South African Reserve Bank

An update on 'Africa rising'

Address by Mr Daniel Mminele,
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1. Introduction

Good morning, ladies and gentlemen

It is a pleasure for me to address you today, some five years since the inaugural Africa Financial Summit that was held in Cape Town in 2012. At that time, George Abed[1] noted the great progress that African countries had realised in stabilising their economies – a particularly remarkable achievement during a period of unprecedented global financial turbulence. However, he also cautioned that the prospects for continued growth in sub-Saharan Africa (SSA) were contingent on greater economic diversification and on reducing dependence on commodity exports – an issue to which I will return later in my address.

I see from the programme that yesterday you have covered much ground regarding the economic and financial issues currently facing Africa. There is no doubt that the economic environment has changed drastically since 2012. Indeed, the challenges are presently somewhat greater and more complex. Today, I will touch on this changing economic landscape, focusing on digital finance and financial inclusion as

[1] George Abed is the former Senior Counsellor and Director for Africa and the Middle East at the Institute of International Finance.

well as the financial regulatory environment. Each one of these is important in the African growth context.

2. A pause in the 'Africa rising' narrative?

Beset by war, corruption, bad governance as well as poor macroeconomic policies, Africa was labelled 'the hopeless continent' in 2000. Some 10 years later, this narrative changed to a more inspiring one, of 'Africa rising', facilitated by the commodities boom, growing manufacturing and services sectors, a rapidly growing middle class, improved health prospects for many Africans, and a new-found passion for technology. With a stable economic outlook, foreign investment also increased. This was all the result of most African economies putting in place good governance frameworks as well as sound macroeconomic and market-orientated policies which spurred growth, trade, and investment.

The Global Financial Crisis, which caused turmoil in both advanced and emerging economies, did not affect SSA quite as severely. In part, limited financial integration with international capital markets and an inward focus of African banks had shielded the region. So instead, SSA flourished, ranking second behind emerging and developing Asia in terms of growth. Easy monetary policy in the advanced economies, the search for yield as well as excess liquidity in global financial markets benefitted Africa, and 'frontier markets' became the new buzzword and investment destinations of choice.

However, there has been a notable economic turnaround since 2014, coinciding with the period when crude oil prices and commodity prices lost significant ground. Furthermore, as soon as it became clear that the Federal Reserve would begin to normalise monetary policy, international investors and creditors started to withdraw capital. African countries heavily reliant on commodity revenues were negatively affected, their position exacerbated by a failure to build fiscal buffers during the good times, combined with a significant pickup in foreign currency-denominated sovereign bond issuance by African countries during the boom years. Consequently, the overall fiscal balance for SSA moved from an average surplus of 1,7 per cent of GDP[2] in 2004-08 to a deficit of 4,9 per cent in 2016. Government debt accelerated markedly over this period, for example from 28 per cent of GDP to around 70 per cent in Angola and from 30 to 50 per cent of GDP in South Africa. Foreign exchange reserves have been run down in some countries and inflows of foreign direct investment declined in the region as a whole. In addition, SSA's current account deficit increased from an average of 2,1 per cent of GDP in 2004-08 to 5,9 per cent in 2015; it is expected to widen further, to levels above 6 per cent, this year. The most pronounced shifts could be observed in the oil-exporting countries where the average balance moved from a surplus of 13,1 per cent of GDP to a deficit of 3,9 per cent over the same period.[3]

Thus, 2014 marked the end of the 'Goldilocks years' for Africa. SSA growth dropped from 6,8 per cent in 2004-08 to 3,4 per cent in 2015, and, according to the International Monetary Fund (IMF), it is set to decelerate further this year, to around 1,6 per cent – the weakest growth rate since the early 1990s, undershooting global growth for the first time since 2000. Also according to the IMF, per capita income in SSA is anticipated to fall this year for the first time since 1994.

