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Economic and policy challenges in Africa

Ladies and gentlemen, good morning.

Allow me to thank you for the opportunity to address this conference that explores a very important issue facing the economies of Africa today: 'The role of urbanisation, and how the cities of the future will be structured and managed amid economic and policy challenges in Africa'. Of course, the growth and future of African cities is interdependent with the economic evolution of the continent in the next few decades, and how policies will shape that economic outlook.

I therefore propose to discuss the external and internal challenges that the continent's economy faces as it strives to move to a stronger, more inclusive pace of growth, and how policy – in particular monetary policy – can assist in that respect. Finally, I will look at whether the South African experience can inform future choices of the other countries in sub-Saharan Africa.

Africa's performance in the global context

The 2000s was a rather good period for the continent. After several decades when it had generally failed to 'catch up' with the more advanced regions and therefore converge towards the technological frontier, sub-Saharan Africa outpaced the world

economy and other emerging regions, save East Asia and the Pacific.[1] According to data published by the International Monetary Fund (IMF), the region's economy grew by an annual average of 5.7% versus 3.9% for the world economy and 6.1% for emerging markets during that period.

Furthermore, economic growth became more diversified. The services sector in particular contributed strongly to the overall expansion, including retail, financial services and telecommunications.

More generally, the private sector played a growing role in driving investment in productive capacities, while the sources of international financing became increasingly diverse too. Importantly, what some analysts described as 'a continent on the mend' proved fairly resilient to the global financial crisis of 2008-09, even if this was (in part) due to the relatively loose linkages of African countries to the world's major financial centres. In 2009, growth in sub-Saharan Africa slowed to 'only' 3.9% versus 2.8% for the emerging world as a whole and a 0.2% contraction for the global economy.

As the present decade started, the region continued to grow strongly, helped by a rebound in commodity prices and strong growth in China, which had over the previous decade turned into Africa's largest and fastest-growing trading partner. However, this pace of growth hit a 'snag' in 2016, when real gross domestic product (GDP) increased by a mere 1.4%, thus decoupling from emerging-market and global norms. The negative impact from the 2014-15 collapse in oil prices on some of the continent's major oil exporters played an important part. However, the deceleration was relatively broad-based[2] and exposed several underlying fragilities that had accumulated in earlier years, including the rise in external or fiscal account constraints.

Where do we stand now?

Economic growth has recovered since the abrupt deceleration of 2016, and major international institutions now forecast a moderate pickup into 2019. For example, the World Bank, in its June 2018 *Global Economic Prospects*, projects real GDP

[1] If one excludes China, sub-Saharan Africa actually outpaced growth in all the other major regions in the 2000s.
[2] Out of 43 countries, 23 witnessed a deceleration in growth in 2016, according to World Bank data.

growth of 3.5% next year, after 3.1% in the current year and 2.6% in 2017. However, this gradual pace of expansion still falls short of what the continent experienced, on average, in the previous decade. Furthermore, economists agree that, with per capita GDP growth rising by only about 1% a year, it will not make a major dent in poverty and inequality.

The imbalances that have built up over the past decade have not disappeared. The region's current account deficit, which had peaked at an elevated 6% of GDP in 2015, narrowed to 2.6% last year. However, the IMF expects that it will widen moderately again this year and the next, to around 3% of GDP. Furthermore, this aggregate hides the disparate performances across countries. The recovery in Brent crude prices has helped to alleviate the external pressures for oil exporters, but in countries whose strong growth has been heavily dependent on import-intensive public infrastructure investment, current account deficits remain high and, in many cases, are rising.

In any event, external debt (expressed as a share of GDP) for sub-Saharan Africa as a whole is rising, with the servicing cost of that debt representing a growing chunk of export earnings – a clear sign that there is no room for complacency.

'Twin deficits' have become the norm across the region over the past decade. Sub-Saharan Africa's government balance was in surplus, on average, between 2004 and 2008, but the region posted a deficit in excess of 4.0% of GDP from 2015 to 2017. Admittedly, most of the countries have now taken steps towards fiscal consolidation, and official forecasters expect a narrowing of that public deficit. Nonetheless, public-debt ratios are projected to continue rising in 2018, and the IMF has recently highlighted the concerning rising trend in debt-servicing costs as a percentage of national budgets. There are indications already that public deficits are, in some cases, starting to 'crowd out' financing for private-sector projects.

