

# 1. Navigating Uncertainty

Growth in sub-Saharan Africa is projected to remain at 3.2 percent in 2019 and rise to 3.6 percent in 2020. Growth is forecast to be slower than previously envisaged for about two-thirds of the countries in the region. The downward revision reflects a more challenging external environment, continued output disruptions in oil-exporting countries, and weaker-than-anticipated growth in South Africa.

Growth prospects vary considerably across countries in the region in 2019 and beyond. Growth is projected to remain strong in non-resource-intensive countries, averaging about 6 percent. As a result, 24 countries, home to about 500 million people, will see their per capita income rise faster than the rest of the world. In contrast, growth is expected to move in slow gear in resource-intensive countries (2½ percent). Hence, 21 countries are projected to have per capita growth lower than the world average.

Inflation is expected to ease going forward. While the average sub-Saharan African-wide debt burden is stabilizing, elevated public debt vulnerabilities and low external buffers will continue to limit policy space in several countries.

The outlook faces further downside risks. External headwinds have intensified compared to April and include the threat of rising protectionism, a sharp increase in risk premiums or reversal in capital inflows owing to tightening global financial conditions, and a faster-than-anticipated slowdown in China and in the euro area. Regionally, near-term downside risks include climate shocks, intensification of security challenges, and the potential spread of the Ebola outbreak beyond the Democratic Republic of the Congo. In addition, fiscal slippages, including those ahead of elections in some countries, and a lack of reform in key countries could add to deficit and debt pressures. Over the medium term, a successful implementation of reforms, including in the context of the African Continental Free Trade Area (AfCFTA), could pose significant upside risks.

A three-pronged strategy that reduces risks and promotes sustained growth across all countries in the region requires:

- **Carefully calibrating the near-term policy mix:** Amid limited buffers and elevated debt vulnerabilities in some countries, policymakers have limited room for maneuver to counter external headwinds. The room for supporting growth remains mainly on the monetary policy side and restricted to countries where inflation pressures are muted and growth is below potential. In the event downside risks materialize, fiscal and monetary policy could be carefully recalibrated to support growth, in a manner consistent with debt sustainability and available financing, and as part of a credible medium-term adjustment plan. In countries that are growing slowly, the pace of adjustment could be more gradual, provided financing is available, or its composition fine-tuned to minimize the impact on growth. In fast-growing countries that are facing elevated debt vulnerabilities, the priority remains rebuilding buffers.
- **Building resilience:** This would help the region sustain longer episodes of strong growth. Building resilience, including to weather-related, health, and security challenges, would require mobilizing domestic revenue, streamlining inefficient subsidies, and improving public financial management (Chapter 3) to strengthen sovereign balance sheets and create fiscal space for development needs. Promoting economic diversification, improving macroeconomic policy frameworks, and reducing nonperforming loans (NPLs) would reduce countries' vulnerability to shocks.
- **Raising medium-term growth:** Raising per capita growth rates, especially for resource-intensive countries, is essential to sustain improved social outcomes and create jobs for the 20 million (net) new entrants poised to join labor markets every year.

---

This chapter was prepared by a team led by Seung Mo Choi and comprising Michael Gorbanyov, Cleary Haines, Siddharth Kothari, Andresa Lagerborg, Nkunde Mwase, Malika Pant, and Torsten Wezel, under the supervision of Papa N'Diaye and Catriona Purfield.

Comprehensively tackling tariff and nontariff barriers in the context of the AfCFTA, developing regional value chains, and implementing reforms to boost investment and competitiveness (Chapter 2) could lift the region's medium-term growth.

The rest of this chapter looks more closely at (1) the challenges the global and regional environments pose for the region, (2) the region's balance sheet vulnerabilities, and (3) key policy priorities.

Chapter 2 analyzes the level of product market competition in the region and discusses policies to enhance competitiveness. The level of competition in sub-Saharan Africa remains low relative to the rest of the world. This is reflected in higher firm markups, especially in nontradable sectors, and in higher product prices. Empirical analysis suggests that, by increasing competition, the region can benefit from significant growth and welfare gains through improved productivity, stronger export competitiveness, and lower consumer prices. Boosting competition in the region requires holistic reforms encompassing an effective competition policy framework, openness to trade and foreign direct investment, and business regulations and macro policies that create an even playing field among firms.

Chapter 3 assesses domestic arrears and discusses policies to clear them and to prevent their accumulation. Based on a newly constructed database of sub-Saharan African countries, the chapter finds that financing spending through domestic arrears is prevalent, with incidence increasing in the face of large adverse exogenous shocks, such as the 2014 commodity price shock. Domestic arrears are found to negatively impact private sector activity and the delivery of social services while increasing banking sector vulnerabilities and undermining citizens' trust in the government. It also shows that arrears weaken the ability of fiscal policy to support the economy, casting doubt on the merit of relying on arrears financing to avoid spending cuts. The chapter discusses policies to clear arrears and to prevent their accumulation, including through fiscal management reforms, building buffers, and timely external support.

<sup>1</sup> Technology tensions include US actions related to Chinese technology companies.

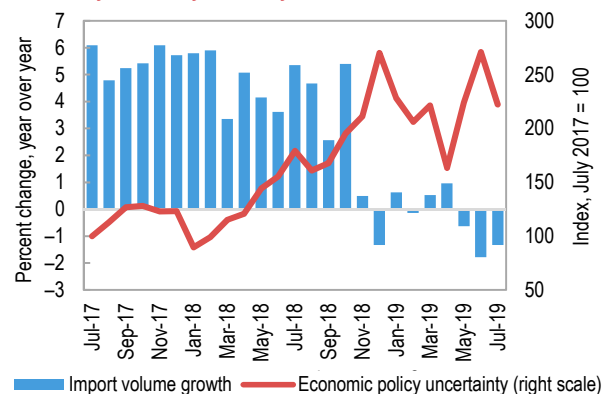
## MACROECONOMIC DEVELOPMENTS AND PROSPECTS

### Less-Supportive Global Environment

Global growth is expected to rise from 3.0 percent in 2019 to 3.4 percent in 2020. The projected recovery in the global outlook is precarious, with significant downside risks relating to trade and technology tensions.<sup>1</sup> These tensions have increased policy uncertainty and lowered trade volumes (Figure 1.1). Over the medium term, global growth is projected at 3.6 percent, mainly driven by emerging market economies.

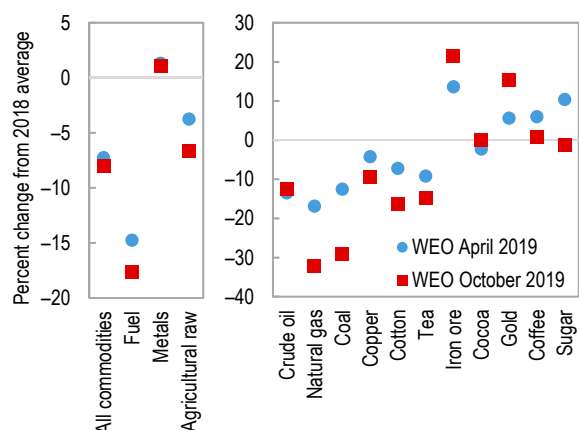
Commodity prices are set to fall. Subdued global growth is expected to weigh on the region's exports and most commodity prices except metals prices (Figure 1.2). The effects of soft commodity prices on the region, especially oil prices, are mixed. They will help the fiscal and external positions of the region's commodity importers but will provide headwinds to commodity exporters. And as commodity exporters have a significantly larger economic weight than importers and host about two-thirds of the region's population, soft commodity prices typically mean slower growth and weaker fundamentals for the region. The softening of commodity prices is projected to persist through the medium term, with broadly balanced risks around this forecast. Downside risks stem from higher-than-expected shale oil production in the United States, while upside risks are related to potential further supply disruptions in major oil-producing countries such as Iran and Venezuela.

Figure 1.1. Global Import Volume Growth and Global Economic Policy Uncertainty Index, July 2017–July 2019



Sources: Davis (2016); and World Trade Organization.

**Figure 1.2. Projected Change in Commodity Prices: Expected Changes, Average 2019–20 versus 2018**



Sources: IMF, Commodity Price System; and IMF Global Assumptions.

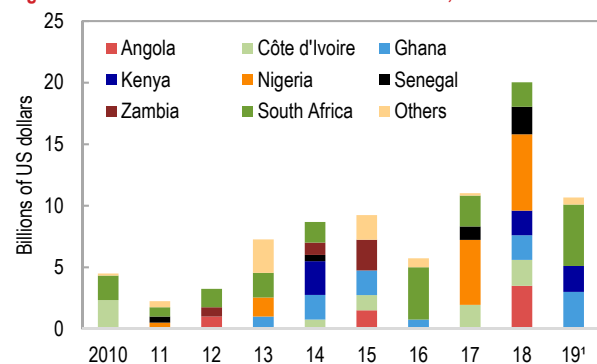
Note: Besides oil, some of the main export commodities in the region are copper (Democratic Republic of Congo, Zambia), iron ore (Liberia, Sierra Leone, South Africa), coal (Mozambique, South Africa), gold (Burkina Faso, Ghana, Mali, South Africa, Tanzania), and platinum (South Africa). WEO = World Economic Outlook database.

Global financial conditions have eased since early 2019 as major central banks shifted toward greater monetary accommodation. Global equity prices have risen, bond yields have declined, and capital inflows into the region’s bond markets have resumed, although volatilities in inflows and spreads remain high. These conditions have supported issuances of international sovereign bonds by the region’s frontier markets of more than US\$10.5 billion so far in 2019 (Figure 1.3).

### Rising Regional Challenges

The region continued to suffer from weather-related shocks. Severe droughts caused by El Niño have affected Angola, Botswana, Ethiopia, Kenya, Lesotho, Namibia, Zambia, and Zimbabwe, causing

**Figure 1.3. Sub-Saharan Africa: Eurobond Issuances, 2010–19**



Source: Bloomberg Finance L.P.

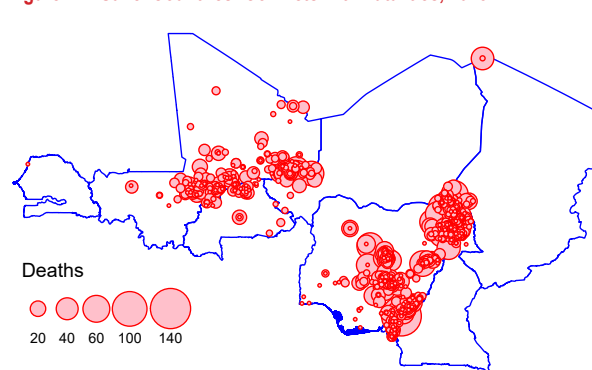
<sup>1</sup> Data as of September 2019

food insecurity, migration, inflation pressure (owing to supply constraints), fiscal pressure, electricity shortages, and lower trade balances. In addition, cyclones Idai and Kenneth hit Mozambique and other southeastern African countries in March and April, affecting millions and causing more than US\$2 billion in damages. The cyclones also weakened economic activity, by disrupting the functioning of major ports, and added pressure to inflation, fiscal balances, and trade balances.

