A collage of images representing African economic and social activities: an oil pumpjack, a tractor in a field, a busy street with taxis and people, and a group of people walking with flags.

# ECONOMY

**LIVE**

**Sub-Saharan Africa**  
Phumelele Mbiyo

Moving Forward™

## Sub-Saharan Africa in 2017: constructive outlook

### Closer to finding the bottom

**It is reasonable to believe that growth in Sub-Saharan Africa is closer to finding the bottom. The performance of countries that have prioritised investment spending, mostly relying on external financing, will continue to outperform those of commodity-producing countries that typically rely on domestic savings to finance investment spending.**

**It seems as if policymakers in commodity-producing countries that have opted to prevent their currencies from adjusting to a lower commodity price environment have done so out of a determination to prioritise consumption over investment spending**

Despite protestations to the contrary, it seems as if policymakers in commodity-producing countries that have opted to prevent their currencies from adjusting to a lower commodity price environment have done so out of a determination to prioritise consumption over investment spending. The consequence of this policy choice has generally been that domestic savings in those countries have fallen, depriving such economies of the financing required to bolster investment spending. Invariably, overall GDP growth has been undermined by a deterioration in the trade balance. Yes, lower commodity prices have played a role in depressing exports, but the unwillingness to restrain consumption spending has also ensured that imports remain far more elevated than would have been the case if policymakers had sought an appropriate macro adjustment to the low commodity price environment.

The Rwandan experience is instructive in this respect and indicates that a predilection for bolstering investment spending allows a country that is going through something of a balance of payments shock to continue growing solidly nevertheless. In the past two years exports of metals – mainly cassiterite and coltan – declined significantly, leading to a widening of the current account deficit.

What's more, financial inflows also came under pressure as some government loan disbursements were delayed. Yet the government opted to restrain recurrent spending, leading to a moderation of imports. It still sought funding from the International Monetary Fund (IMF), and initially allowed the currency to bear the brunt of the adjustment. The upshot has been a much more subdued slowdown in economic activity even as international foreign exchange reserves have been clearly under pressure.

**The respective central banks continue to ration foreign exchange supply to favoured sectors of the economy, maintaining exchange rates at levels that are probably overvalued, and thereby, arguably, also inadvertently discouraging investment spending**

By all accounts, these lessons have not been accepted by Nigerian or Angolan policymakers. The respective central banks continue to ration foreign exchange supply to favoured sectors of the economy, maintaining exchange rates at levels that are probably overvalued, and thereby, arguably, also inadvertently discouraging investment spending. As a consequence, it is much harder to foresee a significant recovery in economic growth in these economies. Perhaps the only silver lining is that economic growth is unlikely to deteriorate much further over the coming year. Indeed, we may have even passed the worst point in the adjustment process. But the rationing of foreign exchange in these economies will continue to undermine the appropriate adjustment process, restraining economic activity.

### Could structural factors keep growth persistently depressed?

Our preferred narrative to characterise the challenges that have led to average growth in the continent subsiding to an estimated growth below 2.0% in 2016 from mostly over 5.0% before 2014, as measured for Sub-Saharan Africa by the IMF, has not hinted at structural factors. It is very hard to construct a narrative in which structural factors are constraining growth of many countries on the continent. Indeed, we see the slowdown as having been primarily instigated by a cyclical slowdown in global demand.

In principle, these countries could have stimulated aggregate demand. However, it has been pretty clear that some countries' capacity to boost economic growth by stimulating domestic demand is limited. Mauritius, for example, has slowed down to an annual growth rate consistently below 4.0% in the past five years from well over 5.0% in the 1990s. Several attempts by the government to boost demand by increasing infrastructure investment since 2008 have not made a dent.

The economy may actually have some structural constraints. The central bank has identified low savings and lack of productivity growth as factors holding back the economy. Perhaps to that list may be added demographic factors, specifically slow population growth, that has depressed labour force growth. For an island nation, with a small population, there are clearly limited avenues to stimulate economic growth via domestic demand.

