

1. Restoring the Conditions for Strong and Sustainable Growth

The sub-Saharan African economic outlook remains clouded. Growth slowed sharply in 2016, averaging 1.4 percent, the lowest in two decades. About two-thirds of the countries in the region, together accounting for 83 percent of the region's GDP, slowed down—although some countries still continued to expand strongly. A modest rebound in growth to 2.6 percent is expected in 2017, but even that rebound will be to a large extent driven by one-off factors in the three largest countries—a recovery in oil production in Nigeria, higher public spending ahead of the elections in Angola, and the fading of drought effects in South Africa, combined in all three countries with modest improvements in the terms of trade. At this rate, growth for the region as a whole will continue to fall well short of past trends and barely deliver any per capita gains.

Unfortunately, this deteriorated outlook is partly a result of delayed and still limited policy adjustments, with an ensuing increase in public debt, declining international reserves, and pressures on financial systems placing stress on private sector activity:

- The countries hardest hit by the oil price shock (Angola, Nigeria, and the countries of the Central African Economic and Monetary Community, CEMAC) are still struggling to deal with the unusually large terms-of-trade shock and implied budgetary revenue losses. The pains from this shock continue to do damage to these economies, with the risk of generating even deeper difficulties both within and across borders if unaddressed. Some other commodity exporters, such as Ghana, Zambia, and Zimbabwe, are also grappling with larger fiscal deficits in a context of already high debt levels and concerns about growth.
- Elsewhere, nonresource-intensive countries, such as Côte d'Ivoire, Kenya, and Senegal,

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have generally maintained high growth rates. However, while budget deficits have remained elevated for a number of years as governments rightly sought to address social and infrastructure gaps, vulnerabilities are now starting to emerge in some of these countries. In particular, public debt is on the rise, and reliance on domestic financing as foreign financing declined, has increased borrowing costs. In some cases, arrears are emerging and nonperforming loans in the banking sector are increasing, even in a context of strong growth.

Furthermore, on the external front, the somewhat improved global outlook comes with significant uncertainties and downside risks. External financial conditions for frontier economies in the region have loosened from the peaks reached in early 2016, but they still remain tighter than conditions for emerging markets in the rest of the world. They could rapidly tighten further against the backdrop of fiscal policy easing and monetary policy normalization in the United States. A faster-than-expected pace of interest rate hikes in the United States could also trigger a more rapid tightening in global financial conditions and a sharp U.S. dollar appreciation.

Importantly, even the recent increase in commodity prices is not expected to provide much relief. Oil prices have recovered somewhat from the trough reached in early 2016, but they are still far below the average price in 2011–13, and are not expected to recover much further. More broadly, even if improvements in commodity prices provide welcome breathing space, they will not be enough to address the current liquidity stress and the large imbalances in the resource-intensive countries.

Additional policy actions are therefore urgently needed to address growing imbalances and ensure macroeconomic stability—both to restore the conditions for strong and sustainable growth in resource-intensive countries and to preserve the existing momentum elsewhere.

- For the hardest-hit resource-intensive countries, fiscal consolidation remains urgent to halt the sharp decline in international reserves and offset revenue losses that the recent firming up of commodity prices will not erase. This is especially the case in CEMAC, where fiscal measures should be complemented by binding limits on central bank financing to governments. In countries where the exchange rate instrument is available (such as Angola and Nigeria), allowing greater exchange rate flexibility, as part of a coherent package of adjustment measures, and lifting exchange rate restrictions would remove distortions that are inflicting serious damage on the real economy. Even if, initially, the required adjustment further dampens activity, additional delays would be even more damaging, risking a sudden stop and ultimately an even sharper adjustment. Additional financing, preferably on concessional terms where appropriate, could usefully complement a credible multi-year plan to restore macroeconomic stability and smooth the impact on overall activity.
- For other countries, reducing emerging vulnerabilities by strengthening fiscal and external buffers should become a priority, lest the current growth momentum comes under threat. While the expansionary fiscal stance has been appropriate so far, with debt and borrowing costs rising, now is the time to shift the fiscal stance toward gradual fiscal consolidation. Delaying this shift would raise the risk of a rapid slowdown in growth down the road. Notably, for the fast-growing West African Economic and Monetary Union (WAEMU) countries, implementation of planned fiscal consolidation at the country level and better policy coordination at the monetary union level are important to preserve external stability. Likewise, fast-growing countries in East Africa need to ensure that the scaling up of public investment, which has led to rapidly rising debt, is steadily trimmed to normal levels consistent with continued fiscal and external sustainability.

While restoring macroeconomic stability is a prerequisite, this rebalancing will only be durable and protect the gains made in the past if further

efforts are simultaneously made to boost domestic revenue mobilization, address structural weaknesses, and provide a social safety net well targeted to the most vulnerable segments of the population. Those efforts would also contribute to making progress toward the authorities' Sustainable Development Goals (SDGs) adopted just two years ago.

The rest of Chapter 1 first documents the increased uncertainty surrounding the global environment and discusses the extent and quality of policy adjustments made to date in the region. It then highlights the implications for private sector activity, including for the financial sector, which is increasingly feeling the pinch from decelerating growth and inappropriate macroeconomic policies. The chapter then discusses the growth outlook and near-term risks. A final section focuses on policies that would foster a stronger recovery.

Chapter 2 sheds further light on how to revive economic activity by looking at the region's experience with growth turning points, examining the extent to which they have led to episodes of durable growth, and identifying factors that have fostered such an environment. Achieving durable and inclusive growth also means bringing everyone on board, and Chapter 3 discusses this through a close evaluation of informality in the region. The analysis recognizes that for the foreseeable future, the informal sector will continue to provide an important pool of jobs for the large and rising sub-Saharan African working-age population. At the same time, by lifting the impediments to the development of formal activities, policymakers can gradually find ways to tap the region's large unexploited growth potential hidden in mostly lower-productivity informal activities.

LIMITED ROOM FOR MANEUVER

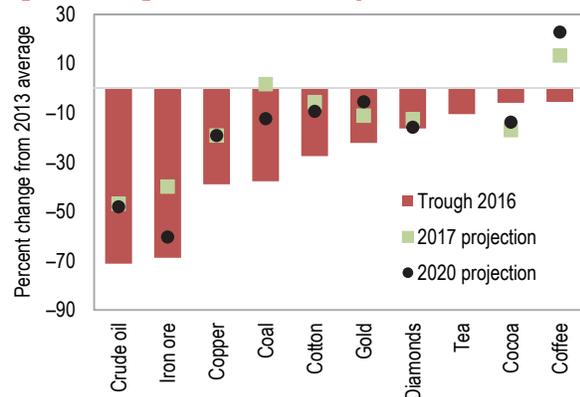
Mixed signals from the global environment...

The global economic outlook has improved somewhat since the October 2016 *Regional Economic Outlook*. The end of 2016 and early 2017 signaled an uptick in global growth, especially in advanced economies. In addition, China's growth was still strong reflecting continued policy support. But overall, global growth remained modest at 3.1 percent in 2016 (see the April

2017 *World Economic Outlook*). While the overall forecast, ticking up to 3.5 percent in 2017, is expected to be boosted by anticipated fiscal policy easing in the United States and continued strong growth in China, these developments will have mixed implications for the region, as also discussed in Chapter 2 of the April 2017 *World Economic Outlook*:

- On the heels of the slightly improved outlook, in particular for China, and of the deal by the Organization of Petroleum Exporting Countries to cut oil production, commodity prices have picked up from low levels. However, they remain far below the 2013 peaks. Furthermore, they are not expected to change much over the medium term since deeper trends continue to be at play, including China’s rebalancing of its growth model from investment to less-commodity-intensive consumption (Figure 1.1).
- While external financial conditions have loosened from the peaks reached about a year ago, financing costs for frontier economies in the region remain higher than for other emerging markets. They could rapidly tighten further against the backdrop of fiscal policy easing and monetary policy normalization in the United States (Figure 1.2). In this context, issuance episodes at much higher yields since early 2016 remind us that countries with delayed adjustments should expect to continue to face higher borrowing costs.

Figure 1.1. Change in Selected Commodity Prices since 2013



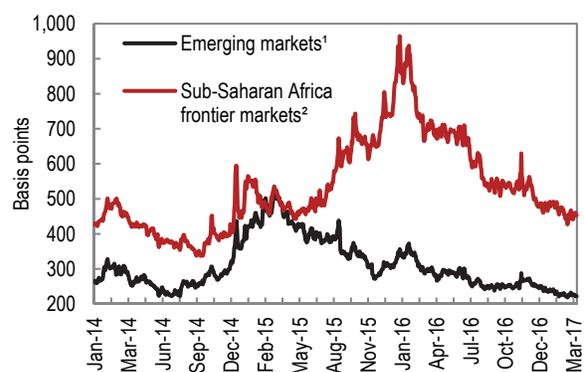
Sources: IMF, Commodity Price System; and IMF Global Assumptions. Note: Besides oil, some of the main export commodities in the region are copper (Democratic Republic of Congo and Zambia), iron ore (Liberia and Sierra Leone), coal (Mozambique and South Africa), gold (Burkina Faso, Ghana, Mali, South Africa, and Tanzania), and platinum (South Africa).

...while 2016 was already a difficult year for sub-Saharan Africa

Meanwhile, sub-Saharan Africa started 2017 from a weak position. Activity decelerated markedly in 2016, with growth estimated to have reached only 1.4 percent (Figure 1.3). The deceleration was broad-based, with about two-thirds of the countries—accounting for 83 percent of the region’s GDP—growing more slowly than in 2015, although to different degrees:

- Most oil-exporters were in recession. Economic activity contracted by an estimated 1½ percent in Nigeria, ¾ percent in the CEMAC countries, and as much as 13¾ percent in South Sudan, while Angola’s economy stagnated.
- Conditions in many other resource-intensive countries also remained difficult. Continued political uncertainty (South Africa), weak fundamentals (Ghana), and acute droughts (Lesotho, Malawi, Zambia, and Zimbabwe) compounded the effect of still-weak commodity prices in many countries. However, some other countries continued to grow more robustly, supported by domestic factors such as investment spending and accommodative monetary policy (Burkina Faso, Mali, Niger) and strong mining and services growth (Tanzania).

Figure 1.2. Sub-Saharan Africa Frontier and Emerging Market Spreads, 2014–17



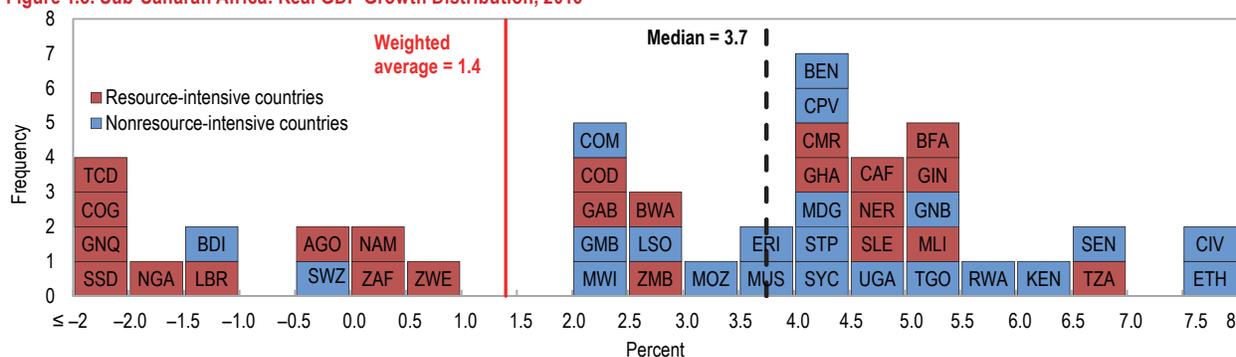
Source: Bloomberg, L.P.

Note: Data as of March 31, 2017.

¹ The emerging market average includes the Emerging Market Bond Index Global (EMBIG) spreads of Argentina, Brazil, Bulgaria, Chile, Colombia, Hungary, Malaysia, Mexico, Peru, Philippines, Poland, Russia, South Africa, Turkey, and Ukraine.

² The frontier market spread includes the spreads of Côte d’Ivoire, Gabon, Ghana, Kenya, Nigeria, Senegal, Tanzania, and Zambia.

