1. The Quest for Recovery

The broad-based slowdown in sub-Saharan Africa is easing, but the underlying situation remains difficult. Growth is expected to pick up from 1.4 percent in 2016 to 2.6 percent in 2017, reflecting one-off factors—particularly, the rebound in Nigeria’s oil and agricultural production, the easing of drought conditions that impacted much of eastern and southern Africa in 2016 and early 2017—and a more supportive external environment. While 15 out of 45 countries continue to grow at 5 percent or faster, growth in the region as a whole will barely surpass the rate of population growth, and in 12 countries, comprising over 40 percent of sub-Saharan Africa’s population, income per capita is expected to decline in 2017.

A further pickup in growth to 3.4 percent is expected in 2018, but momentum is weak, and growth will likely remain well below past trends in 2019 (Figure 1.1). Ongoing policy uncertainty in Nigeria and South Africa continues to restrain growth in the region’s two largest economies. Excluding these two economies, the average growth rate in the region is expected to be 4.4 percent in 2017, rising to 5.1 percent in 2018–19. But even where growth remains strong, in many cases it continues to rely on public sector spending, often at the cost of rising debt and crowding out of the private sector.

Key downside risks to the region’s growth outlook emanate from the larger economies, where elevated political uncertainty could delay needed policy adjustments and dampen investor and consumer confidence. Some progress has, however, been made to address the policy inertia in the Central African Economic and Monetary Community (CEMAC) as most hard-hit oil exporters have embarked on adjustment programs to facilitate economic recovery, while discussions with the remaining two CEMAC members are underway.

The evolution of the global environment since 2016 has become more favorable for sub-Saharan Africa. Commodity prices (notably oil) remain low but above last year’s troughs. Global growth is on track to exceed 3½ percent in 2017–18, with higher-than-expected growth in the euro area and China, both of which have strong trade and investment links with sub-Saharan Africa. Moreover, increased appetite for yield has translated into improved market access for the region’s frontier economies, reflected in Eurobond issuances by Côte d’Ivoire, Nigeria, and Senegal in the first half of 2017.

On the domestic front, many countries are facing rising vulnerabilities:

- Public debt rose above 50 percent of GDP in 22 countries at end-2016 (Figure 1.2). Debt servicing costs are becoming a burden, especially in oil-producing countries, and in Angola, Gabon, and Nigeria are expected to absorb more than 60 percent of government revenues in 2017. Fiscal risks are also starting to materialize in several fast-growing non-resource-intensive countries, partly reflecting security developments and a decline in cocoa prices (Côte d’Ivoire) and fiscal slippages during an election year (Ghana, Kenya).

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This chapter was prepared by a team led by Jaroslaw Wieczorek and composed of Romain Bouis, Paolo Cavallino, Cleary Haines, and Nkunde Mwase.

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Figure 1.1. Sub-Saharan Africa: Real GDP Growth, 2013–19

Source: IMF, World Economic Outlook database.
Note: proj. = projection. See page 76 for country groupings table.
Growing exposure to the sovereign and the accumulation of domestic arrears have magnified pressures in the financial sector, as evidenced in higher nonperforming loans (Angola, Ghana, Nigeria), a sharp decrease in the growth of credit to the private sector (CEMAC, Zambia), and bank undercapitalization (Nigeria).

While current account deficits have started to narrow and exchange market pressures appear to have abated, in part in response to much needed monetary tightening, international reserves have fallen below adequacy levels in many countries, especially those with fixed exchange rate regimes.

In this context, addressing fiscal vulnerabilities emerges as a key policy priority in many countries, which needs to go hand in hand with renewed efforts to tackle constraints on growth. While medium-term growth projections in most sub-Saharan African countries incorporate an appropriate degree of fiscal adjustment, the challenge is to implement these plans in a timely manner and avert a further buildup of vulnerabilities.

Consolidation needs are largest and most pressing in the oil-exporting countries, which must adjust to oil revenues now less than half their 2013 level and expected to decrease further, as a percentage of GDP, in the near term. For these countries, raising noncommodity revenues should be the primary area of focus, but cutting unproductive public spending—including inefficient investment—is also needed to put public finances on a solid footing.

In most other economies, consolidation needs are considerably smaller but require countries to commit to credible medium-term adjustment paths. Here, the focus should be on reducing inefficient recurrent spending (such as unproductive subsidies), enhancing the efficiency of capital spending, and raising noncommodity revenues, in part to create room for high-priority public investment and other spending with desirable growth and social impacts.

Sub-Saharan African countries can also seize opportunities to enhance growth above current projections through structural transformation and export diversification. Strengthening macroeconomic stability in itself carries a large premium, but beyond that, many countries could also strengthen their growth prospects by improving access to credit, infrastructure and the regulatory environment, and building a skilled workforce.

Against this backdrop, Chapter 2 lays out choices regarding the path and composition of fiscal consolidation in order to contain its impact on output and incomes, and to ensure sufficient fiscal space for priority spending. By looking at past episodes of fiscal consolidation in sub-Saharan Africa, Chapter 2 examines output responses across country characteristics and states of the economy and identifies policies that can mitigate the potential contractionary effects of fiscal consolidation.

Figure 1.2. Sub-Saharan Africa: Total Public Debt as a Percentage of GDP

![Map of Sub-Saharan Africa showing total public debt as a percentage of GDP in 2013 and 2016.](source: IMF, World Economic Outlook database.)
Finally, Chapter 3 reviews progress on economic diversification in sub-Saharan Africa and its association with economic growth. Cross-country experiences show that policies need to build on a country’s endowments and existing strengths and be tailored to tackle specific challenges in order to yield successful diversification. The chapter seeks to identify policies that facilitate structural transformation and export diversification, using cross-country data and country case studies.

A MODEST RECOVERY IS UNDERWAY

A Gradually Improving External Environment

The external environment for sub-Saharan Africa improved with a shift in the composition of global growth and markedly better financing conditions for the region’s frontier markets. However, the outlook for commodity prices remains weak.

The October 2017 World Economic Outlook projects global growth at 3.6 percent in 2017 and 3.7 percent in 2018, slightly above the April 2017 World Economic Outlook forecasts. Growth in China is still below the levels seen in the recent past, and the growth projection for the United States has been revised downward a notch, reflecting lowered expected fiscal stimulus. Overall, in the first half of 2017, growth surprised on the upside in the euro area and China and was strong in India, the three export destinations that account for the bulk of sub-Saharan Africa’s exports to the rest of the world (Figure 1.3).

