

I. Overview

Recent Developments in the World Economy

In recent years countries in sub-Saharan Africa have enjoyed some of their highest growth rates in decades, thanks both to favorable external conditions and improved domestic policies. In late 2007 and early 2008, however, the global environment deteriorated, as noted in the Spring 2008 *Regional Economic Outlook: Sub-Saharan Africa* (REO). Since then it has become even more challenging. Food and fuel prices have risen further, global financial markets have become more turbulent, and the global slowdown is expected to deepen. In particular

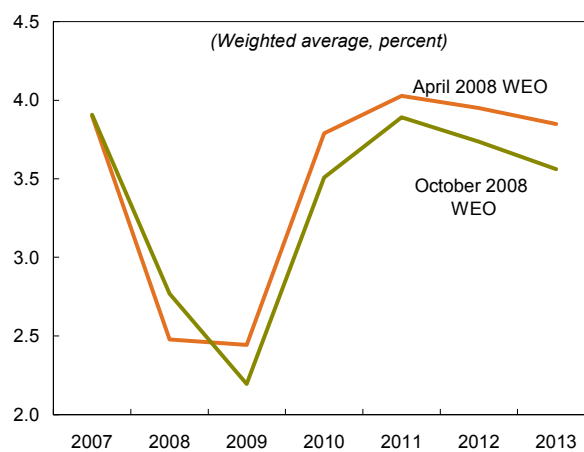
- Global growth is projected to fall to 4 percent in 2008 and 3 percent in 2009. As a result, the market for sub-Saharan African exports is projected to grow by only 3 percent in 2008 and 2 percent in 2009, down from 4 percent in 2007 (Figure 1.1).
- Despite recent price declines, food and fuel prices are projected to remain substantially above their 2007 levels (Table 1.1, Figure 1.2).¹ As a result, and although some sub-Saharan African countries have benefited from rising prices on their exports of non-oil commodities, such as aluminum, cotton, and gold, for the first time in several years most African oil-importing countries are expected to see a significant and lasting decline in their terms of trade relative to 2007.² Commodity price projections are

currently beset with unusually large uncertainty, however, and substantial surprises cannot be excluded.

The impact of continued global financial market turbulence on sub-Saharan Africa appears to be

Figure 1.1. GDP Growth in Recipients of Sub-Saharan African Exports

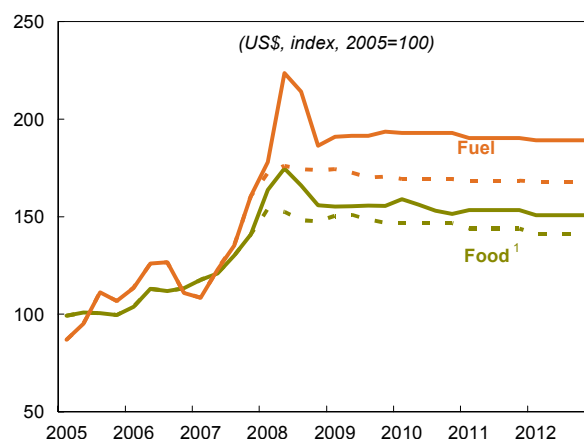
Demand for sub-Saharan African exports has fallen.



Source: IMF, *World Economic Outlook* (WEO).

Figure 1.2. World Commodity Prices

Food and fuel prices eased recently but remain far above 2007 levels.



Source: IMF, *World Economic Outlook*.

Note: Solid lines show current projection, dotted lines April 2008 projection.

¹Includes cereals, vegetable oils, meat, seafood, sugar, bananas, and oranges.

This chapter was prepared by John Wakeman-Linn and Hans Weisfeld, with research assistance from Gustavo Ramirez and editorial assistance from Emma Morgan.

¹ As of mid-September, oil prices stood at about US\$100 a barrel, some 40 percent below their mid-July peaks. Similarly, food prices eased 8 percent from their June peak.

² As in previous *Regional Economic Outlooks*, we divide sub-Saharan African countries into oil exporters and oil importers. Oil-importing countries are further categorized as middle-

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income, low-income, and fragile countries. For a complete classification, see the Statistical Appendix.

Table 1.1. Sub-Saharan Africa: Selected Indicators, 2004–09¹

	2004	2005	2006	2007	Projections 2008	Projections 2009
<i>Percent change</i>						
Real GDP	7.0	6.2	6.3	6.7	5.9	6.2
<i>Of which:</i> Oil exporters ²	11.2	7.8	7.5	8.9	8.1	8.8
Oil importers	5.1	5.6	5.8	5.7	4.8	4.9
Real non-oil GDP	7.1	6.4	7.8	7.7	6.9	6.2
Consumer prices (average)	7.3	8.8	7.3	7.1	11.7	9.5
<i>Of which:</i> Oil exporters	14.9	14.7	8.2	5.7	9.9	9.0
Oil importers	4.2	6.2	6.9	7.8	12.6	9.7
Per capita GDP	4.9	4.2	4.3	4.6	3.6	4.1
<i>Percent of GDP</i>						
Exports of goods and services	34.4	36.8	38.0	38.2	41.5	39.5
Imports of goods and services	33.0	33.9	34.7	36.4	37.5	37.3
Gross domestic saving	21.3	22.8	24.6	24.1	26.2	25.5
Gross domestic investment	20.3	20.2	21.6	22.2	22.2	23.2
Fiscal balance (including grants)	-0.2	1.7	5.0	1.6	2.2	1.5
<i>Of which:</i> Oil exporters	4.5	8.2	11.7	5.0	7.1	5.5
Oil importers	-2.1	-1.2	1.5	-0.2	-1.1	-1.3
Current account (including grants)	-1.5	-0.4	0.5	-2.4	-0.3	-2.1
<i>Of which:</i> Oil exporters	2.7	7.7	10.9	3.8	9.7	5.7
Oil importers	-3.1	-4.0	-5.0	-5.8	-7.1	-7.6
Terms of trade (percent change)	3.5	9.4	9.8	6.0	15.1	-2.8
<i>Of which:</i> Oil exporters	15.6	32.4	16.6	8.0	38.1	-6.1
Oil importers	-1.2	-0.9	6.3	4.9	-0.6	-0.4
Reserves (months of imports)	4.3	4.7	5.6	5.8	6.1	6.7
<i>Memorandum items:</i>						
Oil price (US\$ a barrel)	37.8	53.4	64.3	71.1	107.3	100.5
GDP growth in SSA trade partners (in percent)	4.2	3.6	4.1	3.9	2.8	2.2

Sources: IMF, African Department database; and IMF, World Economic Outlook (WEO) database.

Note: Data as of October 3, 2008. Arithmetic average of data for individual countries, weighted by GDP.

¹ Excludes Zimbabwe. See Statistical Appendix tables for the list of sub-Saharan African countries.

² Consists of Angola, Cameroon, Chad, Republic of Congo, Equatorial Guinea, Gabon, and Nigeria.

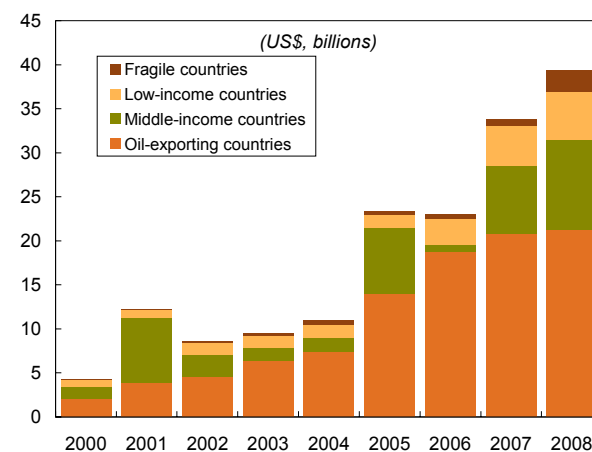
contained so far. While the turbulence has reduced global growth and demand for sub-Saharan Africa's exports somewhat, interest in investing in the continent appears to continue, in part because rates of return there are high relative to those in mature markets and because sub-Saharan Africa offers unique diversification opportunities. In particular, foreign direct investment (FDI) has continued to grow, increasingly benefiting non-oil producers. FDI is attracted in part by high non-oil commodity prices and opportunities to invest in services like telecommunications (Figure 1.3). A substantial and growing part of FDI inflows comes from China, and increasingly also the Gulf countries.

