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Impact of the Global Financial and Economic Crisis on Africa



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AFRICAN DEVELOPMENT BANK GROUP

***Impact of the Global Financial
and Economic Crisis on Africa***

Working Paper No. 96

March 2009

**ECON
OFFICE OF THE CHIEF ECONOMIST**

Kasekende Louis, Ndikumana Léonce, Rajhi Taoufik*

EXECUTIVE SUMMARY

The current financial and economic crisis has affected the drivers of Africa's recent growth performance. Demand for and prices of African commodities are falling, capital flows are declining, and promised increased aid has not materialized. China's growth has slowed. The only good news is the easing of inflationary pressures. In Asia and Latin-America, growth forecasts have already been drastically revised downwards. Although the immediate impact of the crisis were contained, the medium-term effects are likely to be greater.

Africa's low level of financial integration meant that African economies were relatively isolated from the direct impact of the financial crisis. Thus, Africa found itself shielded from the impact of the 2007 sub-prime and the summer 2008 banking crises, thereby avoiding the negative effects of a financial crisis that affected the very foundations of international financial markets.

African financial systems are dominated by the banking sector, and financial markets are still underdeveloped and even non-existent in many countries. Foreign

borrowing by banks is regulated in the context of exchange control and banks face little risk associated with off-balance sheet operations. This largely explains the limited impact on the banking sector in Africa.

Most African financial markets were affected by contagion effects, resulting in large losses in value and capital outflows. For Africa's relatively liquid financial markets (e.g. Egypt and Nigeria) the contagious effect were amplified by pre-crisis stock over-valuation and limited diversification of stocks.

The financial crisis amplified the increase in the margin applied to loans in the international financial markets, especially for emerging and African countries. From October 2008, sovereign debt spreads have increased. For that similar reason, several African countries (Tunisia, Kenya, Uganda and Tanzania) decided to postpone resorting to international financial markets to mobilize the resources necessary for financing their growth, turning instead to local markets.

With the deepening crisis in developed countries and in China, the downward trend of primary commodity prices has

increased and threatens to undermine the gains recorded in recent years. This decrease will have several consequences including declining reserves, non-profitability of some oil fields and mineral deposits, reduction in government funding capacity and cancellation or postponement of a number of investments in extractive industries that are highly dependent on foreign direct investment.

Africa will not be spared from the pessimistic world trade outlook for 2009. This outlook is reflecting the bad growth outlook of industrialized and emerging countries, resulting in weak global demand. Export growth rate is expected to drop by 7% and import growth rate will decline by 4.7%, resulting in a deterioration of commercial balance.

In the short run, the financial and economic crisis is expected to have an important negative impact on Foreign Direct Investment (FDI), contributing to a continuing fall in FDI in 2009.

Preliminary estimates of private flows to Africa are relatively better than for other regions for several reasons. Among these are Africa's low share of total capital flows, the limited number of countries leveraging funds on international markets and the limited correlation between African and industrialized countries' finan-

cial markets. However, no bonds issue in foreign currency has been registered in 2008 for African countries. This situation raises concern in particular as several countries rely on foreign private capital to cover their current account deficits.

Recent data on migrant remittances show signs of stagnation or slight decline worldwide. However, in the absence of data, it is too early to draw a definitive conclusion for Africa

Overall, Africa will move from a budgetary surplus accounting for 2.3% of GDP in 2008 to a budgetary deficit of 5.5% in 2009. Oil exporters will register a deficit of 7.7% of GDP 2008, down from a surplus of more than 5% in 2008. The deficit will deepen for oil importers as well (from -1.6% to -2.8%).

From an overall current account surplus position of 3.5% of GDP in 2008, the continent will face a deficit of 3.8% of GDP in 2009. The large surplus of 9.8% of GDP for the group of oil exporters will turn into a deficit of 4% of GDP. This is a direct result of the expected decline in oil revenue.

For the continent as a whole, inflation was higher in 2008 (10.9%) than in 2007 (7.4%). The 10.4% inflation was 3 percentage points above projections made prior

to the financial crisis. In contrast, lower inflation is expected in 2009 (8.7%). However, falling oil prices notwithstanding, inflationary pressures will persist in several countries, mainly due to the high cost of foodstuff and supply bottlenecks.

Africa is expected to grow at a low rate of 2.9% in 2009, down from 5.75 in 2008 and 6 % in 2007. Preliminary projections show expected a loss of 4.2% of growth rate for oil-exporters in 2009 and 1.2% decline in growth for oil-importing coun-

tries. For the first time since the 2000s, oil-importing countries will register higher growth rates (3.4%) than oil-exporting countries (2.4%).

The sectors most affected by the crisis will be mining, tourism, textile, and manufacturing. Enterprise failures, cancellations and postponements of projects are becoming widespread in African countries. Substantial job losses are registered, with negative effects on household's standards of living.

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TABLE OF CONTENTS

1. INTRODUCTION	1
2. Impact on the banking system	1
3. The Impacts of the financial crisis on markets	4
3.1 The collapse of financial markets	5
3.2 The rise of sovereign debt spreads	5
3.3 Volatility of exchange markets	5
3.4 The fall of commodities prices	7
4. The long and medium term transmission channels	10
4.1 Trade flows	10
4.2 Capital flows	10
5. The economic outlook after the financial crisis	12
5.1 The fall in reserves and government budget	12
5.2 Inflation	13
5.3 Growth Prospects	14
5.4 Sectoral impact	14
6. CONCLUSION	16

1. INTRODUCTION

Prior to July 2008 and despite the sub-prime crisis, Africa recorded excellent economic growth. The drivers of strong economic growth included macroeconomic reforms, a world economic situation that was characterized by high demand for commodities, rising capital inflows and China's strong growth. Analysts were optimistic about the capacity of the continent and the world economy to generate the necessary resources for development and poverty reduction.

