AFRICA AND THE GLOBAL ECONOMIC CRISIS: CHALLENGES AND OPPORTUNITIES

INTRODUCTION

Most African states may have been spared the worst of the world’s financial crisis due to a limited, if any exposure to off-shore markets, particularly the syndicated financial instruments that turned “toxic”. Nevertheless, the harsh reality is that they have become victims of an unfolding economic crisis of global proportions, a crisis that had its origins in the developed world. Serious shockwaves are hitting Africa’s shores, with the extent and depth of the damage, whether ongoing or forthcoming, being extremely difficult to assess or project at this point in time. The pattern of financial flows associated with investment, lending and trading activity has been dramatically altered for the time being, with the fallout affecting all regions of the world, including the African continent. It is thus critical that counter-balancing actions be pursued to safeguard stability in the short- to medium-term, so as to avoid a further deterioration of economic conditions and the ensuing social implications.

The ongoing global financial crisis has led to a considerable economic slowdown in most countries across the globe and to contracting domestic output in several advanced economies. In addition to the United States of America (USA), Japan and the United Kingdom (UK), all the countries within the Euro zone (with the exception of its most recent member, Slovakia) are “technically”¹ in a recession. Equity markets have fallen sharply from their recent highs and strong bearish sentiment prevails.

A deep financial crisis, largely perpetrated by irresponsible governance and risk management practices on the part of numerous large corporations, policy-makers and regulatory authorities in the most advanced of economies, has spread globally. Creditor and investor sentiment has soured on the back of poorly performing or collapsing financial institutions (particularly investment banks, funds and mortgage lenders) and generalised

¹ An economy is “technically” in recession when its gross domestic product registers contractions (i.e. negative growth) in real terms over at least two consecutive quarters.
nervousness over the exposure (actual or perceived) of such institutions to the so-called “toxic” assets.

In an effort to “unfreeze” the credit markets, to rescue the financial system from the brink of absolute paralysis and to revive economic activity, policy-makers around the world have been pursuing rescue efforts, including fiscal and monetary stimulus and bail-out packages running into trillions of US dollars on a global basis. Nevertheless, global economic growth has weakened substantially and the outlook is quite bleak.

According to the latest (28 January 2009) forecasts by the International Monetary Fund (IMF), world growth is projected to reach only 0.5% in 2009, down from the 2.2% forecast in November 2008. Emerging markets are expected to grow by 3.3% this year, while Africa is expected to register 3.4% growth, down from the 5.2% estimated by the IMF for 2008 as a whole. Further downward revisions are almost certain in light of a deteriorating economic environment.

As one would expect, the direct and indirect effects, actual as well as anticipated, of the worst financial crisis to hit the global economy since the Great Depression vary substantially from country to country within the African continent. The impact has been largely of an ‘indirect’ nature, stemming more from the credit squeeze and global economic slowdown rather than the financial crisis per se, given the continent’s relative marginalisation from the global financial system.

The severity of the impact has been highly correlated to the extent of a country’s integration within the global financial system, its dependency on export trade and the composition of its export basket, as well as its reliance on capital inflows, such as portfolio and foreign direct investment flows, remittances and official development assistance. The adverse impact of
the crisis on the African continent has been gradually spreading from a regional perspective, and its serious effects are progressively mounting.

From a financial perspective, the following are critical ingredients for Africa’s growth and development performance:

- **Foreign direct investment** (FDI) inflows, which reached almost USD53 billion in 2007 and estimated to have totalled just under USD62 billion in 2008;
- **Portfolio investment** flows, which had reached USD15.7 billion in 2007. Equity market capitalisation in Africa represented 60% of GDP in 2007, or treble the 20% ratio recorded in 2005.
- **Trade credit lines** that are being used to finance imports and investments;
- **Remittances** from the African diaspora, which are estimated to have averaged at least USD12 billion on an annual basis in recent years; and
- The recent entry by some countries into the sovereign bond market in order to source financing for the development of physical infrastructure, with maiden sovereign debt issuance basically doubling every year from 2005 to 2007 towards the USD6.5 billion mark.

The weakening or even reversal of these flows, due to institutional deleveraging\(^2\), pessimistic investor sentiment and the economic downturn in general, is having a significant impact on emerging markets and other developing economies, including African economies. Extreme risk aversion and the credit squeeze have been reflected in portfolio outflows and reduced lending to such countries. Foreign direct investment flows are also expected to contract, although the rather long lead-time of the typical projects would imply that some of the capital may have already been committed. In order to boost government finances, several Sub-Saharan African countries had been counting on floating their maiden sovereign bonds, as was done by Gabon and Ghana. However, the scope for international debt issuance has basically all but vanished along with investor appetite, with not one single Sub-Saharan Eurobond having come to market last year.

These developments in capital markets are delaying infrastructure and other large projects requiring long-term financing, including the commissioning time-lines for many of the private sector projects targeting the continent’s incomparable resource base. Where capital is

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\(^2\) Deleveraging refers to the process of reducing financial leverage, or financial institutions lowering their high lending-to-assets ratios after an extensive period of excessive or injudicious lending activity. This results in a tightening of conditions in global credit markets, with adverse implications for investment and trade flows.
available, its cost may have risen substantially, with implications for the viability of projects and for the debt repayment obligations of African countries. Such adverse trends, coupled with reduced export demand, deteriorating terms of trade as commodity prices tumbled, lower tourism revenues and weaker foreign worker remittances, are not only impacting negatively on capital inflows, but also leading to greater volatility in foreign exchange markets and significant currency depreciations.