The Ebola outbreak in the Democratic Republic of the Congo worsened. As of September 2019, about 3,000 cases were reported, of which more than 2,000 were fatal. Vaccination has provided some protection, but the disease has spread to Goma—a city with a population of more than 2 million. This prompted the World Health Organization to declare a “public health emergency of international concern.” So far, economic growth, fiscal revenue, and foreign exchange reserves have been broadly unaffected as economic activity is located elsewhere. In a positive development, experimental drugs administered to Ebola patients have been reported to cut mortality rates significantly. In addition, in Burundi, the outbreak of malaria has infected nearly half the population, killing about 1,800 people this year as of July 2019.

Security tensions in the Sahel continued to intensify (Figure 1.4). Reported terrorism incidents in Sahel countries rose by 75 percent in 2019 (annualized based on January through September). Burkina Faso, Mali, and Niger were the most affected. Security challenges have had substantial fiscal impact in some of these countries, translating into lower revenue and higher military and

**Figure 1.4. Sahel Countries: Conflicts with Fatalities, 2018**



Source: Uppsala Conflict Data Program.

security spending. Military and security spending doubled in 2019 in Burkina Faso, Mali, and Niger, representing about 4 percent of GDP and absorbing 20 percent of fiscal revenues.

## Outlook

### Diverging Growth Paths

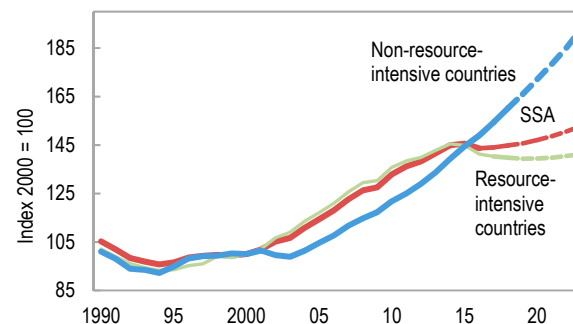
Growth for the region is projected to remain at 3.2 percent in 2019 and rise to 3.6 percent in 2020, amid steady growth in private consumption and investment and slower growth in public consumption and investment. The growth outlook relies on continued support from monetary policy in countries with independent monetary policy and a modest recovery in oil exporters from very low levels. The growth momentum is expected to be held back somewhat by fiscal consolidation in most countries.

The projected growth rates are lower than envisaged in April, by 0.3 percentage point and 0.1 percentage point for 2019 and 2020, respectively. Growth has been revised down in about two-thirds of the countries in the region, reflecting the challenging external and regional environment (described above) and weaker-than-anticipated growth in South Africa.

There is significant heterogeneity in the growth paths across countries. Non-resource-intensive countries are expected to grow nearly three times faster (at 6.0 percent in 2019) than oil exporters (at 2.1 percent) and other resource-intensive countries (at 2.7 percent) (Figure 1.5). The diversity is also manifest within country groupings, with wide differences across countries depending on the degree of diversification, the macroeconomic adjustment to the 2014 terms-of-trade shock, policy uncertainty, and debt vulnerabilities. This difference in performance holds even among oil exporters, with the more diversified economies having higher GDP growth rates (Figure 1.6).

Economic activity in the region's three largest economies, Nigeria (an oil exporter), South Africa (a non-oil, resource-intensive country), and Ethiopia (a non-resource-intensive country), illustrates the bifurcated growth paths in the region.

Figure 1.5. Sub-Saharan Africa: Real GDP per Capita, 1990–2023

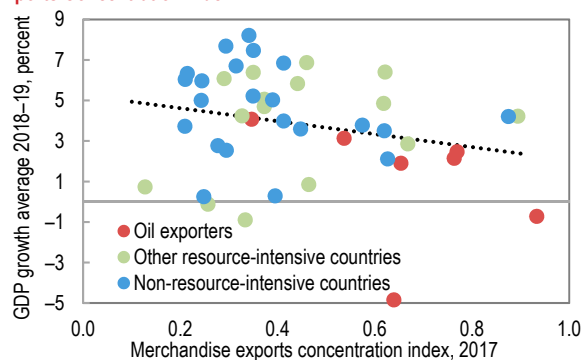


Source: IMF, World Economic Outlook database.

Note: SSA = sub-Saharan Africa.

- Nigeria is projected to grow at 2.5 percent in 2020, up from 2.3 percent in 2019, driven by both oil and non-oil sectors. Medium-term growth is projected at slightly higher than 2.5 percent, implying no progress in per capita growth. This low growth is driven by insufficient policy adjustment, a large infrastructure gap, low private investment, and banking sector vulnerabilities.
- South Africa's growth is projected to remain subdued, increasing only mildly from 0.7 percent in 2019 to 1.1 percent in 2020, as private investment and export growth are expected to remain low. Medium-term growth is projected to be slightly lower than 2 percent, barely above population growth. This reflects structural constraints (including high cost of doing business, inflexible product and labor markets, and low public enterprise efficiency), which are expected to keep business confidence and private investment lackluster.

Figure 1.6. Sub-Saharan Africa: Real GDP Growth versus Merchandise Exports Concentration Index



Sources: United Nations Commission on Trade and Development; and IMF, World Economic Outlook database.

Note: Higher values for the merchandise exports concentration index imply higher concentration.

- Ethiopia is expected to grow by 7.2 percent in 2020, slightly below the 7.4 percent rate projected for 2019. Growth is expected to ease over the medium term to about 6.5 percent reflecting efforts to address large external imbalances through fiscal and monetary policy tightening.

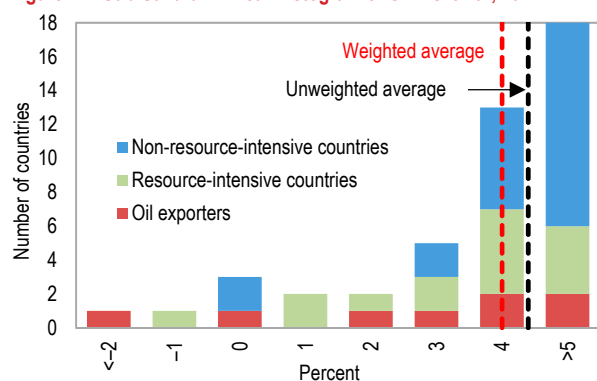
Sluggish growth in Nigeria and South Africa is likely to limit positive spillovers to their trading partners, especially remittances, financial sector activity, and import demand.

Non-resource-intensive countries are expected to continue to grow rapidly at about 5½ percent (excluding Ethiopia) in 2020. The growth momentum remains strong, partly due to private investment (Côte d'Ivoire, Rwanda, Senegal), productivity growth in the agricultural sector (Benin), and public investment (Mauritius, Rwanda).

Over the medium term, growth in the region is projected to be close to 4 percent, or about 1½ percent in per capita terms. Excluding the two largest countries (Nigeria and South Africa), medium-term growth would be somewhat higher at above 5 percent. The bifurcated growth paths between resource- and non-resource-intensive countries are expected to persist through the medium term with growth forecast to be strong in non-resource-intensive countries (about 6 percent) and sluggish in resource-intensive countries (about 3 percent) (Figure 1.7).

- In per capita terms, 21 out of 45 countries in the region would have per capita growth

Figure 1.7. Sub-Saharan Africa: Histogram of GDP Growth, 2022



Source: IMF, World Economic Outlook database.

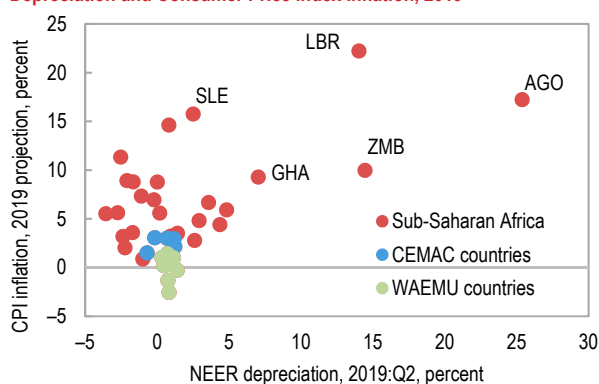
lower than the world average, of which 12 countries (representing about one-third of the region's population) are expected to have negative per capita growth in 2019.

- At the same time, 24 countries, which are mostly non-resource-intensive and home to about 500 million people, will see their per capita income rise faster than the rest of the world. Rapid growth in services, particularly communication, wholesale, retail, and financial services, as well as construction, is expected to continue to drive growth going forward. These sectors have grown on average by more than 5 percent a year during 2013–17.

### Easing inflation

Average inflation in the region is poised to ease, from 8.5 percent in 2018 to 8.4 percent in 2019 and 8.0 percent in 2020, but there are wide differences across countries. Inflation is likely to rise in countries that have suffered from conflicts or political turmoil, experienced large depreciations (Angola, Liberia) (Figure 1.8), suffered from droughts (Kenya, Lesotho, Namibia, Zambia, Zimbabwe), or have larger fiscal deficits (Figure 1.9). In contrast, inflation is expected to remain low in monetary unions (West African Economic and Monetary Union [WAEMU] and Central African Economic and Monetary Community [CEMAC]). Some WAEMU countries are likely to experience deflation.

Figure 1.8. Sub-Saharan Africa: Nominal Effective Exchange Rate Depreciation and Consumer Price Index Inflation, 2019

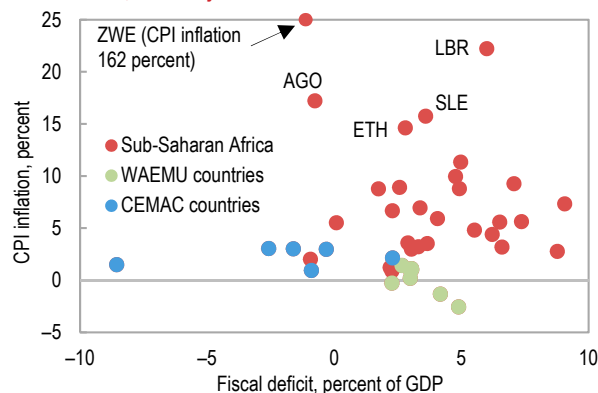


Source: IMF, World Economic Outlook database.

Note: CEMAC = Central African Economic and Monetary Community; CPI = consumer price index; NEER = nominal effective exchange rate; WAEMU = West African Economic and Monetary Union. Excludes Zimbabwe. See page vi for country abbreviations list.



**Figure 1.9. Sub-Saharan Africa: Fiscal Deficit and Consumer Price Index Inflation, 2019 Projections**



Source: IMF, World Economic Outlook database.

Note: CEMAC = Central African Economic and Monetary Community; CPI = consumer price index; NEER = nominal effective exchange rate; WAEMU = West African Economic and Monetary Union. See page vi for country abbreviations list.

