Time for a Policy Reset

Sub-Saharan Africa's economies face severe strains and must take action to reignite sustainable growth

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OVER the past few years, I have been heartened by the progress on the ground in sub-Saharan Africa. Along with the extended period of strong economic growth of the past 15 years came improvements in health indicators and standards of living. Now that the region's economy has entered a rough patch, there is a risk that the progress that has reached so many will stall. A confluence of external and domestic factors is exerting severe strain on many countries, including the largest ones. So to reignite the engine of sustainable growth that has propelled the region in the recent past and secure favorable medium-term prospects, governments must implement a strong policy reset.

The pace of economic expansion in the region declined to 3½ percent in 2015, the slowest in some 15 years. The growth outlook varies greatly across countries in the region, but the IMF projects overall growth to slow further this year to 3 percent—well below the 6 percent or so observed over the past decade, and barely above population growth. Indeed, GDP per capita growth will be under 1 percent for two years in a row for the first time since the late 1990s.

World of multiple shocks

The slowdown reflects the adverse impact of the commodity price slump on some of the larger economies, tighter financing conditions, and, more recently, the drought in eastern and southern Africa.

The sharp decline in commodity prices in recent years has severely strained many of the largest sub-Saharan African economies. While oil prices have recovered somewhat since the beginning of 2016, they are still some 60 percent below their 2013 peak levels, a shock of unprecedented magnitude. As a result, oil exporters such as Nigeria and Angola, as well as most countries in the Economic Community of Central African States, continue to face particularly difficult economic conditions.

Growth will slow further for the region's oil exporters in 2016, to 2¼ percent, from as high as 6 percent in 2014, according to IMF projections. For example, growth in Angola will likely be slowed by limited foreign exchange supply and lower public spending. Similarly, in Nigeria, economic activity is constrained by the lower oil prices and compounded by disruptions to private sector activity through exchange rate restrictions. Unfortunately, nonenergy commodity exporters, such as Ghana, South Africa, and Zambia, have also been hurt by the decline in commodity prices.

The shift in the sources of China's growth—from resource-intensive investment and exports to more domestically driven growth—is certainly playing a role in the slowdown experienced by many countries in the region. During the 2000s, China became the region's single largest trade partner, and African countries have enjoyed a healthy trade surplus with that country, especially since the global financial crisis. With the slump in commodity prices, this has changed dramatically, and the trade balance has recently turned negative. These trends are likely to continue to limit growth over the medium term.

For most of the region's frontier markets, external financing conditions have tightened substantially compared with those before mid-2014, when markets enjoyed ample access to global liquidity. At the same time, some forms of capital flows to the region—notably, cross-border bank loans, relied on by more than just frontier markets—have declined significantly.

And on top of all this, several southern and eastern African countries are suffering from a severe drought that is putting millions of people at risk of food insecurity. The drought will probably dampen growth in a number of countries, including Ethiopia, Malawi, and Zambia, and food inflation is accelerating in many countries. Humanitarian needs are putting additional strain on the budgetary and external positions of many of the affected countries. The impact of the drought varies across countries, but whenever food security is precarious, there are severe human costs. And this already tragic situation could still get a lot worse; a shocking 40 to 50 million people are likely to be food insecure by the end of 2016.

Strong potential

This confluence of factors is exerting serious headwinds. But does this mean that the region's growth momentum has stalled? I don't think so—for several reasons.

First, the overall weak picture masks, as usual, widely varying circumstances—not surprising, given that the region is home to 45 very diverse countries. Many countries across the region, notably those with the lowest income, continue to register robust growth. Most oil importers are generally faring better, with growth over 5 percent, often supported by ongoing infrastructure investment and strong private consumption. For instance, growth in Kenya is projected to rise to 6 percent in 2016, aided by investment in the transportation sector, a pickup in electricity production, and a rebound in tourism. Similarly, Senegal is expected to see continued strong growth at 6½ percent, supported by improving agricultural productivity and a dynamic private sector. In Côte d'Ivoire, high cocoa prices and good agricultural production, as well as an anticipated boost in investment following the recent presidential election, should drive growth to 8½ percent this year. In some other countries, such as the Central African Republic, growth prospects are now rebounding from severe shocks or with the attenuation of conflict. And the decline in oil prices has benefited many of these countries, though the drop in other commodity prices and currency depreciations have partly offset the gains.

More broadly, the region's medium-term growth prospects continue to be favorable. True, the near-term outlook for many sub-Saharan African countries remains difficult and clouded by risks. But generally the underlying domestic drivers of growth over the past decade or so still persist. In particular, the much improved business environment and favorable demographics are likely to play an important role in supporting growth in the coming decades.

Pressing the reset button

While the region's growth potential remains strong, the current slowdown highlights that the region is not immune to the multiple transitions afoot in the global economy. As a result, to reap the region's strong potential, a significant policy reset is critical in many cases. Such a reset is particularly urgent in two groups of countries—the region's commodity exporters and countries with access to international capital markets.

For natural resource exporters, a robust and prompt shift in policy response is needed given the prospect of an extended period of sharply lower commodity prices. To date, commodity exporters—particularly oil exporters—have generally responded hesitantly and insufficiently to the historically large terms-of-trade decline they are experiencing. Faced now with rapidly depleting fiscal and foreign reserves and constrained financing, they must respond quickly and strongly to prevent a disorderly adjustment and to lay the groundwork for a quicker, durable, and inclusive economic recovery.

For countries that are not part of a monetary union, exchange rate flexibility should be part of the first line of defense against commodity price declines, as part of a broader macroeconomic policy package. Because the fall in revenues from the extractive sector will likely be long lived, many affected countries also must contain fiscal deficits and build a sustainable tax base from the rest of the economy. In their consolidation efforts, countries should aim to preserve priority spending, such as social expenditures and growth-friendly capital investments, also with a view to maintaining their longer-term development goals.

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Driven by the favorable external financing environment of recent years, fiscal and external current account deficits have grown substantially in many of the region's frontier markets, as they sought to strengthen their weak infrastructure, including roads, railways, and electricity and water networks. Now that external financing is much tighter, these countries will need to reduce their fiscal deficits—depending on the country's circumstances—either by better prioritizing spending or by boosting tax revenues. That will help these countries rebuild cushions against possible worsening of external conditions.

Indeed, the current challenges sub-Saharan Africa faces are a sobering reminder of the need to strengthen resilience against external shocks. Structural measures, such as enhancing the business climate and improving the quality of public investment, would nurture the private sector and help diversify the export base and sources of growth and jobs beyond commodities. In addition, further developing the region's financial sector, including by strengthening legal frameworks and corporate governance, could also help.

Now is the time to reset policies to address current challenges and ensure the resumption of Africa's strong rising path. The required measures may cause a short-term slowdown in growth, but they will prevent the risk of crises if action is not taken promptly. With that, I believe countries in the region will be well positioned to reap their substantial economic potential. ■