Despite early signs of a pending downturn since 2007, few could have anticipated a crisis of the magnitude observed since the second half of 2008. Today, the world economy is officially in stagnation, industrialized countries are in recession and Africa faces serious uncertainties over its growth and development prospects. The current financial and economic crisis has affected Africa's growth drivers. Demand for and prices of commodities are falling, capital inflows are declining and promises of increased aid have not materialized yet. China's growth has slowed. The only good news is the easing in inflationary pressures. Although the immediate impact of the crisis were contained, the medium-term effects are likely to be greater.

This paper presents a preliminary assessment of the impact of the financial crisis on African economies thus far. The paper first explains the impact on the banking sector and why Africa has not been directly affected

by the banking crisis (Section 2). It goes on to discuss the direct impact of the crisis on financial markets, foreign exchange markets and commodity markets (Section 3). Section 4 shows that the negative effects will mainly be felt through trade and capital flows, including foreign direct investment and migrant remittances. Section 5 discusses the prospects for public finance, inflation and growth. A sectoral analysis is also carried out, highlighting the impact on tourism and mining. Section 6 concludes by a discussion on some policies that could mitigate the impact of the crisis.

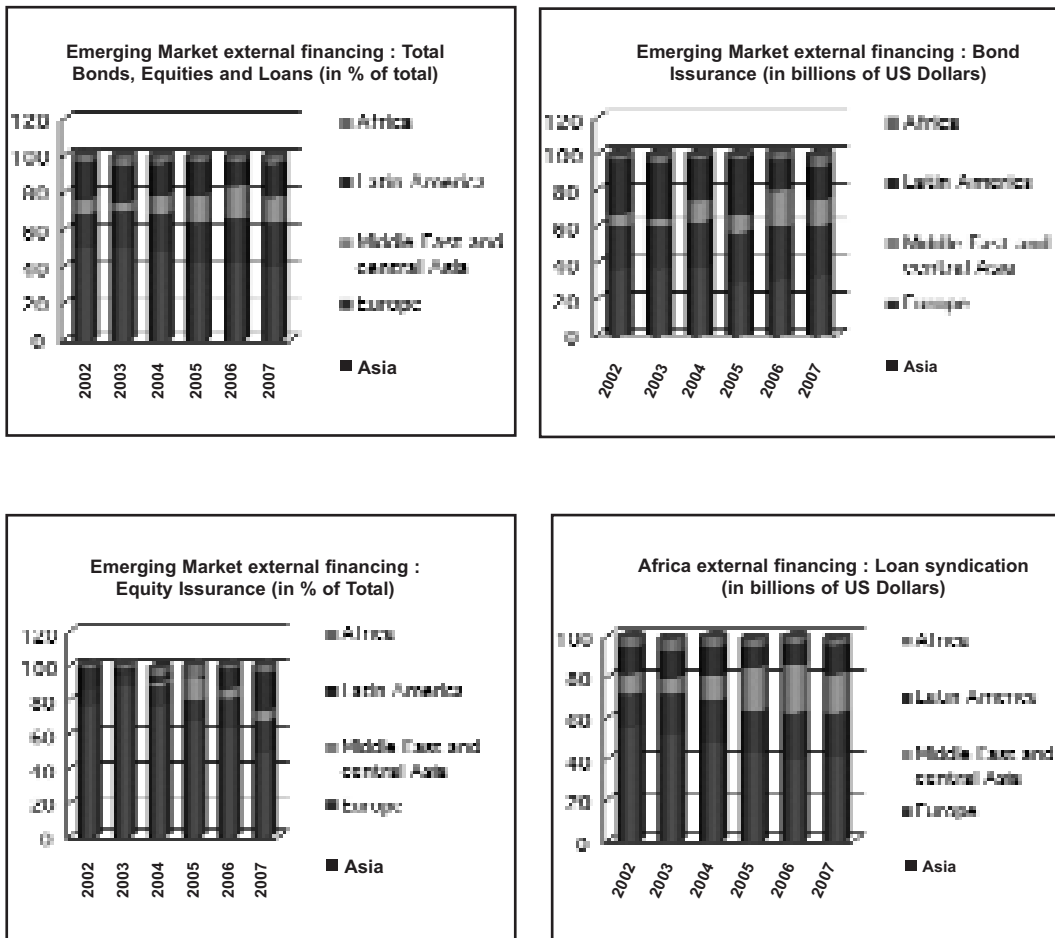
2. Impact on the banking system

Africa's low level of financial integration meant that African economies were relatively isolated from the direct impact of the financial crisis. Thus, Africa found itself shielded from the impact of the 2007 sub-prime and the summer 2008 banking crises, thereby avoiding the effects of a financial crisis that affected the very foundations of international financial markets. Compared to emerging countries, Africa's external financing (bond issue, stocks and private borrowing) is low, representing only 4% in 2007 of overall issue for emerging economies. In 2007, bond issues stood at only USD 6 billion, compared to USD 33 billion for Asia and USD 19 billion for Latin America. Furthermore, in terms of access to private resources, Africa received only USD 3 billion in 2007, compared to USD 42 billion for Asia.

Africa's stock market capitalization is still very low, representing only 2.09% of world capitalization. Furthermore, African banking assets represent only 0.87% of global banking assets, compared to 58.15% for the

15 countries of the Euro zone and 15.09% for the United States. Africa's financial globalization ratio is comparable to Latin America's, at 181.3% and 176.4%, respectively, far behind that of Asia at 369.8%

Figure 1 : Financial Globalization Indicators



Source: IMF, Global Financial Stability Report, October 2008

The low financial integration indicators partly explain why Africa escaped both the sub-prime and banking crises. No African country announced a bank rescue plan at the scale observed in many developed countries. Few banks and investment firms in Africa have held derivatives backed by sub-prime mortgages (or “toxic assets”). No difficulties have been reported on African sovereign wealth funds and the eventual impact on their returns. Generally, African banks have not engaged in complex derivative products and are not heavily dependent on external financing.