Figure 1.3. Sub-Saharan Africa: Real GDP Growth Distribution, 2016



Source: IMF, World Economic Outlook database.
 Note: See page 70 for county groupings and page 72 for country abbreviations.

- Conversely, nonresource-intensive countries, such as Côte d’Ivoire, Ethiopia, Kenya, and Senegal, generally continued to grow robustly, benefiting from strong domestic demand and high levels of public spending, though in some cases, growth eased from 2015.

primary deficit), Cameroon, Gabon, and Nigeria (Figure 1.4), and remaining above 15 percent of GDP in the Republic of Congo, Equatorial Guinea, and South Sudan. The picture was a bit more mixed among other countries, where fiscal balances also worsened in 2016 in about half of the countries, in some cases on the back of increased expenditures (The Gambia, Malawi), but also due to revenue shortfalls (Lesotho, Swaziland, and Zimbabwe).

POLICIES HAVE BEEN EXPANSIONARY

Lagging Fiscal Adjustment

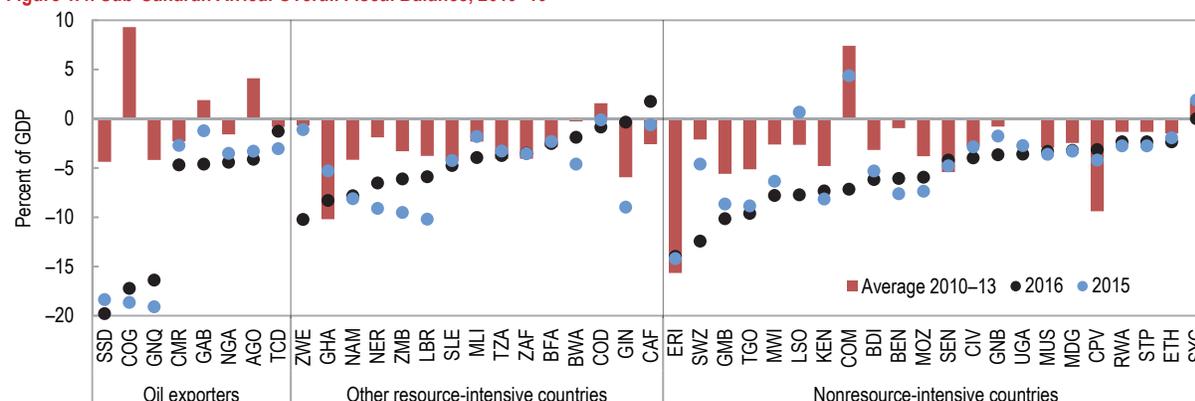
The average fiscal deficit in sub-Saharan Africa continued to widen in 2016, reaching $-4\frac{1}{2}$ percent of GDP following levels of -4.1 percent in 2015 and $-3\frac{1}{2}$ percent in 2014. These developments reflected continued pressures on revenues that were generally not fully offset by expenditure cuts.

While most of the hardest-hit countries did implement some fiscal adjustment, they did not offset the loss in revenue and did not emphasize sufficiently new (noncommodity) sources of revenue (Figure 1.5):

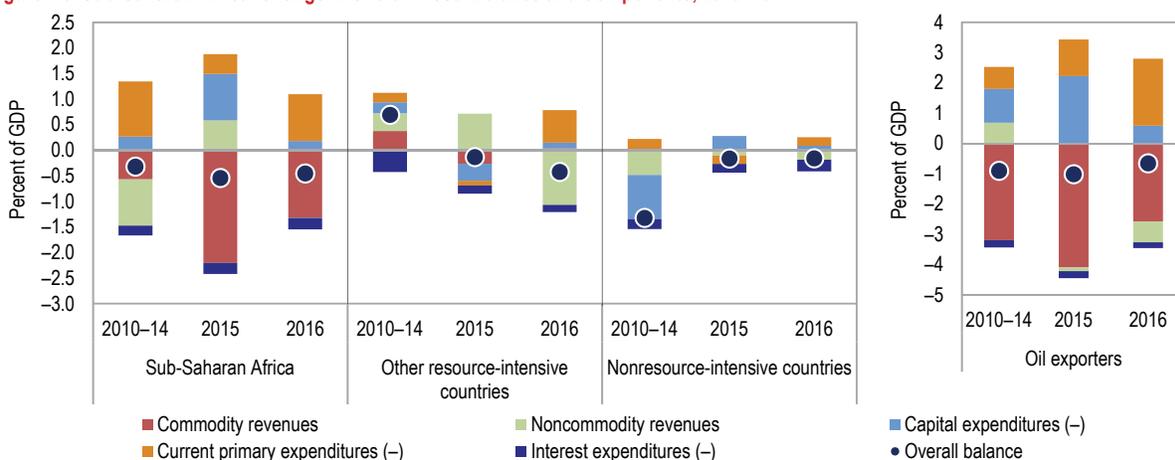
This was most obvious among oil exporters, with the fiscal position further deteriorating in 2016 in Angola (despite adjustment in the non-oil

- To the extent that capital expenditures were already sharply cut in 2015, oil exporters, especially Angola and Nigeria, focused most of their 2016 adjustment (about $2\frac{1}{2}$ percent of GDP) on current spending. However, this

Figure 1.4. Sub-Saharan Africa: Overall Fiscal Balance, 2010–16



Source: IMF, World Economic Outlook, database.
 Note: See page 70 for country groupings and page 72 for country abbreviations.

Figure 1.5. Sub-Saharan Africa: Change in Overall Fiscal Balance and Components, 2010–16

Source: IMF, World Economic Outlook database.

Note: An increase (decrease) in revenue contributes positively (negatively) to the fiscal position. An increase (decrease) in expenditure contributes negatively (positively) to the change in fiscal position. See page 70 for country groupings.

was not sufficient to arrest the deterioration in the fiscal balance, as further losses in oil income were compounded by declining non-oil revenues, reflecting lower economic activity and emphasizing the need for the authorities to accelerate the implementation of their strategies to widen revenue sources.

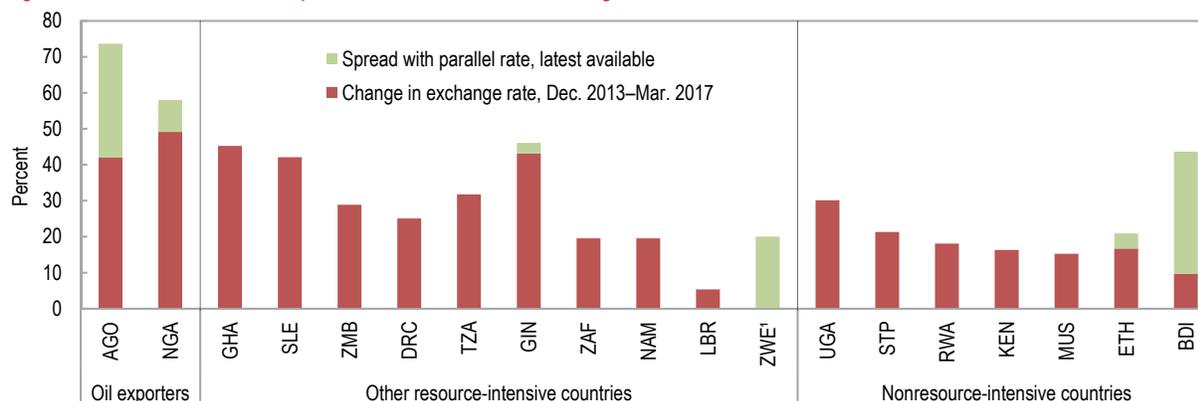
- Fiscal revenue also declined among other resource-intensive countries in a context of weak growth. In response, the authorities cut recurrent spending, and in some cases capital expenditures (Guinea, Namibia, Niger, and Zambia), with only a few countries strengthening revenue collection (for example, by temporarily increasing the value-added tax rate in Guinea and by conducting a campaign against corruption and tax evasion in Tanzania).
- In nonresource-intensive countries, the average fiscal position was broadly stable. However, in many of those countries, the deficit has been elevated (and in some cases rising) for several years now, despite buoyant growth. In the East African Community (EAC), the fiscal deficit reached 5¼ percent of GDP in 2016. It was 4½ percent of GDP among WAEMU countries, and has been constantly rising since 2012 despite consolidation commitments by its member countries.

In this context of incomplete adjustment, one worrisome development has been the relatively

widespread accumulation of domestic arrears (and, in a few cases, external arrears). The proliferation of domestic arrears was particularly marked in oil-exporting countries, with official estimates putting the stock of arrears at the end of 2016 to more than 7½ percent of GDP in Gabon, at least 4 percent in the Republic of Congo, almost 3 percent in Cameroon, 2.2 percent in Nigeria, and at least 2 percent in Angola. But other countries also experienced an increase in the stock of domestic arrears, including other commodity exporters (to more than 9 percent of GDP in Zambia, 4½ percent in Guinea, and potentially up to 3 percent in Ghana) and elsewhere (for example, Mozambique, São Tomé and Príncipe, Swaziland, and Uganda).

Exchange Rates under Pressure

To respond to the large terms-of-trade shock and tighter external financing conditions, many countries appropriately let their exchange rates depreciate to help absorb external pressures. However, some of the hardest-hit countries also resorted to harmful exchange rate restrictions to stem the depletion of reserves (Angola, Nigeria). These restrictions, now in place in some countries for more than a year, have added to growing policy uncertainties, generated deep economic distortions, and led to a widening of spreads in parallel markets (Figure 1.6). Angola has retained the priority list for foreign exchange access at the official rate, a special tax on service payments, and stricter limits on foreign currency for travel introduced in 2015.

Figure 1.6. Sub-Saharan Africa: Depreciation of National Currencies Against the U.S. Dollar since December 2013

Sources: Bloomberg, L.P.; and country authorities.

Note: Positive indicates a depreciation. See page 70 for country groupings and page 72 for country abbreviations.

¹ Unofficial estimates report the spread to be up to 20 percent between cash (U.S. dollars) and domestic bank deposits and bond notes.

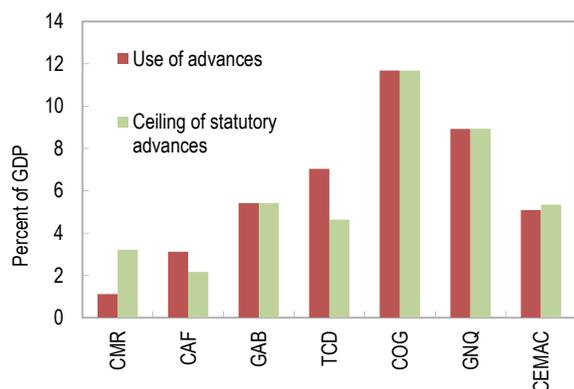
The ensuing scarcity of foreign currencies widened the parallel market spread from 5 to 10 percent in mid-2014 to around 130 percent at the end of March 2017. In Nigeria, restrictions, including on the acquisition of foreign exchange in the domestic market for the importation of 40 categories of goods, also remain in place. Meanwhile, rationing of foreign exchange has intensified in Burundi, foreign exchange and import permit restrictions were introduced in Ethiopia, and various current and capital account restrictions in Zimbabwe have resulted in a widening of exchange rate spreads with the parallel market.

