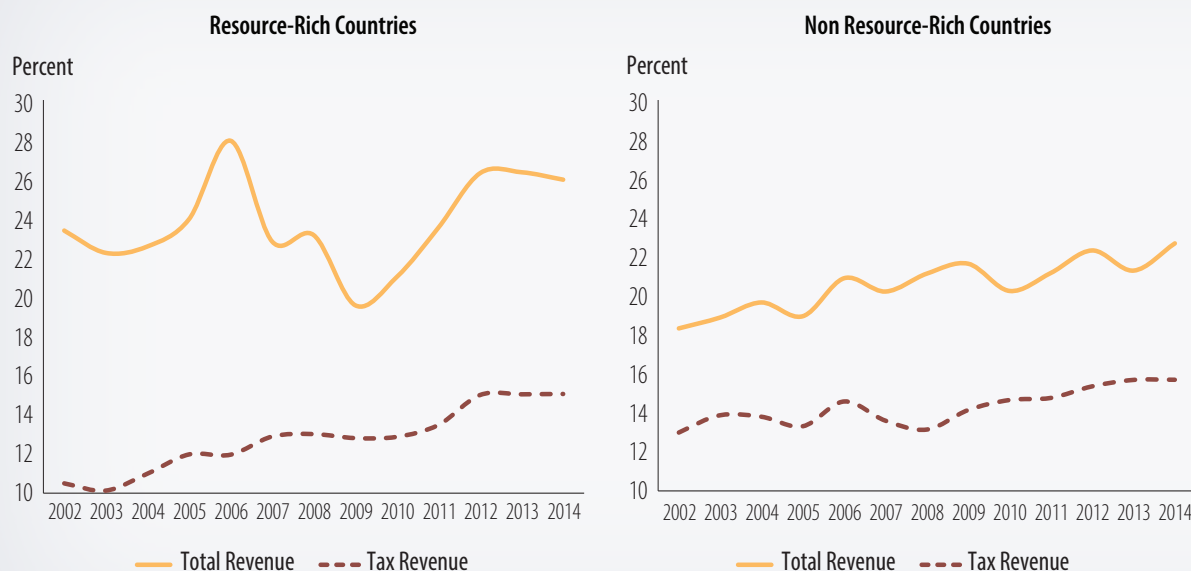
development agenda moves towards the achievement of proposed Sustainable Development Goals. Government revenues in Sub-Saharan Africa are lower than those of other regions: tax revenues as a percentage of GDP is about 15-16 percent in resource-rich and non-resource-rich countries (figure 1.13). Funding much needed social programs and public investment may reduce the inequality of opportunities that affect these countries.

What can governments do to raise domestic revenue mobilization? On the revenue side, fiscal authorities should implement policies to strengthen tax administration, including technical capacity building among revenue authorities as well as transparent and efficient operating procedures. The design of better enforcement mechanisms, tax audits and inspection will help increase the compliance of taxpayers. The simplification of tax codes and legislation will discourage evasion and curtail corruption of both tax collectors and tax payers. On the other hand, tax incentives should be streamlined so that they avoid tax base reduction and complication of tax administration and, at the same time, improve investment climate.

On the expenditure side, improvements in the transparency and disclosure of budget expenditures that are legally binding in the long term might be required along with a reduction of earmarked expenditure. The reprioritization of expenditures will help reduce unproductive expenditure. Resource reallocation towards investment programs should come along with upgrading the quality of spending. Infrastructure investment, in this context, requires: (a) better coordination among different levels of government, (b) enhancing the planning, bidding, contracting, construction and evaluation process of better quality projects, and (c) improving the efficiency of the selection and implementation of these projects (Keefer and Knack 2007).

Finally, effective resource mobilization might entail strengthening public fiscal management systems among Sub-Saharan African countries. What is needed is a coherent accounting framework to monitor

**FIGURE 1.13: Government total and tax revenues (percent of GDP)**



Government revenues in Sub-Saharan Africa are lower than those of other regions. Policies to strengthen tax administration, including technical capacity building are urgently needed

Source: World Economic Outlook, IMF.

expenditures and to make fiscal policy makers accountable. Transparency can be boosted through the provision of timely and regular reporting of fiscal outcomes. Complementary to these efforts, there is need to establish internal checks and balances within the framework to track the execution of government expenditure along the lines of the approved budget. Finally, the framework needs to account for the inter-temporal nature of fiscal policymaking. Therefore, governments need to develop credible and transparent medium-term fiscal frameworks along with the build-up of government capacity (Gupta and Tareq 2008).

The changing global economic environment also underscores the need for governments in the region to speed up (or in some cases embark on) structural reforms to alleviate the domestic impediments to growth, notably power supply bottlenecks. Several countries are experiencing severe power shortages that caused activity to slow significantly in 2015. The factors that contributed to the ongoing electric power crisis, which requires policy makers' attention, include drought and its effects on hydropower, underinvestment in new capacity, mismanagement of state-owned utilities, fuel shortages, and a failure to enact reforms to encourage private investment.

## RISING GLOBAL RISKS ADD TO THE CHALLENGE OF ACCELERATING POVERTY REDUCTION

Over the past 20 years, perceptions of Africa have changed dramatically from a continent of wars, famines, and entrenched poverty in the late 1990s, to one that is on the rise. Much of this change in perception has been aided by remarkably robust average annual economic growth of around 4.5 percent, especially when contrasted with the continuous decline during the 1970s and 1980s. The improved perceptions of Africa are reinforced by positive developments in poverty reduction, in all its dimensions. The regional poverty flagship "Africa Is Rising: But Are People Better Off?" by Beegle et al. (2015) reviews the latest evidence.

### *Progress in Poverty Reduction in All Dimensions of Poverty*

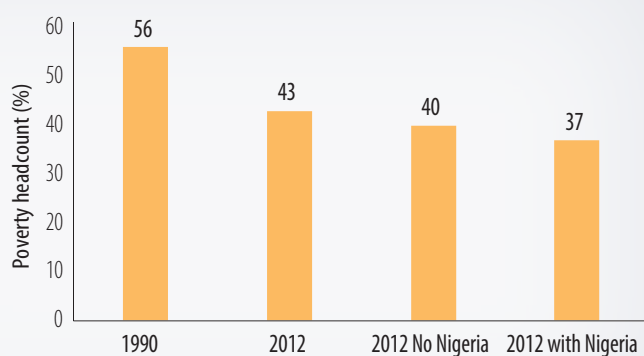
First, progress in reducing income poverty may have been faster than we thought. According to the latest estimates from the World Bank, poverty in Africa, based on an international poverty line of \$1.90 (in 2011 purchasing power parity U.S. dollars), declined from 56 percent in 1990 to 43 percent in 2012 (figure 1.14). Much of this decline was recorded in the past 15 years—reversing years of increasing

poverty in the 1990s—when growth rates held steady.

However, as is widely recognized, these estimates rely on a patchwork of household surveys, which are not conducted annually and often are not considered to be of very high quality. Reassessing poverty in light of the caveats related to the data shows that poverty reduction in Africa has not been overestimated. And there is some indication that poverty has fallen faster than has been estimated.

Poverty may be lower than currently thought. Based on an international poverty line of \$1.90 (in 2011 PPP U.S. dollars), it declined from 56% in 1990 to 43% in 2012

**FIGURE 1.14: Poverty rates in Sub-Saharan Africa**



Source: Beegle et al. 2015.

Note: 2012 No Nigeria = using comparable and good quality data excluding Nigeria; 2012 with Nigeria = using comparable and good quality data including Nigeria.



Second, Africa's population saw progress in all nonmonetary dimensions of well-being, particularly health and freedom from violence. Between 1995 and 2012, adult literacy rates rose by 4 percentage points. Gross primary enrollment rates increased dramatically, and the gender gap shrank. Life expectancy at birth rose 6.2 years, and the prevalence of chronic malnutrition among children under five fell by 6 percentage points. This puts the region among the strongest recent performers in the world, above South Asia, where life expectancy increased by 6 years (since 1995). This progress follows directly from the rapid decline in under-5 mortality rates in the region, on account of increased immunization and progress in reducing malaria-related deaths.

The number of deaths from politically motivated violence also declined by 75 percent and the tolerance and incidence of gender-based domestic violence dropped. Scores on voice and accountability indicators rose slightly, and there was a trend toward greater participation of women in household decision-making processes.

Third, although inequality remains high, it has not worsened during a period of moderately high growth. Africa has some of the most unequal countries in the world. Yet, once the seven countries with extremely high inequality are excluded, the remaining countries show inequality that is not particularly higher (or lower) than that in other countries at similar income levels. Over time, inequality is falling in half the countries for which we have data, and rising in the others. The change in inequality does not have a clear association with factors such as resource richness, level of development, or fragility. A sharper pattern emerges for horizontal inequalities within countries. These continue to be dominated by unequal education levels and high urban-rural and regional income disparities. In sum, taking the range of the latest evidence on inequality in Africa, the picture that emerges is quite nuanced.

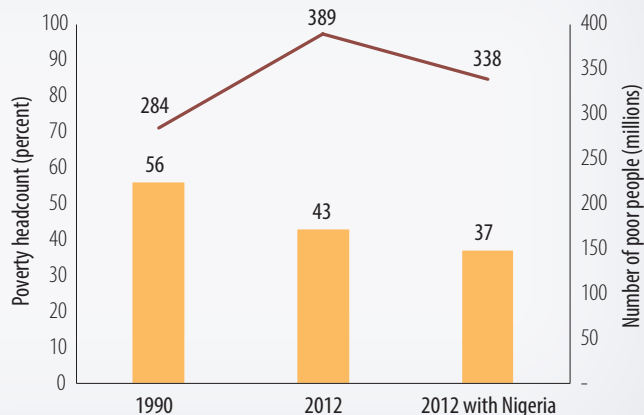
A portion of inequality in Africa can be attributed to inequality of opportunity, circumstances at birth that are major determinants of one's poverty status as an adult. Intergenerational occupational persistence, at least as captured by three broad occupation categories, remains high in some countries. Fortunately, at least in some countries, there has been a rise in intergenerational educational mobility among more recent generations, holding hope that inequality of opportunity will decline.

### *But the MDG on Halving the Number of Extreme Poor Will Not Be Reached*

Despite these positive developments, the human toll of poverty in Africa cannot be overstated. Poverty remains high and, given the population growth rates in the region, the number of poor implied by current estimates has increased from 284 million people to a staggering 389 million people. Even under the best case scenario, where poverty may be as low as 37 percent in 2012, more than 330 million people are still living in poverty (figure 1.15). The Millennium Development Goal (MDG) of halving the share of the population living in poverty between 1990 and 2015 (UN 2015) will be reached in all developing regions except Africa. Looking ahead, it is widely recognized that meeting the first Sustainable Development Goal, to eradicate extreme poverty by 2030, is aspirational and feasible only under very optimistic of scenarios. This is especially true for Africa—which is forecasted to continue to have the highest rate and depth of poverty of all regions of the world beyond 2030 (*Africa Pulse, volume 8*).

The number of poor people in the region remains high. The MDG on poverty will not be met

**FIGURE 1.15:** The number of poor in Sub-Saharan Africa



Source: World Bank.

### Progress Has Been Uneven, with Fragile Countries Lagging

One-third of the poor in Africa are in fragile and conflict-affected countries that continue to lag in poverty reduction. Those countries have higher poverty rates as well as lower rates of poverty reduction (where we have data to measure it). Between 1996 and 2012, poverty decreased in fragile states (from 65 to 53 percent), but the decline was much smaller than in non-fragile economies (from 56 and 32 percent). The gap in performance is 12 percentage points in favor of non-fragile countries (figure 1.16a, panel a), which rises to 15 percentage points conditional

on three other country traits—resource richness, income level, and whether the country is landlocked.

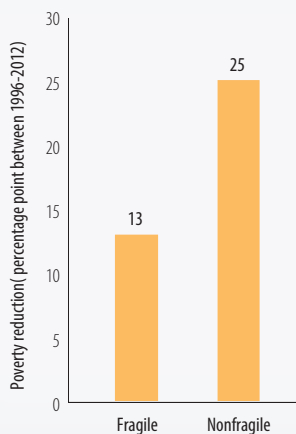
This situation partly results from the long-lasting effect of conflict. Countries suffering more than 100 casualties in a particular year experienced, for example, a decline in their economic growth of 2.3 percent (own calculations). Conflict has likewise held back Africa’s progress in under-5 mortality and life expectancy, which have been positively and negatively associated, respectively, with the number of fatalities among noncombatants in the country.

After years of enjoying a period of relative peace during the first decade of the 21st century, the number of violent events has been rising again (figure 1.16, panels b and c), especially in Central Africa and the

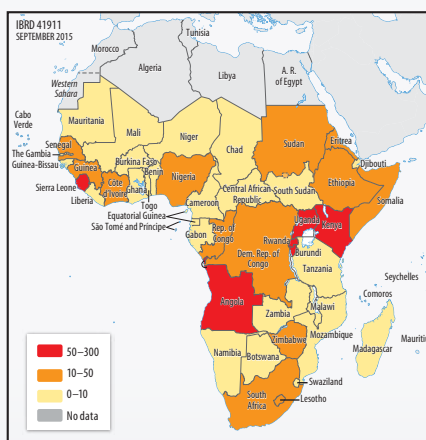
After years of relative peace during the first decade of the 21st century, the number of violent events has been rising again. Fragility is a drag on poverty reduction

**FIGURE 1.16:** Fragility and poverty reduction

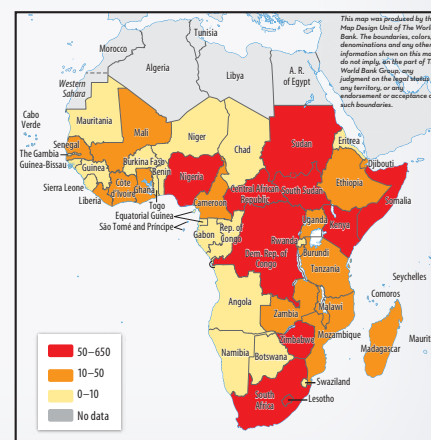
**a. Poverty reduction between 1996 and 2012**



**b. Annual number of violent events against civilians (1997-1999)**



**c. Annual number of violent events against civilians (2014)**



Source: Armed Conflict Event Locator Database (ACLED); and Beegle et al. 2015.

