

The consequences of the crisis: a focus on African financial markets

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Outline of the presentation

- A brief overview of the impact of the crisis on African countries
- A quick look at channels of transmission
- Focus on the exposure of African fragile countries to the crisis
 - Vulnerability and resilience to external shocks
 - Links with emerging African countries directly affected by financial crisis
- A model & results for the transmission of financial shocks to African countries (Margherita Velucchi)

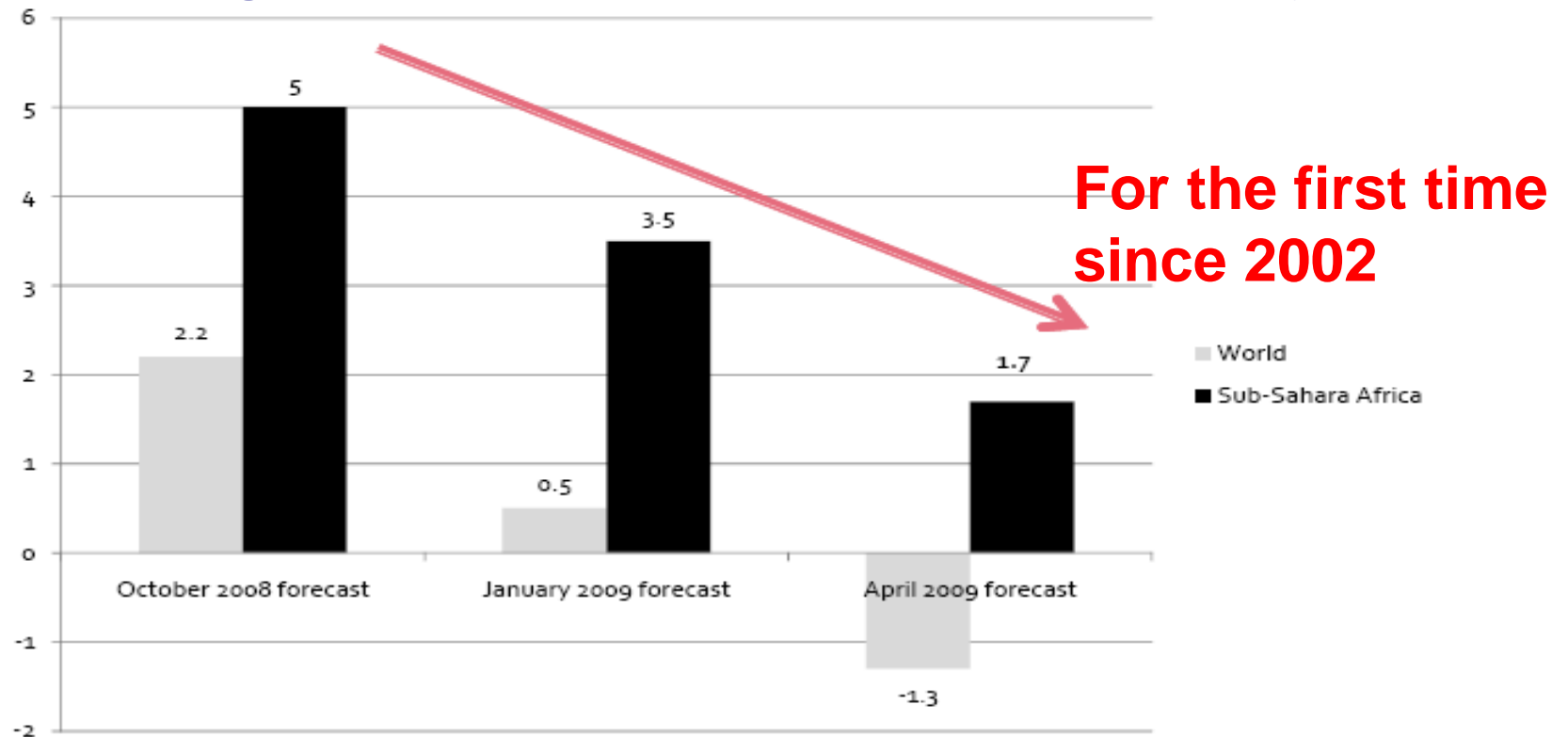
The questions:

- **To what extent is SSA at risk because of the recent economic and financial crisis?**
- **Are all SSA countries equally at risk? If not why?**
- **Does the financial transmission work in financial underdeveloped countries?**

Consequences of the crisis for Africa: at first a moderate optimism....

