Daniel Mminele: Underpinnings of sustainable growth in Africa

Address by Mr Daniel Mminele, Deputy Governor of the South African Reserve Bank, at the IIF Africa Financial Summit, Sandton, 11 November 2013.

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Mr Tim Adams, President and CEO, Institute of International Finance (IIF),

Mike Brown, Chief Executive, Nedbank,

and honoured guests,

allow me to express my gratitude for the honour and privilege to present the opening keynote address of the 2nd Africa Financial Summit.

1. Introduction

In May 2000, the Economist magazine labelled Africa the "Hopeless Continent", claiming that natural disasters, mass murders, a string of wars, institutional constraints and a lack of commitment to democratic practices meant that the new millennium had brought disaster rather than hope to Africa.[1] In March 2013, the Economist had a complete change of mind declaring that Africa is "a Hopeful Continent" since "African lives have greatly improved over the past decade…and the next ten years will be even better"[2]. It is heartening to note that negative perceptions about African economic prospects, which were the norm at the turn of the millennium, are less of an issue today. While many challenges persist, Africa has shown that there is a high level of commitment and potential to achieving economic success.

In this address, I would like to take stock of some of the economic successes that African countries have achieved, highlight some of the underpinnings for sustainable growth outcomes and prospects in Africa, and then look at some of the challenges facing monetary authorities.

2. Africa's economic successes

Africa's average growth rates have exceeded 5 per cent since 2000, double the pace of the 1980s and 1990s. Over the past decade, six of the world's ten fastest-growing countries were from the African continent. Equatorial Guinea recorded an average growth rate of 17 per cent while the Angolan economy expanded by 11 per cent per annum between 2000 and 2009. In addition, seven other countries on the continent recorded in excess of 7 per cent per annum growth during this period.[3]

With the outbreak of the financial crisis in 2008, there was justifiable concern that African economies were under threat. For example, the International Monetary Fund (IMF) kept revising downwards the growth forecasts for sub- Saharan Africa (SSA) for 2009, from 5 per cent in October 2008, to 3,5 per cent in January 2009, to 1,7 per cent in April 2009 and 1,3 per cent by October. However, SSA recorded a growth rate of 2,6 per cent in 2009 which was twice the pace predicted by the IMF. In addition, the pickup in economic activity in the post crisis period also exceeded forecasts with growth averaging 5,3 per cent between 2010 and 2012.

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1 http://www.economist.com/node/333429.

2 http://www.economist.com/news/special-report/21572377-african-lives-have-already-greatly-improved-over-past-decade-says-oliver-august.

3 These countries included Chad, Mozambique, Ethiopia, Nigeria, Rwanda, Sierra Leone and Tanzania.

Part of the explanation for Africa's resilience to the financial crisis was related to the rise in commodity prices. In fact, the boom in commodity prices during the 2000s provided a significant boost to export revenues given that mineral exports account for over half of the continent's total exports. Statistics from the United Nations Conference on Trade and Development (UNCTAD) show that there was almost a fourfold increase in Africa's exports from USD149 billion in 2000 to USD595 billion in 2011.

The slowdown in the traditional export markets in the advanced countries as a result of the global financial crisis was countered by the rise of emerging countries in the world economy. This facilitated the diversification of export markets which served to sustain the demand for Africa's commodity exports. For example, the share of exports destined to the European Union (EU) and United States (US) declined from 47 per cent in 2000 to 33 per cent in 2011 while the share to the BRIC (Brazil, Russia, India and China) nations increased from around 8 per cent to approximately 23 per cent during the same period.

However, there was more to it than just commodity prices. Africa has been increasingly better managed, with the improvements in governance helping to promote an overall conducive environment to growth and development. There has been a steady rise in the contribution of domestic demand to gross domestic product (GDP). Part of the explanation here is the fast-growing middle class in many African countries. Estimates by the African Development Bank (ADB) show that consumer spending by the middle class reached US$680 billion and accounted for 25 per cent of Africa's GDP in 2008. This figure is projected to reach US$2,2 trillion by 2030. On the supply side, the rise of the services sector has been one of the defining characteristics of the structural change in African economies. Telecommunications, banking, and the retail sector have been flourishing in many countries. This has contributed to the improvement in Africa's growth prospects, which in turn, has attracted the attention of foreign investors.

