1. Resilience and Risks

Introduction

Sub-Saharan Africa's recovery from the global financial crisis is proceeding apace. Following a sharp drop in the growth rate to 2½ percent in 2009, the region's economy is set to expand by almost 5 percent this year and a higher still 5½ percent in 2011. If these projections prevail, economic growth in most countries in the region will have effectively bounced back to the high levels registered in the mid-2000s. The overall picture, therefore, is one of resilience in the face of one of the most wrenching periods for the global economy.

But this picture is not without blemishes. First, the economic slowdown in 2009 has exacted a heavy toll. Most significantly, progress toward the Millennium Development Goals (MDGs) has likely been delayed as a result of falling incomes and increasing unemployment. And with limited formal safety nets in place to help those affected, the implications for human suffering have been dire. Second, should global economic growth fail to hit the 4–4½ percent rate currently being projected for 2011 and beyond, the prospects for sub-Saharan Africa would also be more circumspect. So while growth is set to recover in the region, the slowdown has been costly, and future recovery will be fairly contingent on the health of the global economy.

The rest of this chapter aims to provide a detailed picture of recent developments and prospects by addressing three questions:

- What are the prospects for a sustained recovery in sub-Saharan Africa?
- What explains sub-Saharan Africa's resilience?
- What has been the legacy of the global financial crisis and what are the policy priorities now?

This overview chapter is complemented by two analytical chapters:

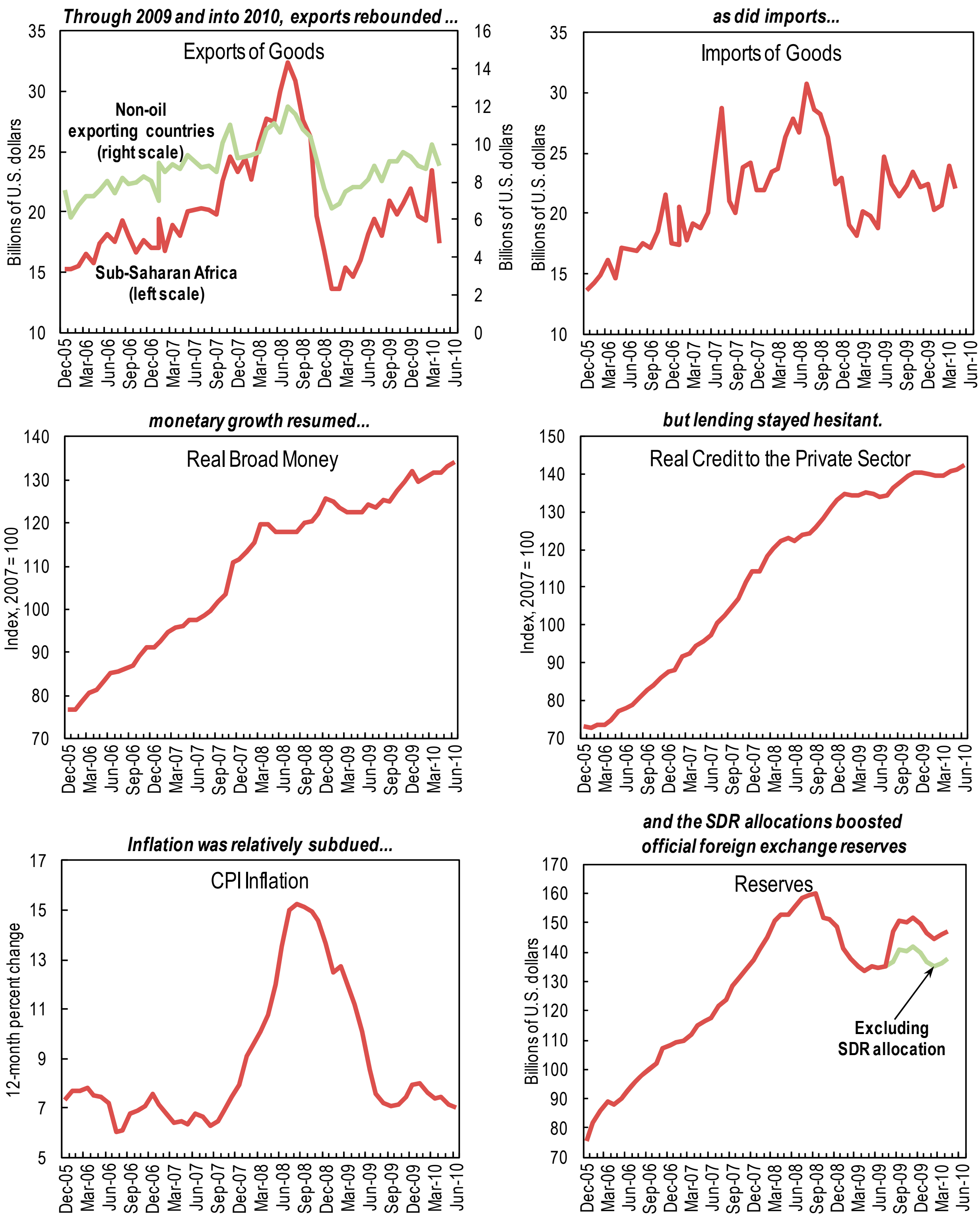
- *Monetary Policy Effectiveness in sub-Saharan Africa.* A central argument in previous editions of this publication has been the countercyclical manner in which fiscal and monetary policies were conducted in most countries in the region during the global financial crisis. The last *Regional Economic Outlook* looked closely at fiscal policy; this time, the focus is on the role of monetary policy.
- *The Quest for Higher Growth in the West African Economic and Monetary Union (WAEMU) and Implications for Fiscal Policy.* Long-term growth in the WAEMU region has been lower than in sub-Saharan Africa's top performers. This chapter considers what may be needed to increase trend growth in the region and the fiscal policy implications.

What Are the Prospects for a Sustained Recovery in Sub-Saharan Africa?

The high frequency indicators available for countries in the region all point to a stalling or marked drop in economic activity from late 2008 through early 2009 and a sustained recovery since then. This is perhaps most evident in trade data—the main channel through which the global recession affected sub-Saharan Africa (Figure 1.1). After peaking in July 2008, export proceeds fell by more than 50 percent through February 2009 as both prices and volumes plummeted. Imports fell in tandem with exports. This pattern tracked closely the experience of other regions in the world. It is important to note,

This chapter was prepared by Abebe Aemro Selassie, Jon Shields, and Alexis Meyer-Cirkel; research assistance was provided by Gustavo Ramirez and Duval Guimarães.

Figure 1.1. Sub-Saharan Africa: Macroeconomic Indicators



Sources: IMF, *Direction of Trade Statistics*; and IMF, *International Financial Statistics*.

Note: Country coverage is limited by availability of monthly data. For example, the figure on CPI inflation covers from 33 to 42 countries, depending on the time period; for the reserves data, only 31 countries are used throughout, covering approximately 95 percent of 2009 sub-Saharan African reserves.

however, that although exports have been increasing fairly rapidly since mid-2009, in both sub-Saharan Africa and the world, as of April 2010, they both remained well below their precrisis peak. The behavior of other economic and financial indicators in sub-Saharan Africa, such as broad monetary aggregates and credit to the private sector, are also consistent with a sharp but fairly short-lived retrenchment in activity from late 2008 through early 2009.

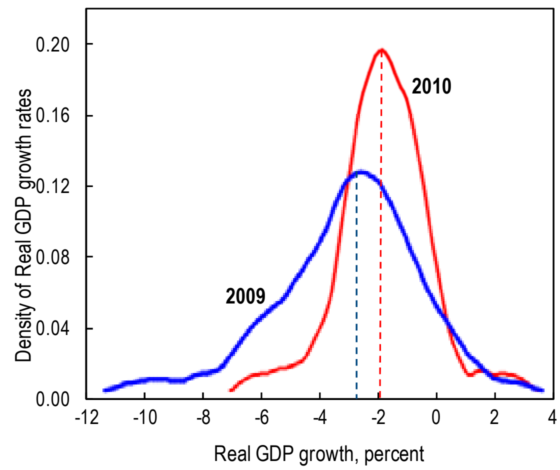
The recovery looks fairly broad-based.