Diverging Monetary Policy Responses

Mirroring the policy response to external pressures and the pass-through of currency depreciations, inflation continued to rise in 2016 in some of the key commodity exporters. End-of-year inflation reached 42 percent in Angola and 18½ percent in Nigeria, and remains slightly above the upper target band in South Africa, although inflationary pressures eased in Zambia and in Ghana as a result of tight monetary policy over the past year. Some nonresource-intensive countries also experienced an uptick in inflation, although to a lesser extent, as a result of which median inflation in the region accelerated from 4½ percent in 2015 to 5½ percent in 2016, reversing the trend observed over the last decade. In this differentiated context, monetary policy stances have also followed different paths across the region:

- Despite recent tightening as inflationary pressures increased, monetary policy among some resource-intensive countries has tended to remain loose. In particular, policy rates remained very low and negative in real terms in Angola (even after base money growth was tightened and the policy interest rate corridor narrowed in the second half of 2016) and in Nigeria (despite a 3 percentage point increase in the policy rate in early 2016). In the CEMAC, the regional central bank (*Banque des Etats de l'Afrique Centrale*, BEAC) has sought to mitigate liquidity constraints through accommodative monetary policy, in particular via credit to governments (related to the incomplete adjustment on the fiscal front), an increase in the refinancing of banks, and cuts in reserve requirements. However, this policy has reached its limits, with all CEMAC countries except Cameroon reaching or exceeding the statutory limit for advances from the BEAC (Figure 1.7).
- In nonresource-intensive countries, the picture has been mixed. Where underlying inflation pressures were easing until recently, as in the countries of the EAC, the policy stance was, rightly, loosened. Since April 2016, Uganda has reverted 550 basis points of the 600 basis point cumulative policy rate hike introduced when inflation pressures emanated from a large Shilling depreciation, and Tanzania reduced the discount rate in March 2017 by 400 basis points. In Kenya, the policy rate was cut by

Figure 1.7. Central African Economic and Monetary Community: Stock of Statutory Advances, 2016



Source: Banque des Etats de l'Afrique Centrale (BEAC).

Note: CEMAC = Central African Economic and Monetary Community. See page 72 for country abbreviations.

150 basis points to 10 percent by end-2016 in an attempt to reverse the ongoing slowdown in private sector credit growth, which had been further compounded by the unwelcome cap on commercial lending rates introduced in the first half of 2016. In a similarly unwelcome stance, inexpensive access to the refinancing window of the regional central bank of the WAEMU (*Banque Centrale des Etats de l'Afrique de l'Ouest*, BCEAO) had led banks in that region to rely on that source of funding to increasingly invest in treasury securities, keeping sovereign financing costs low in the context of fiscal expansion. The December 2016 decision by the BCEAO to increase its credit facility rate by 100 basis points and to tighten access to its refinancing window was an appropriate move to tighten financing conditions for sovereigns at the regional market, but its impact has since been mitigated by a subsequent cut in reserve requirements for banks.

THE PAIN IS SPREADING WITHIN AND ACROSS COUNTRIES

Rising External Pressures

As a result of the delayed policy adjustment, external pressures persist throughout much of the region, especially for resource-intensive countries, and this despite some relief from the recent uptick in oil and metal prices.

While estimated to have narrowed to 4 percent of GDP in 2016 from almost 6 percent a year earlier, the current account deficit for the region remains far above the 2 percent or so prevailing prior to the commodity price shock (Figure 1.8, panel 1). Furthermore, for oil exporters, this deficit has not always been matched with equivalent financing, exerting further pressures on reserves. Challenges raised by these large and often growing financing needs were compounded by a contraction in foreign direct investment and decreases in portfolio flows that were broad-based across the region—including investment flows from China, which despite picking up slightly in 2016, were still below the levels reached in 2013 (Figure 1.8, panel 2).

Access to international capital markets remained tight for sub-Saharan African frontier market economies, with only Ghana and Nigeria tapping the market since early 2016. This stands in sharp contrast to both the recent past in the region and increased issuances among emerging markets in 2016 (Figure 1.8, panel 3). More broadly, financing conditions as reflected in secondary market prices continue to be significantly tighter than for peers (Figure 1.9).

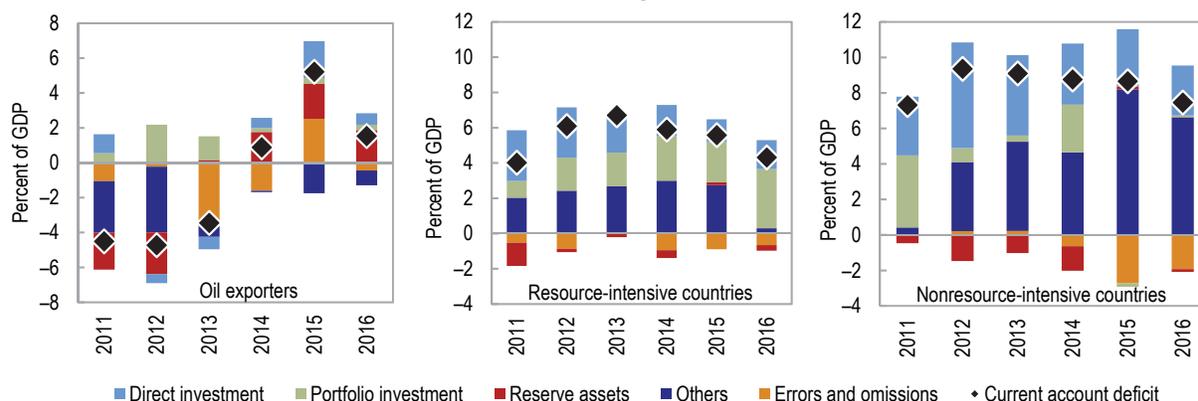
In countries with flexible exchange rates where the authorities resisted depreciations, the level of international reserves continued to fall. Elsewhere, absent the exchange rate instrument, CEMAC countries drew heavily on their pool of international reserves as the insufficient fiscal adjustment continued to exert strong external pressures (Figure 1.8, panel 4).

Increasing Public Indebtedness

Rising public sector debt is becoming a cause for concern in sub-Saharan Africa as a result of both delayed adjustments in hard-hit countries and expansionary fiscal stances elsewhere. On average, the ratio of public debt to GDP has increased by some 10 percentage points since 2014 to an average of 42 percent of GDP in 2016 (and a median of 51 percent). This is the highest value since many countries received debt relief in the 2000s under the Heavily Indebted Poor Countries/Multilateral Debt Relief Initiative. This trend accelerated sharply after 2014, for all categories of countries in the region (Figure 1.10).

Figure 1.8. Persistent External Pressures

1. Sub-Saharan Africa: Current Account Deficit and Sources of Financing, 2011–16

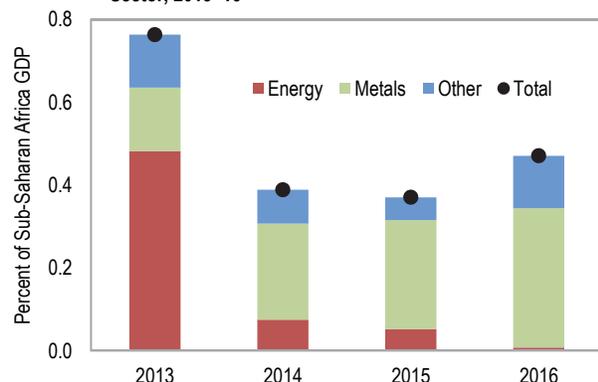


Source: IMF, World Economic Outlook database.

Note: Others includes items such as commercial bank financing from abroad and disbursements of loans to the government.

See page 70 for country groupings.

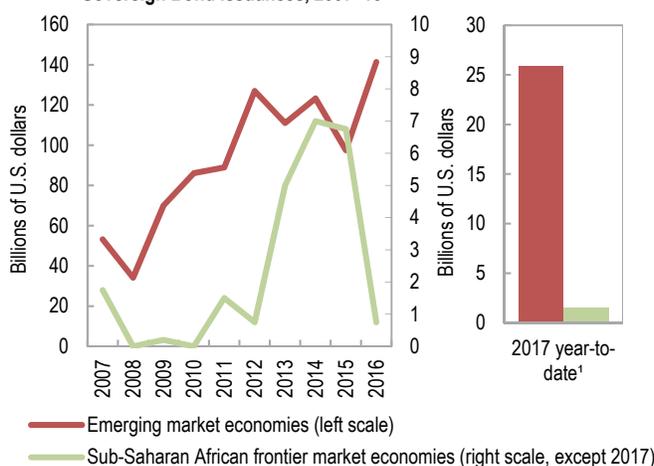
2. Investment Flows from China to Sub-Saharan Africa by Sector, 2013–16



Source: China Global Investment Tracker, American Enterprise Institute.

Note: Data include Angola, Benin, Congo, Rep. of, Côte d'Ivoire, Eritrea, Ethiopia, Guinea-Bissau, Kenya, Madagascar, Malawi, Mozambique, Nigeria, São Tomé and Príncipe, Senegal, and Uganda.

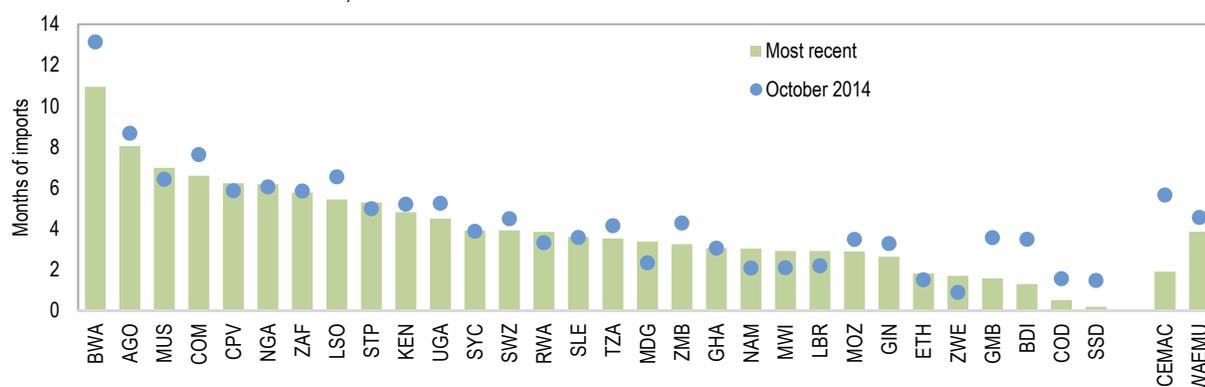
3. Emerging and Frontier Market Economies: International Sovereign Bond Issuances, 2007–16



Sources: Dealogic; and Haver Analytics.

¹ Data are as of March 31, 2017.

4. Sub-Saharan Africa: Reserves, 2014–17

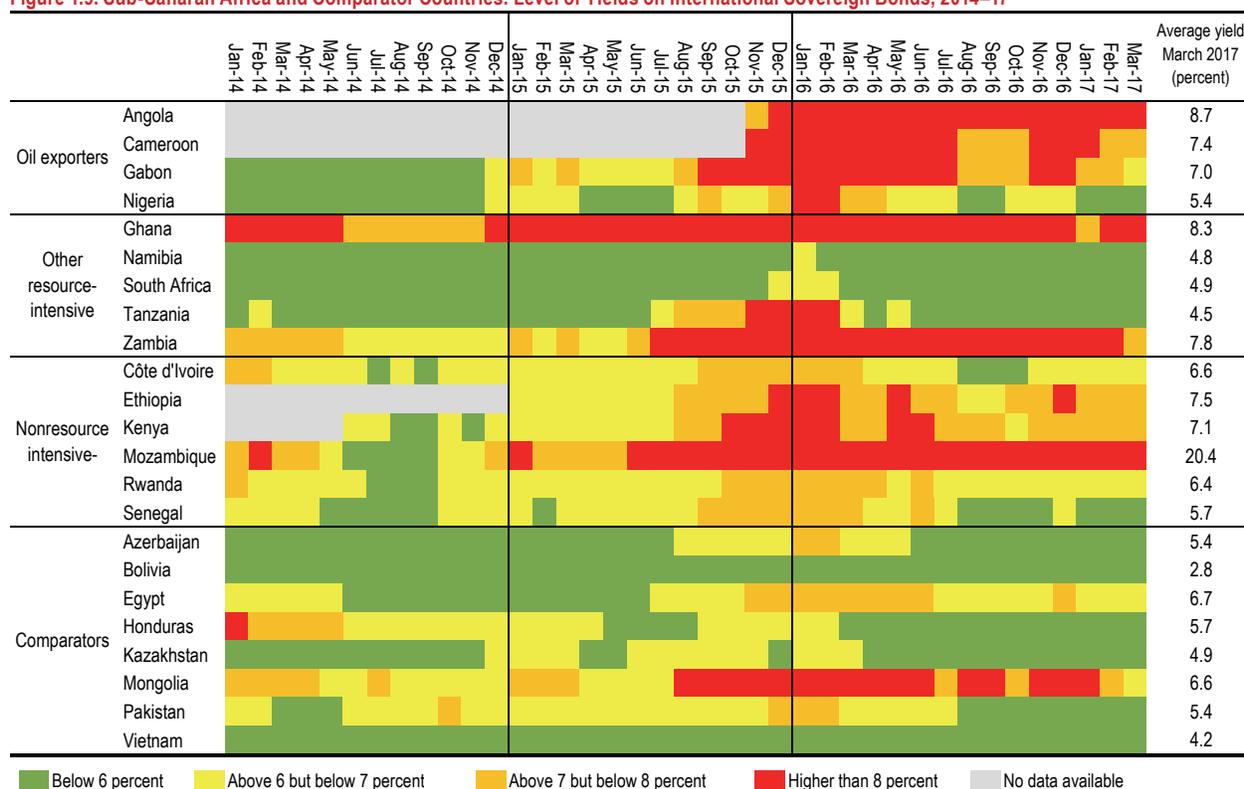


Sources: IMF, World Economic Outlook database; IMF, International Financial Statistics; and country authorities.