Low commodity prices continue to weigh heavily on sub-Saharan Africa’s growth outlook. After a slight rebound in 2016, commodity prices have stabilized at relatively low levels compared with their earlier peaks, with oil and iron ore prices less than half their 2013 highs (Figure 1.4). In addition, there were sizable drops in the prices of agricultural raw materials in the first half of 2017, including key sub-Saharan African agricultural commodities (for example, cocoa), though some items (coffee, tea) witnessed price increases.

At the same time, external financing conditions have improved markedly since 2016, with several sub-Saharan African frontier economies (Côte d’Ivoire, Nigeria, Senegal) returning to the market in the first half of 2017 and another (Angola) planning to do so soon. International sovereign bond issuances by the region’s frontier markets in 2017 reached $4.6 billion through June, compared with $750 million in 2016 as a whole (Figure 1.5). The difference between the spreads of sub-Saharan African frontier markets and comparable emerging markets has decreased (Figure 1.6).
Push rather than pull factors appear to be the predominant drivers of sub-Saharan Africa’s improved access to international finance.1

A Modest Growth Pickup Is Expected in 2017...

Growth in sub-Saharan Africa is expected to reach 2.6 percent in 2017, nearly double that in 2016, but still well below past trends and barely above population growth.

With a good harvest and a recovery in oil production after the easing of tensions in the Niger Delta, Nigeria is expected to contribute more than half of the added growth in 2017. Smaller contributions from the other two largest economies reflect a rebound in oil production in Angola, and an uptick in mining and a good harvest in South Africa (Figure 1.7), but growth rates continue to be very low in each of these economies. Growth also remains subdued in the CEMAC oil-producing countries; only strong non-oil GDP growth in Cameroon is keeping growth in that region in positive territory (Figure 1.8).

Growth in the rest of sub-Saharan Africa is higher, on average just short of 5 percent and close to the levels seen in the region since the early 2000s. With the easing of drought conditions, notably in southern Africa, growth is set to increase as agricultural output rebounds in Malawi and Zambia, where good rains also boosted electricity production.2 Meanwhile, the growth momentum has weakened in hitherto fast-growing countries, such as Côte d’Ivoire, where postconflict catch-up effects are fading, and Uganda, where drought and slowing private sector credit impacted growth, at least temporarily.

Growth is gaining traction in some countries in fragile situations, including those affected by the 2015 Ebola outbreak, although Sierra Leone faces renewed challenges in the wake of a recent natural disaster. In others (Burundi, South Sudan), growth prospects continue to be weak, constrained by internal conflict (Box 1.1).

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1 Applying the coefficients reported in Box 1.2 of the October 2016 Regional Economic Outlook: Sub-Saharan Africa, to recent changes in spread determinants indicates that the decline in sub-Saharan African spreads since the end of 2016 has been mostly driven by global factors: lower volatility in global financial markets (proxied by the VIX index); lower perception of uncertainty (evidenced by lower US term premiums); lower funding costs (a smaller LIBOR-Overnight Indexed Spread); and higher or stable commodity prices. In contrast, domestic macroeconomic fundamentals, such as GDP per capita growth rate, the public-debt-to-GDP ratio, and international reserves as a share of GDP, have all deteriorated in the average sub-Saharan African frontier market. Only inflation and current account imbalances improved slightly on average.

2 Hydroelectric sources account for 97 percent of total electricity production in Zambia (World Bank).
Following the commodity price shock, inflation rose sharply during 2015–16, mainly reflecting the pass-through of large currency depreciations in several resource-intensive countries, including Angola and Nigeria. Regionwide, year-over-year inflation began to recede in early 2017 (Figure 1.9) and is expected to drop in 2017 by more than 2 percentage points (from 12.5 percent in 2016). Inflation pressures have eased in Angola and Nigeria with monetary tightening and greater exchange rate stability, as well as in Ghana, Malawi, and Zambia, which also had experienced inflation surges. More recently, several East African countries saw a temporary pickup in inflation in early 2017, following a drought-induced spike in food prices. In Kenya, food price inflation increased from 11.2 percent in December 2016 to a peak of 21.5 percent in May 2017, and headline inflation stayed above the 7.5 percent upper bound of the authorities’ target range through June. A similar pattern has occurred in Rwanda, Tanzania, and Uganda. Subsequently, inflation has fallen in these three countries and in Kenya, where government measures aimed to increase maize imports helped bring inflation below 7.5 percent in July. In Madagascar food prices rose sharply after a cyclone devastated its rice crop in March 2017.

Fiscal Deficits Are Stabilizing...

The deterioration of fiscal balances experienced by many sub-Saharan African countries in recent years is expected to abate in 2017, with fiscal deficits expected to stabilize at their 2016 levels. For many countries, however, these levels remain high—two-thirds of the sub-Saharan African countries are running fiscal deficits in 2017 above their average 2010–13 levels, including several countries where fiscal deficits have widened in recent years in the context of already strong economic growth (Figure 1.10).

- Oil exporters are set to maintain their (weighted) average fiscal deficit at 5 percent of GDP in 2017, broadly unchanged from 2016, but their noncommodity primary deficit (of about 7½ percent of GDP in 2017) is expected to be about 0.3 percentage point of GDP higher than in 2016 (Figure 1.11). This marginal deterioration in the noncommodity primary balance

...and Inflation Pressures Are Gradually Receding

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is driven by developments in Nigeria and Angola. In Nigeria, a recovery in oil production is compensating for the continuing weakness in non-oil revenues, while financing constraints slow budget execution, restraining expenditures. In Angola, non-oil revenues continue to decline as the impact of the oil price shock and subsequent cuts in capital spending spreads to all sectors of the economy. In contrast, the oil-producing CEMAC countries are expected to see a strengthening in both their overall fiscal balances and their noncommodity primary balances due to expenditure cuts in Cameroon, Equatorial Guinea, and the Republic of Congo, while higher non-oil revenues will create some fiscal space in Chad and Gabon (Box 1.2).
1. THE QUEST FOR RECOVERY

from current to capital. Revenue collection is expected to be lower than budgeted in Côte d’Ivoire (due to the drop in cocoa prices) and Kenya, while the scaling up of infrastructure investment will widen the deficit in Madagascar. Consolidation efforts, equally distributed between expenditure cuts and revenue measures, are expected to improve fiscal balances in The Gambia, Guinea-Bissau, and Togo.