The 2016 slowdown in the region's economies was compounded by a broad-based depreciation in most of its free-floating currencies, which triggered faster inflation and forced central banks to raise rates, sometimes aggressively. Thankfully, such negative forces largely reversed in 2017: in an environment of rising global investor appetite for risk, recovering commodity prices and softness in the United States (US) dollar, most of the liquid, tradable African currencies either stabilised or recovered against the

dollar. This improved performance, helped in some cases by a shift to a tight monetary stance – in particular, in the large oil exporters like Angola and Nigeria – allowed a broad-based decline in inflation rates.

In fact, in most of the largest economies of the continent, inflation in the early part of 2018 has been close to central banks' targets, or within such targets, when the central bank targets an inflation *range* as opposed to an inflation *point*. This has allowed several central banks to reduce interest rates in the past year or so – in some cases by a moderate amount (Angola, Kenya), and in others more substantially (Ghana, Mozambique, Tanzania, Uganda, Zambia). It is encouraging to note that many in the latter group of countries had in earlier years been forced to hike aggressively to combat inflation pressures; this policy tightening thus appears to have borne fruit.

The ongoing challenges of development

Several factors point to a moderately improved short-term growth, inflation and monetary outlook for sub-Saharan Africa. Nonetheless, as I have mentioned earlier, the growth levels projected for the next year or two remain insufficient to engineer a serious reduction in poverty as well as the other social or economic ills that typically accompany it, such as crime, malnutrition and illiteracy. The strong growth over 2000-2014 did help to alleviate both the incidence and the depth of poverty. For example, statistics compiled by the World Bank show that the percentage of people living below US$1.9 a day fell from 58% in 1999 to 42% in 2013, the latest year for which data are available. Nonetheless, this indicator has not declined near as fast anywhere else, and remains well above the similar indices for Latin America, South Asia and East Asia – even though, in the last-mentioned, poverty incidence was higher than in sub-Saharan Africa back in 1990.

This unfavourable comparison highlights the urgent need for sub-Saharan Africa to restart the 'high growth spells' which had characterised the pre-2015 period – yet which, according to IMF research, tended to be shorter in duration and more vulnerable to an eventual crash than in other regions.[3] According to that same research, both exogenous and internal factors influence the shift to a higher growth

[3] See the article titled 'Restarting sub-Saharan Africa's growth engine' in the IMF's *Regional Economic Outlook* published in May 2017 (Chapter 2).

path and the duration of these growth spells. These factors include global financial conditions, changes in the terms of trade, low inflation, flexible exchange rates, and policy stability, including prudent fiscal management and well-managed debt dynamics.

I would therefore like to dwell for a moment on the external environment that sub-Saharan Africa is likely to face in the coming years, as well as on the role that domestic policies can play in fostering renewed development.

However, before I move on to these topics, allow me to highlight the importance of economic growth for African cities – for this is, after all, the subject of this conference, and the economic implications of and for urbanisation need to be better understood.

Many economists point out the long-term benefits of urbanisation for economic growth: by living in a large city, individuals can access the type of job opportunities, and can participate in such business networks, that are not available in a rural setting, or much less so. Economies of scale are also generally understood to be larger in urban areas. Hence, it may not come as a surprise that, in most countries, a higher degree of development generally coincides with a higher share of the population living in large conurbations.

However, those of us who frequently travel to African cities are also appalled at the problems that seem to come with the continent's fast rate of urbanisation, namely the prevalence of slums, poor sanitation, squalor, traffic congestion, and high levels of insecurity. Why does this happen? An exhaustive study published by the World Bank last year offers some explanations.[4] According to the authors, Africa's cities suffer from poor spatial organisation that raises the costs of both living and doing business – and, as a consequence, businesses remain 'trapped' in low-value-added, non-tradable economic activities. In a word, African cities are not 'economically dense' and hence fail to benefit from those regional or global growth opportunities which, in other continents, become available to new urban dwellers.

[4] See *Africa's cities: opening doors to the world* published by the World Bank in 2017.

How can these problems be remedied? If, as the report's authors suggest, they can be traced to poor spatial organisation, lack of proper urban infrastructure and excessive costs, it would appear that those policies which encourage higher investment in both physical capital (including public infrastructure) and human capital, which lower the costs and risks associated with doing business, and which allow economies of scale should take priority. Facilitating access to networks, in particular information technology (IT) networks (including the roll-out of broadband access to individual homes and small businesses), will need to receive special attention.