However, during the course of 2008, portfolio inflows have come under some pressure as global liquidity has tightened; as exchange rates and capital markets have become more volatile, increasing the perceived risk of investing in local-currency-denominated assets; and as investors have become more concerned about an increase in political and macroeconomic risks and the liquidity of their assets. For example, issuances by African countries of foreign-currency-denominated bonds ceased in the first half of 2008, after doubling yearly from 1.5 billion dollars in 2005 to 6.5 billion dollars in 2007. Further, reflecting both domestic factors and the changing attitudes of global investors, South Africa saw portfolio flows reverse starting in late 2007 while its stock market became more volatile and the rand depreciated.³ Nigeria also saw interest in its sovereign and corporate debt titles decline temporarily in early 2008. In Kenya, election-related violence early in the year had a transitory negative impact on capital flows, but inflows returned in April in the context of the privatization of a telecommunications provider.

The intensification of global financial market turbulence in September has further increased

Figure 1.3. Sub-Saharan Africa: Foreign Direct Investment

FDI inflows have continued to grow.



Source: IMF, *World Economic Outlook*.

investor preference for highly liquid and high-quality assets and may affect portfolio flows going forward. While most African countries rely mainly on official flows to finance balance of payments needs, countries that have started in recent years to tap the global financial markets to finance sizable current account deficits are particularly vulnerable to a potential reversal in capital flows. Governments in these countries should implement particularly prudent macroeconomic policies to boost investor confidence as much as possible. Another channel through which the global financial market turbulence could affect Africa is a potential weakening of domestic banks. In particular, foreign ownership of African banks could constitute a vulnerability if parent retail banks started to withdraw funds from their African subsidiaries. So far, however, African banks appear to have been affected only little in this regard. No withdrawal by parent banks, located mainly in France, the United Kingdom, and South Africa, has been observed. Also, African banking systems are not likely to experience the same kind of turbulence as U.S. banks because in Africa banks that extend loans generally hold them, the interbank market is small, and the market for securitized and derivative instruments is small or nonexistent.

Looking ahead, if the financial turbulence were to constrain global growth below levels currently

³ South Africa has also seen an increase in interest rates relative to rates in mature markets. This primarily reflects gradual monetary policy tightening in South Africa, not a change in global financial market conditions.

expected, this would affect Africa through still-lower demand for its exports and likely lower commodity prices. In such a scenario, foreign direct investment, portfolio aid, and remittances inflows could fall as well.

Domestic Developments

GDP growth

Although GDP growth has tapered off somewhat in sub-Saharan African countries, at slightly less than 6 percent, the growth rate for 2008 is still expected to be relatively strong, thus continuing the healthy growth trend of previous years. This does not mean that sub-Saharan Africa has not been affected by developments elsewhere, it means that other factors are also at play:

- In oil exporters, growth is expected to fall temporarily by half a percentage point, to 8 percent in 2008, reflecting mainly lower-than-expected oil output in the Niger Delta due to recurring violence there; slightly lower-than-expected production in Equatorial Guinea's maturing main oil field; and weaker non-oil growth in Chad due to insecurity.⁴
- In oil importers, growth is also projected to decelerate, by half a percentage point, to 5 percent. The deceleration is to be expected given the changes in the global environment.⁵ Among influential factors

⁴ Unless otherwise stated, data for sub-Saharan Africa as a whole or groups of sub-Saharan Africa countries are weighted by GDP at purchasing power parity or in U.S. dollars, as appropriate (see the Statistical Appendix for details).

⁵ It appears that a 1 percentage point decline in growth in (and export demand from) trading partners reduces GDP growth in sub-Saharan Africa by about 0.5 percentage point, in addition to any effects from commodity price changes (see the April 2008 *Regional Economic Outlook: Sub-Saharan Africa*, Chapter 1). It also appears that a terms-of-trade-induced income reduction of 1 percentage point tends to reduce growth in sub-Saharan Africa by about 0.05 percentage point, in addition to any effects from changes in global growth (see Ndulu and O'Connell, 2007). Therefore, the projected slowdown in trading partners of 1.1 percentage points and the projected income effect of 1.3

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not directly related to the price shock is the continued growth of FDI. For example, the Democratic Republic of Congo and Madagascar are profiting from FDI in mining, Kenya from FDI in telecommunications, and Senegal from FDI in infrastructure and tourism. Improved security in parts of eastern Africa has also benefited growth (e.g., by boosting Uganda's exports to its neighbors). By contrast, in South Africa, growth is slowing on account of energy bottlenecks, the global slowdown, and tighter monetary policy. South Africa's energy shortages have also limited power delivery to and growth in neighboring countries, such as Mozambique and Swaziland. Finally, Kenya saw a serious contraction in the first quarter of the year due to violence in the wake of disputed elections; it will not be able to repeat in 2008 its growth performance of 2007.

Inflation

In the first six months of 2008, average consumer price inflation in sub-Saharan Africa rose from 9 to 15 percent, mainly because food price inflation accelerated from 10 to 20 percent and fuel price inflation from 12 to 19 percent (Table 1.2 and Figure 1.4).⁶ In some countries, demand pressures have also contributed to inflation. This is the case, for example, in South Africa, where the output gap has remained positive over several quarters despite recently declining growth, and in Ghana and Ethiopia, where public investment in infrastructure has been growing at a sustained pace. The increase in inflation cuts across countries with different exchange rate regimes and different economic structures and levels of development. However, in the CFA franc zone inflation has picked up by less than in most other countries. This is likely due to

percent of GDP from the terms of trade deterioration in oil importers (discussed below) would tend to reduce growth in these countries in 2008 on average by 0.6 percent.

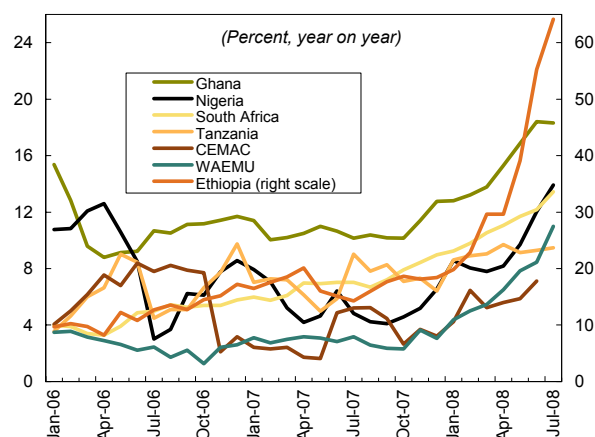
⁶ These are simple averages.

both the anchoring of inflation expectations in the zone's fixed exchange rate with respect to the euro and the inflation-dampening effect of the euro appreciation in the first half of 2008. In many countries inflation now exceeds central banks' targets by substantial margins.

Meanwhile, indications of possible second-round effects have emerged, suggesting that inflation may be starting to increase beyond what is justified from the increase in the relative price of food and fuel alone.⁷ In particular, average core inflation in sub-Saharan Africa increased from 5 percent at the end of 2007 to 8 percent in June 2008.⁸ Wage inflation also appears to have accelerated: in 8 out of the 14 countries for which wage data are available, annual growth rates for nominal wages are now 10 percent

Figure 1.4. Sub-Saharan Africa: Inflation in Selected Countries

Inflation has risen substantially in 2008.



Source: IMF, *International Financial Statistics*.

Table 1.2. Sub-Saharan Africa: Inflation and Monetary Policy Response, 2007–08
(Percent, year on year)

	Dec-07	Latest 2008 Observation	Month	Inflation Objective (percent)	Policy Response ¹ (percentage points)
Ethiopia	18.4	61.6	August	<10	+0.40
Ghana	12.7	18.1	August	6–8	+3.50
Nigeria	6.6	12.4	August	<10	+0.75
South Africa	9.0	13.6	August	3–6	+1.00
Tanzania	6.4	9.8	August	≤5	...
CEMAC	3.2	5.9	May	≤3	+0.25
WAEMU	3.0	7.9	May	≤3	+0.50
Sub-Saharan Africa	8.7	15.0	various

Source: IMF, *International Financial Statistics*; and IMF, African Department database.

¹ Change in policy interest rate during December 2007–August 2008.

or higher.⁹ In spite of this, monetary policy has generally been tightened only a little so far. For example, interest rates have not been raised much,

allowing real interest rates to decline in many countries (Figure 1.5).¹⁰ Against this background, inflation in 2008 is projected to climb by 5 percentage points to 12 percent, a noticeably stronger increase than in advanced countries.

