The Financial Crisis: Impact on Africa and the role of the AfDB

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Prof. Léonce Ndikumana
Director, Development Research Department
African Development Bank

Outline

- The context and an overall assessment
- Africa not decoupled: impact on markets and assets
- Impact on trade flows
- Worsening macroeconomic balances
- Liquidity shortage, collapse in demand and impact on the private sector
- Impact on poverty: the worst is yet to come …
- Africa is trying, but the policy space is limited
- Large and widening financing gaps
- The crisis puts into question Africa’s growth model
- The role of the AfDB and other MDGs

Context and overall assessment

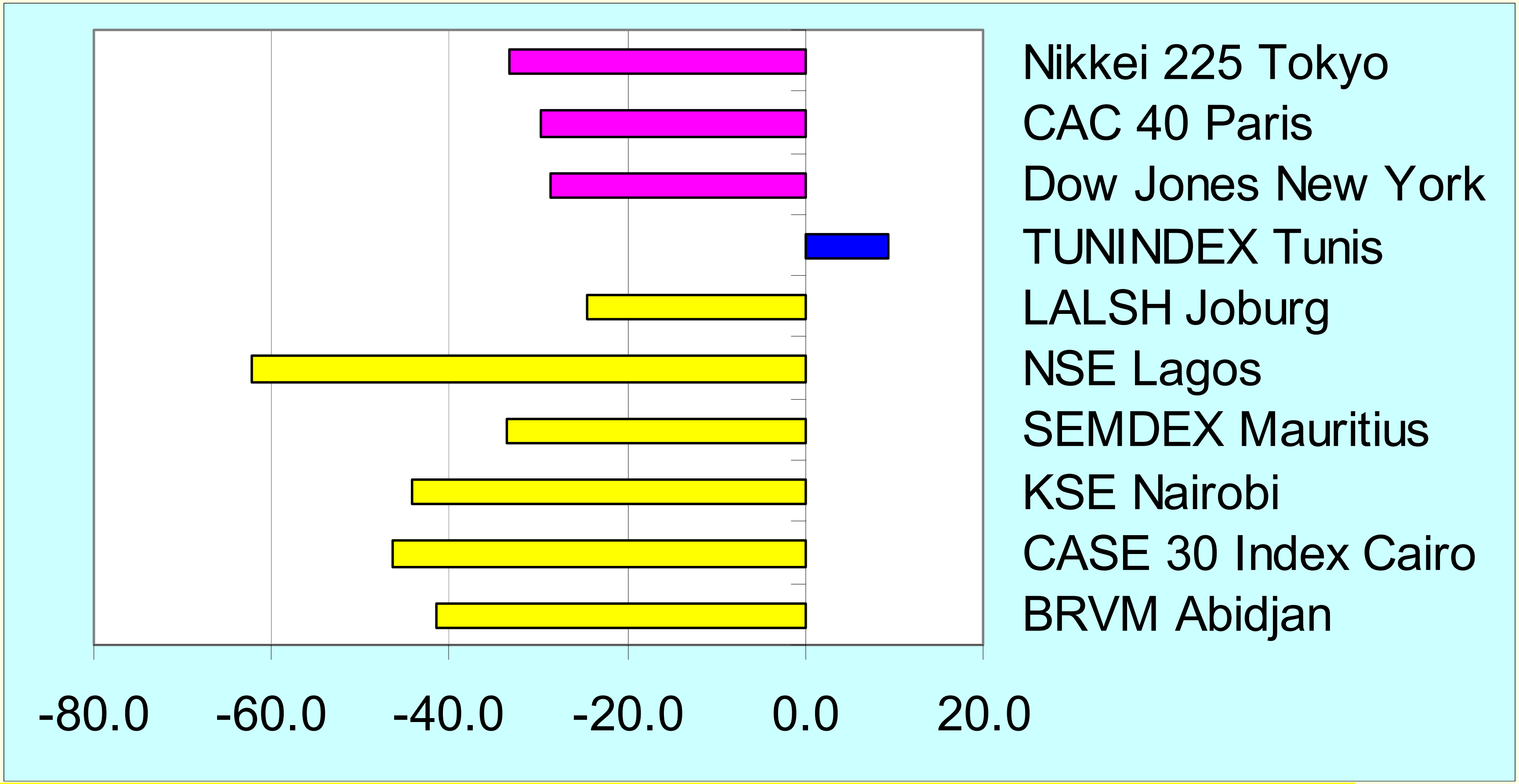
- The crisis has come at a time when Africa was turning the corner, steadily building the foundations for higher growth and poverty reduction.