Horn. Violent events increased by more than a factor of four to more than 4,000 in 2014, although the number of victims per event declined (to four compared with 20 during the late 1990s). Unlike the past, the latest spike in conflict and overall insecurity is driven by terrorism, drug trafficking, maritime piracy, and criminality. Addressing fragility and conflict must be high on Africa's poverty reduction agenda.

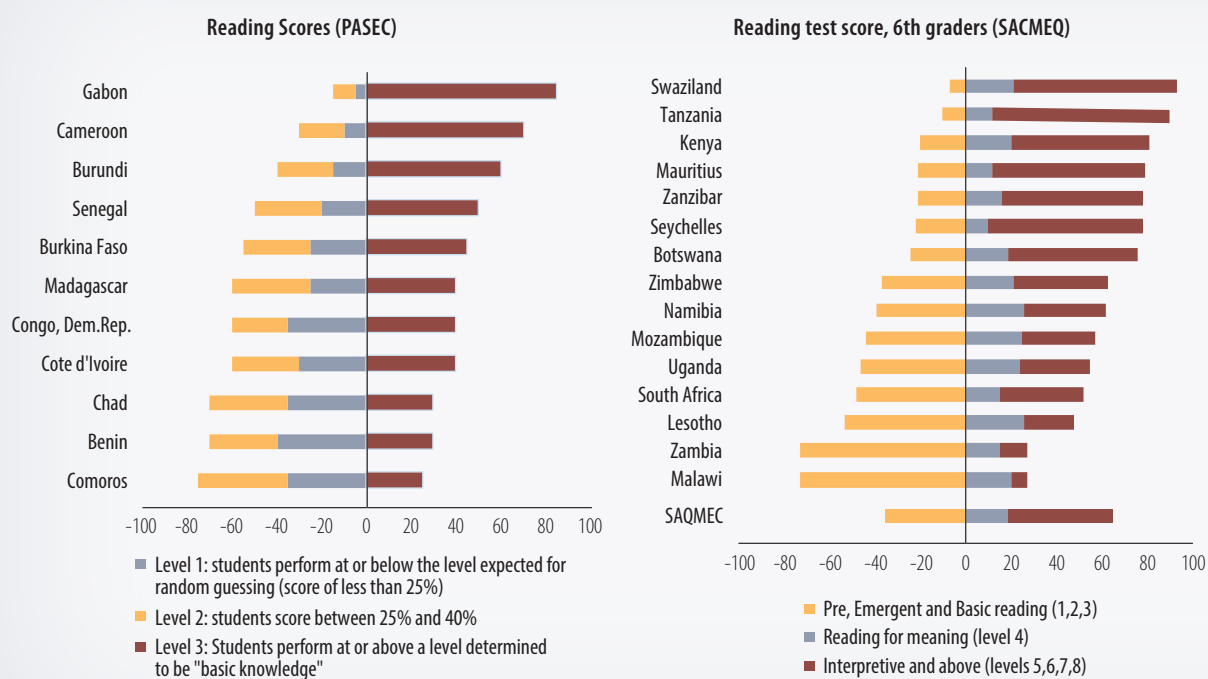
### Unfinished Agenda on Non-Income Dimensions of Poverty

Life expectancy in Africa continues to be held back by the prevalence of under-5 mortality and HIV/AIDS. These two factors alone explain more than three-quarters of the variation in life expectancy in the region: 50.4 percentage points are explained by under-5 mortality, and 28.2 percentage points are explained by HIV prevalence. The continent's HIV prevalence rate peaked at 5.8 percent in 2002, after which it declined to 4.5 percent in 2013 (HIV estimates from World Development Indicators). In 2012, 1.1 million people died of AIDS in the region, with Southern Africa continuing to be the epicenter of the disease, compared with about 300,000 in the rest of the world.

Progress in adult literacy has been slow and masks substantial regional variation. More than half the population is illiterate in seven countries, almost all in West Africa. There remains a significant literacy gap of about 25 percentage points by gender, which also varies significantly across countries. Gender parity in literacy is especially low in Western Africa.

Hard won increases in enrollment have not been accompanied by quality improvements. For instance, a staggering 73 percent of sixth graders in Malawi and Zambia could not read for meaning (figure 1.17). Even in the relatively well-performing countries, such as Kenya and Tanzania, the results

FIGURE 1.17: Reading test score



Higher enrollment has not been accompanied by quality improvements. For instance, a staggering 73 percent of sixth graders in Malawi and Zambia could not read for meaning

Source: Beegle et al. 2015.

were 10 and 20 percent, respectively, for lack of reading skills. Among francophone countries in the region, 30 to 40 percent of students perform at or below the level expected for random guessing. Scores for numeracy skills and mathematics are generally worse. For instance, in Côte d'Ivoire, 32 percent did not reach the minimum performance threshold.

### *Data Underpinning Poverty Measurement Require a Big Push*

High quality and comparable consumption surveys, conducted at regular intervals, are the building blocks for measuring poverty and inequality. The number of household surveys in Africa has been rising, especially since the 2000s, although this expansion has been confined almost entirely to surveys that do not collect consumption data. The increase in household consumption surveys has been sluggish, although country coverage has increased. The number of countries that either did not conduct a consumption survey or do not allow access to the micro data has declined from 18 in 1990-99 to four in 2003-12, and the number of countries with at least two consumption surveys over these decades increased from 13 to 25. Many fragile states—namely, Chad, the Democratic Republic of Congo, Sierra Leone, and Togo—were part of this new wave of surveys. Nonetheless, fragile states still tend to be the most data deprived.

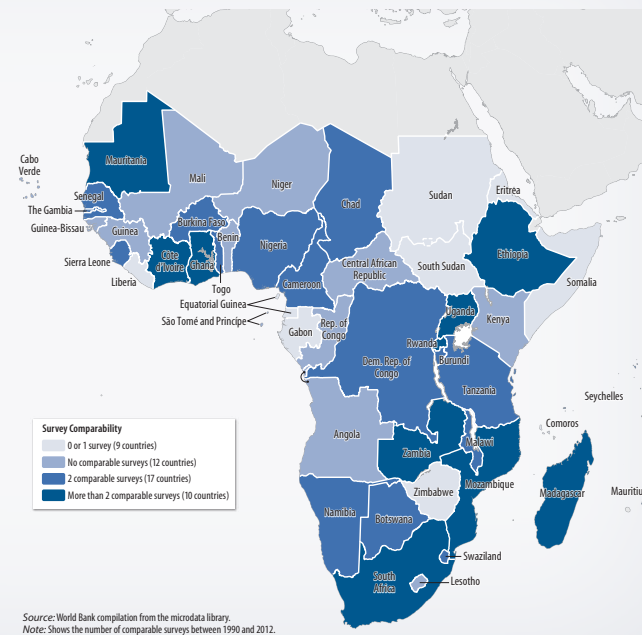
Even when available, surveys often are not comparable with other surveys within the country or are of poor quality (including as a result of misreporting and deficiencies in data handling). Consequently, countries that appear to be data rich (or have multiple surveys) can still be unable to track poverty over

time. Much regional work in Africa and elsewhere disregards these important differences, relying on databases such as the World Bank's PovcalNet, which, until very recently, did not explicitly vet surveys on the basis of comparability or quality.

As a consequence, levels and trends in poverty, especially consumption-based poverty, have lacked consensus because of unsettled debate over the quality of the data (Devarajan 2013; Jerven 2013). Therefore, accurate and improved poverty monitoring in Africa will need a big push in improving the quality and frequency of consumption surveys. Better data make for better decisions and better lives.

Lack of Comparable Surveys in Africa Makes It Difficult to Measure Poverty Trends

**FIGURE 1.18:** Survey comparability map in Sub-Saharan Africa



## Section 2: Africa's Resilience? Threatening External Headwinds and Rising Macroeconomic Vulnerabilities

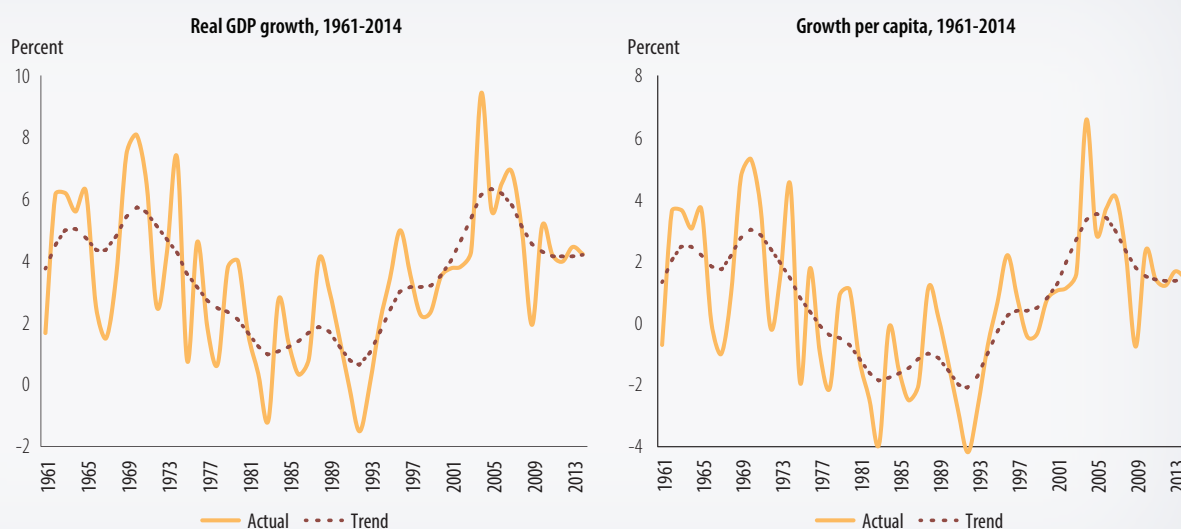
- ▶ Rising external headwinds are threatening the growth path of countries in the region. Do the countries have the adequate macroeconomic policy space to withstand the negative shocks to their growth rate?
- ▶ When the global financial crisis of 2008-09 unfolded, some countries in Sub-Saharan Africa (SSA) were able to use their built-in buffers to finance policy responses. Government expenditure in SSA, on average, increased by 3 percentage points of gross domestic product (GDP), while public debt grew by nearly 2 percentage points of GDP. During the post-crisis recovery, government expenditure continued to expand, and grew by approximately 0.5 percent of GDP in 2013.
- ▶ Macroeconomic policy vulnerabilities have risen in the aftermath of the crisis. Fiscal vulnerabilities have emerged in an environment of lax fiscal policies. For the region as a whole, the median fiscal deficit has widened from 1.7 percent of GDP in 2003-08 to about 3 percent of GDP in 2009-14. Again, there are differences across country groups: the median fiscal balance of resource-rich countries has shifted from a surplus of 0.6 percent of GDP in 2003-08 to a deficit of 2.2 percent of GDP in 2009-14.
- ▶ Current account deficits have also widened in the region over the past five years. The current account (after netting out foreign direct investment) has deteriorated from 2.5 percent of GDP in 2003-08 to about 4 percent of GDP in 2009-14. The combination of widened fiscal and current account deficits in some Africa countries is putting them under pressure to devalue their currencies. Debt vulnerabilities have increased for some countries in recent years; however, this may be understated compared with the high levels of indebtedness prior to receiving debt relief (under the Heavily Indebted Poor Countries initiative and the Multilateral Debt Relief Initiative).
- ▶ At the same time, economic performance in the aftermath of the global financial crisis has not been as stellar as that in the pre-crisis period. There has been a marked slowdown in per capita GDP growth over the post-crisis period compared with the pre-crisis period, declining from 2.5 to 1.5 percent per year from 2003-08 to 2009-14.
- ▶ Unsurprisingly, there is a great deal of heterogeneity in economic performance at the country level. Resource-rich countries have experienced a sharper slowdown in growth than non-resource-rich countries. In the post-crisis period, public investment has expanded significantly among resource-rich countries, whereas private consumption and domestic investment have increased in non-resource-rich countries.
- ▶ Overall, the analysis shows that before the current bout of global difficulties, (a) Policy buffers in 2011-14 were showing signs of vulnerability in terms of overvalued currencies and larger fiscal and current account deficits, and (b) these buffers are lower than they were before the global financial crisis, thus constraining the response to the current situation.

## 2.1 SHIFTING TRENDS IN AFRICA'S GROWTH PERFORMANCE

The unprecedented growth in Sub-Saharan Africa (SSA) since 1995, coined as *Africa Rising*, has been characterized by many countries averaging annual GDP growth that exceeded 5 percent. The benefits of this greater growth were reaped by resource-rich countries, non-resource-rich countries, and a few fragile countries. Many countries in the region have been able to continue having positive GDP growth in spite of the large external shock in 2008-09. However, the economic performance in the post-crisis period has not been as stellar as that of the pre-crisis period. For instance, figure 2.1 depicts the actual rate of growth of GDP and growth per capita as well as the trend growth component. Both series point to a slowdown in economic activity during the post-global financial crisis period. This implies that forces beyond cyclical factors may also be driving the growth slowdown of the region. Figure 2.1 shows that the (actual) rate of growth per capita (solid line) contracted from 3.2 percent per year in 2007-08 to about 1.6 percent per year in 2013-14.

Many countries in the region have grown in spite of the large external shock in 2008-09. However, their economic performance in the post-crisis period has not been as stellar

**FIGURE 2.1:** Actual and trend growth in Sub-Saharan Africa, 1961-2014



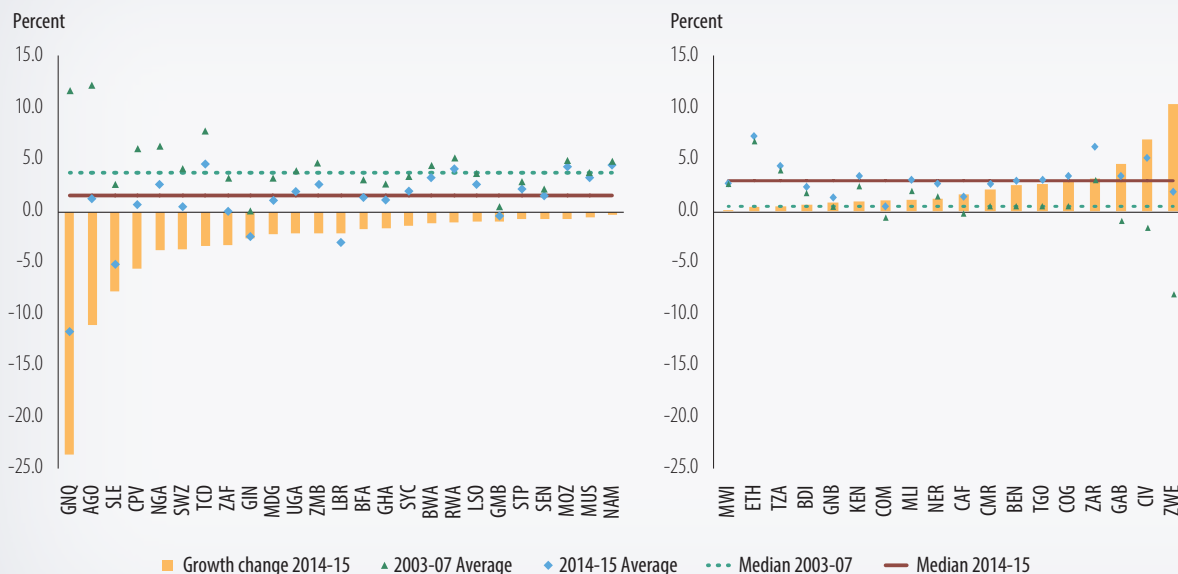
Source: World Development Indicators, World Bank.