- little impact: African banks and financial sector not really integrated, growth “decoupled”
- with time, optimism start decreasing

Economic growth forecasts, IMF World Economic Outlook Projections



Consequences of the crisis for Africa: the numbers

- **Poverty:** 27 million new poor people (AfDB 2009)
- **Unemployment:** could increase by 8,5% in 2009 (3 million new unemployed, ILO 2009)
- **28 million additional vulnerable jobs** (AfDB 2009) in different sectors (most at risk, mining, but also others)
- **Setback on progress towards Millennium Developments Goals:** increase in infant mortality – 400 thousands additional deaths (AFDB, 2009), stop in progress to increase education (may have bad long term consequences)

The crisis: channels of transmission

- The trade channel (Berman-Martin)
- Aid (Bertoli-Sanfilippo)
- The financial transmission (Giovannetti-Velucchi)
- Remittances
- Foreign Direct Investment

Trade: a first look at data

- **In SSA exports amount to 34% of GDP and are strongly correlated to high income countries' growth rate**
(*Naudé, 2009*)
- **Export revenues losses: with minus 250 billion \$ in 2009**, (of which 200\$ bill for oil exporters) due to decrease in world demand and in commodity prices, implying deterioration of **current account deficits** and **loss of reserves**. In Nigeria reserves fell by 19% between Sept 08 and January 09. (*AfDB, 2009*)
- **Exports revised downwards by 40 percent**, (*AfDB, 2009*)
- **Loss of Trade Tax Revenues: 15 billions \$ i.e. 1% of GDP and 4.6% of government revenue**. (*AfDB, 2009*)

**Prices and Quantities go in different directions;
different countries face different problems....**

**Quantity and price effects of the crisis on some
export commodities (AfDB, 2009)**

		change in Volume % 07-09	Change in Price %, 07- 09	Change in Value %, 07- 09
Nigeria	oil	- 5.4	-31.1	-34.8
CAR	Diamond	-23.5	5.7	-19.2
Ghana	Gold	22.1	6.8	30.4
Cote d'Iv.	Cocoa	3.0	2.4	5.5
Kenya	Tea	-8.6	2.1	-6.7
Burundi	Coffee	1.1	9.6	10.8

Aid: a first look at data

- SSA countries are more dependent on aid than other regions: aid accounts for **4.5 % of GNI** in SSA compared to 0.20% in MENA and 1.8% East Asia and the Pacific (Naudé, 2009)
- Risk of a reduction in aid flows because of the crisis. Projections of aid to Least Income Countries already started to decline in 2009 (IMF 2009)

Remittances: a first look at data

Official Remittances represent **2.5% of GDP** in SSA region (1.5 % in LAC and 1.8 % in East Asia and the Pacific)

Migrants' remittances to Africa reach countries where other private flows are limited (non-existent), sometimes even exceeding the size of official development assistance.

According to Ratha et al. (2008) remittances were likely to remain resilient. But now Ratha and Mohapatra (2009) suggest that remittances to SSA will **fall between 5 and 8 percent in 2009.**

Economic Outlook for Sub-Saharan Africa presents even less optimistic figures, as IMF (2009) suggests that “**a 1 percentage point decline in growth in host countries would lead to a 4 percent decline in remittances**”. IMF (2009) argues that this figure could actually represent an upper bound (the current crisis is unprecedented in the historical data).

Es **Kenya remittances almost halved in three months** falling from 61 million \$ in October 2008 to 39 million \$ in January 2009

Foreign Direct Investment: a first look at data

- Starting in 2005, Africa experienced a significant surge in inward FDI (thanks to high commodity prices, liberalization process and a progressive improvement in investment environment, WIR, 2008).
- Now, with fall in prices of commodities, **many investment projects have been postponed or cancelled** (Committee of African Finance Ministers, 2009):
 - A \$ 6 billion coal fired project delayed in **Botswana**
 - Petronas put on hold a refinery project in **Sudan**
 - Rio Tinto and Vodacom postponed investment in mining in **Tanzania**
 - Even Chinese companies have left local mines in **Congo** and **Zambia** as the prices of raw materials decreased (Herbst and Mills, 2009)

Financial transmission: a first look at the data

- Financial markets are characterized by increasing degrees of integration, but African markets are considered fairly independent;
- Because of “the presumed independence”, *The Economist* presented Africa as globalization’s final frontier for investors (29/7/07) and suggested “Buy Africa” (19/2/2008)
- Nevertheless, recent turmoil has hit African markets, too
- **Developments in South Africa and China seem to affect African stock markets more than those in US and UK**

What is at risk?