Note: CEMAC = Economic and Monetary Community of Central Africa; WAEMU = West African Economic and Monetary Union.

See page 72 for country abbreviations.

Figure 1.9. Sub-Saharan Africa and Comparator Countries: Level of Yields on International Sovereign Bonds, 2014–17



Source: JP Morgan.

Note: See page 70 for county groupings.

In most oil-exporting countries, a large part of debt accumulation between 2011 and 2013 had been through stock-flow-adjustments, reflecting net acquisition of financial assets (including accumulation of international reserves) during the boom periods prior to 2014. Since then, though, and following the sharp drop in oil prices, most oil-exporters not only drew down their reserves but also ran increasingly large fiscal deficits—a major source of debt accumulation in a context of lagging fiscal adjustment. Exchange rate movements (Angola) and the appreciation of the U.S. dollar against the euro (CEMAC) have also significantly increased the burden of external debt.

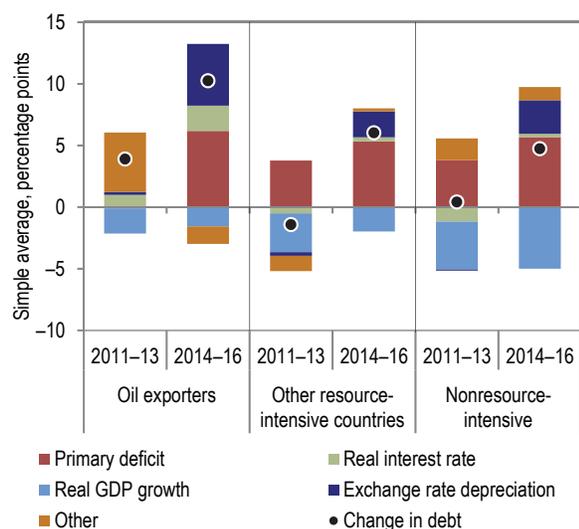
For other countries in the region, debt accumulation continued to be driven by primary deficits. In particular, debt continued to rise at a fast clip among nonresource-intensive countries as a whole, following a period of big increases in public investment, and despite the fact that growth had been buoyant and the oil price shock a tailwind for

those countries. Debt trajectories are now squarely on an upward trend and at around or above 50 percent of GDP in many nonresource-intensive countries (Benin, Cabo Verde, Côte d'Ivoire, Ethiopia, Kenya, Malawi, Mauritius, Mozambique, São Tomé and Príncipe, Senegal, and Togo).

Even in cases where debt levels are still relatively low, tighter financing conditions and increased debt financing have started to worsen debt service burdens, with an upward trend in both the debt-service-to-revenue ratio and the external-debt-service-to-exports ratio (Figure 1.11, panels 1 and 2). The change has been most dramatic for oil exporters, with a seven-fold increase in debt service, from an average of 8 percent of revenues in 2013 to 57 percent in 2016, and has been especially acute in Nigeria (66 percent) and Angola (60 percent).

Accordingly, the risk of debt distress has increased in a number of countries in the region since 2013 (Figure 1.11, panel 3).

Figure 1.10. Sub-Saharan Africa: Public Sector Debt Accumulation Decomposition, 2010–16¹



Sources: IMF, Debt Sustainability Analysis database; and IMF staff calculations.

¹ Data may deviate from that in the WEO database due to different publication dates for the Debt Sustainability Analysis database.

Note: Lesotho and South Sudan have been excluded due to data inavailability. The “Other” category comprised debt relief (under the Heavily Indebted Poor Countries and other initiatives), privatization proceeds, recognition of implicit or contingent liabilities, other country-specific factors (such as bank recapitalization), asset valuation changes, and other unidentified debt-creating flows as defined in the IMF-World Bank Debt Sustainability Framework. See page 70 for country groupings.

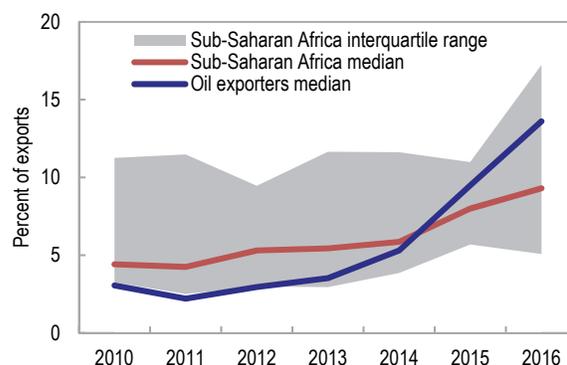
Mounting Financial Sector Pressures

As delayed adjustments exert pressures on all parts of the economy, financial sectors are beginning to feel the pinch:

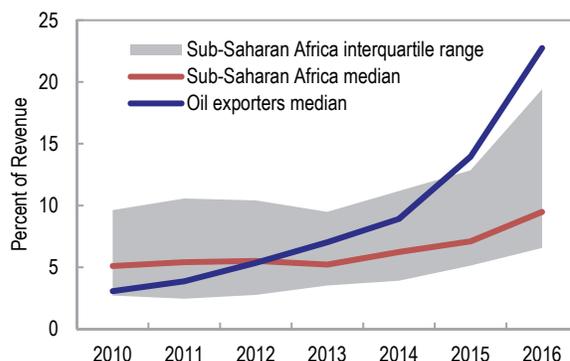
- Weakening commodity exports, the ensuing sharp slowdown in economic activity, and the buildup of government payment arrears to contractors are all restricting private firms’ capacity to service their loans to various degrees across the region. This has resulted in a widespread increase in nonperforming loans, triggering higher provisioning, straining banks’ profits, and weighing on solvency (Figure 1.12, Panel 1).
- In the face of deteriorating asset quality and declining banking system liquidity (CEMAC, Ghana), tighter monetary policy (Ghana, Zambia), weak growth (South Africa), a possible ending of the credit cycle (EAC), and increased exposure to the government (CEMAC, WAEMU, Zambia), commercial

Figure 1.11. Sub-Saharan Africa: Debt Service Indicators

1. Sub-Saharan Africa: External Debt Service-to-Exports Ratio, 2010–16

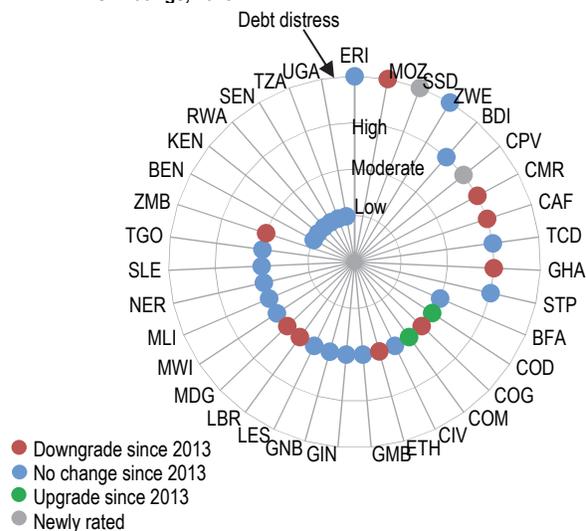


2. Sub-Saharan Africa: Total Debt Service-to-Revenue Ratio, 2010–16



Source: IMF, World Economic Outlook database.

3. Sub-Saharan African Low Income Countries: Debt Risk Ratings, 2013–17

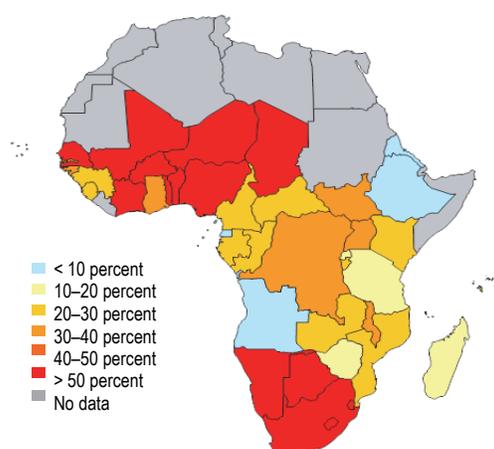


Sources: IMF, Debt Sustainability Analysis database.

Note: Ratings are based on the latest published IMF, Debt Sustainability Analysis. See page 72 for country abbreviations.

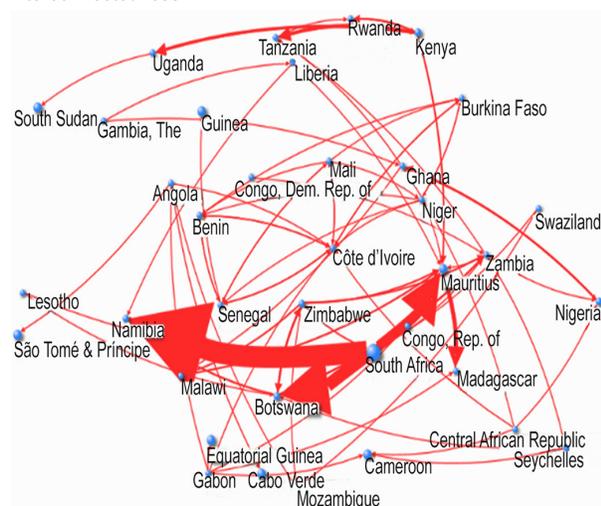
Other cross-border spillovers are occurring through trade (formal and informal) and banking channels. For example, some banks have lost correspondent banking relationships, affecting local banks in terms of funding and cross-border payments and possibly disrupting trade (Angola, Guinea, and Liberia). In some cases, bank funding could be significantly affected by a sharp slowdown in portfolio flows from abroad (South Africa).

Figure 1.13. Pan-African Banking Group Deposits, 2015
(Percent share of total)



Source: IMF, International Financial Statistics.

Figure 1.14. Sub-Saharan Africa: Cross-Border Firm Interconnectedness



Source: Orbis.

Note: Created with NodeXL. Arrows represent the extent of firms ownership of subsidiaries in the country at which the arrow points.

WHAT LIES AHEAD

Subdued Outlook

With policies behind the curve, pressures on sovereigns rising, and spillovers to the private sector intensifying, the near-term outlook for growth in the region is foreseen to remain subdued. The modest rebound in aggregate growth—to 2.6 percent in 2017 in our baseline—is expected to be driven to a large extent by a mitigation of adverse circumstances that caused growth to slump sharply in the largest countries in 2016 (Table 1.1):

- Reflecting some idiosyncratic developments, *the three largest economies* (Angola, Nigeria, and South Africa) are expected to contribute about three-quarters of the regional rebound. Following a deep recession, economic activity in Nigeria is expected to recover, with growth forecast at 0.8 percent on the back of higher oil production—if relative peace in the Niger Delta can be maintained—and strong agricultural production. A fading impact of the drought combined with improved terms of trade are projected to drive growth to 0.8 percent in South Africa, although political risks continue to loom large. In Angola, a more expansive fiscal stance ahead of this year’s elections, along with an improvement in the terms of trade, are expected to push growth up to 1.3 percent.
- Meanwhile, the situation in *CEMAC countries* is expected to remain difficult. The nature of the fiscal consolidation strategy—which involves lowering high-import-content spending, eliminating expenditure items that have contributed little to growth in the past, and gradually repaying domestic arrears—is designed to limit the adverse impact of fiscal consolidation on growth. Still, the continued decline in oil production is expected to keep Equatorial Guinea in deep recession (–5 percent). Further cuts in capital spending will likely slow growth in Cameroon (3.7 percent) and Gabon (1 percent), while new oil production is expected to push growth up to 0.6 percent in the Republic of Congo, notwithstanding very deep fiscal adjustment.