Note: The trend component is computed using the Hodrick-Prescott filter.

Figure 2.2 compares the per capita growth of SSA countries in 2003-07 and 2014-15. It separates the countries with growth rate declines from those with increases in two blocks. The figure confirms the message that the rate of per capita growth in the region is slowing down and even contracting in some countries. The median growth per capita across countries in the region declined from about 2.9 percent in 2003-07 (dotted green line) to about 2.5 percent in 2014-15 (dotted red line). Although the decline in economic growth does not appear to be significant for the region as a whole, there is a great deal of heterogeneity in economic performance at the country level. In 2014-15, compared with 2003-07, 25 of 43 countries in the region experienced a drop in the rate of growth of real GDP per capita. The average drop in per capita growth for those 25 countries was about 3.3 percentage points while the average increase for the remaining 18 countries in the region was approximately 2.4 percent. There are only two countries with a growth acceleration that have exceeded 5 percentage points (Côte d'Ivoire and Zimbabwe) while there

**FIGURE 2.2: Growth per capita in Sub-Saharan African countries, 2003-07 vs. 2014-15**

Per capita growth in Sub-Saharan Africa is slowing down. Out of 43 countries in the region, 25 have experienced slower growth in 2014-5 when compared with 2003-07



Source: World Economic Outlook, IMF.

Note: Countries are sorted by the change in growth per capita in 2014-15 vis-à-vis 2003-08.

are four countries with growth deceleration greater than 5 percentage points. The countries with the largest drop in growth per capita have been severely hit by lower oil prices (Angola and Equatorial Guinea), the Ebola virus disease and lower prices of extractives (Liberia and Sierra Leone), and weak domestic demand and a prolonged downturn in key trading partners in Europe (Cabo Verde).

Africa's Pulse volume 9 (2014) found that the acceleration of growth in the region since 1995 was characterized by shorter and smaller recessions, faster recoveries, and longer and protracted recessions.<sup>2</sup> The report argues that the improved economic performance in Sub-Saharan Africa is attributed to a more favorable external environment and due to a reduction of macroeconomic policy vulnerabilities. Zooming in the performance of growth per capita in the region during 1995-2014, there is a marked slowdown in the aftermath of the 2008-9 global financial crisis. In this context, it is warranted to ask whether structural and macroeconomic policy vulnerabilities have risen in the aftermath of the crisis. The slowdown in economic activity is being accompanied by a less favorable global environment. Rising external headwinds are threatening to adversely influence the growth path of countries in the region; namely, the weak recovery of the Euro Area, uncertainty on the timing of the US monetary policy lift-off, the appreciation of the US dollar, the slowdown of economic activity in China and the plunge in commodity prices.

The resilience of growth in Sub-Saharan Africa will be repeatedly tested as new shocks and/or old shocks under new manifestations occur. Therefore, it merits asking whether countries in the region have the adequate macroeconomic policy space to withstand negative shocks that affect their growth rate. Is the growth trajectory of Sub-Saharan African countries resilient to the current downside risks? Are they prepared to face potential downside risks?

<sup>2</sup> Link: [http://www.worldbank.org/content/dam/Worldbank/document/Africa/Report/Africas-Pulse-brochure\\_Vol9.pdf](http://www.worldbank.org/content/dam/Worldbank/document/Africa/Report/Africas-Pulse-brochure_Vol9.pdf).

The 2008-09 global financial crisis rapidly transmitted from the U.S. financial sector to global financial markets and to the real sector of both industrial economies and developing countries. The international transmission of the global financial crisis to developing countries—including the Sub-Saharan Africa region—took place through two different (and, in some cases, interrelated) channels (Blanchard, Das and Faruqee 2010, Milesi-Ferretti and Tille 2011):

- (1) The sharp drop in export volumes. In general, the global recession led to a global trade collapse. In 2009, real world output declined by about 1 percent while real trade flows plunged by 11 percent (Bussière et al. 2013). In addition to the collapse of trade, commodity exporting countries suffered from the plunge of international commodity prices.
- (2) The unprecedented collapse of international financial flows after years of rising financial globalization (Blanchard, Das and Faruqee 2010). Global capital flows steadily increased from about 7 percent of world GDP in 1998 to over 20 percent in 2007. During the crisis, these flows turned considerably to negative in the fourth quarter of 2008. This turnaround was sharper than the one for trade flows (Milesi-Ferretti and Tille 2011)

The severity of the impact of external shocks on Sub-Saharan Africa and, more generally, on developing countries depended on two main measures:

The first is the degree of exposure to the external shocks –as measured by the extent and composition of trade and financial openness. High dependence on volatile sectors (e.g. primary industries) and greater-equity debt ratios are factors that determine the vulnerability associated to greater international integration.

The second is the degree of macroeconomic policy vulnerabilities – as measured by the extent of liquidity buffers (say, international reserves) and policy space (for example, fiscal surpluses, and lower debt burden, among others) to cushion external shocks. Lane and Milesi-Ferretti (2011) argue that macroeconomic policy vulnerability has played a key role in understanding the incidence and severity of the 2008-09 crisis across countries.<sup>3</sup>

## 2.2 EXPLAINING THE POST-CRISIS SLOWDOWN IN SUB-SAHARAN AFRICA

Figures 2.1 and 2.2 document the growth slowdown of Sub-Saharan African in the aftermath of the global financial crisis. This section examines the correlates of the growth slowdown in the region from the following dimensions: (a) evolution of the aggregate demand, (b) sectoral activity, (c) economic and political institutions, and (d) macroeconomic and financial conditions.

**Aggregate demand.** Table 2.1 shows the evolution of the average, median, and standard deviation of the different components of aggregate demand in the periods pre- and post-crisis; that is, 2003-08 and 2009-14, respectively. The growth rate per capita has declined over the post-crisis period

<sup>3</sup> Countries that will more affected by the external shocks are those with greater vulnerabilities in monetary policy (high inflation, low levels of international reserves and overvalued currencies), fiscal policy (large fiscal deficits, excessive public debt burden, and greater share of current spending in total spending), and external imbalances (widened current account deficits, high share of short-term debt in total debt, and excessive external debt). In general, countries with good macroeconomic and financial conditions were able to implement countercyclical policies to withstand the crisis.



compared with the pre-crisis period (from 2.5 percent per year in 2003-08 to 1.5 percent per year in 2009-14). This growth slowdown has taken place in spite of the fact that both public consumption and domestic investment (including private and public capital outlays) have increased significantly (as a ratio to GDP) over that time span. On the other hand, private consumption, exports and imports have remained statistically invariant. These findings confirm that, on average, Sub-Saharan African countries have expanded public consumption and domestic investment (which includes both public and private investment) although the growth of investment outperformed that of public consumption. It could be argued that the lower than proportional response in growth per capita may indicate the low quality and inefficiency of government expenditure (public consumption and investment).

Looking at the different country groups in Sub-Saharan Africa, the growth slowdown of resource-rich countries is sharper than that of nonresource-rich countries. Furthermore, public investment has expanded among resource-rich nations whereas private consumption and domestic investment had a boost among nonresource-rich countries. Finally, per capita growth of fragile and conflict-affected states has slightly increased (although it is not statistically significant). This has been supported, on average, by greater public consumption and domestic investment. Again, the increase of both public expenditure and domestic investment by more than 2 percentage points of GDP has failed to give a bigger boost to real economic activity among fragile and conflict-affected states.

TABLE 2.1: Aggregate demand and sectorial activity, 2003-2008 vs. 2009-2014

	Growth Per capita	Consumption Private	Public	Domestic Investment	Exports	Imports	Agriculture	Manufacturing	Resources	Services
<b>Sub-Saharan Africa</b>										
<i>Average</i>										
2003-2008	2.46	74.58	14.20	21.60	34.18	45.79	26.26	10.25	16.05	47.36
2009-2014	1.52	73.45	15.32	25.14	33.85	46.89	23.86	9.33	16.48	49.76
<i>Mean Equality tests</i>										
2003-2008 vs. 2009-2014	(0.093)	(0.570)	(0.085)	(0.003)	(0.862)	(0.607)	(0.118)	(0.181)	(0.767)	(0.059)
<b>Resource-Poor Countries</b>										
2003-2008	1.75	80.59	15.17	20.21	28.00	45.25	26.15	11.85	9.91	52.09
2009-2014	1.55	78.17	15.95	24.08	28.36	46.89	24.41	10.93	11.08	53.74
<i>Mean Equality tests</i>										
2003-2008 vs. 2009-2014	(0.702)	(0.092)	(0.371)	(0.001)	(0.845)	(0.511)	(0.308)	(0.312)	(0.048)	(0.244)
<b>Resource-Rich Countries</b>										
2003-2008	3.79	64.37	12.55	24.03	45.66	46.78	26.48	7.20	27.69	38.31
2009-2014	1.48	65.39	14.27	26.86	43.50	46.89	22.90	6.48	26.11	42.56
<i>Mean Equality tests</i>										
2003-2008 vs. 2009-2014	(0.065)	(0.817)	(0.058)	(0.246)	(0.569)	(0.978)	(0.241)	(0.366)	(0.633)	(0.023)
<b>Fragile and conflict states (FCS)</b>										
2003-2008	0.40	83.30	12.89	16.68	29.22	42.55	35.69	8.73	13.95	41.50
2009-2014	0.69	79.24	14.86	19.61	28.80	42.09	34.40	8.09	14.29	43.27
<i>Mean Equality tests (2-tailed test)</i>										
2003-2008 vs. 2009-2014	(0.819)	(0.284)	(0.100)	(0.033)	(0.890)	(0.884)	(0.640)	(0.483)	(0.903)	(0.312)

Source: World Development Indicators, World Bank.

**Sectoral activity.** Table 2.1 also depicts the evolution of sectorial activity (agriculture, manufacturing, resources, and services) during 2003-08 and 2009-14. Africa's Pulse volumes 9 and 10 documented the trends in sectoral activity (that is, declining shares of agriculture and manufacturing and rising shares of services) and their impact on poverty in Sub-Saharan Africa (World Bank 2014a, 2014b).

When comparing the average shares of sectoral activity in Sub-Saharan Africa in 2009-14 vis-à-vis 2003-08, the pattern of structural transformation in the region is confirmed. The share of value added in agriculture (as a percentage of total value added) declines from 26.3 percent of GDP in 2003-08 to 23.9 percent of GDP in 2009-14. The share of the service sector increases from 47.4 percent of GDP in 2003-08 to 49.8 percent of GDP in 2009-14. These changes over time are statistically significant. On the other hand, the shares of manufacturing and resources sectors remains (statistically) unchanged. Africa's Pulse volume 9 showed that growth per capita in the region over the past two decades was driven by factor accumulation and that the contribution to growth of total factor productivity was negligible (World Bank 2014a). These two findings may imply that economic activity in SSA has been specializing in sectors (low-productivity traditional services) that are dragging the growth of total factor productivity in the region as a whole.

Interestingly, the share of the service sector has expanded significantly over the last five years for resource-rich countries (from 38.3 percent of GDP in 2003-08 to 42.6 percent of GDP in 2009-14) while the resources sectors (which includes mining and quarrying) have stood at about 26 percent of GDP in 2009-14. On the other hand, the the resources sector has expanded significantly in 2009-14 (to 11.1 percent of GDP up from 9.9 percent of GDP in 2003-08) in nonresource-rich countries. Unlike resource-abundant nations, the expansion is attributed to the construction sector and infrastructure (electricity, gas and water). The services sector remains (statistically) unchanged in 2009-14 at about 54 percent of GDP. Finally, fragile countries in the region did not experience any changes in the shares of sectorial activity over the past 5 years –with the share of agriculture and services at 34 and 43 percent of GDP in 2009-14, respectively.

**Outward orientation and macroeconomic policies.** Table 2.2 compares the medians in 2003-08 and 2009-14 of indicators that capture: (a) exposure to international trade and financial integration, and (b) macroeconomic policy vulnerabilities. The first group of indicators comprises measures of trade openness (exports and imports as percentage of GDP) and international financial integration (the Chinn-Ito index of financial openness, and net FDI inflows as a percentage of GDP). The group of macroeconomic policy vulnerabilities is classified into three different groups: monetary policy, fiscal policy and external sector. Changes in these indicators enable the examination of whether good policies and institutions contributed to the improvement in economic resilience of SSA countries.

The acceleration of growth in Sub-Saharan Africa in the 1995-2008 (when compared with 1974-94) period was influenced by a benign external environment: improved macroeconomic policy frameworks and institutions among industrial countries, the emergence of China and India as important players in the global economy, the super cycle of commodity prices, and a period of ample global liquidity.<sup>4</sup> In contrast, when comparing 2003-08 and 2009-14 we observe a confluence of adverse shocks: the global financial crisis that spread rapidly across borders as well as the dramatic plunge in global trade and

<sup>4</sup> These external tailwinds supported positive growth prospects in developing countries and, notably, in Sub-Saharan Africa. The lower volatility of the global economy in this period, the surge of global capital flows and robust commodity prices benefited both commodity exporting countries and low-income nonresource-rich countries in the region.