The concerted efforts of policymakers to address some of the major binding growth constraints, which were previously neglected, have also played a significant role in Africa's enhanced growth performance over the last decade. Research from the McKinsey Global Institute (MGI) show that natural resources and activities directly related to the primary sector accounted for only about a third of Africa's growth.

The World Economic Forum estimates that more than half of Africa's enhanced growth performance can be attributed to improvements in infrastructure.[4] Policymakers have devoted significant attention to addressing the growth constraints on the continent, the dividends of which have been reflected in the growth outcomes of the past decade. However, having said that, infrastructure bottlenecks still persist and further attention is needed in this area to enhance Africa's growth prospects.

The 2013 "Doing Business Report" published by the World Bank earlier this year highlights that 66 per cent of countries in Africa enacted at least one business- enhancing reform in 2012 – this is double the number of countries in 2005. The report acknowledges that nine African countries rank among the top 20 most improved in terms of business regulations since 2009. These include Benin, Burundi, Cote d'Ivoire, Ghana, Guinea-Bissau, Liberia, Rwanda, Sierra Leone, and Togo. These countries are bound to reap the benefits of these business-friendly reform measures.

Foreign investors have taken note of these changes. Over the past decade Africa has increasingly been earmarked as a profitable investment destination by international investors. Foreign Direct Investment (FDI) to Africa increased from approximately US$10 billion per year in 2000 to more than US$50 billion in 2012. While the commodity price boom has played some part, the institutional and political changes coupled with the

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[4] The Africa Competitiveness Report 2013.

continent's enhanced growth potential have been the main factors underpinning investor confidence in Africa[5]. According to UNCTAD, greenfield investment into Africa constituted approximately 10 per cent of global greenfield investment between 2006 and 2012, compared to two per cent of global mergers and acquisitions that was directed to Africa. An increasing share of the greenfield FDI flows into the continent were destined for sectors, such as metals, renewable energy, automotive equipment and financial services.

Africa is also seen as an attractive FDI destination by those multinational investor groups that are keen to benefit from the intra-Africa trade opportunities that currently exist. In addition, other investors that already have operations in Africa are looking to expand their footprint on the continent, to ensure that they are well positioned to benefit from the favourable growth prospects that prevail in many countries. Investors from developing economies, particularly those from China, have significantly increased their ventures into the continent. In the post crisis period, China accounted for more than half of the greenfield FDI to Africa.

It is also worth noting that intra-continent FDI has been growing at a healthy pace. In fact, the share of African countries in total FDI in the continent more than doubled between 2003 and 2012; whereas in 2003 some 8 per cent of FDI into African countries came from other African countries and 92 per cent from other continents, by 2012 the intra-African share had risen to 18 per cent.

As expected, multinationals from South Africa have seized the opportunity to expand their production networks across the continent. The number of projects in Africa originating from South Africa has increased by over 500 per cent in the past decade. Between 2010 and 2013, South African multinationals made FDI investments into 18 African countries. In 2012, South Africa invested in more new FDI projects in Africa than any other country in the world. According to Ernst & Young's 2013 Attractiveness Survey, South African FDI into Africa has created almost 46 000 jobs in Africa since 2003.

The financial crisis has shown that the conventional view of a positive relationship between finance and growth cannot be taken for granted. In fact, the shallowness of Africa's banking system has helped to insulate many African countries from the adverse effects of the financial crisis. However, financial innovation and development over the past decade has helped to significantly increase the share of the population with access to basic formal financial services and technology in many African countries.

We know that capital markets can be a significant driver of economic growth. While many countries in Africa have capital markets that are small and illiquid, some steady progress has been made towards developing financial markets in Africa. Increasingly African countries are accessing international capital markets, and their ability and success in doing so has contributed towards the funding of massive infrastructure projects, which I will touch on later. The ability to issue in international markets has been made possible by an increasing number of African countries obtaining sovereign credit ratings and because of heightened interest by international investors in the so-called frontier markets, in an environment of low global interest rates. Many of the debut dollar denominated sovereign bonds issued have been done so at relatively attractive yields, which have declined over time. Nigeria for example paid a 7 per cent yield on its debut two years ago with a 10-year dollar-denominated note, while the 2013 10-year bond issue was priced to yield 6.375 per cent. Nigeria's most recent bond issues were four times oversubscribed compared with 2.5 times in 2011. According to Moody's[6], primary issuance by African sovereigns in 2013 has already reached its highest level ever of US$8 billion. Furthermore, Moody's is positive on sustained investor interest in the region, citing a strong macroeconomic growth outlook. Six countries in Sub-

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[5] African Development Bank: Annual Development Effectiveness Review 2013.