- All four country groupings that this publication considers (oil-exporting, middle-income, fragile, and other low-income countries) are expected to see an expansion in output of 3 percent or more in 2010. The grouping that was hit hardest by the crisis, the middle-income countries, after contracting by about 1¾ percent in 2009, is set to expand by 3¼ percent in 2010. The region's 29 low-income countries have fared better during the global recession. While growth decelerated from 6¼ percent during 2004–08 to 4¾ percent in 2009, this was still a high rate by historic standards, particularly in the context of the deepest global recession in several decades.

- Within each of these groupings, the dispersion of output growth rates among countries is also expected to narrow substantially in 2010 (Figure 1.2). Only Madagascar, still in the grips of heightened political uncertainty, is expected to experience a contraction in economic activity this year.

- In geographic terms, it was the southern part of the continent that was hit hardest by the global recession—with output in Botswana, Namibia, and South Africa, contracting in 2009 and barely expanding in Lesotho and Swaziland. The subregion's slump reflected the heavy toll the crisis exacted on the demand for minerals and precious stones, and in the case of South Africa its strong links to the global economy, particularly in exports sensitive to credit conditions in advanced countries (finished goods, inputs for manufactured products, and so forth). But activity in all countries in the subregion is expected to rebound in 2010 because of the resurgence of mining output and demand for consumer and capital goods.

Figure 1.2. Sub-Saharan Africa: Distribution of GDP Growth in 2009 and 2010



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

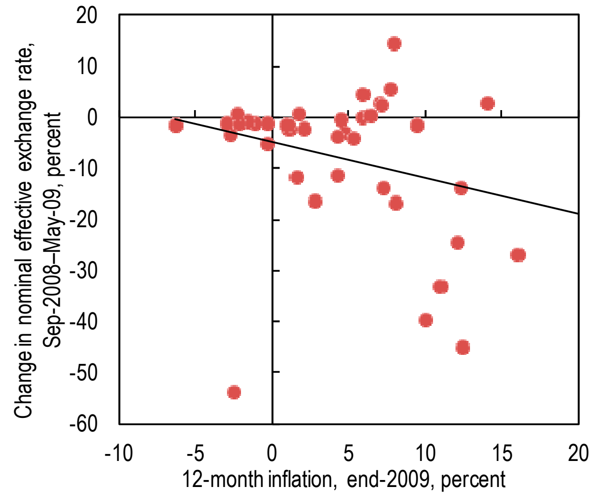
Although the pattern varies, inflation in most countries decelerated markedly through 2009 and is set to remain subdued in 2010. For the region as a whole, the 12-month inflation rate ended in 2009 below 8 percent, compared with more than 13 percent a year earlier in the wake of the spike in food and fuel prices. Inflation in 2009 remained highest in those countries where effective exchange rates depreciated most significantly in the wake of financial turmoil in late 2008 (Figure 1.3). But even in these countries inflation remains on a downward trend. By the end of 2010, only 6 countries (mostly fragile states) are projected to have double-digit inflation compared with 27 countries at end-2008.

As elsewhere, fiscal deficits in most sub-Saharan African countries are set to remain elevated in 2010, after having increased in 2009. The overall fiscal balance for the region, on average, deteriorated by some 6½ percentage points of GDP between 2008 and 2009. But mainly, it was the middle-income and oil-exporting countries, with more financing room, that experienced the largest deteriorations in their fiscal balances in 2009 (as implied by movement to below the 45° line in Figure 1.4a).

Both a decline in revenues (as activity slowed and commodity prices fell) and increases in spending (particularly discretionary spending increases in the middle-income and oil-exporting groupings) contributed to increases in fiscal deficits. In 2010, while the average fiscal deficits of oil exporters are expected to more than halve from 7½ percent to 3½ percent of GDP (Figure 1.4b), because of higher oil prices, other country groupings will show more modest changes. For the region as a whole, an average deficit of about 4½ percent of GDP for the general government balance is expected in 2010, compared with 5 ¾ percent in 2009.

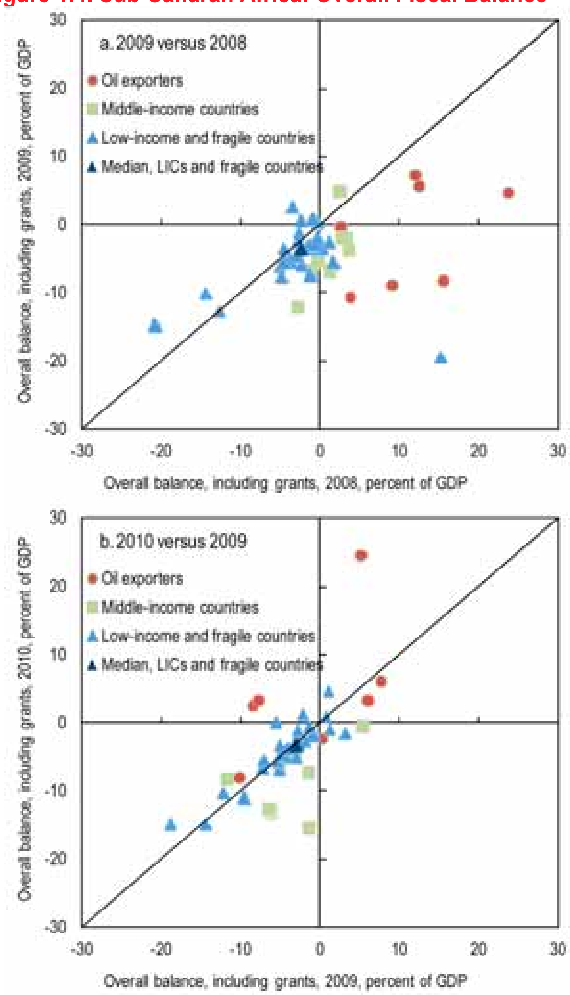
The external accounts of most countries are expected to remain fairly steady in 2010. Oil exporters generally experienced sharp deteriorations in their external balances relative to (declining) GDP in 2009 because of lower oil prices; but only a partial rebound is expected this year. In other country groupings, trade balances have been less affected by the global financial crisis because fluctuations in the value of imports have tended to offset a major part of the changes in exports. External reserve positions, after deteriorating in the early months of the global financial crisis as several countries sought to support their exchange rates, and subsequently receiving a boost of nearly US$12 billion from SDR allocations in August/September 2009, have since remained fairly stable.

Figure 1.3. Sub-Saharan Africa: Nominal Effective Exchange Rate and Inflation



Sources: IMF, *Information Notice System*, and IMF, *International Financial Statistics.*

Figure 1.4. Sub-Saharan Africa: Overall Fiscal Balance



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

Financial sectors in most countries have also proved fairly resilient. This reflects, on the one hand, the relatively subdued impact of the crisis on output compared with other regions and, on the other, the limited exposure of banks to the market and liquidity risk that took a toll in many advanced countries. In most countries in sub-Saharan Africa, balance sheet structures are simpler than in advanced countries, being concentrated on the asset side on traditional lending and holding of government securities. On the funding side, banks in the region rely on retail deposits, which tend to be a more stable source of funding.[1] Nonetheless, localized difficulties were experienced in a number of countries (for example, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Ghana, Nigeria). These largely reflected preexisting weaknesses, exacerbated in some countries by the economic downturn.