**Perhaps Mauritius is exceptional in having a strong case that such a slowdown has been exacerbated by structural factors**

Of the economies that have experienced a persistent decline in economic growth over the past decade, perhaps Mauritius is exceptional in having a strong case that such a slowdown has been exacerbated by structural factors. Even attempts to boost exports, by sponsoring the development of new industries for example, would still be limited if the authorities were not to attract the requisite skills.

With specific reference to commodity-producing countries, a key concern is that the dislocation in FX markets has effectively been caused by policymakers' unwillingness to allow their currencies to depreciate. As a consequence, the required macroeconomic adjustment is not happening.

**Prioritising consumption rather than investment spending: this is most clearly evident when considering the experience with budget execution of Angola and Nigeria over the past year**

There is also some nascent anecdotal evidence pointing to a predilection of these policy makers for prioritising consumption rather than investment spending. This is most clearly evident when considering the experience with budget execution of Angola and Nigeria over the past year. The Angolan government hardly spent anything on infrastructure in the first six months of 2016. Similarly, the Nigerian government has been well behind schedule in its infrastructure spending plans.

In both cases, funding pressures were the most likely cause. In Nigeria's case, not only was revenue generation below budget, but the government struggled to obtain the external financing it required. The experience of Angola was fairly close to that. For these governments to rely on domestic funding sources, it seems inevitable that they must accept rising domestic interest rates.

The longer the status quo remains, the greater the risk that growth may remain depressed for a prolonged period. Of course, an increase in commodity prices that would restore the ability of these economies to generate the domestic savings they used to enjoy would eliminate those risks.

### **Commodity prices: trending sideways**

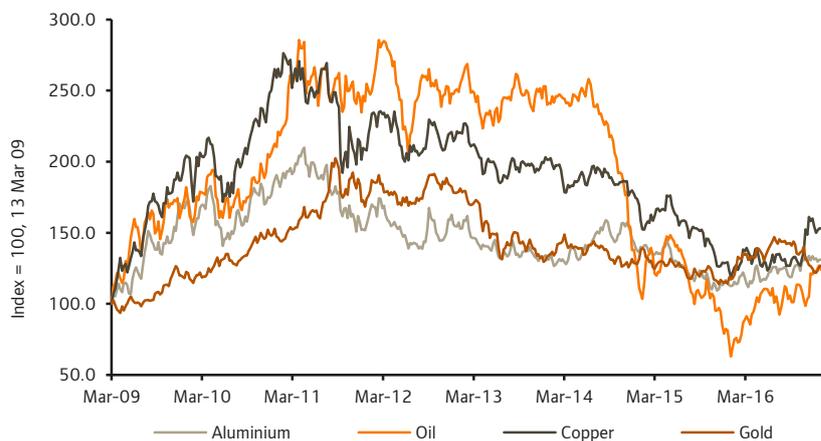
January began with OPEC and some non-OPEC members implementing oil production cuts that were agreed in December 2016. In the immediate aftermath of the agreement, oil prices jumped higher, with Brent crude trading above USD56.00/bbl, after having been stuck between USD45.0/bbl and USD50.0/bbl for about six months.

Copper prices also rallied strongly, rising by some 28% between late October 2016 and early December. Interestingly, despite this spurt, consensus market forecasts are effectively implying a rather flat trajectory for copper prices over the course of this year. We are inclined to believe that prices are not likely to decline on a sustainable basis from current levels, but will rather trend sideways on a multi-month basis.

**The supply-demand dynamics for some commodities may not be amenable to sustained increases in prices**

The supply-demand dynamics for some commodities may not be amenable to sustained increases in prices. Take oil prices for example. While the reduction in supply has bolstered prices in the near term, the magnitude of the increase has been fairly small thus far. It is not entirely clear that there is potential for prices to rise much from current levels. The arrangement has no credibility given that OPEC members have a well-documented tendency not to comply. Furthermore, US supply would most likely rise if prices were to rise further.

