

The Impact of the Global and Economic Crisis on Southern Africa

Agricultural Trade Forum
16th Public Policy Dialogue

SOUTHERN AFRICA GLOBAL
COMPETITIVENESS HUB



Keith Jefferis Windhoek, March 24, 2009

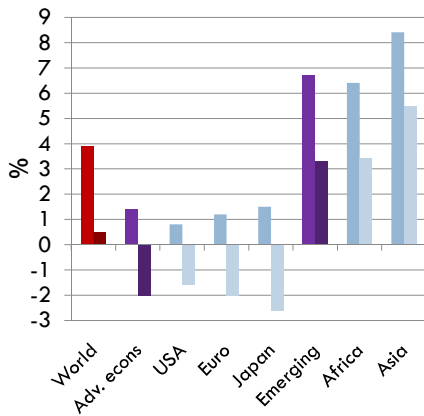
Structure of Presentation

- The Global Financial and Economic Crisis
 - Origins of the crisis
 - Unfolding of the crisis
 - Impact of the Crisis on Developing Countries
- Implications for SADC Economies
 - Exports
 - Balance of payments & financing
 - Fiscal position
 - The Bright Side!
 - Policy Implications

Global Financial & Economic Crisis

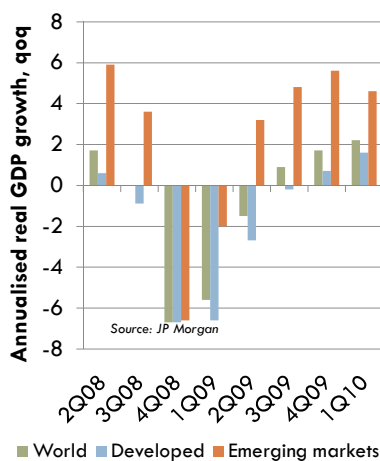
Global Growth Slowdown

**IMF Growth Forecasts, 2009
(July 2008 & Jan 2009)**



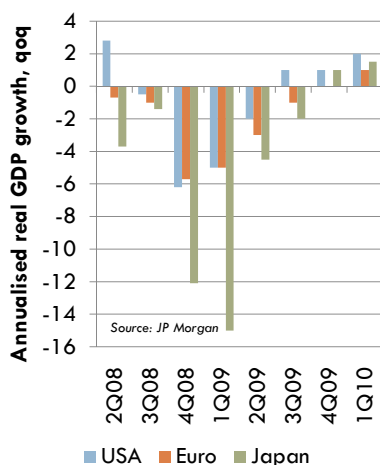
- World economy now in deep recession
- Global growth forecasts for 2009 revised down from 3.9% to 0.5% (IMF)
- Developed country growth forecasts slashed to -2.0%
- Emerging / developing faster growth at 3.3%, but still affected
- Trend of downward revision of forecasts not yet over
- IMF forecasts the most optimistic, e.g. JP Morgan -2.6% for 2009

Global Growth Slowdown



- Depths of recession – 4Q2008 and 1Q2009
- Now widely acknowledged to be worst recession since 1930s
- Stronger growth in emerging markets, but still big drop
- Weak recovery projected towards end of 2009
- Sluggish but positive growth in 2010
- Robust world growth (>3%) only likely in 2011

Global Growth Slowdown - Advanced economies



- Four quarters of negative growth, with total decline in GDP of:
 - USA – 3.4%
 - Euro zone – 3.7%
 - Japan – 8.3%
- Even when recovery starts, there will be a long “catching up” process
- 2008-9 recession likely to be deeper than slowdowns of 2001, 1991 & 1981

Origins of the Crisis

- The global financial economic crisis has its origin in three interconnected areas:
 - ▣ Financial Sector Issues
 - ▣ Global macroeconomic imbalances
 - ▣ Commodity Prices

Financial sector

- Sub-prime mortgage lending
- New models of financial behaviour (originate-to-distribute -> off balance sheet)
- Complex new financial instruments (CDOs)
- Misaligned incentives (selling of loans not repayments; determination of bonuses)
- Credit explosion
- Lax monetary policy
- Asset price bubbles (housing, equities)
- Defective risk assessment (rating agencies)
- Weak regulation