While all layers of government will have to be involved in the reforms that facilitate the economic growth of cities, it is the municipal authorities that should be at the forefront of spatial development, the provision of infrastructure, and educational or social cohesion programmes. This stresses the need for African municipalities to create the necessary fiscal space for the provision of such services – and highlights, in turn, the crucial role that both fiscal and monetary policy can play in facilitating economic and urban development, which I will elaborate on shortly. While not the focus of our interaction today, we should not neglect the development challenges that rural areas face, which also deserve attention. Appropriately designed and targeted policies for rural development are similarly important.

Potentially, a more challenging external environment

First, though, let me discuss how the global outlook is likely to influence Africa's economic and policy framework in the next few years.

At present, as I have indicated earlier, most official and private forecasters appear confident of a moderate acceleration in economic growth in the coming two to three years. However, several 'warning bells' suggest that the unusually benign environment that the world faced in late 2017 – with a combination of upside growth surprises in most of the major economies, supportive global financial conditions, moderately rising commodity prices, and low financial market volatility – has already started to fade.

First, global economic growth is becoming less synchronised. While the US economy registered strong growth of 4.1%[5] in the second quarter of 2018, buoyed by fiscal stimulus and a continued strong performance of the labour market, activity in the eurozone and Japan failed to return to the surprisingly strong pace seen late last year, despite the rebound from a poor, weather-affected first quarter. High-frequency confidence indicators confirm that shift to a slower, albeit still-dynamic, pace of growth.

In the eurozone, the political risks which most market participants thought had faded have, to some extent, come back after this year's Italian election. In the United Kingdom, the elevated uncertainties around the Brexit process seem to be weighing on corporate investment decisions. In China, activity lost some momentum in the first half of the year amid lesser fiscal support and tighter financial regulation, and while Chinese authorities now seem more willing to relax the policy stance somewhat, the potential conflict between ensuring a stable growth path and allowing highly leveraged sectors to reduce debt will continue to pose some risks to growth in the years to come.

Second, growing trade tensions – not just between the US and China, but also between the former and other key trading partners such as the European Union, Canada and Mexico – have the potential to undermine global expansion. So far, it is too early to tell whether the selected imposition of tariffs has had an impact on trade flows. However, survey evidence already suggests that businesses are becoming more circumspect in investing and hiring, especially in those sectors that rely on international demand. And while sub-Saharan Africa is not directly involved in the present trade conflicts – in large part because it is not a strong direct competitor to US manufacturing producers, and also because its countries do not run large bilateral surpluses with the US – the region would still be vulnerable to a structural shift in global trade growth, as are most small economies with limited internal markets that rely in part on exports for development. Greater restrictions to global trade would also limit the ability of African countries to become more integrated in global value chains, and hence gradually reduce their dependence on commodity exports – which remains a source of vulnerability.

[5] Seasonally adjusted, annualised

Third, the current global financial conditions are not as loose as they were at the start of the year. Following a strong performance in the latter part of 2017, most of the major equity markets are down from their January 2018 peaks, and dividend yields have increased. At the same time, while benchmark government bond yields remain quite stable despite the higher US policy rates, investment-grade corporate bond spreads in the US and some of the other advanced economies have widened from the early-year levels, as have emerging-market sovereign spreads. While this move remains muted for the time being, and while measures of market volatility like the widely watched Chicago Board Options Exchange Volatility Index (VIX) index are still at low levels, its impact on emerging-market financing is being compounded by US dollar appreciation, with the US Federal Reserve's broad trade-weighted dollar index up by 3.8% from the start of the year.

Tighter global financial conditions can be a particular challenge for those sub-Saharan African countries which have relied on private offshore investors, and especially Eurobond investors, to finance their 'twin deficits' in recent years. In 2017, following a period of declining investor appetite for 'frontier markets', African Eurodollar bond issuance rose to US$7.9 billion[6], second only to the record of US$8.5 billion in 2014. The trend gathered pace in the first seven months of 2018, with no fewer than six African sovereigns tapping the market for a combined amount of US$13 billion. However, sovereign Eurobond spreads have widened again since March 2018, and while they remain relatively low by recent historical standards, African sovereigns may find it harder, or at least more costly, to cover their external funding needs if global risk aversion rises significantly further.

What should the policy response be?

It would therefore appear that sub-Saharan African countries cannot solely rely on external dynamics to shift to a higher, more durable pace of growth. Domestic policies will have to play an important part too. However, as I have already discussed, the room for manoeuvre for fiscal policy has become very limited. While the debt-to-GDP ratios have not reached crippling levels yet, countries in the region will want to avoid a repeat of the over indebtedness of the 1970s and 1980s, which had forced many of them into

[6] This is equivalent to 0.5% of sub-Saharan Africa's GDP.

socially and economically painful adjustment programmes. It is more likely that the challenges for fiscal policymakers in the coming years will be of a structural nature, such as broadening the tax base and improving taxpayers' compliance, reducing fiscal revenue dependency on natural resources, and re-prioritizing expenditure away from wasteful, inefficient interventions.