WHILE THE CHALLENGES MOUNT, A MULTITUDE OF OPPORTUNITIES REMAIN

A temporary, albeit serious setback to Africa’s recent growth performance

Africa’s robust growth since early in the new millennium has been substantially supported by the remarkable performances of commodity-rich countries, particularly (but not confined to) the oil producers such as Nigeria, Angola, Egypt, Equatorial Guinea and the Sudan, which have reported growth rates ranging from 5% to 20%. However, domestic reform in numerous countries has played a critical role, with vastly improved macro-economic management bringing along greater price stability, rising incomes and spending, increased investment in physical and social infrastructure and attracting foreign investment activity in productive sectors.

Africa’s economic outlook looked promising indeed. Widespread economic reforms and notable improvements in overall governance were bearing fruit, while several long-standing conflicts had come to an end and reconstruction was beginning. The heightened attractiveness of Africa’s resource wealth over the commodity “super-cycle” was reflected in fast-expanding foreign direct investment, increasingly from non-traditional sources such as China and India, while significant debt relief was being provided and other forms of foreign assistance were being committed. The strong performance\(^3\) of the last few years seemed set to continue, with the continent’s economies having expanded on average by about 6% per annum over the period 2003 to 2008.

The unfortunate turn of events on a global basis, however, altered the outlook radically. Overall, the direct effects of the global financial crisis on the continent are not expected to be

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\(^3\) Over the period 1997 to 2007, real GDP per capita grew by: more than 50% in Mozambique, Nigeria and Sierra Leone; between 25% and 50% in Burkina Faso, Ethiopia, The Gambia, Ghana, Madagascar, Mali, São Tomé & Príncipe, and Tanzania. Regrettably, however, GDP per capita declined over the same period in Burundi, Central African Republic, Comoros, the DRC, Côte d’Ivoire, Eritrea, Guinea-Bissau, Liberia, Togo and Zimbabwe. (Source: IMF’s International Financial Statistics database)
as severe as in other regions of the world because of Africa’s relatively lower level of integration (with the exception of a couple of countries) within the international financial system. However, the impact of a fast deteriorating global economic environment on the productive sectors of Africa’s economies must not be underestimated. Weaker external demand and lower commodity prices will be the major mechanisms through which the crisis will be transmitted, with serious implications for external trade receipts and investment inflows.

The African continent will almost certainly be an innocent victim of a fast deteriorating global environment as demand weakens, unfavourable terms of trade develop, corporate earnings decline, investment activity slows down and jobs are shed. Small- and medium-sized enterprises, which dominate Africa’s business landscape, are particularly vulnerable to dwindling demand for their goods and services. Their demise would jeopardise the massive efforts over the years to build a thriving SME sector on the continent.

Due to its weak savings capability and propensity, the continent relies heavily on international capital for investment financing, which is increasingly difficult to access due to the credit crisis. Additional adverse factors that are likely to intensify liquidity pressures, with some lag, include a possible moderation in official development assistance flows to low income countries in Africa (as donor countries may face reduced fiscal positions due to the financial crisis) as well as a weaker inflow of remittances from African workers residing overseas.

The prices of many commodities have plunged as global demand weakened and the potential for a swift and meaningful recovery is yet poor. This has seriously affected Africa's commodity producers as their export earnings contracted. Nevertheless, it also proved a blessing for many African countries⁴, as the recent sharp drop in the prices of petroleum products and a smaller, but nevertheless important, decline in the prices of food products (most African countries are net importers of fuel and food products) impacted positively on their balances of payments and on price stability through lower imported inflation. In a continent where the bulk of individual consumption expenditure is on food products, this is

⁴ Amongst the African countries whose balances of payments were most negatively affected by the shocks imposed by sharply higher prices for oil, food and other commodities over the twelve months to June 2008 were: Liberia (the total balance of payments impact as a percentage of GDP was -15.3%), Guinea-Bissau (-8.8%), Eritrea (-8.6%), Comoros (-6.5%), Togo (-5.5%), The Gambia (-5.1%), Malawi (-4.7%), Sierra Leone (-4.4%) and Guinea (-4.2%). (Source: IMF)
no small mitigating factor, although some downward price rigidity may still be expected in the coming months.

The unfolding financial turmoil and its mounting ramifications onto the production side, or the so-called “real” sectors of the world’s economies, have led to continuous downward revisions in economic growth projections for advanced, emerging and developing economies alike. The International Monetary Fund (IMF) has recently estimated Africa’s economic growth in 2008 to have been in the region of 5.2%, downward from its previous estimate of 5.9%. The IMF forecasts Africa’s gross domestic product (GDP) to grow by 3.4% in 2009, down from the 4.7% forecast late last year, with further downward revisions almost certain to ensue. In any event, Africa’s efforts to expand its economic base, to bring greater numbers of workers into the formal economy’s fold, and to alleviate poverty in a meaningful way, will suffer a harsh setback.

According to the most recent World Economic Survey, which was released by the CESifo in November 2008, an economic deterioration was expected in countries such as South Africa, Tanzania, Nigeria, Mauritius, Morocco, Tunisia, Egypt and Algeria. In contrast, conditions were expected to improve in Kenya due to an anticipated increase in private consumption and exports.

