Special Report

Sub-Saharan Africa – Steady real GDP growth expected ahead, but the path could be bumpy

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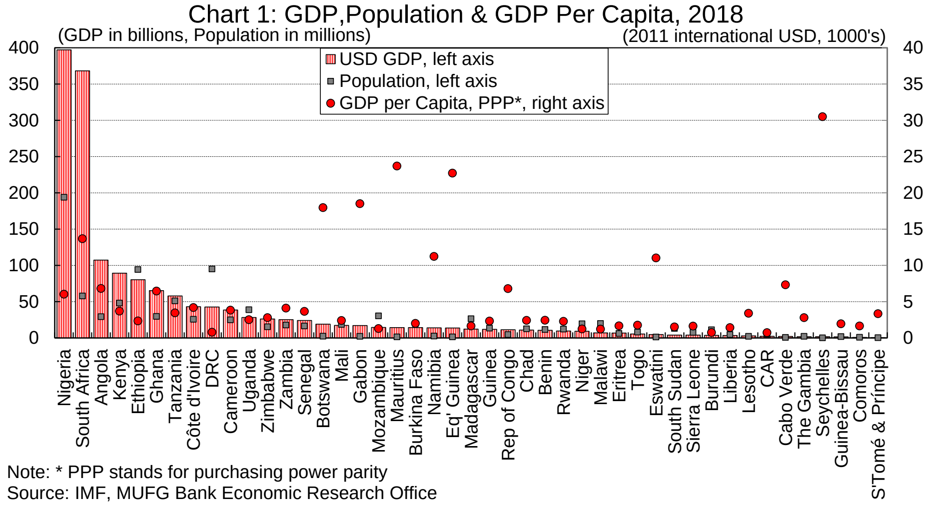
1. Introduction

Sub-Saharan Africa (SSA) has continued to grow steadily over the last decade and is projected to account for around 2.2% of total nominal world GDP by 2024. However, prospects differ significantly by country. The region has wide differences in gross domestic product (GDP), population and GDP per capita (Chart 1). Equally, the real GDP growth outlook in SSA is currently mixed and varies significantly by country. At the same time, SSA is also facing both near-term and longer-term challenges, such as reducing the infrastructure gap. This report will explore the current situation and examine some of the potential policy responses.

Chart 1: GDP,Population & GDP Per Capita, 2018



Note: * PPP stands for purchasing power parity
Source: IMF, MUFG Bank Economic Research Office

2. SSA Real GDP Growth Expected to Pick-up Slightly

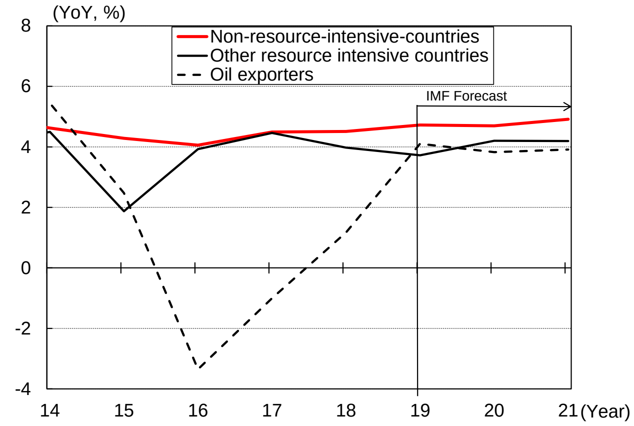
Our analysis breaks down the SSA region into resource intense countries (oil and other resources exporters) versus non-resource intense countries[1]. Resource intense countries are defined as countries that have net oil exports of more than 30% of total exports and/or the export of non-renewables that exceeds 25% of total exports. The IMF characterises 24 economies in SSA, containing two-thirds of the region's population, as being resource intense exporters. The remaining 21 countries can be simply grouped as 'non-resource-intense' countries. GDP per capita levels vary widely across both groups.

In non-resource intense countries as well as countries reliant on non-oil resources, the average real GDP growth rate has been fairly stable, despite weaker Chinese demand in the latter (Chart 2). Real GDP growth was driven by a broad range of factors in non-resource intense countries. The fifth largest economy, Ethiopia, for instance, was driven by both private consumption and public investment, and averaged real GDP growth of 9.3% over the last 5 years. There is one pronounced exception to the stable growth in these countries: South Africa, the second largest economy in SSA (a country reliant on non-oil resources). Its real GDP growth fell into technical recession in the first half of 2018 due to lingering structural constraints, such as weak investment.