- Considering FDI, aid, remittances and portfolio outflows together, the amount of financial resources at risk in Africa may be around 12 – 15 per cent of Africa's GDP.
- A (foreseeable) fall by 30 – 40 per cent in these inflows, would mean a **\$50 - \$ 60 billion** annual decline in financial resources (Naudé, 2009)

Why is the crisis relevant for fragile countries?

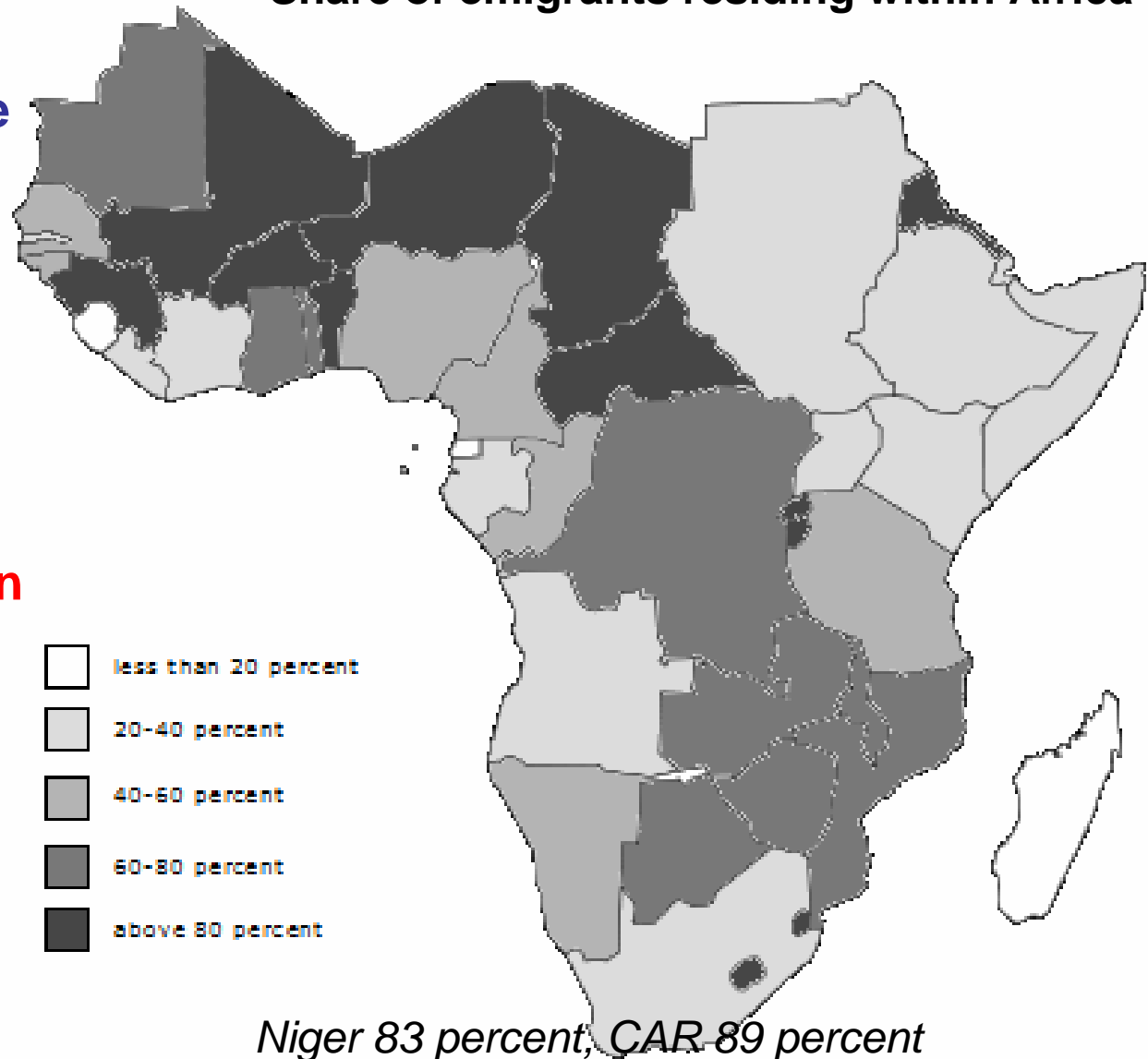
- Fragile countries are affected through a decrease of demand for their exports, a fall in aid flows and FDI.
- They are subject to negative spillover from emerging African economies, affected directly through financial channels by the crisis
- They are likely to suffer because of a decrease in intra regional migration, to which they are particularly sensitive

Intra-regional migration

Migrants from fragile countries, on average poorer than non fragile countries, tend to stay on the continent because of the high costs associated to migration to a high-income country.