Much of the more recent slowdown in SSA can be attributed to developments in the two largest economies, Nigeria and South Africa, which account for more than half of SSA growth. To put this into context: the IMF projects that Nigeria, which had been growing by 10 per cent in the 2000s, will contract by 1,8 per cent this year while South Africa will barely grow at 0,1 per cent in 2016. I should, however, mention that the most recent forecast of the South African Reserve Bank (SARB) has lifted the projection for economic growth in the country to 0,4 per cent in 2016. McKinsey highlights that, for the African continent, economic deterioration emanates from two distinct groups: the North African countries affected by the Arab Spring, and the oil exporters (which include Nigeria) affected by the sharp decline in oil prices. Together, these two groups account for nearly three-fifths of Africa's combined GDP.

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[2] gross domestic product

[3] Various issues of the sub-Saharan Africa *Regional Economic Outlook* of the International Monetary Fund

The real annual GDP of the Arab Spring countries declined by 4,8 per cent in 2010-15, and that of the oil exporters by 3,3 per cent.[4]

Many parts of SSA have witnessed a turnaround, but this is not true of the entire region. We need to recognise the increasingly important role that East Africa is playing in driving growth, as it benefits from cheap oil, slowing inflation, lower interest rates, and an improved regulatory regime with increased investment in key sectors such as transport and telecommunications.

Nonetheless, some believe that the ‘Africa rising’ story was directly related to elevated commodity prices underpinned by China’s success and its many years of double-digit growth rates. It is postulated in some quarters that the rebalancing of China’s economy away from investment to focus more on domestic consumption would give rise to a slowing in the Chinese economy, spilling over to commodity prices and negatively affecting commodity-producing countries in Africa. But this is only part of the story; the global economic recovery has not been particularly robust and the slowdown is also not unique to SSA. Emerging markets in general have slowed, with a few key economies having entered recession.

It is imperative to ensure that the deceleration in Africa’s growth trajectory is indeed temporary. For this reason, countries on the continent must ensure that there is strict fiscal discipline, that market-friendly policies are implemented (such as flexible exchange rates), and that the strides made in strengthening institutions are maintained and further entrenched. To reiterate what George Abed said in 2012: revenue bases must be broadened, and Africa needs to continue improving the basics, including infrastructure development.

On this note, it was heartening to note German Chancellor Angela Merkel’s remarks a few weeks ago, made on the sidelines of the G-20[5] Summit in China, that, during Germany’s presidency of the G-20 in 2017, there will be a focus on Africa,

[4] *Lions on the move II: realizing the potential of Africa’s economies*, McKinsey & Company, September 2016.
[5] Group of Twenty (Finance Ministers and Central Bank Governors)

particularly pertaining to investment in infrastructure and direct investment in the continent.

It has been said many times before: it would be difficult to ignore the potential that this continent has to offer in terms of its fast-growing young population which is more educated and wealthier than ever. According to the United Nations (UN), Africa's population is expected to rise from the current 1,2 billion people to 2,5 billion in 2050. Granted, such population growth can be to the detriment of the continent if there are no new jobs, but a recent report by McKinsey shows that job creation is outpacing labour force growth at 3,8 per cent a year versus 2,8 per cent.[6] Africa is also the world's fastest-urbanising region; its household consumption is expected to grow at 3,8 per cent a year between now and 2025 to reach US$2,1 trillion that year. Africa could double its manufacturing output from the current US$500 billion to almost US$1 trillion in 2025, largely based on African companies meeting domestic demand. We should also remember that Africa's natural resources remain in abundance and that the continent is more peaceful and democratic than it was a decade ago. Indeed, in terms of projected growth rates for 2016, of the 10 fastest-growing economies in the world, 3 are from Africa.[7] The *World Bank ease of doing business report* further shows that, despite the economic turnaround, 5 of the 10 fastest reformers are African.[8]