…and Monetary Policy Has Responded to Inflationary Pressures

Monetary policy responses have varied widely across the region (Figure 1.12). In oil-exporting countries, after easing in the immediate aftermath of the commodity price collapse, the monetary policy stance was tightened during 2016. This change reflected the growing need to respond to mounting external and inflationary pressures exerted by large fiscal deficits.

- In Angola, raising the policy rate from 12 to 16 percent between March and June 2016 entailed a sharp drop in banks’ excess liquidity and a reversal in base money growth from 25 percent in May 2016 to year over year –15.7 percent in May 2017.

- In Nigeria, where the central bank maintained an exchange rate peg until mid-June 2016, the policy rate was increased from 11 to 12 percent in March and to 14 percent in July 2016; however, the effectiveness of this tightening was limited in the context of excess naira liquidity, which was only later reined in by increased central bank foreign exchange interventions.

- In the CEMAC, the regional central bank (Banque des États de l’Afrique Centrale—BEAC) raised the policy rate by 50 basis points (to 2.95 percent) in March 2017, after an accommodative period that witnessed a large loss of reserves. The BEAC also announced a gradual elimination of its statutory advances to member countries’ governments and the imposition of ceilings on the amounts of government securities that can be accepted as collateral for bank refinancing.

Meanwhile, monetary policy in other countries, mostly with flexible exchange rate regimes, has been broadly accommodative as inflationary pressures have diminished.

- In South Africa, the policy rate was cut at the end of July 2017 for the first time in five years (by 25 basis points) to 6.75 percent in a context of lower inflation, which dropped below 6 percent in the second quarter of 2017, and weak growth. In Namibia, consistent with the peg to the rand, the central bank followed the South Africa Reserve Bank and lowered the policy rate from 7 to 6.75 percent in August 2017.

- In Kenya, Tanzania, and Uganda, the monetary policy stance has been appropriately accommodative, focusing on core inflation, which remained subdued, even though headline inflation rose sharply following a temporary spike in food prices. In Uganda, for example, consistent with its inflation-targeting regime introduced in 2011, the central bank successfully kept core inflation in a narrow band around its 5 percent target; guided by its core inflation forecast and considering the weak growth outlook, it reduced its policy rate by 700 basis points from April 2016 to July 2017 (Box 1.3).

- In Ghana, the central bank cut its benchmark interest rate by 500 basis points from November 2016 to August 2017, following the downward trend in core inflation.

Figure 1.12. Sub-Saharan Africa: Change in Monetary Policy Rate, January 2016–August 2017

Sources: Haver Analytics; and IMF, International Financial Statistics.
Note: CEMAC = Central African Economic and Monetary Community; WAEMU = West African Economic and Monetary Union.
In Many Countries, Exchange Market Pressures Have Eased…

Strong negative exchange market pressures experienced by several countries in recent years started to recede in 2017 (Figure 1.13). This reflected a combination of factors: tighter domestic policies (Mozambique, Uganda); improved trade balances as commodity revenues strengthened (Nigeria, Zambia); and increased foreign financing, including sovereign bond issuances (Nigeria) and other forms of borrowing abroad (Ghana, Zambia). In Nigeria, the easing of pressures facilitated some steps toward liberalizing access to foreign exchange, which has encouraged portfolio inflows and contributed to the narrowing of the parallel market spread from 60 percent in February 2017 to less than 20 percent in August 2017. In contrast, pressures remain high in a number of low-income, resource-intensive countries (Democratic Republic of the Congo, Guinea, Liberia).

In Ghana, portfolio inflows attracted by the issuance of local currency bonds worth US$2 billion helped boost reserves from 2.6 months of imports at end-2016 to 3.3 months in June 2017.
1. THE QUEST FOR RECOVERY

...as Current Account Deficits Have Narrowed...

Current account deficits narrowed throughout the region in 2016, and are expected to narrow further in 2017 (Figure 1.14). For oil exporters, current account balances improved due to increased oil production in both Angola and Nigeria as well as a contraction in imports, in some cases (such as the Republic of Congo) related to a scaling back in public investment. Elsewhere, the narrowing of the current account deficit is explained by a drop in imports due to financing constraints (Togo), completion of major investment projects (Ethiopia), and weak domestic demand (South Africa).

Current account deficits in non-resource-intensive economies are expected to remain high—averaging close to 8 percent of GDP in 2017—but are largely financed through foreign direct investment.

...but External Buffers Remain Low

The improvement in current account balances has yet to translate into an appropriate reconstitution of external buffers. While international reserves in sub-Saharan African countries average 4.8 months of imports, above the traditional three-month import benchmark, half of the region’s economies have less than three months of imports’ worth of reserves, and in some countries international reserves are at critically low levels (for example, the Democratic Republic of the Congo and Zimbabwe have about 0.4 month and 0.6 month of imports’ worth of reserves, respectively). Moreover, looking at broader indicators of reserve adequacy (see IMF 2013), the IMF’s metric for credit-constrained countries suggests a desired 2017 level of reserves equivalent to about 5.6 months of imports, with higher levels for resource-intensive economies and economies with fixed exchange rate regimes (Figure 1.15). Against this metric, the reserves of the resource-intensive countries with conventional pegs appear particularly low, while countries with other exchange rate arrangements have seen their reserves fall further below adequacy levels.

Vulnerabilities to terms-of-trade and weather-related shocks remain elevated. While much of the volatility in recent years has been driven by oil prices, a number of sub-Saharan African countries have large agricultural exports where price swings—or harvest disruptions—can significantly impact export receipts. Indeed, the sharp decline in cocoa prices in early 2017 is expected to affect several sub-Saharan African economies, including the three leading producers of cocoa (Cameroon, Côte d’Ivoire, Ghana) (Figure 1.16).

4The adequacy benchmarks have increased since 2013 for the economies with other exchange rate regimes, on account of the increased domestic vulnerabilities and higher likelihood of external shocks.
Mounting Domestic Vulnerabilities

Public debt has increased as a percentage of GDP since 2013 in all but four sub-Saharan African countries and, in many of them, amplified strains on the financial sector. This was driven by slow growth, a slump in commodity prices, widening fiscal deficits, and in some cases sharp exchange rate depreciations.