The contagion effects may be amplified by foreign bank presence, which is high in some countries. The share of foreign bank assets reaches 100% in some countries such as Mozambique,

Swaziland and Madagascar. The headquarters of these foreign banks are located mainly in France, Portugal and the United Kingdom, where banking institutions suffered tremendous losses in stock capitalization and profit during the financial crisis.

The financial meltdown suffered by the parent banks following market capitalization losses was not passed down to their African subsidiaries. In fact, some subsidiaries of foreign banks saw a considerable increase in their market capitalization. For example, Swaziland Nedbank, Bank of Africa Benin and Standard Bank of Ghana saw their market capitalization increase between July 2007 and January 2009. Therefore, the contagion effect of financial meltdown is weak compared to the effect on parent banks.

Table 1: Share of Banking assets held by foreign banks (%)

Countries	Share of Banking assets held by foreign banks (%)	Largest Foreign Banks	Home country
Angola	53	Banco BPI	Portugal
Botswana	77	Barclays Bank	UK
Mozambique	100	Banco Commercial Portugues	Portugal
Swaziland	100	Standard Bank	SA
Uganda	80	NetBank	SA
Zambia	77	Standard Bank	SA
Ghana	65	Barclays Bank	UK
Cote d'Ivoire	66	Standard Chartered Bank	UK
Madagascar	100	Standard Chartered Bank	UK
Cameroun	63	Barclays Bank	UK
		Société Générale	France
		Calyon	France
		Bank of Africa	Benin
		BFBP	France

Source: *Global Development Finance*, World Bank 2008 and JPMorgan

African financial systems are dominated by the banking sector, and the role played by financial markets is weak, or in some cases non-existent. Borrowing from foreign banks is regulated in the context of exchange control regulations. Off-balance sheet exposure is not widespread in Africa, which is in contrast to industrialized countries that have complex financial securitization instruments such as the ones that triggered the sub-prime crisis.

The accumulation of reserves following the commodities boom has supported the expansion of sovereign wealth funds in Nigeria and Botswana and the creation of new ones in Libya, Algeria, Sao-Tome and Principe and Sudan. While these funds represent only 2% of the sovereign funds' global assets, the accumulated volume amounted to more than USD 124 billion, before the 2008 financial crisis.

Table 2 : Sovereign wealth funds by country (billions of US dollars) mid-2008

Country	Nonpension	% Africa
Libya	50	40 %
Algeria	47	38 %
Nigeria	17	14 %
Botswana	7	6 %
Gabon	0.40	
Sudan	0.10	
São Tomé and Principe	0.02	
Africa	124.42	100 %
World	2975.00	
<i>Africa, % of World</i>	4.1	

Source: *Sovereign Wealth Fund Institute*, 2008
 FN: — not applicable

The sterilization of such reserves and their conversion into foreign assets helped countries avoid strong exchange rate appreciation. So far, there is little information on the negative effect of the financial crisis on African sovereign wealth funds. Nevertheless, sovereign funds profitability is expected to drop, in line with other financial wealth instruments on the global market. It is certain that the fall in oil prices will contribute to a dramatic reduc-

tion in the investment capacity and the size of such funds.

3. Impact of the financial crisis on markets

There are three distinguishable immediate effects of the crisis, namely the contagion effects on financial markets, foreign exchange markets and commodity markets. These are discussed in the following sections.

3.1 Effects on financial markets

Although African banking systems were not directly exposed to the sub-prime crisis, there were strong indications of increased asset price and risk premium volatility on African financial markets as early as the summer of 2008. The contagion and inter-dependence significantly affected the region's financial markets. For some African markets (e.g. Egypt and Nigeria), the impact was much higher than for markets in developed countries (Table 1).

Africa's relatively liquid financial markets not only suffered from the contagious effect but also faced amplification thereof, possibly attributable to the over-valuation of stocks and the outflow of portfolio investments. African investors, in general, and Egyptian and Nigerian investors in particular, recorded within six months an average loss of more than half the wealth invested at the end of July 2008. This is higher than the losses recorded on American, French and Japanese markets.

3.2 The rise of sovereign debt spreads

The costs of external debt for emerging countries on international financial markets started to increase in July 2007. The spreads remained moderate until the beginning of the financial crisis. Tunisia felt the brunt of the crisis in its attempt to issue bonds on the international financial markets in July and August 2007. The first attempt to raise funds on the Japanese

financial market was hampered by restrictive financial requirements. Indeed, faced with debt spreads estimated at between 45 and 50 basis points, Tunisia had to increase its offer by 25 basis points to attract entice investors.

The financial crisis amplified the increase in the margin applied to loans in the international financial markets, especially for emerging and African countries. From October 2008, sovereign debt spreads rose by an average of 250 basis points for emerging countries. The spread of the JPMorgan emerging countries equity index reached its highest level since 2002, increasing by 800 basis points in October 2008. Spreads increased by 100 basis points for Egypt and rapidly increased to above 200 basis points for Tunisia during the toughest periods of bank failures in the United States. The increase in the risk premium forced Kenya, Uganda and Tanzania to postpone tapping of international financial markets to mobilize long-term resources, turning instead to local markets.

3.3 Volatility of foreign exchange markets

In most countries, the impact of the financial crisis manifested itself through currency fluctuations, especially against the US dollar or the Euro. The depreciation of some currencies is attributable to the impact of the financial crisis on commodity prices and the decline in foreign exchange reserves. Thus, the 65.8% drop in copper prices, from the highest recor-

ded price of July 2008 at USD 8985/metric ton to USD 2 902/metric ton at end

December 2008, led to a considerable fall in Zambia' foreign reserves.