### Weak Balance Sheets

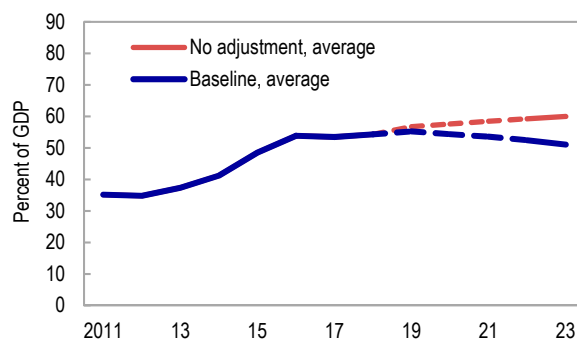
Elevated balance sheet vulnerabilities in many countries limit the room for macroeconomic policies to address downside risks to growth. Several countries have weaknesses in public balance sheets, with high debt ratios and limited repayment capacity, low levels of foreign exchange reserves, and weaknesses in financial and nonfinancial corporate balance sheets.

### Public Debt Vulnerabilities Remain Elevated

The region's public debt as a ratio to GDP has stabilized at about 55 percent on average across countries (Figure 1.10). Oil exporters' debt ratios have fallen by about 10 percentage points of GDP since 2016. Adjustment in this group of countries occurred through expenditure compression. The reduction in the noncommodity primary fiscal deficit of nearly 14 percentage points of GDP during 2013–18 was achieved largely by cutting public investment and, to a lesser degree, current primary expenditure, while noncommodity revenue fell slightly (Figure 1.11). Other resource-intensive countries also made some progress on fiscal consolidation, mainly by reducing recurrent spending. In non-resource-intensive countries, the primary fiscal deficit increased as revenue fell as a ratio to GDP, contributing to higher debt ratios.

Despite the stabilization of debt dynamics, public debt vulnerabilities remain elevated in some

**Figure 1.10. Sub-Saharan Africa: Public Debt, 2011–23**

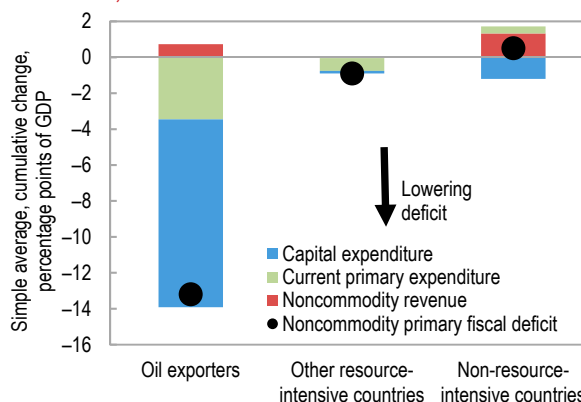


Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Baseline projections reflect the program or baseline scenarios reported in the latest IMF staff reports. "No adjustment" projections assume that the primary deficit, the real interest expenditure, and the other components of debt accumulation will remain at their 2016–18 levels, while the exchange rate and real GDP growth components are as in baseline projections. Excludes Burundi, Eritrea, and South Sudan due to data availability.

countries. Among low-income and developing sub-Saharan African countries, seven (accounting for 3 percent of regional GDP) are in debt distress (Eritrea, The Gambia, Mozambique, Republic of Congo, São Tomé and Príncipe, South Sudan, Zimbabwe), and nine (accounting for 16 percent of regional GDP) are at high risk of debt distress (Burundi, Cabo Verde, Cameroon, Central African Republic, Chad, Ethiopia, Ghana, Sierra Leone, Zambia) (Figure 1.12). The remaining 19 low-income and developing countries have low to moderate debt vulnerabilities. For middle- and upper-income countries, public debt remains sustainable under the baseline in most cases.

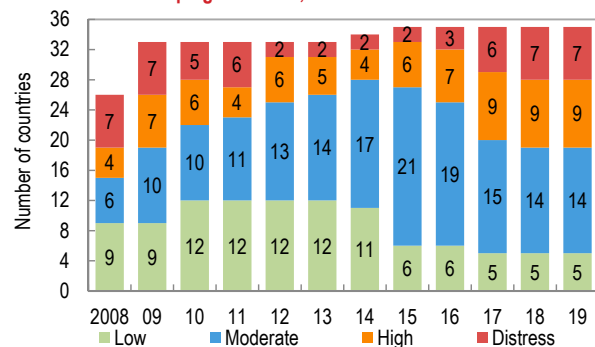
**Figure 1.11. Sub-Saharan Africa: Change in Noncommodity Primary Fiscal Deficit, 2013 versus 2018**



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Excludes Burundi, Eritrea, and South Sudan due to data availability.

**Figure 1.12. Sub-Saharan Africa: Debt Risk Status for PRGT Eligible Low-Income Developing Countries, 2008–19**



Source: IMF, Debt Sustainability Analysis Low-Income Developing Countries database.

Note: Debt risk ratings for Burundi, Chad, The Gambia, Lesotho, Rwanda, São Tomé and Príncipe, and Zimbabwe begin in 2009, Cabo Verde in 2014, and for South Sudan in 2015. PRGT = poverty reduction and growth trust.

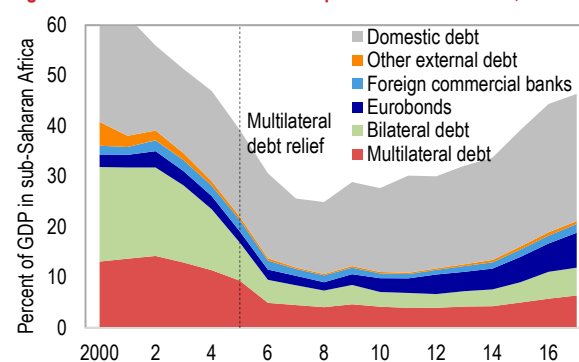
There are also vulnerabilities related to the composition of public debt. Public debt stocks are mainly from commercial sources, with more than half from domestic creditors and about 15 percent from Eurobonds (Figure 1.13). Official bilateral and multilateral debt accounted for only about a quarter of total public debt in 2017, much less than in the early 2000s. The greater reliance on commercial public debt exposes sovereign balance sheets to greater rollover and exchange rate risks. Also, an increase in debt from domestic creditors could crowd out financing for private sector projects.

### External Buffers Remain Low

For the region, the (simple) average current account deficit is expected to widen from 6.2 percent of GDP in 2018 to about 7.2 percent of GDP in 2019, reflecting larger deficits in oil exporters (due to lower projected oil prices) and in countries suffering from weather-related shocks (Lesotho, Mozambique). At the end of 2019, foreign exchange reserves are expected to remain between 3 and 4 months of imports, with wide differences across countries.

There remains substantial diversity in external positions across countries. Large external imbalances emerged in oil exporters following the decline in oil price in 2014–15. Since then, current account deficits have narrowed significantly to about 1 percent of GDP on average in 2018, as fiscal consolidation advanced and contributed to domestic demand compression and their terms

**Figure 1.13. Sub-Saharan Africa: Composition of Public Debt, 2000–17**



Sources: World Bank, International Debt Statistics; and IMF, World Economic Outlook database.

Note: Excludes Equatorial Guinea, Namibia, Seychelles, and South Sudan due to data availability.

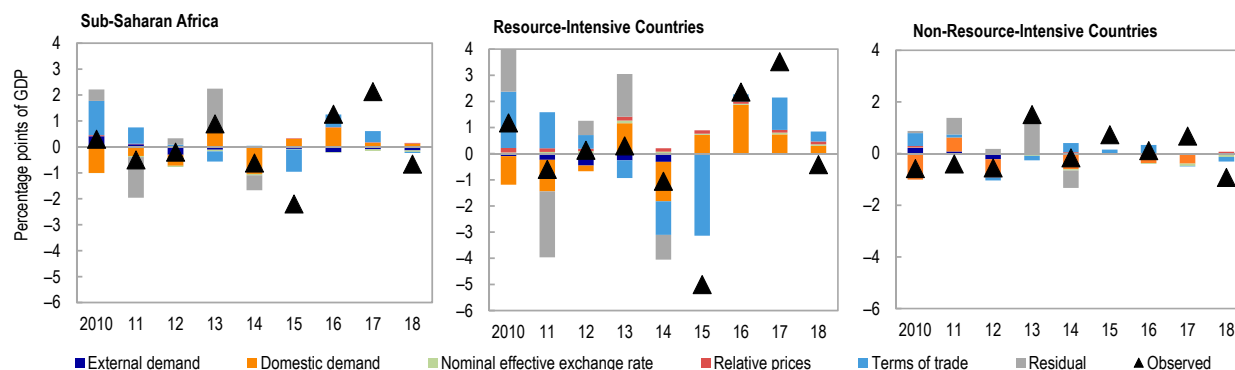
of trade improved (Figure 1.14). While this is a positive development, the current account adjustment is likely to be less durable than if it had occurred through a reallocation of resources toward more productive, export-oriented sectors. The nature of the adjustment reflects the fact that exchange rates and relative prices played little role as several countries had fixed exchange rate regimes or had concerns about large foreign currency-denominated liabilities, a significant pass-through of exchange rate changes to inflation (estimated at about 40 percent), and limited responsiveness of output and exports to changes in real exchange rates. For non-oil-exporting countries, current account deficits remain elevated, reflecting mainly larger public savings–investment gaps.

Looking ahead, and under current policies, only a small decline in current account deficits is expected owing to continued pressure to address development needs. As a result, foreign exchange reserves are expected to remain low leaving several countries exposed to terms-of-trade shocks (Figure 1.15).

### Banks' Balance Sheets Remain Weak

NPL ratios remain elevated, averaging 11 percent. This reflects, in some cases, deficiencies in risk management practices, the legacy of the commodity price shock, and weaknesses in public balance sheets, which have weighed on suppliers' finances, including through domestic arrears. The accumulation of arrears, in turn, has hampered suppliers' ability to service their liabilities to banks (Figure 1.16; Chapter 3).

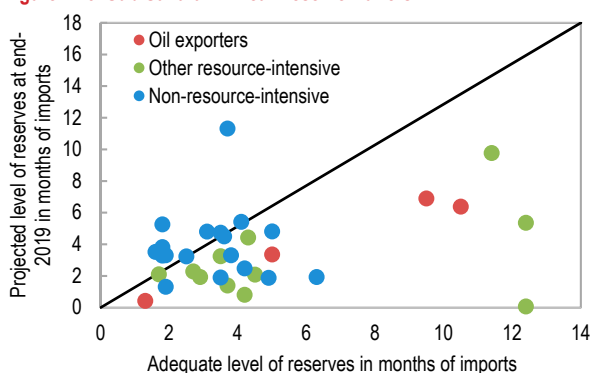
**Figure 1.14. Sub-Saharan Africa: Contributions to Current Account Adjustment**



Source: IMF staff calculations.

Note: Contributions based on the results of an extended model of the Harberger-Laursen-Meltzer effect. The model relates changes in the current account balance to the terms of trade, domestic, and external demands; the nominal exchange rate; and relative prices. The part of the bars labeled residuals contain the average country fixed effects.