- Africa has been hit severely by the crisis, with its growth rate forecasted to dip below 3 percent in 2009 (January projections = 2.8%) for the first time since 2002.

- The slowdown in growth is primarily due to decline in trade flows, decline in capital inflows, drying up of liquidity/credit, decline in mining and oil sector production.

- The worst may be yet to come…

Africa not decoupled: stock market losses larger than in developed countries (31/7/08 – 17/4/09, %)



The more open markets were the first to be hit (Johannesburg, Lagos, Cairo); less open markets are less affected (Tunis)

Behind stock market index losses are large losses in asset value

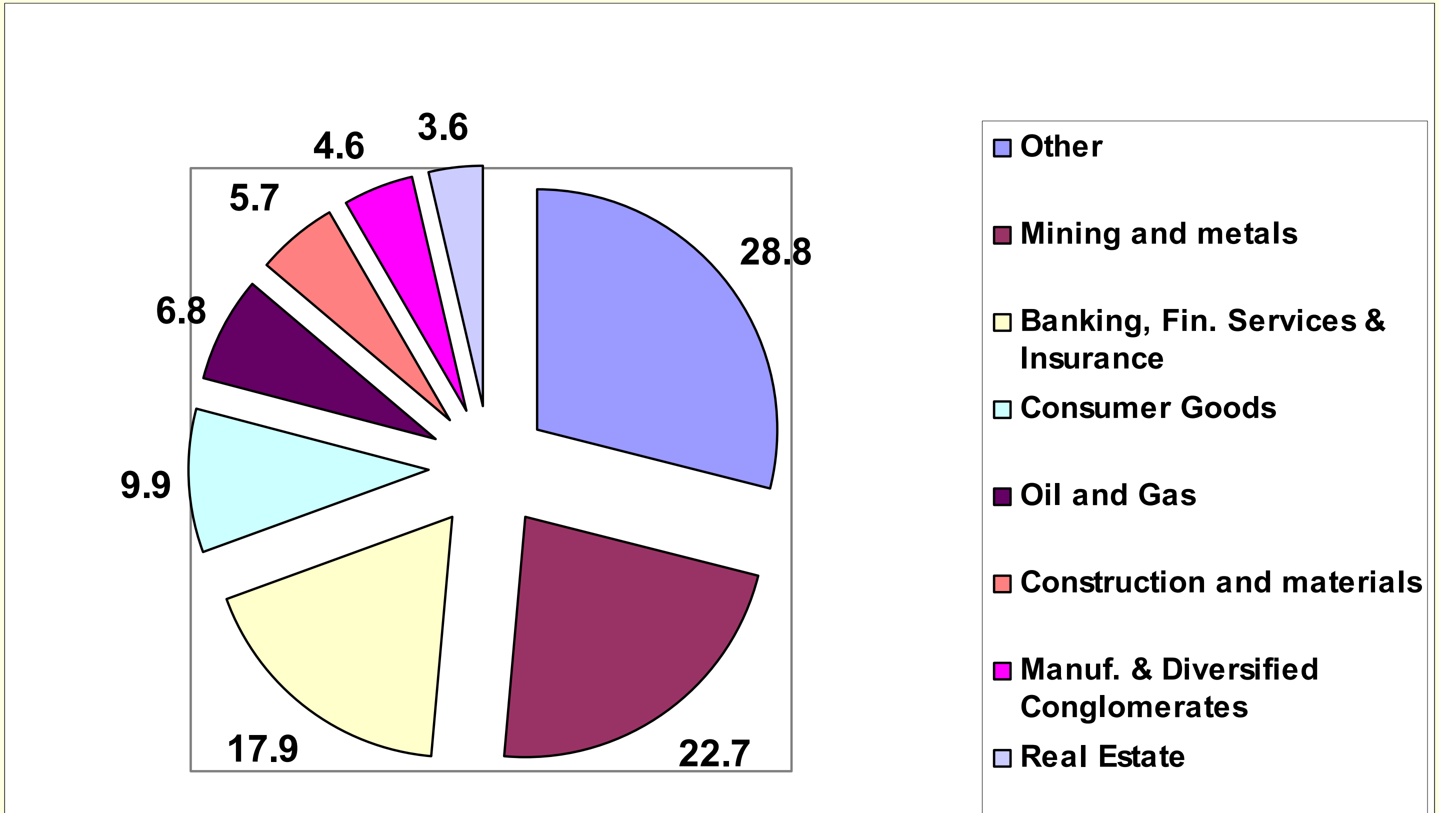