Outlook for 2011 and Beyond

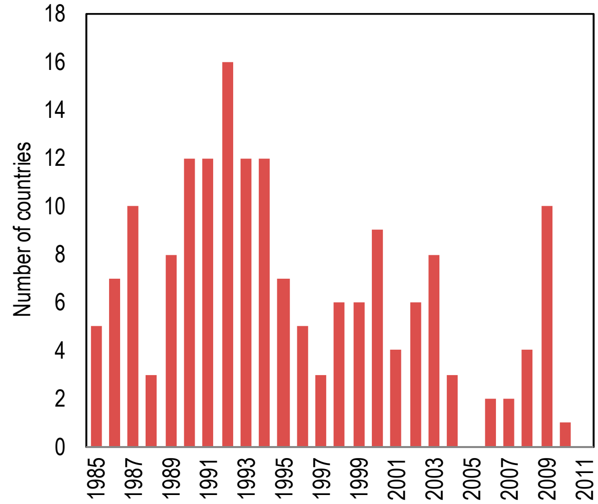
The prospects for the region are promising. With the expansion in global output set to continue, IMF country teams are projecting that, barring shocks, most countries will grow faster in 2011 than in 2010: for the median country, growth is set to increase by more than ½ a percentage point between the two years. And in aggregate, average economic growth for the region is expected to be 5½ percent in 2011 compared with just under 5 percent this year. It is important to note, however, that this assumes that no country will have negative growth in 2011—a relatively rare event historically (Figure 1.5).

Beyond output, other key variables are also expected to evolve favorably:

- Fiscal balances are expected to improve somewhat in 2011 relative to 2010—although they would still remain well below levels that prevailed in the mid-2000s (see below).[2]
- Although ratios of government debt to GDP are expected to rise, on average, the deterioration should be relatively modest in 2011 reflecting additional debt relief as well as improved fiscal performance and faster growth.
- Only a slight deterioration is projected in external current account balances in 2011 as demand growth dips marginally in the region's trading partners. Little change is expected in the levels of foreign exchange reserves.

The diversity in experience and prospects between different countries in sub-Saharan Africa can be effectively conveyed by considering the five largest economies in the region and also the five countries that have performed least effectively over the last three years. Boxes 1.1 and 1.2 show the main features of these countries' backgrounds, policies, and economic developments.

Figure 1.5. Sub-Saharan Africa: Number of Countries with Negative Growth



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

[1] A notable exception is South Africa where there is significant reliance by banks on wholesale funding. But reflecting strong balance sheets and prudent lending practices, the banking sector there too has remained profitable through the recession.

[2] Data for the overall fiscal balances of fragile countries up to 2010 reflect a number of one-off Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI) operations that can in some cases mask the underlying picture.

Box 1.1. What Are the Prospects and Challenges in the Five Largest Economies?

The five largest economies (South Africa, Nigeria, Angola, Ethiopia, and Kenya) account for two-thirds of the region's output and just under half of its population. The group is also quite diverse, comprising a middle-income oil importer, two oil exporters (one of which is also now middle income) and two low-income oil importers (Ethiopia, Kenya) with a more diversified (but, in Ethiopia's case, small) export base. As well, per capita incomes in the last two countries are quite different—about US$330 in Ethiopia and US$840 in Kenya. This diversity mirrors the heterogeneity of the region. All told, therefore, prospects in these five countries should be a useful proxy for trends in the region.[1]

Among the five, only South Africa went into recession in 2009. It felt the impact of the crisis particularly strongly both because of its stronger trade and financial linkages and because the crisis hit the country after economic growth had already started decelerating. The effect was quite brutal, leading to the loss of about 1 million jobs. Angola was also affected heavily by global developments, particularly the volatility in oil prices, and growth decelerated from more than 13 percent in 2008 to under 1 percent in 2009. The other three countries fared much better. In Nigeria and Kenya, growth actually increased slightly; whereas in Ethiopia the marginal fall still left growth at almost 10 percent.

The five countries are set to grow on average by some 5 percent this year and 5½ percent in 2011, playing off the global recovery. But this will require addressing the following challenges:

In **South Africa**, the growth momentum, after three quarters of acceleration, showed signs of tapering off in the second quarter of this year. Despite this, the recovery is expected to be sustained, with output growth of 3–3½ percent projected for 2010–11. In this context, the key for macroeconomic policy is to strike the right balance between supporting the ongoing recovery and strengthening policy buffers, including external reserves. Reforms to improve the effectiveness and efficiency of labor and product markets could help to raise potential growth and to make such growth more labor intensive.

In **Nigeria**, strong non-oil growth in recent years, in particular in agriculture, looks set to continue. GDP growth of about 7½ percent is projected for 2010–11. With growth at potential, it will be important to ensure that fiscal policy is appropriately countercyclical to avoid overheating the economy and to replenish the oil savings account. Improvements in infrastructure and business environment can further increase Nigeria's growth potential.

In **Angola**, the government's adjustment program, supported by an IMF stand-by arrangement, has largely succeeded in restoring macroeconomic stability, following the initially destabilizing effects of the 2009 oil price collapse. Output growth is expected to approach 6 percent in 2010 and 7 percent in 2011, helped by growing oil production. Large government payment arrears to domestic contractors and suppliers has weighed on output in the non-oil sector; resolution of these arrears will be needed if growth objectives are to be realized. Further fiscal consolidation is also needed to strengthen the external position and fully stabilize the economy.

In **Ethiopia**, the economy has recently enjoyed strong and broad-based growth, including rising contributions from the service sectors and industry. Macroeconomic imbalances heightened sharply in 2008–09, but a strong tightening of monetary and fiscal policies since late 2009 has helped reduce inflation to single digits and rebuild international reserves. Exchange rate adjustments have also helped. GDP growth of 8–8½ percent is projected for 2010–11. Monetary policy has been recast to support remonetization. Structural reforms and liberalization will be needed to improve the business environment and secure a robust supply response from the private sector.

In **Kenya**, a fine line should be followed between maintaining the recovery through further fiscal stimulus measures and ensuring that there are no risks to debt sustainability. Similarly, monetary policy will need increasingly to be directed toward inflation objectives. Although growth is recovering well, it is expected to stay below its potential of 6 percent for the next two years.

[1] The correlation between real GDP growth in these five countries and the rest of sub-Saharan Africa is quite high at 87 percent.

Box 1.2. How Can the Region's Five Weakest Growth Performers Sustain Recovery?

The five countries in which output actually fell between 2007 and 2009 were Botswana, Chad, Eritrea, Seychelles, and Zimbabwe. As in the case of the five largest economies, this group is quite disparate, comprising two middle-income countries (Botswana, Seychelles), an oil exporter (Chad), and two fragile states (Eritrea, Zimbabwe). In aggregate they account for about 5 percent of the region's total output and population.

With the exception of Botswana, poor policy environments before the crisis were the main sources of the drops in output, although the crisis added to countries' difficulties. Deep-rooted policy challenges remain in a number of these countries.

In **Botswana**, the demand for diamonds collapsed as the global financial crisis unfolded. However, because of previously prudent policies, the authorities were able to ease fiscal and monetary policies promptly, and the nonmining sector grew by a healthy 6¼ percent in 2009. Overall, the economy contracted by 3¾ percent in 2009. With a rebound of activity in the diamond sector and continuing strength elsewhere in the economy, activity is expected to accelerate to 8½ percent in 2010 and settle back to 5 percent in 2011. In future, public spending will need to return to a more sustainable level with an emphasis on quality and effectiveness.

In **Chad**, the chronically unstable security situation and poor business environment have hindered growth and poverty reduction, notwithstanding sizable oil revenues collected since 2003. Following a weak 2009, real GDP is expected to increase by 4¼ percent in 2010. To date, the oil revenue windfall has led to a weakening of public financial management practices and an unsustainable level of government spending. Medium-term fiscal policy needs to be set with an eye to the trend decline of oil resources over the next 20 years. This will require across-the-board improvements in public financial management practices.

In **Eritrea**, output fell by 10 percent in 2008 in the wake of the world food and fuel price crises and a severe drought, while inflation surged to double digits. The authorities responded by loosening fiscal and monetary policies, through increased social subsidies. The financing of large fiscal deficits, however, further stressed an already fragile banking system. With the return of rains in 2009, growth reached an estimated 3½ percent. Economic growth is expected to remain sluggish in 2010 in the absence of key structural reforms, such as liberalization of the trade and exchange systems, a reform of the banking system, and correction of an overvalued exchange rate.

