

Executive Summary

TIME FOR A POLICY RESET

Economic activity in sub-Saharan Africa has weakened markedly, but, as usual, with a large variation in country circumstances. Growth for the region as a whole fell to 3½ percent in 2015, the lowest level in some 15 years, and is set to decelerate further this year to 3 percent—well below the 5 to 7 percent range experienced over the past decade.

- The sharp decline in commodity prices has put severe strains on many of the largest sub-Saharan African economies. Oil exporters, which include Angola and Nigeria, continue to face difficult economic conditions (with growth for oil exporters as a whole forecast to slow further to 2¼ percent this year from 6 percent in 2014), but so do non-energy-commodity exporters, such as Ghana, South Africa, and Zambia. Meanwhile, Guinea, Liberia, and Sierra Leone are only gradually recovering from the Ebola epidemic, and several southern and eastern African countries, including Ethiopia, Malawi, and Zimbabwe, are suffering from a severe drought.
- At the same time, many other countries continue to register robust growth. Most oil importers are generally faring better, with growth in excess of 5 percent and even higher in countries such as Côte d'Ivoire, Kenya, and Senegal. In most of these countries, growth is being supported by ongoing infrastructure investment efforts and strong private consumption. The decline in oil prices has also helped these countries, though the windfall has tended to be smaller than expected, as exposure to the decline in other commodity prices and currency depreciations have partly offset the gains in many of them.

Although this overall markedly weaker picture begs the question as to whether the region's recent growth momentum has stalled, our view is that medium-term growth prospects remain favorable.

Clearly, with the advent of a far less supportive external environment, the immediate outlook for many sub-Saharan African countries remains difficult and clouded by downside risks. But beyond these current challenges, the underlying drivers of growth that have been in play domestically in the region over the past decade or so—most importantly, the much improved business environment—generally continue to be in place, and favorable demographics are poised to support these drivers over the coming decades.

However, to realize this potential, a substantial policy reset is critical in many cases.

- To date, the policy response among most commodity exporters to the historically large terms-of-trade shock has generally been behind the curve. A year and a half into the shock, and with fiscal and foreign reserves running low and financing constrained, a robust and prompt policy response is needed urgently to prevent a disorderly adjustment. For countries outside monetary unions, exchange rate flexibility, coupled with supportive monetary and fiscal policies, should be the first line of defense. Because the reduction in revenue from the extractive sector is expected to persist, many affected countries also critically need to contain fiscal deficits and build a sustainable tax base from the rest of the economy.
- With the external financing environment markedly tighter, fiscal policy will also need to be recalibrated among the region's market access countries where fiscal and current account deficits have been elevated over the last few years, lest they find themselves with low buffers and vulnerable to a financial crisis if external conditions worsen further.

WEATHERING THE COMMODITY PRICE SLUMP

The second chapter of this publication examines in more detail how the dependence on natural resources has made nearly half of the countries in the region vulnerable to a decline in commodity prices. As a result, though higher commodity prices have in part supported these countries' strong growth of the past decade or so, their exposure to commodity price fluctuations also has a strong macroeconomic impact in downturns, as recent developments attest.

The most vulnerable countries by far are the region's oil exporters. For them, the commodity terms-of-trade shock since mid-2014 has represented an income loss from oil price fluctuations of about 20 percent of GDP. A shock of such a magnitude typically shaves annual growth by some 3 to 3½ percentage points for several years—which is broadly consistent with the growth deceleration observed for oil exporters since 2014. Comparatively, metal exporters have tended to be less affected, although there are important price thresholds, beyond which mines close and jobs are lost, with a detrimental impact on activity.

Evidence from past downswings also highlights the critical role of exchange rate flexibility as a shock absorber for countries that are not part of a currency union. Countercyclical policies too can be important to smooth temporary shocks, and in the last few years, commodity exporters have indeed allowed fiscal deficits to widen in response to declining revenues. However, with fiscal space rapidly diminishing among sub-Saharan African commodity exporters, and commodity prices foreseen to remain low for long, adjustment is increasingly called for. Better domestic revenue mobilization offers substantial potential to strengthen the fiscal balance, while efforts to improve the prioritization, quality, and efficiency of public investment and to enhance the business climate should be actively pursued, so as to further economic diversification and increase economic resilience.

FINANCIAL DEVELOPMENT AND SUSTAINABLE GROWTH

The third chapter documents the substantial progress made by the region in financial development, including in financial services based on mobile telephone and through large home-grown pan-African banks. Empirical evidence suggests that financial development has indeed supported growth and reduced its volatility in the region, as it helped mobilize and allocate financial resources, and supported other economic policies in enhancing growth and stabilizing the economy.

Even so, there is still considerable scope for further financial development, especially compared to other regions—a gap that, if filled, could yield as much as 1½ percentage points of additional growth on average for countries in the region. With the exception of the region's middle-income countries, both financial market depth and institutional development remain lower than in other developing regions.

The region's improving financial development has been largely driven by better macroeconomic fundamentals, but hindered by weak institutional quality, and policies should focus especially on improving legal frameworks and corporate governance to further support financial development.