Public Debt Has Risen...

The median level of public sector debt in sub-Saharan Africa rose from about 34 percent of GDP in 2013 to 48 percent in 2016, and is expected to exceed 50 percent in 2017. Debt accumulation was particularly high (about 8 percent of GDP a year) during 2014–16 in oil-exporting countries, reflecting large primary deficits, growing interest bills and balance sheet effects associated with exchange rate depreciation and low (and at times negative) economic growth (Figure 1.17). The debt-to-GDP ratio has been increasing less rapidly in other countries. Still, also there, the average annual rate of debt accumulation during 2014–16 approached 5 percent of GDP as primary deficits have risen, but consistently higher growth, especially in the case of non-resource-intensive countries, has slowed the increase in the debt-to-GDP ratio. In addition, in several countries, debt has increased due to a variety of below-the-line operations, including the buildup of arrears, adjustments for incomplete recording of treasury transactions, and operations on special accounts for public enterprises.

The composition of public debt has changed since 2013. Although external debt remains dominant, its share in total public debt has fallen in recent years as governments in oil exporting and nonresource-intensive countries have increasingly relied on domestic bank and nonbank financing. (Figure 1.18).

Debt service costs have risen sharply, especially in oil-exporting countries. The median debt service-to-revenue ratio among sub-Saharan African countries increased from 5 percent in 2013 to almost 9 percent in 2016 and is expected to reach nearly 10 percent in 2017 (Figure 1.19). In oil-exporting countries the median debt-service-to-revenue ratio more than tripled between 2013 and 2016, and in 2017 is expected to exceed 26 percent, with the highest expected increases in Gabon (from 55 percent in 2016 to 71 percent in 2017) and Nigeria (from 22 percent in 2016 to nearly 62 percent in 2017).
The debt sustainability outlook has worsened considerably since 2013. The number of low-income countries in debt distress or facing a high risk of debt distress increased from 7 in 2013 to 12 in 2016. Also, consistent with the broader trend of credit downgrades in emerging markets, several sub-Saharan African frontier markets or other countries with sovereign credit ratings have been downgraded; only Namibia was still rated by Fitch as investment grade at the end of August 2017 (Figure 1.20), while Moody’s downgraded Namibia to non-investment grade on August 11, 2017. Furthermore, several countries are engaging creditors on debt restructuring or rescheduling operations (Chad, Republic of Congo, The Gambia, Mozambique).

...Contributing to the Growth of the Banks-Sovereign Nexus

Increased lending by domestic banks to governments has further raised their exposure to the sovereign. In addition, with many sub-Saharan African governments continuing to accumulate arrears, banks’ liquidity and solvency indicators have deteriorated, with potential negative feedback loops as liquidity stress in the banking system raises rollover risks for the sovereign. In some countries, banks’ purchases of government securities have been facilitated by central banks’ refinancing operations of commercial banks (The Gambia, Togo), with banks taking advantage of the spread between interest rates on government debt and refinancing rates, resulting in an indirect monetization of fiscal deficits.

...and the Slowing of Credit to the Private Sector

Credit growth to the private sector decreased from 18.6 percent on average in 2011–13 to 11.2 percent in 2014–16. This negative trend has accelerated in recent months, with private sector credit contracting in real terms in 18 countries in the region between March 2016 and March 2017.

Higher bank exposure to the government appears to be at least in part responsible for this slowdown (for example, in Angola, CEMAC, The Gambia). Indeed, the decline in credit growth to the private sector in 2014–16 relative to 2011–13 was more pronounced in countries where banks’ exposure to the government increased the most between the two

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**Figure 1.18. Sub-Saharan Africa: Public Sector Debt Decomposition, 2010–16**

<table>
<thead>
<tr>
<th>Domestic debt</th>
<th>External debt</th>
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<tbody>
<tr>
<td>7</td>
<td>17</td>
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<td>15</td>
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<td>14</td>
<td>28</td>
</tr>
<tr>
<td>18</td>
<td>33</td>
</tr>
</tbody>
</table>

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

**Note:** Debt is recorded on a currency basis. See page 76 for country groupings table.

**Figure 1.19. Sub-Saharan Africa: Total Debt Service as a Percentage of Revenue, 2010–17**

<table>
<thead>
<tr>
<th>Percent of revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
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<td>2011</td>
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<td>2012</td>
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<td>2015</td>
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<td>2016</td>
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<tr>
<td>2017</td>
</tr>
</tbody>
</table>

**Source:** IMF, World Economic Outlook database.

**Note:** See page 76 for country groupings table.

**Figure 1.20. Sub-Saharan Africa: Fitch Credit Risk Ratings, 2013–17**

*Note: Ratings below BBB are non-investment-grade. The Republic of Congo was in “Restricted Default” during August 3–11, 2016. Namibia’s rating was downgraded by Moody’s from Baa3 to Ba1 (non-investment-grade) on August 11, 2017. See page 78 for country abbreviations.*
periods (Figure 1.21). However, the recent credit slowdown in some East African Community (EAC) countries and its contraction in real terms does not appear to result from crowding out (in some countries, both the exposure of banks to sovereigns and credit growth to the private sector decreased), but rather from an autonomous weakening of credit demand, likely related to bank clients’ difficulties with servicing outstanding debt. A tightening of credit standards by banks and, in the case of Kenya, the impact of the interest rate caps imposed on loans to the private sector, also dampened credit growth. Moreover, in Kenya and Rwanda, the credit slowdown has been accompanied by a marked decline in broad money growth.

**Financial Conditions of Banks Have Weakened…**

The economic slowdown in 2016 has affected the financial sector in sub-Saharan Africa. Strains have been exacerbated by foreign exchange market pressures, particularly in countries with dollarized bank balance sheets (Angola, Ghana, Zambia, EAC) and where liquidity conditions have been tightened sharply (CEMAC). Nonperforming loans have edged upward (Chad, Kenya, Nigeria) (Figure 1.22), bank profitability has decreased (Chad, Kenya, Namibia, Nigeria), and bank capital adequacy indicators have weakened in many countries, despite efforts to clean up banks’ balance sheets (Angola, Ghana, Nigeria). Although the profitability of banks appears high in some cases (The Gambia), this mainly reflects large holdings of government securities.