In **Seychelles**, the radical reform program initiated in 2008 has corrected years of policy errors and structural distortions. The outlook is positive, with GDP growth of 4–5 percent projected for 2010–11. Although the economy proved resilient to the global crisis, tourist and export earnings remain sensitive to the external environment and the threat of piracy. Building on a successful debt restructuring, and prudent fiscal and monetary policies, progress in tax reform and public enterprise restructuring will be key to securing high medium-term growth.

In **Zimbabwe**, a decade of incoherent economic and structural policies and poor governance resulted in a cumulative output decline of more than 40 percent by 2008, inflation spiraling out of control, and a humanitarian crisis. Since 2009, strengthened economic policies, higher commodity prices, and good agricultural seasons have underpinned economic recovery. Real GDP is projected to increase by 6 percent in 2010. Maintaining this growth momentum will require fiscal restraint, in particular with respect to the public sector wage bill, resolution of infrastructure bottlenecks, further progress in containing banking system vulnerabilities, restructuring the Reserve Bank of Zimbabwe, and strengthening property rights enforcement.

Comparing Recoveries

Sub-Saharan Africa's growth performance has kept pace with or surpassed that of other developing regions through the global downturn. In particular, sub-Saharan Africa's performance has most closely paralleled that of developing Asia in having avoided a contraction in output (Figure 1.6). Certainly, some countries in both regions were hit very hard (South Africa in sub-Saharan Africa and Malaysia in developing Asia, for instance). But, on the whole, most countries in these regions escaped with a slowdown in growth in 2009 rather than a recession. They are also enjoying a fairly robust rebound in activity through 2010. It is only in 2011 that the profiles of the projections for the two regions part, with growth in developing Asia set to decline slightly; while growth in sub-Saharan Africa is projected to increase moderately.

Risks

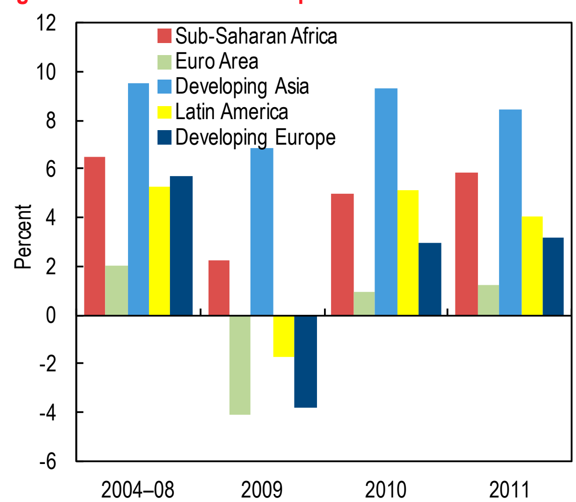
This relatively favorable outlook for sub-Saharan Africa is nonetheless subject to some important qualifications:

- Just as the region's recovery has hinged on broader developments in the global economy so will the prospects for further increase in economic growth in 2011. Should global economic growth fail to reach the consensus (and IMF) forecast of more than 4 percent in 2010 and 2011, the likelihood of a further acceleration in growth to 5½ percent in sub-Saharan Africa would become quite slim. For now, the baseline scenario for the global economy on which this publication's projections for sub-Saharan Africa are anchored, is continued recovery, albeit with differentiation across regions and persisting concerns about rising sovereign risk in many advanced countries. Nevertheless, given the heightened risks of the recovery stalling in all or some key trading partners of sub-Saharan Africa, we discuss below what might prevail should these risks materialize.

- Sub-Saharan Africa's growth will also closely hinge on sustained financing flows (both from official and private sources) at their recent elevated levels (Figure 1.7). If instead risk aversion was to prevail for an extended period or, say, fiscal retrenchment in Europe was to lead to a sharp drop-off in donor support, this would almost certainly hamper the envisaged acceleration in GDP growth.

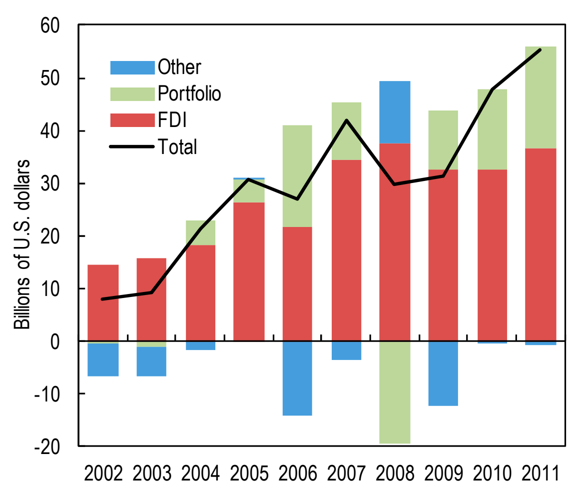
- While region-wide developments tend to be influenced by global factors, the economic fortunes of individual countries tend to be impacted more by domestic developments.

Figure 1.6. International Comparisons: Real GDP Growth



Source: IMF, World Economic Outlook.

Figure 1.7. Sub-Saharan Africa: Private Financing Flows



Source:IMF, *World Economic Outlook.*

For example, in 2009, political instability accounted for output disruptions in four of the eight countries that experienced a contraction in output. In this regard, 2011 could be particularly challenging with the possibility of elections in as many as 17 countries in the region. Although there is little evidence in sub-Saharan Africa of the occurrence of systematic political business cycles, this heavy political calendar could delay some required policy reforms (Box 1.3).[3]

A Downside Scenario

While our central scenario remains very much for the global recovery to be sustained and for sub-Saharan Africa to do particularly well, downside risks to the global recovery have heightened in recent months. This begs the question, how will the region fare if there is a hiatus in the global recovery? The July 2010 *World Economic Outlook* update included estimates of the possible growth impact of heightened financial stress and contagion as a result of mounting sovereign risk. Assuming shocks to financial conditions and domestic demand in the euro area as large as those experienced in 2008, the illustrative model simulations suggested that world growth next year would be reduced by some 1½ percentage points relative to the baseline—that is, global growth just below 3 percent rather than the 4¼ percent currently projected for 2011.

Under such a downside scenario, projected growth in sub-Saharan Africa for 2011 would drop from about 5½ percent to 4 percent. About half of this drop would stem from an assumed cutback in oil production as oil exporters respond to lower OPEC quotas. Growth in oil-importing countries would be about ¾ of a percentage point lower than in the central scenario. Within this group, countries heavily dependent on exports to and tourist receipts from Europe would be hit particularly hard. The impact on their external balances, however, would be mitigated by a reduction in import growth, as demand growth slows, and by much lower oil prices. Assuming only limited responses in government spending, fiscal balances in oil-importing countries would generally deteriorate by less than 1 percent of GDP, but some oil exporters could experience a fiscal deterioration relative to the central scenario of up to 5 percent of GDP. In sum, the effect of a significant slowdown in global growth would be to dampen growth in the region quite markedly, and delay further the effort to rebuild policy buffers.

As long as these risks do not materialize, our view remains that the region is poised to do quite well, with our baseline scenario showing growth almost reverting back to the high rates enjoyed during 2004–08. The reasons for this are considered next.

[3] Countries where major elections in 2011 are planned or have been mooted include Benin, Cameroon, Cape Verde, Chad, Comoros, Democratic Republic of Congo, The Gambia, Liberia, Madagascar, Niger, Nigeria, São Tomé & Príncipe, Seychelles, Swaziland, Uganda, Zambia, and Zimbabwe.

What Explains Sub-Saharan Africa's Resilience?

Two factors that helped to underpin sub-Saharan Africa's resilience during the global recession are likely to be of continuing importance in sustaining the region's recovery. First, the improved economic fundamentals and policy space that provided room for the effective use of countercyclical macroeconomic policy in the global downturn will continue to provide some protection from future fluctuations. Second, insofar as trade remains a crucial factor for sustained growth in many countries, the pronounced shift in the region's trading pattern toward faster-growing parts of the global economy should help to maintain export growth, as it did increasingly during the mid-2000s. By limiting the direct impact on the region's economies of the global recession, these factors also make it less likely that potential growth will be permanently affected.