The African economies that will contain the adversity of the current downturn are likely to be those that remain highly vigilant in managing the downside potential, those that are in a position to adopt counter-cyclical measures and that make an effort to seek new opportunities and competitive gains. However, as highlighted in later sections of this analysis, liquidity or fiscal constraints may prevent the majority of African countries from adopting economic stimulus packages as the majority of the advanced economies have had the “luxury” of rolling-out.
Weakening export demand, sharply lower commodity prices and balance of payments implications

The indirect impact of the crisis on Africa’s real economy has already been felt, and could be quite severe if the economic downturn becomes deeper and more protracted. As mentioned earlier, the economies of the USA, Japan, the Euro zone member states (with the exception of Slovakia) and the UK are already in recession, whilst the Chinese economy is expected to grow at a relatively slower rate of 7.5% to 8% in 2009 (the Chinese authorities, however, are still projecting 9% growth). Consequently, Africa’s export performance will be more subdued, with demand from the advanced economies considerably weaker and trading activity with emerging markets like China, which expanded ten-fold over the past decade, declining to a much lesser extent. The World Bank estimates that Africa’s exports fell by 2% in 2008, with significant drops in certain countries (e.g. a 30% decline in Angola).

The reliance of many African countries on advanced economies as key markets for their exports is being reflected in adverse movements in their trade balances and in weakening currencies. After all, despite the rapidly growing trade between Africa and Asia, the USA and the European Union remain Africa’s largest trading partners. The majority of African currencies depreciated by 10% to 28% against the US dollar during the course of 2008, with the South African rand (and by implication the Common Monetary Area currencies of Lesotho, Namibia and Swaziland) being the worst performer on the continent and one of the worst globally. The Ghanaian cedi took a substantial knock as well, losing basically one-quarter of its value. The Nigerian naira, which had been basically stable against the US dollar for most of 2008 due to strong oil revenue flows, suffered a sharp drop in December as liquidity dried up after the central bank’s decision to ration foreign exchange sales to the commercial banks. Those currencies with a closer relationship with the Euro exhibited a better performance (i.e. a depreciation of under 10%) – these included the West African CFA franc, the Egyptian pound, the Tunisian dinar and the Moroccan dinar.

Under normal circumstances a weak currency would act as a shock absorber by boosting exports while lessening the impact of a cyclical downturn, but this time around weakening global demand has resulted in declining export volumes, especially (but certainly not confined to) those destined for the advanced economies, which have been the most affected by recessionary conditions. Falling demand for commodities is quite evident, as commodity prices have fallen sharply across the board, while global shipping indices such as the Baltic Dry Index are at their lowest levels since the late 1990s. Lower commodity prices and weakening export volumes have taken a toll on the foreign exchange earning potential of commodity rich countries.
Global demand for oil and minerals, which comprise the bulk of Africa's exports (together, hard and soft commodities accounted for 78% of Africa's overall exports in 2007), has been receding visibly, leading to sharp falls in prices. Hovering around USD45 per barrel, Brent crude is a mere fraction of the level reached in early July 2008 (i.e. USD144 per barrel). Soft commodity prices have also tumbled – for example, the prices of Arabica coffee and cocoa (Ethiopia's main exports) dropped by over 20% since July 2008. Demand for Africa's non-traditional exports is also declining.

Forecasts for most commodity prices in 2009 point either downward or, at the very best, a very modest recovery. Consequently, operational shutdowns, delays in project implementation and cutbacks have been reported in the global mining industry, particularly over the past couple of months. The setback is being felt across the board, from platinum to copper, silver, nickel, diamonds and even gold producers. The large commodity producers such as Nigeria (oil exports), Angola (oil exports), the DRC and Zambia (copper and cobalt exports), Botswana (diamonds) are likely to suffer the most. Zambia, for instance, is likely to face supply set-backs as additional finance may not be accessible, while weak global demand for metals has resulted in certain mining operations in the DRC being temporarily suspended and future projects either being postponed or abandoned. Countries that rely substantially on soft commodities as primary foreign exchange earners, such as Cameroon, Ghana and Uganda are feeling the impact of lower levels of demand and weaker prices.

Despite increased commodity exports over recent years, particularly to Asian and most advanced western economies, Africa’s share of world trade has actually been on the decline – from a 6% share in 1960 to a mere 3% in 2007. Furthermore, the majority of African countries remain highly dependent on one, or at most a handful of export commodities. Faster rates of economic growth in the new millennium have reinforced this concentration on a few export products in a number of resource-rich African countries, such as Angola. Lesser resource-endowed countries such as Tanzania, Morocco and Tunisia have
progressed to a significant extent in diversifying their export baskets, whereas certain countries (e.g. Mauritius, Kenya and Ghana) have expanded their manufacturing sector to a reasonable extent (e.g. iron and steel, fish, cut-flowers and vegetables in the case of Kenya).

The importance of establishing an environment that is conducive to the expansion and diversification of export sectors, as well as for the clustering of sectoral activities, has also been highlighted time and time again. Such clustering, for instance, would tend to attract additional investment activity, as was the case in several Asian countries under initiatives aimed at expanding their export-oriented sectors.

Despite regional integration efforts in several parts of the continent, the poor permeability of borders in Africa (as compared to those of Western Europe, for instance) also constrains the beneficial economic interaction, including trade flows, investment activity and the pooling of resources among African countries that would promote the emergence of regional growth centres and “neighbourhood” spill-over benefits. Hence, intra-regional trade (e.g. intra-SADC trade) remains muted despite trade liberalisation measures. The continued presence of non-tariff barriers plays a role in this regard, but so does the relatively weak industrial base of most African countries (e.g. considering that the majority of the SADC member states are producers of primary products, their import preferences lie in higher value-added items that are manufactured in South Africa or in the rest of the world).