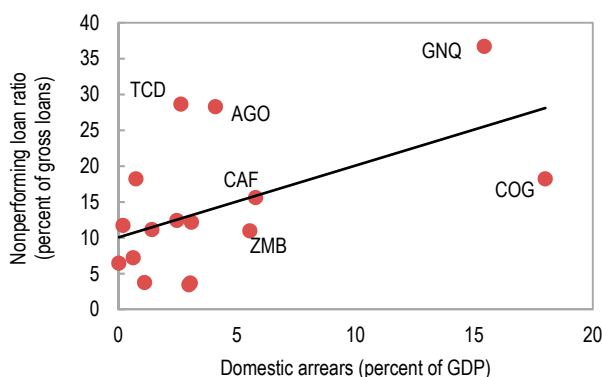
**Figure 1.15. Sub-Saharan Africa: Reserve Buffers**



Sources: IMF, World Economic Outlook database; and IMF staff calculations.

Note: Adequate levels of reserves based on methodology for assessing reserve adequacy for credit-constrained economies (IMF 2016). Oil exporters, excluding Angola, Nigeria, and South Sudan, are grouped into one data point corresponding to Central African Economic and Monetary Community (CEMAC). West African Economic and Monetary Union (WAEMU) countries are grouped into one single data point and classified as non-resource-intensive.

**Figure 1.16. Sub-Saharan Africa: Domestic Arrears and Nonperforming Loan Ratio, 2018**

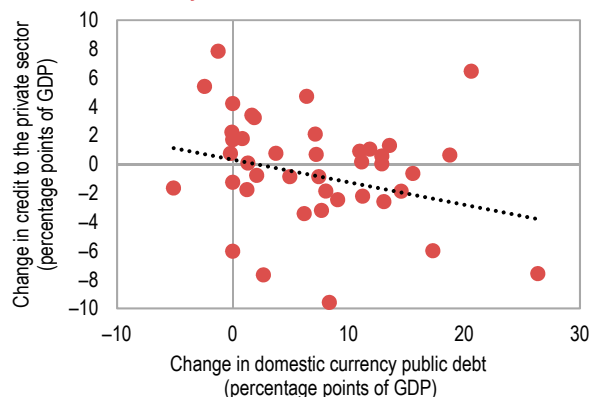


Sources: IMF, International Financial Statistics; Chapter 3 of this volume of the *Regional Economic Outlook: Sub-Saharan Africa*.

Note: See page vi for country abbreviations list.

High NPLs, public borrowing, and regulatory changes have contributed to slowing private sector credit growth (Figure 1.17), hampering economic activity. Credit growth remains well below its long-term average (close to 10 percent during 2006–19). Weak credit growth also reflects countries’ introduction of new prudential norms aligned with Basel II/III, for which banks had to increase provisions and raise capital (WAEMU). Banks’ capital ratios are high on average across countries (21 percent in the third quarter of 2018), but there is significant variation across countries and individual banks, with some banks remaining undercapitalized in some countries. Other sources of concern include foreign currency liquidity mismatches (Angola), high loan concentration (Benin, Eswatini, Lesotho, Malawi), and increased household and corporate debts (Namibia).

**Figure 1.17. Sub-Saharan Africa: Change in Credit to the Private Sector and Domestic Currency Public Debt, 2014–18**



Sources: Country authorities; and IMF, World Economic Outlook database.



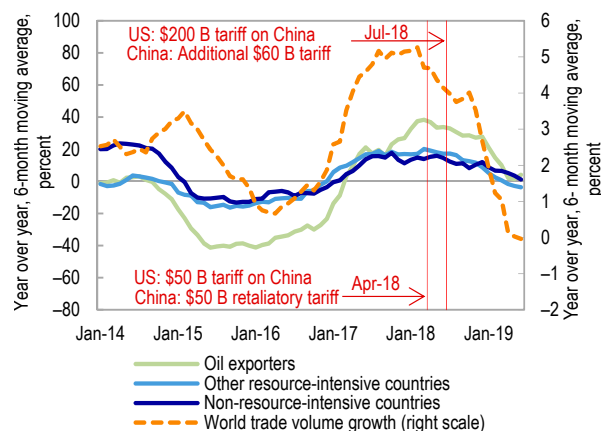
## RISKS TO THE OUTLOOK

The growth outlook for sub-Saharan Africa faces considerable downside risks. On the external front, near-term risks include (1) rising protectionism, (2) a sharp rise in risk premiums, and (3) faster-than-anticipated slowdown in China and in the euro area. Domestically, near-term downside risks include climate shocks, intensification of security challenges, and a further spreading of the Ebola outbreak in the Democratic Republic of the Congo to neighboring countries. In addition, fiscal slippages, including ahead of elections in some countries, and lack of reform in key countries could add to deficit and debt pressures.<sup>2</sup> Over the medium term, a successful implementation of reforms, including in the context of the AfCFTA, could provide significant upside risk (discussed later in this chapter).

### Rising Protectionism

Additional trade and technology barriers and threats of new actions would reduce global growth, both directly, through lower investment and a dislocation in global supply channels, and indirectly through adverse confidence effects and financial market volatility. This would likely lower commodity prices, negatively affecting the region's resource-intensive countries. Current trade tensions have taken a toll on the region's export growth (Figure 1.18).

Figure 1.18. Sub-Saharan Africa: Export Growth, Jan. 2014–Jun. 2019



Sources: CPB Netherlands Bureau for Economic Policy Analysis, *World Trade Monitor*; and IMF, Direction of Trade Statistics.

Note: B = billions.

<sup>2</sup> Presidential elections are scheduled in Botswana, Guinea-Bissau, Mozambique, and Namibia in 2019. In 2020, Burkina Faso, Burundi, Central African Republic, Comoros, Côte d'Ivoire, Ethiopia, Ghana, Guinea, Seychelles, Tanzania, and Togo will have elections.

### Sharp Rise in Risk Premiums

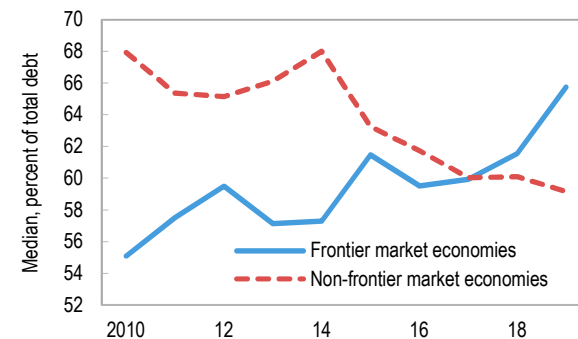
Against a backdrop of easy monetary policy and supportive financial conditions in many advanced economies, global risk appetite could drop abruptly in the event of increased trade tensions, renewed stresses in emerging market economies, or a disorderly Brexit. This could translate into a sharp rise in risk premiums and a sudden stop or reversal of portfolio flows into the region. In such circumstances, the region's frontier economies could experience higher public debt service costs, further depreciation pressures, and weaker bank balance sheets. Many frontier market economies have a large share of foreign currency-denominated debt in total public debt, which exposes them to exchange rate and refinancing risks (Figure 1.19).

The effects of a sudden tightening of global financial conditions could add to financial and fiscal stress and derail the region's progress in growth and development. Increased financial flows into the region's frontier markets have provided resources to finance development needs. However, a tightening of global financing conditions at a time when countries need to roll over large amounts of bonds could force a sharp adjustment in domestic spending, with attendant adverse consequences on growth.

### Faster-than-Anticipated Slowdown in China or Euro Area

If China or the euro area slow down faster than anticipated (for example, because of a disorderly Brexit in the case of the euro area), their demand

Figure 1.19: Sub-Saharan Africa: Foreign Currency Share in Total Debt, Median, 2010–19



Source: IMF, World Economic Outlook database.

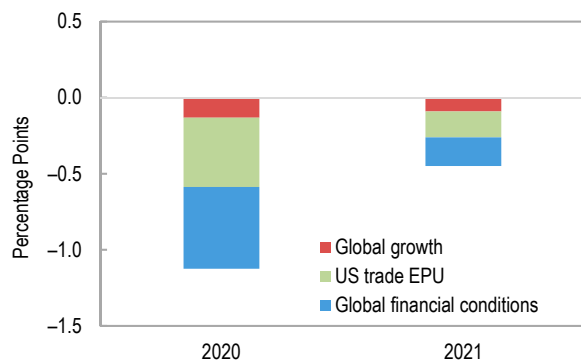
for the region’s commodity exports could fall, which would hamper growth for the commodity exporters. China and the euro area account for about 20 percent and 30 percent of total trade, respectively.

Growth-at-risk analysis shows that, in a combined scenario in which all three external shocks mentioned above materialize, the region’s growth could fall by about 1 percent in the initial year and by about ½ percent in the next year (Figure 1.20). Differences in impacts across countries would vary with countries’ dependence on commodities and openness to trade and financial flows.

### Natural Disasters

The frequency and intensity of natural disasters have increased over the past 30 years. The frequency of floods, for example, rose sixfold from the 1980s to the 2000s in sub-Saharan Africa (compared with threefold in the world, Figure 1.21). The expected El Niño in early 2020 points to elevated risks of flooding and droughts in various areas. Heavy reliance on rain-fed agriculture makes the region vulnerable to weather-related disasters, such as droughts, cyclones, and heavy rainfalls (IMF 2016a). In addition, a spreading of the Ebola outbreak in the Democratic Republic of the Congo to large cities and neighboring countries could, in addition to causing terrible human losses, undermine confidence, investment, and trade activities in the region.

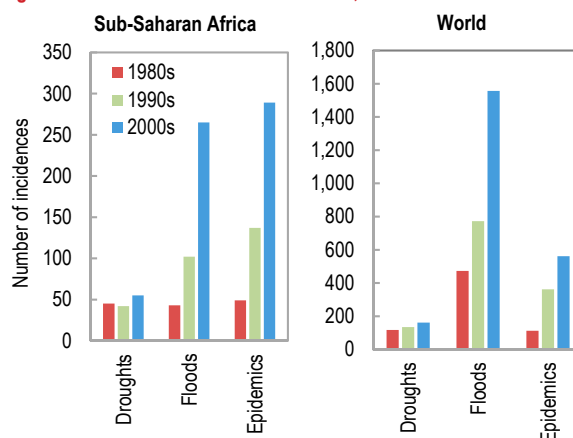
**Figure 1.20. Downside Risk Scenario: Impact of Escalating Trade Tensions, Global Slowdown, and Tightening Global Financial Conditions on Sub-Saharan African Growth**



Source: IMF staff calculations.

Note: The scenario assumes an increase in the US trade policy uncertainty index by two standard deviations, global financial conditions tightened by one-third of a standard deviation, and a slowdown in global growth by one-third of a standard deviation. EPU = economic policy uncertainty.

**Figure 1.21. Incidence of Natural Disasters, 1980s–2000s**



Source: Center for Research on the Epidemiology of Disasters, Emergency Events database (EM-DAT).