**Figure 8: Direction of commodity prices is uncertain, but likely not down**



Source: Bloomberg; Standard Bank Research

**For African commodity-exporting countries, the implication is that it is unlikely that there will be much deterioration in economic performance**

For African commodity-exporting countries, the implication is that it is unlikely that there will be much deterioration in economic performance. Neither is there likely to be any further deterioration in balance of payment metrics even for these countries. Even then, policymakers in these countries should not look up to a resurgence in commodity prices to bring about macroeconomic rebalancing in those economies. Moreover, it may take a long time for those countries that are rationing foreign exchange supply to stop doing so.

**Unavailability of FX, not its price, is still the more pervasive risk**

There is nothing that suggests that policymakers in Angola and Nigeria are about to devalue their currencies. Importantly, even in countries with currencies that are not depreciating or foreign currency is not in short supply at the moment, there is no assurance that the situation will remain so.

Take the **Zambian kwacha**. There is much to suggest that if the correct policy choices are made the kwacha would, at worst, depreciate only marginally over the course of the next 12 months. The Bank of Zambia has maintained a tight policy stance since late 2015, ensuring that Treasury bill and bond yields would remain elevated, mainly in excess of 20%. That policy tightness has constrained economic activity, dampening import demand as well. High interest rates on government paper also attracted foreign portfolio investment inflows, helping to keep the exchange rate reasonably stable since mid-2016.

Of course, even as the exchange rate has remained stable, there are still signs that major economic adjustments are required. Foreign exchange reserves have continued to decline, a sign that financial inflows are not sufficient to cover the current account deficit. Further policy tightening is required. However, inflation, which spiked to 22.2% in March 2016, dropped to 7.5% by December. So, the risks are now weighted towards the central bank easing the monetary policy stance.

But such an easing would most likely boost domestic economic activity sufficiently to increase import demand. This would also likely push Treasury bill yields lower, eroding

the attraction of Treasury bills for foreign investors. The upshot could very well be further downward pressure on foreign exchange reserves.

Another reason that foreign investors were attracted to **Zambian Treasury bills** and bonds was because of assurances by the government to restrain fiscal spending and seek financial assistance from the IMF. Government debt as a percentage of overall gross domestic product has been increasing in recent years. Fiscal deficits have been elevated, and, as pointed out above, the yields on government paper has been elevated. Left unchecked, these developments could lead to a fiscal crisis in coming years. The government needs to restrain fiscal spending in order to avert such a crisis. Additionally, that fiscal restraint would lend a hand in bolstering the country's balance of payments by reducing import demand. Financial assistance by the IMF would lend credence to the government's fiscal consolidation effort, thereby mollifying foreign investor concerns.

But failure to embark on a program to reduce the fiscal deficit and seek financial assistance from the IMF could undermine confidence in the kwacha. So, while it is currently stable, the exchange rate could depreciate in much the same way as it did in 2015. As was the experience then, acute shortages of foreign exchange would be the bigger constraint for businesses operating in the country rather than the price thereof.

These same concerns would become pertinent in other economies of course, if their currencies were to come under pressure. The experience of the past two years or so suggests that policymakers are prepared to disrupt the optimal functioning of the foreign exchange market in order to preserve the appearance of calm in the market. Invariably in those instances, foreign exchange shortages become pervasive.

### Weather influences still relevant

#### **Drought in Southern Africa seems to be easing**

Drought in Southern Africa seems to be easing. As a consequence, food production is likely to be revived, helping to moderate food inflation pressures. Food inflation in countries like Namibia, Malawi, Mozambique, Lesotho etc. rose substantially in 2016. In some cases, food inflation rose to well beyond 15.0%. Those pressures will reverse course over 2017, helping to pull down overall inflation.

#### **In contrast, parts of East Africa have been experiencing rainfall below normal**

In contrast, parts of East Africa have been experiencing rainfall below normal. As a consequence, food price pressures are already becoming evident. There are fears that the drought in Kenya could be the worst in decades. As typically happens during drought-induced food shortages in East Africa, Ugandan food inflation is likely to rise the most.

### Political risks: some hotspots

#### **Perhaps the Democratic Republic of the Congo poses the highest risk of major instability**

Of the countries that have national elections this year, perhaps the Democratic Republic of the Congo poses the highest risk of major instability. On paper, President Kabila will step down in December this year. Constitutionally, his term ended in 2016. However, elections, which should have been held in November, were not organised. The electoral body cited the complexity and cost of the process, indicating that it would only be ready to organise them in April 2018.