Policy Response, Unchanged Potential Growth

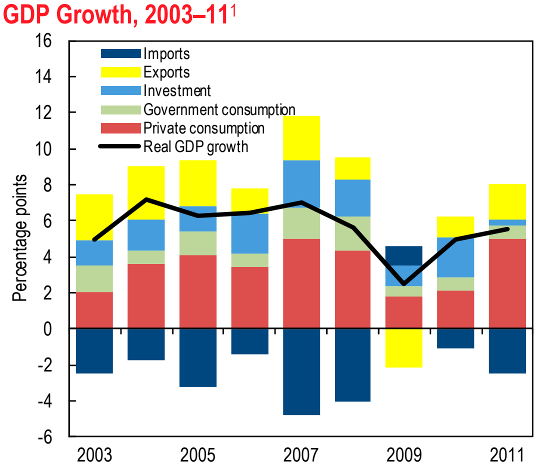
Several factors specific to sub-Saharan Africa have helped to maintain activity through the global recession:

- Most sub-Saharan African countries were on a better macroeconomic footing on the eve of the global financial crisis than possibly ever before. Accordingly, in contrast to previous global shocks, when countries were unable to offset the impact on their domestic economies, this time they were able to ease monetary and fiscal policies to help limit the adverse effects.[4] Although policy space has been somewhat depleted by these actions, there remains some additional scope for further loosening action.

- Second, domestic demand has been a driving force behind growth in sub-Saharan Africa in recent years (Figure 1.8). This trend is expected to continue. In 2011, with few countries in the region set to embark on anything like the policy tightening currently being implemented or contemplated by some advanced countries and emerging markets, our projections are for private consumption, and to a lesser degree, exports and government consumption to provide the main impetus for growth.

- Third, and a bit more speculatively, our view is that potential growth in most sub-Saharan African countries has not been affected much by the global financial crisis. In other words, the factors thought to have lowered potential growth in most of the advanced countries are largely absent in most low-income sub-Saharan Africa countries. These factors include high household and sovereign indebtedness and weakened financial systems. The implications of the likely increased cost of funding over the long term and the steep increase in unemployment are also likely to be smaller in low-income countries.

Figure 1.8. Sub-Saharan Africa: Contributions to Real GDP Growth, 2003–11[1]



Sources: IMF, *World Economic Outlook*; and IMF, African Department database.
[1]Contributions do not always sum to GDP growth because of statistical discrepancies.

[4] See April 2010 *Regional Economic Outlook: Sub-Saharan Africa* on countercyclical fiscal responses; and Chapter 2 of this edition on monetary policy responses during the global financial crisis.

To be sure, the reduced growth path for many advanced economies will have some impact on growth in the region—and output levels may have been permanently affected, as elsewhere in the world—but these factors may be mitigated to some degree by the increased orientation of the region's trade toward the other faster developing parts of the global economy. We consider this next.

Impact of the Differing Growth Prospects for Asia, Europe, and the United States

A positive development for the region's dynamism in recent years has been the increasing orientation of some of its trade toward fast-growing parts of the world—particularly China and other developing countries in Asia and Latin America. But the impact of this shift has varied from country to country and it remains difficult to quantify the net effect on economic growth in the region.

Starting with the aggregate picture, the region's main trading bloc remains the European Union; exports to the European Union and other advanced countries still account for more than half of all exports from sub-Saharan Africa. Despite the heterogeneity of sub-Saharan Africa, this finding is true even at the level of individual countries. And this is just for goods. If one were to include trade in services, including tourism and other income flows, such as workers' remittances, the share would likely be much higher for a vast majority of countries. Therefore, a first stylized fact to be considered with regard to external markets is the continued importance of the European Union and other advanced economies as counterparties for the region.

Second, in most sub-Saharan African countries, exports of goods and services make relatively small contributions to aggregate demand. For more than half of the countries in the region—including all but a handful of low-income oil importers—the ratio of exports to GDP is less than 30 percent. The major exceptions are the oil exporters.

Potential gains to output from a rapid rate of increase in exports outside the European Union and other advanced countries are therefore limited. In practice, it is the exporters of oil and other natural resources that are most likely to benefit in the short term. Even then, with output constrained more by supply than demand, most of the impact is likely to be felt through higher prices rather than volume. However, over the longer term, noncommodity exporters may increasingly gain as new markets are exploited.

Nevertheless, there have been some dramatic shifts in trading patterns during the last few years toward China and other parts of Developing Asia (Table 1.1 and Figure 1.9). These shifts have been so marked that by 2009, the share of China in sub-Saharan Africa's total exports and imports exceeded that of most other regions in the world. The nature of export growth to Developing Asia and its impact can perhaps be best illustrated by considering three countries in the region: Angola, Kenya, and Nigeria:

- Angola's share of exports to Developing Asia increased by 22 percentage points to 50 percent between 2005 and 2010—a period in which Angola's exports (which are predominantly oil and account for nearly 60 percent of GDP) effectively tripled in U.S. dollar terms. In this case, not only was the price of Angola's exports affected by Developing Asia's rapid growth but there was also a large shift in its volume.

- Nigeria's exports are also predominantly oil, but the share going to Developing Asia, while rising swiftly, has been much more modest, increasing by 6¾ percentage points to 10½ percent of total exports between 2005 and 2010. Nevertheless, export earnings have increased sharply in recent years because of higher oil prices. Thus, in this case, the

impact of surging demand in Developing Asia has worked primarily through its impact on world oil prices.

- Kenya's share of exports to Developing Asia increased by just 2 percentage points to 14 percent of the total between 2005 and 2010. Kenya has a fairly diversified export base, and growth in Developing Asia seems to have had a much more limited impact on export volume and prices.

It is hard to quantify how significant an impetus to growth the increasing importance of Developing Asia to the world economy and the reorientation of trade will be for the entire region. Although higher growth in partner countries will certainly be a boon, it is difficult to foresee a significant direct impact on growth for most countries given the limited share of exports in their output. There is, however, a minority of countries, including the major natural resource exporters, for which the impact of Developing Asia on global export demand and commodity prices will be significant in both the short and long term.

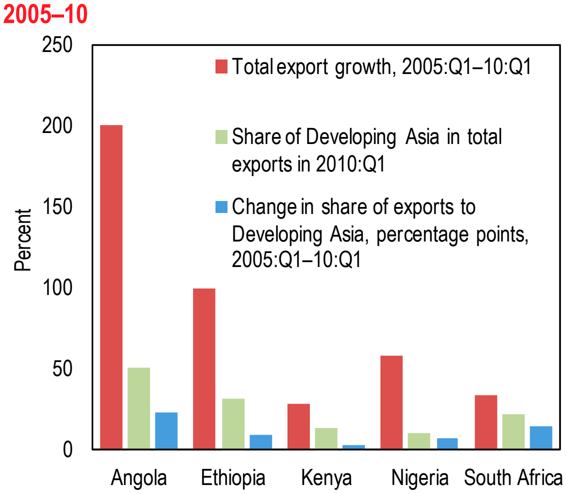
In sum, our view is that the region's increased exposure to demand from Developing Asia has certainly helped attenuate the impact of the global financial crisis and will help keep growth on its current trajectory for some countries. This will support other factors that remain the key drivers of growth: primarily political stability; the business climate, including the prudent exploitation of natural resources; and the quality of economic management.

Table 1.1. Share of China in Total Merchandise Trade

	2000	2005	2009
	(Percent of total)		
Share of China in total world trade	3.8	7.2	9.6
Exports	4.1	7.9	10.8
Imports	3.5	6.5	8.4
Share of China in Sub-Saharan Africa trade	3.4	7.8	13.6
Exports	3.3	7.6	12.6
Imports	3.5	7.9	14.5
Share of China in European Union trade	1.8	3.2	4.5
Exports	1.0	1.6	2.5
Imports	2.6	4.9	6.5
Share of China in Developing Asia trade	2.5	4.0	5.8
Exports	2.1	3.2	4.4
Imports	2.8	4.4	6.4
Share of China in Middle East trade	4.1	6.3	9.7
Exports	3.8	5.9	8.6
Imports	4.7	6.9	10.9
Share of China in Western Hemisphere trade	1.5	5.0	9.1
Exports	1.0	3.2	6.8
Imports	2.0	6.8	11.3

Source: Arora and Vamvakidis, 2010; and IMF, *Direction of Trade Statistics*.