**TABLE 2.2: Structural and macroeconomic policy vulnerabilities, 2003-2008 vs. 2009-2014**

	Macroeconomic Policy Vulnerabilities											
	Structural Vulnerabilities			Fiscal Policy			Monetary Policy			External Sector		
	Trade Openness (% GDP)	Financial Openness (Chinn-Ito)	Net FDI Inflows (% GDP)	Fiscal Deficit (% GDP)	Gen. Govt. Gross Debt (% GDP)	Current Spending (% Total)	CPI Inflation (%)	FX Reserves (% GDP)	REER Over-valuation	External debt (% GDP)	Short-term Ext. Debt (% Ext. Debt)	CA Deficit net of FDI (% GDP)
<b>Sub-Saharan Africa</b>												
2003-2008	69.90	-0.62	3.06	1.74	59.77	73.18	7.30	11.52	0.99	56.06	7.67	2.54
2009-2014	72.65	-0.34	3.46	3.03	36.19	70.33	5.66	13.99	1.05	28.13	6.61	3.98
<i>Equality tests</i>												
2003-2008 vs. 2009-2014	(0.489)	(0.011)	(0.181)	(0.000)	(0.000)	(0.055)	(0.002)	(0.003)	(0.000)	(0.000)	(0.408)	(0.013)
<b>Resource-Poor Countries</b>												
2003-2008	65.81	-0.71	2.23	2.41	60.14	70.23	6.52	13.30	0.99	56.48	7.70	3.85
2009-2014	66.62	-0.32	2.94	3.54	39.85	70.19	4.68	14.25	1.05	29.73	8.66	4.64
<i>Equality tests</i>												
2003-2008 vs. 2009-2014	(0.779)	(0.003)	(0.320)	(0.004)	(0.000)	(0.916)	(0.105)	(0.336)	(0.000)	(0.000)	(0.653)	(0.242)
<b>Resource-Rich Countries</b>												
2003-2008	86.33	-0.46	4.82	-0.57	58.46	75.51	8.01	7.56	0.99	56.06	7.38	-4.39
2009-2014	87.49	-0.37	5.40	2.17	29.49	70.45	7.04	12.61	1.05	21.59	6.13	-0.04
<i>Equality tests</i>												
2003-2008 vs. 2009-2014	(0.876)	(0.633)	(0.650)	(0.005)	(0.007)	(0.038)	(0.180)	(0.001)	(0.001)	(0.000)	(0.337)	(0.192)
<b>Fragile and conflict states (FCS)</b>												
2003-2008	68.15	-0.99	2.39	1.95	94.95	74.72	7.53	8.87	0.99	79.46	7.88	3.77
2009-2014	67.83	-0.55	3.25	2.32	40.01	73.06	5.40	11.92	1.06	30.93	4.59	4.26
<i>Equality tests</i>												
2003-2008 vs. 2009-2014	(0.923)	(0.002)	(0.067)	(0.486)	(0.000)	(0.484)	(0.089)	(0.003)	(0.000)	(0.000)	(0.064)	(0.668)

Source: IMF International Financial Statistic and World Development Indicators, World Bank.

commodity prices. External headwinds continue posing a threat to economic activity of SSA countries; namely, the imminent policy rate lift off in the United States and the apparent weakening of economic activity in China (as early manifested by contraction in exports and manufacturing activity).

The global financial crisis hit the region mainly through the real channel; that is, demand for SSA exports lowered and their terms of trade deteriorated. International financial flows (FDI, remittances, and foreign aid) also contracted in 2009 but the financial channel primarily operated through trade credit collapse.<sup>5</sup>

The depth of the growth slowdown (or contraction) was partly related to the existing size of liquidity and policy buffers that enabled policy makers to conduct countercyclical policies to support economic activity. Prior to the global financial crisis (the global boom period of 2003-8), monetary authorities and fiscal policy makers undertook prudent policy actions. Despite climatic shocks that affected food prices, CPI inflation had remained in single digits. International reserves amounted to 11.5 percent of GDP. On average, fiscal deficits were reduced to 1.7 percent of GDP while (public and external) debt was sharply reduced thanks to HIPC and MDRI initiatives. Greater export volumes and more favorable terms of trade

<sup>5</sup> Ahn, Amiti and Weinstein (2011) show that trade credit may have played a role in the collapse of global trade. Using firm-level evidence, they show that exporters cut back on exports if their financial institutions became unhealthy while imports were significantly reduced in sectors that had greater external financial dependence.

enabled resource-rich countries in the region to have both fiscal and current account surpluses during the global boom period. The fiscal surplus was about 0.6 percent of GDP while the current account surplus (net of FDI) was nearly 4.4 percent of GDP. Nonresource-rich and fragile countries in SSA had manageable fiscal and current account deficits.

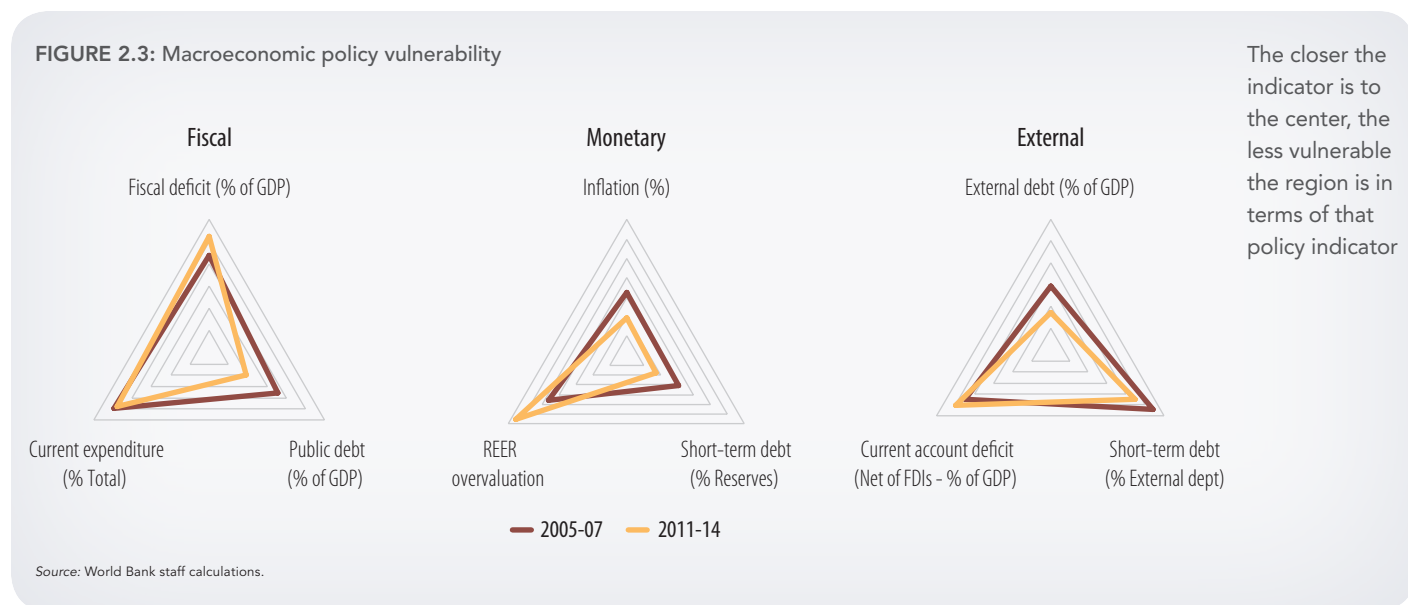
During the global financial crisis, the policy response depended on the countries' monetary and fiscal space. Some countries managed to cut monetary policy rates to stimulate aggregate demand (for instance, South Africa, Mauritius and Botswana) while others implemented public works programs to alleviate infrastructure bottlenecks (Botswana, Kenya, Tanzania and Uganda). Exogenous factors were supportive to the region and helped lower ex post vulnerability in the period 2003-8. However, fiscal vulnerabilities have emerged in an environment with lax fiscal policies. If prudent fiscal management (as measured by sustainable and countercyclical fiscal policy responses) is determined by the strength of the institutional framework, the sluggish progress of economic institutions constitutes a hindrance to sounder fiscal policies.<sup>6</sup>

Fiscal balance in Sub-Saharan African countries has deteriorated over the past 5 years. For the region as a whole, the median fiscal deficit has widened from 1.7 percent of GDP in 2003-08 to about 3 percent of GDP in 2009-14. However, there are differences across country groups in Africa. The median fiscal balance of resource-rich countries have shifted from a surplus of 0.6 percent of GDP in 2003-8 to a deficit of 2.2 percent of GDP in 2009-14. Current account deficits have also widened in the region over the past 5 years. After accounting for net FDI inflows, the current account deficit has deteriorated from 2.5 percent of GDP in 2003-8 to about 4 percent of GDP in 2009-14. The combination of widened fiscal and current account deficits in some SSA countries is putting downward pressure on their currencies. Additional pressures to weaken the currency of commodity exporting countries is coming from the plunge in the price of their commodities. Depreciation pressures will increase macroeconomic vulnerabilities—especially in those countries where the pass-through from exchange rate depreciation to inflation is high, and the balance sheets of households, corporations and governments are greatly exposed to currency risks.

Figure 2.3 depicts the different indicators of macroeconomic policy vulnerability in Sub-Saharan Africa along three different dimensions: fiscal policy, monetary policy, and the external sector. It explores the macroeconomic policy indicators that surpass certain thresholds of vulnerability and examines whether the macro-financial conditions of the region have improved or deteriorated in 2011-14 compared with 2005-07. On the fiscal front, fiscal deficits appear to be wider in 2011-14 when compared with those of the period 2005-07. Public debt stocks, on the other hand, have sharply reduced due to debt forgiveness initiatives—that is, HIPC and MDRI programs benefited some low-income and lower-middle income countries in the region. From the monetary policy dimension, the greater vulnerability arises from the greater overvaluation of the currency (in real terms) and the fact that inflation has not declined sharply in the recent period when compared to 2005-07. Again, the sharp drop in the ratio of short-term external debt to reserves is attributed to debt forgiveness and a greater accumulation of reserves. The external front highlights the widening of the current account deficit in 2011-14 (even after accounting for the

<sup>6</sup> Recent papers document the role of institutional quality in explaining countercyclical fiscal policy responses (Calderón and Schmidt-Hebbel 2008, Frankel, Végh and Vuletin, 2013, Calderon, Duncan, and Schmidt-Hebbel 2015, Calderón and Nguyen 2015).

net inflows of FDI into the region). Overall, the analysis shows that: (a) macroeconomic conditions in 2011-14 were already showing signs of vulnerability in terms of overvalued currencies and widened fiscal and current account deficits, and (b) these buffers are lower than before the global financial crisis, thus constraining the response to the current situation.



**Economic and political institutions.** Advances of institutional reforms—specifically, economic institutions—were slow-paced in the region (see Table 2.3).<sup>7</sup> There is a slight improvement in the overall ICRG index in 1995-2008 when compared with 1974-94—although the extent of improvement is statistically significant. The different dimensions of this index of economic institutions, however, evolve in different directions. For instance, investment profile and rule of law appear to have improved whereas there is deterioration of indicators of bureaucratic quality and corruption.

Political institutions, on the other hand, showed a more notable progress among SSA countries. Improvement in political constraints and checks and balances signal stronger veto points in the economic policymaking process that support credible and sustainable monetary and fiscal policy frameworks. Furthermore, increases in the score of the Polity2 index signal greater openness, competition and participation in electoral processes (see Table 2.3).

<sup>7</sup> Table 2.2 measures economic institutions with the following indicators: the ICRG political risk index and individual indicators like investment profile, corruption, rule of law, and bureaucratic quality.

TABLE 2.3: Economic and political institutions, 2003-2008 vs. 2009-2014

	Quality of Institutions					Political Institutions		
	Overall Index	Investment Profile	Corruption	Rule of Law	Bureaucratic Quality	Polity 2 Index	Political Constraints	Checks & Balances
<b>Sub-Saharan Africa</b>								
<i>Average</i>								
2003-2008	-0.9686	0.6157	0.3177	0.4711	0.1967	1.8556	0.2078	2.4521
2009-2014	-0.9915	0.5815	0.3303	0.4645	0.2105	2.3717	0.2384	2.4358
<i>Mean Equality tests</i>								
2003-2008 vs. 2009-2014	(0.811)	(0.059)	(0.345)	(0.703)	(0.293)	(0.271)	(0.076)	(0.875)
<b>Resource-Poor Countries</b>								
2003-2008	-0.8907	0.6206	0.3258	0.4745	0.2134	2.2931	0.2254	2.5091
2009-2014	-0.9677	0.5749	0.3257	0.4651	0.2281	2.5172	0.2661	2.5310
<i>Mean Equality tests</i>								
2003-2008 vs. 2009-2014	(0.523)	(0.073)	(0.998)	(0.652)	(0.393)	(0.718)	(0.051)	(0.845)
<b>Resource-Rich Countries</b>								
2003-2008	-1.0825	0.6084	0.3058	0.4661	0.1722	1.0625	0.1736	2.3542
2009-2014	-1.0264	0.5913	0.3371	0.4637	0.1847	2.1111	0.1848	2.2727
<i>Mean Equality tests</i>								
2003-2008 vs. 2009-2014	(0.719)	(0.481)	(0.136)	(0.935)	(0.527)	(0.126)	(0.705)	(0.692)
<b>Fragile and conflict states (FCS)</b>								
2003-2008	-1.5722	0.5231	0.2923	0.3855	0.1274	1.3333	0.1395	2.4500
2009-2014	-1.5806	0.5046	0.2887	0.3947	0.1346	2.0989	0.2290	2.5211
<i>Mean Equality tests</i>								
2003-2008 vs. 2009-2014	(0.954)	(0.549)	(0.878)	(0.683)	(0.753)	(0.244)	(0.003)	(0.691)

Source: International Country Risk Guide, Polity Codebook Project IV, Henisz (2000, 2002), Beck et al. (2011).