In addition, regional integration remains a priority for Africa over the long term. In this respect, Agenda 2063 sets out the vision for this path, recognising that with deeper regional integration come larger markets, greater industrialization and productivity, as well as greater talent mobility. Investment in infrastructure means less congestion along regional corridors and the facilitation of trade by cutting barriers such as time and costs. The African Regional Integration Index[9] was launched earlier this year for the purpose of measuring and providing an assessment of developments across the continent to identify gaps in terms of integration. The average Regional Economic

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[6] *Lions on the move II: realizing the potential of Africa's economies*, McKinsey & Company, September 2016.
[7] These are Ivory Coast (8,5 per cent), Tanzania (6,9 per cent), and Senegal (6,6 per cent).
[8] 'Business in Africa, making Africa work', *The Economist*, 16 April 2016
[9] *Africa Regional Integration Index Report 2016* by the United Nations Economic Commission for Africa, African Union and African Development Bank.

Community (REC) scores are around 0,47 on a scale of 0 (low) to 1 (high). Overall, the index shows that integration in the region could significantly progress, with the East African Community the top performer (0,54) followed closely by SADC[10] (0,531). It is interesting to note that the highest scores are on trade integration while the lowest scores are on financial and macroeconomic integration.

The African Central Bank (ACB)[11], one of the three financial institutions of the African Union, is due to be set up by 2028, after the achievement of certain milestones, including the establishment of an African Common Market as well as an Economic and Monetary Union that would include Continental Fiscal and Banking Unions. All these milestones (including the establishment of the ACB) are envisaged to be achieved between 2029 and 2034. Given the tight timelines, it is doubtful whether the establishment of the ACB is still within schedule. It may therefore be useful to pause at this juncture and take stock in order to assess where the continent finds itself in its economic and financial integration journey in relation to set goals. The focus should first be on pursuing integration within regions before accelerating integration across the continent.

3. Digital finance and financial inclusion

Globalisation and the information technology (IT) revolution provide unprecedented opportunities for countries and regions to make significant advances in reducing poverty and improving incomes, which in turn could underpin the desired economic and social transformations. As the G20 High Level Principles for Digital Financial Inclusion pointed out, one can no longer talk about growth without reference to the Fourth Industrial Revolution and digital finance – a powerful and effective tool of expanding access beyond financial services to other sectors, holding enormous opportunities for the expansion of basic services and enhancing financial inclusion.

[10] Southern African Development Community

[11] The African Central Bank (ACB) was agreed upon in the 1991 Abuja Treaty. Once fully implemented via Pan-African Parliament legislation, the ACB will be the sole issuer of the African Single Currency, it will become the banker of the African Government, it will become the banker to Africa's private and public banking institutions, it will regulate and supervise the African banking industry, and it will set the official interest and exchange rates – all in conjunction with the African Government's administration.

These are powerful engines for job creation in developing countries – and they have an increasingly important role to play in promoting the development of small businesses. Indeed, this was a key topic at the most recent World Economic Forum on Africa, held in Kigali during May 2016. The World Bank highlighted digital finance as an area which can contribute to achieving the goal of universal access to financial services by 2020. The G-20 also recognised the potential role that digital finance can play and released the *G-20 high-level principles for digital financial inclusion* during its Hangzhou Leaders' Summit in September 2016. Countries were encouraged to consider these principles as a basis for the development of country action plans to leverage the huge potential offered by digital technologies. The promotion of digital financial services would contribute towards the growth of inclusive economies.

At this stage, allow me to hone in on financial inclusion as it relates to the sphere of digital finance. As has recently been reported by the G-20 through the work done by the Global Partnership for Financial Inclusion, 2 billion adults globally – the majority of whom are women – do not have access to formal financial services and are thus excluded from opportunities to improve their lives. In SSA, the percentage of the population with an account at a financial institution is just above 30 per cent, compared with almost 50 per cent in emerging Asia and almost 70 per cent in East Asia. Only about 23 per cent of small and medium enterprises in Africa have access to formal financing.[12] The SADC Financial Inclusion Strategy Workshop Report[13], developed by the FinMark Trust and presented to stakeholders in February 2016, notes that financial inclusion in the SADC region is relatively low and varies widely across countries. A number of supply barriers have been identified, which include a lack of incentives and appropriate delivery channels that constrain financial institutions in providing and extending financial products and services to unserved and underserved segments of the population. On the demand side, barriers include administrative, systemic as well as attitudinal challenges, many of which are more pronounced among certain groups, such as the youth and women. These barriers

