Njuguna Ndung'u: The African economic picture and the Kenyan economy after the crisis

Notes by Prof Njuguna Ndung'u, Governor of the Central Bank of Kenya, at an address to the Emerging Market Traders' Association, Nairobi, 20 November 2009.

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General Africa's macroeconomic overview

After a decade of strong performance in Africa's economies, the global economic crisis has dented its growth path

- Economic growth in SSA has fallen from an average of 6.5% in the 2005–2007 period to 1.1% in 2009 (from a projected growth of 6.2%)
- Exports have fallen from an average of 37.7% of GDP in 2005–2007 period to 31% in 2009 with reduced demand
- The economic crisis has dampened the expectations on commodity futures markets thereby inducing falling prices and demand for most commodities
- Falling export demand/declining commodity prices spread the impact of the crisis to far more SSA countries; suppressing economic activity and causing fiscal and external balances to deteriorate significantly
- Africa's oil exporters and middle income countries have been hard hit when compared to their low-income counterparts while the fall in copper and diamond prices has resulted in a significant drop of export receipts for Zambia and Botswana, respectively
- Most of these countries had extensively built some fiscal space before the crisis – this has suffered severely
- Current account balance has worsened with a significant drop in exports as compared to imports

Economic effects of the crisis on Sub-Saharan Africa (SSA)

- What emerged about 16 months ago as a global financial crisis turned into the sharpest global economic contraction in modern times. Its negative effects on Sub-Saharan Africa are still unfolding
- The crisis initially hit African countries with stronger financial linkages to international capital markets; significant trade relations with the Western world and rich natural resource countries
- The initial phase of the crisis manifested itself through weakening of local currencies, declining foreign reserves and bubble busts in capital markets
- Declining foreign reserves
  - Decline in demand leading to significant drop in commodity prices and worsening terms of trade in general
  - Non-resident outflows from equity and bond markets ("flight to safety")
  - The market-determined or flexible exchange rate acted as an automatic stabilizer during this crisis in most African economies and accumulated reserves were drawn down to cushion the economies

- Weakening of stock markets as a result of
  - Outflow of non-residents' funds – dumped stocks
  - Unfavorable investor sentiments: concerns about global recession and negative impact on domestic economies

Impact of the crisis differs across countries and regions – growth

	2007	2008	2009*	2010*
Growth				
Kenya	**7.1**	**1.7**	**3.0**	**4.0**
Tanzania	7.1	7.4	5.0	5.6
Uganda	8.4	9.0	7.0	6.0
Sub Sahara Africa	6.9	5.5	1.1	4.1
EAC	7.4	5.8	4.5	5.1
COMESA	11.1	8.6	3.1	6.0
SADC	7.2	5.1	–0.9	3.4
Fiscal Space Has suffered-(Overall Fiscal Balance % of GDP)				
Kenya	–3.0	–4.40	–5.7	–5.5
Tanzania	0.0	–5.4	–5.7	–5.1
Uganda	–1.1	–2.0	–2.6	–2.9
Sub Sahara Africa	1.2	1.3	–4.8	–2.4
EAC	–1.6	–3.9	–3.5	–4.7
COMESA	2.7	1.7	–3.4	–2.6

(Source: IMF Africa Regional Outlook – 2009)

SSA not spared by the crisis: see selected indicators

	2007	2008	2009*	2010*
Real GDP (growth rate)	**6.9**	**5.5**	**1.1**	**4.1**
Oil Exporting	**9.2**	**7.0**	**1.9**	**5.5**
Oil Importers	**5.7**	**4.7**	**0.8**	**3.3**
Consumer prices	**7.1**	**11.6**	**10.5**	**7.2**
Oil Exporting	**5.6**	**10.5**	**10.6**	**8.9**
Oil Importers	**7.8**	**12.1**	**10.4**	**6.4**
Exports as % of GDP	**38.9**	**41.0**	**31.2**	**33.5**
Imports as % of GDP	**36.2**	**38.2**	**34.2**	**34.6**
Fiscal balance (incl. grants)	**1.2**	**1.3**	**–4.8**	**–2.4**
Oil Exporting	**3.6**	**6.3**	**–5.9**	**1.5**
Oil Importers	**–0.2**	**–2.0**	**–4.2**	**–4.7**

Current account (incl. grants)	**1.1**	**1.0**	**–3.1**	**–2.1**
Oil Exporting	**14.4**	**14.0**	**1.6**	**7.9**
Oil Importers	**–6.2**	**–7.6**	**–5.6**	**–7.9**
Terms of trade (% change)	**5.1**	**3.1**	**–2.2**	**1.7**
Reserves (months of imports)	**6.0**	**5.3**	**5.8**	**5.5**

How has Africa responded to the crisis?

- Foreign exchange rates allowed to depreciate freely to absorb the dollar pressure
- Foreign exchange reserves holdings allowed to decline absorbing dollar depreciation pressure
- Most central banks have reduced policy rates to signal easing monetary policy. Increased liquidity is expected to ensure availability of funds to finance economic activities
- Fiscal stimuli: most countries have used countercyclical budget policies to jump-start economic activities

What is happening on the ground in Africa?