Oil exporting economies too, also experienced quite a significant drop in real GDP growth from 2014 and suffered from a subsequent recession over the course of 2015 to 2017, as the world oil price plunged. The average real GDP growth rate has since recovered but, as one would expect, remains susceptible to fluctuations in oil prices. Nigeria, the largest economy and largest oil exporter in SSA, experienced a volatile real GDP growth trajectory over this period, which subsequently recovered to a more modest 1.9% YoY in 2018.

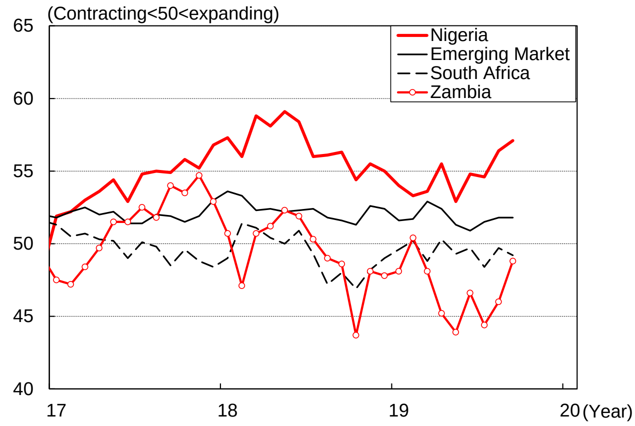
Over the course of 2019, Nigeria managed to boost oil production, although this may now be limited by its OPEC+ production quota. In contrast, in Angola, oil production has been on a long-term decline despite a slight rebound recently. Short-term indicators, such as PMIs, suggest a recent increase in growth momentum for a few countries (Chart 3).

Chart 2: Real GDP Growth, Average



Source: IMF World Economic Outlook
MUFG Bank Economic Research Office

Chart 3: Select Countries, Composite PMIs



Source: IHS Markit, Macrobond
MUFG Bank Economic Research Office

The latest IMF outlook forecasts an average real GDP growth of 3.2% in 2019 before a rise to 3.6% in 2020, from 3.2% in 2018. Delving deeper into the forecasts reveals a wide divergence in growth prospects. Real GDP growth is expected to grow most quickly in non-resource intense countries "averaging about 6%" according to the latest IMF. In other resource intense countries, real GDP growth prospects are much lower with a forecast of just 2.5% YoY in 2020. Oil exporters' prospects are expected to remain mixed in 2020.

However, we should note that the IMF in its latest regional economic outlook has revised down its aggregate SSA real GDP growth forecasts to reflect the "more challenging external environment, continued output disruptions in oil-exporting countries, and weaker-than anticipated growth in South Africa".

3. Challenges: Public & External Risks, Infrastructure Gap

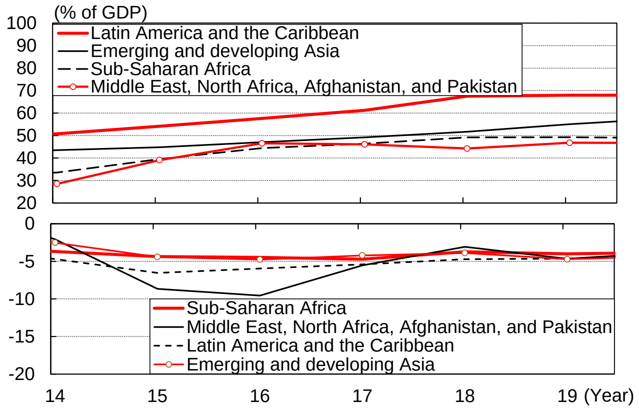
Although there are three clear challenges: public finances, external risks and the infrastructure gap, these can be split temporally. In the near term, these include the general upward trajectory of gross general government debt and its change of composition, together with the increase of interest payments and arrears in some instances. On the external side, greater Eurobond issuance has led to higher foreign currency denominated debt too which has increased foreign currency and roll-over risks. In the longer-term, SSA suffers from an infrastructure gap and a comparatively low level of investment.