Intra-regional migration can represent a relevant transmission channels from emerging African countries to fragile ones.

Share of emigrants residing within Africa



How to measure **Vulnerability**

- **Vulnerability Index: probability of a system to undergo a negative change due to a perturbation**
- **Need to account for heterogeneity of countries: different sources affect countries in different ways**

Following Naude, 09 & Guillaumont, 09, use ranking based on:

Openness, export concentration, indebtedness (trade shocks)

Growth of credit to the private sector, banks cross-border liabilities to banks in advanced economies, capital to risk-weighted assets of a country's banking system (financial shocks)

NB IMF 09 vulnerability table is different, more weight to reserves, less to finance

A Rank according to the vulnerability Index

LOW	MEDIUM	HIGH
Sierra Leone, Comoros, Uganda, Rwanda, CAR, Ethiopia, Benin, Eq. Guinea, Eritrea, Madagascar, Niger, Malawi, Congo Rep of, Gambia	Chad, Guinea-Bissau, Togo, Lesotho, Tanzania, Botswana, Guinea, Burkina Faso, Kenya, Senegal, Swaziland, Namibia, Sao Tome, Cameroon, Zambia	Burundi, Mozambique, Gabon, South Africa, Nigeria, Angola, Mali, Mauritius, Ghana, Cape Verde, Cote d'Ivoire, DRC, Liberia, Sudan, Seycelles

How to measure **Resilience**

- **No matter how vulnerable, different countries have different capacity to cope...**
- **What does Resilience mean?** It can be broadly defined as the ability to cope with change - ability of a system to come back to equilibrium after a shock
- **How can we measure it?**
- Again no agreement, “borrowing” the measurement by Naudé (2009), based on:
 - **Macroeconomic management,**
 - **good governance,**
 - **ease of doing business,**
 - **social cohesion**

NB only macro aspects (need of more work to account for micro aspects, Recent IDS paper, 09)

A Rank according to Resilience

LOW	MEDIUM	HIGH
DRC, Chad, Burundi, CAR, Eritrea, Congo Rep, Guinea-Bissau, Cote d'Ivoire, Guinea, Niger, Kenya, Liberia, Sudan, Angola, Comoros	Ethiopia, Sierra Leone, Zambia, Malawi, Sao Tome', Cameroon, Mali, Uganda, Nigeria, Ghana, Senegal, Cape Verde, Rwanda, Equatorial Guinea, Gambia	Burkina Faso, Togo, Madagascar, Tanzania, Mozambique, Lesotho, Swaziland, Seycelles, Gabon, Namibia, South Africa, Mauritius, Botswana

High Vulnerability and low Resilience is the worst!

HIGH Vulnerability LOW Resilience	HIGH Vulnerability Medium Resilience	HIGH Vulnerability HIGH Resilience
MEDIUM Vulnerability LOW Resilience	MEDIUM Vulnerability Medium Resilience	MEDIUM Vulnerability HIGH Resilience
LOW Vulnerability LOW Resilience	LOW Vulnerability Medium Resilience	LOW Vulnerability HIGH Resilience

VERY HIGH	HIGH	MEDIUM	LOW	VERY LOW
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Vulnerability and Resilience: fragile countries are at risk

Congo DRC, Burundi Cote d'Ivoire, Liberia Angola, Sudan	Mali, Nigeria Ghana, Cape Verde Mauritania	Mozambique Seycelles, Gabon South Africa Mauritius
Chad, Guinea Guinea-Bissau Zimbabwe Somalia, Kenya	Zambia, Sao Tome, Cameroon, Senegal Djibouti	Burkina Faso, Togo, Tanzania, Lesotho, Swaziland Namibia, Botswana
CAR, Eritrea Congo (rep of) Niger, Comoros	Ethiopia, Sierra Leone Malawi, Uganda Rwanda, Equatorial G. The Gambia	Madagascar Benin

VERY HIGH	HIGH	MEDIUM	LOW	VERY LOW
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Lets now see more in detail the financial transmission mechanism