Figure 1.9. The Increasing Role of Developing Asia. 2005–10



Sources: IMF, *Direction of Trade Statistics;* and IMF staff calculations.

What Is the Legacy of the Global Financial Crisis and What Are the Policy Priorities Now?

The legacy of the global recession on the main macroeconomic aggregates in sub-Saharan Africa, then, can be roughly summarized as follows (Figure 1.10):

- Output growth for a majority of low-income countries in 2010 is expected to revert back to just a little shy of the boom years of 2004–08, although the picture is much more mixed for middle-income countries and oil exporters. Some middle-income countries are benefiting temporarily from a bounce back from the slowdown, whereas others are still weighed down by its impact. For oil exporters, no repeat is expected of the rapid buildup in oil production that allowed Angola and Equatorial Guinea to grow at double-digit rates in the mid-2000s. Nevertheless, a positive general feature across sub-Saharan Africa is that rising investment rates (public and private) during the 2000s seem unlikely to be interrupted.

- The global financial crisis has taken its toll on fiscal balances, particularly in middle-income countries and oil exporters. Revenues have fallen in these country groupings as a share of GDP, reflecting lower-than-trend output and below-peak commodity prices, while government spending growth has been maintained to offset external shocks. This has not yet seriously impacted debt levels in any country grouping, but it will do so soon, unless there is fiscal adjustment.

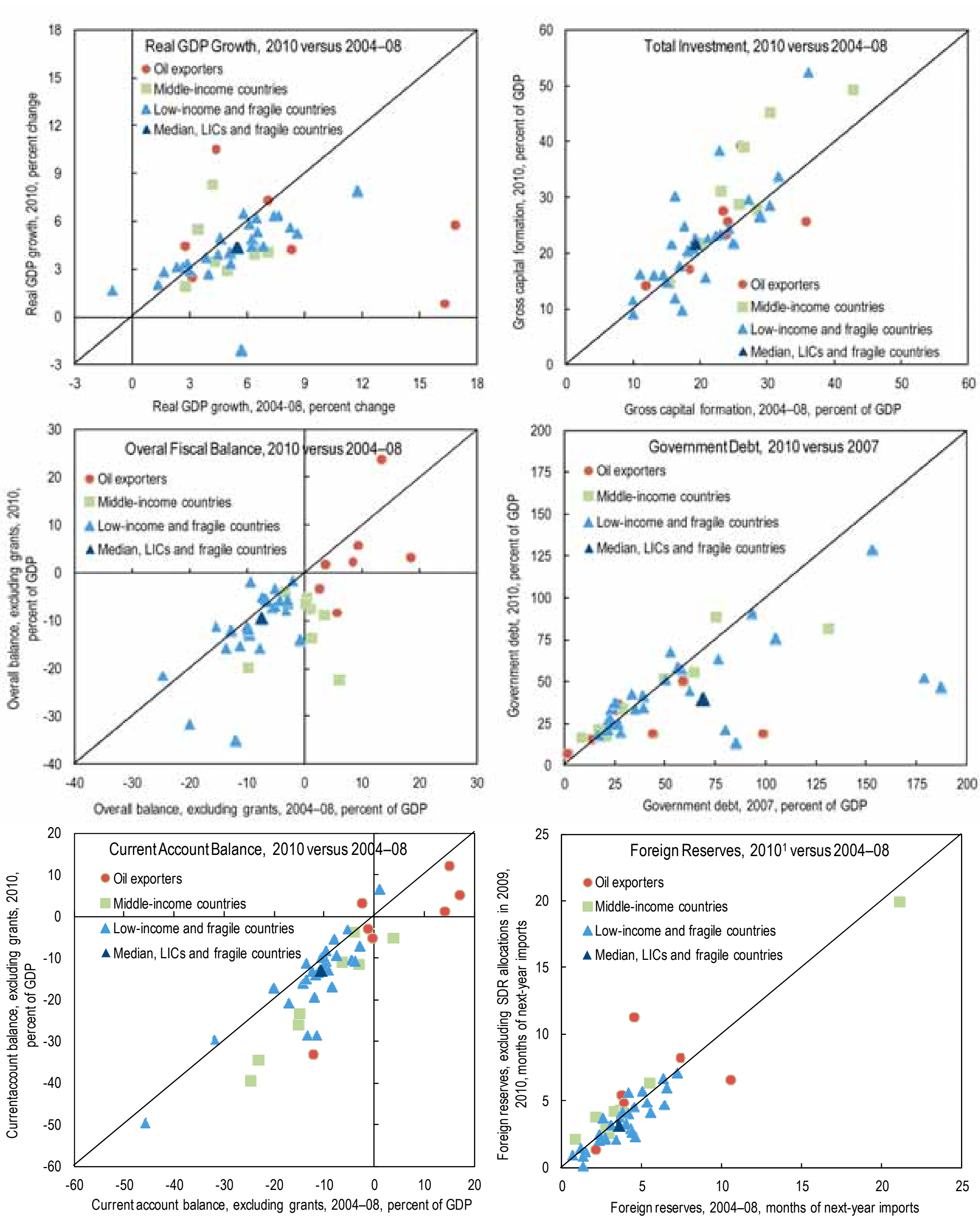
- Most middle-income and oil-exporting countries have yet to restore the levels of exports, relative to GDP, that they achieved before the global financial crisis; whereas import ratios are generally closer to previous trends. In reaction to the initial sharp deterioration in external balances, a few countries drew heavily on their foreign exchange reserves to support their exchange rates and have not yet replenished them. But most low-income countries experienced little underlying change in their external balances or in reserves during the slowdown; and they benefited in addition from the IMF's SDR allocations in August and September 2009.

With this as background, what should fiscal and monetary policy focus on now? Some important considerations for the coming months are set out below.

Fiscal Policy

As the global financial crisis started to weaken economic activity, in a break from past experience, fiscal policy in most countries in the region became countercyclical. In most cases, this amounted to spending (in real terms) being maintained at the elevated levels of previous years while tax revenue shortfalls were generally accommodated. In particular, government spending as a ratio to GDP was higher in 2009 than in 2008 in 31 out of 44 countries in the region. And this relatively broad-based spending increase occurred in the face of declining revenue ratios in many countries. Moreover, spending is set to remain at these higher levels in most countries in 2010. Indeed, in the 29 low-income countries in the region, for example, the median level of spending is actually estimated to increase from 24 percent to 24¾ percent of GDP between 2009 and 2010.

Figure 1.10. Sub-Saharan Africa: After the Global Recession, 2010 versus 2004–08



Sources: IMF, *World Economic Outlook;* and African Department database.
[1] The value of the SDR allocations made in August/September 2009 is subtracted from foreign reserves for 2010.

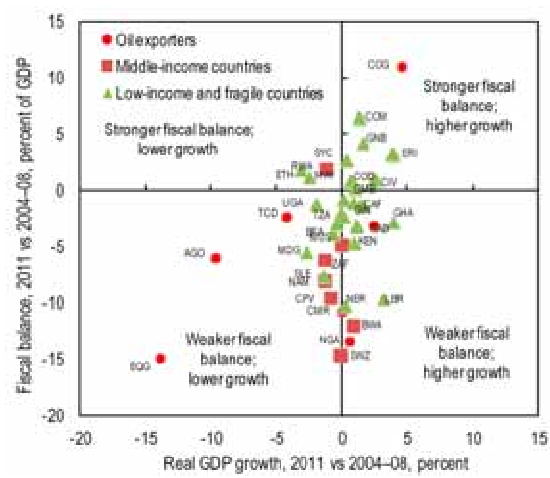
The result has been wider fiscal deficits virtually across the board. Between 2008 and 2009, the median fiscal deficit in the region (excluding grants) increased by some 2½ percentage points of GDP—by ¾ of a percentage point of GDP in the case of the 29 low-income countries. Wherever financing constraints were not binding, it clearly made sense for fiscal policy to be put on such an expansionary footing as growth decelerated. And as a sign of how much macroeconomic conditions in the region have improved, these marked increases in the fiscal deficits have been financed with relative ease and without engendering macroeconomic imbalances.