With regard to the international trade regime, the Obama presidency in the USA is expected by many to eventually bring forth certain positive developments, although domestic considerations will certainly take precedence during the initial phase of the new USA administration. It is also hoped that fairer trade agreements may, in due course, be entered into, and that more aid will be forthcoming (although more effectively applied). However, one cannot possibly ignore the brewing concern regarding the potential emergence of protectionist tendencies as the leading trading nations, including the USA, attempt to shelter their individual economies in a time of crisis. Africa would certainly suffer if the global reaction to a prolonged economic slowdown also entailed a rise in protectionism in developed countries and in key emerging markets.

Africa’s somewhat “insulated” financial sector has been holding up relatively well, but access to capital is increasingly difficult

With very few African banks holding, either directly or indirectly, the so-called “toxic assets” (principally the USA and European sub-prime mortgage backed securities or other risky
derivative securities), while keeping the bulk of their loans on their balance sheets, the continent’s financial sector initially looked primed to weather the storm. Furthermore, the vast majority of African countries (with the exception of those with large stock-markets, such as South Africa) had not benefitted to any substantial degree from the easily-reversible capital flows, the so called “hot money” that aggravated the East Crisis in the late 1990s. Secondary markets for trade in bank loans are also relatively small on the continent, with the same applying to derivatives markets.

Even South Africa, whose economy is certainly the most integrated within the global financial system, had very limited exposure to the unfolding financial meltdown (principally the limited exposures of Old Mutual and Investec, while Absa has the UK’s Barclays as its largest shareholder). In fact, the two continental heavyweights – South Africa and Nigeria – only have some 5% of their assets in foreign ownership, as compared to the world average at around 40%. Largely the outcome of capital or exchange controls, and further strengthened by tight regulations by the supervisory financial authorities in the respective African countries, this limited exposure helped cushion, to some extent, the impact of the financial crisis on Africa.

Despite Africa’s low level of integration to the global financial system, the depth and breadth of the crisis can hardly justify any degree of complacency from Africa’s standpoint, as the continent’s financial markets remain vulnerable to risk aversion and institutional deleveraging. Initially, Africa’s small\(^5\) equity markets seemed to be holding up relatively well when compared to both the developed and larger emerging markets in the early part of 2008, even though they were well off their peaks. However as various institutional funds began to liquidate their positions and repatriate capital, the contagion turned into a generalised retreat from all risk, with very little consideration for the underlying economic fundamentals.

Several African stock-markets were caught up in this retreat, with those of Egypt (-41%), Namibia (-40%), Botswana (-29%), Kenya (-28%), Mauritius (-27%) and South Africa (-23%) recording some of the sharpest declines, in local currency terms, over the period 1 August 2007 (i.e. pre-crisis) to 31 December 2008. The Tunisian stock exchange, on the other hand, recorded gains of around 17% in local currency terms (15% in US dollar terms, as shown in the accompanying graph) over this period. Uganda and Zambia also experienced

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\(^5\) With the noteworthy exception of South Africa’s Johannesburg Securities Exchange (JSE), which is the world’s 16\(^{th}\) largest in terms of market capitalisation.
the fallout of the liquidation of a fund that had large positions in these two markets. As investors liquidated their positions in emerging markets, numerous currencies started to depreciate rapidly, with the South African rand being one of the worst performers. Already, it has been estimated that portfolio flows to Africa have declined sharply as global liquidity tightened, to a mere USD5.9 billion in the course of 2008 compared to USD15.7 billion in 2007.

Although relatively “insulated” from the global financial crisis, African banks are feeling the freeze in interbank lending worldwide\(^6\), and the deleveraging process appears to be far from having run its full course. The African banking sector could also come under substantial pressure should the economic slowdown intensify. Lending by African commercial banks to local businesses expanded rapidly in a variety of countries (e.g. Nigeria, Ghana and Kenya) over recent years, thus exposing the sector to a potential escalation of non-performing assets should borrowers face difficulties in servicing their debt. This would jeopardise the solvency of individual banks, some of which are publicly listed, and potentially lead to banking crises in individual countries, through runs on banks by depositors and investor panic, that could well spread beyond their borders into regional economic groupings.

The mere possibility of such an adverse scenario materialising begs concern over the ability of most African central banks to provide guarantees to depositors, to intervene in individual financial institutions through bail-outs and other restructuring efforts, or to rely on external assistance through regional or multilateral institutions for the purpose of containing an unfolding crisis. Considering the inherent weaknesses in the financial sectors of many

\(^6\) According to the United Nations’ report World Economic Situation and Prospects 2009, the volume of bank loans to emerging markets declined by around 40% in 2008 when compared to the levels recorded in 2007.
African countries, it would be prudent for the relevant authorities to concentrate on facilitating access to bank credit and development funding, on deepening markets, improving financial sector efficiencies and ensuring the adequacy of prudential regulations.

The development finance system, whose relevance has often been downplayed by private financiers, multilateral institutions and policy-makers, may play a critical role in facilitating access to credit. The financing capacity of the vast majority of Africa’s development finance institutions (DFIs) may be extremely limited at this point in time, with this regrettable state of affairs being a lesson for the future. However, a few of the continent’s DFIs are indeed capable of coming to the fore in a very meaningful manner (e.g. the Industrial Development Corporation of South Africa, the Development Bank of Southern Africa and the Botswana Development Corporation). The multilateral African Development Bank and International Finance Corporation are certainly key development financiers that will alleviate the credit scarcity.

**Investment activity is clearly moderating, but is expected to recover**

Foreign direct investment (FDI) flows into Africa grew strongly in recent years as low interest rates globally encouraged financiers to support the investment plans of those seeking access to natural resources during the commodity “super-cycle”. Foreign investors were also undoubtedly attracted by domestic economic reforms and political stability in many African countries.