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**Figure 1.21. Sub-Saharan Africa: Change in Banks’ Exposure to the Government and Change in Private Credit Growth, Average, 2011–13, versus Average, 2014–16**


Note: This figure shows the negative relationship between the change in the average banks’ exposure to the government (measured by banks’ holdings of government securities as a share of total assets) and the change in the average annual growth rate of credit to the private sector, from 2011–13 to 2014–16. See page 76 for country abbreviations.

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**Figure 1.22. Sub-Saharan Africa: Bank Nonperforming Loans as a Percentage of Total Loans**

Sources: Country authorities; and IMF, *International Financial Statistics.*

Note: See page 76 for country groupings table and page 78 for country abbreviations.

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5 The negative relationship between banks’ holdings of government securities and credit growth to the private sector is confirmed by cross-country analysis controlling for traditional determinants of credit growth. A 1 percentage point increase in banks’ exposure to the government is associated with a 0.6 percentage point decrease in the annual growth of credit to the private sector (Bouis, forthcoming).

6 Holdings of government paper also benefit from the absence of capital requirements (given the zero-risk weight assigned to sovereign debt), lower cost of access to central bank refinancing, and in some cases, tax exemption on interest (for example, in WAEMU countries).

7 For instance, the Angolan authorities have launched a publicly financed asset-management vehicle to collect on impaired loans for both state-owned and selected private banks.

8 Econometric analysis indicates that bank profitability (measured by the return on assets) is positively explained by bank holdings of government securities as a share of total assets (Bouis, forthcoming).
1. THE QUEST FOR RECOVERY

…and Many Countries Have Experienced Withdrawals of Correspondent Banking Relationships

The loss of correspondent banking relationships (CBRs) has continued to spread, reflecting heightened risk-adjusted cost of doing business in host jurisdictions, notably due to greater rigor in enforcing regulations against money laundering and terrorism financing. While CBR exits were initially limited to Angola and smaller jurisdictions (for example, Comoros or Liberia, where all commercial banks have lost at least one CBR in the past three years), more recently, banks in other economies (Democratic Republic of the Congo, Côte d’Ivoire, Kenya) have also seen CBR exits (Figure 1.23). SWIFT data, which capture a meaningful share of correspondent banking activity, indicate that Angola, Mozambique, and Uganda experienced the largest drops in SWIFT transactions, averaging 30 percent in value terms from January 2011 to June 2016 (FSB 2017).

The economic impact of CBR exits is likely to be significant in countries where remittances represent a large share of GDP (Cabo Verde, Comoros, The Gambia, Lesotho, Liberia, Senegal, Togo) and in smaller jurisdictions where further loss of CBRs could disrupt economic activity (Seychelles). Furthermore, the withdrawals of CBRs could result in longer payment chains, an increasing number of intermediaries involved in processing the same payment, an increasing number of restrictions, and higher concentration on the correspondent and respondent side. This could accentuate financial fragilities and undermine long-term growth and financial inclusion by increasing costs of financial services and negatively affecting bank ratings (FSB 2017, IMF 2017).

WHAT LIES AHEAD—OUTLOOK AND RISKS

Modest Recovery Expected to Continue in 2018 but Weak Momentum

Growth is expected to continue to recover in 2018 to 3.4 percent, but will likely remain flat in 2019, and well below the levels achieved earlier in the decade. Similarly to 2017, the growth increase in 2018 will be driven by a few one-off factors, including the expected full-year effect of the recovery in oil production in Nigeria, which started in 2017, and, to a lesser extent, the long-anticipated coming onstream of new oil fields in the Republic of Congo and Ghana (Figure 1.24; Tables 1.1 and 1.2). Beyond these one-off factors, near-term growth prospects appear to have improved for several small and medium-sized countries (Burkina Faso, Lesotho, Malawi, Uganda), but growth will likely be lower than previously anticipated in South Africa due to weak consumer and investor confidence and a normalization of mining and

Figure 1.23. Sub-Saharan Africa: Number of Correspondent Exits, 2011–16

Source: Financial Stability Board, Correspondent Banking Coordination Group (CBCG) survey.
Note: Countries with bars in green are in fragile situations. See page 78 for country abbreviations.

Figure 1.24. Sub-Saharan Africa: Growth Prospects, 2017 and 2018

Sources: IMF, World Economic Outlook database; and IMF staff calculations.
agriculture production after one-off increases in 2017. While the non-resource-intensive countries are expected to continue to grow robustly, growth prospects in many countries will depend critically on planned fiscal consolidations.

**Elevated Downside Risks**

On the external front, risks appear broadly balanced in the near term. On the upside, growth momentum in the euro area and East Asia could prove more durable than expected. Downside risks include a higher external market premium for sovereign bonds due to changing investor sentiment, a more rapid than expected tightening of global monetary conditions, and a further drop in commodity prices. Sovereign downgrade risks could further weigh on the investment climate and adversely affect growth, particularly in South Africa, with potential regional spillover effects, while a deterioration in market sentiment could heighten the rollover risk. In the medium term, risks are skewed to the downside and include the possibility of a sharp adjustment in China.

On the domestic front, downside risks appear to dominate. Delays in implementing policy adjustments would reduce fiscal space for progrowth expenditures and adversely impact the external sector while the continued crowding out of the private sector may stifle the expected pickup in growth. In countries with pressing macroeconomic sustainability concerns, failure to implement needed policy adjustments in a timely manner risks disruptive outcomes. Many countries should also be mindful of the risks associated with the ongoing disruption in correspondent banking relationships.
Exogenous shocks remain a critical source of vulnerability in many sub-Saharan African countries. Climatic variations in rainfall (including droughts and floods) are a particular concern due to continued high dependence on rain-fed agriculture as well as other weather-sensitive activities such as electricity production (especially in East Africa and Central Africa, where hydropower accounts for over 50 percent of electricity generation). Other important risk factors include a resurgence in socioeconomic tensions (for example in postconflict countries, such as Côte d’Ivoire), and terrorist operations (Lake Chad region, the Sahel, Kenya).

FISCAL CONSOLIDATION IS ENVISAGED IN MANY COUNTRIES

How Much and How Fast?