Table 3: African exchange rates against the US dollar

Region/Country	Currency name	Benchmark 07/31/2008	Value at end of Week (13/02/2009)	Rate of depreciation
Algeria	<i>Algerian Dinar</i>	63.0	73.7	-14.5
Angola	<i>New Kwanza</i>	75.2	75.2	0.0
Benin	<i>CFA Franc</i>	429.2	520.1	-17.5
Botswana	<i>Pula</i>	6.5	8.1	-19.8
Burundi	<i>Burundi Franc</i>	1,191.5	1,233.5	-3.4
Cape Verde	<i>Escudo</i>	71.8	87.1	-17.6
Comoros	<i>Comoros Franc</i>	316.9	381.9	-17.0
Congo. Dem. Rep. of	<i>Congolese Franc</i>	437.0	712.8	-38.7
Djibouti	<i>Djibouti Franc</i>	178.7	179.6	-0.5
Egypt	<i>Egyptian Pound</i>	5.4	5.6	-4.3
Ethiopia	<i>Birr</i>	10.0	11.2	-10.8
Gambia, The	<i>Gambian Dalasi</i>	21.5	26.6	-19.3
Ghana	<i>New Cedi</i>	1.2	1.4	-15.1
Guinea	<i>Guinea Franc</i>	4,653.6	4,868.6	-4.4
Kenya	<i>Kenyan Shilling</i>	68.7	83.0	-17.2
Lesotho	<i>Loti</i>	7.5	10.1	-25.6
Liberia	<i>Liberian Dollar</i>	64.0	65.0	-1.5
Libya	<i>Libyan Dinar</i>	1.2	1.3	-8.5
Madagascar	<i>Ariary</i>	1,612.9	2,018.9	-20.1
Malawi	<i>Kwacha</i>	144.0	143.8	0.2
Mauritania	<i>Ouguiya</i>	234.5	263.5	-11.0
Mauritius	<i>Mauritius Rupee</i>	27.6	34.2	-19.3
Morocco	<i>Dirham</i>	7.4	8.6	-14.5
Mozambique	<i>New Metical</i>	24.1	25.6	-5.9
Namibia	<i>Namibian Dollar</i>	7.6	10.2	-25.6
Nigeria	<i>Naira</i>	118.9	149.1	-20.3
Rwanda	<i>Rwandan Franc</i>	556.5	578.4	-3.8
São Tomé & Príncipe	<i>Dobra</i>	14,773.4	14,661.9	0.8
Seychelles	<i>Seychelles Rupee</i>	8.0	16.9	-52.4
Sierra Leone	<i>Leone</i>	2,997.7	3,093.9	-3.1
Somalia	<i>Somali Shilling</i>	1,450.9	1,448.5	0.2
South Africa	<i>Rand</i>	7.4	10.0	-26.1
Sudan	<i>Sudanese Pound</i>	2.1	2.3	-6.8
Swaziland	<i>Lilangeni</i>	7.4	9.9	-25.1
Tanzania	<i>Tanzanian Shilling</i>	1,187.6	1,341.6	-11.5
Tunisia	<i>Tunisian Dinar</i>	1.2	1.4	-16.3
Uganda	<i>Uganda Shilling</i>	1,671.0	1,978.5	-15.5
Zambia	<i>Zambian Kwacha</i>	3,588.9	5,398.6	-33.5
Zimbabwe	<i>Zimbabwe Dollar</i>	353,950.0	37,456,777.0	-99.1
OTHERS				
Europe	<i>Euro</i>	0.6	0.8	-17.5
Japan	<i>Yen</i>	108.1	90.2	19.7

*Benchmark as at 31/07/2008 except for Zimbabwe at 31/08/2008

Sources: AfDB Statistics Department and Oanda, Online Database January 2009

The Zambian Kwacha exchange rate to the US dollar depreciated sharply in 2008 by as much as 50%, although the exchange rate slightly improved at the end of the year.

3.4 The fall of commodity prices

Commodity exports have been one of the main drivers of growth in many African countries. Strong growth in industrialized and emerging countries such as India and

China has been an important factor of the increase in the prices and demand for commodities. Unfortunately, the financial crisis has had a negative impact on world growth prospects and seriously dampened expectations on commodity futures markets (Table 4), thus inducing falling prices and demand for most commodities. For instance, the price of crude oil dropped by 65 percent, from USD 125.73 per barrel at the start of the financial crisis to USD 43.48 in January 2009.

Table 4 : Forecast of commodity prices

% Change	2000-2005	2006	2007	2008	2009	2010
Energy	13.5	17.3	10.8	45.1	-25	0.9
Oil	13.6	20.4	10.6	42.3	-26.4	1.8
Natural Gaz	10.4	33.9	1	57.2	-10.8	-4.2
Coal	12.7	3.1	33.9	97.8	-23.1	-10
Non energy	8.3	29.1	17	22.4	-23.2	-4.3
Agriculture	6	12.7	20	28.4	-20.9	-1.3
Foods	6	10	25.6	35.2	-23.4	-0.3
Grains	4.8	18.4	26.1	50.9	-27.7	2.6
Raw materials	5	22.7	9	13	14.9	2.7
Metals and minerals	12.3	56.9	12	5	25.5	5.5
Cooper	15.2	82.7	5.9	0.6	-32.2	-4.2

Source: World Bank, *Global Economic Prospects 2009: Commodity markets*

The crisis has taken a heavy toll on countries that are highly dependent on natural resources, especially those relying on copper, oil, timber and diamonds. The fall in copper prices resulted in a significant drop of export receipts for Zambia and a considerable reduction in its foreign exchange reserves. Since the second half of 2008, the volume of reserves generated by the mining sector dropped by 30%,

from USD 649 million during the first half of 2008 to USD 454.5 million during the second semester of that year.