### 2.3 EXTERNAL HEADWINDS ARE PUTTING THE BRAKES ON GROWTH IN THE REGION

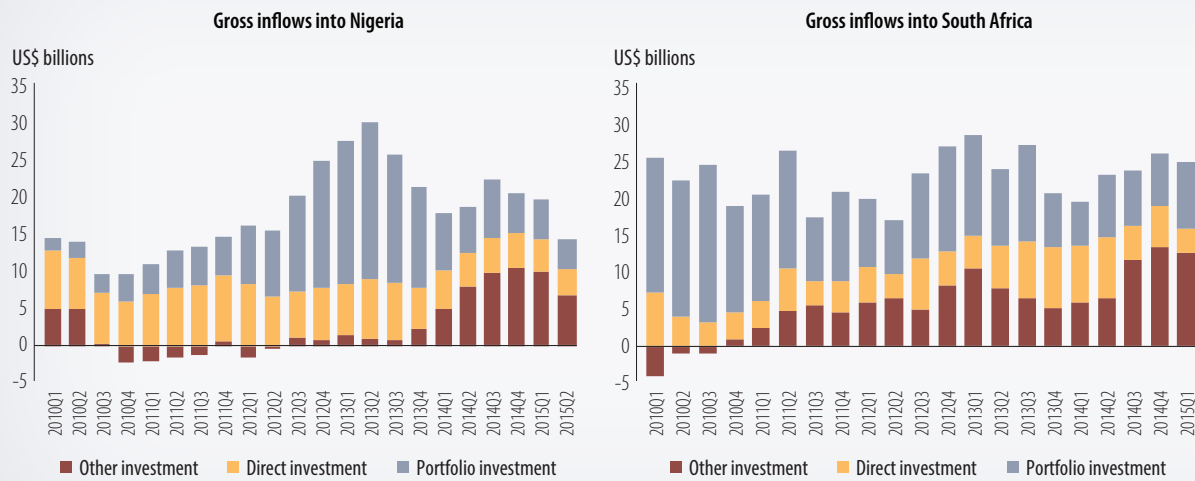
As discussed in Section 2.1, the specter of weaker economic activity in the Euro Area and China, persistently lower commodity prices, and the likelihood of higher US interest rates is weighing down upon the global economy. Plunging commodity prices, slower growth in China and lower growth prospects among SSA countries have led to a reduction of inflows in emerging markets—and, notably, in some African countries. On the other hand, the direction and composition of capital flows have changed in the midst and the aftermath of the global financial crisis. Figure 2.4 shows the evolution of gross inflows to South Africa and Nigeria on a quarterly basis.<sup>8</sup> South Africa and Nigeria are representative of the region as half of the FDI stocks in Sub-Saharan Africa are located in these countries (while the top ten countries of the region account for almost 80 percent of total FDI stock).

Greater financial volatility in China may lead to contagion to emerging markets and to Sub-Saharan Africa markets regardless of their fundamentals. Countries in the region with a composition of capital flows biased towards short-term investment (e.g. portfolio investment flows), are potentially more vulnerable to an outflow of foreign capital. In general, countries with weaker fundamentals (say, widened

<sup>8</sup> In order to reduce the volatility at the quarterly frequency, Figure 2.4 depicts the annualized gross inflows by type for each of the two countries.

**FIGURE 2.4:** Capital flow composition

South Africa and Nigeria are representative of the region as half of the FDI stocks in Sub-Saharan Africa are located in these countries



Source: Balance of Payments Statistics, IMF.

fiscal deficits, unhealthy external position, and low growth prospects) and a greater share of debt rather than equity flows are more prone to sudden stops (Levchenko and Mauro, 2007; Calderon and Kubota, 2013). Countries can prevent capital flow reversal by financing the widened current account deficits with equity-related rather than debt-related flows. During the last decade, countries with greater debt inflows have become more vulnerable to surges while those with more accumulation of equity inflows have been more neutral or become less vulnerable (at best) to surges (Calderon and Kubota, 2014).

The composition of gross inflows of foreign capital to South Africa is tilted to loan-related flows (portfolio investment in debt securities and other investment flows), thus making the economy more vulnerable to the imminent U.S. policy rate liftoff. The recovery of global bank activity, on the other hand, may have propelled the rise in other investment inflows to South Africa in the post-crisis period. It appears that there has been a switch in the composition of gross inflows as the amount of portfolio investment (PI) flows has declined from (an annualized amount of) US\$ 18.25 billion in 2010q1 to US\$ 8.61 billion in 2011q3 while other investment (OI) inflows have increased from US\$ -3.94 billion to US\$ 5.53 billion in 2010Q1 (Figure 2.4). The sharp decline in PI has been partly substituted by OI inflows. Meanwhile, gross FDI inflows did not fluctuate over this period. After the taper tantrum (of May 2013) the changing composition between PI and OI continued accelerating as OI outperformed PI with the latter reaching US\$ 6.95 billion and the former about US\$ 13.38 billion in 2014Q4). The substitution of gross inflows away from PI and into OI has occurred in Nigeria. It appears that FDI and PI inflows have been substituted for OI inflows, as the sum of FDI and PI have become the mirror image of the evolution of gross OI inflows (Figure 2.4). After the taper tantrum, gross OI inflows have consolidated their growth and have outperformed both gross FDI and PI inflows; especially, after the drastic drop in oil prices in June 2014.

## 2.4 MONETARY POLICY

Prospects of a Chinese economic slowdown, the plunge in commodity prices and the flight of global investors from riskier emerging markets have pummeled currencies across Sub-Saharan Africa (Figure 2.5). Along with external factors, domestic factors have also played a role in warranting a weakening of the currency. For instance, slow growth, energy problems, lack of structural reforms, and policy uncertainty have led to the depreciation of the rand since 2011. The depreciation of the Zambian kwacha is explained by factors other than the lower price of copper. Power shortages are hindering economic activity in the copper sector and manufacturing—thus, lowering growth prospects. Widened external imbalances and fiscal deficits are operating as forces towards the weakening of the currency. Figure 2.5 shows that current account deficits have deteriorated for the majority of SSA countries when comparing their current account balances in 2011 and 2014. First, 39 of 43 countries in the region display a current account deficit in 2014 and this amounts to a median current account deficit of 9 percent of GDP. Second, 23 of 39 countries have experienced a shift from surplus to deficit or an even wider deficit of the current account in 2014 compared with their position in 2011. Third, the median current account deficit of these 23 countries has deteriorated from a median of about 5 percent of GDP in 2011 to 9 percent of GDP in 2014. Finally, the distribution of current account balances in the region is clearly asymmetric as 14 countries register a deficit that exceeds 10 percent of GDP in 2014 and only 4 countries managed to post a surplus.

Current account deficits have deteriorated for the majority of countries in Sub-Saharan Africa when comparing their current account balances in 2011 and 2014.

**FIGURE 2.5:** Current account deficits in the region (percent of GDP)



Source: World Economic Outlook, IMF.

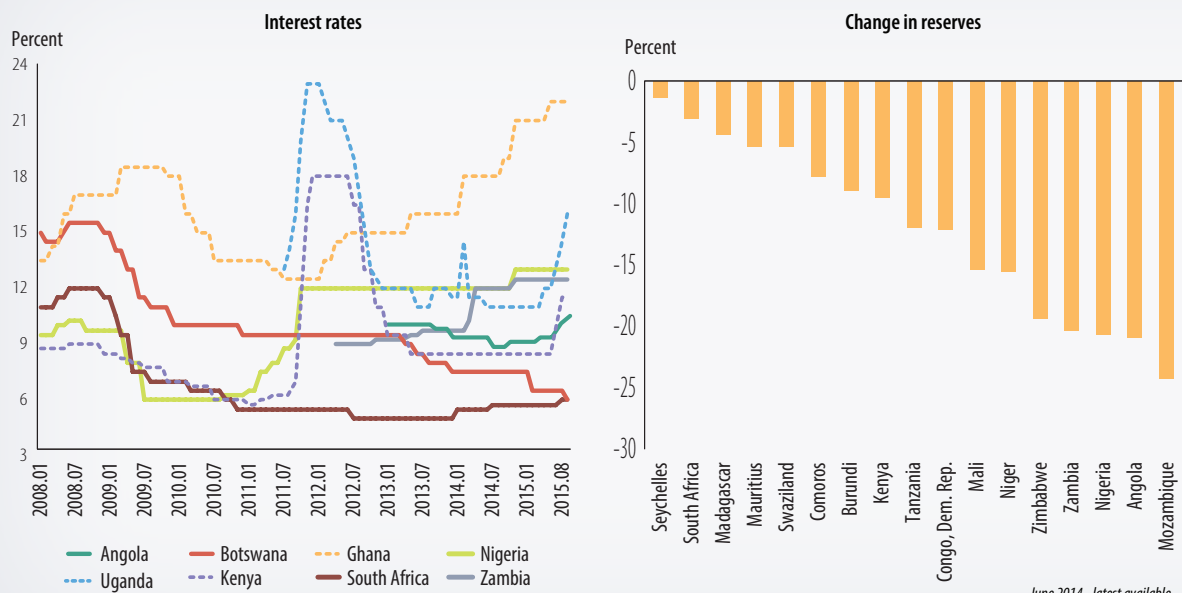
As countries face exchange market pressure, excess demand for foreign exchange can be met through different channels that are not necessarily mutually exclusive.<sup>9</sup> In the event of greater demand for foreign exchange (say, US dollars), a depreciation or devaluation of the currency takes place in the absence of intervention. However, the central bank may instead accommodate currency pressures by selling their international reserves or prevent greater demand of foreign currency by raising interest rates.

<sup>9</sup> Girton and Roper (1977) develop a model of exchange rate market pressure and this is implemented for a wide set of countries by Eichengreen, Rose and Wyplosz (1996).



The strategy followed by monetary authorities to deal with the existing currency pressures varies across countries depending on the policy space and the array of tools at their disposal. Figure 2.6 depicts the changes in policy rates among SSA countries since the global financial crisis. For instance, the widened current account and fiscal deficits have undermined the confidence in the Uganda shilling which has weakened more than 30 percent so far this year. The monetary authorities have responded by raising the monetary policy rate by 500 basis points this year. Efforts to shore up the Kenyan shilling have led the central bank to raise rates by 300 basis points since June 2014. The Bank of Ghana has raised policy rates to 25 percent (up by 100 basis points) in September 2015 in an effort to support the Ghanaian cedi and subdue inflation expectations.

**FIGURE 2.6:** Policy interest rates and change in international reserves

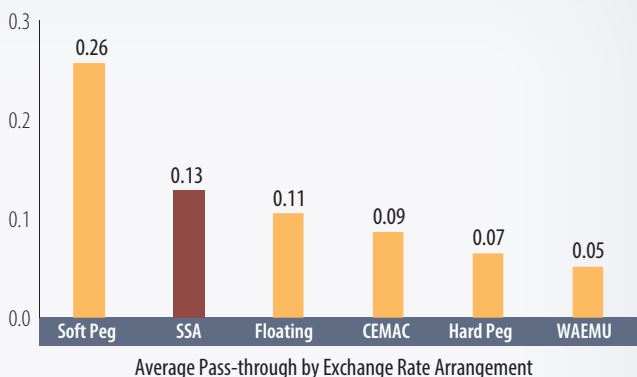


Source: Bloomberg and IMF International Financial Statistics.

Countries with less flexible exchange rate arrangements have defended their currencies by running down their international reserves —especially, commodity exporting countries in the region. For instance, Nigeria and Angola have tried to support the level of their currencies by drawing down international reserves. Since June 2014, the cumulative drop of international reserves for both countries has exceeded 20 percent. Relative to the size of their economies, the reduction of international reserves represents about 2 percent of GDP for Nigeria and 6 percent of GDP for Angola. Other commodity exporters with sharper declines in reserves are Chad, Republic of Congo, South Sudan, and Equatorial Guinea (Figure 2.6). As we argued above, many of the SSA currencies have been hit hard by the plunge in oil prices. Oil in many of these countries represents an important share of the export basket and it is a key source of government revenues. In conjuncture with deteriorating fiscal and external positions their currencies have lost ground.

On average, the estimated pass-through for the region is a modest 0.13. This implies that a 10% depreciation or devaluation of the currency will lead to an inflation increase of 1.3%

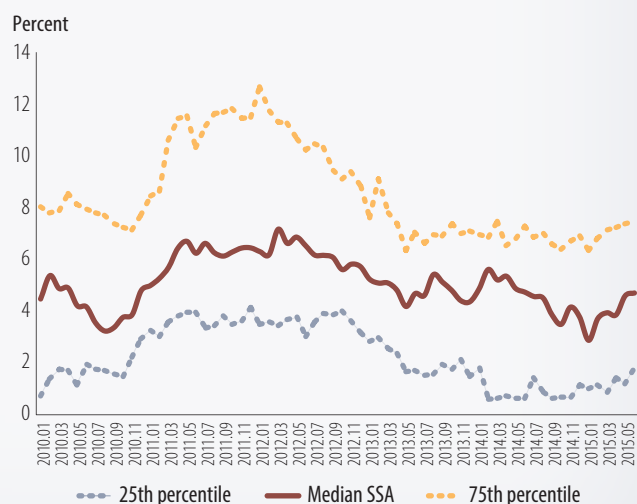
**FIGURE 2.7: Pass-through from depreciation to inflation**



Source: World Bank staff calculations.

Inflation appears to be contained but is picking up recently

**FIGURE 2.8: Inflation**



Source: International Financial Statistics, IMF.

The lack of policy space will hinder the ability of countries in the region to accommodate a more orderly depreciation of the currency, which would allow the countries to reap gains in competitiveness. At the same time, a disorderly depreciation may feed into inflationary dynamics—especially in those countries where the share of imported goods (and, more specifically, imported food items) is the largest. Figure 2.7 shows the coefficient of pass-through from depreciation to inflation for a wide array of SSA countries. There is a great deal of heterogeneity in the estimated coefficient of pass-through across SSA countries. On average, the estimated pass-through for the region is a modest 0.13. This implies that a 10 percent depreciation or devaluation of the currency will lead to an inflation increase of 1.3 percent. The largest average pass-through is exhibited by countries in the region with a soft peg (0.26); unsurprisingly, countries with a hard peg have the lowest pass-through (about 0.05).

Inflation for the region as a whole seems to be relatively contained at annualized rates below 5 percent. In recent months, the median inflation has shown a slight uptick from about 3 percent in January 2015 to 4.7 percent in June 2015 (figure 2.8). Furthermore, 21 of 36 countries with monthly CPI data have seen their inflation

in 2015Q2 increased relative to that of 2014Q1. However, this issue seems to be more worrisome in some countries, such as Angola, Ethiopia, Ghana, Guinea, and Nigeria, where the annualized rate of CPI inflation exceeds 8 percent.

Finally, while the pass-through from depreciation to inflation is meager, it is somewhat large for a few countries: for example, 0.7 for Angola and 0.2 for Ghana. Countries with greater pass-through and without inflation expectations properly anchored could witness an increase in their inflationary rates if they do not tighten monetary policy.