Global imbalances

- Mismatch between surplus and deficit nations
 - $X - M = S - I$
- Surplus nations:
 - high savings (> investment)
 - = current account surpluses
 - capital exports to RoW
 - Fx reserve accumulation
- Deficit nations:
 - low savings (< investment)
 - = current account deficits
 - capital imports from RoW
 - debt accumulation
- Two sides of the same coin
 - Capital outflows from surplus nations financed deficits in low-savings nations, contributed to low interest rates and credit expansion
 - e.g. China, oil exporters buying US T-bills and bonds
- Exchange rate inflexibility :
 - Asian currencies (managed) undervalued
 - US dollar overvalued
 - EUR-USD rate bears burden of adjustment

Commodity price bubble

- Commodity prices at historically high levels by 2007/early-2008:
 - Oil
 - Metals
 - Foodstuffs
- Structural change effects – e.g. Rapid growth and infrastructure investment in China
- Long growth upswing
- Credit-induced spending
- Supply inelasticity
- Accentuated global imbalances, e.g. raised savings by commodity exporters

How the crisis unfolded - 1

- Financial Sector
 - ▣ Sub-prime defaults, triggered defaults on wide range of financial instruments
 - ▣ Risk exposure and risk mis-pricing apparent
 - ▣ Credit ratings inaccurate
 - ▣ Uncertainty in markets
 - ▣ Inter-linkages between institutions amplified problems
 - ▣ Credit crunch, collapse of financial institutions, rescues, de-capitalisation

How the crisis unfolded - 2

- Global imbalances
 - ▣ Rising savings in deficit nations:
 - rebuilding HH and corporate balance sheets
 - reduced consumption, lower demand
 - ▣ Desire to accumulate reserves
 - perceived as economic strength
 - but we can't all run surpluses!
 - ▣ Imbalances will have to be unwound:
 - exchange rate misalignments must be corrected (but flight to quality has led to strengthening dollar);
 - needs rising consumption in high savings nations

How the crisis unfolded - 3

- Commodity Prices
 - ▣ Rising inflation
 - ▣ Declining real income in oil-consuming countries, hence reduced real expenditure
 - E.g. on automobiles
 - ▣ Tighter monetary policy (higher interest rates exacerbated credit problems)

Impact of the Crisis

- Three phases
 - ▣ Financial crisis (systemic)
 - ▣ International financial flows/risk aversion
 - ▣ Economic crisis (collapse in real growth rates, trade flows)

	Systemic banking crisis	Cross-border financial flows	Growth & trade effects
Advanced countries	I		III
Emerging markets		II	III
Less-developed countries		II	III

Financial Contagion - Markets

- Aversion to emerging market (EM) risk + liquidity calls
- Capital flow reversals as foreign investors withdraw
- Falling equity markets
- Pressure on exchange rates (weaker)
- Rollover risks for existing borrowers (corporate and sovereign)
- Higher cost of funds (EM spreads)
- Trade finance scarce
- Inflows of FDI much reduced
- IIF estimates net private capital flows to EMs to fall sharply
 - \$930bn in 2007
 - \$467 bn in 2008
 - \$165 bn in 2009
- EMs that used commercial finance to fund CADs esp. vulnerable
- In Africa, small but growing
- Ghana & Kenya
 - postponed planned international bond offerings
- SA, Nigeria
 - external financing for companies, banks scarce & expensive (higher interest rates)

Financial Contagion – Other Flows

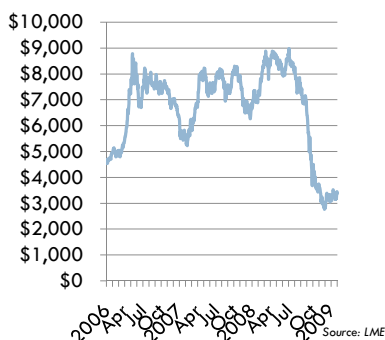
- Of particular importance to LDCs
 - ODA flows under pressure
 - Donor country budgets under pressure
 - Commitments to increase ODA now doubtful
 - Remittances falling sharply
 - Falling employment and real incomes in advanced economies
- Greater reliance on MFIs
 - IMF
 - World Bank
 - IFC
 - AfDB