(1) Public finances

Public finances have weakened as non-concessional government debt borrowing and SSA government debt levels have grown. There has been an increase of government debt in SSA by 15.6 percentage points to 49.2% of GDP in 2018, from 33.6% of GDP in 2014 (Chart 4). The average level of government debt in SSA is now above that of the Middle East, North Africa, Pakistan and Afghanistan region. At the same time, Eurobond issuance in SSA has increased from a relatively low base to stand at around 15% of total public debt stock in 2017.

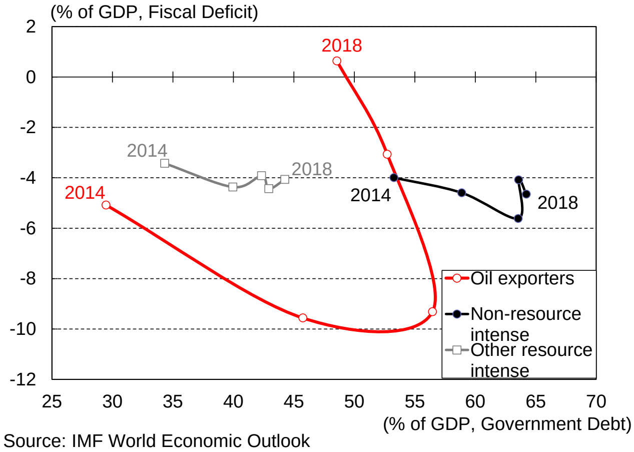
Despite fiscal consolidation predominantly in oil exporters (Chart 5), and a high level of concessional debt across SSA, which has lower interest payments and longer maturities versus non-concessional borrowing (typically domestic and Eurobond), worries have risen over greater fiscal risks. Fiscal risks include both higher government debt, its change of composition, higher interest payments and the increase of arrears. The increase of government debt is due to a mixture of factors from greater government debt issuance to fund infrastructure, the hit from the commodity price slump from 2014 to 2016, increased contingent liabilities, to the exchange rate effects on foreign-currency-denominated government debts.

Chart 4: Government Debt and Fiscal Balance



Source: IMF World Economic Outlook
MUFG Bank Economic Research Office

Chart 5: Public Finances by Types, 2014-2018



Source: IMF World Economic Outlook
MUFG Bank Economic Research Office

Eurobond issuance has increased as some SSA governments have taken advantage of more favourable international borrowing rates and investor appetite for SSA government bonds. In turn, foreign–currency-denominated debt has become a greater component of total government debt. The main implications of greater foreign currency denominated debt include greater foreign currency and rollover risks. For instance, the USD's 28% trade-weighted appreciation from 2011 to 2016 coincided with the large increase in both gross general government debt and interest payments. In addition, the greater reliance on external borrowing, which in most cases is commercial, tends to lead to higher rollover risks. These risks are expected to increase from 2021, as a number of Eurobonds mature.

In terms of domestic borrowing, higher interest payments mainly reflect higher domestic borrowing costs as policy rates have risen to combat inflation. SSA government interest payments, on average, have grown to 10% of total revenues and grants in 2018, from under 5% in 2012, as government debt has increased. Given that, in some cases, current expenditures and, in particular, wages have also risen, it could also be argued that together with higher interest payments fiscal rigidity has increased. Further ahead, developments in the interest payment structure could have implications for government capital expenditures, which could affect potential real GDP growth.

Against this backdrop, fiscal risks have therefore increased. In fact, Republic of Congo defaulted twice, in 2016 and 2017, and Mozambique from 2016, according to Fitch Ratings. Recent IMF analysis highlights that among the lower income and developing countries, seven are now in debt distress "when a distress event like arrears or a restructuring, has occurred or is considered imminent". A further nine countries are also considered to be at high risk. Added to this, arrears have increased in recent years, and stand at around 3.3% of GDP in 2018.

(2) External risks

IMF analysis suggests that current account deficits (CADs) in some SSA countries may be worse than levels "consistent with medium-term fundamentals", although the range of CADs does vary widely. The CAD for the region is expected to widen to 7.2% of GDP in 2020, from 6.2% in 2019. For those with higher CADs, this has been for a number of reasons – in some cases they have increased as a result of greater capital goods imports for infrastructure projects, such as in Ethiopia. Gross external debt and debt service costs (which includes both principal and interest) have also risen. These are not necessarily negative trends by themselves, but at the same time, reserve levels are now only adequate in less than 50% of countries and are projected to decline over 2019. Reserve coverage differs across SSA, with oil importers relatively less well prepared for any pressures on the CAD. Consequently, some countries in SSA are expected to remain vulnerable to terms of trade shocks in 2020.

