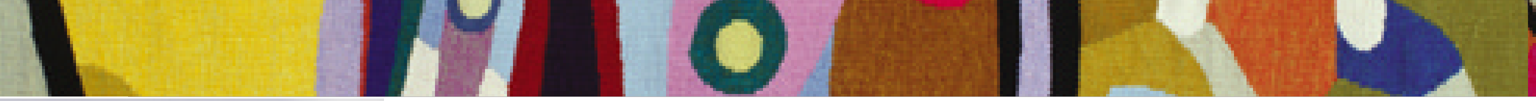

# Impact of the Asian Crisis on Sub-Saharan Africa

Most sub-Saharan African countries have been largely unaffected by the Asian crisis. What accounts for this relatively favorable outcome, and what steps should these countries consider taking to reduce poverty and increase economic growth in a more uncertain global environment?

*Elliott Harris*

THE FINANCIAL upheaval that first hit several Asian countries in mid-1997 and then spread rapidly to other countries to become an international financial crisis has had a profound effect on many emerging market countries. Massive outflows of short-term capital from Asian countries put their currencies under intense pressure and led to sharp exchange rate depreciations. Since their banks were heavily exposed to exchange risk through large short-term borrowing in foreign currency, their financial sectors also suffered serious setbacks. These reverses combined to drive their economies deep into recession, from which a few of them are only now beginning to emerge.

The abrupt contractions in the countries whose economies were directly affected and the reduction in overall world demand have contributed to a sharp decline in international commodity prices and exacerbated the softness in the prices of petroleum products, which have fallen by some 30 percent over the past 12 months. South Africa is the only country in sub-Saharan Africa that has been significantly affected by the international crisis through financial channels. The impact of the crisis on other countries in the region has been primarily through terms of trade shocks. For all but the oil-exporting countries among them, however, the net impact of the recent commodity price declines has been relatively small. What explains sub-Saharan African countries' relative good fortune in the midst of this general downturn, and what implications does this have for their policy agendas in the years to come?

## East Asian and African experiences

The impressive achievements of many East Asian countries over the past thirty years in terms of growth and poverty reduction have been due, at least in part, to their success in liberalizing their economies and integrating them into global markets for goods, services, and capital. They were less successful, however, in addressing certain structural weaknesses, such as inadequate financial sector regulation and prudential supervision, a lack of transparency in government and corporate affairs, and a paucity of reliable and timely economic information—particularly on private sector activities. These weaknesses, compounded in some countries by inappropriate exchange rate policies, deepened the crisis of investor confidence that grew out of rising fiscal and current account deficits. The very openness of these countries to short-term capital inflows made them particularly vulnerable to the abrupt outflows that resulted from loss of confidence.

African countries may well have escaped the worst of the financial crisis *because* they have lagged behind other regions in opening their markets to world trade and, in particular, to private capital flows. Financial markets in most sub-Saharan African countries are still largely embryonic, and many of their banking systems are just emerging from a prolonged period of crisis. Owing to underlying economic weakness and the persistence of capital controls, most countries have not been able to attract significant amounts of private capital. Moreover, they have very little private external debt, and most of their public debt is long term, so they have little exposure of the sort that proved so damaging to some of the East Asian economies. The constellation of factors that contributed to the banking crisis in Asia was thus not present in Africa, despite the weakness of the latter's banking systems. Finally, although African countries still suffer from the same structural shortcomings mentioned previously for East Asia, many have registered significant improvements in their macroeconomic fundamentals—including their exchange and interest rate policies—over the past five years.

## Impact on sub-Saharan Africa

In October 1998, the IMF's African Department carried out a quantitative evaluation of the *direct* effects of commodity price changes as well as other effects of the world crisis on the projections for 1998 for real GDP growth, real income, overall fiscal balance, external current account balance, and terms of trade of sub-Saharan African countries. Indirect or secondary effects—such as shifts in domestic demand induced by crisis-related changes in real income—were not explicitly considered. This exercise distinguished among changes in the macroeconomic variables owing to the decline in petroleum prices, changes in other commodity prices, and other effects of the crisis, in order to illustrate the sharp contrast between the large negative impact of the crisis on the oil-exporting countries and the much more modest effects on the other countries.