Trade & Growth Effects

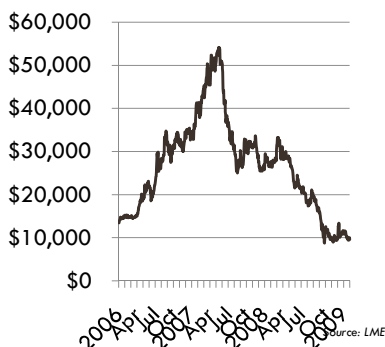
- Reduced prices and volumes for major commodity exports
- Major ToT deterioration for commodity exporters (reduced real incomes)
- General reduction in trade flows worldwide
- World trade expected to decline in 2009
 - ▣ First time since 1982
 - ▣ Largest fall for 80 years
 - ▣ 2008Q4 saw major falls in exports in many countries
- Compounded by drying up of trade finance
- Risk of protectionism & slow progress on DDA negotiations

Minerals prices way down....

Copper (\$/tonne)



Nickel (\$/tonne)



Trade & Growth Effects - Africa

- SS Africa growth forecast to remain positive in 2009 (IMF 3.5%)
 - but much reduced from 2007 levels
- Changing employment patterns
 - from dynamic export sectors to lower productivity sectors
 - reversal of urban-rural migration
- Higher poverty due to:
 - reduced employment
 - lower wages
 - lower remittances
- Concern about fragile states (Zim, DRC, Burundi, Guinea-Bissau, Liberia)
- Reduced availability of finance will inhibit investment in infrastructure & human capital



Global Growth Slowdown – Key risks & uncertainties

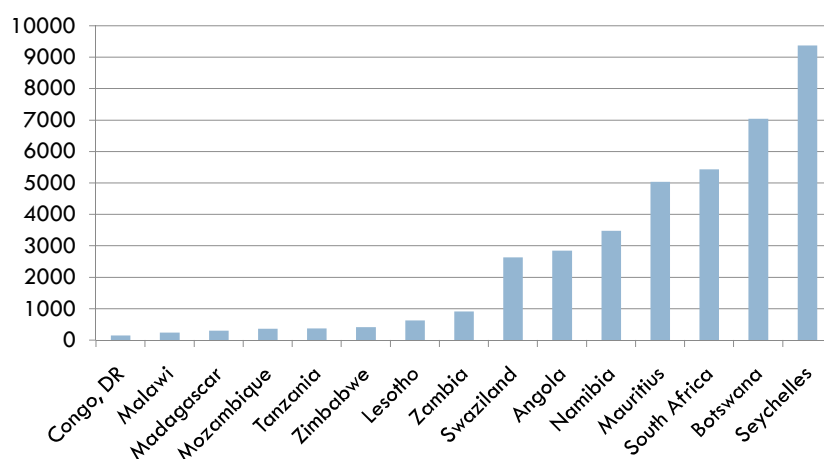
- | | |
|--|--|
| <ul style="list-style-type: none"> □ Depth and duration of recession <ul style="list-style-type: none"> □ - how long and how deep? □ V-shape or L-shape? □ Shape of Financial Sector <ul style="list-style-type: none"> □ Institutions? □ Regulation? □ Public/private ownership? | <ul style="list-style-type: none"> □ Impact on international trade <ul style="list-style-type: none"> □ Reversion to protectionism? □ Prospects for DDA? □ Macroeconomic Impact <ul style="list-style-type: none"> □ Monetary expansion -> inflation □ Fiscal stability & future taxes □ Exchange rate realignment □ Unemployment |
|--|--|

Implications for SADC Economies

Impact on SADC Economies

- Domestic financial sector
 - ▣ Limited impact, at least initially
- Trade
 - ▣ Impact of global recession and ending of commodity price boom
 - ▣ Export slowdown
 - ▣ Protectionism?
- External balance (BoP)
 - ▣ Wider CAD
 - ▣ Financing constraints
- Fiscal balance
 - ▣ Revenue slowdown
 - ▣ Higher spending
 - ▣ Larger deficits
- GDP
 - ▣ Growth slowdown very likely
- Positives
 - ▣ Inflation
 - ▣ Power supplies
 - ▣ Oil imports