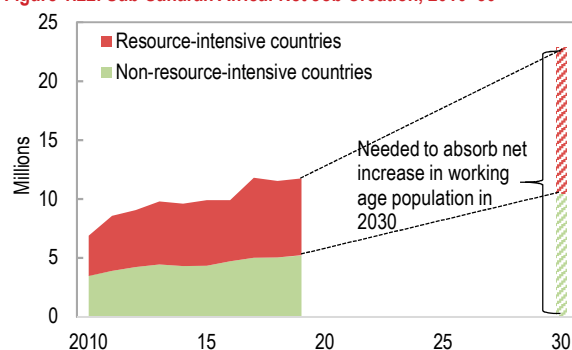
### POLICIES

The region faces immense development challenges. Meeting the 2030 United Nations Sustainable Development Goals (SDGs) requires significant spending—resources estimated at an additional 15 percent of GDP on average a year—from the public and the private sectors, and multilateral and bilateral official sources (Gaspar and others 2019). At the same time, a significant increase in job creation will be required to employ about 20 million (net) new entrants poised to join labor markets every year through 2030. This is twice as large as what the region has created annually during 2017–19 (Figure 1.22). Thus, it is important to advance reforms to promote growth and job creation. Failure to do so could place at risk gains made in macroeconomic stability and see development progress stall, with potential spillovers to other regions, including via migration.

#### Near-Term Policy Mix

Amid limited buffers and elevated debt vulnerabilities in some countries, policymakers have few options to counter external headwinds. Most countries have appropriately continued to tighten fiscal policy to address vulnerabilities, and several have loosened monetary policy. For example, policy interest rates have been reduced in 2019 in Angola, Botswana, the Democratic Republic of the Congo, Eswatini, The Gambia, Ghana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Nigeria, Rwanda, and South Africa

Figure 1.22. Sub-Saharan Africa: Net Job Creation, 2010–30

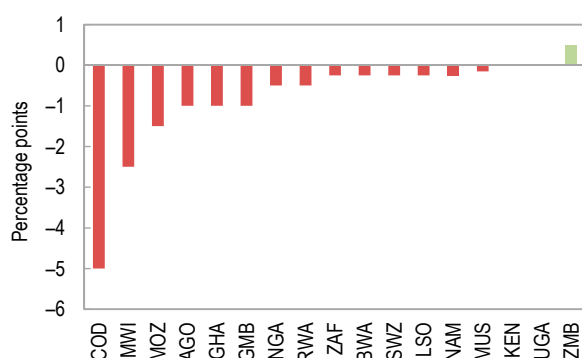


Sources: International Labour Organization; United Nations World Population Prospects; and IMF staff calculations.

(Figure 1.23). Looking ahead, the room for supporting growth remains mainly on the monetary policy side and limited to countries where inflation pressures are muted and growth is below potential.

In the event downside risks materialize, fiscal and monetary policy could be recalibrated to support growth, in a manner consistent with debt sustainability and available financing, and as part of a credible medium-term adjustment plan. In countries that are growing slowly, the pace of adjustment could be made more gradual, provided financing is available. If not, they should design the composition of adjustment to minimize the impact on growth. In fast-growing countries that are facing elevated debt vulnerabilities, the priority remains rebuilding buffers.

Figure 1.23. Sub-Saharan Africa: Changes in Monetary Policy Rates since December 2018



Sources: Haver Analytics; and IMF, International Financial Statistics.  
Note: See page vi for country abbreviations list.

## Medium-Term Policies to Build Resilience and Raise Longer-Term Growth

The reform spurt of the 1990s across most countries in the region (Chapter 2) has allowed them to enjoy sustained periods of positive real GDP growth, spanning over 30 years in some cases. The continued growth has led to a doubling of GDP in 28 out of 45 sub-Saharan African countries. The time has come for countries to undertake a new wave of reforms to lift medium-term growth, create the jobs for future entrants to labor markets, and make progress toward the SDGs. The launch of the AfCFTA provides an opportunity to catalyze such reforms. The AfCFTA is expected to establish a single unified market of 1.2 billion people with a combined GDP of \$2.5 trillion.<sup>3</sup>

To sustain and propel growth, countries also need to enhance resilience to external shocks. This would require reducing debt vulnerabilities, improving the flexibility of the economy, upgrading macroeconomic policy frameworks, and repairing balance sheets. Policies should also aim to build resilience to natural disasters and improve political and governance institutions to minimize security risks. The sections below provide a range of policies needed to strengthen resilience and lift medium-term growth. The prioritization and sequencing of these policies will vary with individual country circumstances, including implementation capacity.

### Building Resilience

#### *Reducing public debt vulnerabilities.*

**Improving debt dynamics.** Further fiscal consolidation is needed over the medium term to reduce debt vulnerabilities and create fiscal space for development needs. Interest-growth differentials—which are negative for most countries and average –6 percent—ease budget constraints but are not enough for preventing growing debt. To keep debt dynamics in check, primary deficits also need to be contained (Figure 1.24). In particular, oil exporters would need to continue to adhere to their plans

<sup>3</sup> With the signing by Benin and Nigeria in July 2019, nearly all African countries have signed the agreement. As of September 2019, 27 countries have ratified the AfCFTA. While the operational phase of the AfCFTA was launched during the African Union Summit in July 2019, its full operationalization still would require countries to agree on the rules of origin, the schedule of tariff concessions, the monitoring and elimination mechanism on nontariff barriers, and digital payment and settlement platforms.

of reducing noncommodity primary fiscal deficits by about 3 percentage points of GDP. Other resource-intensive countries and non-resource-intensive countries would also need to implement the planned reduction in noncommodity primary fiscal deficits of about 1½ percentage points and 1 percentage point of GDP, respectively (Figure 1.25).

**Advancing domestic revenue mobilization.** Since 2016, revenue in the region has risen by only 0.2 percent of GDP a year on average, although countries have room to mobilize, on average, between 3 percent and 5 percent of GDP in revenue (IMF 2018a). Several countries continue to have low tax rates (Angola, Nigeria), narrow tax bases (Ethiopia, Nigeria, Republic of Congo, São Tomé and Príncipe), or broad exemptions (Angola, Cameroon, Chad, Côte d’Ivoire, Ethiopia, Nigeria). In some countries, proposed reforms have not been adopted (Equatorial Guinea) or fully implemented (Gabon, Niger, Senegal, São Tomé and Príncipe). In several countries, tax administrative capacities remain weak, and governance is a concern. Also, the informal sector is large in many countries (including Angola, Central African Republic, Chad, Guinea, Nigeria), resulting in low tax compliance. Finally, challenging security conditions are hindering tax collection in some countries (Burkina Faso, Mali). Mobilizing more domestic revenue requires improving tax administration (such as assigning tax

identification numbers for commercial importers, improving land registries, and strengthening tax audit functions, customs administration, and compliance management of large taxpayers) and reforms to broaden revenue bases, including through fewer exemptions (IMF 2019a).

**Streamlining inefficient subsidies.** Subsidies and other transfers from the government averaged more than 5 percent of GDP (or 25 percent of expenses) as of 2017 for sub-Saharan African countries with available data.<sup>4</sup> Fuel subsidies tend to be poorly targeted, foster overconsumption, curtail investment and maintenance in related sectors, and crowd out more productive government spending. Some countries need to take the opportunity afforded by low oil prices to reduce fuel subsidies to free up additional fiscal space (Cameroon, Nigeria, Senegal), as was done in Mozambique and South Sudan and is being pursued by Burkina Faso. There is also a scope to reexamine how to improve the effectiveness of other types of subsidies (for example, Malawi’s farm input subsidy program, IMF 2018b). International subsidy reform experience (including in sub-Saharan Africa) suggests that the following elements can increase the chances of success: (1) a comprehensive reform plan; (2) a far-reaching communication strategy, aided by improvements in transparency; (3) appropriately phased energy price increases, which can be sequenced differently across energy products;

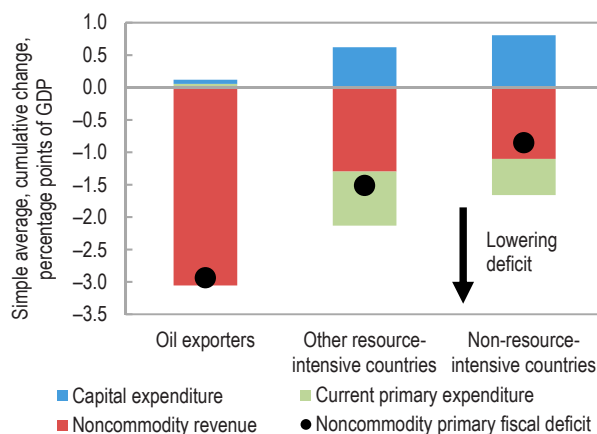
**Figure 1.24. Sub-Saharan Africa: Primary Fiscal Balance and Debt-Stabilizing Balance, 2014–18**



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
 Note: Each point represents a country year. Bold numbers correspond to the number of data points in each quadrant.

<sup>4</sup> See IMF (2018g, page 18).

**Figure 1.25. Sub-Saharan Africa: Change in Noncommodity Primary Fiscal Deficit, 2018 versus 2023**



Sources: IMF, World Economic Outlook database; and IMF staff calculations.  
 Note: Excludes Burundi, Eritrea, and South Sudan due to data availability.

(4) improvement in the efficiency of state-owned enterprises (SOEs) to reduce producer subsidies; (5) targeted measures to protect the poor; and (6) institutional reforms that depoliticize energy pricing, such as the introduction of automatic pricing mechanisms (Clements and others 2013).

#### **Improving public financial management.**

Weaknesses in public financial management have contributed to domestic payment arrears in several countries, hampered the efficiency of public investment and social spending, and increased vulnerabilities in public sector balance sheets. Mechanisms should be put in place to monitor domestic arrears, accompanied by specific actions to clear and prevent their accumulation (Chapter 3). Strategies to clear arrears should be consistent with maintaining macroeconomic stability, anchored on inclusive growth, and implemented transparently. Strengthening fiscal policy, institutions and building buffers would limit arrears buildup. Several countries are taking actions to improve public financial management, including enhancing medium-term expenditure frameworks (Angola, Botswana), switching to a treasury single account (Republic of Congo, Côte d'Ivoire, Guinea, Sierra Leone, Tanzania), moving to performance-based budgeting (Botswana), and enforcing internal controls (Angola, Uganda). In addition, countries are adopting measures to improve the selection of capital projects to enhance the efficiency of public investment and reduce potential risks arising from SOEs and public-private partnerships (Seychelles). Better governance could help to raise the efficiency of public investment (Box 1.1), with significant growth payoffs (IMF 2015a).

#### **Building strong debt management frameworks.**

With several countries facing increased foreign exchange and refinancing risks, it is critical to enhance debt management frameworks and transparency. Some have made strides by using debt buybacks to ease near-term refinancing risks and reprofile external debt (Côte d'Ivoire, Ghana), better aligning repayment currency with foreign exchange earnings (Seychelles), and relying on multitranches Eurobond issuances.