In Burkina Faso, export growth dropped from 6.9% in 2007 to 3.5% in 2008, following the fall in cotton production and the decline in lint cotton export. The balance of trade sharply deteriorated under the combined impact of falling agricultural production

and declining lint cotton export (from CFAF 160 million in 2007 to CFAF 12 million in 2008). The current account deficit is estimated at 12.9% of GDP in 2008, a 3.8 point decline compared to 2007.

The adverse impact of the crisis on export commodity prices and resource inflows threatens to reverse the gains from the recent economic performance of African economies. Key consequences include declining reserves, non-profitability of some oil fields that have high extraction costs, reduction in government funding capacity and cancellation or postponement

of a number of investments in extractive industries that are highly dependent on foreign direct investment.

The effects of the crisis will hit both oil exporters as well as producers of non-energy commodities, namely minerals and agricultural products (Table 5). Agricultural and food products are following a similar downward trend estimated at around 20%. The decline in food prices should mitigate the impact of the economic crisis on African countries, especially on the balance of payments and government budget.

Table 5: **Commodity prices**

Commodity	Unit	Benchmark 07/31/2008	Value at end of Week (13/02/2009)	% Change Index
Crude Oil (Brent)*	<i>US\$ per barrel</i>	125.73	44.09	-64.93
Gold	<i>US\$ per Troy Ounce</i>	918.00	935.50	1.91
Silver	<i>US\$ per Troy ounce</i>	17.48	13.37	-23.51
Platinum	<i>US\$ per Troy ounce</i>	1,758.00	1,055.00	-39.99
Cotton, N° 2 Future	<i>USd/lb.</i>	49.71	45.22	-9.03
Cocoa beans	<i>US\$ per tonne</i>	2,908.50	2,682.12	-7.78
Coffee, Arabica	<i>US cents per pound</i>	131.10	99.00	-24.49
Coffee, Robusta	<i>US cents per pound</i>	115.09	81.75	-28.97

Source: AfDB, February 2009

However, the decrease of primary commodity prices will have a positive impact on the external accounts of oil importing countries, in particular countries that have

sustained a large deficit on the trade account due to the large oil import bill. These include Burundi, Seychelles, Togo and Malawi.

Table 6: Countries vulnerable to commodities prices decrease

Countries dependent on non-oil primary commodities	Share of nonfuel primary commodities in exports (%)	Countries dependent on oil exports	Share of oil in exports (%)
Gambia	97	Libya	98.7
Uganda	91	Algeria	95.7
Ethiopia	84	Nigeria	95.6
Niger	83	Congo. Rep.	92.1
Malawi	82	Angola	92
Rwanda	80	Equatorial Guinea	83.8
Burundi	79	Sudan	74.5
		Gabon	71.1

Source: *World Economic Situation and Prospects*, United Nations, 2009

These countries have large current account deficits ranging between -37.6% for Burundi and -18.6% for Malawi (Table 7). The effect will depend on the combined impact of the decrease of energy prices and non-oil primary commodity prices. The deficit on the

current account will need to be financed by a surplus on the capital account, notably aid and private capital inflows. These countries would face significant difficulties if FDI and ODA were to decrease due to the effects of the global slowdown.

Table 7: African countries with large oil imbalances, 2007 (% of GDP)

Country	Current account	Oil Balance	Non-oil commodities balance	Commodities balance	FDI inflows	Net ODA disbursements
Burundi	-37.6	-11.6	0.4	-12.0	0.0	46.0
Seychelles	-32.7	-36.5	0.7	-35.8	18.8	1.8
Togo	-21.9	-8.5	4.6	-4.0	3.5	3.6
Malawi	-18.6	-4.3	11.6	7.3	-	21.3

Source: *World Economic Situation and Prospects*, United Nations, 2009

4. The long and medium term transmission channels

4.1 Trade flows

The global recession will adversely impact the flow of goods and services. World and African trade were part of the main drivers of growth between 2000 and 2007. However, signs of a slow-down have been registered since 2008 and will likely continue in 2009. The global economy has recorded a decrease in volume and value of tradable goods and services. Indeed, world trade in volume increased by 6.3% in 2007, by 4.4% in 2008, and by only 2.1% in 2009. Due to the economic downturn in the industrialized countries and lower primary commodity prices, global trade is expected to contract by 4.4% in value in 2009.

Africa will not be spared from the pessimistic world trade outlook for 2009. Exports and imports growth rates are forecast at 3.6% and 10.5% in 2009, respectively compared to 10.6% and 15.2% in 2008. As a result, the impact of the crisis on foreign exchange reserves is expected to be large. Having benefited from the recent primary commodity boom, Africa will experience a loss of

45.4% of its exports value in 2009. Losses in export growth rates are not compensated for by decreasing import growth rates in value terms, implying that the trade balance may deteriorate.

4.2 Capital flows

4.2.1 Impact on foreign direct investment

The latest global foreign direct investment estimates show a sharp decline of 21% in 2008 that is likely to worsen in 2009. Total foreign direct investment in 2008 is estimated at USD 1.4 trillion. FDI inflow to Africa are currently steady at a relatively low level at USD 61.9 billion (2008), an increase of 16.8% from 2007. However, there are large discrepancies across countries: whereas Egypt and Morocco respectively reported a decline of -5.6% and -7%, FDI in South Africa more than doubled in 2008 (Table 8).

In the short term, the financial and economic crisis is expected to cause FDI to fall further in 2009. Africa will not be spared, especially if commodity prices continue to fall. This will further increase Africa's financial marginalization and undermine growth in foreign capital dependent sectors such as natural resources.