The United Nations Conference on Trade and Development (UNCTAD) estimates that FDI flows to African countries amounted to USD61.9 billion in 2008. This represents a 16.8% increase on the previous year’s FDI inflows – the highest regional rate of growth and well in excess of the 3.6% rate of increase estimated for developing economies as a block, which received USD517.7 billion in FDI inflows out of a global total of USD1.45 trillion. South Africa welcomed a more than
doubling of FDI inflows to USD12 billion, while Egypt experienced a contraction towards the USD11 billion mark. The developed economies, in turn, recorded a 32.7% contraction in FDI inflows towards USD840 billion in 2008.

According to UNCTAD, “In the face of a global recession, tighter credit conditions, falling corporate profits, and gloomy prospects and uncertainties for global economic growth, many companies have announced plans to curtail production, lay off workers, and cut capital expenditures, all of which tend to reduce FDI”. The level of adversity now being experienced by the global financial system will impact upon project financing in Africa to a serious extent, both from the demand side as the world’s economies slow down, and from the financial perspective as capital flows dry up and the cost of funding escalates. An enormous cutback in the quantity of lending available has been evident for some time, regardless of the level of interest rates. Such developments are altering the implementation and/or viability of investment projects across the continent, at least in the shorter-term.

For instance, weaker demand and falling metal prices have led to the temporary suspension of certain operations in the DRC (e.g. the copper and cobalt operations of Central African Mining & Exploration; the mining operations of Katanga Mining at the Tilwezembe open pit and in ore processing at its Kolwezi concentrator due to weaker cobalt prices) as well as in the postponement or cancellation of mining projects (e.g. according to media reports, over 60 Chinese mining companies left the DRC’s mineral-rich Katanga province over the past couple of months as copper and cobalt prices fell). Moreover, despite very attractive company valuations, the market downturn has been disconcerting enough to lead major players to abandon acquisitive deals (e.g. South Africa’s Impala Platinum retreated from the Northam Platinum and Mvelaphanda Resources deal early in January 2009).

Normally, major crises bring to the fore not only comparative weaknesses but also comparative strengths. Thus, economies that survive the downturns are those that exploit their comparative strengths instead of focusing on their weaknesses (e.g. stronger, cash-flush companies may be tempted to acquire weaker competitors). Africa can overcome rising food prices if it utilizes its land resources more effectively. Our continent is also richly endowed with commodities that are likely to derive long-run benefits given their finite nature and the anticipated resumption in demand as the world’s population grows and economic performances recover. Therefore, given the demand and supply forces at play, commodity prices are likely to resume an upward trend in years to come.
After all, the long-term demand for commodities from the fast-growing and very large emerging economies such as China and India has certainly not evaporated. Robust growth will eventually resume and support a recovery of commodity prices. Hence, the currently weaker level of demand for commodities from emerging markets is transitory, and once the current financial crisis abates and credit starts flowing again, investment activity will strengthen once again. Large infrastructure projects continue to be favoured by emerging economies like China in order to support overall growth, while advanced countries such as the USA are seeing them as a way out of their crisis. This should support a recovery in commodity markets and renewed investor interest in Africa for its resource wealth.

Taking due consideration of the long-term fundamentals, several international exploration and mining development companies have, therefore, continued their activities in Africa (e.g. the diversified mining giant Rio Tinto remains interested in the exploration of minerals such as bauxite, coal, diamonds and mineral sands in some 12 African countries; Equinox Minerals is involved in a large copper project in Zambia; Uranium-mining company Uranio has acquired a coal project in Madagascar).

Favourable conditions are not only expected to resume for the commodities that underpin construction materials, but also for crude oil and even food items. The potential for growing demand-supply imbalances is ever present as larger portions of the global population attain higher levels of purchasing power. For instance, rapid growth, industrialisation and modernisation in China and India have led to rising energy consumption, which in turn compelled these economies to seek energy supplies, including access to oil resources, across the world and in Africa especially.

Around 9.5% of the world’s proven oil reserves are found in Africa, largely in oil-rich countries like Nigeria, Angola, Algeria and Libya, amongst others, with the oil in the Gulf of Guinea being often preferred over that sourced in the Middle East due to its lighter, sweeter and thus more easily refineable characteristics. Cognisant of their long-term requirements and the potential presented by African oilfields, China and India have been investing in projects from Angola to Algeria, with China’s “Angolan model”7 being increasingly favoured by their respective agents as the mechanism through which to access Africa’s resources.

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7 China’s so-called “Angolan model” involves the provision of resource-backed loan funding, typically for the roll-out of critical infrastructure. Its Exim Bank, for instance, has offered Angola investments totalling USD4.4 billion covering oil and mining operations, as well as the rapid building of schools, roads, railways and airports.
This model has also been used in Zambia, Gabon and in the DRC, where China announced in 2007 a multi-billion dollar deal that would give it access to copper and cobalt deposits in exchange for infrastructure development facilities covering thousands of kilometres of railways and roads, hydroelectric dams, a port on the Atlantic coast, as well as airports, schools and hospitals. However, this deal has apparently gone very silent, thus reinforcing the sceptics’ belief that China’s “scramble” for Africa was not as much part of a grand, long-term strategy, but rather more of an opportunistic, predatory market strategy. According to media reports, there has been a large exodus of Chinese companies from countries such as the DRC and Zambia as signs of a severe downturn in commodity markets intensified.