**Developing credible medium-term fiscal frameworks.** This will require fiscal rules, supported by adequate public financial management

systems, a greater use of state contingent financial instruments, and, for commodity exporters, an adequate institutional framework to manage the revenue inflows from natural resources.

#### *Enhancing External Sector Resilience.*

**Fostering economic diversification.** Cross-country data suggest that macroeconomic stability, improved access to credit, good infrastructure, conducive regulatory environments, and a skilled workforce are associated with higher economic diversification, including in exports, and would enhance the region's resilience to commodity price shocks (IMF 2017a). Labor market reforms that align workers' productivity and wages and facilitate the reallocation of resources across sectors are also important to promote diversification. Policies supporting export-oriented sectors could help encourage the development of new industries, provided such policies are carefully implemented.

#### **Promoting flexibility in exchange rates.**

Allowing for greater exchange rate flexibility, where balance sheets' foreign currency mismatches are not a concern, would promote adjustment to commodity price shocks and the development of tradables. In countries with fixed exchange rate regimes (including CEMAC and WAEMU), such flexibility would mainly stem from relative price adjustments, and thus would require further structural reforms to enhance wage and price flexibility. In these countries, policies should aim to build adequate foreign exchange reserves and sustain fiscal positions consistent with the peg.

**Dealing with capital flows.** Although easy global financial conditions and associated capital inflows into the region's frontier economies could help finance development needs, the fickle nature of these flows also creates significant macroeconomic challenges (IMF 2018c). In the event of large financial inflows, appreciation pressures could rise, causing risk of overvaluation and buildup of financial imbalances. In the event of large outflows, depreciation pressures could raise inflation, tighten domestic financial conditions, and cause a sharp contraction in activity. Countries with stronger fundamentals and larger buffers are better positioned to contain these risks. Countries in the region could implement countervailing



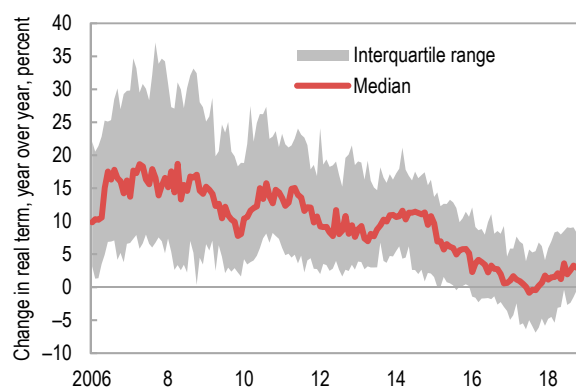
macroeconomic and macroprudential policies while buffers are being restored. Foreign exchange interventions should be reserved to counter temporarily disorderly market conditions given the need to rebuild reserve buffers. Attracting foreign direct investment (FDI) inflows could provide more stable and longer-term sources of funding for the region's sizable development needs.

### *Improving the effectiveness of monetary policy.*

**Reinvigorating credit growth.** In many countries, monetary authorities are trying to reinvigorate decelerating credit growth (Figure 1.26) with varying degrees of success. Some countries tried to reduce the cost of credit through interest rate controls, but this led to lower credit availability (Kenya). Nigeria introduced a requirement for banks to achieve a minimum loan-to-deposit ratio, which could significantly weaken banks' balance sheets and lower the cost of funds (as banks could quote low rates to curtail new deposits). Developing credit or collateral registries as well as resolving nonperforming loans and domestic arrears could lift credit growth (Liberia, Mali, Zimbabwe). A more efficient financial sector can mobilize domestic savings and channel these savings toward productive investment. Shifting investment from the public to the private sector, especially in non-resource-intensive countries, could create space for private sector credit to grow.

**Enhancing the monetary transmission mechanism.** The transmission mechanism between policy rate and lending conditions remains weak

**Figure 1.26. Sub-Saharan Africa: Bank Credit to Private Sector, 2006–18**



Sources: Country authorities; and IMF, International Financial Statistics.

in many countries. Enhancing it would require mopping up excess liquidity, developing deeper interbank markets and well-functioning secondary markets, and repo transactions for public debt securities (CEMAC, WAEMU). Countries or monetary areas facing excess liquidity (CEMAC, Namibia) could use open market operations or higher reserve requirements. Countries operating under interest rate-based monetary policy frameworks should continue to guide short-term market rates using interest rate corridors linked to the key policy rate (Malawi, Mauritius, Rwanda, Seychelles). The effectiveness of monetary policy could also be improved by reducing fiscal dominance, setting a medium-term inflation objective, and ensuring operational independence of the central bank (IMF 2015b). Further improving the effectiveness of monetary policy—including by enhancing the quality and timeliness of information sharing between the government and central bank—would help anchor inflation expectations and macroeconomic management, especially given the limited fiscal space in most countries. Zimbabwe's steps toward monetary policy normalization (including limiting the fiscal deficit and liberalizing the foreign exchange market) have reduced the spread between the official and parallel market exchange rates through August 2019.

### *Repairing banking sector balance sheets.*

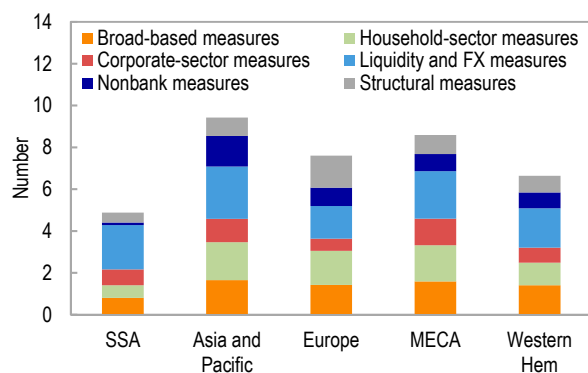
**Reducing NPLs.** Reducing banking systems' NPLs would reinvigorate credit and support growth. With varying results, some countries have adopted strategies to clean up banks' balance sheets, including mandating accelerated write-offs (Comoros, Mauritius, Sierra Leone, Tanzania), transferring defaulted claims to asset management companies (Angola, Guinea-Bissau, Zimbabwe), clearing domestic arrears (Eswatini, Gabon), restructuring or resolving failing banks (Côte d'Ivoire, Ghana, Kenya), facilitating foreclosure or out-of-court settlements with debtors (Cameroon), and a combination of such measures (Malawi, Mali, Togo).

**Improving banking sector resilience.** This would require better use of both macroprudential and microprudential policies. Among 25 surveyed countries in the region, countries on average had

only five macroprudential measures available at the end of 2016 (Figure 1.27). Macroprudential measures that have been most used by sub-Saharan African countries include restrictions on banks' foreign exchange positions, reserve requirements, and capital requirements. Since 2017, more countries have adopted higher capital requirements (Angola, Ghana, Mozambique, Tanzania) as a macroprudential tool to safeguard financial stability. Where relevant, such measures could be used to prevent a further buildup of risks. Strengthening regulations on concentration risks, including requiring the use of realistic capital adequacy risk weights for loans to SOEs, would also contribute to improving banking sector resilience in some cases.

**Limiting the transmission of cross-border financial risks.** The expansion of pan-African banks has contributed to improving competition and supporting financial inclusion (IMF 2016b). And this trend is expected to continue as the AfCFTA is expected to further liberalize trade in cross-border financial services (IMF 2019b). However, the lack of adequate cross-border supervisory oversight of banks on a consolidated basis could result in regulatory arbitrage. Thus, policies should focus on (1) improving cross-country collaboration among home and host supervisors; (2) expediting

**Figure 1.27. Number of Available Macroprudential Measures per Country, 2016**



Source: IMF (2018d).

Note: Based on the IMF survey of member countries conducted in 2017. 141 (including 25 sub-Saharan African countries) out of 192 jurisdictions responded. FX = foreign exchange; MECA = Middle East and Central Asia; SSA = sub-Saharan Africa; Western Hem = Western Hemisphere. Structural measures include capital surcharges for systematically important institutions, limits on the size of exposures between financial institutions, etc.

harmonization of regulations and supervisory procedures, including complying with core Basel standards;<sup>5</sup> and (3) establishing an appropriate mechanism for resolving unviable cross-border financial institutions.

#### **Expanding correspondent banking relationships.**

Some countries continue to face challenges in securing correspondent banking relationships. Ongoing reforms to strengthen the financial stability framework and to address the risks related to anti-money laundering and combating the financing of terrorism (AML/CFT) would help reduce the risk of further loss of correspondent banking relationships.

#### *Building resilience to natural disasters.*

A comprehensive approach to building resilience would consist of enhancing structural resilience, building financial resilience, and making contingent planning and related investments (IMF 2019c).

Several countries are seeking to **enhance structural resilience** through better infrastructure and other investments. Some countries have introduced new crop varieties that are more resilient to droughts and water stress or harvest rainwater at a local level (Burkina Faso). Others are using mobile technology to supply farmers with rainfall forecasts to optimize planting of crops and purchase crop insurance (Ethiopia, Kenya, Rwanda). As part of risk-informed planning, São Tomé and Príncipe and Zambia helped their populations relocate away from flood-prone areas. Kenya diversified its energy generation away from drought-prone hydropower to include gas and geothermal.

**Building financial resilience** by creating fiscal buffers and using prearranged financial instruments to protect fiscal sustainability and manage recovery costs is also essential. For example, sub-Saharan Africa has a regional sovereign insurance pool called the African Risk Capacity (established in 2013), which covers droughts and extreme weather events.

<sup>5</sup> About 32 percent of sub-Saharan African countries that responded to the EIB (2018) survey is compliant with Basel III standards while 41 percent is working towards compliance. Also, 64 percent is compliant with Basel II standards while 36 percent is working toward compliance. (In 2016, only 46 percent responded that they are compliant with Basel II standards.)

### Contingency planning and related investments

could ensure a speedy response following a disaster. Increasing households' and firms' access to finance and cost-effective insurance could help risk transfer. To help risk retention, countries could enhance social safety nets, including by improving public health system.

Ultimately, sustained resilience to climate shocks would require international coordination given the externalities associated with carbon emissions that are contributing to the rise in global temperatures. Stepped-up and targeted financing from donors and international financial institutions would help to build up the resilience of sub-Saharan African countries.

### Raising Longer-Term Growth

Lifting the region's medium-term growth prospects will require broad reforms to boost productivity and investment in physical and human capital.<sup>6</sup> The measures needed to lift medium-term growth, create jobs, and spur the region's development vary with individual countries' situations. Examples include ensuring greater integration into regional and global trade and financial markets, enhancing competitiveness, and deepening inclusion.