Still, these more recent increases in fiscal deficits come on top of an upward drift in spending levels relative to GDP in most countries in recent years. Revenue ratios have not kept pace. The trend in these two aggregates cannot continue in this vein without triggering either an undesirable buildup of debt or the risk of countries resorting to harmful forms of financing, such as domestic arrears or the inflation tax. So while work by IMF staff shows that the increase in indebtedness as a result of the countercyclical policy response and the drop in growth in the wake of the global financial crisis has not—to a significant degree—pushed public debt toward unsustainable trajectories, this may yet happen if fiscal deficits do not soon revert back to their medium-term sustainable levels.[5]

Thus, looking ahead, a shift in the emphasis of fiscal policy likely is necessary in many countries in the region. Specifically, with growth in most countries in the region having reverted close to potential, the motivation for wider fiscal deficits can no longer be a means of supporting output. In three-fourths of the countries in the region (33 out of 44), growth in 2011 is set to be above or within 1 percentage point of the levels registered in 2004–08. At the same time, fiscal balances have deteriorated relative to GDP in 24 of these countries, with a deterioration in excess of 5 percentage points of GDP in 11 countries (Figure 1.11). In these cases it will be particularly important to review the consistency of fiscal deficits with financing and debt sustainability considerations. At the same time, to promote growth, poverty reduction, and investment over the medium term, attention should increasingly be refocused on the composition and quality of government spending and revenue. Accordingly:

- if the current and projected levels of the fiscal deficit are already consistent with medium-term objectives, no change in the overall fiscal stance would be required;
- where the fiscal deficit has increased as a result of discretionary measures to help support output to levels above those consistent with medium-term objectives, these measures should be reversed or offset in forthcoming budgets as soon as evidence is clear that output growth has reverted to potential levels; and
- even where the fiscal deficit has increased largely on account of the operation of automatic stabilizers to levels above those consistent with medium-term objectives,

Figure 1.11. Sub-Saharan Africa: GDP Growth and Fiscal Balance



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

[5] April 2010 *Sub-Saharan Africa Regional Economic Outlook* and IMF (2010a).

policymakers should ensure that revenue collections and spending are on a trajectory that will allow the fiscal deficit to revert back to its desired medium-term path.

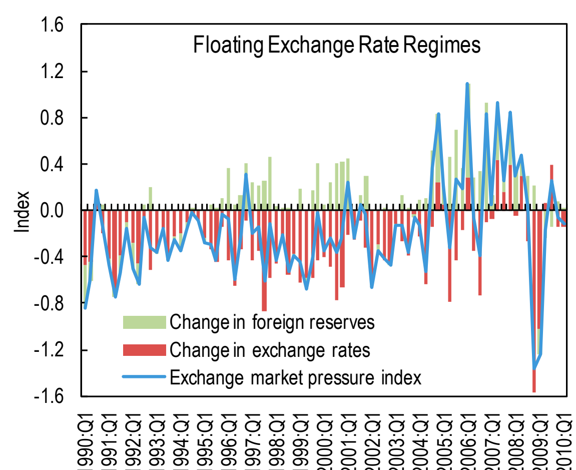
Is the uncertainty regarding the global growth outlook an argument for maintaining an accommodative fiscal stance? Our view is that, barring a realization of the fears for the global economy, fiscal policy should be reoriented promptly toward medium-term policy objectives in sub-Saharan Africa in all countries where output growth has reverted close to potential. It made good sense to use fiscal policy to counter the effects of the large adverse shock engendered by the global financial crisis. But for smaller shocks, governments should look to use other levers, including monetary policy, as the main line of defense. This is because in most countries in the region, fiscal institutions and policy levers are not conducive to a nimble response to more moderate shocks.

Monetary Policy

As with fiscal policy, the monetary policy response in sub-Saharan Africa—first, to the food and fuel price crisis and second, to the global recession—has on the whole been appropriately countercyclical. As food and fuel prices shot up, policymakers considered the steep increases as a largely temporary phenomenon and increased interest rates only moderately. And when the global economy looked headed into recession, policymakers lowered nominal interest rates quickly and by significant margins (see the next chapter). In real terms, however, policy rates did not fall as much or even increased somewhat in some countries as inflation decelerated much more sharply.

On the basis of past relationships, we would expect the fall in nominal policy rates to have provided some support to output (Chapter 2). However, the effect may have been dampened or even offset during the global financial crisis. When central banks tried to lower domestic interest rates in response to slowed economic activity, particularly in some countries with open capital accounts and floating exchange rate regimes, domestic interest rates often drifted upward because of rising global risk premiums. Overall, the monetary policy response can perhaps be characterized as fairly nimble and effective. Policymakers moved adroitly from dealing with inflationary shocks (the food and fuel price shock) to countering more recessionary pressures (the global downturn). The shift over time in the manner in which exchange rate policy was conducted is another case in point. In the countries with flexible exchange rate regimes, a much greater willingness to allow exchange rates to adjust was evident in 2008–09 (Figure 1.12), even against the backdrop of generally comfortable international reserve levels in many countries. And as for the overall effectiveness of the monetary policy response during the crisis, it can be gauged by the fact that in the vast majority of countries, inflationary pressures have remained contained and excessive balance of payments pressures have been avoided.

Figure 1.12. Sub-Saharan Africa: Exchange Market Pressure Index,[1] 1990–2010



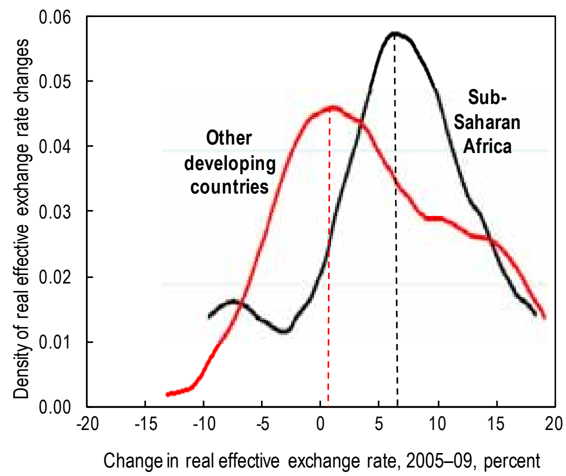
Sources: IMF, *International Financial Statistics;* and IMF staff calculations.

[1]Unweighted averages of country-specific indices. The index is the weighted average of quarterly changes in foreign reserves and quarterly changes in nominal bilateral exchange rates, using the inverse of their standard deviations as weights. Changes in foreign reserves are normalized on base money.

Looking ahead, we see the challenge for monetary policy in the region as follows. In most countries, inflationary pressures look fairly subdued. Consequently, a broadly neutral monetary policy stance is appropriate in these cases. Where there is a clearer case for a tighter monetary policy stance are those countries where inflation is projected to be in double digits (some 6 countries) or above inflation targets. In these cases, unless there are clear signs that inflationary pressures are of a transitory nature, intermediate monetary targets—policy interest rates or reserve money growth—should be tightened. On the other side, in countries where inflation is subdued, output gaps are not expected to close in the near term, and foreign exchange reserve levels are adequate, there may be a case for further easing of monetary policy.