⁷ The term “second-round effect” refers to a longer-term increase in inflation as a result of a one-off price shock. For additional explanations, see Box 1.4.

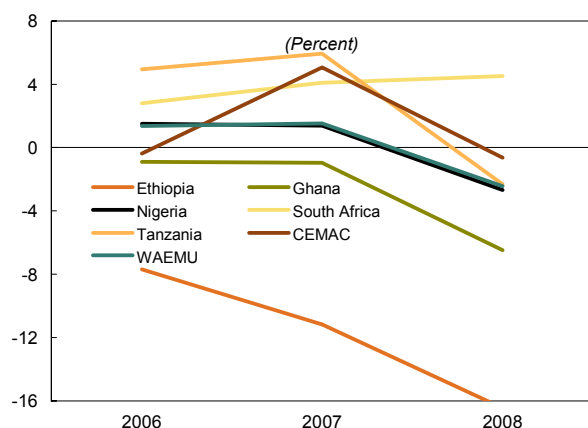
⁸ Here, core inflation is defined as headline inflation excluding food and fuel items. It is not necessarily the case that core inflation thus defined reflects second-round effects only; it may also reflect indirect first-round effects. The longer core inflation remains high, however, the more likely it is that second-round effects are present and that they predominate.

⁹ In most cases, wage data reflect public sector wages only.

¹⁰ Measuring real interest rates is challenging, and Figure 1.5 provides an indication of broad trends only. Real interest rates through 2007 were measured as the difference between central bank policy rates and observed headline inflation. For 2008, they were measured as the difference between policy rates and projected headline inflation. For South Africa, real interest rates were calculated as the difference between the policy interest rate and a measure of expected inflation extracted from the yields of nominal and inflation-indexed government bonds.

Figure 1.5. Sub-Saharan Africa: Real Interest Rates in Selected Countries

Real interest rates have fallen in many countries.



Source: IMF, *International Financial Statistics*.

Fiscal positions

In oil exporters, fiscal surpluses excluding grants are projected to rise to 7 percent of GDP in 2008, reflecting a substantial oil revenue windfall. The average non-oil primary deficit as a share of non-oil GDP, a measure of the spending of oil revenue, is

projected to grow somewhat in 2008 (Table 1.3), indicating that a limited part of the windfall is being spent. In line with this, it appears that fiscal policy is contributing to inflationary pressures in several oil exporters, including Angola, Chad, Equatorial Guinea, and Nigeria.¹¹

Oil importers' fiscal balances are deteriorating because of lower GDP growth and the cost of policy measures to cushion the impact of the food and fuel price shock, estimated at an average of 0.5 percent of GDP in 2008.¹² Fiscal deficits excluding grants are expected to worsen by 1 percent of GDP to 3 percent of GDP in 2008, and fiscal deficits including grants are projected to deteriorate by almost as much, from close to zero to 1 percent of GDP. Perhaps surprisingly, grant inflows to oil-importing countries have responded little to the food and fuel price shock. Among the few countries to report substantially higher aid are Rwanda and Burundi, thanks in part to the World Bank.¹³ More generally, official development assistance flows from countries of the Organization for Economic

Table 1.3. Sub-Saharan Africa: Non-Oil Primary Fiscal Deficits in Oil Exporters¹
(Percent of non-oil GDP)

	2005	2006	2007	2008 (proj.)	2009 (proj.)
Angola	62	50	57	51	41
Cameroon	1	1	3	6	6
Chad	5	15	22	25	18
Congo, Rep. of	30	51	56	43	40
Equatorial Guinea	61	55	50	47	74
Gabon	18	18	13	13	9
Nigeria	27	29	28	32	32
Average (weighted)	33	33	33	35	34

Source: IMF, African Department database.

¹ Non-oil revenue excluding grants minus noninterest spending.

¹¹ The fact that inflation in oil exporters as a group nevertheless remains below that in oil importers appears to be due mainly to CEMAC's fixed exchange rate regime.

¹² Based on data for 22 countries.

¹³ So far, the World Bank has approved additional grants of US\$95 million in response to the food crisis, benefiting nine countries (Burkina Faso, Burundi, the Central African Republic, Eritrea, Ghana, Liberia, Madagascar, Rwanda, and Sierra Leone). The Bank plans to approve a total of US\$615 million by end-2008, benefiting 23 countries. Also, several countries have received increased assistance from the IMF in the form of new Poverty Reduction and Growth Facility (PRGF) programs or augmentation of existing PRGF programs. As of end-July 2008, new PRGF arrangements (with a higher level of access than initially planned) have been approved for Burundi, Mali, and Niger. Increases in the size of existing loan programs have been granted for Benin, Burkina Faso, the Central African Republic, Guinea, Madagascar, and Malawi. Several other requests for augmentations are under discussion.

Cooperation and Development (OECD) to sub-Saharan Africa (excluding debt relief to Nigeria and Liberia) have remained broadly flat since 2003, suggesting that the doubling of aid to sub-Saharan Africa pledged at the G-8 summit in Gleneagles in 2005 is still to materialize.

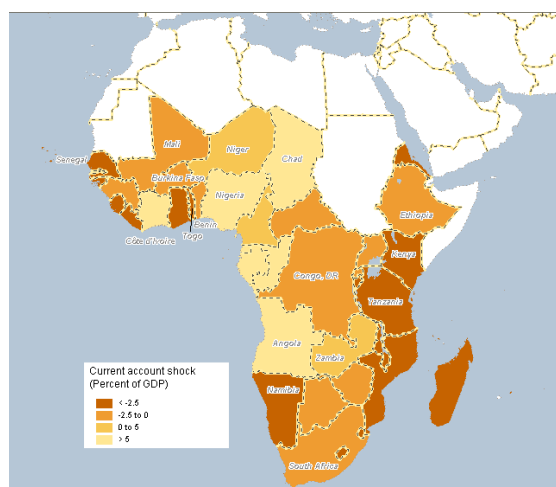
Terms of trade and external positions

As a result mainly of the fuel price shock, the terms of trade of oil exporters are projected to improve by 38 percent in 2008 and those of oil importers (excluding South Africa) to deteriorate by 4 percent.

A country's terms of trade, however, are not always a good indicator of the likely impact of international price changes on its external position (and its citizens' purchasing power) and the consequent need for adjustment. This is because, although an increase in export and import prices by equal percentages leaves a country's terms of trade unchanged, it will lead to a deterioration of the trade balance in a country that is running a deficit to start with. In 2007, oil-importing countries had substantial trade deficits, meaning that any deterioration in their terms of trade understates the impact price changes have had on their external positions. Analysis using a constant trade volumes methodology reveals that in 2008 the terms of trade changes should have a positive current account impact on oil exporters of 24 percent of GDP, and a negative impact on oil importer current accounts of 4 percent of GDP (Map 1.1).¹⁴ Among the low-income countries experiencing a negative current account impact, 17 have been especially hard-hit: Benin, Burkina Faso, Burundi, the Central African Republic, Comoros, Eritrea, Ethiopia, The Gambia, Guinea, Guinea-

Map 1.1. Sub-Saharan Africa: Current Account Impact of 2008 Commodity Price Changes

Many oil importers see a negative impact.



Bissau, Liberia, Madagascar, Malawi, Mali, Sierra Leone, Togo, and Zimbabwe.¹⁵

With real exchange rate developments (see below) taken into account, the current accounts including grants of oil exporters are thus projected to improve substantially, to 10 percent of GDP in 2008. In contrast, the current accounts including grants of oil importers are projected to deteriorate to 7 percent of GDP, reflecting not only the commodity price shock, but also limited tightening of monetary policy and fiscal deterioration. So far, the negative impact on oil importers has led only to a limited loss of reserves and has not increased debt to official creditors. However, and in spite of projected FDI inflows, there is no guarantee that current reserve cushions in all oil importers will be sufficient to withstand a lasting deterioration in the current account balance.

¹⁴ These data are unweighted averages. The food price increase is expected to have a small positive current account impact in Mauritius, Namibia, and Swaziland, and a negative impact in all other countries, and the oil price impact is generally substantially larger than the food price impact.