[6] International Sovereign Issuance in Africa 2013/2014: A Rating Agency Perspective", October 2013.

Saharan Africa are expected to issue inaugural bonds in the international markets within the next few years, including Angola, Cameroon, Kenya, Tanzania, Uganda and Mozambique and given expectation that the issuance sizes could be in the region of US$500 million, may make them eligible to be included in the JP Morgan Emerging Markets Bond Index. This of course helps to raise visibility, and provides access to a larger pool of investors, while also setting a benchmark for local corporates.

As financial innovation and deepening evolves on the continent, it is imperative that the regulation of the financial system keeps pace with these developments. Here the emphasis should fall on appropriate regulation – that is, striking the right balance between guiding financial markets and protecting financial systems (some of which may still be at a nascent stage) on the one side, while not stifling innovation and progress on the other.. Too much regulation would entail increased costs which could hinder further development of the financial sector. But if due regulatory attention was not given to financial innovation and development then countries could be exposed to financial sector vulnerabilities which could pose a threat to sustainable economic outcomes.

3. Regional integration

There are concerted efforts to foster greater financial integration at the regional level. For example, in the area of payment systems, the SADC Integrated Regional Electronic Settlement System (SIRESS) was launched on 22 July 2013 as a pilot. There are currently 21 participants (4 CMA central banks and 17 commercial banks). This system enhances and harmonises the legal and regulatory frameworks in the region and provides an integrated regional cross-border payment settlement infrastructure, allowing inter-country payments to be effected quickly, efficiently and safely.

In fact, the benefits are already starting to manifest themselves. SIRESS processed 1 780 settlement instructions to the value of R15 billion during August 2013 which was the first full month in which the system was in operation. The settlement amounts will increase quite significantly with roll-out to four more countries by April 2014 and eventually more broadly in SADC. Further developments are also envisaged. For example, the SADC Banking Association and a work group from the Committee of SADC Stock Exchanges (COSSE) are working on the business model and related agreements for the settlement of the cash leg of securities trades.

Rising intra-regional trade has been a defining characteristic of globalisation over the last two decades. However, it has long been recognised that Africa is highly fragmented with poor institutional arrangements and insufficient coordination at national and sub-regional levels. These factors have undermined the role of intra-regional trade in fostering economic growth on the continent. While Africa’s intra-regional trade share has doubled from 6 per cent to 12 per cent between 1990 and 2011, this remains remarkably low in a global context, considering the spatial proximity of African countries to one another.

The Treaties establishing the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), and the South African Development Community (SADC) provide for the establishment of a Monetary Union in each bloc. However, overlapping memberships, the slow ratification and implementation of protocols coupled with the socio-economic policy divergences have proven to be a serious obstacle to the process of regional and continental integration. Significant progress on economic integration has been achieved in some quarters, the most notable being the long track record of the Southern African Customs Union (SACU) and Common Monetary Area (CMA). One needs to warn against overly rapid monetary union formation, however, and emphasise the importance of the context and sequencing of economic integration initiatives. As the European experience has demonstrated, a monetary union without significant elements of a fiscal union could amplify tension rather than bring harmony.

In June 2011, African Heads of State and Government committed themselves to the Tripartite Free Trade Area (TFTA) which aims to remove trade barriers, develop regional value chains and create jobs in COMESA, EAC and SADC. Negotiations towards the creation of the Tripartite Grand Free Trade Area between COMESA, EAC and SADC commenced in May 2013, with the objective to conclude these negotiations by December 2014, and the Agreement entering into force at the beginning of 2015. Last month, the African Development Bank approved a grant of US$7,5 million to finance a capacity building programme in support of the TFTA.

4. Challenges for policymakers on the African continent

Let me now briefly highlight some of the current challenges confronting monetary policymakers on the continent. Although our continent is diverse with differing experiences and challenges, it is possible to make some general comments.