### Sub-Saharan Africa

**Effects of the world crisis and commodity price changes, 1998**

| | Effect of changes in oil price | Effect of changes in non-oil commodity prices | Other effects of the crisis | Tofal effects of the crisis |
|---|---|---|---|---|
| | | (percent) | | |
| Real GDP growth | | | | |
| Sub-Saharan Africa | 0.0 | –0.1 | –0.3 | –0.3 |
| Oil-exporting countries | –0.3 | –0.0 | –0.2 | –0.5 |
| Oil-importing countries | 0.2 | –0.1 | –0.3 | –0.3 |
| Real income effect | | | | |
| Sub-Saharan Africa | –1.7 | –0.2 | –0.2 | –2.1 |
| Oil-exporting countries | –7.1 | –0.1 | –0.0 | –7.2 |
| Oil-importing countries | 0.4 | –0.2 | –0.3 | –0.1 |
| External current account | | (change in percent of GDP) | | |
| Sub-Saharan Africa | –2.6 | –0.1 | 0.1 | –2.6 |
| Oil-exporting countries | –10.3 | –0.1 | –0.1 | –10.5 |
| Oil-importing countries | 0.5 | –0.2 | 0.2 | 0.5 |
| Overall fiscal balance | | | | |
| Sub-Saharan Africa | –1.9 | 0.0 | –0.1 | –2.0 |
| Oil-exporting countries | –6.9 | –0.1 | –0.0 | –6.9 |
| Oil-importing countries | 0.0 | 0.0 | –0.1 | –0.1 |
| Terms of trade index | | (percentage change) | | |
| Sub-Saharan Africa | –7.4 | –0.5 | 0.2 | –7.7 |
| Oil-exporting countries | –28.4 | –0.6 | 0.0 | –29.0 |
| Oil-importing countries | 0.9 | –0.5 | 0.3 | 0.7 |

Source: IMF African Department.

Note: Including all countries south of the Sahara except Djibouti, Mauritania, and Somalia. The results have been rounded up to the nearest decimal point. Figures showing 0.0 do not necessarily have the value zero.

***Overall assessment.*** The impact of the commodity price declines and other effects of the crisis on sub-Saharan African countries is summarized in the table. Compared with the baseline projections for 1998 prepared for the IMF's October 1997 World Economic Outlook exercise, real GDP growth is roughly a third of a percentage point lower and real income growth is 2.1 percentage points lower. The external current account deficit widens by 2.5 percentage points to 5.8 percent of purchasing-power-parity-based GDP ($14.7 billion), while the overall fiscal deficit increases from 2.5 percent to 4.5 percent of GDP. Finally, the terms of trade deteriorate by 7.7 percent, compared with an improvement of 0.7 percent in the above-mentioned baseline projection.

These aggregate results conceal substantial differences between the region's oil-exporting and oil-importing countries. For the oil exporters (Angola, Cameroon, the Republic of Congo, Equatorial Guinea, Gabon, and Nigeria), real GDP growth is reduced by 0.3 percentage point, and real income by 7.2 percentage points; the current account deficit widens by some $7 billion (10.5 percent of GDP); the fiscal balance deteriorates by 7.3 percent of GDP; and the terms of trade worsen by almost 29 percent. By contrast, for the oil-importing countries (that is, all other sub-Saharan countries), the effect on real GDP and real income is slightly positive; the external current account balance improves by 0.5 percentage point of GDP; the overall fiscal balance worsens only marginally; and the terms of trade strengthen somewhat.

## Interpretation of results

Given the rudimentary state of financial markets in most sub-Saharan African countries and the rather limited amounts of private capital flowing into them, the financial contagion from the Asian crisis was effectively limited to South Africa (see below). The primary channel through which the impact of the international crisis has been transmitted to sub-Saharan Africa has thus been the declining prices of key non-oil export commodities, such as cotton, timber, vanilla, sugar, cobalt, aluminum, nickel, tobacco, and gold. In some countries, however, the negative effects of such declines have been mitigated by increases in the prices of other key commodity exports, such as coffee, cocoa, and tea. Moreover, the pass-through of international commodity price developments in 1998 was attenuated in many cases by the use of forward sales contracts, which have helped to compensate for some of the most recent price declines (for example, in cotton). Overall, therefore, the net impact of the changes in non-oil commodity prices on sub-Saharan African countries has been relatively small.

By contrast, the 30 percent decline in petroleum prices has had a marked impact. For the oil-importing countries, the gains from lower petroleum import bills have largely outweighed any losses from other commodity price declines and additional adverse effects of the crisis. As a result, the net impact on oil-importing countries' external current account balances and terms of trade has been positive. For the oil-exporting countries, however, the sharp decline in export revenues and fiscal receipts has been further exacerbated by the impact of other commodity price changes and, in some cases, by a contraction in the demand for other major exports.

Other effects of the crisis have been relatively minor for the majority of sub-Saharan countries, because few of them have major export markets in Asia (for example, in 1997, the value of sub-Saharan Africa's trade with all European Union countries was more than four times greater than its trade with Asian countries). In some areas, however, the crisis has left its mark. Difficulties experienced by some Asian textile producers in securing lines of credit have led, in some cases, to delays in completing export contracts with sub-Saharan producers of cotton. Asian demand for African hardwoods has decreased noticeably, directly affecting the world demand for hardwoods (from, for example, Cameroon, the Central African Republic, Equatorial Guinea, Gabon, and Mozambique). A further effect of the Asian crisis has been a weakening of world demand for diamonds, of which Asia accounts for about one-third, that has led to a self-imposed quota on African production that was expected to reduce diamond exports from Botswana, the Democratic Republic of Congo, Namibia, and South Africa by 5–6 percent in 1998.