SADC Economies – GDP per capita, 2006



Export Slowdown

- Main impact on mineral producers
- Huge declines in:
 - ▣ Oil prices (-70%)
 - ▣ Base metal prices (copper, -70%; nickel, -80%)
 - ▣ Diamond sales volumes, to a lesser extent prices
- Slow recovery forecast in commodities markets, but no return to 2007/8 peaks
- E.g. Stanchart f'casts 2009 avg. vs. end-2008
 - ▣ Nickel +0%
 - ▣ Copper +18%
 - ▣ Oil +56%
- Lower than 2008 avg prices

Export Slowdown

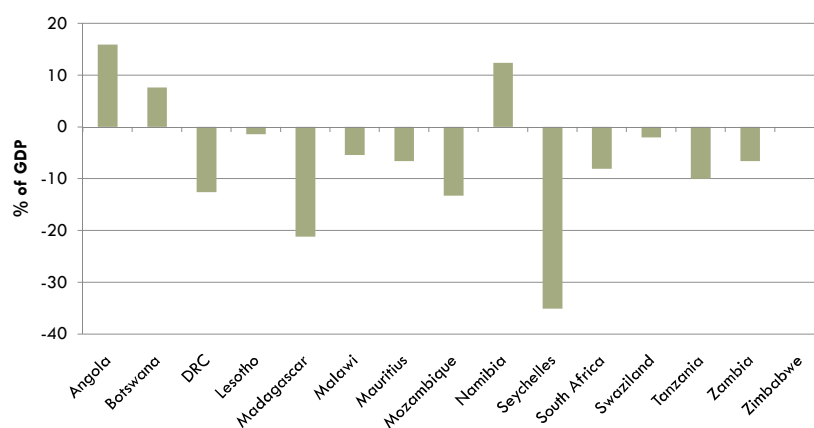
Mineral Exporters

Country	Commodity	% of exports
Angola	Oil, diamonds	99%
Botswana	Diamonds, copper, nickel	90%
Congo DR	Diamonds, oil	64%
Mozambique	Aluminium, gas	74%
Namibia	Diamonds, copper, uranium	59%
South Africa	Gold, platinum, coal	<50%
Zambia	Copper, cobalt	77%

Other Exports

- Tourism
 - ▣ Slowdown in long-haul tourism due to recession
 - ▣ Mauritius, Seychelles most dependent
 - ▣ Also Botswana, SA, Zambia, Namibia, Mozambique, Tanzania
- Motor vehicles (SA)
 - ▣ sharp fall in new vehicle sales due to credit crunch
- Other exports also impacted, but less so
 - ▣ Food, clothing
- Being more diversified helps, but a matter of degree

Current Account Deficit (2009)

