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The Global Economic and Financial Crisis and its implications for Africa

Viewpoint by Professor Kwesi Botchwey, Fletcher School, Tufts University, USA

Is Africa immune from this Global Crisis? No. The current crisis in the global economy and financial system is happening at a particularly bad time for Africa. It comes against the background of a turnaround in the region's economic and political situation, a turnaround marked by relatively strong growth over the past decade, a much improved fiscal situation, declining debt stocks and significantly higher levels of external reserves in many countries. A few African countries in the low income bracket have over the past couple of years launched highly successful debt issues on the international capital markets and Africa's near total dependence on aid flows from the 'traditional donors' has begun to be altered in significant ways by the emergence of new partners, notably, China, India and Brazil, while south-south cooperation is intensifying. The region recorded over \$60 billion in mergers and acquisitions in 2007 and FDI inflows have surged.

Yet as is customary in international debates that follow in the wake of major international crises, the focus of attention in the current debate has been on the epicentre of the crisis - the developed countries and the perennial 'Emerging Markets' including only South Africa from the African region. Indeed, a recent New York Times article (24 October 2008) on Emerging Market vulnerability referred to an analysis by the investment bank Dresdner Kleinwort which rated emerging market vulnerability in the macroeconomic and financial spheres and classified South Africa in the 'less vulnerable' category.

The implications of the current crisis for Africa have either been marginalized in ongoing discussions and the search for remedies or limited to highly generalized intoning about the effects of the crisis on 'developing countries' as a whole, and even then, limited still to the likely impact of the crisis on the macroeconomic conditions. On the likely impact of the crisis on the region's financial and banking systems, the view, again highly generalized and undifferentiated, seems to be that it will be minimal. Indeed, even from within the region itself, central bank governors have taken to giving reassurances of the 'resilience' of their banks and financial systems, or, following the footsteps of their Western counterparts (or even outdoing them) offering to guarantee all bank deposits unconditionally.

This brief provides an outline of the macroeconomic and financial implications of the current crisis for Africa in particular. It also points out that underpinning all this are the

adverse human development impacts of the crisis. In addition this brief serves to provide a menu of ideas that will need further reflection and buttressing with country analysis and data that can then be fused into any general analysis of the impact of the current global economic and financial crisis on developing countries as a whole, to provide the needed African dimension.

A glance at the macroeconomic implications: Compared to its financial impact, the macroeconomic implications of the crisis are medium to long-term and go to the issues of slower growth or even recession, depending on the level of each country's exposure to global trade, including especially, commodity prices, FDI, ODA, remittances and other factors. Most estimates, including the IMF's most recent Regional Economic Outlook (October 2008) point to modestly slowing growth for the region in 2008 and 2009, a higher level of inflation in 2008, and some easing in inflationary trends in 2009. But they also point to the threat of "significant risks to the outlook related to a potentially deeper and longer period of global financial turmoil and resulting slowdown in global activity, and substantial uncertainty concerning commodity prices"¹.

While some countries in the region may be able to cushion the effects of a slowdown in global activity from accumulated reserves, there can be little doubt that the vast majority of countries will need to make macroeconomic adjustments that will include varying levels of fiscal retrenchment. In practice, this will inevitably mean cuts in development expenditure, including expenditure on education and health, with all that this means for human development. While no doubt this calls for an intensification of domestic resource mobilization efforts, it also, importantly, underscores the need for the provision of counter-cyclical compensatory financing. This is something the ECOSOC Committee for Development Policy (CDP) highlighted in its recent report on the current financial turmoil and by which the current crisis can be leveraged to forge some consensus on in the ongoing debates on systemic changes to the global financial system. The aim should be to provide adequate, quick disbursing and conditionality free flows to countries through the unfettering and replenishment of existing facilities like those of the IMF and the EU. Without such a breakthrough, the likelihood is that there will be intolerable reverses in human development gains as a consequence of this and future crises.