Company market value, 2008-2009

	2008	**2009**
Market value of top African company	$72bn (Anglo American, SA)	$23.4bn (Anglo American, SA)
Market value of 200th African company	$670m	$300m (Heliopolis Housing, EGY)
First Bank of Nigeria (market value)	$7.4bn	$2.4bn
Large market value losses imply large losses in household savings (including retirement savings). For banks, these losses also imply shrinking capacity to lend, partly explaining the decline in credit supply.		

Source: IDS In Focus Policy Briefing, Issue 07, March 2009.

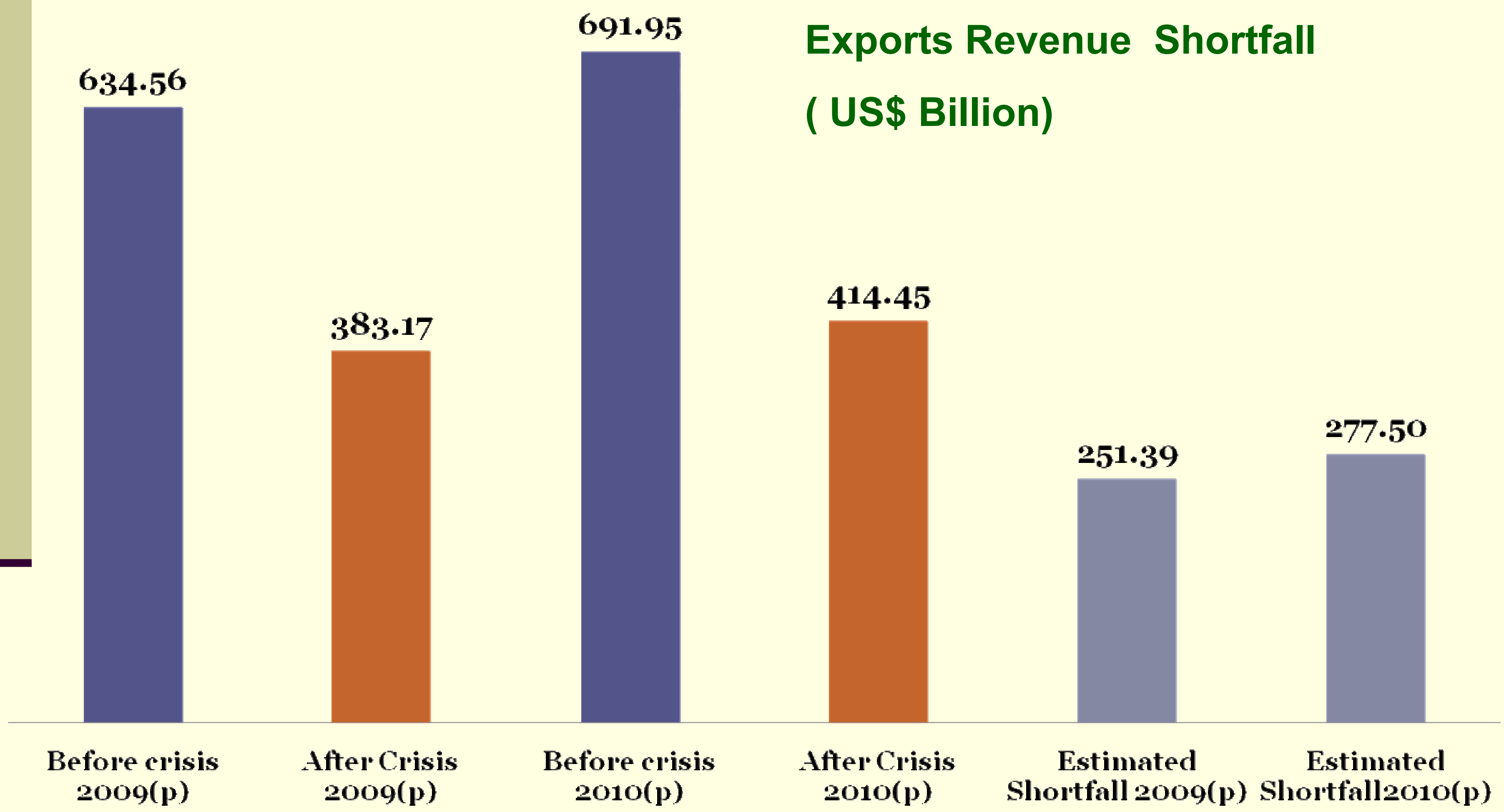
Large asset losses partly due to high concentration of private business in sectors most exposed to the crisis