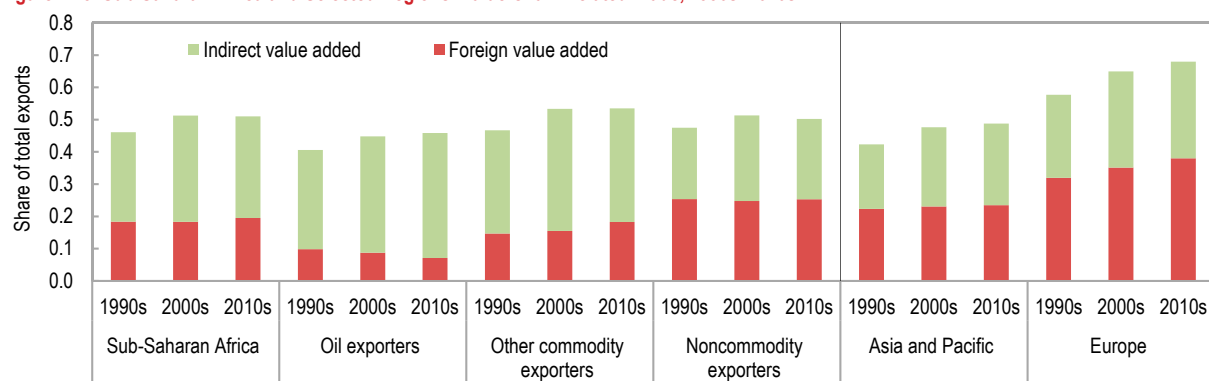
### Promoting regional and global integration.

Developing value chains could provide an opportunity to promote the region's industrialization process and lift growth. Sub-Saharan Africa's ratio of foreign value added<sup>7</sup> to total exports is only about 20 percent, lower than Europe and Asia, and has been stagnant since the 1990s (Figure 1.28). Value chains could expand through deeper intraregional trade in the context of the AfCFTA.<sup>8</sup> This would require tackling tariff and nontariff barriers, including trade and logistics costs (IMF 2019b). As a step in this direction, African central banks are acting to connect major cross-border payment systems, which is expected to facilitate intraregional payments. Structural reforms could complement the regional integration process, as suggested by the experiences of other regional trade agreements (Box 1.2).

### Promoting competitiveness.

Stronger competition across firms would improve productivity, promote export competitiveness, and lower consumer prices. Competition among firms remains low in sub-Saharan Africa relative to the rest of the world (Chapter 2). Boosting competition in the region would require a holistic reform strategy that sees an effective competition policy framework accompanying measures to open sectors to trade and foreign direct investment, cut red

Figure 1.28. Sub-Saharan Africa and Selected Regions: Value Chain Related Trade, 1990s–2010s



Sources: United Nations Conference on Trade and Development, Eora Global Value Chain Database; and IMF staff calculations.

<sup>6</sup> See IMF (2019d).

<sup>7</sup> “Foreign value added” refers to imported inputs used by a country to produce its exports; and “indirect value added” refers to a country's value added to intermediate inputs that are exported to and used by other countries to be re-exported.

<sup>8</sup> IMF (2015d) documents that, in the global sample, a country's insertion into global value chains is determined by tariffs, the index of rule of law, and domestic credit to private sector. Also, as impediments to trade in sub-Saharan Africa, IMF (2015d) identifies high tariffs, the lack of infrastructure, unfavorable governance and business climate, and low access to credit.

tape, and create an even playing field among firms. Competitiveness would be generally supported by strong institutions, including strong contract enforcement and rule of law.

Countries also need to harness the Fourth Industrial Revolution to sustain competitiveness and take advantage of technological advances to spur growth and leapfrog infrastructure (IMF 2018e). Development strategies need to (1) build digital infrastructure (as the region has the lowest internet penetration in the world), (2) ensure education systems are meeting changing skill requirements while catering to lifelong learning, and (3) promote smart urbanization (to build a hub of innovation).

### *Ensuring inclusiveness.*

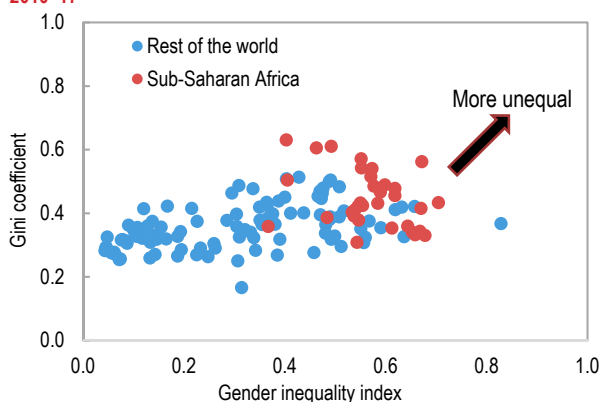
Countries need to ensure more equitable sharing of the benefits of growth and increased prosperity, including equal employment and education opportunities and improved access to and provision of health care and financial services.

- Fiscal policy could focus on moving to more progressive taxation to fund expanded access to high-quality education and health services, while replacing regressive expenditures such as fuel subsidies with more effective and targeted social safety nets (IMF 2017b).
- Promoting gender equality would broaden the gains from growth. Gender inequality in the region remains among the highest in the world (Figure 1.29). Increasing access to health and education services and promoting financial inclusion—especially in rural and

underserved areas and populations—could boost female labor force participation, especially in higher-value-added economic activity.

- Improving labor market outcomes for youth is critical, particularly given the large demographic dividend for the region (IMF 2015c). This would require promoting education and training, and advancing structural reforms to lift growth (discussed above) (Ahn and others 2019).
- Deepening financial access will require supporting financial innovation, while safeguarding financial stability through enhanced consumer protection and cybersecurity. Doing so would extend sub-Saharan Africa's global leadership in mobile money accounts per capita, mobile money outlets, and volume of mobile money transactions (Sy and others 2019).

**Figure 1.29. Gender Inequality Index and Gini Coefficient, Average 2010–17**

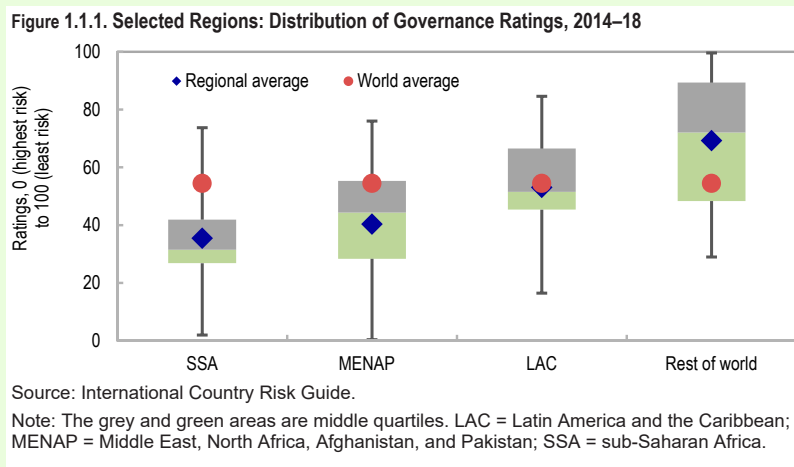


Sources: United Nations Development Programme (UNDP) Human Development Report; and IMF staff calculations.

### Box 1.1. Improving Governance in Sub-Saharan Africa

Good governance can improve overall growth and economic performance. While improving governance takes time, there are already various instruments in place that governments can leverage in the near term.

Substantial gains could be made if governments can successfully deliver on their commitment to improve governance. Bringing sub-Saharan Africa's average governance scores to the rest of the world average could boost the region's growth by about 1 percent of GDP (Hammadi and others 2019). Sub-Saharan Africa's governance indicators tend to lag other regions, including those perceived as having weak governance (Figure 1.1.1).



Elevated corruption is associated with high costs. Examples include higher tax evasion and lower tax revenue; a shift in the composition of government spending; lower efficiency of government spending; higher procurement costs; increased central bank financing; and weaker financial stability, which can all arise from a lack of trust in public institutions, the quest for economic rents, poor lending practices, and weak financial supervision (IMF 2018f).

With increased access to timely information through public dissemination and digital platforms, there is a demand for accountability and transparency from citizens. Also, there is an increasing recognition that weak governance and corruption undermine growth and development in various ways.

Notwithstanding the political commitment, improving governance is difficult as beneficiaries will fight to maintain the status quo. It is also a complex process as governance has various dimensions, each requiring a tailored approach. Although the approach to improving governance is country specific, there are basic principles that apply across countries—including improving the regulatory quality, enhancing government effectiveness, and strengthening fiscal and anti-corruption institutions.

Significant gains are possible in the near term. For instance, adhering to existing laws and public-financial-management regulations could be a first step. This would help improve the budgetary process by closing loopholes that lead to inflated procurement costs and inefficient public investment. Greater checks and balances on state-owned enterprises can improve their economic and operational performance while containing fiscal risks. Safeguarding the independence of central banks will allow them to better supervise the financial system. Additionally, bolstering the framework on anti-money laundering and combating the financing of terrorism (AML/CFT) by implementing measures related to customer due diligence, beneficial ownership, asset declarations, and politically exposed persons will allow for better tracking of illicit transactions and asset recovery.

This box was prepared by Vimal Thakoor.



### Box 1.2. Lessons from Other Regional Trade Arrangements for the African Continental Free Trade Agreement (AfCFTA)

Lessons from other regional trade arrangements (RTAs) suggest that a successful AfCFTA would require signatories to adopt a complementary set of reforms, while ensuring that the AfCFTA is fully implemented and supports an outward-oriented growth strategy.

Regional trade agreements have become an important feature of the international trade architecture. In 2018, there were more than 400 RTAs notified to the World Trade Organization (WTO) (Table 1.2.1). These RTAs vary in size, composition, coverage, and implementation record. The AfCFTA is the world's largest RTA measured by membership and population. The agreement aims, among other goals, to create a single market for goods and services and to facilitate movement of persons. The agreement also contemplates reforms on competition policy, investment, and intellectual property rights.

Table 1.2.1. World: Selected Characteristics of Key Regional Trade Agreements, 2019

	Regional/Total trade (Percent)	Share of World Trade (Percent)	Population (Millions)	GDP (USD Billions)	Exports & Imports to GDP (Percent)	Number of Members	Income status	Type	Date of entry into force	Coverage	Implementation Status
EU	63.8	33.1	510	18,750	88.8	28	AEs (23); EMEs (5)	Common market	1993	GS, TF, IP, RO, DS, M, T, NTB	Full
NAFTA	40.5	15.6	489	23,429	33.3	3	AEs (2); EMEs (1)	Free trade area	1994	GS, TF, IP, RO, DS, M, T, NTB	Full
AFTA	23.1	7.3	647	2,923	120.2	10	AEs (1); EMEs (5); LIDCs (4)	Free trade area	1993	G, IP, TF, DS, RO, M, T	Partial
COMESA	7.3	0.8	546	7,646	4.7	21	EMEs (6); LIDCs (15)	Customs union	1994	GS, RO, T, NTB, TF, CP, DS, IP, M	Partial
Mercosur	13.7	1.5	263	2,488	30.0	4	EMEs (4)	Customs union	1991	GS, T, IP, DS, RO, NTB, CP, M, TF	Partial
<i>Memorandum:</i> AfCFTA	16.4	2.7	1,239	2,323	54.8	54	EMEs (15); LIDCs (39)	Customs union	2019	GS, TF, I, RO, DS, M, T, NTB	Beginning

Sources: IMF, Direction of Trade Statistics; IMF, World Economic Outlook database; and IMF staff calculations.