Any sort of instability in the DRC runs the risk of emboldening the numerous militia groups that are still operating in the east of the country. Moreover, there is also the risk that neighbouring countries could see the need to intervene. However, the United Nations already has a large mission in the country, with an intervention brigade that is mandated to organise offensive operations against rebel groups in conjunction with the army. A leadership vacuum would potentially compromise this mission.

The process leading up to the Kenyan elections in August will be a noisy affair, no doubt exacerbated by other politically contentious developments. Even then, the risk of a

major conflagration, similar to 2007, appears highly improbable. At the insistence of the opposition, the Independent Electoral and Boundaries Commission was disbanded. The process of replacing these commissioners surely added to the complexity of the exercise. Additionally, parliament amended the amendments to the Election Laws Amendment Bill. A contentious clause is one that would allow the IEBC to manually verify voters and transmit results. All these processes will likely lead to mass demonstrations that will capture media attention.

**The Angolan elections, also in August, will probably also be relatively uneventful**

The Angolan elections, also in August, will probably also be relatively uneventful. The only mystery is who the presidential nominee for the ruling Movement for the Liberation of Angola (MPLA) will be. President dos Santos has created intrigue by apparently indicating his intention not to run in the elections. Notably, this was after accepting his re-election by the ruling party as party president. The party also nominated him as its presidential flag bearer. Then there were reports to the effect that the party would nominate the vice-president of the party to be the presidential flag bearer when the party celebrated its 60<sup>th</sup> anniversary. Somehow this did not happen. In the meantime, voter registration is going ahead. The second stage of the voter registration process will run until March.

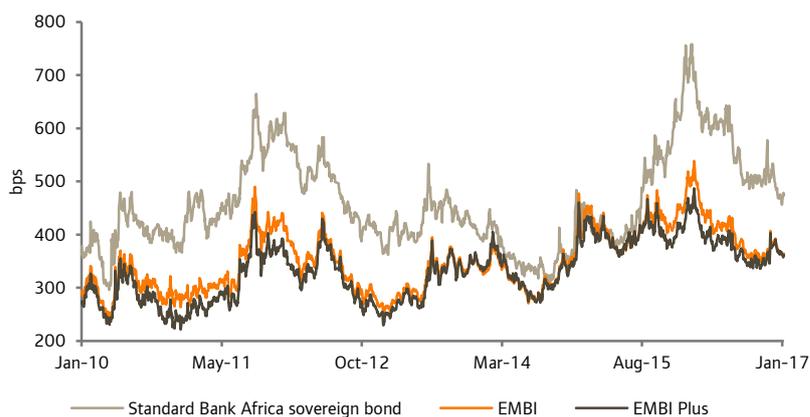
**African Eurobonds: further spread compression**

**It looks likely that African sovereign Eurobond spreads will compress further**

Even after accounting for intermittent, transitory bouts of increased global risk aversion, it looks likely that African sovereign Eurobond spreads will compress further. There are a number of important events that carry with them considerable uncertainty. Perhaps chief amongst these will be pronouncements by President Trump. Additionally, there are important elections in Europe, and the Brexit process, that could roil market sentiment.

Of course, spreads of African Eurobonds have been declining over the past 12 months. Since January 2016 the spread of the Standard Bank Africa Sovereign Bond Index (SBAFSO) over Treasuries declined by over 280 basis points. Events that took the market by surprise, like the Brexit vote and President Trump’s election victory, temporarily caused a spike in spreads.

**Figure 9: Spread compression continuing apace**



Source: Bloomberg

Arguably, the market was mollified by the generally precautionary posture taken by developed market central banks in response to these key events. The Fed stood pat for most of 2016, while making dovish noises regarding the Brexit vote. On the other hand the BOE actually eased the policy stance following the vote. The ECB was tied up in its easing efforts. A number of countries are likely to come to market. Kenya, which was looking to issue last year, opted to tap the syndicated loan market instead. But other countries, like Nigeria and possibly Angola, could be looking to issue paper.

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