Table 8: FDI inflows

	FDI inflows (billion of dollar)		
	2007	2008	Growth rate (%)
World	1833.3	1449.1	-21
Developed economies	1247.6	840.1	-32.7
Developing economies	499.7	517.7	3.6
Africa	53	61.9	16.8
Egypt	11.6	10.9	-5.6
Morocco	2.6	2.4	-7
South Africa	5.7	12	111.2
Latin America	126.3	142.3	12.7
Asia and Oceania	320.5	313.5	-2.2
South East Asia	247.8	256.1	3.3
South-East Europe and the CIS	85.9	91.3	6.2

Source: *World Economic Situation and Prospects*, United Nations, 2009

4.2.2 Short term private capital flows

According to last estimates, short term net private capital flows to emerging countries accounted for USD 253 billions in 2007 and declined to USD 141 billions in 2008. Net portfolio inflows to Africa have also deteriorated in 2008 relative to 2007. This decrease shows the scarcity of financial resources, a result of the deteriorating market conditions and the contraction of the economy in some emerging countries.

Preliminary estimates for capital inflows in Africa are not as bad as for other regions for a number of reasons. Among these are Africa's low share of total capital flows, the limited number of countries leveraging funds on international markets and the limited correlation between African and industrialized countries finan-

cial markets. However, no bonds issue in foreign currency has been registered in 2008 for African countries, whereas it had reached 6.5 billion dollars in 2007 compared to 1.5 billion dollars in 2005. This situation raises concerns, as many countries such as South Africa rely on inflows of private capital to cover their current account deficits.

4.2.3 Impact on remittances

Remittances, which have become a major source of external financing for African countries, have been adversely affected by the slowdown in developed countries. In some countries, remittances exceed official development aid as a source of external financing. The total volume of remittances to Africa stood at USD 38 bil-

lion in 2007. Remittances between African countries have fallen following job cuts and the decline of activity in the mining sector. The decline in the volume of remittances has a direct negative impact on the well-being of households since such transfers – unlike other types of transfers – are directly used to cover primary needs such as food, education and healthcare.

While updated data on emigrant transfers remain incomplete, they tend to show signs of a negative impact of the crisis. Monthly data for December 2008 and January 2009 indicate some stagnation or a slight decline worldwide. Surprisingly, remittances in some countries such as Kenya have increased. Nonetheless, in the absence of data, it is too early to draw a definitive conclusion on the impact of the crisis on remittances in Africa.

5. The economic outlook after the financial crisis

5.1 *The fall in reserves and government budget*

Rising commodity prices have enabled African countries to accumulate foreign exchange. Thus, Africa accumulated USD 369 billion in 2007, USD 110 billion by Algeria, compared to USD 79 billion by Libya and USD 51 billion by Nigeria. These receipts enabled oil-exporting

countries to acquire considerable fiscal space to undertake major public investment programs and repay foreign debt. Now, some countries that had prepared budgets based on prices averaging USD 70 will be forced to scale down their investment plans if the downward price pressures persist. Forecasts show a budget deficit of -7.7% of GDP for oil exporting countries in 2009 against a surplus of 5.1% of GDP in 2008 and 4% of GDP in 2007.

Overall, Africa will move from a global budget surplus accounting 2.3% of the GDP in 2008 to a deficit of 5.5% in 2009. The deficit will deepen for oil importers as well (from -1.6% to -2.8%).

Under the effect of the crisis, current account deficits have worsened since 2008 in twenty-six countries. From an overall current account surplus position of 3.5% of GDP in 2008, the continent will face deficit of -3.8% of GDP in 2009. The large surplus of 9.8% of GDP for the group of oil exporters will turn into a deficit of -3.9% of GDP. This is a direct result of the expected decline in oil revenue. North-Africa is the only region with a current account surplus of approximately 3% of GDP, led by Morocco (10.7%) and Algeria (5.6%).

In 2009, some countries will face a twin deficit (current account and budget defi-

cits). This is because exports will fall faster than imports (causing current account deficit) while governments try to keep up with expenditure levels in the context of declining revenue. Thus several countries face the threat of structural macroeconomic imbalances in the medium term if the crisis persists.

5.2 Inflation

The inflation estimate for 2008 (10.9%) is higher than the 2007 (7.4%), due particularly to the sharp increase in oil prices and food during the first half of 2008. The 10.4% inflation in 2008 is 3 percentage points above projections made prior to the financial crisis. However, falling commodity prices should exercise a downward

pressure on inflation, resulting in lower inflation in 2009.

The pattern expected in 2009 is almost reversed compared to the one observed in 2008 since some drivers of the rising prices became, during the second semester of 2008, drivers of declining inflation. As a consequence, the big losers in 2008 are likely to become the big winners in 2009. In any case, oil-importing countries inflation rate will register a 3.6% decrease, which would bring inflation back to its 2007 level. In oil-exporting countries, inflation rates will remain quite high due to inflation inertia. For these countries, the expected inflation rates for 2009 are similar to the rates observed in 2008.

Table 9 : **Rate of Inflation (% annual)**

	Rate of Inflation		
	2007(e)	2008(p)	2009(p)
Africa	7.4	10.9	8.7
North Africa (including Sudan)	7.0	8.6	7.7
Sub-Saharan Africa	7.7	12.5	9.4
By oil production			
Oil-exporting countries	7.2	10.0	9.1
Oil importing countries	7.7	11.8	8.2
By region			
Central Africa	2.9	8.8	7.2
Northern Africa	6.8	8.1	7.6
Southern Africa	9.3	12.4	9.7
Western Africa	5.4	10.6	8.6

Source : *African Economic Outlook 2009*, Preliminary results

5.3 Growth Prospects

Global growth prospects have been reviewed downwards for most regions. Slowing growth worldwide and in all industrialized countries was the rule in 2008. For 2009 growth is expected to be at 0.9% for the world and -0.1% for industrialized countries. Only China will continue to post a sustained growth rate of 7%, which was revised downward from 12% at the beginning of 2008.