The very recent clash between Russia and the Ukraine over gas contracts, which led to an interruption in gas supplies as an excessively harsh winter set in, has once again highlighted the vulnerability of several European nations. An alternative is needed to the gas pipeline passing through the Ukraine and the African continent holds 8.2% of the world’s proven gas reserves, some 80% of which are located in Egypt, Algeria and Nigeria. Algeria’s Sonatrach is already supplying gas through its pipeline to Spain but, going forward, the European Union will certainly be much more active in the African continent in order to reduce its dependency on Russian supplies.

Investment in Africa’s agricultural sector is expanding, albeit from a very low base. In order to secure food supplies, for instance, Saudi Arabia and the United Arab Emirates have been investing in wheat, maize, lucerne and soy bean projects in the Sudan.

Across the commodities spectrum, the challenge remains for African countries to make the most of a future recovery, tirelessly encouraging the beneficiation of their resources instead of continuing to export value-adding opportunities, missing out on massive export earnings potential and in fact creating much-needed employment opportunities elsewhere in the world.

**Reduced tourism flows and weaker earnings**

The tourism sector is growing in importance as a foreign exchange earner and contributor to employment creation and poverty reduction in African countries. South Africa, Egypt, Morocco, Tunisia, Kenya, Mauritius, Swaziland, Botswana and Nigeria are among the leading destinations for international tourists visiting Africa.

It goes without saying that global economic prosperity is one of the main drivers of tourism growth, and that a substantial downturn will impact on tourist flows. This may be particularly
the case for long-haul destinations such as South Africa, Mauritius, Botswana and Swaziland, and to a lesser extent for countries such as Kenya and Morocco, as overseas tourists curtail their travelling budgets by visiting nearby countries. A tendency for down-scaling tourist expenditure in the final tourism destination is also anticipated.

**Fiscal space becoming more limited as revenue sources come under strain**

A decade of growth, rising incomes and expanding middle classes raised the tax revenue collection potential of many African countries, thus providing greater leeway than in previous crises. However, the financial turmoil and a weakening global economy are leading to considerable fiscal pressures for African governments as revenue sources come under strain while spending requirements escalate in an effort to sustain growth levels.

Many African governments may thus be compelled to make very difficult choices regarding state expenditure on social and economic infrastructure due to budgetary shortfalls, at least in the near-term. For example, the budgetary processes of the DRC and Nigeria suffered serious setbacks as the fall in the prices of metals and oil, respectively, affected their revenue collection⁸. National treasuries may have little choice, as most external sources of funding have started drying up, from debt markets to hedge funds.

Fortunately for numerous African countries, external debt levels have dropped considerably as a result of multilateral debt relief, improved macro-economic management and the benefits accrued from the recent commodity boom. Despite the current financial crisis, the IMF has pledged to continue supporting the Heavily

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⁸ Mineral revenues account for around half of the Democratic Republic of Congo’s fiscal budget.
Indebted Poor Countries programme\textsuperscript{9} and to issue debt relief to African states as and when they qualify.

African states that either have poor credit ratings or are not rated as such, typically face difficulties in accessing foreign credit. Foreign aid is therefore essential for these economies. Already, the Group of 8 most industrialised countries is reportedly USD240 billion behind on the commitments made at Gleneagles (Scotland) in 2005, when they promised to double aid to Africa by 2010. The situation is likely to be aggravated by mounting pressure on the fiscal space of donor countries\textsuperscript{10}, with a potential shrinkage in official development assistance (ODA) allocations resulting in enormous fiscal challenges for African countries that rely heavily on such inflows (e.g. São Tomé and Príncipe, the Democratic Republic of the Congo, Burundi, Eritrea, Guinea-Bissau, Liberia, Sierra Leone, Mozambique, Malawi and Rwanda). The likely contraction in ODA over the short- to medium-term demands the most effective possible utilisation of any inflows that do materialise.

Also of serious concern for numerous African countries (e.g. Kenya) is the level of remittances from African workers working overseas, which are estimated to have totalled some USD12 billion on an annual basis. Such remittance flows are likely to contract as the global economic downturn impacts on the incomes or even the employment status of Africans residing overseas.

\textbf{Infrastructure development will suffer delays}

Until recently, strong commodity prices, economic growth and improving confidence in the continent’s future revitalised interest in Africa’s infrastructure as an essential component of economic development. The continent’s massive deficit in all economic infrastructure sectors (i.e. transportation, energy, water and telecommunications) is well documented\textsuperscript{11}. Across Africa, less than 50\% of its population has access to safe water, less than 8\% are connected to a power grid, up to 75\% live without road access within a kilometre to two kilometres of their homes, and many countries have a very low teledensity, with the penetration rate for telecommunications estimated at less than 13\%.

\textsuperscript{9} HIPC programme beneficiaries to date have included Cameroon, Ghana, Rwanda and Zambia, while Togo has recently qualified for debt relief under this programme.

\textsuperscript{10} The USA, the UK, France, Italy and Spain are running high fiscal deficits.

\textsuperscript{11} A recent Goldman Sachs report estimated the overall infrastructure demand in a sample of 12 African countries at USD 1 trillion over the next forty years.
In a continent with a strong reliance on natural resources for economic growth and development, there is obviously a strong relationship between resource availability and access infrastructure. For the resource to be exploited, a strong integrated infrastructural network is necessary. In the absence of such support infrastructure, a country’s economic development is likely to be severely stunted, resulting in low rates of economic growth, a lack of competitiveness and reduced export potential.