Share of market values of largest 100 African companies (% of subtotal)



Source: African Business, No. 352, April 2009

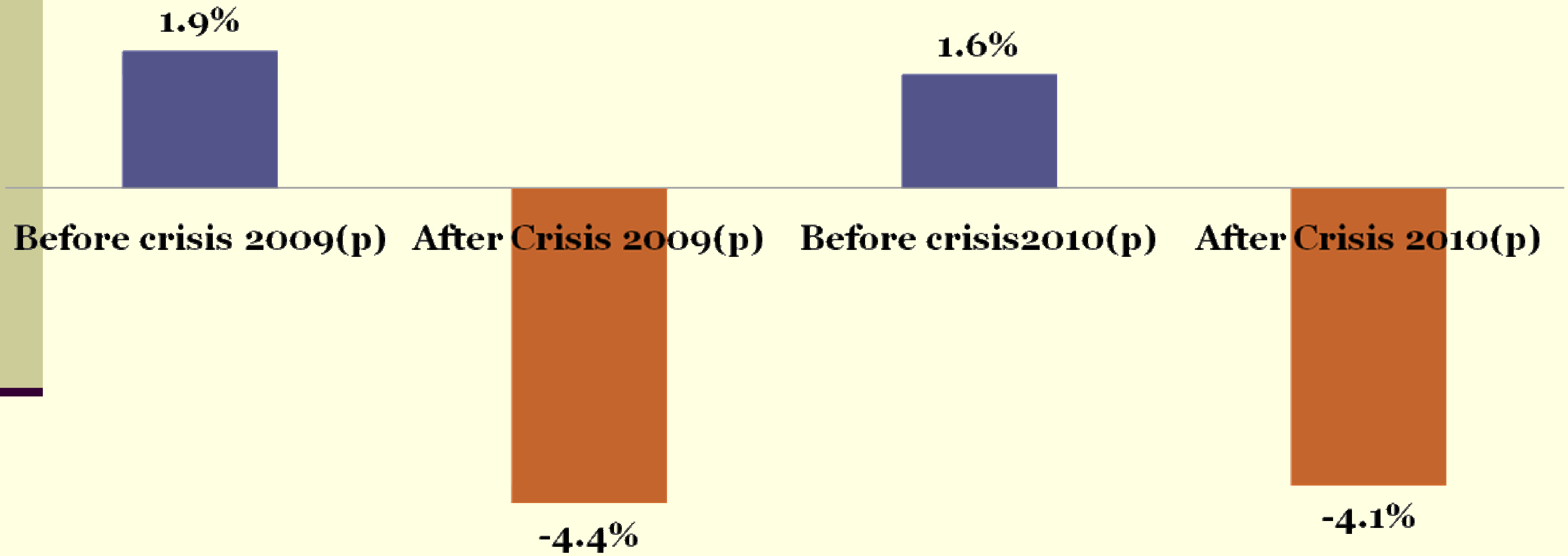
The crisis severely affects trade flows



Worsening macroeconomic balances

- From a comfortable overall current account surplus of 2.7 per cent of GDP for both 2008 and 2007, the continent will record an overall deficit of 4.3 per cent of GDP in 2009.
- The stocks of foreign exchange reserves are deteriorating.
- Government revenues are declining.
- Overall budget balances will worsen for the continent, going from a global budgetary surplus of 2.8 per cent of GDP in 2008 to a deficit of 5.4 percent of GDP in 2009.