How serious are the financial sector implications? Again in comparison with the macroeconomic turmoil, the impact of the economic and financial turmoil on the financial and banking system of a country would tend to raise immediate or relatively

¹ IMF. Online abstract. Regional Economic Outlook, October 2008
<http://www.imf.org/external/pubs/ft/reo/2008/afr/eng/sreo1008.htm>

short-term concerns, typically, a credit crisis or major bank failures, depending on the extent of a country's dollar denominated debt or the strength or fragility of its external viability. Indeed, even as regards bank failures, the convention is to see a more or less systemic banking crisis only when there are indications of large banking failures that affect more than 20% of a banking system's total deposits. Seen from this point of view, there may, on the face of things, be good reason not to fret about the susceptibility of African banks to systemic banking failures on the scale we have witnessed in the US, for instance. African banks had little or no access to the mountain of synthetic (and toxic) products that Wall Street erected on the foundation of the sub-prime mortgage market and sold around the world. Nor have they benefitted to any significant extent from the easily reversible flows whose large-scale reversal precipitated the East Asian credit crisis for instance. Moreover, in general, secondary markets for trade in bank loans are small as are markets for derivatives. Still, it is unwise to be complacent.

To begin with, even in the short term, trade credits from prime European and American banks that African banks need in the normal course of their business may very well begin to slacken, should the credit crunch persist. But more importantly, it needs to be recognized that there is something of a dialectical relationship between the macroeconomic environment and the stability of the banking system.

Over the medium term, a down turn in growth, whether from falling commodity prices, reduced remittances, lower flows of ODA, or from whatever external shock, will, unless compensated for by other interventions, not only lead to fiscal retrenchment and poverty-aggravating cuts in public expenditure. It may *also* affect the banking system in significant ways.

Bank lending (especially to enterprises) has grown significantly in a number of African countries, including Ghana and Nigeria, in recent years. A severe and protracted downturn in economic performance will doubtless affect the ability of borrowers, especially net foreign exchange users, to service their debts, leading to a rise in non-performing assets and solvency problems for many banks as happened for instance in Ghana in the mid-seventies to early eighties. If this should happen today, especially in well-banked and pivotal regional markets like Nigeria and Kenya where all major banks are publicly listed, it would put these banks in crisis, causing panic among depositors and intensifying liquidity problems. The critical questions, if such a scenario should unfold, are:

- Will central banks be in a position in their individual capacities to provide generalized guarantees to depositors to thwart a systemic crisis
- Will regulators have the capacity to take over (nationalize!) insolvent banks and turn them around in ways that will help restore banking confidence?
- Are there regional or sub-regional institutions that will

help coordinate efforts by African central banks and governments to manage the crisis and avoid a meltdown and a severe region-wide reversal of human development gains?

- Is it time to renew the debate on the role of development banks in the so-called developmental state now that the hubris and triumphalism of the 'market economy' is subsiding?

The idea is not to sound any doomsday alarm bells. It is to suggest that rather than succumb to the temptation to see the current crisis as essentially marginal to Africa's economic growth and human development prospects, it is sensible to lean in the wind of change generated by the current crisis to address the *core* problems of the African banking system – increasing investments in banking technology and products to improve efficiency, expanding banking access, deepening markets, and improving prudential regulations across the region – as a necessary and vital condition for macroeconomic stability and accelerated human development.

The United Nations' Doha Review Conference on Financing for Development presents a unique opportunity to address many of the issues that have been pushed to the forefront by the global financial crisis.

Finally, it is hoped that there will be a successful conclusion of the Doha trade round, given the spillover of the financial crisis to trade. In light of the financial crisis, the African Ministers of Finance and Planning and Governors of Central Banks who recently met in Tunis, urged the Doha Round to pay particular attention to sequencing of reforms in financial services and called upon all countries to refrain from protectionist tendencies.

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For more information contact:

United Nations Development Programme
Regional Bureau for Africa
One United Nations Plaza, DC1-24th floor
New York, NY 10017

africa.viewpoint@undp.org
www.undp.org/africa

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