[12] World Bank (http://datatopics.worldbank.org/financialinclusion/region/sub-saharan-africa)
[13] FinMark Trust (http://www.finmark.org.za/wp-content/uploads/2016/03/Rep_SADC-Financial-Inclusion-Strategy-Workshop_Feb2016.pdf)

undermine or downright prohibit the ability to access and use financial products and services.

Thus, much remains to be done in furthering financial inclusion, as the financial markets in many African countries continue to lack depth and therefore offer limited financing opportunities to small- and medium-sized enterprises, and to the population at large. It is widely acknowledged that there are limited financial avenues for basic services such as savings and making payments. For example, by paying wages and transfers digitally, instead of in cash, governments and the private sector can play a pivotal role in increasing financial inclusion. While there is wide recognition on the continent of the growing importance of mobile money accounts and digital technology in the financial sector, this potential needs to be leveraged much more. However, we also need to keep in mind that there is a key trade-off between inclusion and maintaining the integrity of the financial system; a balanced regulatory and supervisory approach is therefore required in considering the Fourth Industrial Revolution.[14]

The breakthrough innovation brought on by crypto-currencies and block chain technology, amongst others, will continue to bring about significant and wide-ranging changes to society and the broader economy, and is very likely to have a positive spillover effect on the financial services sector and markets in the African continent. Many financial institutions have already experienced cyber attacks, including banks, insurers, and even central banks. Central banks have to be vigilant in assessing potential systemic risks and enhancing the financial system's resilience to cyber-threats. Reported attacks, such as those on the Society for Worldwide Interbank Financial Telecommunication (SWIFT)[15], the financial messaging network that underpins most international money transfers, have the potential to paralyse global trade and finance. It is no surprise that cybersecurity has in the recent past moved swiftly up the list of priority issues in a number of countries as regulatory authorities

[14] Wolrd Bank Global Findex Database 2014, Measuring Financial Inclusion around the World.

[15] There have been three successful attacks on banks using the SWIFT money transfer network. The latest of these affected an Ecuadorian bank on 12-22 January 2015. During this period, at least 12 fraudulent transfer requests instructed Wells Fargo to send US$12 million belonging to Ecuador's Banco del Austro to accounts in Dubai, Hong Kong, and the United States. Wells Fargo complied with these requests.

seek to address cybersecurity threats and enhance cyber-resilience. It is therefore very important to strengthen international cooperation and peer exchange of information in this area. In this regard, the SARB hosted its first cybersecurity conference last month, with the theme of 'Collaboration for building cyber-resilience'.

4. The rise in African cross-border banks and financial regulatory impacts on Africa

As I come to the end of my remarks, I would like to briefly touch on the rapid growth in recent years of African cross-border banks, or pan-African banks (PABs) – a further testimony to the 'Africa rising' theme.

PABs are improving competition, especially in host countries with small markets, driving innovation and bringing new opportunities for diversification for the home countries. But with rapid growth come a number of responsibilities, such as maintaining financial stability and ensuring adequate cooperation and resolution strategies among home and host financial supervisors[16]. The rising trend of cross-border banking in Africa is an opportunity to further strengthen regional financial integration. In this regard, the work of the Association of African Central Banks under the auspices of the Community of African Banking Supervisors (CABS) is an important initiative to consider the potential macro financial spillovers across countries. Implementing regulatory coordination measures on financial integration and access will have substantial benefits in promoting growth on the continent.