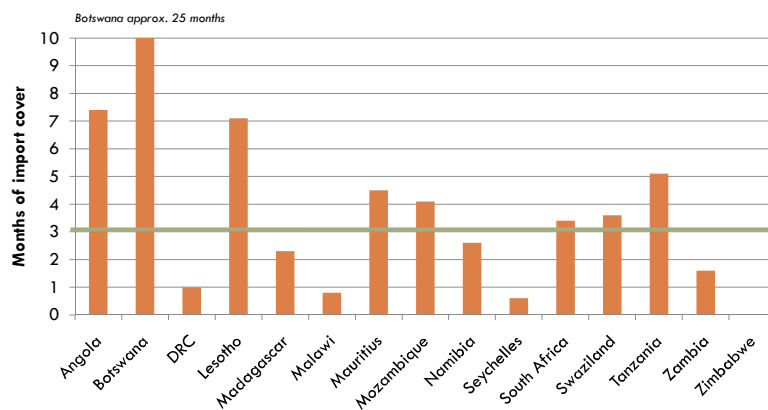


Source: IMF Regional Economic Outlook for Sub-Saharan Africa, Oct 2008

Financing of Current Account

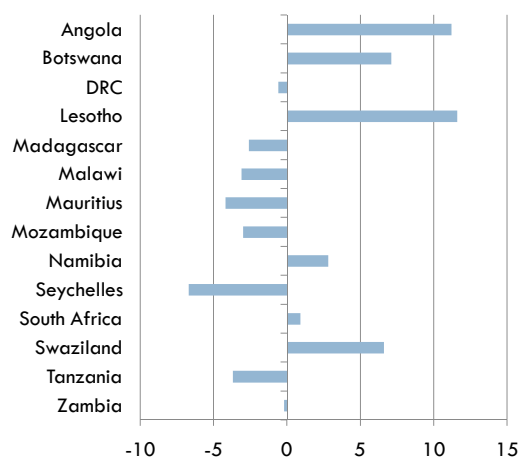
- Short-term portfolio flows (MICs)
 - Tightening of credit markets and “flight to quality” has hit emerging markets
 - Higher cost of funds (risk premium)
- FDI (all ex. Zimbabwe)
 - Credit crunch
 - Project viability (esp. minerals)
 - Reduced inflows, esp. in natural resource sectors
- Donor funds & concessionary borrowing (LICs)
 - Fiscal pressures in donor countries
 - Limited IMF and World Bank funds
- Remittances (Lesotho, Madagascar, Malawi, Zimbabwe)
 - Rising unemployment in developed countries
 - Reduced remittance flows expected in 2009
- FX reserves
 - Cannot provide prolonged financing of deficits

Foreign Reserves, 2008



Source: IMF Regional Economic Outlook for Sub-Saharan Africa, Oct 2008

Fiscal Balance (2007)



- Initial fiscal position reasonable:
- Several countries with surpluses
- Deficits mostly manageable
- Benefits of ongoing fiscal reforms

Fiscal Balance & Financing

- Lower revenues likely due to reduced trade and growth
- Higher spending, e.g. social safety nets
- Vulnerabilities:
 - Commodity-revenue dependence
 - Donor dependence
 - Existing budget deficits
 - High debts
 - SACU revenues
- Deficit financing may be a problem
 - Access to international capital markets (eurobond issues) limited
 - Domestic financing capacity – varies from country to country
 - Banks – depends on many other factors
 - Bond markets - generally underdeveloped – but now may be a good time to develop
 - Danger of crowding out of private sector

Donor dependence

- Donor funds of great importance to low-income SADC countries:
 - Malawi, Lesotho, Mozambique, Madagascar, Zambia, Tanzania
 - Funding of budget, BoP, crucial for development projects
- Previous commitments to increase donor funding now questionable
- Need for donor funding rising
- Need for effective lobbying to – at a minimum – preserve donor funding levels

Role of MFIs

- MFIs have a crucial role given adverse markets
- Source of concessional finance for LICs
- Less risk-averse than banks
- WB & AfDB for infrastructure finance, but slow
- IMF more flexible and can provide budget and BoP support
 - ▣ Exogenous shocks facility
- Under-funded; need for recapitalisation
- G20 Agreement to increase IMF funding
- Still issues over “voice” and US veto
- Conditionality issues – esp. in the context of exogenous shocks

Summary of negative impacts

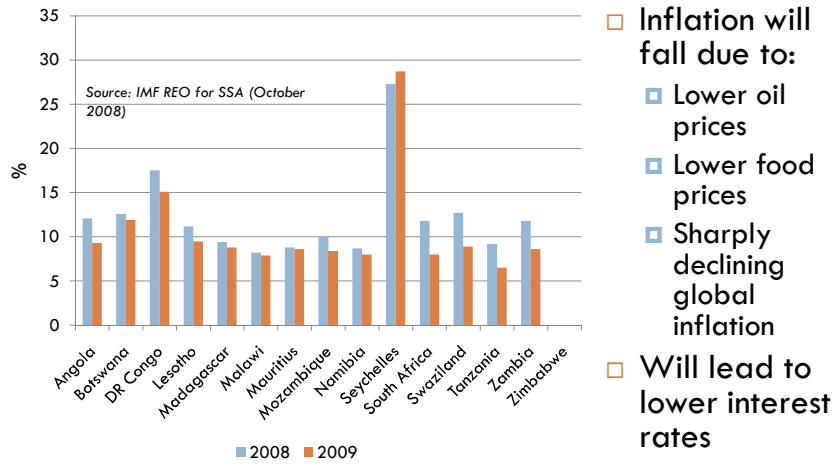
- Slower / negative GDP growth
- Reduced investment
- Increased current account deficits; financing constraints
- Exchange rate weakness
- Fiscal deficits; financing constraints
- Rising unemployment & poverty
- Uncertainty over depth and duration of crisis
- Risks mostly on the downside