Table 1.1. Sub-Saharan Africa: Real GDP Growth
(Percent change)

	2004–08	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Sub-Saharan Africa	6.6	3.9	7.0	5.0	4.3	5.3	5.1	3.4	1.4	2.6	3.5
<i>Of which:</i>											
Oil-exporting countries	8.7	6.7	9.2	4.7	3.9	5.7	5.9	2.6	-1.4	0.9	2.0
<i>Of which: Nigeria</i>	7.7	8.4	11.3	4.9	4.3	5.4	6.3	2.7	-1.5	0.8	1.9
Middle-income countries	6.6	3.6	6.9	4.5	4.3	4.7	4.6	2.7	0.5	1.8	2.8
<i>Of which: South Africa</i>	4.8	-1.5	3.0	3.3	2.2	2.5	1.7	1.3	0.3	0.8	1.6
Low-income countries	6.3	5.2	7.2	6.9	4.5	7.2	6.8	5.6	4.4	5.2	5.6
Memorandum item:											
World economic growth	4.9	-0.1	5.4	4.2	3.5	3.4	3.5	3.4	3.1	3.5	3.6
Sub-Saharan Africa other resource-intensive countries ¹	4.9	0.6	4.8	5.2	4.1	4.3	3.4	2.5	2.0	2.8	3.6
Sub-Saharan Africa nonresource-intensive countries ²	6.0	4.9	6.4	5.4	5.8	6.4	6.6	6.6	5.8	5.7	6.1
Sub-Saharan Africa frontier and emerging market economies ³	6.8	4.2	7.3	5.1	4.5	5.2	5.1	3.6	1.5	2.6	3.5

Source: IMF, World Economic Outlook database.

¹ Includes Botswana, Burkina Faso, Central African Republic, Democratic Republic of Congo, Ghana, Guinea, Liberia, Mali, Namibia, Niger, Sierra Leone, South Africa, Tanzania, Zambia, and Zimbabwe.

² Includes Benin, Burundi, Cabo Verde, Comoros, Côte d'Ivoire, Eritrea, Ethiopia, The Gambia, Guinea-Bissau, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Rwanda, São Tomé and Príncipe, Senegal, Seychelles, Swaziland, Togo, and Uganda.

³ Includes Angola, Cameroon, Côte d'Ivoire, Ethiopia, Gabon, Ghana, Kenya, Mauritius, Mozambique, Nigeria, Rwanda, Senegal, South Africa, Tanzania, Uganda, and Zambia.

- In *other resource-intensive countries*, economic growth is foreseen to pick up gradually, reaching close to 3 percent after an estimated 2 percent in 2016, helped by somewhat improved terms of trade. Growth above 5 percent is projected in Mali and Niger on the back of strong public investment and favorable harvests, notwithstanding continued security issues. With a rate of 6¾ percent, driven by continued strong mining and service activities, Tanzania would remain the fastest-growing resource-intensive country. Growth in Ghana is expected to reach 5.8 percent, boosted by the coming on-stream of new oil fields. On the other hand, economic and social vulnerabilities are expected to increase further in Zimbabwe, despite some rebound in agricultural production.
- Despite the buildup of vulnerabilities highlighted in earlier sections, the growth momentum in *nonresource-intensive countries* is expected to remain robust. However, in many cases, new shocks have materialized and are starting to weigh on activity. For example, while growth in Côte d'Ivoire is expected to remain brisk at 6.9 percent, supported by continued large infrastructure investment, that growth rate will still mark a deceleration from last year as a result of lower cocoa prices and the intensification of social tensions. The EAC

countries, Kenya, Rwanda, Tanzania, and Uganda are foreseen to continue to grow at 5 percent or more, supported by sustained public spending, but the ongoing drought would dent the growth momentum somewhat. Growth is forecast to reach 6.8 percent in Senegal with the continued implementation of the *Plan Sénégal Emergent*. Elsewhere, economic activity is expected to continue to strengthen in Madagascar on the back of expanding mining projects and an increase in vanilla prices, and in Comoros following improvement in electricity production.

Adding to this overall subdued outlook, political tensions and security issues continue to have a significant humanitarian impact and weigh on economic activity in several countries, including Burundi, Central African Republic, Chad, Democratic Republic of the Congo, Mali, and South Sudan.

Furthermore, while the effect of the drought that hit most southern African countries in 2016 is fading, a new bout of drought is now affecting parts of eastern Africa (Ethiopia, Kenya, South Sudan, and Tanzania) as the erratic weather patterns of La Niña hit these countries. In addition, pest and armyworm infestations in some southern African countries (Democratic Republic of Congo, Malawi, Namibia, South Africa, Zambia, and Zimbabwe)

are impacting agricultural activity negatively. As a result of these developments, about half of sub-Saharan African countries have reported food insecurity situations that could potentially impact 60 million more people in the region this year. Worse still, famine has been declared in South Sudan and is looming in northeastern Nigeria as a result of past and ongoing conflicts.

Other macroeconomic projections mirror these different growth experiences (Table 1.2):

- The inflation outlook is expected to continue to be extremely heterogeneous across the region. On the one hand, inflationary pressures are foreseen to remain in large oil exporters (Angola, Nigeria) against the backdrop of unresolved external imbalances, and South Sudan is forecast to continue to suffer from excessive inflation. Similarly, Burundi, Democratic Republic of Congo, Ghana, Malawi, Mozambique, and Sierra Leone are still foreseen to register inflation rates in excess of 10 percent. Conversely, inflation is expected to remain below 3 percent in the WAEMU and CEMAC countries, while some Eastern African countries are expected to see a modest uptick in inflation reflecting pressures on food prices from the ongoing drought.
- The aggregate fiscal deficit is expected to remain elevated at 4½ percent of GDP, unchanged from 2016. While fiscal deficits are foreseen to widen in Angola and Nigeria, the CEMAC countries, which are planning to implement significant fiscal measures, will likely see the overall deficit decline from 7.2 to 3.4 percent

of GDP in 2017 for the union as a whole. Among oil importers, the average fiscal deficit is expected to narrow marginally from 4.3 to 4.2 percent of GDP. Most notably, the deficit is foreseen to decline to 5 percent of GDP in Ghana (6.8 percent on cash basis) after pre-election slippages drove fiscal deficits to about 8¼ percent of GDP in 2016. Finally, the deficit is expected to decline from 7.8 to 5.3 percent of GDP in Malawi, with fiscal and monetary policy working hand-in-hand to reduce inflation. Continued public investment in the largest countries in the WAEMU is forecast to result in an increase in the currency union's fiscal deficit from 4.5 percent to 4.6 percent of GDP in 2017, while the fiscal deficit in the EAC is expected to remain elevated at 5.3 percent of GDP.

Implementation Risks amid Global Uncertainty

Downside risks stemming from both the external environment, as discussed in the IMF's April 2017 *World Economic Outlook*, and domestic factors drive the near-term uncertainties around our growth projection for sub-Saharan Africa.

On the external side, uncertainties persist despite the slight improvement in the global outlook and generally accommodating financial conditions. While fiscal policy easing is currently projected in the United States, the extent of expansion and the associated path of monetary policy normalization remain uncertain. Faster-than-expected normalization of monetary policy could also imply a sharp U.S. dollar appreciation and a tightening of financing conditions, especially for countries where fundamentals have deteriorated. A broad

Table 1.2. Sub-Saharan Africa: Other Macroeconomic Indicators

	2004–08	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
				(Percent change)							
Inflation, average	8.8	9.8	8.1	9.4	9.3	6.6	6.3	7.0	11.4	10.7	9.5
				(Percent of GDP)							
Fiscal balance	1.7	-4.5	-3.4	-1.1	-1.8	-3.1	-3.5	-4.1	-4.5	-4.5	-3.9
Of which: Excluding oil exporters	-0.6	-4.2	-4.3	-3.6	-3.6	-3.9	-3.8	-4.1	-4.3	-4.2	-3.8
Current account balance	2.1	-2.8	-0.9	-0.8	-1.8	-2.4	-3.9	-6.0	-4.0	-3.8	-3.7
Of which: Excluding oil exporters	-4.3	-4.9	-3.9	-4.7	-7.0	-7.4	-6.7	-6.7	-5.7	-5.9	-6.2
				(Months of imports)							
Reserves coverage	5.1	5.2	4.1	4.6	5.3	5.0	5.3	5.8	4.8	4.7	4.5

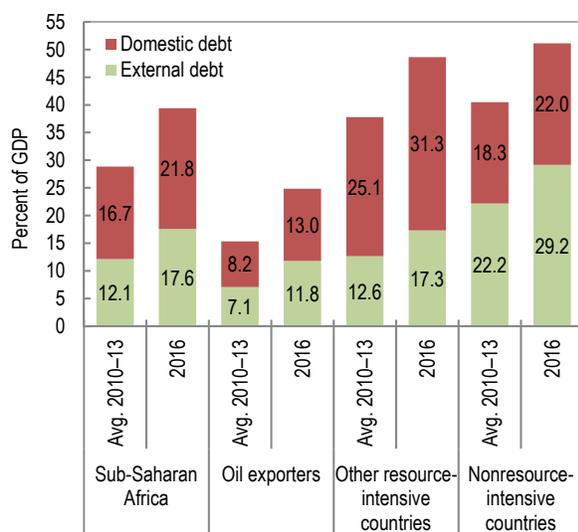
Source: IMF, World Economic Outlook database.

shift toward inward-looking policies, including protectionism, could impede global growth by reducing trade, migration, and cross-border investment flows, and negatively impact commodity prices and exports from the region.

In particular, a potential further U.S. dollar appreciation could have mixed implications for the region:

- On the upside, a stronger U.S. dollar against the euro would imply depreciation of currencies that are pegged to the euro, fostering price competitiveness in the WAEMU and CEMAC. Given that most commodities are quoted in dollars, this would also mean higher proceeds in domestic currencies for commodity exporters, but conversely a higher import bill for oil importers.
- On the downside, a stronger U.S. dollar would most likely imply tighter financing conditions for frontier and emerging market economies in the region, as well as a higher external debt burden. First, higher yields on low-risk advanced market paper would make emerging and developing countries' bonds less attractive, further exacerbating the discrimination against sub-Saharan Africa frontier market economies

Figure 1.15. Sub-Saharan Africa: Public Sector Debt Decomposition, 2010–13 and 2016



Sources: IMF, Debt Sustainability Analysis database; and IMF staff calculations.

Note: Lesotho and South Sudan have been excluded due to data inavailability. See page 70 for country groupings.

with delayed policy adjustment and/or weak fundamentals. Second, a large share of sovereign debt in the region is denominated in foreign currency (Figure 1.15). As a result, a further appreciation of the U.S. dollar could increase foreign debt servicing cost significantly.

A depreciation of national currencies could also result in a spike in inflation.

On the domestic side, further delays in adjusting, and political developments, also pose risks in some countries. In Angola and Nigeria, ongoing reliance on exchange restrictions will continue to depress activity in the non-oil sector and enhance the risk of a disorderly adjustment. In CEMAC, implementation of the fiscal consolidation strategy is paramount. Elsewhere, upcoming elections in Angola and Kenya could make it more difficult for these countries to address weaknesses in their underlying fundamentals.

COMING OUT STRONGER

With growth having slowed in much of the region, and large fiscal consolidation still needed in many oil-exporting countries, achieving sustained, durable, and inclusive growth is needed more than ever to respond to the aspirations of a growing and young population for better living standards. This would, however, require decisive efforts at a time when most of the factors known to adversely affect the duration of growth episodes in the past—including unfavorable external conditions, and deteriorating macroeconomic conditions—are now present in most countries in the region (see Chapter 2). Specific policy measures will depend on country circumstances, but ensuring macroeconomic stability, in a growth-friendly manner, is a prerequisite and urgently needed in many countries:

- *Resource-intensive countries*, in particular oil exporters, need to take decisive, sizable, and restorative measures to re-anchor macroeconomic stability. In the CEMAC, further fiscal adjustment is critical. The strategy of delaying the necessary fiscal adjustment by relying on central bank financing and drawing down on reserves has reached its limits, and the

recent firming up of oil prices provides only limited external and fiscal space. While fiscal adjustment would likely further dampen economic conditions in the short term, it is still a prerequisite to prevent the negative and much more long-lasting impact of macroeconomic instability.¹ For oil exporters with scope for exchange rate flexibility (Angola and Nigeria), the exchange rate should be allowed to fully absorb pressures, and exchange restrictions should be eliminated to address the damage that is being inflicted on the private sector, undermining growth recovery efforts.