## 2.5 FISCAL POLICY

The ability of fiscal policy makers to deploy countercyclical responses in bad times depends on the risk management practices put in place prior to the downswing in real economic activity. On average, fiscal balances have remained in deficit in the region but were lowered in the run-up to the crisis, whereas debt stocks have been considerably reduced. The latter is partly attributed to debt forgiveness initiatives (such as HIPC and MDRI) and to sounder fiscal policies.

Countries in SSA were able to create fiscal space prior to the crisis (Cassimon et al. 2015). When the global crisis hit the region, some countries were able to use their built-in buffers to finance policy responses. Government expenditure in SSA, on average, increased by 3 percentage points of GDP, while public debt grew by nearly 2 percentage points of GDP. During the post-crisis recovery, government expenditure continued expanding by approximately 0.5 percent of GDP in 2013 for countries in the region, while those expansions have exceeded 1 percent of GDP among all low- and middle-income countries (Calderon and Nguyen 2015).

Figure 2.9 depicts the fiscal position of SSA countries in 2014 and whether that position has improved or deteriorated relative to 2011. About 37 countries in the region (of 43 with information on fiscal balances) had a fiscal deficit in 2014, of which 27 have widened that deficit. For those countries experiencing a deterioration in their fiscal position, the average drop in the fiscal balance amounts to 3 percent of GDP and is primarily driven by increases in government spending (an average increase of 2.5 percentage points of GDP in spending and a reduction of half a percentage point of GDP in revenues).

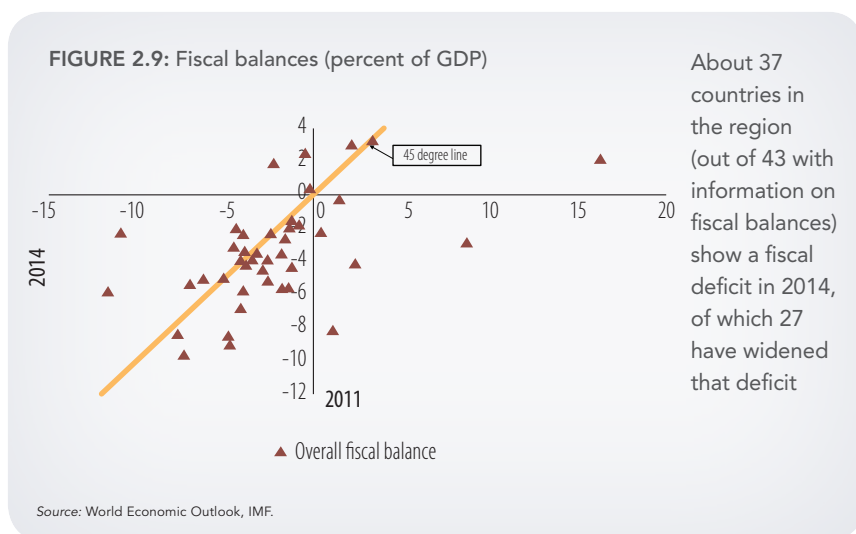


Figure 2.10 shows the change in the overall fiscal balance (in percentage points of GDP) for countries in SSA in 2014 compared with 2011, and whether changes in revenues or changes in expenditures are the main driver of change. Four countries had a deterioration in fiscal balance that exceeded 5 percentage points of GDP (Angola, Chad, Equatorial Guinea, and Republic of Congo). The Republic of Congo is the only country in this group where the widened deficit was attributed primarily to an expansion of government expenditure.

Oil exporting countries in the region (Angola, Chad, Equatorial Guinea, and Nigeria) experienced the largest decline in government revenues (which exceeded 5 percentage points of GDP). For instance, government revenues in Angola declined more than 10 percentage points of GDP between 2011 and 2014, while those in Chad and Nigeria had a cumulative drop of 7-8 percent over this period. Other

Oil exporting countries in the region experienced the largest decline in government revenues. For example, Angola saw a decline of more than 10% of GDP in 2011-14

**FIGURE 2.10: Evolution of Fiscal deficits: Revenues vs Expenditure (percent of GDP)**



Source: World Economic Outlook, IMF.

Note: This graph shows the difference between the variable in percent of GDP in 2014 and 2011.

countries, such as Gambia, Guinea, Mozambique, Niger, and Zambia, had expansions of government spending that exceeded 5 percentage points of GDP, which constituted the main driver of larger deficits.

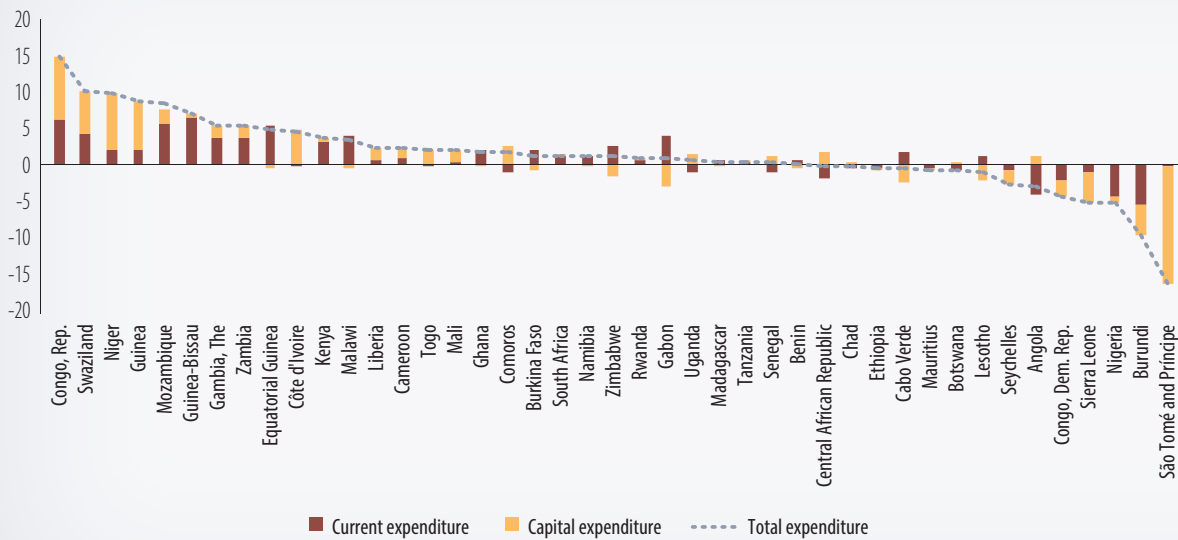
Figure 2.11 provides further information about the cumulative change in government expenditure during 2011-14 by inspecting its sources of variation, namely, changes in current and capital expenditure. During this period, 29 of 43 countries in the region have experienced an increase in government expenditure. The median increase is about 3.6 percentage points of GDP, of which 2 percentage points of GDP correspond to greater current expenditure and 1.6 percentage points of GDP is attributed to capital expenditure.

However, there is a great deal of variation in the composition of government expenditure across countries in SSA. The Republic of Congo is the only country with an expansion of government expenditure that exceeded 10 percentage points of GDP during 2011-14; specifically, 14.9 percent of GDP. More than half of this increase is attributed to an expansion of capital expenditure (about 8.6 percent of GDP), although the expansion of current expenditure is also large (6.3 percent of GDP). Other countries that have expanded current expenditure beyond 4 percentage points of GDP are Equatorial Guinea, Gabon, Guinea Bissau, Mozambique, and Swaziland. Countries where government capital expenditure have increased by more than 4 percentage points of GDP include Côte d'Ivoire, Guinea, Niger, and Swaziland.

A noteworthy feature of the period after the global financial crisis is the steady and marked reduction in the proportion of countries in the region with fiscal surpluses, which dropped from 30 to 9 percent

**FIGURE 2.11:** Contribution of current and capital expenditure to the growth of total expenditure (percent of GDP)

29 out of 43 countries in the region experienced an increase in government expenditure between 2011 and 2014. The median increase was about 3.6% of GDP



Source: World Economic Outlook, IMF.

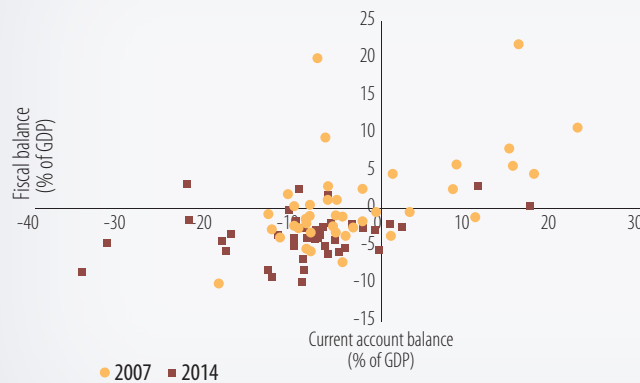
Note: This graph shows the difference between the variable in % of GDP in 2014 and the variable in % of GDP in 2011.

between 2008 and 2014. At the same time, the number of countries with fiscal deficits that exceeded 10 percent of GDP increased from 3 to nearly 30 percent between 2007 and 2014.

It could be argued that the widening of fiscal deficits might be attributed to the deployment of resources to support economic activity amid the global financial crisis. However, as growth reignited and stabilized among African countries, fiscal deficits continued widening. For instance, about half the countries in the region had a fiscal deficit that did not exceed 5 percent of GDP in 2012. That share of countries was less than one-quarter in 2013. Figure 2.12 plots the fiscal and current account balances in 2014 compared with those in 2007. The figure shows a deterioration in the current and fiscal account balances among SSA countries after the onset of the global financial crisis. This deterioration reflects, among other things: (a) the dependence of SSA countries on external savings, and (b) the greater share of expenditures that may not be able to fully repay themselves in the future.

**FIGURE 2.12:** Shift in external and fiscal positions towards widened deficits (percent of GDP)

Current account and fiscal balances have deteriorated for the majority of Sub-Saharan African countries during the post-crisis period



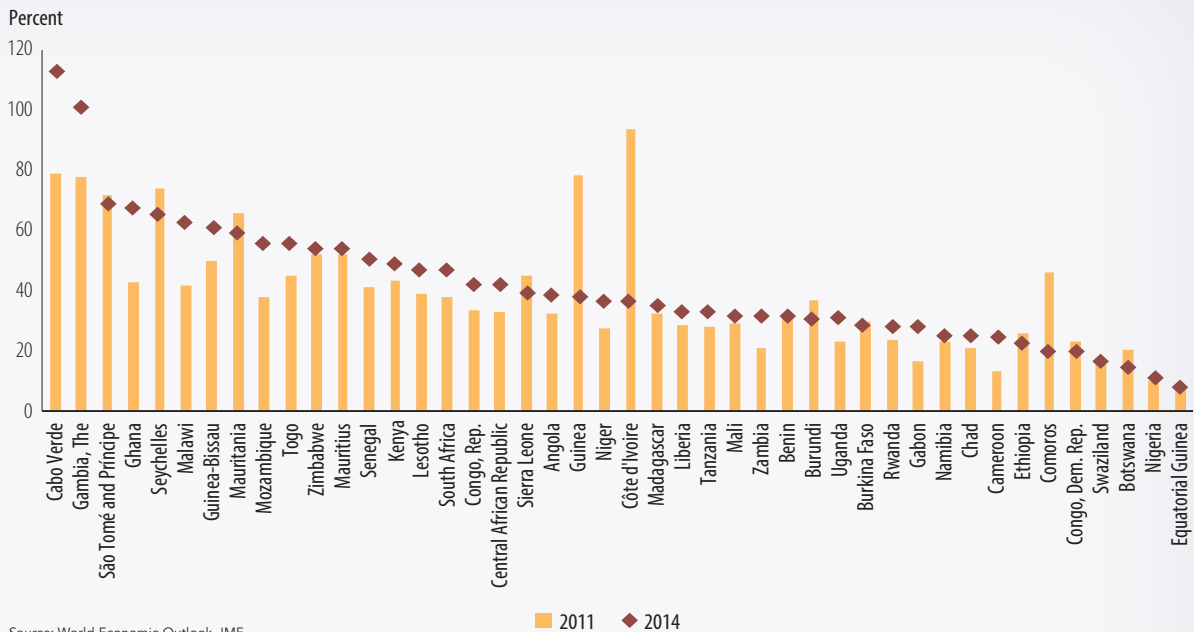
Source: World Economic Outlook, IMF.

## 2.6 DEBT DYNAMICS IN SUB-SAHARAN AFRICA

Looking at the evolution of public debt over the past 25 years presents quite an optimistic outlook for the region as a whole. But this picture masks a great extent of heterogeneity across countries. Debt vulnerabilities have increased for some countries in recent years; however, this may be understated when compared with the high levels of indebtedness prior to receiving debt relief. Figure 2.13 shows the levels of public debt of countries in SSA in 2014 compared with 2011.

Debt stocks drastically declined in the period of debt forgiveness. Those stocks have been rising since then

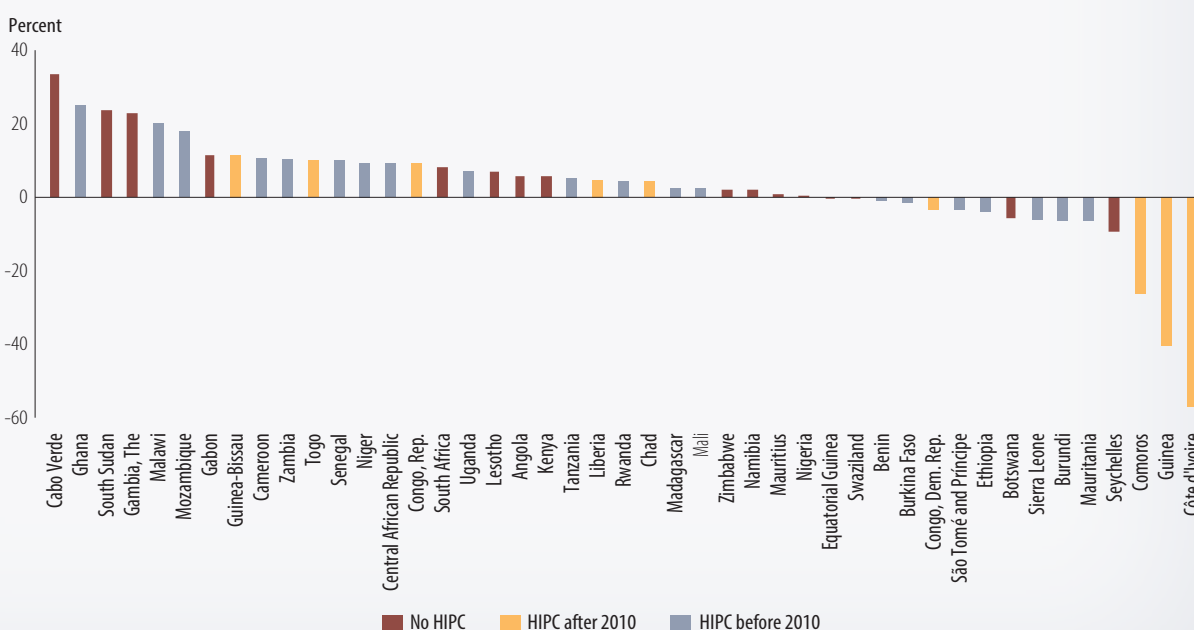
**FIGURE 2.13: Public debt (percent of GDP), 2011 and 2014**



Source: World Economic Outlook, IMF.