Although Africa escaped direct effect of the financial crisis, it cannot be shielded from global recession, even if the degree of the continent's trade integration remains low. Africa's projected growth rate in 2009 (2.9%) is about half that of 2008 level (5.7%) (Table 4). Preliminary projections show expected losses of 4.4% of growth rate for oil-exporters in 2009 and 1.2% decline in growth for oil-importing countries. For the first time since the 2000s, oil-importing countries should register higher growth rates than oil-exporting countries. Middle-income countries will be affected by decreasing foreign demand for manufactured products, textile and tourism and should suffer growth losses comparable to oil-importing and low-income countries. Growth deceleration may compromise Africa's efforts towards reaching the Millennium Development Goals and poverty reduction.

5.4 Sectoral impact

Although it is too early to accurately predict the impact of the global financial and economic crisis, preliminary evidence demonstrates that some key sectors in African economies have already felt its adverse effects.

5.4.1 Tourism

Tourism has suffered a big hit from the crisis as a result in declining incomes in developed and emerging countries, where most tourist flows originate. Yet tourism receipts represent an important share of government revenues in many countries. Both arrivals and receipt have declined substantially in many countries. Kenya announced a 25 % to 30% decline in tourist arrivals. Kenya Airways posted a 62.7% drop in profit for the half-year at the end of September 2008. The decline in tourism would have a negative impact on the services sector, which was becoming a key growth engine prior to the crisis. This calls for further efforts towards diversification not only of the services sector but also of the entire economy. Egypt also announced a 40% cancellation of hotel reservations. The Seychelles announced a 10% fall in tourism revenue.

5.4.2 Mining Sector

Several projects in the extractive industries were cancelled or postponed in

DRC, Zambia, South Africa, CAR and Cameroon. In Zambia, the USD 1.5 billion Kafu Gorge Dam Project was kept in abeyance following the reticence of several investors caused by falling copper prices. Such mining companies as First Quantum Minerals, Albidon and Makambo Copper Mine have given up all new explorations. At the same time, Konkola Copper Mines – the largest copper mine in Zambia – has ordered a 40% reduction in all supplier contracts.

In the Democratic Republic of Congo, extraction operations at the open-cast mine Tilwezembe and the treatment of ore at Kolwezi plant have nearly been brought to a halt because of the slump in prices of cobalt. As many as 70 mining companies operating in Kantaga closed. Since the end of 2008, Forrest International laid off 650 employees and indicated that the exploitation of cobalt is not profitable at the price of USD9/pound. According to the Ministry of mining in DRC, these closures would have caused a loss of up to 200000 jobs.

The fall of the price of manganese by 60% in 2008 had serious repercussions in Gabon, second world manganese producer. The Comilog company, which has operations in the South-east of the country (Moanda), decided to reduce by half its production in the first quarter of 2009.

If the price of oil and manganese is not restored, Gabon will be suffer negative effects on its budget and current account balances.

The fall in the price of the iron since the crisis has also affected Senegal and Mauritania. For Senegal this fall delayed the operational startup of the exploitation in Flémé whose production is envisaged for 2011 and the agreement was signed February 2007 with Arcelor Metal, a French company. The Mauritanian production of iron which accounts for 50% of exports was heavily affected by the fall in the price of the iron.

The price of the uranium declined from USD140 to USD53 per pound between July 2008 and January 2009 will have harmful consequences on the export earnings of Niger. Uranium accounts for 50% of these export earnings. Niger counts on the increase in production although it may not compensate for the drop in prices. The French company Areva signed a contract to exploit the second largest reserves in Africa.

The fall of the price of bauxite which dominates the mining sector of Guinea, the second largest exporter in the world, will affect export earnings. The mining sector accounts for 30% of the public revenue and 70% of the export earnings.

A project to construct an aluminum factory, gathering three international groups, is likely to be deferred.

5.4.3 Textile

Several textile factories were closed in Madagascar and Lesotho. The latter recorded a decline in external textile demand from South Africa and the United States, its major trading partners. In Madagascar, recent data shows an 8% to 15% decline in economic activity in various sectors. Employment pressures have emerged, attributable to the vulnerability of labor-intensive sectors (tourism and textile) to the crisis. A local textile company in the West of the country closed, causing the loss of 4000 jobs.

5.4.4 Other sectors

The manufacturing sector has been affected by both falling global demand and rising cost of imports of intermediate goods caused partly by currency depreciation. As a result, factories run at low capacity and employment is seriously threatened. For instance in Uganda, the Uganda Manufacturers Association (UMA) reported that fifteen factories closed in 2008 due to the high cost of doing business. South Africa announced a significant drop in the sale of new cars, reflecting the crisis facing vehicle manufactu-

ers worldwide. The decline in activity in the manufacturing sector has caused large job losses with damaging effects on living standards.

6. CONCLUSION

The global financial crisis will have a significant impact on Africa, although Africa's growth outlook is still better compared to industrialized countries. A 3.2% growth rate compared to a decline of 0.1% for advanced economies may appear as a good performance. However, compared to 2007, it represents a loss of 3 percentage points. In addition, this level is far from the growth required to reach the Millennium Development Goals. The current economic crisis affects all the drivers of African growth: prices and demand for primary commodities, capital flows, especially foreign direct investment. Many countries face the risk of twin deficits (current account and budget deficits). If the crisis was to last, it could even threaten the gains achieved in the last decade in the fight against poverty.

The major challenge is to mobilize resources to finance growth, development, investment in infrastructure and poverty reduction programs. This will require that aid commitments by donors are met, and that African countries improve their performance in resource mobiliza-

tion at the national and regional level. However, long-term strategies must be oriented toward building more resilience to the crisis and sustaining growth.

The following areas will require immediate attention from African governments, the Bank and the continent's development partners.

- Supporting domestic growth drivers: Economic policy at the macroeconomic and sectoral level needs to target support for domestic growth drivers and be tailored to each country's circumstances. Measures should be investigated to support tourism, mining and other export oriented activities.
- Increasing investment in infrastructure: It is critically important that African countries keep an adequate level of infrastructure investment to support private sector activity in general and enhance competitiveness and diversification in particular.
- Preparedness and targeted responses by the Bank: the Bank should play a

critical role in assisting African countries to devise strategies for preventing and mitigating the impact of financial crises. In particular, it is important to evaluate the resource requirements for assisting countries affected by the crisis.