SSA will also remain vulnerable to global economic developments. The Overseas Development Institute highlights that the USD's "28% trade-weighted appreciation from 2011 to 2016" had multiple spill-over effects that included "record SSA currency depreciations against the dollar (including in Ghana, Mozambique, Tanzania and Zambia) and investment outflows, particularly from economies with 'twin' deficits in their external current and fiscal accounts (such as in Mozambique and Ghana)".

(3) Infrastructure Gap

The infrastructure gap, which for the most part results from insufficient finance, increases the costs of moving goods, people and services, and acts as a drag on higher sustained real GDP growth. Despite a pick-up of infrastructure spending in recent years and a significant contribution from the increase of physical capital to real GDP growth[1], the infrastructure gap remains. In January 2019, the financing gap was between USD 68 to 108 billion, with total

[1] Real GDP growth from 2000 to 2014 was driven by the increase of physical capital which averaged just over 3% per annum, but despite this, infrastructure needs still remain large

infrastructure needs estimated at between USD 130 to 170 billion per year (or around 7.9% to 10.3% of SSA GDP) according to the African Development Bank (AfDB).

4. Policy Response

SSA is trying to overcome these challenges through a mixture of policy responses, one of which is stronger real GDP growth. In turn, this could be boosted by policies to increase SSA trade, strengthen competiveness and reduce SSA's infrastructure gap. In fact, going further, the IMF advocates a 'three-pronged' strategy which similarly focusses on raising medium term real GDP growth prospects, but also advises a near-term policy mix that proposes the use of fiscal policy to support real GDP growth for those countries that have the fiscal space. While the IMF has suggested rebuilding fiscal buffers for those that face higher debt vulnerabilities, it also suggests improvements to public financial management, among others.

(1) African Continental Free Trade Area (AfCFTA)

The African Continental Free Trade Area (AfCFTA), which is hoped to facilitate greater intra-SSA trade, could act as a vehicle for greater real GDP growth and productivity. The implementation of AfCFTA will be crucial. The agreement, signed in March 2018, is designed to "eliminate 90% of tariffs on current intraregional trade flows" according to the IMF. So far in 2019, 54 of the African Union's (AU's) 55 member states have become signatories.

The trade agreement is significant as intra-African trade is currently very low (although there are exceptions between certain economies within SSA). The region also suffers from a low share of global trade and lacks a diversified export base. Forecasts of potential benefits vary, but the United Nations Commission for Africa has estimated that the trade agreement could boost intra-African trade by 52% by 2022. Likewise, the IMF suggests that the agreement "can significantly boost intra-African trade".

There are a couple of key points to note here. First, although these could be considered fairly optimistic forecasts, the increase is from a low base. Intra-SSA trade on a nominal level has been low and stable for an extended period of time and only accounts for 16 percent of the continent's total trade volume, due to high tariff and non-tariff trade barriers. Next, the real GDP growth impacts are expected to be gradual– the IMF expects an increase of 1 percentage point per year to real GDP growth even if all tariffs are removed and non-tariff barriers halved. More comprehensive implementation would of course lead to a stronger boost to real GDP growth. Third, the success of the trade agreement will be heavily tied to how effective it is in alleviating any negative impacts from the dislocation of firms and workers. Given the low level of GDP per capita, SSA will have less leeway than other more developed regions.

Crucially, will the trade agreement be implemented fully? This is a difficult task, to say the least. Implementation of the agreement would be truly unprecedented. The elimination of tariffs would involve the reduction of SSA governments fiscal resources, estimated at around USD 4 billion annually by UNCTAD. In short, we will have to wait and see, but we can look at the recent track record of wider reform implementation as a guide.