Debt stocks have been building up at a faster pace in some countries

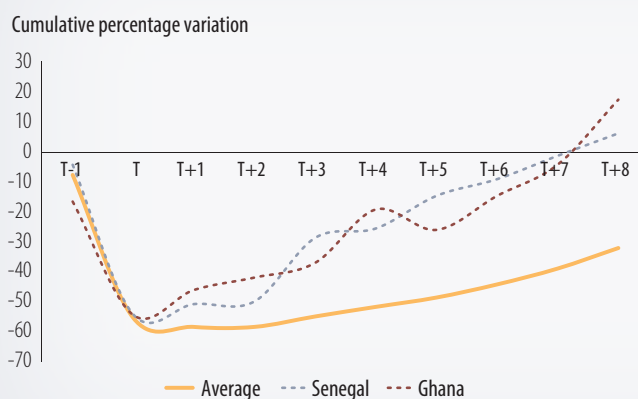
**FIGURE 2.14: Debt burden for HIPC and non-HIPC (percent of GDP), 2014**



Source: World Economic Outlook, IMF.

Many countries in Sub-Saharan Africa were able to gain fiscal space thanks to the sharp reduction of debt stocks as a result of debt forgiveness initiatives—such as HIPC and MDRI. Figure 2.15 shows the evolution of public debt stocks for SSA countries that have received debt forgiveness and T represents the period where these benefits have started. There is immediate and drastic decline in debt stocks in period T and, on average, debt stocks have increased steadily—although it is still 30 percent below the pre-debt forgiveness period. However, debt stocks have been building up at a faster pace in some countries. This is the case of Senegal and Ghana. After more than halving their debt stocks in the first year of the debt forgiveness (period T), public debt burden has increased steadily and at a faster pace than that of the average country in the region. After 8 years, Ghana and Senegal have debt stocks that are higher than those during the pre-debt forgiveness period.

**FIGURE 2.15: Evolution of public debt in HIPC countries in Sub-Saharan Africa**



Source: World Economic Outlook, IMF.

After more than halving their debt stocks in the first year of the debt forgiveness, Ghana and Senegal have seen their public debt burden increase at a faster pace than that of the average country in the region

### *Drivers of Public and External Debt Changes in Sub-Saharan Africa*

This section examines the role played by endogenous and exogenous sources of fluctuations in debt stocks, namely, primary deficits, changes in the real exchange rate, real GDP growth, real interest rates, and other factors, including debt relief. Battaile, Hernandez, and Norambuena (2015) conduct this analysis for 33 countries in SSA with debt sustainability analysis (DSA).<sup>10</sup>

### *Public Debt*

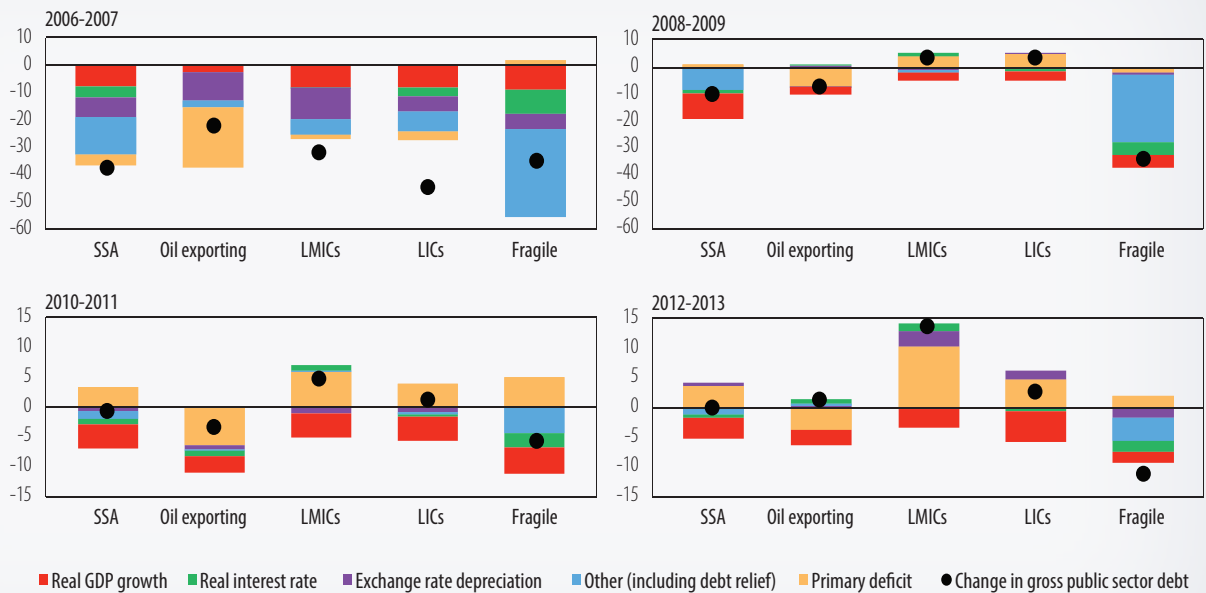
Figure 2.16 depicts the flows that have contributed to changes in public debt for countries in SSA over 1960-2013. In this analysis, public debt is measured as the gross public and publicly guaranteed external and domestic debt stocks. Public sector debt experienced a sharp decline during 2006-07: the ratio of public debt to GDP fell from around 90 percent in 2005 to 54 percent in 2007. Debt reduction slowed down at the onset of the global financial crisis, and the level of public debt stabilized at about 43 percent of GDP during 2010-13.

The unprecedented growth in economic activity in the region has played an important role in reducing the debt ratios in SSA throughout the period. Debt relief was also an important driver of debt reduction during 2006-09. However, the implementation of countercyclical policy responses led to fiscal deficits in the region, which, in turn, have contributed to a positive debt accumulation since 2009. Shifts in the average real interest rate explain a drop in debt ratios during 2006-08, thus revealing the predominance of concessional borrowing in low-income countries (LICs) and fragile economies. The debt reduction observed among oil

<sup>10</sup> Twenty-seven DSAs were carried out during the 2014 fiscal year, and six during the 2013 fiscal year.

Growth in economic activity played an important role in reducing debt ratios in Sub-Saharan Africa as did debt relief. On the other hand, the implementation of countercyclical policy responses led to fiscal deficits and debt accumulation since 2009

**FIGURE 2.16: Contribution to Changes in Public Debt**  
(cumulative by sub-periods, percent of GDP)



Source: Battaile, Hernandez, and Norambuena 2015.

Note: GDP = gross domestic product; LICs = low-income countries; MICs = middle-income countries; SSA = Sub-Saharan Africa.

exporting countries, middle-income countries (MICs), LICs, and fragile countries during 2006-07 were driven by different factors. Debt relief was oriented to resource-poor fragile countries, whereas oil exporting nations benefited from higher government revenues (a product of rising commodity prices).

Debt reduction came to a halt with the onset of the global financial crisis. However, the dynamics across country groups were different. The impact of the global financial crisis was more clearly observed in LICs and MICs whose public debt increases were mainly driven by primary deficits in 2008-09. Debt relief continued explaining the debt reduction of fragile non-oil-exporting countries. Fiscal surpluses were still contributing to reduce the debt stocks among oil-exporting nations.

In the post-crisis period (2010-13), public debt ratios for the region as a whole were relatively stable. The contribution of economic growth was partly offset by widened primary deficits. Although growth explains a cumulative reduction of 7.5 percentage points in the ratio of public debt to GDP, primary deficits account for an increase of 7 percentage points. This is not the case for MICs: fiscal deficits widened and countries engaged in costlier borrowing. Primary deficits and average real interest rates explain an increase of the public debt ratio for these countries of about 16 and 2 percentage points, respectively.

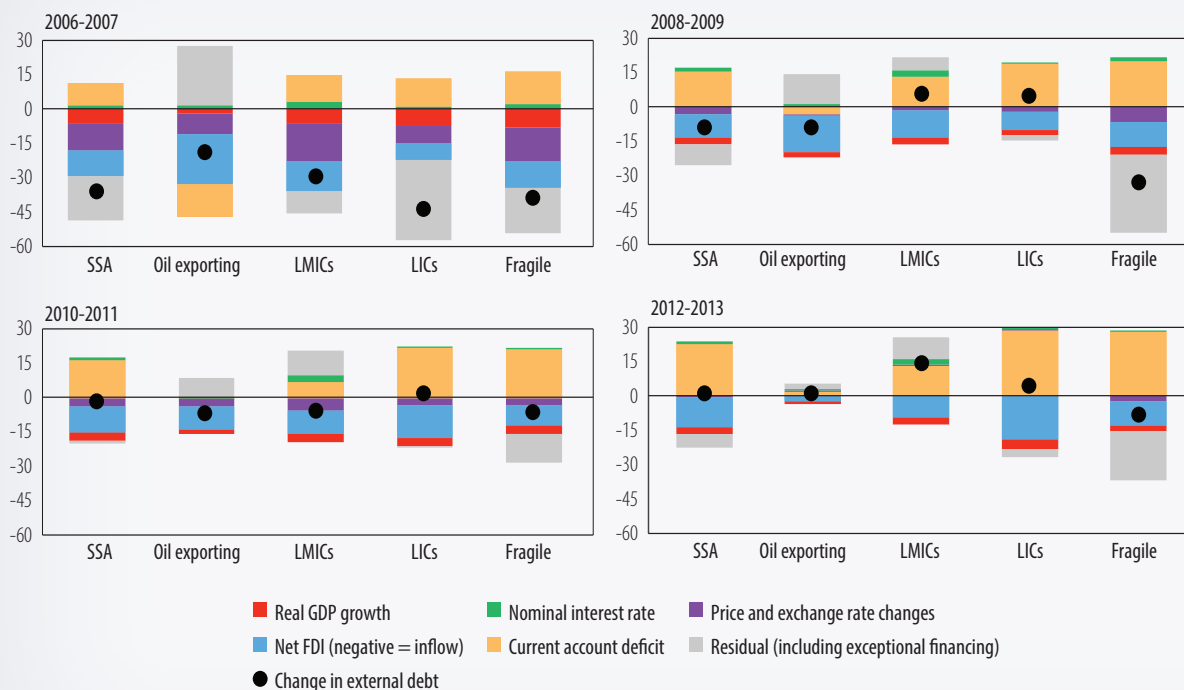
### External Debt

Figure 2.17 plots the external debt-creating flows in SSA during 2006-13. Total external debt includes public and publicly guaranteed external debt, private nonguaranteed external debt, and short-term debt. External debt decreased by 37 percentage points during 2006-07 (from 83 percent of GDP in 2005 to 46 percent of GDP in 2007). The pace of debt reduction slowed down during the global financial crisis. External debt has stabilized at 37 percent of GDP since 2010.



**FIGURE 2.17: Contribution to Changes in External Debt (cumulative by sub-periods, percent of GDP)**

Current account surpluses and FDI inflows explained the decline of debt among oil exporting countries in the region. Local currency appreciation and net FDI inflows were the main drivers of the decline in debt among MICs



Source: Battaile, Hernandez, and Norambuena 2015.

Note: FDI = foreign direct investment; GDP = gross domestic product; LICs = low-income countries; MICs = middle-income countries.

Economic growth in the region alleviated the external debt burden by 4.3 percentage points in 2006 and its contribution was reduced and remained stable at an average of 1.6 percentage points per year since 2007. The importance of factors such as exceptional financing (such as changes in arrears and debt relief) highlights the contribution of debt forgiveness initiatives (HIPC and MDRI). However, widening current account deficits have played a greater role in explaining higher external debt levels throughout 2006-13 (notably, through surges in imports and reduced official transfers since 2008). Their impact on debt creation was partially mitigated by (net) FDI inflows, which have been fairly stable throughout the period and have contributed to external debt reduction of about 5-6 percentage points of GDP per year. Trends in external debt reduction for the region mask important differences across groups in their underlying factors: current account surpluses and FDI inflows drove the decline of debt among oil-exporting countries. Local currency appreciation and net FDI inflows explained the reduction of debt among MICs, while debt relief played a crucial role in LICs and fragile economies (figure 2.17).

In the midst of the global financial crisis, the external debt creation of MICs and LICs was driven by current account deficits and costlier borrowing. The debt dynamics of oil-exporting nations continued to benefit from current account surpluses, while debt relief helped fragile countries. In the post-crisis period (2010-13), external debt stocks have expanded for MICs (a cumulative 15 percentage points of GDP for the entire period). Fragile economies and LICs have registered a sizable increase in their current account deficits; however, this has been partly offset by net FDI inflows and exceptional financing in the case of fragile countries.

## *Debt Vulnerability of SSA Countries Under Shock Scenarios*

This section examines the sensitivity of the debt burden indicators of countries in SSA to shocks affecting key macroeconomic variables.<sup>11</sup> The section explores the deterioration of debt burden indicators for the region as a whole and for specific country groups under different scenarios embedded in the DSA. The alternative scenarios cover shocks to the primary balance, real GDP growth, exchange rate depreciation, external financing conditions, and export growth.