- Slow economic recovery
- Unemployment still rising (youth unemployment – social strife in some African cities) as companies in real sector still shedding jobs
- Entering international capital markets via sovereign bonds has been postponed to a later date when economic performance at the global level improves – postponed infrastructure projects
- Inflationary pressures have eased in most SSA economies but the challenge is being compounded by weather conditions that have seen a rise in food prices
- Excess capacity exists in export industries across sectors
- Drop in immigrant remittances which has become a key source of finance
- Penetration of China and India to African region at a period when the western countries are at their weak economic position – changing trade and FDI flows (***China has pledged US$10 billion in economic cooperation with Africa***)
- Key banks in the business of lending, which fuels investment and job creation, are not yet lending at pre-crisis levels, as such hurting the economy as a whole
- Banks remain reluctant to lend, and tight credit especially for small businesses, stands in the way of the strong recovery we need – but more driven by slowdown of economic activity
- Government borrowing has increased and it will be important that this crowds-in the private sector with the amounts borrowed going to production activities – the best as we have seen are the infrastructure bonds
- Ongoing efforts to re-build foreign reserves to pre-crisis level or regional convergence criteria – ESF

Prospects for Africa in the post crisis period

- Africa's prospects in the post-crisis period is contingent on the behavior of policymakers both in Treasury and central banks
- The first issue at the moment in most countries is to do as much as possible to support economic recovery through job creation and protect the wage good
- **Fiscal policy in post-crisis Africa**
  - Sustaining domestic demand in the post-crisis period critical
  - Countercyclical fiscal policy to sustain demand through supporting jobs is important at the initial recovery period
  - In the medium term, fiscal policy should be directed firmly towards growth and long term development objectives
  - Adequate capital spending should be a top priority to address large deficits in infrastructure and human capital
- **Central banking in post-crisis Africa**
  - Inflation in most countries has reverted to single digits, and the likelihood of a significant liquidity overhang is minimal
  - In many countries exchange rates have also been strengthening towards the pre-crisis level. Re-correction after the crisis
  - All these factors point towards retaining the current supportive monetary policy stance in most countries and for central banks to avoid conventional wisdom to raise interest rates soon
  - Central banks should be in no hurry to tighten their policy rates when underlying inflation is below target. They need to continue with the same monetary stance until the expected inflationary pressure threatens instability in the economic environment

What the Central Bank of Kenya has done during the crisis

- The Central Bank of Kenya – has pursued an accommodative monetary policy stance to help cushion the economy from the negative effects of the global financial crisis
- Measures taken so far
  - Reduction of cash reserve ratio from 6% to 4.5% (100 basis points in December 2008 and 50 basis points in July 2009) – thus releasing an equivalent of Ksh.12.5 billion for lending to the economy
  - Consecutive reduction of the Central Bank Rate from 8.75% to 7.75% to signal to banks to lower lending rates
  - Allowing a reduction in foreign exchange reserves to less than 3 months to take pressure off the depreciation pressure of the Kenya shilling vis-à-vis the hard currencies (Had the CBK not allowed this, the inflationary effect of the shilling's depreciation would have been worse – in terms of intermediate imports, oil prices etc)

Kenya's fiscal policy attempts to spur economic activity during economic downturn

The 2009/10 Finance Bill took recovery head on – six solutions:

- Commitment from Treasury to maintain a stable macroeconomic environment
- Creating fiscal space through expenditure rationalization from non-productive sectors/activities to productive sectors
- Reducing the cost of doing business
- Developing key infrastructure facilities and public works to stimulate growth, employment and poverty reduction
- Fiscal stimulus through measures that expand economic opportunities in rural areas for employment creation

Global outlook

- The fear of the "Second Great Depression" has subsided
  - Impact of the crisis on output has been ameliorated by coordinated Government Policies
- However, significant downside risks remain to the positive outlook
  - Global recovery could yet prove more anaemic than currently projected
  - Evidence still unclear as to whether the slowdown has hit bottom in SSA

Going forward

- Diversification of trade relations
  - China and India are gaining entry to African region – perhaps change trade & FDI flows
  - Regional integration to promote trade relations. The crisis has awakened the need for regional integration
- Financial sector development
  - Put more effort to developing capital markets including bonds and stock markets to widen options for saving and investment financing
  - World Economic Outlook Financial Development Index covers only three SSA countries. Development of such index to capture more SSA countries is crucial in monitoring progress in the development of the sector
  - Develop financial sector strategies to accommodate innovative policy designs and financial innovations
- Partnership
  - AfDB, IMF and WB have done well so far
  - They have both short-term rescue packages and enhanced development assistance
- Mobilization of adequate resources to finance growth
  - Put in place innovative avenues for investment and saving with adequate financial sector development
  - Boost development budgets to sustain infrastructure development

- Stay the path of reforms – do not sacrifice long-run growth
  - But remain within attainable targets – credibility of reforms
- Regulation of the financial sector
  - An emergence of regulatory arbitrage – Domestic regulators should talk to each other
  - But we should be careful not to call for "more" regulation rather than "better" regulation
  - "Better" regulation: A regime that can readily identify emerging vulnerabilities; that can properly price risks; and that strengthens incentives for prudent behaviour (Andrew Crockett, FD Supplement September 2009)
- Foreign reserves have served countries in Africa well:
  - In theory, in a floating exchange rate regime, there is no need to hold foreign exchange reserves or to use them
  - But developing and emerging economies accumulated foreign exchange reserves to very high levels – it served them well in the crisis
  - The future of dollar denominated reserves requires close observation