(2) Domestic reforms

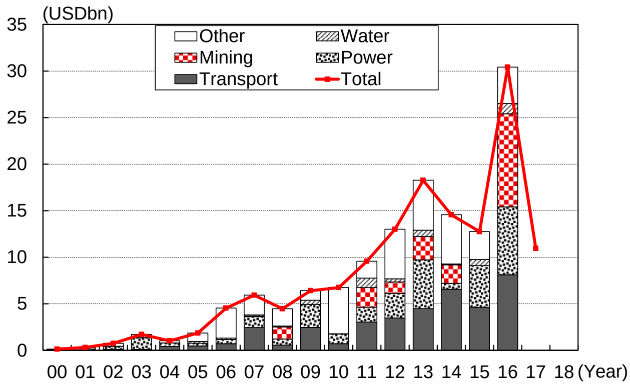
Significant progress over the years has been made by a few countries with regards to economic and developmental reforms. In Kenya, there have been significant structural and economic reforms, and more recently the development of ‘Vision 2030’, which includes developing manufacturing, healthcare, housing and food security. Likewise, in Ethiopia, the government is also implementing its own development plan to develop its infrastructure and manufacturing industries. In addition, there are some strong performers in the World Bank’s ‘ease of doing business’ (EoDB) indicators. Mauritius and Rwanda are ranked 20th and 29th respectively, out of 190 countries. Both perform well due to sustained reforms over the years.

This being said, the World Bank’s EoDB indicators currently show that SSA, on the whole, ranks poorly versus other regions. Equally, many countries face their own idiosyncratic challenges and political difficulties. World Bank governance indicators for SSA lag behind those of other regions too, especially for government effectiveness. With this in mind, we can likely expect better implementation of the trade agreement by those with a better track record of domestic reforms.

(3) Reducing the infrastructure gap

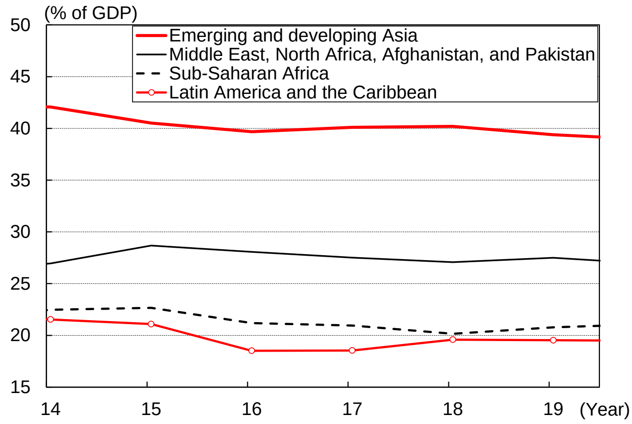
Some countries have looked to Chinese investment to fill infrastructure needs. Although it is difficult to find a comprehensive[2] data set for Chinese investment, one exists for Chinese loans (excluding repayments). The data set shown in Chart 6 shows that SSA has been fairly successful in attracting Chinese loans; which have been on a long-term upward trajectory from 2000 to 2013, despite a recent dip. However, further policy measures might be needed to boost investment. The level of investment, as a percent of GDP, has remained stable over the same time frame and continues to lag behind other regions (Chart 7). On the flipside of low investment levels, gross domestic savings in SSA are fairly low. There are many reasons for low gross domestic savings but perhaps most prominent is the high level of private consumption which limits the scope for savings. As GDP per capita is low, consumers typically spend more of their incomes on necessities.

Chart 6: Nominal Chinese loans, Select SSA Countries



Note: Loan data represents amounts borrowed each year. These totals are amounts borrowed and not current debt figures .
Source: Johns Hopkins SAIS China-Africa Research Initiative, MUFG Bank Economic Research Office

Chart 7: Investment



Source: IMF World Economic Outlook
MUFG Bank Economic Research Office

5. SSA to Grow Steadily, Progress to Remain Monitored

Overall, SSA is expected to grow steadily in the long-run, but in turn will face a bumpy path of both near and longer-term challenges. The policy response has broadly been in the right direction, but we will need to carefully watch further the progress of the AfCFTA deal as well as related domestic reforms, together with fiscal and external metrics for further signs of distress or heightened risks.

[1] *The IMF regional economic outlook counts 45 countries as being part of the Sub-Saharan Africa region. Oil exporters include Angola, Cameroon, Chad, Republic of Congo, Equatorial Guinea, Gabon, Nigeria, and South Sudan. Other resource intensive exporters includes, Botswana, Burkina Faso, Central African Republic, Democratic republic of Congo, Ghana, Guinea, Liberia, Mali, Namibia, Niger, Sierra Leone, South Africa, Tanzania, Zambia, Zimbabwe. Non-resource intensive countries include, Benin, Burundi, Cabo Verde, Comoros, Cote d'Ivoire, Eritrea, Eswatini, Ethiopia, Gambia, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Togo, and Uganda*

[2] *Angola is another major recipient of Chinese loans, but is not included in this dataset.*