¹⁵ Countries have been identified as especially hard-hit when the current account impact has exceeded either 50 percent of initial international reserves or 2.5 percent of GDP. The second threshold has been applied only to countries in the CFA franc zone, for which a reserves-based indicator is less meaningful, and to countries with particularly weak initial institutions. Senegal and Ghana, which would otherwise have qualified, have been excluded because of other influences on the balance of payments.

Exchange rate developments

An increase in food and fuel prices will tend to lead to an appreciation of the equilibrium real exchange rate in countries that see a positive current account impact, and a depreciation where the current account impact is negative. In fact, consumer price index (CPI)–based real exchange rates of oil exporters have appreciated somewhat in recent months (Figure 1.6).¹⁶ In Nigeria, this is the result of a stable nominal effective exchange rate and substantial inflation. In the oil-producing member countries of the Central African Economic and Monetary Union (CEMAC), real appreciation has resulted mainly from nominal effective appreciation as the euro strengthened, although in Equatorial Guinea and Chad, inflation has also made a substantial contribution (Figure 1.7). In Angola, by contrast, nominal depreciation and substantial inflation have kept the real exchange rate stable.

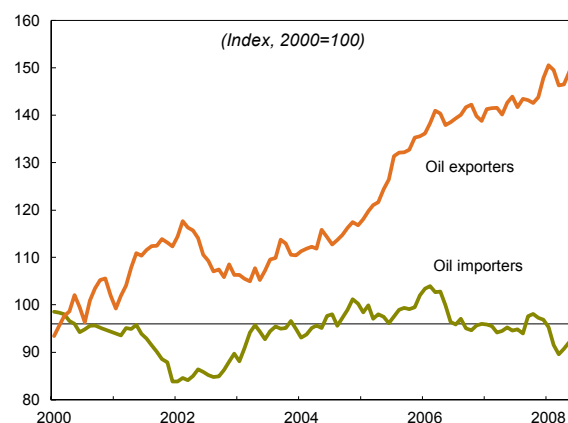
Similarly, CPI-based real exchange rates of oil importers have depreciated somewhat. However, the experience of oil importers has varied widely. For example, South Africa has seen a real depreciation that tracks the nominal depreciation of the rand. The rand depreciation has also allowed depreciation in other southern African countries, such as Botswana and Swaziland, given the importance of the rand for their currencies. In contrast, the member countries of the West African Economic and Monetary Union (WAEMU) have seen a real appreciation of the CFA franc.

¹⁶ Real exchange rate data based on the relative prices of traded and nontraded goods (probably the more relevant measure in the current circumstances) are not available for sub-Saharan African countries: the real exchange rates must be based on differences between domestic and foreign CPI-based inflation rates. Under some conditions, however, CPI-based real exchange rates can move in the opposite direction from real exchange rates based on the relative prices of traded and nontraded goods.

Poverty concerns

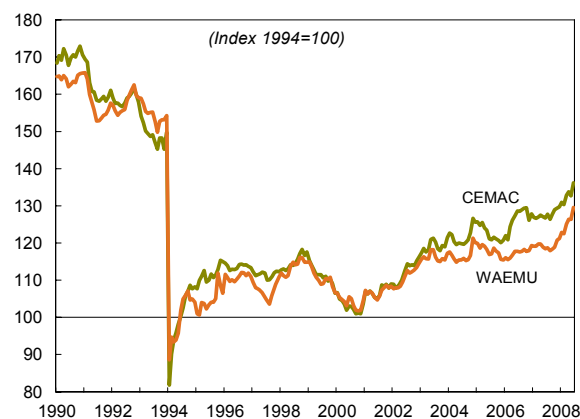
Food and fuel price increases could lead to a substantial increase in poverty rates in a number of countries, especially where the current account impact is substantially negative. For example, in 2008, through July world market prices for rice rose by 111 percent, those for wheat 89 percent, and those for maize 48 percent, and world market prices for fuel products rose by 64–82 percent, before easing recently. The impact on poverty of the food price increases could be particularly large in sub-Saharan Africa given that average households there

Figure 1.6. Sub-Saharan Africa: Real Effective Exchange Rates in Oil Exporters and Oil Importers
Oil exporters have seen real appreciation, oil importers real depreciation.



Source: IMF, Information Notice System.

Figure 1.7. Sub-Saharan Africa: Real Effective Exchange Rates in the CFA Franc Zone
Both CEMAC and WAEMU have seen substantial real appreciation in recent months.



Source: IMF, Information Notice System.

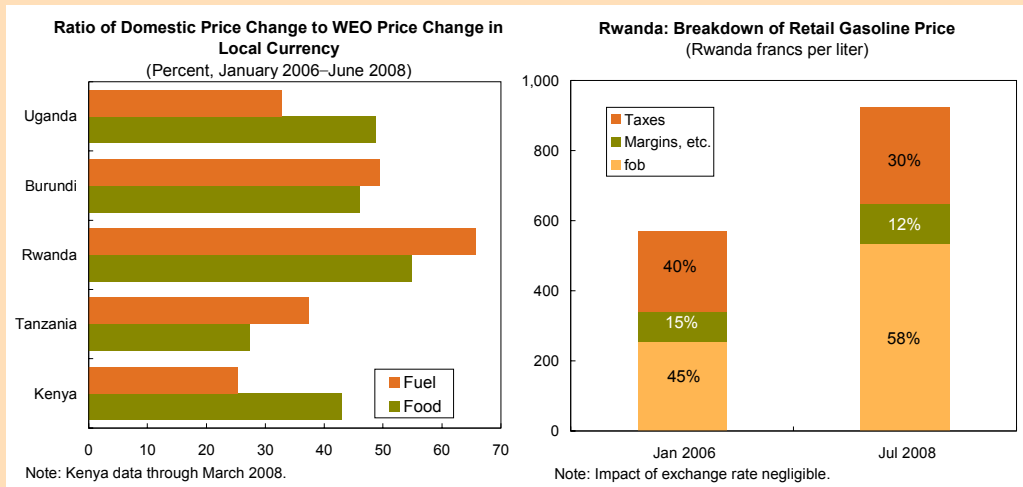
spend about half of their income on food. The fuel price increases are likely to have a smaller direct impact on poverty than the food price increases because households in sub-Saharan Africa typically spend less than one-tenth (7 percent) of their income on fuel products. Nevertheless, the ultimate effect of the fuel price increases on poverty rates is likely to be substantially greater than the direct effect, because fuel is an intermediate input into most other goods.

A recent study (Ivanic and Martin, 2008) finds that if domestic prices of important internationally traded food commodities were to rise by the same percentage as their world market prices, the poverty head count in a number of low-income countries around the world and in Africa could rise by as much as 4–5 percentage points. Fortunately, the impact of world market prices on domestic prices is

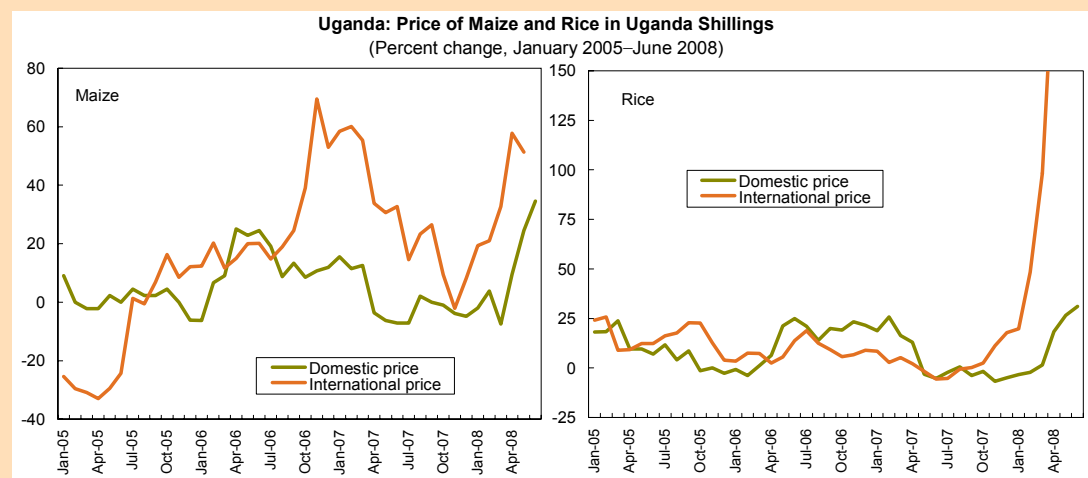
typically less than proportional. Box 1.1 discusses this impact, using as an example developments in the East Africa Community. It finds that domestic food and fuel prices there have on average risen by less than half of the increase in world market prices. Another study (Wodon, 2008) finds that if domestic prices of internationally traded food commodities were to rise by half as much as their world market prices, poverty rates in West and Central Africa could rise by 3–4 percentage points. Both studies also find that the urban poor are generally hit hardest by high food and fuel prices as the rural poor are more likely to be at least partially self-sufficient in food supplies. However, even food-surplus farmers may suffer an income loss as a result of higher food and fuel prices if production and marketing costs rise faster than prices for their agricultural output.