Current Account Balance (as% of GDP) : before and after the Crisis



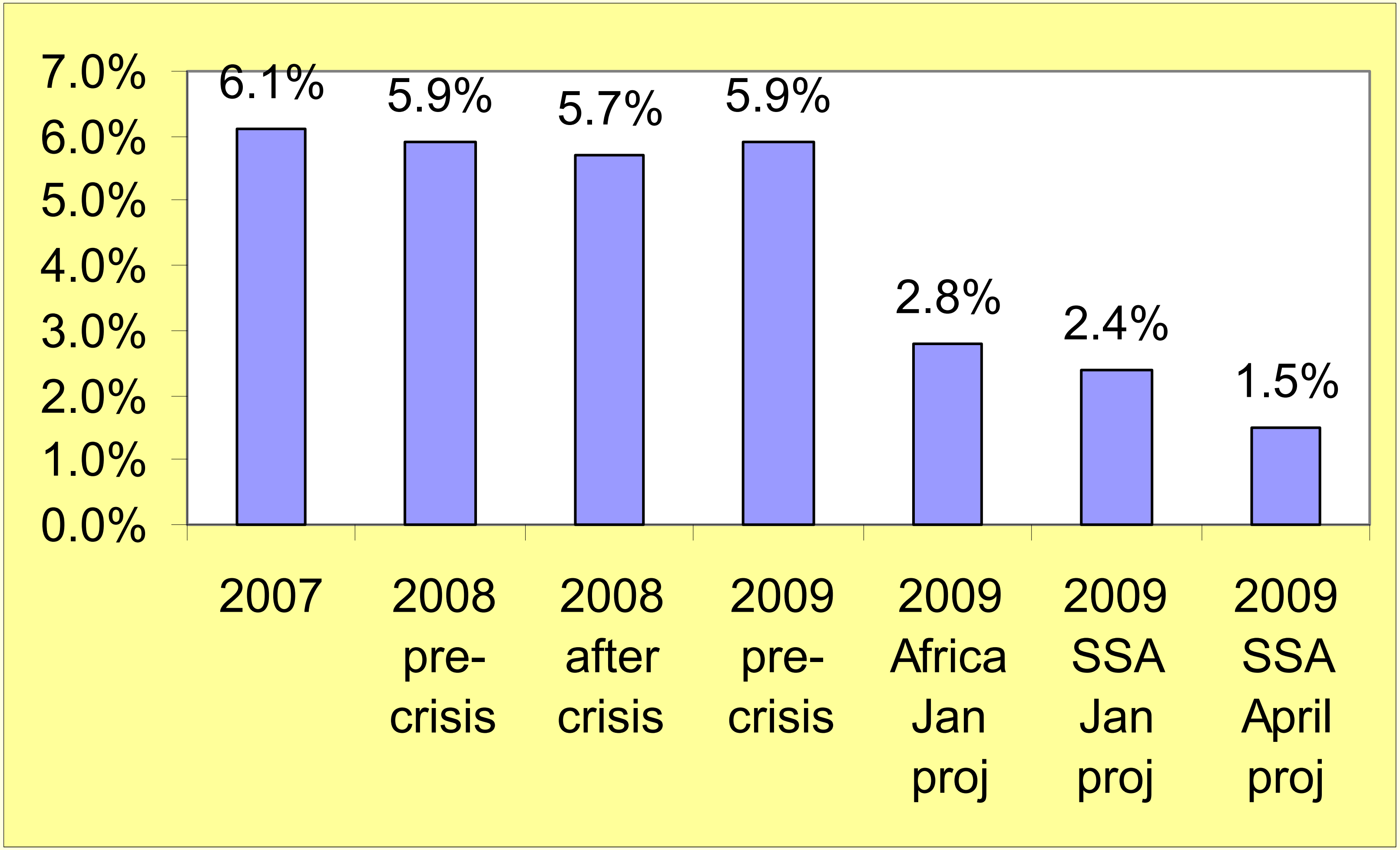
Impact on the Private Sector

- **The Bank sector:**
  - Drying up of liquidity
  - Rising cost of funds and widening margins/ Risk premia
  - Difficulty in securing lines of credit

- **The Manufacturing Sector:**
  - The crisis has worsened the constraints to industrialization; inadequate infrastructure; high investment risk; low productivity and competitiveness; difficult access to global markets (protectionism not withstanding)

- **The mining sector:**
  - Slowdown in production and exploration
  - Reduced private investment: foreign firms closing…

Growth prospects have deteriorated



Real GDP Growth (%): before and after the Crisis

Impact on poverty: The worst yet to come

- Growth deceleration has a larger (negative) impact on poverty than growth acceleration
- The poor have not recovered from earlier crises (food and oil)
- Channels:
  - Decline in labor demand
  - Increase in the prices of basic commodities
  - Decline in public spending, including social transfers
  - Human capital impact: health, nutrition, schooling(higher drop outs, lower enrollments)