With many countries facing elevated debt levels and increasing debt service costs, it becomes increasingly important to ensure that fiscal policy strikes an appropriate balance between addressing development needs and avoiding unsustainable debt buildup. Most sub-Saharan African countries reflect this consideration in their medium-term economic strategies. Consequently, subject to the planned fiscal adjustment’s being undertaken, in most countries, debt-to-GDP ratios should stabilize or decrease, alleviating debt sustainability concerns. Experience shows, however, that planned fiscal adjustments tend to be postponed—yet the forward-looking analysis offers little scope for further postponement.

A continuation of the elevated pace of debt accumulation seen in 2014–16 would increase public debt to unsustainable levels in each of the country groupings (Figure 1.25). While this aggregate picture masks considerable heterogeneity in country circumstances, most sub-Saharan African countries are planning fiscal consolidations over the medium term in order to maintain their public finances on a sustainable path going forward, thereby safeguarding macro-stability as well as harmonizing the fiscal policy stance with absorptive capacity limits—as summarized in the baseline projections aggregated in Figure 1.25.

The size and pace of the projected adjustment differ depending on country circumstances:9

- For oil-exporting countries, the projected consolidation effort amounts on average to 5.3 percentage points of GDP over the next five years (Figure 1.26). In some cases (such as Angola) a considerable adjustment has already been made, but most of the adjustment so far has been achieved through capital spending cuts, reflecting a combination of deliberate policy choices and financing constraints.

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9 For countries with IMF-supported programs, the analysis is based on program scenarios. For other countries, it is based on baseline projections or, if available, on an alternative scenario that reflects the additional adjustment needed to ensure macroeconomic stability. The GDP projections underpinning the analysis in each case are consistent with the projected fiscal consolidation. For the sake of comparability across country groups and to sharpen the focus on efforts that are within the remit of country authorities, the analysis focuses on the noncommodity primary fiscal balance.
Going forward, consolidation efforts in oil-exporting countries are expected to focus on increasing noncommodity revenues—which averaged only about 9 percent of GDP in 2016 and were as low as 3.3 percent of GDP in Nigeria and 4.5 percent of GDP in Equatorial Guinea—and on making targeted reductions in current spending.

- In other resource-intensive countries, where commodity revenues represent a much smaller share of total revenues, the projected medium-term consolidation amounts on average to 2.6 percent of GDP over five years. The bulk of the adjustment is envisaged to come from cuts in current spending, which has grown rapidly in the context of the expansionary fiscal policies of recent years (Figure 1.27). In some countries, the consolidation path features an increase in capital spending relative to current levels.

- For non-resource-intensive countries, the projected consolidation is estimated at 3.3 percent of GDP over the next five years. The consolidation effort is expected to focus on raising noncommodity revenues—the countries’ main source of earnings—and on reducing current expenditure, while ensuring space for investment spending.

**How Can the Impact of Fiscal Adjustment on Growth and Social Outcomes Be Mitigated?**

To limit the negative impact on growth, fiscal adjustment should rely on quality measures with low short-term multipliers. Drawing on the analysis in Chapter 2, cuts in capital expenditure, which are associated with the highest negative output impact, should generally be avoided unless the contemplated investment spending is unproductive or cannot be efficiently implemented, or if the level of debt and consolidation needs are so large, for example due to binding financing constraints, that cutting investment spending is unavoidable to ensure debt sustainability. Multipliers associated with raising additional tax revenues and cuts in recurrent spending (for example, subsidies) are lowest, though some expenditure cuts may have important distributional consequences that would need to be addressed via social protection schemes.
A timely and well-planned fiscal consolidation is critical in order to avoid the necessity of too sharp an adjustment and to provide time to mitigate adverse impacts on growth and social outcomes. Further, in defining the scope for expenditure cuts, particular attention should be devoted to preserving progrowth spending, such as that on education and health. Adequate allowance should also be made for the operation and maintenance of existing infrastructure, which often gets sidelined by new investment outlays without due consideration for their efficiency and economic soundness.

Monetary policy can help lessen the burden of fiscal tightening. Countries that wholeheartedly adopted interest-based operational frameworks have achieved a lower level and less volatility of inflation, without compromising real output stabilization. In these countries, the policy rate can be used to stimulate growth and mitigate the contractionary impact of prospective fiscal tightening.

**Implementation Can Be a Challenge**

Instilling fiscal discipline and putting debt on a sustainable path in most cases will require strong structural fiscal reforms, including to ensure adherence to fiscal responsibility laws, and will place pressure on public financial management systems and revenue mobilization.

- On the revenue side, widespread exemptions, limited tax bases, and poor administration may constrain the ability to achieve revenue gains in the near term. In many countries, overoptimistic revenue projections have been a source of frequent and persistent revenue shortfalls that lead to the accumulation of arrears.

- On the spending side, lax commitment controls, revenue earmarking, and limited coverage of fiscal accounts (nonconsolidated government accounts) can lead to frequent and large spending overruns. Recurrence of domestic arrears not only undermines the credibility of budget targets, but also has a negative impact on the private sector, including banks.

Mustering political buy-in for reforms is key, as fiscal consolidation will likely involve taking on vested interests. The probability of success can be enhanced through a combination of transparency and investing in technical capacity to strengthen key institutions.

**Measures Are Also Needed to Loosen the Banks-Sovereign Nexus**

Bank financing of the government provides fiscal breathing space but may fuel inflation if supported by central bank refinancing, expose the banking sector to liquidity stress, and crowd out credit to the private sector, further weakening the economy and worsening fiscal balances. These risks should be addressed through a combination of policies that includes fiscal consolidation; a gradual tightening of central bank refinancing of commercial banks in countries where this has significantly increased; the removal of various benefits attached to government securities holdings (including, among other things, tax deductibility and exemptions on exposure or reserve requirements); a reduction of state ownership of banks; and the implementation of macroprudential measures such as large exposure limits and capital surcharges on the sovereign.10 The pace of implementation of these measures should, however, be subject to country-specific circumstances so as not to deprive a sovereign of financing resources when they are most needed and force an unduly abrupt fiscal adjustment.

In the medium term, improving financial market infrastructure (including property titling and the availability of credit bureaus to reduce information asymmetries) can broaden banks’ investment opportunities and foster the diversification of loan portfolios.