While Africa's growth performance has been impressive in a comparative context, this has not translated into an adequate, widely spread improvement in living standards. This is evident in the continent's progress in terms of attaining the Millennium Development Goals (MDG). Despite 15 of the 20 countries which made the greatest progress on the MDGs in 2012 being from Africa, according to the "2013 MDG Report" Africa's rate of poverty reduction would not be sufficient to reach the target of halving extreme poverty by 2015. Structural reform across a wide range of areas has to be intensified in order to make the progress which the continent needs. In this regard reference has already been made to a number of key areas, such as infrastructure improvement and creation of a more business-friendly environment.

According to the 2013 World Economic Forum Africa Competitiveness Report, the quality of infrastructure is one of the major impediments to developing trade and improving competitiveness in Africa. The World Bank estimates that the continent's infrastructure spending needs amount to approximately US$93 billion per year, half of which is funded by the government. There is thus a huge infrastructure funding gap which in effect dictates that efficiency gains in the use of the existing infrastructure network are essential.

An area that stands central to development has not been mentioned yet; namely, education and training, where huge challenges must be faced and overcome if Africa is to blossom further through inclusive growth and development. Labour markets in many countries are characterised by frictions and strife. In this regard, there are two major challenges confronting policymakers. Firstly, over the short-term there is an urgent need for the creation of labour-intensive jobs to absorb the large number of people entering the labour market each year. Secondly, over the longer term there is need to move up the value chain in production in both the manufacturing and service sectors. This would require significant investment in education both at the school and higher education levels. Programmes directed at entrepreneurship development and other training initiatives that could provide the technical skills required to support infrastructure development are key to the attainment of sustainable growth on the continent.

Where do central banks fit into the sustainable growth picture? While most of the structural reform imperatives fall outside the mandate of central banks, I believe that central banks, by keeping inflation in check and creating an environment of financial stability, can make a meaningful contribution. Economic prosperity is built on stable foundations provided by central banks taking their mandate seriously. Thinking of the dozens of countries on the African continent that had high double-digit rates of inflation 20 years ago and contrasting that with the current situation, much progress has been made.

In general, while inflation rates have increased marginally over the last couple of years they remain entrenched at single-digit levels in many countries. The rise in food and fuel prices coupled with the impact of currency depreciations have been important sources of inflationary pressures in many countries. The current uncertainties in the global financial

environment and their associated impact on currencies may continue to pose a major threat to inflation outcomes in many countries.

Recently the issue of currency movements and its impact on competitiveness has received much attention in the general press as well as in policy and academic circles. While it may be difficult to determine the equilibrium exchange rate, it is well recognised that a significantly misaligned exchange rate or excessively volatile exchange rate leads to a misallocation of resources which eventually thwarts sustainable growth. In some countries like South Africa for example, a special effort has been made to build up the level of foreign exchange reserves – to some US$50 billion at present, from US$8 billion a decade ago – since adequate reserves contribute to investor confidence and moderation in exchange rate volatility. In some other countries the nature of the foreign exchange market and risk appetite of the authorities does, at times, allow for central bank intervention in an attempt to moderate episodes of abnormal depreciation or appreciation.

The shorter-term challenge to macroeconomic policymakers on the continent is to strike a balance between controlling inflation and supporting economic growth. As pointed out earlier, growth is driven from the supply side over the long-term. The trade-off between growth and inflation can only be avoided with increases in potential output. Monetary policy can only play a facilitating role in enhancing the productive capacity of the economy. Once inflation picks up significantly and stays at elevated levels, nominal interest rates also have to rise to match inflation so that saving is sustained and a macro-economic environment conducive to sustainable growth is maintained. In this regard, countries with rising inflationary pressures and limited fiscal space will be constrained in their use of expansionary macro policies to stimulate the growth momentum. On the other hand, where inflationary pressures are contained, further monetary stimulus could be provided.

5. Conclusion

In conclusion, the recent financial crisis has exposed the strains in the banking system in the advanced world. While the banking systems in many African countries are not well developed, they are stable. In general, African banks are well capitalized and have avoided being overly exposed to the sub-prime and other financial crises that have affected the world economy over the past two decades. The challenge confronting policymakers on the continent is to ensure that the hard-fought economic gains achieved during the past decade are not lost. In this regard, African central bankers are committed to ensuring that monetary policy makes a significant contribution to sustainable economic outcomes by fostering price and financial stability. But much more is required than what central banks can contribute: The challenge to Africa in general is to not only plan but also implement the structural reforms necessary to bolster the continent's sustainable growth rate.

Thank you.