Notwithstanding the plethora of infrastructure development opportunities throughout Africa, infrastructure projects have struggled to attract capital, particularly from the private sector. However, private sector funding for infrastructure in Sub-Saharan Africa has increased substantially in recent years, with sectors such as power generation, mobile telephony and ports, having been relatively more successful than power and water distribution as well as road networks.

One of the reasons for the ongoing difficulty in attracting financiers has been the lack of bankable projects - that is projects that have established their financial viability from the financier’s standpoint. This normally requires financing, time and skills which are often lacking in Africa. The preparation and packaging of projects is often expensive and risky as this process includes establishing a detailed cost-benefit analysis in order to ensure the sustainability of the project.

In spite of several initiatives having been put in place to take infrastructure projects to bankability stage and eventually financial closure, there seems to have been a lack of adequate initial “upstream” preparation, which mainly falls in the first two phases of infrastructure project development. These phases normally entail having the relevant policies, laws, regulations and institutions that permit and support the development of infrastructure projects, as well as having a concept idea, project purpose, initial design and action plans.

This has resulted in a growing criticism that, despite the existence of these project preparation facilities, many have not had adequate funding to impact significantly on the flow

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12 Examples include the NEPAD Infrastructure Project Preparation Facility, which is managed by the African Development Bank and was launched in collaboration with the Canadian government; and the NEPAD Project Preparation and Study Facility, set up by the Development Bank of Southern Africa and Agence Française de Dévelopement.
of bankable projects while some facilities have focused on financing specific sectors or individual projects. Even with all these facilities, a substantial financing gap remains.

Where the viability of strategic, large projects has been proven, the African investment landscape was, until recently, becoming very competitive – a matter of “too much money chasing too few projects”. In addition, experience has shown that financiers who participated at the pre-feasibility and/or the feasibility stage of a project stood a better chance of financing the project once it was proven bankable, and of influencing procurement in support of capital goods and services from their own countries.

In simplistic terms, this was the infrastructure financing and development landscape of the African continent until the global crisis set in. Considering the adverse developments highlighted elsewhere in this analysis, substantial delays are anticipated in infrastructure development, whether pertaining to upgrades or new projects.

Serious factors are at play in this regard, ranging from those of a direct nature (e.g. the global liquidity squeeze; fiscal constraints that will impact on the ability of African governments to allocate funds for infrastructure development) to those that play an indirect role (e.g. reduced investment activity resulting from weaker demand and falling commodity prices). Nevertheless, spending on economic and social infrastructure remains critical to Africa’s future development and indispensable for political stability.

**Inflationary pressures contained for the time being**

Most African economies have been experiencing higher inflationary pressures following the surge in oil and food prices not long ago, while oil producing countries also experienced the adverse impact of excess liquidity on price stability. The recent dramatic drop in oil prices, to basically one-third of their 2008 highs, will provide much relief on the inflation front. Complemented by weakening prices of other commodities, including food items, such developments have positive implications for price inflation at both the producer and consumer levels, although currency depreciations reduce the benefits to some extent. Hence, there should be room for a gradual easing of monetary policy in several African countries (e.g. the central banks of South Africa, Nigeria and Kenya have started lowering interest rates) so as to sustain domestic expenditure and lessen the extent of the economic downswing.

The global credit crunch, collapsing asset prices, faltering demand and rising unemployment are certainly posing a strong deflationary push in the short-term. However, there are rising
concerns over the longer-term inflation risks created by the massive liquidity injections into the world’s financial system in recent (and forthcoming) months, as well as over the manner in which governments will deal with the concomitantly ballooning public debt. Furthermore, an upward trend in commodity prices should resume in years to come, as demand-supply imbalances expand in line with growing consumption from the large emerging economies, which are also amongst the most populous.

**The attainment of poverty reduction goals will be further hindered**

The timing of the current global crisis could not have come at a worse time for Africa’s poor. Not only were they still reeling from the adverse effects of concurrent food and fuel price shocks, but had yet to benefit from an improved economic growth performance since the onset of the millennium.

Rapid increases in food and fuel prices pushed headline consumer inflation into double digits in almost half of the countries in Africa. The World Bank had earlier estimated that about 44 million people worldwide would be plunged into poverty in 2008 as a result of the price increases, with the impact being particularly severe in Sub-Saharan Africa as many of its households spend almost half of their income on food.

The more recent decline in commodity prices, particularly food and petroleum products, will gradually filter through to the consumer level and impact positively on Africa’s poor. However, weaker overall economic growth, lower investment activity and either job losses or constrained employment creation will reverse the modest gains in poverty reduction of recent years and hamper the attainment of the Millennium Development Goals.

Unlike the advanced economies and several emerging markets, most African countries have an extremely limited fiscal space, low foreign exchange reserves and now even less access to foreign capital due to the global financial crunch, leaving them in a precarious position to counter a burgeoning humanitarian crisis.

**Difficult times call for extraordinary business leadership**

The impact of ongoing international efforts to thaw global credit markets and stimulate economic activity will take time to bear results. In the meantime, competitive forces scrambling for a weakened global pie will pose unprecedented threats to African enterprises. Such challenges may include aggressive market penetration efforts, including predatory pricing from market players, as well as currency devaluations and even protectionist measures on the part of foreign governments.
African businesses and investment projects that rely heavily on imported inputs will benefit from sharp declines in the prices of fuel and other commodities, but will be adversely affected by currency depreciations. The latter will present temporary price competitiveness to export-oriented enterprises, but these will face very subdued conditions in global markets, particularly in the advanced economies. The foreign exchange earnings of commodity exporters are being adversely affected by the market downturn across the commodities spectrum, but local currency depreciations will cushion the impact to some extent.