With fiscal space constrained by rising public debt, addressing growing vulnerabilities in banking systems will be particularly important to ensure that financial institutions can support private sector expansion to mitigate the negative impact of fiscal consolidation on growth and support a sustainable recovery. To this end, fiscal consolidation plans

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10 Traditional microprudential tools are less suitable to mitigate risks from bank lending to the government, as all sub-Saharan African countries (except South Africa) have opted for either Basel I or Basel II regulations, which assign a zero-risk weight to all sovereign debt denominated in domestic currency.
need to be supplemented by arrangements to resolve domestic payment arrears to government suppliers, one of the key factors driving the growth of nonperforming loans. Meanwhile, liquidity pressures in the banking sector should be addressed by putting in place emergency liquidity facilities for banks that roll over domestic securities, as implemented recently by the BEAC. Authorities should also conduct rigorous asset quality reviews of banks linked to stress tests to help identify forward-looking capitalization needs. Weaker banks should be immediately recapitalized or resolved to avoid threatening confidence in the banking system.

**STIMULATING GROWTH IN THE MEDIUM TERM**

Efforts to strengthen medium-term sustainability prospects through fiscal consolidation are urgent. But no less important for most sub-Saharan African countries is to act on a broader front to stimulate growth, including by improving conditions for private investment and diversifying away from commodity dependence.

**Creating Space for Private Investment**

While reducing banks’ exposure to the government can create space for private sector investment in sub-Saharan African countries and support growth, complementary measures may be needed to address infrastructure bottlenecks. Most notably, deficits in physical infrastructure in countries in the region could constrain GDP growth by 2 percentage points a year (AfDB 2016). This underscores the need to protect capital spending during fiscal consolidation, ensuring the highest possible degree of efficiency during the process and prioritizing public projects according to their growth and social impact. Sub-Saharan African countries also have much to do to improve governance, including the rule of law and government effectiveness, even compared with other developing economies (Figure 1.28). For instance, public-private partnerships remain limited due in part to the lack of institutional frameworks, weak judicial systems, and capacity constraints (Gurara and others, forthcoming).

Addressing the constraints and market failures mentioned above could help unlock private investment. In the near term, this will require improving the macroeconomic environment, reducing fiscal dominance, and enhancing the public-private partnership framework. Innovations, including further expansion of fintech, could also enhance domestic private sector investment and inclusiveness. New international initiatives (Compact with Africa by the G20 and China’s One Belt One Road) also provide opportunities to expand space for infrastructure investment, including with private sector financing.

**Fostering Structural Transformation and Economic Diversification**

As documented in Chapter 3, structural transformation and export diversification have been slower in sub-Saharan Africa than in other regions. The aggregate picture masks the significant progress achieved in the region’s other resource-intensive economies and non-resource-intensive economies, many of which have diversified their economies at a similar pace to their global peers. Structural reforms to foster further economic diversification depend on a country’s circumstances and endowments, and should strengthen macroeconomic and political stability, improve education outcomes, bolster governance and transparency in regulation, and deepen financial markets. These policies, together with better infrastructure, can contribute to stronger growth and improved resilience (IMF 2015).
Countries in fragile situations face deep development challenges. These countries are often characterized by a legacy of severe social and political turmoil, economic instability, and, in some cases, violent conflict. Currently, there are about 20 such countries in sub-Saharan Africa. Since the start of this century, only a few countries (for example, Rwanda, Uganda) have been able to build resilience and escape fragility, which has been achieved through focused policies necessary to foster economic stability and growth, improve governance and security, and strengthening institutions to enable the state to deliver basic services (Gelbard and others 2015). In light of the above, the impact of lower commodity prices in sub-Saharan Africa has been more negative in countries in fragile situations than in other countries, often exacerbated by sociopolitical, governance, and security problems. While the policy response has been uneven across and within countries, several countries have recently improved their economic policy frameworks, which, combined with a modest rebound in commodity prices in 2017–18, is expected to pave the way for economic recovery. But there are significant risks, underscoring the need for determined actions to build resilience.

During the past three years, many of the sub-Saharan African countries in fragile situations were negatively influenced by lower commodity prices and, in some cases, surges in political instability, epidemics, or conflict. For the group as a whole, economic growth and incomes fell, inflation rose, fiscal deficits and debt increased, and foreign reserves declined. Most countries were severely affected by these developments, although some managed to avoid major consequences or even fared relatively well, partly because their economies are relatively less dependent on commodity exports, but also because of appropriate policies and reforms.

Figure 1.1.1. Sub-Saharan Africa: Macroeconomic Indicators

Source: IMF, World Economic Outlook database.
Note: Proj. = projection.

This box was prepared by Enrique Gelbard.

1 Countries are deemed to be in a fragile situation if the three-year average of their Country Policy and Institutional Assessment rating (compiled by the World Bank) is less than 3.2 or if they are hosting a United Nations/regional peace-keeping or peace-building mission. In sub-Saharan Africa, these countries are Burundi, the Central African Republic, Chad, Comoros, Democratic Republic of Congo, the Republic of Congo, Côte d’Ivoire, Eritrea, The Gambia, Guinea, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Sāo Tomé and Príncipe, Sierra Leone, South Sudan, Togo, and Zimbabwe. Other organizations that compile lists of countries said to be fragile include more sub-Saharan African countries in this situation (for example, the Organisation for Economic Co-operation and Development States of Fragility Report 2016, and the Fund for Peace Fragile States Index, 2017).
Burundi, Chad, the Democratic Republic of the Congo, the Republic of Congo, Eritrea, The Gambia, Liberia, Sierra Leone, South Sudan, and Zimbabwe experienced a rather marked deterioration in their economic performance. In comparison, Comoros, Guinea, Madagascar, São Tomé and Príncipe, and Togo avoided significant declines in economic growth, although their fiscal and debt positions worsened. Notably, the Central African Republic, Côte d’Ivoire, Guinea-Bissau, and Mali managed to record strong economic growth, while scaling up public investment.

Economic policies have varied across the region. Several countries have put in place policy frameworks to achieve or preserve macroeconomic stability while supporting growth and poverty reduction, which has enabled close engagement with the IMF and the international community (Central African Republic, Chad, Côte d’Ivoire, The Gambia, Guinea-Bissau, Madagascar, Malawi, Mali, Sierra Leone, Togo). In some other countries, policies and reforms have not progressed much due to political, governance, and, in some cases, security challenges (Burundi, Democratic Republic of the Congo, Republic of Congo, Eritrea, South Sudan, Zimbabwe).