The Bright Side

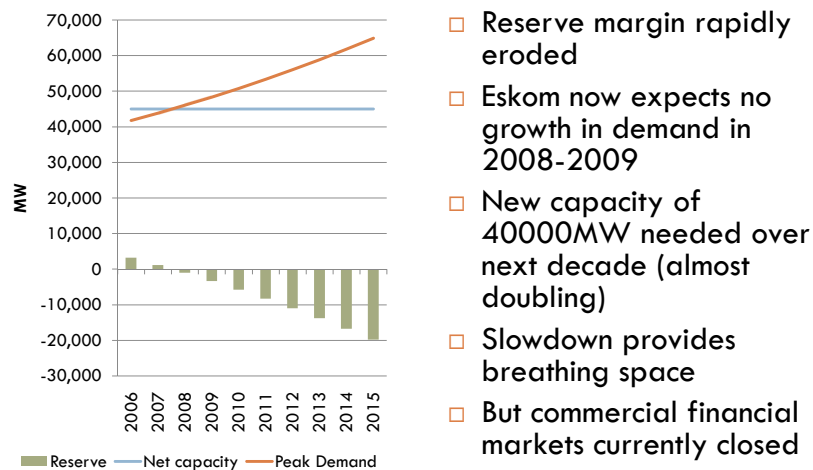
Financial Sectors

- Mostly untouched by first round of crisis:
 - commercial banks sound
 - much improved regulation and supervision
 - limited cross-border banking linkages
 - limited exposure to complex financial products
 - deposit-funded lending
 - money markets functioning normally
- Vulnerability - protracted downturn elevates risk:
 - falling incomes, borrowers less able to service debts
 - sectoral concentration of bank portfolios
 - market volatility if banks have lent for investment in stock markets
 - withdrawal of funds from parent banks
 - equity markets following global trends

Inflation Forecasts



Electricity



Import Bills

- Lower commodity prices:
 - ▣ All except Angola & DRC net oil importers
 - ▣ Fuel approx 20% of total imports on average
 - ▣ Will help CAD
 - ▣ Mainly oil, but also other commodity-related imports (e.g. steel)
- Net food importers also aided by lower world food prices

Summary of Country Impacts

	ANG	BWA	DRC	LES	MAD	MAL	MAU	MOZ	NAM	SEY	SA	SWZ	TAN	ZAM	ZIM
Exports															
Minerals	XX	XX	XX					X	XX		X			XX	
Tourism		X			X		XX	X	X	XX	X		X	X	
Finance															
CAD			XX		XX	X	X	XX		XX	X	X	XX	X	
FDI	X	X	X	X	X	X	X	X	X	X	X	X	X	X	
Remittances				X	X	X									X
Donors						X		X					X	X	
Reserves			X		X	X			X	X				X	X
Positives															
Inflation		✓					✓		✓		✓				
Power		✓		✓					✓		✓	✓			
Oil Imports		✓		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

Summary of Impacts

- All countries will be hit, but impact will vary from country to country, depending on:
 - trade structure, fx reserves, fiscal position
- Impact less if:
 - sound policies in place
 - good reserves & low debt
 - more diversified
- Vulnerability from previous high inflation and CADs
- Most vulnerable are mineral exporters with high dependence on foreign capital

Policy Responses - 1

- Internationally, lobby for:
 - No protectionism!
 - Resume DDA
 - Additional resources for IMF/WB, that can be disbursed quickly and flexibly
 - Preservation of donor funding commitments
 - Fair treatment for migrant workers

Policy Responses - 2

- Domestically:
 - Exchange rate flexibility – to support adjustment
 - Use monetary policy to support growth when inflation is low
 - Fiscal policy – can be expansionary s.t. sustainability constraints
 - Ensure quality of government budgeting & spending
 - Renewed focus on financial sector supervision & regulation – banks & non-banks
 - Need for high quality, timely economic and financial data
 - Contingency planning & monitoring of evolving conditions
 - Sustain reforms

Thank You