Box 1.1. Global Commodity Prices and Price Developments in EAC Countries

The countries in the East Africa Community (EAC) offer a useful example of the impact of international food and fuel prices on domestic prices. In the EAC, average headline CPI inflation increased from 8 percent in 2007 to 20 percent in June 2008. Rising global commodity prices have been perceived as the main culprit, yet domestic commodity prices have risen substantially less than global ones.



A number of factors can reduce the effect of global commodity prices on domestic prices, including stable domestic labor costs, profits, taxes, and exchange rate appreciation. The main factor limiting the impact of world market price increases has been taxation, implemented as cuts in the rates of explicit or implicit taxes (Uganda, Tanzania, Kenya, Rwanda). In some countries, importers' profit margins also came down. The main factor limiting the impact of global food price increases on domestic food prices has been domestic production of several food commodities in combination with a partial insulation from the world market that arises from poor infrastructure and trade barriers, such as the recent export bans in Tanzania. As a result, the

Box 1.1 (concluded)

price of commodities that are mainly imported, such as rice, has historically been closely correlated with the world market price, while the prices of crops that are mainly domestically produced, such as maize, have been more closely related to domestic supply conditions (although the correlation with world prices has increased over the last few months). In Uganda and Kenya, exchange rate movements also mitigated the impact of world market price increases on domestic prices.

Econometric estimates of the impact of global commodity prices on headline CPI inflation in the EAC in 1997–2007 suggest that an increase in world food prices of 10 percent contributed on average 0.7 percentage point to headline inflation, while a 10 percent increase in oil prices contributed 0.4 percentage point. Based on these estimates, the contribution of world food and oil prices to CPI inflation in the EAC was 1.5 percentage points in 2007 and should increase to 4.6 percentage points in 2008.

Estimated Contribution of World Food and Oil Prices to Inflation in EAC Countries
(Percentage points)

	Burundi	Kenya	Rwanda	Tanzania	Uganda	EAC average ¹
Estimated pass-through from world food and oil prices to inflation ²						
World food price	0.8	1.1	1.0	0.4	0.3	0.7
World oil price	0.8	0.4	0.3	0.2	0.6	0.4
Estimated contribution to average inflation, 2007 ³						
Headline inflation ⁴	8.3	9.8	9.1	7.0	6.8	8.3
World food price	1.1	1.7	1.6	0.6	0.4	1.1
World oil price	0.9	0.4	0.3	0.2	0.6	0.4
Total contribution	2.0	2.1	1.9	0.8	1.0	1.5
Estimated contribution to projected average inflation, 2008 ⁵						
Projected inflation ⁴	19.1	25.8	12.0	9.0	7.3	16.3
World food price	2.4	3.5	3.3	1.2	0.8	2.2
World oil price	5.4	2.4	1.8	1.2	3.8	2.3
Total contribution	7.7	5.9	5.1	2.4	4.6	4.6

Sources: IMF, *World Economic Outlook* submissions; and IMF, staff estimates.

¹Calculated as weighted average, using the 2005 nominal GDP in U.S. dollars as weight.

²Contribution of 10 percent increase in each variable to headline inflation.

³Multiples of the pass-through coefficients and actual increase in world food and oil prices.

⁴Actual and projected annual average inflation submitted for the WEO.

⁵Estimated using the increase in world food and oil prices projected by the WEO for 2008.

Note: This box was prepared by Michael Gorbanyov, Zuzana Murgasova, Manrique Saenz, and Yuri Sobolev.

Any change in poverty rates as a result of the food and fuel price increase would come on top of a possible upward revision of the number of poor that has been suggested by Chen and Ravallion (2008). These authors argue that the traditional poverty line of US\$1 per day may underestimate the cost of a minimum consumption basket.

Policy Challenges and Responses to Date

The challenge for policymakers is to adjust to the food and fuel price shock, preserve macroeconomic stability, and shield the poor. To do so, policymakers in each country need to implement a balanced policy mix appropriate to that country's circumstances. For countries hit by a sustained terms of trade decline not compensated for by higher aid—the situation most oil importers are in—adjustment must involve shifting demand away from imported goods to domestically produced ones and reducing domestic absorption relative to domestic output.¹⁷ This will generally require some combination of letting the real exchange rate depreciate and tightening macroeconomic policies. How much real depreciation and tightening is necessary will depend, among other things, on the elasticity of the current account balance with respect to the exchange rate, as well as on external sustainability and therefore the larger balance of payments situation—the availability of financing for larger current account deficits through FDI,

¹⁷ Absorption is the sum of private and public consumption and investment. When there is a need to reduce absorption, the burden will generally fall on both the private and the public sector. The more reduction is achieved in the public sector, the less will have to come from the private sector.

As described above, the food and fuel price shock and the associated change in countries' terms of trade are projected to have a large permanent component, and the policy discussion presented in this report focuses mainly on adjustment to this permanent change. A temporary shock would demand much less adjustment because it would pose smaller risks for longer-term price stability and fiscal and external sustainability. A temporary shock could therefore be accommodated to a much larger degree by letting fiscal and external balances deteriorate.

portfolio, aid, and other inflows. It will also be important to fully pass through price changes over time to encourage consumers and producers to adjust, avoid permanent increases in untargeted and inefficient subsidies, preserve debt sustainability, and ensure that scarce resources can be channeled to progrowth and pro-Millennium Development Goal expenditures. At the same time, the poor need to be protected through well-targeted measures. The final element of the policy challenge is to preserve medium-term price stability, as higher inflation would tax the poor and discourage investment.¹⁸

Determining and applying the best policy mix is not always easy, because policymakers face tight constraints, uncertainty, trade-offs, and conflicting goals. For example:

- *Constraints:* In many countries, fiscal space for cushioning the impact on the poor is limited, targeted transfer mechanisms are not available, and putting new ones in place takes time and administrative capacity. The challenge, then, is to find alternatives that are fiscally affordable and reasonably well targeted. A positive example would be school lunch programs; a less positive one would be raising civil service wages, which would likely be a costly and poorly targeted policy.
- *Uncertainty:* This pertains, among other things, to forecasting commodity prices and their impact on domestic prices and economic activity, evaluating the effectiveness and distributional impact of mitigating policies, and assessing the political impact of implementing a policy tightening.
- *Trade-offs:* Policymakers can respond with somewhat different policy mixes, but these choices imply trade-offs. For example, implementing restrictive monetary policy to

¹⁸ See Box 2.1 of the Spring 2008 *Regional Economic Outlook: Sub-Saharan Africa* for a discussion of the choice of medium-term inflation objectives in low-income countries.

avoid sustained inflation would likely tend to reduce private economic activity and dampen private investment more than a fiscal policy tightening geared toward public sector wage restraint. The impact on poverty and income distribution more generally would be different, and so would be the political feasibility of each. The choices could also affect the long-run growth outlook. For example, spending cuts might help stabilize the economy but could also hurt human and physical capital accumulation in the longer run, particularly if the cuts reduce public investment.

- *Conflicting goals:* Often fiscal policy is confronted with two at least apparently inconsistent goals. For example, cushioning the impact of a price shock on the poor will tend to lead to a deterioration of the fiscal position, whereas macroeconomic adjustment would tend to call for a tightening of policies. In addition, measures that minimize changes in the domestic prices of food products will help consumers but also reduce incentives for the medium-term supply responses that governments will want to encourage.

In the following, specific recommendations are offered concerning fiscal, monetary and exchange rate, and structural policies, and actual policies observed are assessed in light of these recommendations.