- Ensuring adequate flows of development aid: Despite the economic downturn in developed and emerging countries, it is important that donors honor their aid commitments. Any reduction in aid will amplify the negative impact of the crisis on African economies, which in turn will delay global economic recovery by depressing demand.

The Bank will share its analysis of the impact of the financial crisis on different sectors in African economies. The analysis will also serve as input for the Operations Departments in the preparation of Country Assistance Strategies as well as Project and Programme Interventions. The Bank envisages intensified interventions in RMCs by targeting growth drivers and the most affected sectors.

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Annex 1: Impact on selected financial markets

Region/Country	INDEX		Benchmark 07/31/2008	Value at end of Week (13/02/2009)	Losses dues to financial crisis (%)
	Name	Code			
AFRICA					
Cote d'Ivoire	BRVM Composite Index	BRVM CI	242.54	169.34	-30.18
Egypt	CASE 30 Index	CASE 30	9251.19	3600.79	-61.08
Kenya	Kenya Stock Index	KSE	4868.27	2855.87	-41.34
Mauritius	Mauritius AllShares	SEMDEX	1735.77	1005.69	-42.06
Morocco	Casa All Share Index	MASI	14134.70	10352.81	-26.76
Nigeria	NSE All Share Index	NSE	52916.66	23814.46	-55.00
South Africa	All Share Index	JALSH	27552.65	20650.38	-25.05
Tunisia	Tunis se Tnse Index STK	TUNINDEX	3036.87	3049.6	0.42
OTHERS					
USA	Dow Jones Industrial	DJ Index	11378.02	7,850.41	-31.00
France	CAC 40 Index	CAC 40	4392.36	2,997.86	-31.75
Japan	Nikkei 225 Index	N 225	13376.81	7,779.40	-41.84

Source: AfDB, Statistics Department, January 2009

Annex 2: World and African trade prospects

	Rate of Growth				Loss of Growth		Rate of Growth				Loss of Growth	
	2006	2007	2008	2009	2008-2007	2009-2008	2006	2007	2008	2009	2008-2007	2009-2008
	Volume of Exports						Value of Exports					
World	8.8	6.3	4.4	2.1	-1.9	-2.3	14.9	15.6	18.9	-4.4	3.3	-23.3
Africa	0.2	10.1	10.6	3.6	0.5	-7	18.6	20.1	38.3	-7.1	18.2	-45.4
North Africa	16.5	10.4	14.3	6.6	3.9	-7.7	33.1	19.4	52.7	-5.4	33.3	-58.1
Sub-Saharan Africa (excluding Nigeria and South Africa)	4.7	8.1	6.1	4.9	-2	-1.2	20.7	21.2	42.1	-22.5	20.9	-64.6
	Volume of Imports						Value of Imports					
World	8.8	6.3	4.4	2.1	-1.9	-2.3	14.9	15.6	18.9	-4.4	3.3	-23.3
Africa	11.6	17.6	15.2	10.5	-2.4	-4.7	19.5	25.5	29.1	6.6	3.6	-22.5
North Africa	16	24.9	24.3	17.9	-0.6	-6.4	20.8	33.7	50.8	15.2	17.1	-35.6
Sub-Saharan Africa (excluding Nigeria and South Africa)	4.7	8.1	6.1	4.9	-2	-1.2	12	18.7	18.2	2.8	-0.5	-15.4

Source: *World Economic Situation and Prospects*, United Nations, 2009

Annex 3: Overall fiscal balance and current account balance (% GDP), 2007-2009

	Fiscal balance			Current account		
	2007	2008(e)	2009(p)	2007(e)	2008e)	2009(p)
Africa	1.89	1.82	-5.06	2.66	2.72	-4.05
North Africa (including Sudan)	2.90	2.38	-5.79	10.65	10.14	1.75
Sub-Saharan Africa	1.25	1.48	-4.61	-2.37	-1.68	-7.70
By oil production						
Oil-exporting countries	3.87	4.32	-7.30	9.11	8.78	-4.00
Oil importing countries	-0.41	-1.75	-2.12	-4.79	-5.88	-4.13
By region						
Central Africa	5.46	10.73	3.26	-1.47	3.88	-9.39
Northern Africa	3.51	2.98	-6.15	13.05	12.15	3.02
Southern Africa	2.47	2.32	-3.46	-3.34	-3.01	-7.65
Western Africa	-0.54	-0.08	-9.00	0.11	0.72	-8.57

Source: *African Economic Outlook 2009 (preliminary estimates)*, AfDB, 2009

Annex 4 : Growth and inflation in Africa, 2007-2009

	Inflation			Real GDP growth		
	2007	2008(f)	2009(p)	2007	2008(e)	2009(p)
Africa	7.4	10.9	8.7	6.1	5.7	2.9
North Africa (including Sudan)	7.0	8.6	7.7	5.7	6.0	3.5
Sub-Saharan Africa	7.7	12.5	9.4	6.4	5.5	2.4
By oil production						
Oil-exporting countries	7.2	10.0	9.1	6.8	6.6	2.4
Oil importing countries	7.7	11.8	8.2	5.4	4.6	3.4
By region						
Central Africa	2.9	8.8	7.2	4.0	5.0	2.8
Eastern Africa	10.1	17.8	10.2	8.8	7.3	5.5
Northern Africa	6.8	8.1	7.6	5.3	5.8	3.3
Southern Africa	9.3	12.4	9.7	7.0	5.3	0.4
Western Africa	5.4	10.6	8.6	5.4	5.4	4.2

Source: *African Economic Outlook 2009 (preliminary estimates)*, AfDB, 2009

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