- *For nonresource-intensive countries* including some countries in the WAEMU and in the EAC, it will be important to ensure that public investment, which has led to rapidly rising debt levels, is steadily returned to normal levels consistent with medium-term fiscal and external sustainability. In addition, in the WAEMU, there is a need for stronger coordination to ensure that individual country deficits are consistent with regional stability, guided by the regional convergence criteria. In both cases, a much greater focus on domestic revenue mobilization is required, which, when combined effectively with public investment, should crowd-in private investment (Box 1.3).

These measures aside, Chapter 2 explains in greater detail why policies needed to restart the growth engine in the region will need to go beyond restoring macroeconomic stability. Addressing structural weaknesses is also critical, and doing it now, in parallel with the measures above, will enable the region to emerge stronger.

Key structural issues on the fiscal side include:

- *Boost domestic revenue mobilization to create space for growth-enhancing spending.* Previous analysis in the October 2015 *Regional Economic Outlook* suggests that the median country in the region has the potential to increase tax revenues by about 3 to 6½ percent of GDP, while there is also scope in many to make the tax system more progressive. For resource-intensive countries, the focus should be on broadening

the sources of taxes away from commodity related income, including by better balancing income taxes and indirect taxes, and broadening the tax base to improve the resilience of tax revenues (see IMF 2011). More broadly, countries should focus on strengthening and streamlining tax procedures as was done in Mauritius and Tanzania in the mid-2000s.² This includes tapping into e-filing programs to improve the efficiency of tax collection.

- *Leverage financial development to broaden the tax base.* A major challenge to revenue mobilization in the region has been the large size of the informal sector (cash-based economy). However, as is shown in more detail in Chapter 3, there is evidence to support the role of financial development (including the ongoing drive for mobile banking) to help enhance domestic revenue mobilization as informal firms grow (Figure 1.16; see also Gordon and Li 2009).

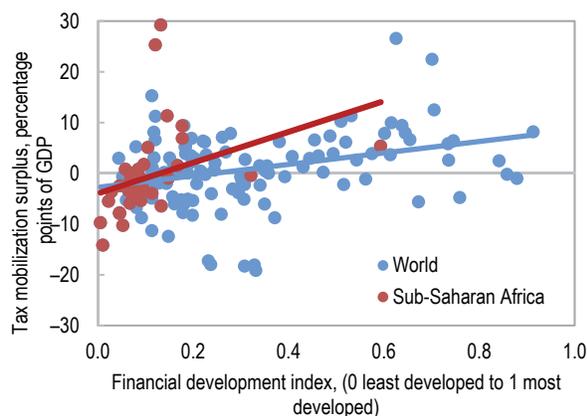
Other structural reforms also need to be advanced to safeguard financial stability and strengthen competitiveness. These include:

- *Strengthening financial supervisory capacity and increasing efforts to strengthen cross-border collaboration to ensure effective consolidated supervision (in particular for pan-African banks) and safeguard financial stability.* The recent deterioration in financial stability indicators points to emerging stress that could spill over within the region. This leaves no room for complacency, especially in countries with the weakest supervisory capacity, as spillover risks might develop undetected.
- *Addressing longstanding weaknesses in the business climate and diversifying economies.* This is needed to unleash the formidable but untapped

²Mauritius broadened its tax base in 2006 while making the system more equitable by eliminating exemptions from the income tax, introducing a simple property tax payable with income tax without the need for cadaster, and normalizing the taxation of its export processing zones. Tax revenues rose from 17 percent of GDP in 2007 to almost 20 percent of GDP in 2016, despite a simultaneous reduction in the corporate tax rate from 25 to 15 percent. In Tanzania, efficiency gains from strengthening the capacity of the tax revenue authority resulted in close to a 5 percentage point increase in tax revenues within a decade, largely without raising tax rates (IMF 2015b).

¹For more detailed advice on fiscal rebalancing, see IMF (2016).

Figure 1.16. Financial Development and Tax Revenue, 1980–2013



Sources: Author's calculations; and Sahay and others (2015).

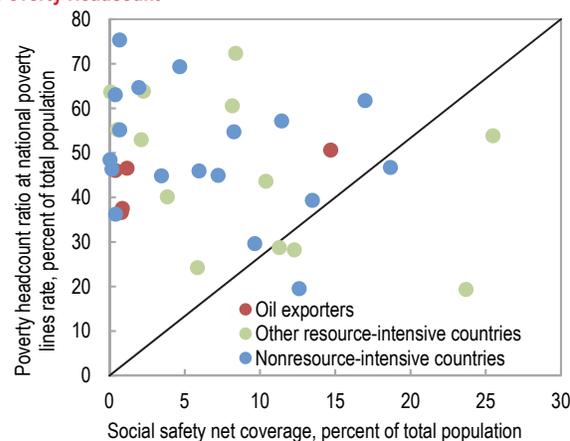
Note: The tax mobilization surplus is the difference between the actual level of tax revenue (in percent of GDP) and its predicted level. It is obtained through fixed effects regression of the tax revenue ratio on purchasing power parity-adjusted GDP per capita (to capture the level of economic development). Post-estimation, all data are averaged at the country level (with data running from 1980–2013).

potential for private sector growth, thereby fostering diversification and resilience. Reforms to support broad financial sector development will also be critical to address what has been a substantial impediment to the development of new sources of growth.

In the meantime, a growth rebound has to be durable and inclusive in order to maintain past gains. This means simultaneously providing a social safety net well targeted to the most vulnerable segments of the population. In fact, strengthening social safety nets and implementing fiscal consolidation are complementary goals—with safety nets mitigating the impact of consolidation on the poor—and can be pursued in parallel at a lower fiscal cost. Addressing key design and implementation gaps could enhance the effectiveness of social safety net programs already in place (Box 1.4). They should also be seen, in a broader context, as setting the stage for more emphasis on SDGs over the medium term.

Countries should develop more integrated social safety net systems. A number of countries are already implementing social assistance programs in one form or another, including cash transfers (conditional or not), food or in-kind transfers, as well as capitation grants for education and health services. But programs are often fragmented, not

Figure 1.17. Sub-Saharan Africa: Social Security Coverage and Poverty Headcount



Source: Beegle, Coudouel, and Monsalve (2017), drawing on the ASPIRE database.

Note: The figure shows the population benefiting from social safety nets as a share of the total population. It includes the latest data on beneficiaries for active social safety nets and social care services. See page 70 for country groupings.

always well-targeted, and cover only a small share of the population in many countries of the region (Figure 1.17). Consolidating benefits into a smaller number of large programs with clearly established objectives and strong targeting mechanisms, while phasing out regressive expenditures such as fuel subsidies or programs that benefit the rich disproportionately, would enhance efficiency and have a greater impact on poverty. This would also create additional room to finance an expansion in coverage with adequate benefit levels.

In parallel, emphasis could shift toward introducing or expanding programs that are poverty-targeted (means-tested or proxy-means tested) and that provide transfers in cash. Such programs have had substantial impacts on poverty in other regions (Brazil and Mexico). There are also lessons from pilot programs in African countries that have successfully introduced poverty-targeted cash transfers, as they show similarly important impacts on consumption, investment in human capital, and productive activities.

Box 1.1. Potential Spillovers from the Financial Sector

African financial systems have become increasingly interwoven, reflecting the rapid expansion of pan-African banks over the last 15 years (IMF 2015a). The number of subsidiaries of the largest pan-African banking groups, with headquarters in Côte d'Ivoire, Kenya, Morocco, Nigeria, South Africa, and Togo, has more than tripled since the early 2000s. The expansion of pan-African banks accelerated following the global financial crisis, as in other emerging regions, partly due to the retrenchment of lenders from advanced economies (see Chapter 2 in the April 2015 *Global Financial Stability Report*). As of 2015, the 14 largest pan-African banks had a share of total deposits above 50 percent in 14 countries and between 30 and 50 percent in an additional nine countries, trumping the importance of long-established European banks in the region.

The organizational structure of pan-African banks and the nature of cross-border banking relations may reduce the risk of contagion from this exposure in the following ways:

- Pan-African banks have expanded mainly through subsidiaries, with limited integration across affiliate networks or with parent banks in terms of funding or capitalization. Figure 1.1.1 illustrates the case of banks with headquarters in South Africa and Nigeria, respectively, where interbank funding from home to host is negligible for most host countries. In particular, net interbank exposure from the parent to the subsidiary is positive only for Kenya and Tanzania in the case of Nigerian banks, and for Burkina Faso, Kenya, Nigeria, and Uganda in the case of South African banks.
- The limited interbank exposures are mainly directed from host to home, reflecting the fact that subsidiaries fund themselves domestically and deposit excess liquidity in parent institutions. In the absence of regulation in host countries impeding the movement of liquidity across jurisdictions, this suggests that pan-African banks have a centralized approach to liquidity risk management. Based on international experience, this is expected to have benefits in terms of financial stability by allowing the parent to open centrally managed cash and collateral resources to subsidiaries under temporary financial pressures (Reinhardt and Riddiough 2014). However, it may also entail the risk that liquidity will be drained from subsidiaries in the event of financial pressures on the parent.
- Direct cross-border lending to the nonbank private sector is also limited. The analysis of direct cross-border bank flows in sub-Saharan Africa is hampered by the fact that countries in the region, with the exception of South Africa, do not report to the Bank for International Settlements. However, other available information suggests that lending to the private sector is mainly extended by domestically funded subsidiaries. Lending by subsidiaries, in turn, appears more stable than direct cross-border lending (Peek and Rosengren 2000; De Haas and van Lelyveld 2006).

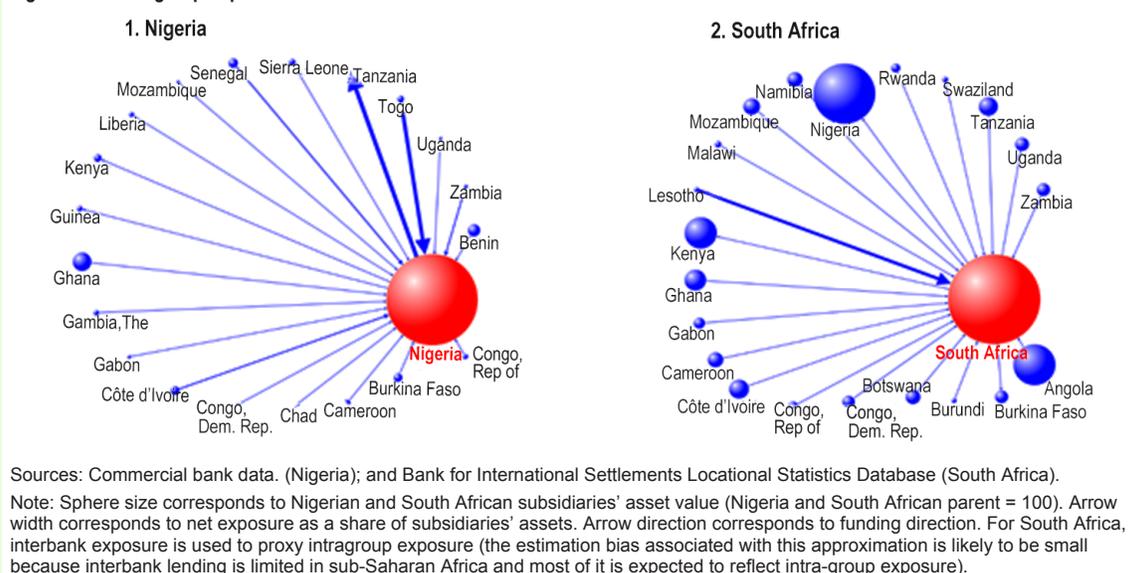
These characteristics suggest that local banking systems might be protected from first-round contagion effects, which usually come through interbank funding and direct cross-border lending. There is a risk, however, that local economies might feel the impact of shocks at a later stage, when reputational risks and confidence effects spread problems in one part of the banking group to other affiliates.