Average liquidity indicators for the region as a whole and the different country groups are only marginally affected by the shocks. This occurs despite the fact that small deviations from the baseline tend to be protracted, especially in the case of debt service to revenue. As a result, the risk ratings are, on average, nonresponsive to liquidity shocks. Moreover, breaches are short-lived and small in the pre-shock situation, thus leading to few cases of high risk of debt distress. The solvency indicators, by contrast, display a greater sensitivity to shocks. They lead to more protracted and larger breaches on average. Public DSA shocks lead generally to protracted deviations from the baseline, although the size of the changes in the ratio of debt-to-GDP varies across groups. The depreciation shock has a smaller average impact, while shocks to the primary balance and real GDP growth have a larger effect on the frontier and HIPC groups. Real GDP shocks are the main source of vulnerability of fragile and oil-exporting countries.

The effects on the solvency indicators in the external DSA are similar to those found for the public DSA, although the impact on breaches compared with the threshold is more significant on the duration rather than the size of the breach. The groups that are more affected by the shocks are HIPCs and fragile countries—in size and length of breaches. Oil exporters, by contrast, are less affected, with the exception of the shock on export growth. Overall, LICs are on average more vulnerable to suffering a risk rating downgrade given that the shocks affect their solvency rather than their liquidity indicators. This result is consistent with their historical —albeit decreasing—access to official financing (Figure 2.18).

## *International Sovereign Bond Issuance by Countries in the Region*

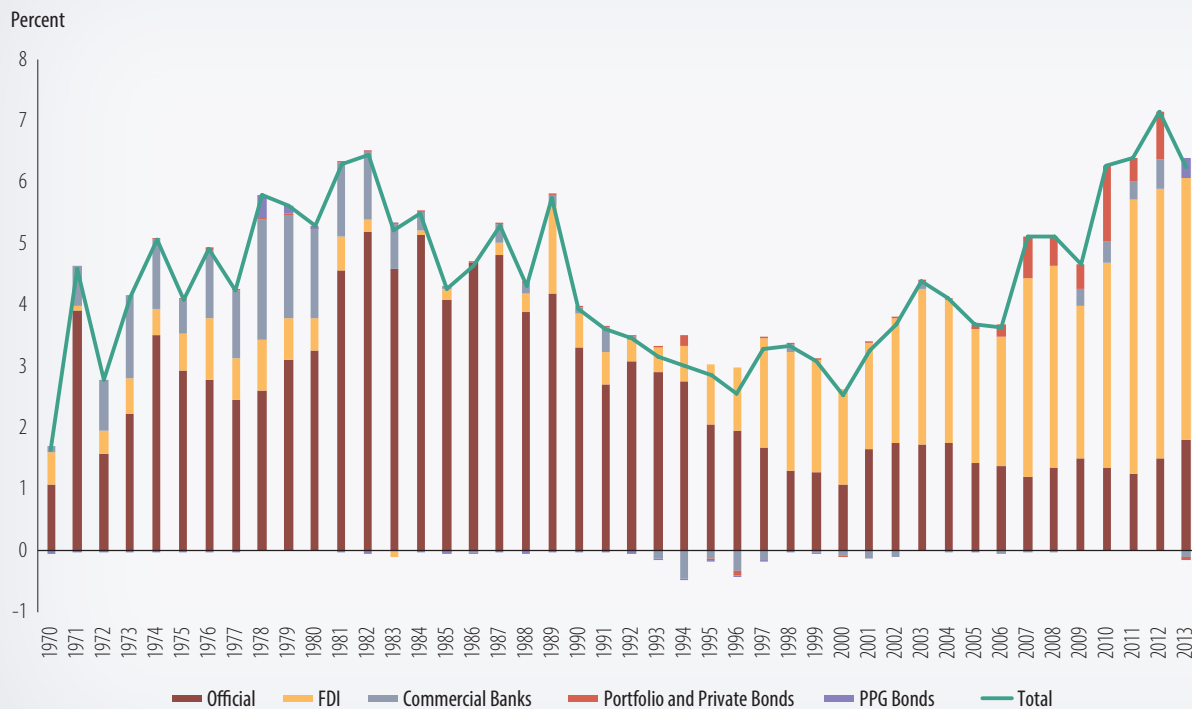
Sub-Saharan African countries have increasingly tapped international markets as an additional source of sovereign financing since the global financial crisis, most notably in the last few years. Historically low interest rates and investors' search for yield have led to record levels of international sovereign bonds by SSA governments in 2013 and 2014 (table 2.4). Increased access to financial markets offers potential benefits to SSA countries, such as supplementing low domestic savings, further diversifying the investor base, extending the maturity profile of debt profiles, and helping address declining access to concessional financing.

International bond issuance also brings significant risks, with increased foreign exchange and rollover risk the most notable. Given the typical large size of international issuances (most frequently greater than US\$500 million), the foreign exchange exposure of the country's debt portfolio can increase significantly, leaving the country at risk of future depreciation inflating servicing costs. This risk can be significant for the region, as evidenced by the large depreciations of the Ghanaian and Nigerian currencies in 2014.

<sup>11</sup> The public debt burden indicators are: public debt-to-GDP, present value (PV) of external debt-to-GDP, PV of external debt-to-exports, PV of external debt-to-revenue, debt service-to-exports, and debt service-to-revenue. In a standard DSA, the responses to these shocks are projected over a 20-year horizon.

**FIGURE 2.18:** Flows to Low Income Countries, 1970-2013 (percent of GDP)

LICs have seen a consistent, yet decreasing, access to official financing



Source: Painchaud and Stucka 2011.

**TABLE 2.4:** SSA Issuance of International Sovereign Bonds (USD millions)

Country	2009	2010	2011	2012	2013	2014	Total
Angola				1000			1000
Côte d'Ivoire		2330				750	3080
Ethiopia						1000	1000
Gabon					1500		1500
Ghana					750	1000	1750
Kenya						2000	2000
Mozambique					850		850
Namibia			500				500
Nigeria			500		1000		1500
Rwanda					400		400
Senegal	200		500			500	1200
Seychelles		168					168
Tanzania					600		600
Zambia				750		1000	1750
<b>Total</b>	<b>200</b>	<b>2498</b>	<b>1500</b>	<b>1750</b>	<b>5100</b>	<b>6250</b>	<b>17298</b>

Source: Tyson (2015).

The recent slowdown in commodity demand from China and the volatility in global commodity prices are reminders of the risks that external shocks present to commodity-based economies in meeting external debt obligations. However, international issuance does not necessarily raise foreign exchange risk. For example, Côte d'Ivoire's 2010 issuance—the largest in the sample—did not exacerbate the foreign exchange exposure of the country. The issuance was part of the country's debt restructuring under the HIPC framework, and resolved commitments to external commercial creditors holding defaulted Brady bonds.

### *Managing Very Large Bullet Repayments: Liquidity Challenge for Some International Bond Issuers in SSA*

Bullet-type repayment structures account for just over two-thirds of SSA issuances. Although the long tenor (typically 10 years) can help reduce shorter-term repayment problems, countries will often face much larger one-time repayment obligations than they have previously managed. Some countries have set up sinking funds to ensure adequate resources will be available to meet bullet repayments (for example, Gabon). Others may be counting on rolling over the bonds, but this can be expected to come at a higher cost than the yields that they have enjoyed at issuance during historically easy global finance conditions.

Spikes in debt service-to-revenue projections significantly add to debt sustainability risks for many issuers. The negative impact of bullet repayments on liquidity risks can be clearly seen in the debt service ratios of recent DSAs. Figure 2.19 shows jumps in debt service obligations relative to projected revenue for each country where bullet repayments are due.<sup>12</sup> For Ghana, bullet repayments after 2023 for recent issuances result in a protracted breach of the baseline projection for the external debt service-to-revenue ratio, and hence the increased liquidity risks associated with sovereign bond issuances have caused Ghana's risk rating of external debt distress to deteriorate from moderate to high risk.

The moderate risk rating for Zambia is due to breaches under shocks for the debt service-to-revenue indicator. The breaches correspond to the timeframe of Eurobond repayments, under the assumption that external funding is secured under commercial terms (similar to the 2012 and 2014 Eurobonds). Côte d'Ivoire is similarly rated at moderate risk of debt distress, with breaches under alternative scenarios corresponding to repayments of Eurobond issuances of US\$250 million and US\$1 billion in 2014 and 2015, respectively.

Rwanda and Senegal maintain their low risk ratings, but dramatic spikes in debt service obligations at the time of bond repayment signal the potential risk of liquidity pressures in the future. Lastly, Kenya and Nigeria show no major effects on their risk ratings, given the overall low levels of external debt. Kenya issued its first international sovereign bonds in 2014, with amortizations due in 2019 and 2024 yielding the corresponding spikes in the debt service ratios. Nigeria's bond repayment shows even less impact. Kenya and Nigeria's debt ratios remain well below the policy-based thresholds.

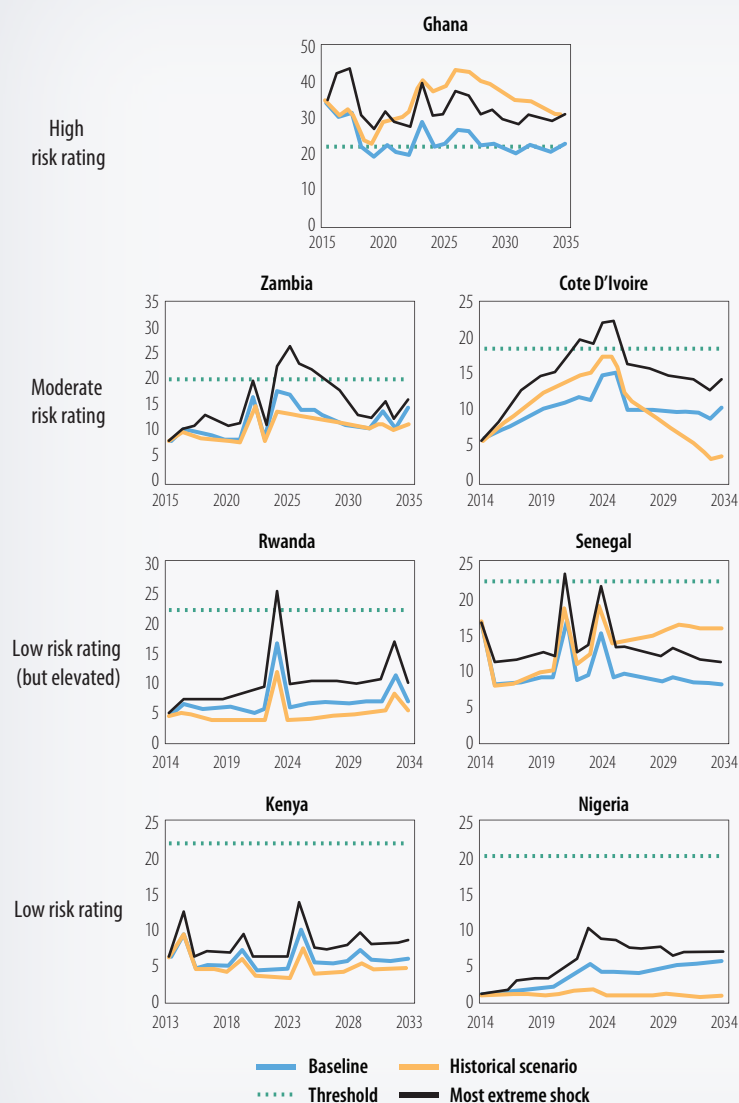
<sup>12</sup> The countries in the figure reflect issuers in table 2.4, and with bullet repayment terms as well as DSAs that incorporate Eurobond repayments.

**The experience of using international sovereign bonds to finance large infrastructure initiatives is mixed.**

Coordinating the availability and magnitude of bond proceeds with time-sensitive project financing needs can be a challenge, especially in capacity constrained environments. There have been delays in the use of bond proceeds (e.g., Senegal and Zambia), though this is not an Africa-only phenomenon. Mongolia, for example, had a very successful sovereign bond issuance in 2012, yet the proceeds could not be fully utilized in the near term. This illustrates the risk of incurring significant carrying costs for idle funds. In addition, there may be the temptation in the face of investor over-subscription to borrow amounts beyond the public investment absorptive capacity of the government. In the larger context, debt sustainability will be negatively impacted because of lower-than-expected growth impacts from borrowing.

**Lastly, it should be noted that the large resource flows into issuing countries may contribute to financial instability.** As noted in Tyson (2015), increasing integration into international private capital markets, combined with financial liberalization and immature but developing domestic financial systems, can mix with sharp volatility in capital flows and lead to financial crisis and damaging macroeconomic instability. This calls for the need to be watchful of the buildup of such risks, especially in light of the eventual reversal of monetary easing in developed economies.

FIGURE 2.19: Debt Service-to-Revenue Concerns



Source: Joint WB/IMF DSAs: Rwanda Nov 2014; Senegal Dec 2014; Zambia May 2015; Ghana Aug 2015; Kenya Sep 2014; Côte D'Ivoire Nov 2014.

These graphs show jumps in debt service obligations relative to projected revenue for each country where bullet repayments are due. They make evident Ghana's risk rating of external debt distress which has deteriorated from moderate to high risk

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# Appendix I

## Country Classification for Analysis, 2015

Resource-Rich Countries			
Oil	Metals & Minerals	Non Resource-Rich Countries	Fragile and Conflict Affected Countries
Angola	Botswana	Benin	Burundi
Chad	Congo, Dem. Rep.	Burkina Faso	Central African Republic
Congo, Rep.	Guinea	Burundi	Chad
Equatorial Guinea	Liberia	Cabo Verde	Comoros
Gabon	Mauritania	Cameroon	Congo, Dem. Rep.
Nigeria	Namibia	Central African Republic	Congo, Rep.
South Sudan	Niger	Comoros	Côte d'Ivoire
Sudan	Sierra Leone	Côte d'Ivoire	Eritrea
	Zambia	Eritrea	Guinea-Bissau
		Ethiopia	Liberia
		Gambia, The	Madagascar
		Ghana	Malawi
		Guinea-Bissau	Mali
		Kenya	Sierra Leone
		Lesotho	Somalia
		Madagascar	South Sudan
		Malawi	Sudan
		Mali	Togo
		Mauritius	Zimbabwe
		Mozambique	
		Rwanda	
		São Tomé and Príncipe	
		Senegal	
		Seychelles	
		Somalia	
		South Africa	
		Swaziland	
		Tanzania	
		Togo	
		Uganda	
		Zimbabwe	

1 Resource rich countries are those with rents from natural resource (excluding forests) that exceed 10 percent of GDP

2 Fragile countries should meet the following criteria: (a) a harmonized average CPIA country rating of 3.2 or less, or b) the presence of a UN and/or regional peace-keeping or peace-building mission during the past three years.