Note: AE = advanced economies; CP = competition policy; DS = dispute settlement; EME = emerging market economies; G = goods; GS = goods and services; IP = intellectual property; LIDC = low-income developing countries; M = monitoring and implementation mechanism; NTB = nontariff barriers; RO = rules of origin; T = tariffs; TF = trade facilitation.

RTAs have generated broadly positive macroeconomic effects on their membership by:

- Creating trade, with minimal trade diversion (Freund and Ornelas 2010, Vicard 2011). They have also facilitated participation in global value chain (GVC) trade. Studies have generally found substantial trade creation on the North American Free Trade Agreement (NAFTA) and the ASEAN Free Trade Area (AFTA) but some trade diversion effects on Mercosur.<sup>1</sup>
- Enhancing growth, due to scale effects from a larger domestic market and technological diffusion (Berthelon 2004, Schiff and Wang 2003). Membership in an RTA may also reduce growth volatility due to increased market size, a clearer policy framework, and mechanisms for dispute settlement (Kpodar and Imam 2017).
- Increasing foreign direct investment (FDI), through the extended domestic market as well as through deep integration provisions (including those covering investment, intellectual property rights, standards, and competition policy), which lower political risks and improve the business climate.<sup>2</sup>

This box was prepared by Garth Peron Nicholls, Malika Pant, Hector Perez-Saiz, and José Nicolás Rosas García.

<sup>1</sup> See Chang and Winters (2002), Trefler (2004), Romalis (2007), and Acharya and others (2011).

<sup>2</sup> See Lim (2001), Lederman and others (2005), and Medvedev (2012).

**Box 1.2. continued.**

Some RTAs covering various parts of sub-Saharan Africa for decades have had limited results. The AfCFTA's success in creating trade, enhancing growth, and increasing FDI would hinge on a fundamental change in attitude to regional integration in three areas: (1) the design of the agreement, (2) the implementation of the agreement, and (3) the articulation of an accompanying broad-based reform agenda.

- Design of the agreement:
  - The creation of the AfCFTA should be complemented with a gradual reduction of most-favored-nation (MFN) tariffs.<sup>3</sup> In this way, the AfCFTA would expand the African countries' global trade, especially with more technologically advanced economies. Within the AfCFTA, a key challenge is to coordinate and agree on a reasonable level of common external tariff (CET) for countries at different stages of development in an arrangement without a compensating mechanism. As the cases of Economic Community of West African States (ECOWAS) and East African Community (EAC) have shown, it would be important to set the CET at a level that does not raise the cost of living, especially for low-income households (AfDB 2019, page 80).
  - To maximize the potential gains, the rules of origin should be nonrestrictive and avoid going beyond preventing trade deflection or the transshipment of goods from countries outside the agreement. This would minimize bureaucratic costs and facilitate implementation. There is evidence that complex and stringent rules of origin in some RTAs have discouraged trade flows. Very detailed and complex rules of origin adopted by NAFTA are assessed to have substantially increased the level of protection faced by nonmembers, violated article XXIV of GATT rules, and contributed to trade diversion (Conconi and others 2016). According to the AfDB (2019, page 113), the low-income countries would be disadvantaged as they have to source inputs from higher-cost members if the AfCFTA were to adopt restrictive product-specific rules of origin (that favor upstream capital-intensive sectors).
- Implementation of the agreement: Lack of effective monitoring and implementing mechanisms has been a key reason for the lower performance of some past RTAs in Africa and other regions. It would be crucial for the AfCFTA's institutions to be strengthened and have the authority to create a monitoring mechanism. Such a mechanism could act as a disciplinary device to identify lagging countries as seen during the implementation of the European Union and the East African Community.
- Articulation of an accompanying broad-based reform agenda: Member countries should focus on maintaining macroeconomic stability, fostering business environments where the private sector can thrive, tackling labor market distortions, enhancing social protection, and increasing domestic revenue mobilization. At the regional level, efforts should aim at scaling up investments in the continental infrastructure and creating a regional competition commission.

<sup>3</sup> RTAs represent a departure from the non-discrimination principle underlying the multilateral trading system and can have both positive and negative effects.

## REFERENCES

- Acharya, R., J. A. Crawford, M. Maliszewska, and C. Renard. 2011. "Landscape." Chapter 2 in *Preferential Trade Agreement Policies for Development: A Handbook*, edited by J. Chauffour and J. Maur, Washington, DC: World Bank.
- African Development Bank (AfDB). 2019. *African Economic Outlook 2019*. Abidjan.
- Ahn, J., Z. An, J. Bluedorn, G. Ciminelli, Z. Kóczán, D. Malacrino, D. Muhaj, and P. Neidlinger. 2019. "Work in Progress: Improving Youth Labor Market Outcomes in Emerging Market and Developing Economies." IMF Staff Discussion Note 19/02, International Monetary Fund, Washington, DC.
- Berthelon, M. 2004. "Growth Effects of Regional Integration Agreements." Working Paper No. 278. Central Bank of Chile, Santiago.
- Chang, W., and L.A. Winters. 2002. "How Regional Blocs Affect Excluded Countries: The Price Effects of Mercosur." *American Economic Review*. 92(4): 889–904.
- Clements, B., D. Coady, S. Fabrizio, S. Gupta, T. Alleyne, and C. Sdravovich. 2013. "Reforming Energy Subsidies: Lessons from Experience." Chapter 4 in *Energy Subsidy Reform: Lessons and Implications*, Washington, DC: International Monetary Fund.
- Conconi, P., M. García Santana, L. Puccio, and R. Venturini. 2016. "The Perverse Effect of Preferential Rules of Origins." Vox CEPR Policy Portal, March 16.
- Davis, S. 2016. "An Index of Global Economic Policy Uncertainty." *Macroeconomic Review* October.
- Estevadeordal, A., and K. Suomien. 2006. "Mapping and Measuring Rules of Origin around the World." Chapter 3 in *The Origin of Goods: Rules of Origin in Regional Trade Agreements*, edited by O. Cadot, A. Estevadeordal, A. Suwa-Eisenmann, and T. Verdier, Oxford: University Press.
- European Investment Bank (EIB). 2018. *Banking in Africa: Delivering on Financial Inclusion, Supporting Financial Stability*. Luxembourg.
- Freund, C., and E. Ornelas. 2010. "Regional Trade Agreements." Policy Research Working Paper 5314, World Bank, Washington, DC.
- Gaspar, V., D. Amaglobeli, M. Garcia-Escribano, D. Prady, and M. Soto. 2019. "Fiscal Policy and Development: Human, Social, and Physical Investment for the SDGs." IMF Staff Discussion Note 19/03, International Monetary Fund, Washington, DC.
- Hammadi, A., M. Mills, N. Sobrinho, V. Thakoor, and R. Velloso. 2019. "A Governance Dividend for Sub-Saharan Africa?" IMF Working Paper 19/1, International Monetary Fund, Washington, DC.
- International Monetary Fund (IMF). 2015a. "Making Public Investment More Efficient." Policy Papers, Washington, DC.
- . 2015b. "Evolving Monetary Policy Frameworks in Low-Income and Other Developing Countries." Policy Papers, Washington, DC.
- . 2015c. "How Can Sub-Saharan Africa Harness the Demographic Dividend?" Chapter 2 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, April.
- . 2015d. "Global Value Chains: Where Are You? The Missing Link in Sub-Saharan Africa's Trade Integration." Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, April.
- . 2016a. "Enhancing Resilience to Natural Disasters in Sub-Saharan Africa." Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, October.
- . 2016b. "Financial Development and Sustainable Growth." Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, April.
- . 2017a. "Economic Diversification in Sub-Saharan Africa." Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, October.
- . 2017b. "Tackling Inequality." Chapter 1 in *Fiscal Monitor*, Washington, DC, October.
- . 2018a. "Domestic Revenue Mobilization in Sub-Saharan Africa: What Are the Possibilities?" Chapter 2 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, May.
- . 2018b. "Malawi—2018 Article IV Consultation and Request for a Three-Year Arrangement Under The Extended Credit Facility." Country Report 18/115, Washington, DC.
- . 2018c. "Capital Flows to Sub-Saharan Africa: Causes and Consequences." Chapter 2 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, October.
- . 2018d. "The IMF's Annual Macroprudential Policy Survey— Objectives, Design, and Country Responses." Policy Papers, Washington, DC.
- . 2018e. "The Future of Work in Sub-Saharan Africa." Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, September.
- . 2018f. "Review of 1997 Guidance Note on Governance - A Proposed Framework for Enhanced Fund Engagement." Policy Papers, Washington, DC.
- . 2018g. "Recovery and Risking Risks." Chapter 1 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, October.
- . 2019a. "Macroeconomic Developments and Prospects in Low-Income Developing Countries—2019." Policy Papers, Washington, DC.

- . 2019b. “Is the African Continental Free Trade Area a Game Changer for the Continent?” Chapter 3 in *Regional Economic Outlook: Sub-Saharan Africa*, Washington, DC, April.
- . 2019c. “Building Resilience in Developing Countries Vulnerable to Large Natural Disasters.” Policy Papers, Washington, DC.
- . 2019d. “Reigniting Growth in Emerging Market and Low-Income Economies: What Role for Structural Reforms?” Chapter 3 in *World Economic Outlook*, Washington, DC, October.
- Kpodar, K., and P. Imam. 2017. “Regional Trade Agreement and Growth Volatility.” Vox, CEPR Policy Portal.
- Lederman, D., W. Maloney, and L. Serven. 2005. Lessons from NAFTA for Latin America and Caribbean countries: A Summary of Research Findings. Washington, DC: World Bank.
- Lim, E. G. 2001. “Determinants of, and the Relation between, Foreign Direct Investment and Growth: A Summary of the Recent Literature.” IMF Working paper 01/175, International Monetary Fund, Washington, DC.
- Medvedev, D. 2012. “Beyond Trade: The Impact of Preferential Trade Agreements on FDI Inflows.” *World Development* 40(1): 49–61.
- Romalis, J. 2007. “NAFTA’s and CUSFTA’s Impact on International Trade.” *Review of Economics and Statistics* 89(3): 416–35.
- Schiff, M., and Y. Wang. 2003. “Regional Integration and Technology Diffusion. The Case of the North American Free Trade Agreement.” Policy Research Working Paper 3132, World Bank, Washington, DC.
- Sy, A., R. Maino, A. Massara, H. Perez-Saiz, and P. Sharma. 2019. “FinTech in Sub-Saharan African Countries: A Game Changer?” Departmental Paper 19/04, African Department, International Monetary Fund, Washington, DC.
- Trefler, D. 2004. “The Long and Short of the Canada-U.S. Free Trade Agreement.” *American Economic Review* 94(4): 870–95.
- Vicard, V. 2011. “Determinants of Successful Regional Trade Agreements.” *Economic Letters* 111: 188–90.