The plight of the poor: unable to afford basic commodities

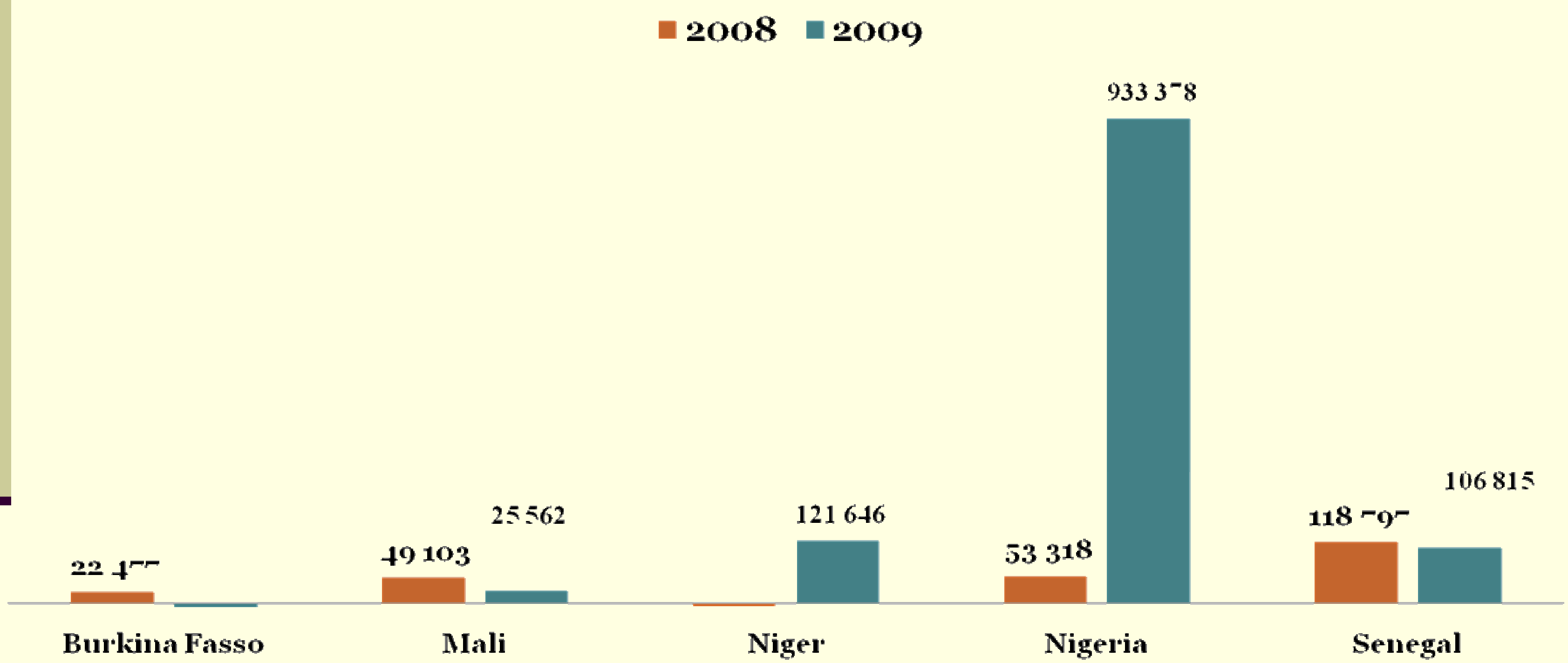
Prices of basic commodities in Malindi, Kenya, 2007-2009

Item	Price 2007	2008	2009
Maize flour (2kg)	50	75	140
Water (20L)	1	1.5	2
Parafin (250ml)	20	25	35
Beans (250g)	10	15	30

Note: USD1 = 80 Ksh (March 4, 2009)

Impact on poverty will be large

Number of people falling below the poverty line due to growth deceleration



Source: AfDB/ECON calculations

Africa is trying, but the scope to do more is very limited

- **Fiscal stimulus packages**. *(Example: In Senegal the government lowered budgetary expenditure by 4 percent of GDP and priority expenditure by 0.6% of the GDP. Similar actions were taken in Cape Verde, Sudan and Uganda.)*
- **Targeted assistance to sectors**. *(Example: In Nigeria, the Government injected N70 billion into the severely weakened textile industry.)*
- **Banking regulation and capital account controls**. *(Example: In Tanzania, profit repatriation has been regulated to minimize contagion, as bank subsidiaries cannot automatically transfer funds to compensate for losses in parent banks.)*

Africa is trying, but …

- Expansionary monetary policy. *(Example: the Egyptian Central Bank has cut its benchmark interest rate for the first time since April 2006.)*

- Bond financing of public expenditure. *(Example: The Kenyan government issued an infrastructure bond that amounted to 18.5 billion shilling (USD 232.6 million) with 12-year maturity in February 2009.)*

Africa is facing large and growing financing gapS

- The shortages of financing severely undermine the continent's ability to achieve the MDGs.