Operating conditions are becoming more challenging not only due to international forces, but also due to the slowdown in domestic demand in many countries. The cost of capital may remain high for longer than anticipated by many business leaders, while the production capacity of their enterprises may be increasingly constrained by deficiencies in support infrastructure, running from electricity supply through to transportation and logistics, due to public sector constraints. This will impact on business performance, including the ability to repay debt and overall financial returns. Tough economic conditions may thus result in increasing numbers of African business enterprises facing severe pressure, with a strong risk of default and insolvency.

African business leaders are thus encouraged to adopt tough, well-formulated strategic decisions as their present strategies may not hold them in good stead under rapidly deteriorating market conditions. Major economic downturns tend to amplify not only comparative weaknesses but also comparative strengths. Business leaders should therefore be seriously vigilant, managing downside potential, adopting counter-cyclical measures, including appropriate cost-cutting measures and efficiency improvements, while constantly seeking opportunities for the development of new/niche markets (e.g. “fair trade” accreditation and labelling) and competitive gains.

Considering that growth in the emerging world will exceed the global average, African businesses should continue to identify growth sectors in such markets, to strengthen trade and investment relations with faster-growing countries and strive to remain competitive so as to accommodate import demand from these economies. Certain key factors support a recovery in investment activity sooner or later. These include low asset prices and industrial restructuring (e.g. consolidation trends), emerging economies with huge financial resources (e.g. China), cash-flush corporations (e.g. several South African companies) and the rapidly growing energy and environmentally-related sectors of economic activity. Mergers and
acquisitions (M&As)\textsuperscript{13} may proliferate in sectors under strain, such as resources and consumer-related industries, as robust companies target vulnerable competitors.

Against a background of extremely tight lending conditions, the development finance institutions operating in Africa (e.g. the Industrial Development Corporation of South Africa, which has a continental mandate, the African Development Bank and the International Finance Corporation) will play an increasing role in sustaining investment activity on the continent, thus filling much of the void left by the private financial sector.

\textit{Strong political leadership required, and no room for complacency on governance}

Not only is the hardiness of African economies being tested by the ongoing economic crisis, but so is the resilience of their political systems. Whenever economies are experiencing an economic downturn, panic-driven, impulsive and poorly thought-through policy decisions often leave economies in a worse situation. Those that safeguard the soundness of their economic policies tend to restore investor confidence faster and often manage to mitigate the impact of a downturn. Over-reactions (e.g. excessive easing of interest rates) may bring forth adverse implications in the long-run.

Political leadership becomes all the more critical under such extraordinary circumstances, as external sensitivity to change is exacerbated. Policy priorities should be revisited and public spending allocations wisely reviewed in order to avoid wasteful expenditure. African countries and businesses that remain committed to competing successfully in global markets stand a greater chance of survival and even attaining prosperity.

African leaders must be as transparent as possible about the reality of the situation in their respective countries. They should be quite vocal about their near-term plans in order to counter unjustified risk aversion and restore confidence, whilst avoiding bad policy choices at all costs. National consensus should be forged around the goals of economic growth, development and inclusivity, backed by a strong leadership that is committed to their attainment. Furthermore, in order to attract and retain capital flows, African governments must secure macro-economic stability and continuously improve their countries’ investment environments so as to grow vibrant and competitive private sectors that will create employment and sustain broad-based economic growth. All feasible forms of support should

\textsuperscript{13} According to UNCTAD, M&A activity in Africa is estimated to have increased by 157\% in 2008, totalling USD26.3 billion. This contrasts with a 15.7\% increase for the developing block (USD177 billion in M&A deals), and a 27.7\% contraction in global M&A activity towards the USD1.18 trillion mark in 2008.
be provided to the private sector at large, so as to sustain its growth potential and developmental impact.

**Calls for greater African participation in global economic governance**

The World Economic Forum’s *Global Risks 2009* report aptly states: “The financial architecture of the future must have an element that transcends national borders. To ensure success its institutions should include broad representation in rulemaking bodies, macro prudential surveillance and have agreed procedures for systematic enforcement.”

As global leaders embrace a more cooperative form of international governance so as to restore order to the financial system, there will be calls from the emerging or developing regions of Asia, Africa and South America:

- To address the unacceptable disparities in wealth distribution;
- For effective reform of the World Bank and the IMF; and
- For increased participation in global governance mechanisms (e.g. expansion of the G8 to, say, a G15 that would include China, India, Brazil, South Africa and Saudi Arabia).

President Barack Obama’s administration in the USA is likely to be far more receptive to such calls for a new multilateralism than its predecessors, whereas a number of European leaders appear willing to support such a momentum. The current leadership of the Bretton Woods institutions has also articulated the need for granting greater power to Asian, African and South American countries on institutional policy issues and decision-making, having initiated review processes for this purpose.

Regulatory reform will become the order of the day to prevent excessive, irresponsible and highly pro-cyclical leveraging from resurfacing. Regulatory moves should be communicated promptly so as to reduce uncertainty and boost confidence in the system, while permitting timely adaptation by the business sector. However, policy-makers and the regulatory authorities should be measured and guard against over-reaction, assessing carefully the benefits of greater prudential regulation in terms of system stability and efficiency versus the detrimental implications for transaction and compliance costs, which will impact on businesses, workers and consumers alike.

“… better governance at corporate, country and global level is necessary to provide the frameworks for stable international relations, and for states and corporations to create greater certainty and trust … successful mitigation of global risks will only be possible once confidence in global governance institutions is restored.” Klaus Schwab, Executive Chairman of the World Economic Forum, in *Global Risks 2009*. 

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