A trend that also bears careful monitoring in the coming months is the nontrivial appreciation of real effective exchange rates observed in many countries in the region. In particular, real effective exchange rates in most countries appear to have appreciated by about 10 percent between 2005 and 2009 (Figure 1.13). This appreciation may to some degree be an equilibrium phenomenon, in view, among other factors, of improvements in the terms of trade of most countries. Still, the large number of countries in the region in which real exchange rates have appreciated (particularly compared with the experience of other developing countries) warrants careful monitoring in coming months.

Figure 1.13. Difference in Real Effective Exchange Rate Index between 2005 and 2009



Sources: IMF, *Information Notice System*; and IMF staff estimates.

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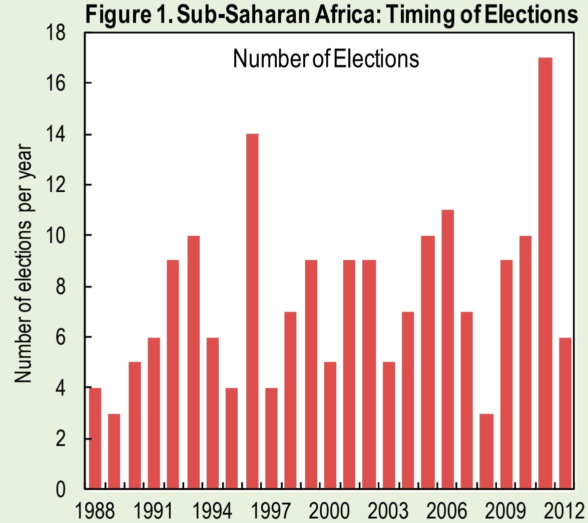
Box 1.3. National Elections and Economic Activity: Are There Political Business Cycles in Sub-Saharan Africa?

Seventeen out of 44 countries in sub-Saharan Africa may stage national elections in 2011: potentially the heaviest political calendar in the region in at least 20 years (Figure 1). Evidence from other parts of the world points to the presence of pronounced budget cycles around elections in some countries. So the question arises whether macroeconomic prospects will be affected by this tight bunching of elections in sub-Saharan Africa—either, in a narrow sense, by the potentially destabilizing impact of fiscal give-aways or postponement of fiscal adjustment or, more broadly, by governments trying to manipulate the overall economic environment.

Elections with major consequences for economic policy determination occur normally on four- or five-year cycles in sub-Saharan Africa. Fixed terms tend to be the norm for the election of presidents with extensive executive powers and for legislatures in countries with constitutional monarchies or with appointed presidents. This raises the possibility of administrations attempting to align business cycles with election cycles on a systematic basis.

Figure 1. Sub-Saharan Africa: Timing of Elections



Sources: Economist Intelligence Unit; and African Elections Tripod.

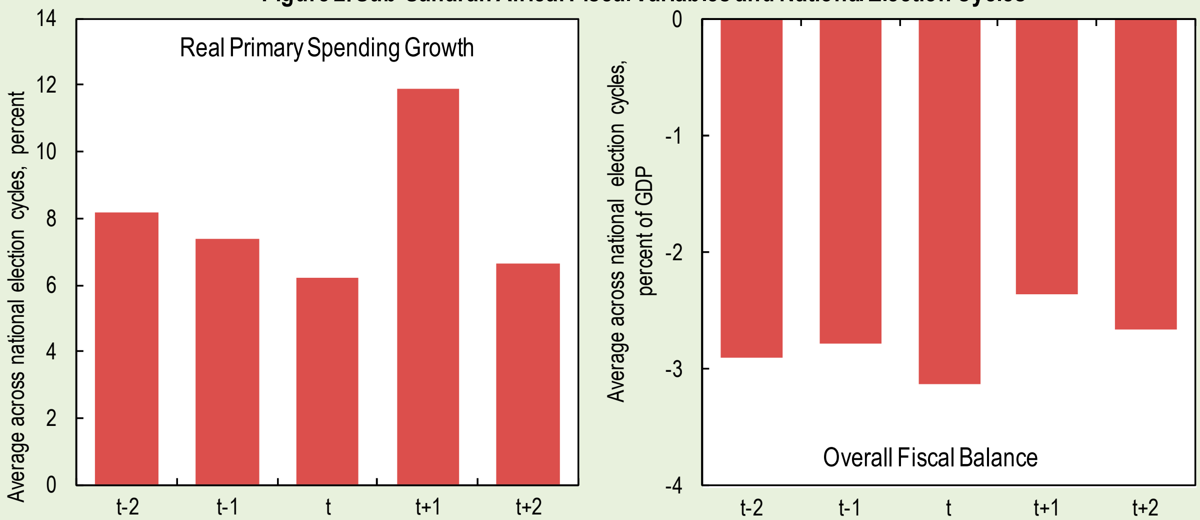
Using a database covering more than 150 elections in 44 countries during 1988–2009, we looked for evidence of consistent patterns in government spending, fiscal balances, or economic growth around elections. These proved hard to detect, particularly for economic growth.

Averaged across all countries and all elections, both government spending growth and fiscal balances tended to be fairly similar in all years of a typical election cycle. Although fiscal balances were slightly lower on average in election years, and spending was slightly higher on average in the year following elections, the differences were not significant (Figure 2). Indeed, when looked at in isolation: in most countries, in most years, fiscal balances were actually higher in election years than in preceding years.

In some countries, however, such as Gabon, Ghana, Kenya, Mozambique, Niger, Seychelles, and Togo, two or more election years during the period were associated with a discernible cycle in fiscal variables, in the sense that real spending growth was markedly higher and/or fiscal balances were markedly lower in these years than in all of the surrounding years. Even when fiscal data for these countries were averaged across all election periods, some regular cyclical patterns were observable.

Turning to measures of economic activity, there was very little evidence of systematic patterns around election years in sub-Saharan Africa. This is perhaps not surprising, considering the limited evidence of cycles in fiscal variables and the particular difficulties that would be faced by an administration in sub-Saharan Africa in attempting to manipulate economic cycles. First, the impact of the government sector (and the central bank) on the real side of the macro economy has tended to be rather limited, particularly where the agricultural or natural resource sectors are dominant. Second, the weakness of fiscal institutions may have inhibited governments' ability to affect very precisely the timing of spending outlays and their impact on output. Third, exogenous shocks may have swamped any domestic action. Fourth, fiscal actions may often have been subject to binding financing constraints.

Figure 2. Sub-Saharan Africa: Fiscal Variables and National Election Cycles



Sources: IMF, *World Economic Outlook;* and IMF, African Department database.
Note: t corresponds to the year in which each election is held.

The few examples in sub-Saharan Africa of systematic fiscal cycles do not seem to have been associated with particular types of political regimes.[1] Some countries exhibiting these cycles were states that have been classified as authoritarian whereas others have had various levels of functioning democratic institutions. This may reflect that, while democratic governments may have greater incentive to manipulate the fiscal or economic cycle for electoral gain, autocracies may in practice have both more potential to deliver the desired economic boost and more confidence that they can mop up its aftereffects.

Implications for 2011

For most of the 17 countries where major national elections are planned or possible in 2011, history does not indicate any generally observable systematic association between elections and fiscal or economic activity variables. A few countries have shown some tendency towards preelection spending surges, but there are only rare examples of any impact on output growth.

Other important influences on economic activity may swamp any potential impact from elections in 2011. The rebound from the global recession in 2009 has provided sufficient momentum in most countries to ensure a strong growth performance in 2011, if the global recovery continues. Fiscal balances are also under strain because of weaker revenue bases and some countercyclical spending: countries have already drawn on fiscal buffers built up during the mid-2000s. On the monetary side, scope for further easing is fairly limited.

Nonetheless, there is a danger that the elections could delay necessary fiscal adjustment. Several countries with elections slated for 2011 are expected to experience both fairly robust growth and elevated fiscal deficits. This may point to the need for cuts in politically sensitive areas, a reprioritization of spending, or revenue enhancement. The election timetable may complicate such decisions.

[1] Block, Ferree, and Singh (2003) reported, however, that multiparty competition increased the likelihood of election years being associated with more stimulative fiscal and monetary policies in sub-Saharan Africa.

This box was prepared by John Shields and Duval Guimaraes.