- Although African countries were growing faster before the crisis, the growth rates were still not sufficient to achieve the MDGs.

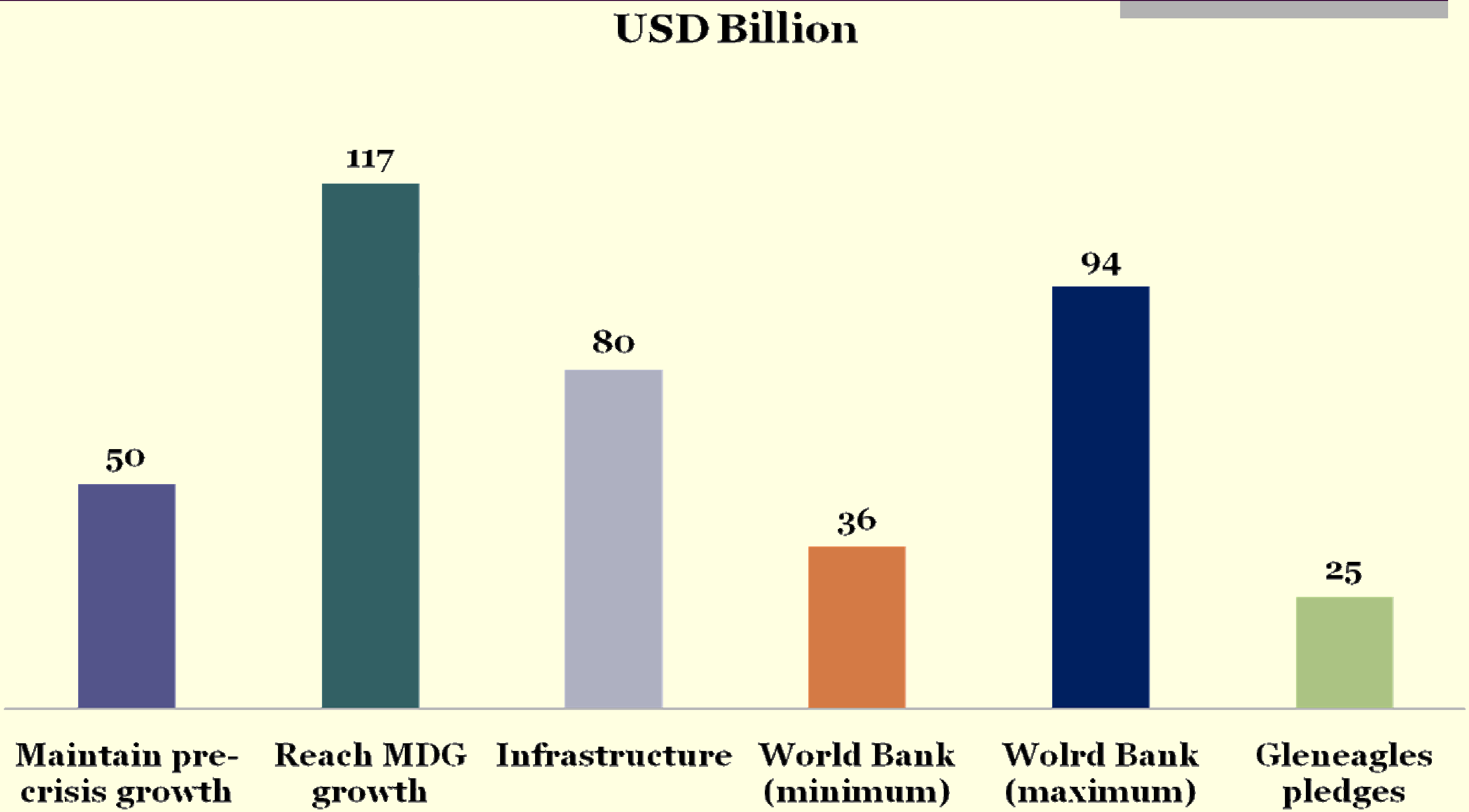
- However, at the moment, even preserving the pre-crisis growth rates seems untenable for many countries due to shortage of financing.