**SOUTH AFRICA IS THE ONLY COUNTRY IN SUB-SAHARAN AFRICA THAT WAS FULLY EXPOSED TO CONTAGION FROM THE WORLD FINANCIAL CRISIS.**

## The special case of South Africa

South Africa is the only country in sub-Saharan Africa with sophisticated financial markets and substantial private capital inflows, and thus it was the only one fully exposed to contagion from the world financial crisis. The weakening of investor confidence in May 1998 and the ensuing downward pressure on the rand was exacerbated by the authorities' large-scale intervention in the foreign exchange market and the uneven stance of monetary policy. As a result, by July the rand had depreciated by 14 percent against the dollar, bond yields had risen sharply, and equity prices had declined. Since July, however, monetary policy has been tighter, and the authorities have refrained from further intervention in the foreign exchange market. By September 1998, the rand had appreciated by some 10 percent from the all-time low it reached in the last week of August, bond prices had rebounded significantly, and equity prices had stabilized.

Significantly higher interest rates, lower economic growth in partner countries, and a drying up of capital flows have all contributed to a weakening of growth in South Africa—a decline of 0.6 percentage point in the projected growth rate for 1998 was directly attributable to the world crisis. By contrast, the current account balance is expected to improve somewhat, owing to lower oil prices and favorable terms of trade developments (excluding gold), and this favorable trend should continue, given the impact of the currency depreciation and substantially higher interest rates on aggregate demand.

## How should African countries react?

The overall negative net impact of the crisis on external current account projections for 1998 is estimated to have ranged between 1.0 and 2.5 percentage points of GDP for nine oil-importing countries in sub-Saharan Africa, but to have been considerably smaller (or, in some cases, even positive) for all the other countries in this group. Only four oil-importing countries are estimated to have suffered negative fiscal effects greater than 0.2 percentage point of GDP. The majority of oil-importing countries should thus be able to absorb the effects of the international crisis in 1998 by undertaking relatively manageable budgetary adjustments combined with some drawdowns of international reserves or by increasing domestic and external deficit financing. The process of macroeconomic adjustment, fiscal consolidation, and structural reform that has been under way for several years in many of these countries is thus unlikely to be derailed.

By contrast, the 30 percent plunge in oil prices since late 1997 means that the oil exporters face deteriorations in their current account balances ranging between 10 and 25 percent of nominal GDP, with the single exception of Cameroon, which has a more diversified export structure. The loss of fiscal revenue is a mere 1 percent of GDP in Cameroon and Gabon, but reaches as high as 10 percent of GDP in Angola. Moreover, prevailing world market conditions make it unlikely that oil prices will return to their former levels in the foreseeable future. The oil-exporting countries therefore face the need for considerable domestic adjustment, since additional recourse to financing would be inappropriate and would increase their already excessive external debts.

The oil-producing countries of the CFA franc zone—Cameroon, the Republic of Congo, and Gabon—share a common currency and, increasingly, a common trade policy stance with other countries in the zone. They therefore can neither depreciate their currencies nor make independent use of traditional expenditure-switching tools, such as tariffs, quotas, or export subsidies. The bulk of the necessary adjustment will thus have to be accomplished through fiscal adjustment—by increasing tax revenues, primarily by expanding the tax base, and cutting government spending—and further tightening of domestic monetary conditions. Running down their reserves poses less of a danger to the oil-exporting CFA countries, which pool their international reserves. For other sub-Saharan oil exporters, the mix of policies used to achieve adjustment could be more flexible, although some exchange rate depreciation may be necessary to avoid too great a rundown of their international reserves or to lessen the contractionary impact of restrictive monetary policies. Nonetheless, in these countries, too, considerable fiscal tightening is likely to be unavoidable.

The IMF-supported adjustment programs in place in many sub-Saharan African countries have been negotiated rather recently, and new annual arrangements with the IMF will soon be concluded in others. Consequently, the most recent projections for commodity prices, as well as any other direct or indirect effects of the crisis, have either already been, or soon will be, taken into account in the design of the programs. The relatively small negative impact of the crisis can in all likelihood be absorbed in existing programs through a combination of higher domestic bank financing, some easing of targets for international reserves and fiscal balances, and—if necessary—some additional external financing. When programs do not exist, the IMF stands ready to assist countries—both in designing the necessary adjustment policies and, where appropriate, by providing financial assistance in the context of IMF-supported programs—to facilitate the adjustment process.

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## Conclusion

Although sub-Saharan African countries' relatively limited integration into the global economy may have shielded them from the full force of the international crisis, their current situation is not sustainable. They need to attract private capital flows, in order to supplement their low rates of domestic saving and to finance much higher rates of investment, if they are to emulate Asian countries' performances in accelerating growth and reducing poverty within an acceptably short time frame. The recent international crisis, however, has demonstrated some of the risks involved in globalization and shown that liberalization must be accompanied by due attention to macroeconomic fundamentals, financial sector solidity, and good governance. When sub-Saharan African countries implement the necessary policies, heeding these lessons should enable them to avoid making some of the mistakes made by countries in other regions and to maximize the benefits they derive from globalization. F&D