But can monetary policy step in and provide support? Before attempting to answer this question, I would first like to stress what monetary policy cannot do – and that is: run an overly stimulative stance for a prolonged period of time in the hope of engineering a sustained pickup in growth. Such an approach would only result in excess demand, and as it could not be met by the domestic supply of goods and services, it would only generate inflation, external imbalances and, in the end, an economic crisis. Of course, in recent quarters, lower inflation in many African countries has allowed central banks to reduce interest rates. However, history shows that inflation can pick up quickly again. In fact, the average volatility of inflation in the region's countries is rather high by international standards, owing in part to the large weight of volatile items like food and fuel in consumer price index baskets.

This suggests that the central banks in the region need to further focus on reducing both the volatility and the average level of inflation, the latter also remaining high by global standards. Such an approach is likely to prove beneficial to long-term growth: in the IMF report cited earlier, the authors estimate that a durable reduction in inflation can increase the expected length of a 'growth spell' by up to 5.5 years. Intuitively, one can understand how a greater anchoring of price expectations can reduce uncertainties for decision-makers and savers alike, how it can reduce the risk premium required by investors in both financial assets and the real economy, how it can help develop financial instruments available for development, and how it can lead to more stable employer-labour relations.

Looking at the South African experience

Can anything be learnt from the South African experience in that respect? Some of the constraints I reflected on earlier – of poor spatial development, inadequate infrastructure provision, and barriers to entry for emerging entrepreneurs – have presented major challenges for South Africa and its major metropolitan areas. In fact,

in addition to the ‘normal’ issues faced by an emerging economy, our country has also had to deal with the legacies of the apartheid system which had, for decades, and for political reasons, contributed to raising these constraints. South Africa’s post-1994 democratically elected government thus had to place particular emphasis on the alleviation of spatial and infrastructure constraints in the previously disadvantaged areas.

South Africa has registered tangible progress in many areas, including electrification, water and sanitation, mobile telephony or Internet access, health and literacy improvement. To give a few examples, the share of households with access to electricity rose from 64% in 1984 to 84% by 2016. Similarly, between 2000 and 2016, cell phone subscriptions jumped from 18 to 147 per 100 people.

However, progress in these development indicators has slowed – and in some cases stalled – over the past decade, as a structural slowdown in economic growth has undermined private investment in future productive capacities and has reduced (together with a sub-optimal allocation of resources) fiscal space for the roll-out of better infrastructure, education and health facilities. One cannot deny that recent economic growth in South Africa, which averaged only 1.5% over the past five years, is far too low to deal with the country’s long-lasting problems of high unemployment, poverty and inequality.

The answer to these growth challenges often lies in structural, long-term policy approaches. Clearly, many of these are outside the remit of monetary policy. Nonetheless, for the past few decades, the South African Reserve Bank (SARB) has strived to ensure a more stable monetary and financial environment, so as to facilitate the attainment of longer-term growth and development goals.

Following decades of high and volatile inflation, the adoption in the early 2000s of a 3-6% inflation target has allowed, first, the sustained decline of consumer price gains into single-digit territory, and then, over time, increased compliance with price stability goals. Inflation expectations have also become better anchored over the years, albeit at levels that are still uncomfortably close to the upper end of the target range.

Over time, not just inflation but also economic growth and, importantly, policy rates as set by the SARB have become less volatile, while greater transparency of monetary-policy decisions – including, in recent times, the publication of the SARB's macroeconomic projections – has increased policy predictability. A more stable monetary environment has also contributed to the soundness of the banking system, the liquidity of financial markets, and the ability of government to lengthen the maturity of its liabilities.

Conclusions

To conclude, let me say that the challenges being faced by the continent, and in particular by its cities, are real – and that policy answers cannot be deferred. Africa's population is growing, and within the next few decades, a growing share of that population will be migrating towards its already-large urban areas. Infrastructure, education and network development needs will continue to grow.

The answer to these inevitable challenges does not just lie in betting on a strong global environment, even if Africa's increased integration into the world economy will bring benefits. The answer also lies in an appropriate policy environment underpinned by strong political will. And, perhaps more than ever, sound fiscal and monetary policies form a crucial part of that framework.

Thank you.