Africa is facing large and growing financing gaps

- **Financing gaps:**
  - *Saving-Investment gap of USD 50 billion to maintain pre-crisis growth rates,*
  - *Saving-Investment gap of USD117 billion to achieve the growth rate of 7 % necessary to achieve the MDGs,*
  - *USD 80-90 billion per year for the next 10 years for Africa's infrastructure (Africa Infrastructure Country Diagnostic study)*

- The 2005 Gleneagles Summit committed to raising aid to Africa by USD25 billion per year until 2010; so far delivery lags behind targets
- The April 2009 G20 Summit promised more resources; the challenge is speedy and flexible delivery; avoid new debt build up

Financing Gaps vs. Aid Pledges for Africa



The crisis puts into question Africa's growth model

	Advanced economies	Africa
Pre-crisis drivers of growth	- Credit >> consumption >> growth - Deregulation (e.g., repeal of 1993 Glass Steagall Act in Nov 99)	•**Commodity exports** •**Other:** improved macroeconomic environment, governance, capital flows.
Crisis	Collapse of lending >> collapse of consumption - **Threat of deflation**	- Collapse of exports - Currency depreciation -Twin deficits -**Threat of stagflation** -**Threat of debt build-up**
Focus of response	- Restore liquidity - Fiscal stimulus - **Protectionism**	- Limited fiscal Space -Risk of policy reversal -Short-run responses vs. long-run strategies

Growth models in question

- Advanced economies:
  - Regulation (emphasized by Europe) vs. fiscal stimulus (emphasized by the US): there is no dichotomy; the key is to strike a healthy balance between markets and the state.

- Africa:
  - Trade-led growth paradigm
    - Africa consuming what it does not produce, and producing what it does not consume (not consuming what it produces)
    - Diversification and economic resilience: beyond **quantity of trade**; focus on **quality of trade**
  - Openness/globalization: "missing the boat" (whose boat?)
    - Need to set a clear national development strategy
    - Need to manage integration into the global economy
    - Need to harness unexploited domestic potential (e.g., savings)
    - Fostering regional integration

Role of the AfDB and other MDBs

- Setting up instruments to fulfill their core mandate, provide **counter-cyclical** assistance and support crisis management:

➢ *Strengthening MDB's **counter-cyclical capacities***
➢ *Creating new instruments*
➢ *Efficiency and innovation in assisting poor countries*
➢ *Supporting the private sector*

- New resources to finance new instruments **while preserving MDB's capital adequacy**

➢ *Assessing MDB's capital adequacy, given their structural and prudential constraints*

The Role of AfDB

- In response to the crisis, the Bank has proposed several initiatives to provide funding to regional member states, notably:

- The ***Emergency Liquidity Facility*** (ELF). The USD 1.5 billion ELF will provide financial support to AfDB eligible countries and non-sovereign operations in RMCs that are suffering from lack of liquidity due to the global financial crisis.

- The ***Trade Financing Facility*** (TFF) . The USD 1 billion TFI will allow African commercial banks and DFIs to use AfDB resources to support trade finance operations.

- The ***Accelerated Resource Transfer to ADF Countries***. The Accelerated Resource Transfer to ADF Countries will support the Bank's low-income concessional borrowers through an accelerated use of currently available concessional resources.

- ***Enhanced Advisory and Advocacy role***: Knowledge generation; African voice; convening capacity (e.g. Committee of Ten) ; Monitory and Policy advice.

What more can the Bank do

- **Need :**
  - More resources
  - More flexibility
- **Support to regional initiatives**:
  - Trade integration: regional infrastructure
  - Financial integration: support to regional equity markets
  - Aid for Trade Initiative
- **Financial regulation and financial development**:
  - National level:
    - ✓ Capacity support in bank corporate and governance reforms; payments systems.
    - ✓ Development of domestic bond markets.
  - Regional level:
    - ✓ Assistance to and collaboration with Sub-regional development banks

What more can the Bank do?

- **Improving targeting of interventions in relation to country specificity and Bank's comparative advantages**:
  - Incorporating ***vulnerability*** in resource allocation processes
  - Better ***diagnostics*** of binding growth constraints
  - Scale up resources for the ***fragile State*** Facility

- **Domestic resource mobilization:**
  - Support to reform on the ***revenue and expenditure*** side
  - ***Bond market*** development (national and regional)

Thank you

L.NDIKUMANA@AFDB.ORG;

WWW.AFDB.ORG