Fiscal policy

Fiscal policy can be used to cushion the impact of shocks on certain parts of the population and to help contain inflation and reduce absorption where needed to preserve economic stability. The first goal can be pursued by reducing the speed and degree to which higher world market prices feed through to domestic prices, and by making targeted transfers. If targeted transfer mechanisms are not immediately available, governments may wish to consider less-targeted short-term measures, such as reducing taxation or increasing subsidies on goods primarily

consumed by the poor. Over time, however, they should strengthen transfer mechanisms, which can include not only cash transfers but also such transfers as school feeding programs or food-for-work programs, and make increasing use of them.¹⁹ In determining the desirable degree and duration of cushioning, policymakers will need to consider the extent to which cushioning is compatible with the goal of keeping the economy stable. For example, some countries may have scope to accommodate the cost of mitigating measures without compromising fiscal sustainability; others will need to create fiscal space to offset this cost.²⁰ Countries that find it difficult to create fiscal space will need to limit the size and duration of fiscal responses or seek outside assistance.

So far in 2008 sub-Saharan African governments have taken a variety of measures to cushion the impact of higher food and fuel prices on the population. Most common and costly to the fiscal accounts have been reductions in fuel and food taxes and tariffs and expansions of food and fuel subsidies. Less common have been price controls, export bans, and targeted transfers. Box 1.2 reviews some measures taken in Liberia, a poor oil importer, and Cameroon, a substantially less poor oil exporter. It illustrates that oil exporters have tended to pass a smaller part of the food and fuel price increase through to the population than oil importers—partly because with higher revenue from oil, they have been better able to absorb the resulting fiscal costs. Box 1.3 discusses the targeting of measures, using Senegal as an example. Overall in sub-Saharan Africa, given that the most common measures—reductions in fuel and food taxes and tariffs and expansions of food and fuel subsidies—are not very well targeted, the effectiveness and efficiency of the measures taken have likely been limited. In the

¹⁹ For a fuller discussion of targeting, see “Food and Fuel Prices—Recent Developments, Macroeconomic Impact, and Policy Responses,” a paper prepared by the IMF’s Fiscal Affairs, Policy Development and Review, and Research Departments, at www.imf.org/external/np/pp/eng/2008/063008.pdf.

²⁰ The notion of “fiscal space” is discussed in the Fall 2007 *Regional Economic Outlook: Sub-Saharan Africa*.

future it will be important both to fully pass through global food and fuel price increases and to better target protective measures. As explained above, this will provide incentives for private sector adjustment, thereby facilitating external adjustment of the economy; limit demands on the public finances and better protect those who need it most.

Regarding the second goal of fiscal policy—helping to contain inflation and reduce domestic absorption where needed to keep the economy stable—the contribution of fiscal policy so far seems to have been limited. In fact, the widening of fiscal deficits in oil importers suggests a loosening in their fiscal

Box 1.2. Policy Responses in Liberia and Cameroon

Several countries have adopted a multipronged approach—changes in taxation, spending on social safety nets, and promotion of agricultural production—in response to the increases in food and fuel prices.

In Liberia, an oil-importing country with an annual per capita income of US\$136, the increase in world commodity prices has been passed through to the domestic economy quickly, in part because of fiscal constraints. This has led to substantial price increases, in particular for rice, a staple that accounts for half the caloric intake of households and a larger share of the spending of poor households. Responding to the commodity price increases is particularly challenging in Liberia, where almost two-thirds of the population lives below the poverty line, the government does not have access to new borrowing, and international reserves are less than one month of imports. The government has therefore started implementing a comprehensive food security strategy designed to

- mitigate the impact of rice price increases and ensure domestic supply: the government temporarily suspended rice import duties, at a fiscal cost of 0.9 percent of GDP, and is exploring long-term rice supply agreements;
- provide vulnerable households with access to food through safety nets: the government started school feeding programs in urban areas, supplementary feeding programs for pregnant women and children, and food-for-work and cash-for-work programs, all at an annual cost of 1.2 percent of GDP, to be financed in part by donor support; and
- promote domestic agricultural production: the government is expanding smallholder production through distribution of seeds, fertilizer, and farm tools; opening up agricultural land and expanding crop diversification; and encouraging large-scale commercial rice farming—all at an annual cost of 0.2 percent of GDP, also to be financed in part by donor support.

In Cameroon, an oil exporter with a much higher annual per capita income of US\$693 and more comfortable fiscal and reserve positions, rising food and fuel prices contributed to social unrest in early 2008, and the authorities decided to pass the increase in world commodity prices through more gradually. They exempted some imported food items from customs duties, kept fuel prices constant, and raised civil service salaries, at a fiscal cost of 1.5 percent of GDP, to be financed from domestic sources.

To offset part of the fiscal impact of these measures, the authorities reduced spending on goods and services. With oil revenue rising, the overall fiscal position improved, though the non-oil fiscal position deteriorated by 0.8 percent of GDP. No new targeted social safety programs have been created as yet.

To safeguard fiscal sustainability and target fiscal spending better, the authorities plan to phase out the tax exemptions and the fuel price freeze and to raise spending on health, education, and agriculture in future budgets.

Note: This box was prepared by Lodewyk Erasmus and Iacovos Ioannou.

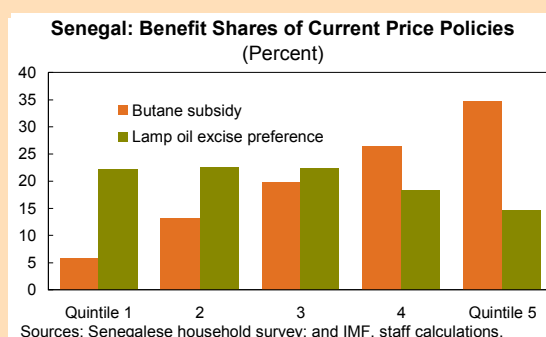
Box 1.3. Targeting of Policies to Protect the Poor from Rising Commodity Prices: The Case of Senegal

Senegal has implemented a number of measures to protect the poor from rising energy and food prices:

- The retail price of butane in small bottles has been kept constant, implying a greater subsidy. Also, lamp oil is still exempt from excise tax, and electricity tariffs are being kept below production costs (generating substantial quasi-fiscal liabilities).
- In July 2007 taxation of rice, wheat, powdered milk, and bread was suspended, and from April through August the price of rice was subsidized. The government controls the prices of rice and wheat.

Currently, more than half of the benefits of subsidies in the country are accruing to households in the top 40 percent of the income distribution. A recent Poverty and Social Impact Analysis, prepared by IMF staff at the request of the Senegalese authorities, shows how subsidies could be better targeted. The following measures are now in various stages of implementation:

- Phasing out of the special import tax on vegetable oil, intended to protect domestic refiners from competition. Vegetable oil is consumed primarily by low-income households.
- Reducing subsidization of butane. If desired, the resulting savings could be used to increase subsidization for lamp oil, which is consumed primarily by the poor.
- Eliminating electricity subsidies, which have little benefit for the rural poor, who have no access to electricity. If desired, the resulting savings could be used for providing electricity subsidies to small consumers to protect the urban poor.
- Targeting of vulnerable groups directly, for example, through school feeding programs and cash grants. Cash grants could be made conditional on such factors as children's school enrollment and receipt of primary health care. The grant could be rolled out gradually in line with administrative capacity.



Note: This box was prepared by Frank Lakwijk and Stéphane Roudet.

stance, which likely contributes to inflation and current account pressures. Given the difficulty of raising revenue and cutting expenditure in the short term, some widening of fiscal deficits was probably an unavoidable consequence of trying to cushion the impact of external shocks on the population; it may even have helped stabilize growth in the wake of the food and fuel price shock. Nevertheless, a tightening of the fiscal stance may be necessary in a number of oil importers to assist with macroeconomic adjustment. In particular, it will be a useful complement to the tighter monetary policy that may

have to be adopted to prevent higher inflation from becoming entrenched (see below). And even if inflation pressures were to abate without fiscal policy being tightened, there might still be a need for such tightening to help reduce current account deficits. When tightening is accomplished by cutting spending, it will be important to cut only the least-productive spending.