The global regulatory reforms agreed to in the aftermath of the Global Financial Crisis have been vast, complex, and ground-breaking in many aspects, requiring effective coordination among many stakeholders. Many of the 'fault lines' that had contributed to the Crisis have been addressed, but the full, consistent, and timely implementation – ensuring a level playing field and addressing the major unintended consequences of the reforms – remains an ongoing challenge.

[16] The report on Pan-African Banks-Opportunities and Challenges for Cross-Border Oversight, IMF, January 12, 2015.

One of these unintended consequences is related to the effects arising from the global reforms addressing the problem of ‘too big to fail’ (TBTF). South Africa directly experienced such changes in business models recently when Barclays announced its intention to reduce its 62 per cent share in Barclays Africa Group Limited (BAGL), a material subsidiary publically listed in South Africa which includes Absa, one of the largest South African banks. Barclays’ intention to reduce its controlling stake in BAGL was mainly informed by global regulatory pressures to meet additional G-SIB[17] requirements. The objective of addressing the problem of TBTF was thus achieved, but in so doing other adverse and unintended effects were introduced. Significant strategic changes by G-SIBs, as well as the fact that these changes are at times made in reaction to regulatory changes rather than necessarily on business considerations, can lead to increased market uncertainty and short-term volatility.

A fallout from the international reforms has been the effect of the decline in correspondent banking relationships (CBRs) on the operations of banks on the African continent. Some G-SIBs have either restricted or exited CBRs in more than 10 African markets. A recent report of the Working Group on Correspondent Banking of the Committee on Payment and Market Infrastructures [18] acknowledges that the issues surrounding the withdrawal from CBRs are very complex and that costs related to anti-money laundering and combating the financing of terrorism (AML/CFT) compliance are only one of the elements that have to be considered in order to understand recent trends. The report states that it is difficult to disentangle the effects of de-risking from other causes, including declining economic activity, external shocks, and the consolidation of the banking system. In Africa, the most pronounced declines in CBRs occurred in Northern Africa and partly in Southern Africa; other regions experienced substantial increases.

Markets in all jurisdictions must have access to a well-functioning global financial system in order to develop and prosper, but de-risking can create financial exclusion and has the potential to drive certain payment flows underground, which can set the

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[17] global systemically important bank
[18] *Correspondent banking*, Committee on Payment and Market Infrastructures, Bank for International Settlements, July 2016.

goal of creating an open and global integrated financial system at risk. In this regard, the efforts of the Financial Stability Board and its outreach programme through the six Regional Consultative Groups (RCGs)[19] to better understand and address the reasons behind the decline in CBRs, as well as the global trend of de-globalising and de-risking, are to be welcomed. The RCG for SSA, which will be held in Cape Town on 25-26 October, will focus on CBRs and the effects of the reforms.

5. Conclusion

In conclusion: while the growth paths in Africa may have diverged, the potential that this continent has is tremendous and outpaces that of any other region in the world. But this potential needs to be harnessed. Integration needs to be deepened, infrastructure improved, and productivity lifted.

The long-term fundamentals remain strong, and while regional integration may not be proceeding at the speed hoped for, this is not necessarily a bad thing, but rather an opportunity to take stock, readjust plans where necessary and implement them with renewed vigour. In this regard, the Fourth Industrial Revolution promises significant benefits, if harnessed correctly.

While some have suggested that the ‘Africa rising’ narrative may have been exaggerated and are starting to question it, to me it looks more like a pause, and we should not allow the current headwinds to detract from the vast potential and opportunities that the African continent continues to offer.

Thank you.

[19] The Financial Stability Board (FSB) has six Regional Consultative Groups (RCGs), established under the FSB Charter to bring together the financial authorities from the FSB member (24) and non-member (41) countries to exchange views on the vulnerabilities affecting financial systems and initiatives to promote financial stability. The FSB RCG for sub-Saharan Africa is co-chaired by Governor Emefiele of the Central Bank of Nigeria and Governor Kganyago of the South African Reserve Bank.