Contagion is also possible if banking groups have interlinkages with other sectors, or if some business segments are particularly sensitive to regional or global lending conditions. The following features in the expansion and business models of pan-African banks amplify these risks:

This box was prepared by Daniela Marchettini.

- Pan-African banks have become increasingly complex, encompassing nonbank activities such as insurance and securities dealings, particularly in the Southern African region (for South Africa, see IMF 2014; for Namibia, see Torres 2016). This increases the linkages between banks and other financial institutions of the same group (deposit funding), and between home and host countries (securities exposures).
- Pan-African banks have significant ownership stakes in a wide variety of financial and nonfinancial entities. Nigerian banking groups have the largest number of controlling ownership linkages with the corporate sectors of other African economies, while South African banking groups have comparatively few controlling ownership linkages. However, these banks are heavily connected to the rest of Africa via noncontrolling interests, particularly in the financial sector.¹ This creates links between bank and nonbank corporate sectors and across banking groups, thus heightening possibilities of contagion within countries' financial sectors and to the real economy.

Figure 1.1.1. Intragroup Exposures: Stock at the End of 2015



¹ For instance, in 2014 the South African banking group Nedbank acquired a share of about 20 percent of the Togolese group Ecobank Transnational Incorporated.

Box 1.2. Firm Ownership in Sub-Saharan Africa and Intra-Regional Spillovers

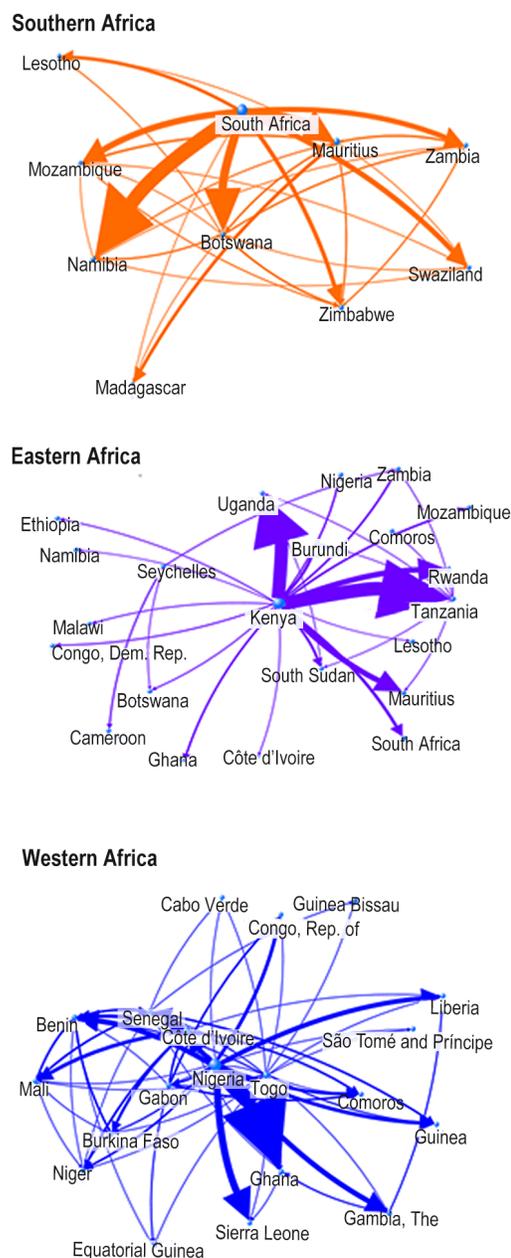
Sub-Saharan African firms are increasingly becoming connected through cross-border ownership structures, with some regional hubs. This interconnectedness comes with many opportunities, such as knowledge transfer and trade, but also poses risks of spillovers of economic downturns from affected countries to other countries, as currently experienced in many countries of the region.

Firms in sub-Saharan Africa are increasingly connected with one another through cross-border firm ownership. Figure 1.2.1, constructed based on firm-level relationships across countries (Orbis), illustrates the extent of cross-border firm activity in all of sub-Saharan Africa. While firms headquartered in South Africa own the most subsidiaries in other sub-Saharan African countries (over 2,400 subsidiaries), other regional hubs have also emerged. Kenyan firms play a key role in investing in neighboring countries in East Africa, and Nigerian firms are the major investor in firms in the neighboring region of West Africa. In contrast, cross-border ownership activity is relatively sparse in Central Africa.

These intra-regional linkages via cross-border firm ownership bring both benefits and increased potential for spillovers in the event of shocks. On the one hand, the strengthening of regional ties fosters more trade integration, sharing of technology and production practices, diversification, and the leveraging of a country's comparative advantages and exploitation of economies of scale and scope. But the increased interconnectedness also implies exposure to shocks emanating from the host country or the headquarter-firm country.

Overall, sub-Saharan African subsidiaries in other African countries have performed relatively well compared to domestically owned subsidiaries (Figure 1.2.2). They have exhibited higher profit margins and higher profitability during some of the period following the global financial crisis, even compared to subsidiaries not owned by sub-Saharan African firms. However, since 2014 there have been some declines in the profitability of subsidiaries owned by both domestic and non-sub-Saharan African firms if measured by return on equity.

Figure 1.2.1 Sub-Saharan Africa: Cross-Border Firm Linkages



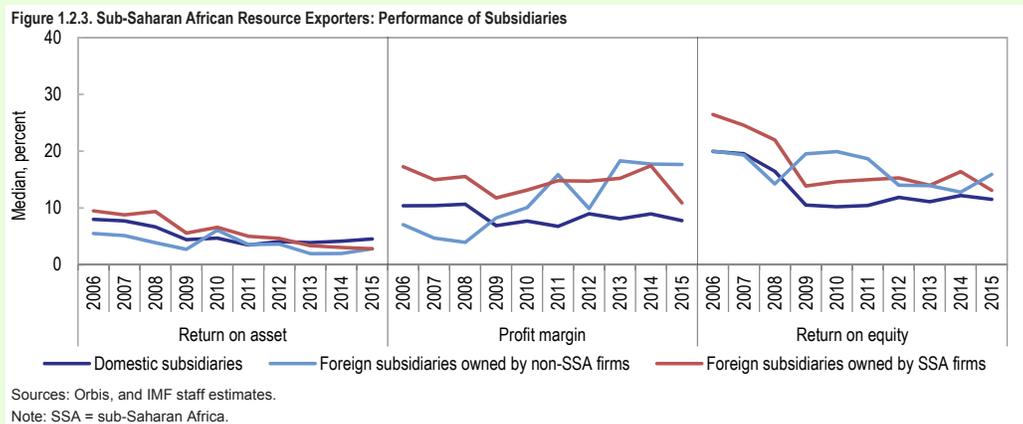
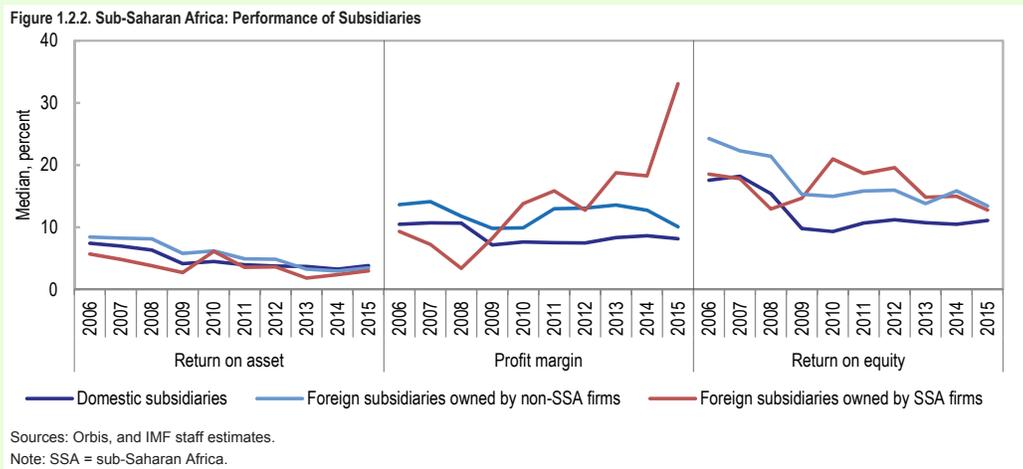
Source: Orbis.

Note: Created with NodeXL. Arrows represent the extent of firms ownership of subsidiaries in the country at which the arrow points.

This box was prepared by Wenjie Chen.

In resource-exporting countries, the performance of domestic subsidiaries and subsidiaries owned by other sub-Saharan African firms has deteriorated compared to subsidiaries owned by foreign firms outside of the region (Figure 1.2.3). As governments have reacted with different sets of policies to the decline in commodity prices, the impact on the operation of these cross-border firms has varied as well. Angola and Nigeria have imposed exchange rate restrictions due to external pressures on the currency, hurting businesses that are operating locally because the controlled allocation of foreign exchange disrupts production. Although subsidiaries owned by firms headquartered outside of Nigeria are likely to have easier access to foreign currency compared to their Nigerian-owned counterparts, the deteriorating condition and decreased demand of the host country has a negative effect on the performance of the local subsidiary and thus poses an increased risk for the parent company.

On the other hand, for Nigerian firms that own subsidiaries in other sub-Saharan African countries that are still experiencing robust growth—such as many of the nonresource-intensive countries in the East African Community (Kenya, Tanzania, and Rwanda)—these cross-border investments, helped by strong internal demand, could act as buffers to offset some of the profit losses at home.



Box 1.3. Fostering Private Investment in Sub-Saharan Africa

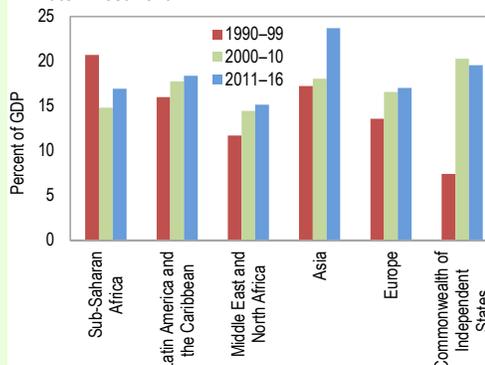
Sub-Saharan Africa's private investment-to-GDP ratio led emerging and developing countries in the 1990s, but fell behind over the following two decades (Figure 1.3.1). While Asia saw its ratio increase from 17 percent of GDP in the 1990s to 24 in 2011–16, and while the ratio increased more modestly in other regions, the ratio in sub-Saharan Africa decreased from 20 percent to 17 percent, at a time when public sector investment has been scaled up to address infrastructure gaps. These trends raise the question as to whether public investment may be crowding-out private investment in sub-Saharan Africa.

Following Servén (2003) and Cavallo and Daude (2011), the ratio of private investment in terms of GDP is modeled as a function of its own lagged values (given the series' high persistence), the lagged ratio of public investment to GDP, the relative price of investment with respect to consumption goods (to capture distortions in the economy), exchange rate volatility (as an indicator of macroeconomic stability), and credit to the private sector in percent of GDP (to capture available funding) for a sample of developing and emerging economies.

Results for a sample of developing and emerging economies confirm that private investment ratios are associated negatively with public investment—providing evidence for crowding out—but positively with higher levels of credit to the private sector (Table 1.3.1, column 1).¹ A similar exercise, restricting the sample to sub-Saharan African economies only, yields comparable results.

However, the crowding-out effect of public investment on private investment can be mitigated when more resources are available to finance government expenditures—a hypothesis tested by estimating the interaction effect of public investment with revenue mobilization and trade openness. The results indeed highlight that increased revenue mobilization and more integration with the rest of the world, as proxied by trade openness, can lessen the crowding out of private investment (Table 1.3.1, columns 1 and 2). An increase in the ratio of government revenue to GDP from the 25th to 75th percentile in the sample reduces the estimated crowding-out effect of public investment by 0.3 percentage points, as it lowers the need for government borrowing in the domestic market. Similarly, the crowding-out effect is reduced by 0.1 percentage points when the country increases its access to the external pool of financial resources and has better opportunities to trade.