For oil exporters the fiscal policy challenge is similar in some respects to that facing oil importers and different in others. Because these countries also see

inflation pressures from higher food and fuel prices, they also face the question of how to keep inflation reasonably low and preserve the purchasing power of the poor. However, unlike oil importers, oil exporters benefit from a strong positive current account and a very substantial revenue windfall. Therefore, the question before them, particularly those with large remaining oil reserves, may not necessarily be whether and how fast to reduce spending, but rather whether and how fast to increase it. The answers depend on administrative capacity to ensure that additional spending is of high quality, on the economy's capacity to absorb such additional spending, and on preexisting inflation pressures. Spending in excess of administrative capacity would do little to enhance the economy's growth potential, and spending in excess of the macroeconomic absorption constraint could easily lead to inflation and excessive real appreciation, undermining the competitiveness of the non-oil sector, particularly where inflation pressures are already present. Even oil exporters should therefore remain fiscally cautious, and should probably consider increasing spending only after inflation pressures have abated, and only after administrative capacity has been strengthened sufficiently to allow high-quality spending, including by enhancing public financial management. It would also be prudent to limit spending to a permanently sustainable level.

Monetary and exchange rate policies

The monetary and exchange rate policy response to the food and fuel price shock should be geared toward (i) allowing the increase in food and fuel prices to lead to temporarily higher inflation to

facilitate relative price adjustment but avoid sustained higher inflation and (ii) working to preserve current account sustainability by allowing real exchange rate adjustment and reducing domestic absorption as needed. Box 1.4 presents a justification for goal (i) and ways governments could pursue it. The key finding is that central banks should resist the inflationary impact of the food and fuel price shock early and aggressively where credibility is weak, where knowledge about the structure and the current condition of the economy is limited, and where demand pressures already contribute to inflation. Most sub-Saharan African countries meet some or all of these conditions.

In pursuing goal (ii)—preserving current account sustainability by allowing real exchange rate adjustment and reducing domestic absorption as needed—policymakers face difficult trade-offs relating to the role of changes in the nominal exchange rate: A nominal depreciation would help address current account imbalances but would also fuel inflation. And keeping the nominal exchange rate stable or even allowing it to appreciate would help reduce inflation but would do little to address current account imbalances. In both cases, restrictive monetary policy will be needed to rein in inflation, ideally supported by sufficiently tight fiscal policy.

While the recent easing of food and fuel prices has reduced inflation pressures, some governments may have “fallen behind the curve” in fighting inflation and may need to tighten monetary policy going forward, especially where inflation has increased

Box 1.4. How Should Monetary Policy Respond to the Food and Fuel Price Shock?

The food and fuel price shock poses a difficult challenge for monetary policy in Africa. After several years of stabilizing inflation and anchoring inflation expectations, policymakers could see hard-won gains reversed.

The standard advice is to allow an increase in inflation if it reflects the first-round effects of supply shocks, but to prevent—and respond to—an increase in the general price level if it reflects second-round effects:

- First-round effects are the direct impact of oil and world food prices on the consumer price index and the indirect effect on consumer prices that results from the use of oil as an intermediate input in the production of local goods. Because first-round effects capture changes in relative prices in the economy, their impact on inflation should be short-lived.

Box 1.4 (concluded)

- Second-round effects are increases in prices beyond first-round effects. In general, they result from pressures to preserve real wage levels.

While relatively straightforward, the first-round/second-round paradigm raises several issues that may limit its practical viability:

- Second-round effects may be inevitable. Particularly if policy credibility is weak and economic agents form inflation expectations on the basis of observed inflation, even a first-round spike in inflation will raise inflation expectations and therefore create longer-term inflation pressures. Also, experience suggests that for a given supply shock, second-round effects tend to be larger if inflation was already high as the price shock hit.
- Disentangling first- and second-round effects may be challenging, as both effects can occur simultaneously. In addition, distinguishing between the two requires detailed knowledge of the consumer basket and the structure of the economy.

These weaknesses are particularly acute in sub-Saharan Africa. Policy credibility is limited in many countries despite the disinflation successes of recent years; inflation pressures were already present in a number of countries when the commodity price shock hit; and pervasive data problems, such as the lack of input-output tables, make it difficult to distinguish first- and second-round effects.

Thus, central banks may wish to resist even first-round effects to some extent to reduce the risk that a more drastic and prolonged tightening may be needed later (“A stitch in time saves nine”). In particular, early and decisive tightening would serve to keep inflation expectations from rising as a result of poor credibility.

If policymakers in a particular country conclude that policy should be tightened at this juncture, the need to do so must be weighed against other considerations. A strong policy response might be particularly contractionary at a time when economies are already being hit by a negative supply shock. In some countries, policy tightening may undermine the stability of the domestic financial system. An additional issue is that countries may need a real exchange rate depreciation to ensure external balance, but that might be at odds with the need for disinflation if it takes place through a nominal depreciation. Together these considerations suggest that the policy response may have to be more gradual than is optimal from the point of view of inflation objectives alone, and inflation may have to remain above target for some time.

Also, the manner in which policy is tightened must be adjusted to the policy regime in place. Inflation targeters would need to raise their policy rates. On the other hand, money targeters would have to be flexible: sticking to previously set targets may be an excessively tight policy. More generally, real money balances must fall relative to planned levels so as to contain aggregate demand and reduce inflation pressures. Finally, countries with fixed exchange rate regimes are limited in their policy options. Limited capital mobility could give them some room for monetary tightening. Any efforts to contain inflation beyond that, however, may require a fiscal adjustment.

In any case, the fact that inflation and monetary aggregates are likely to be above target means that the central bank’s communication strategy is important to help shape expectations and contribute to inflation stabilization. Such communication should explain why targets have been missed, what the policy strategy is for bringing inflation down, and what the central bank will do if inflation does not fall as intended.

Note: This box was prepared by Rafael Portillo, Ali Aliche, and Marshall Mills.

strongly. This is because substantial residual inflationary pressures from the food and fuel price shock and demand pressures may still be present in a number of countries. For example, domestic fuel prices might still increase if and when fuel subsidies are being reduced. Fiscal tightening should support the monetary tightening, particularly where fiscal pressures have contributed to inflation pressures and where monetary policy choices are limited by the exchange rate regime.

Structural policies

Although governments should intensify efforts to reduce obstacles to doing business in general, the food price shock has brought increased attention to the need to strengthen agriculture in particular. Box 1.5 suggests that a strategy for strengthening agriculture should comprise action in four areas: strengthening land and water management, enhancing infrastructure and market access, reducing risk in often-thin markets, and helping farmers adopt appropriate agricultural technology.

Outlook for 2009 and Risks

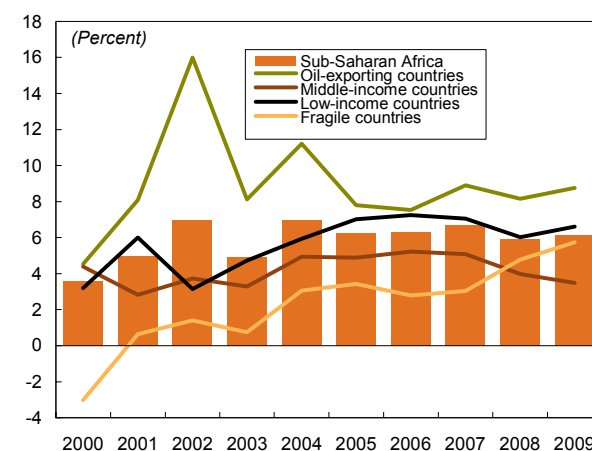
Projections for 2009 look relatively favorable with respect to growth and inflation, but risks have increased significantly as the global outlook has become much more uncertain.

- Growth:* In oil exporters, growth in 2009 is projected to accelerate by 1 percentage point, assuming that the idiosyncratic factors reducing growth in 2008 will disappear. In importers, growth is projected to remain unchanged. Overall, growth in sub-Saharan Africa is thus expected to accelerate moderately to just above 6 percent in 2009—close to the average of recent years but with a somewhat larger difference between oil exporters and importers (Figure 1.8).
- Inflation:* Inflation is projected to fall to 10 percent in 2009 (Figure 1.9), reflecting the anticipated decline in commodity prices relative to 2008 and the related easing of

inflationary pressures. The projection is also based on the assumption that monetary policy will be tightened where needed.

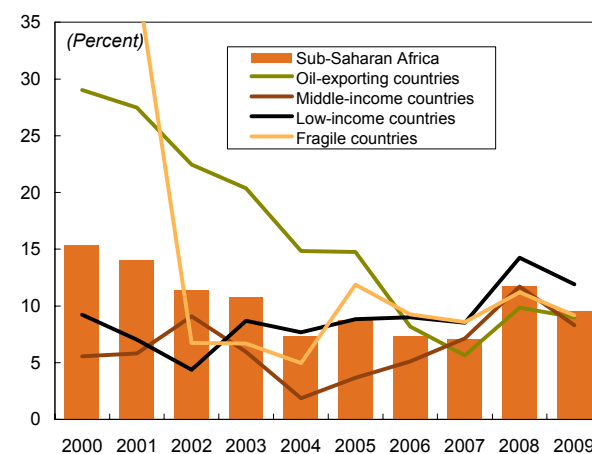
- Fiscal positions:* In oil exporters, fiscal surpluses excluding grants are projected to fall to 5 percent of GDP in 2009, reflecting lower oil prices and consequently lower oil revenue. In oil importers, fiscal deficits excluding grants are expected to remain unchanged at 3 percent of GDP. Grants are projected to change little.

Figure 1.8. Sub-Saharan Africa: GDP Growth
The expansion continues, particularly in oil exporters.



Sources: IMF, *World Economic Outlook*; and IMF, African Department database.

Figure 1.9. Sub-Saharan Africa: Inflation
Inflation, on the rise in 2008, should ease in 2009.



Sources: IMF, *World Economic Outlook*; and IMF, African Department database.

Box 1.5. Expanding Agricultural Production in Sub-Saharan Africa

Thanks to reduced conflict, greater economic stability, and lower taxation, annual agricultural production in sub-Saharan Africa grew from 2.3 percent in 1980–89 to 3.8 percent in 2000–05. Rural poverty rates have started to decline, but higher and sustained agricultural growth is necessary to meet the Millennium Development Goal of halving poverty by 2015. Accelerating and sustaining future growth will need to rely more on agricultural productivity gains as the scope for expanding cultivation declines. With increased commitment and resources, these productivity gains are achievable.

Changes to the global environment offer both challenges and opportunities for agricultural growth in Africa. Higher global fertilizer and energy prices raise farm input costs. Higher food prices may raise farm revenues. Productivity gains can improve profits. Accelerating productivity growth in this new global environment will require investment in four complementary areas emphasized in the recent African Union Comprehensive Africa Agricultural Development Program: (i) land and water management, (ii) market access, (iii) risk management, and (iv) agricultural technology.

Land and water management: Only 18 percent of arable land with irrigation potential in sub-Saharan Africa is irrigated. Current fertilizer application rates are a tenth of South Asia's—not high enough to reverse the decline in soil nutrients drained for decades. Policy improvements and investments are needed to expand irrigated areas and improve the management of rain-fed systems; to improve land and water property rights, particularly for women; and to replace soil nutrients.

Market access: Staple crops dominate current production and will continue to do so for the near future. Nontraditional exports, while still a small share of production, have potential for rapid growth. Reducing postharvest losses and improving efficiency can contribute significantly to growth. Investments in physical infrastructure, with particular attention to roads and communications, and institutional investments for improved regulation, market information, and performance of producer organizations can help strengthen these markets. OECD countries and large emerging market economies like China, India, and Brazil also need to open their markets to Africa.

Risk management: Unpredictable public policies, high transaction costs, and the vagaries of weather increase price volatility, particularly in thin markets. Better market information and marketing extension programs can mitigate these risks. Additional tools, such as hedging instruments and options, are being piloted for organized smallholders in a few countries.

Agricultural technology: Better use of current and adopted seed varieties can double yields. Accelerating adoption of new seed varieties requires improved incentives, investments in agricultural research and extension systems, access to financial services, and “market-smart” subsidies to stimulate input markets. The vast variety among rain-fed systems in sub-Saharan Africa requires adaptation of technologies and services to local conditions—an approach different from that applied during the green revolution in South Asia. Finally, international and regional research efforts through both the Consultative Group on International Agricultural Research and the Forum for Agricultural Research in Africa need to be scaled up.

Note: This box was prepared by Robert Townsend (World Bank).

- *Terms of trade and external positions:* The terms of trade of oil exporters are projected to deteriorate by 6 percent relative to 2008, reflecting mainly lower projected oil prices than in 2008. The terms of trade of oil importers excluding South Africa are projected to decline slightly as well, by 1 percent, in spite of lower projected oil

prices. This reflects a projected decline in the prices of important nonfuel commodities such as metals, beverages (coffee and cocoa beans), and agricultural raw materials. In line with this, oil exporter current account surpluses including grants are expected to fall to 6 percent of GDP, and oil importer current account deficits including grants are projected to deteriorate further to 8 percent of GDP (Figure 1.10).

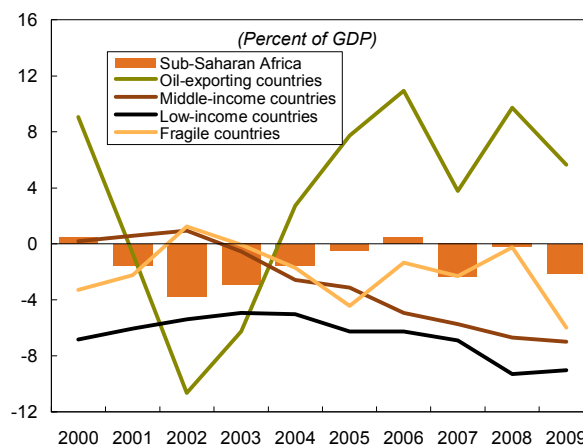
Risks to the outlook for 2009 from the global environment have increased and are tilted to the downside. As already pointed out, one important risk is that the global financial market turbulence could slow global growth by more or for longer than expected, which would likely reduce demand for Africa's exports and depress its terms of trade. In a more-pronounced global downturn, foreign direct investment, portfolio aid, and remittances inflows could slow as well. Another important risk is that fuel and food prices could rise again, approaching the levels seen in mid-2008. While such an increase would benefit oil exporters' fiscal and external balances, oil importers would suffer, and inflation across the continent might be harder to reduce than expected.

To illustrate the uncertainties and the risks to the growth forecast for sub-Saharan Africa relating to the global environment, Figure 1.11 provides confidence intervals based on the WEO assessment of global risks. The intervals incorporate both the historical dependence of African growth on world growth and the historical African growth volatility. The distribution of the confidence intervals around the central forecast suggests there is about a one-in-five chance that growth in sub-Saharan Africa in 2009 will fall to less than 5 percent. To sustain growth and keep inflation in check, countries need to be prepared to respond to sudden changes in global economic conditions, particularly in commodity prices. They may also need to consider building over time an additional cushion in external reserves to better withstand exogenous shocks.

In addition to risks stemming from unforeseen developments in the global environment, there are

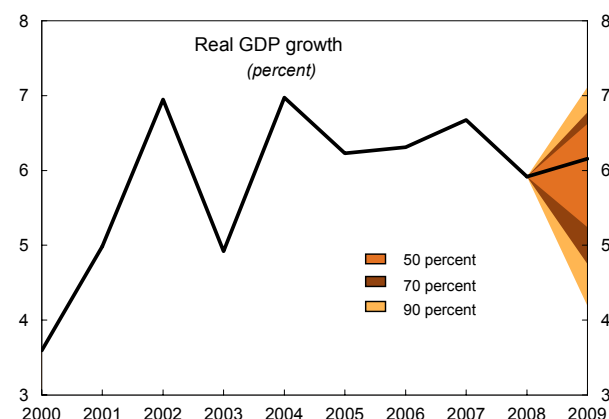
Figure 1.10. Sub-Saharan Africa: External Current Account Balances

The current accounts of oil importers are deteriorating.



Sources: IMF, *World Economic Outlook*; and IMF, African Department database.

Figure 1.11. Sub-Saharan Africa: Growth Prospects¹
One-in-five chance of growth below 5 percent.



Sources: IMF, *World Economic Outlook*; and IMF, African Department database.

¹Including Zimbabwe.

domestic risks. The main domestic risk is that policies could fail to preserve the growth and reform momentum of recent years, either by not providing enough cushioning for the poor or by failing to preserve sufficient macroeconomic stability. This risk appears particularly acute in several hard-hit low-income oil importers, but other countries do not seem immune. Chapter 2 places the current situation in the broader context of Africa's growth takeoff since the mid-1990s. It provides a longer-term perspective on the policies needed to preserve growth and reduce poverty.