Figure 1.3.1. Emerging and Developing Economies: Private Investment



Source: IMF, World Economic Outlook database.

Table 1.3.1. Emerging and Developing Economies: Private Investment

	(1)	(2)
Real private investment in percent of GDP ($t-1$)	0.658*** (6.888)	0.747*** (9.705)
Real public investment in percent of GDP ($t-1$)	-0.664** (-2.531)	-0.486*** (-2.790)
Relative price of investment, Log of	-0.638 (-1.133)	-0.051 (-0.099)
Credit to private sector, percent of GDP, Log of	0.873** (2.355)	0.321 (1.400)
Real exchange rate volatility, Log of	0.165 (0.994)	0.168 (0.757)
Government stability, ICRG	0.048 (0.287)	0.270 (1.453)
General government revenue, percent of GDP	-0.095 (-1.420)	
(Public investment x government revenue)	0.017** (2.370)	
Trade openness, in percent of GDP		0.023 (1.268)
(Public investment x trade openness)		0.003* (1.674)
Constant	-11.933 (-0.447)	5.093 (0.449)
Observations	1,083	1,178
Number of countries	62	62
Adjusted R -squared	0.477	0.866
Hansen	0.896	0.997
Instruments	78	80

Source: Author's calculations

Note: Time fixed effects included. Z-statistics in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$; ICRG = International Country Risk Guide.

This box was prepared by Francisco Arizala, Jesus Gonzalez-Garcia, and Jiayi Zhang.

¹ The generalized method of moment system addresses potential endogeneity concerns.

Box 1.4. Strengthening Social Safety Nets

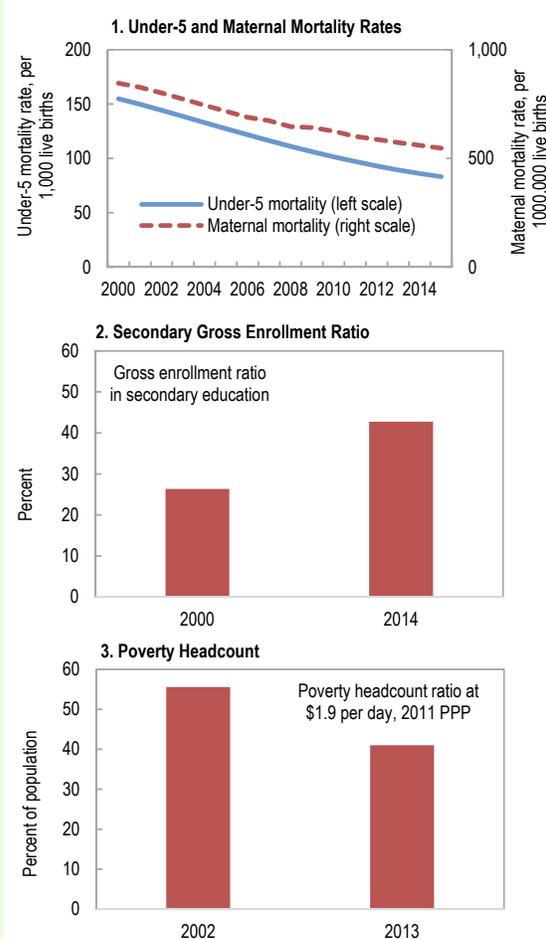
Strengthening social safety nets and fiscal consolidation are not mutually exclusive goals, but spending on social safety nets should, at a minimum, mitigate the social costs of the consolidation. Removing regressive expenditures and improving the efficiency of progressive programs can provide fiscal space to expand targeted social safety net programs providing opportunities to a larger share of the population of poor households.

Strong growth in sub-Saharan Africa over the past two decades has coincided with improvements in several human development indicators (Figure 1.4.1). Health outcomes have improved, with infant mortality and maternal death rates declining. Education enrollment rates have increased, and poverty rates have declined. However, the absolute number of people living below the poverty line has risen.

Varying Coverage of Social Safety Nets

Public spending levels on social safety nets—that is, noncontributory transfer programs that target the poor and vulnerable so that they can meet their basic consumption needs, mitigate the impact of shocks, and invest in their human capital and productive capacity—vary widely across the region (Beegle, Coudouel, and Monsalve 2017; World Bank 2012). Between 2012 and 2016, government spending on social safety nets ranged from less than ½ percent of GDP on average in most oil-exporting countries to an average of about 1½ percent of GDP in other countries (Figure 1.4.2, panel 1). An important share of programs is categorically targeted to provide services to certain demographic groups, often children, including school feeding (Botswana, Lesotho, Malawi, Nigeria, Zambia), the disabled (Guinea-Bissau, Namibia, Niger, Swaziland), or the elderly (Kenya, Mozambique, Mauritius, Nigeria) (Figure 1.4.2, panel 2). Differences in design have resulted in variations in the coverage of social safety nets across countries, with less than 20 percent of the population in the region currently covered by such interventions. The transfer amount (as a share of the international daily poverty line of US\$1.90 purchasing power parity in 2011) varies from less than 5 percent (Ghana, Lesotho, Tanzania, Zambia) to more than 10 percent in higher-income countries (Botswana, Namibia, South Africa).

Figure 1.4.1. Sub-Saharan Africa: Development Indicators

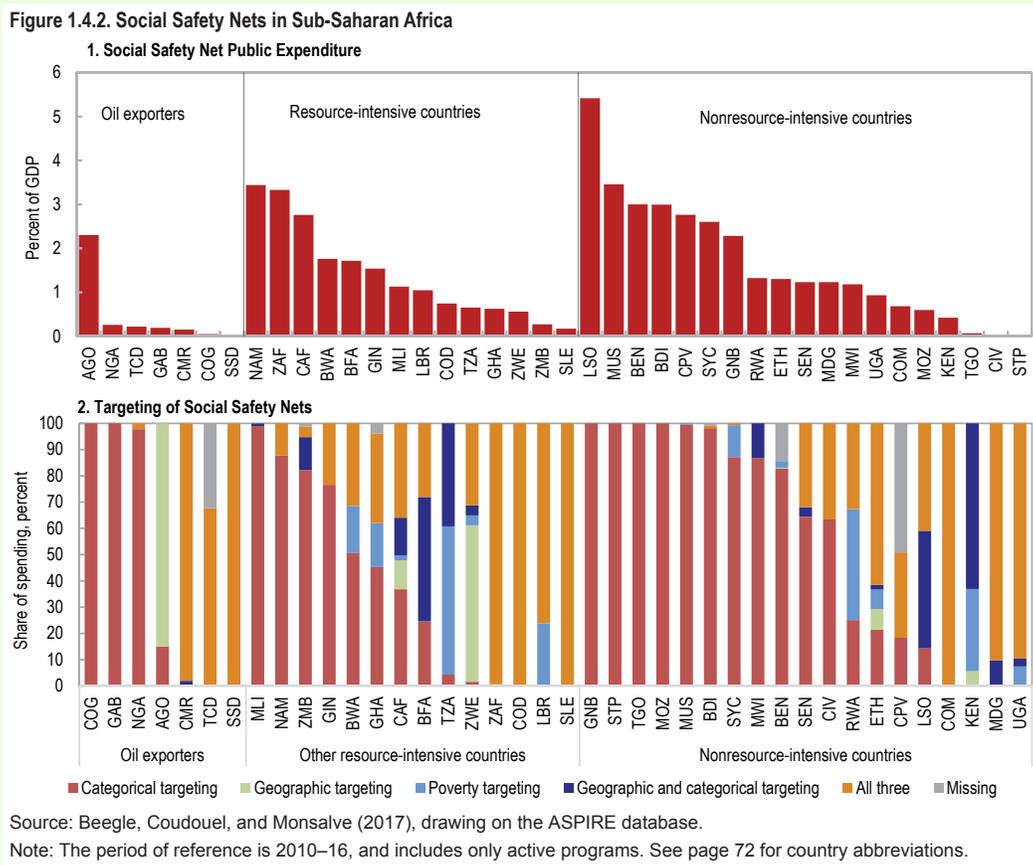


Source: World Bank, World Development Indicators.

Note: PPP = purchasing power parity.

This box was prepared by Aline Coudouel, Emma Monsalve (both from the World Bank), and Monique Newiak.

Box 1.4 (continued)



Varied Impact

The impact of social safety nets on the poorest is important, but varies according to the type of program, the target population, and the generosity of the program. A recent meta-evaluation of social safety nets in Africa underlines their impact in the following areas (Beegle, Coudouel, and Monsalve 2017).

- *Equity.* Programs have a strong impact on households' overall consumption and food consumption, particularly if they have strong targeting protocols for the poor and provide transfers on a predictable and regular basis. The impact on (extreme) poverty rates and depth depends on overall poverty and transfer levels, as programs can improve the consumption of the poorest without bringing them over the poverty line.
- *Opportunity.* Programs can affect productive assets if they have a clearly defined productive objective, and if transfers are larger and given as lump-sums, and combined with complementary activities. Programs can promote investments in human capital, especially for upper primary education and the use of health care services.
- *Resilience.* Programs also promote increased savings and reduced use of negative coping strategies, with a notable reduction in child labor.

Design Matters

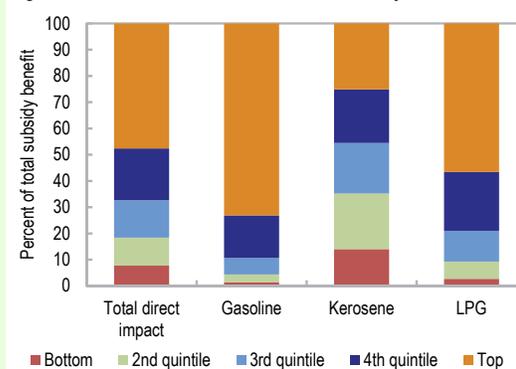
There are no silver bullets for the design of social safety nets, but evidence points to the importance of the design and implementation of effective targeting mechanisms; the right levels and the predictability and regularity of transfers; the sustainability of programs in the long term; a combination of activities that are complementary (school feeding); taking into account particular constraints faced by different groups, such as youth and women; and stronger access to quality basic services. Countries should focus on developing a safety net system that articulates different types of safety nets to respond to their profile of poverty and vulnerability with the following priorities (World Bank 2012; Monchuk 2014; Beegle, Coudouel, and Monsalve 2017):

- *Creating synergies* by building links between existing institutions and programs—for example, by establishing a common institutional platform—and by developing shared instruments to improve efficiency and coordination (particularly through the development of social registries that can be shared by all programs and the establishment of efficient payment systems).
- *Developing the opportunity aspect* of social safety net programs so that, in addition to providing consumption support and mitigating the impact of shocks, they can increase households' human capital and productivity and more generally their resilience to future shocks (for example, cash transfers conditioned on school attendance or enrollment in health programs).
- *Establishing shock-responsive programs* that can be triggered in an efficient and timely manner when shocks occur. Such interventions can build on existing programs and expand them vertically (temporarily adjusting amounts and frequency) or horizontally (adding temporary beneficiaries), triggering new programs for a limited period (ideally building on the administrative systems of permanent programs), or temporarily modifying the program focus or target. Important efficiency gains can be made by responding in a more timely manner with a predefined set of instruments and an adequate financing strategy.

Progressive Funding

Rebalancing from regressive to more progressive expenditures, revenue mobilization, and enhanced public investment efficiency can provide the resources to expand social safety nets. For example, fuel subsidies generally benefit richer households, with less than 15 percent of them received by the bottom 20 percent in the case of kerosene which is mostly used by the poor (3 percent in the case of liquified petroleum gas and gasoline) (Figure 1.4.3). They are, hence, a very inefficient way of increasing the consumption of the poorest households. For sub-Saharan African countries, on average, providing US\$1 to the poorest 40 percent households through untargeted gasoline subsidies costs US\$23 (Coady, Flamini, and Sears 2015).

Figure 1.4.3. Sub-Saharan Africa: Distribution of Subsidy Benefit



Source: Coady, Fiamini, and Sears (2015).
Note: LPG = liquified petroleum gas.

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