The experience of Côte d’Ivoire is noteworthy as a country that built resilience in recent years. Following a decade of political instability, and declines in living standards, the full implementation of a power-sharing agreement paved the way for political normalization in 2011. This has been accompanied by financial support from the international community and focused economic reforms in the areas of revenue administration, public financial management (including expenditure control, debt management, and public banks), the business climate, and the electricity sector. The results have been promising, with increases in public and private investment leading to an average annual rate of economic growth of nearly 9 percent, renewed access to international financial markets, some improvements in health and education indicators, and gains in terms of state legitimacy and governance.

Prospects for 2017 and 2018 point to gradual improvements in economic conditions in most sub-Saharan African countries in fragile situations, but risks abound. Economic growth is expected to pick up in the Central African Republic, Chad, Comoros, the Republic of Congo, The Gambia, Liberia, and Malawi while improvements in fiscal balances are projected to be modest because of spending needs and relatively subdued commodity prices. Prospects for Côte d’Ivoire, Guinea-Bissau, and Madagascar are more promising due to ongoing robust growth, low inflation, and stable fiscal positions and sustainable debt levels. Notwithstanding this positive outlook, there are various risks, including low levels of foreign exchange reserves in many countries, and in some cases, signs of deteriorating soundness in the banking system. In particular, the economic outlook for Burundi, Eritrea, São Tomé and Príncipe, Togo, and Zimbabwe is complicated by high levels of public debt, while climate change risks are also important for Burundi, Eritrea, Madagascar, and Malawi.
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<tr>
<th>Country</th>
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<th>Security</th>
<th>Economic Policies/Reforms</th>
<th>Governance/Public Services</th>
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<td>Zimbabwe</td>
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Progress is being made; policies/reforms are broadly adequate
Need continued attention and, in most cases, additional actions
Serious constraint; progress is essential in period ahead

Sources: Fund for Peace, Fragile States Index 2017; Organisation for Economic Co-operation and Development, States of Fragility 2016; World Bank, World Governance Indicators 2016; and IMF staff estimates
Note: PFM (public financial management) refers primarily to budget and treasury management.
Box 1.2. CEMAC’s Regional Economic Strategy

Member countries of the Central African Economic and Monetary Community (CEMAC) have been particularly impacted by the decline in oil prices. With oil accounting for about 74 percent of the countries’ exports in 2014, this decline has profoundly impaired these countries’ external and fiscal balances, as oil export proceeds and budget oil revenues plummeted between 2014 and 2016. The oil revenue shock and accommodative fiscal policies by member countries contributed to an increase in fiscal deficits and in public debt, from 27 percent of GDP in 2014 to 50 percent of GDP in 2016, despite initial spending cuts by some member countries. The widening fiscal deficits, along with accommodative monetary policy, also contributed to a substantial increase in the current account deficit from 3.9 percent of GDP in 2014 to 13.9 percent of GDP in 2016, and to a sharp decline in the international reserves of the regional central bank (BEAC) from 6 months of imports at the end of 2014 to 2.4 months at the end of 2016 (Figures 1.2.1, 1.2.2, 1.2.3). These economic difficulties have been compounded by security threats from Boko Haram in the Lake Chad region and civil unrest in the Central African Republic.

Faced with these acute economic difficulties, the countries have devised a strategy to turn their economies around. At their extraordinary summit of December 23, 2016, CEMAC’s heads of state committed to implementing strong national and regional policies and reforms to help avert the depletion of reserves and continue to support the monetary union arrangement. In coordination with the IMF and other development partners, this commitment has since been translated into a regional strategy. At the national level, this strategy calls for (1) sizable fiscal adjustments to ensure the fiscal sustainability of each member country and help avert the depletion of reserve assets and initiate rebuilding them to an adequate level; and (2) structural reforms to strengthen public financial management and enhance the business environment, as well as other country-specific steps needed to restore sustainable growth. These objectives will be supported by regional actions to support the third and fourth prongs of the strategy, which are to tighten monetary policy and liquidity management consistent with external stability and to strengthen the financial sector.

The IMF is supporting the authorities in implementing this strategy through financing, policy advice, and technical assistance. In mid-2017 the IMF approved new programs for Gabon, Cameroon, and Chad, and an increase in funding for the Central African Republic. Discussions are ongoing with the Republic of Congo and Equatorial Guinea. In conjunction with financial assistance provided by other development partners, the

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1 CEMAC member countries are Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon.
financing provided under the programs will allow for a more gradual adjustment process than would otherwise be the case. It will also provide more time for countries to implement much-needed structural reforms, which will help them become more resilient to future shocks and crises. The IMF’s policy advice and technical assistance have also covered a broad front, including three areas that will be critical to the success of the reforms: (1) policy coordination among countries and with regional institutions in order to ensure that all CEMAC countries contribute to the regional effort; (2) growth-friendly and inclusive fiscal reforms, notably to mitigate the effects of expenditure cuts through improved spending efficiency and to help protect the poor; and (3) combating corruption and increasing transparency in the use of public resources.

Figure 1.2.3. CEMAC: Reserve Coverage, June 2014–July 2017

Sources: Central African Economic and Monetary Community (CEMAC) authorities; and IMF staff calculations.
Box 1.3. Improving Monetary Policy Frameworks in Sub-Saharan Africa

A number of sub-Saharan African countries with some degree of exchange rate flexibility have adopted forward-looking monetary policy frameworks to anchor inflation and promote macroeconomic and financial stability. These countries have begun to rely on policy rates to signal their monetary policy stance and are assigning a greater role to short-term interest rates in implementing monetary policy. The experience of the last decade suggests that among the 22 sub-Saharan African countries with exchange rate flexibility, those with interest-based operational frameworks experienced lower and more stable rates of inflation without reducing their output growth or increasing output volatility.

This box compares the economic performance of these 22 countries during 2012–16 and 2002–06. The choice of the period is motivated by two reasons. First, since 2012, several central banks have started implementing more effective operational frameworks and have invested in analytical capacity by developing their forecasting policy analysis systems supported by IMF technical assistance and customized training (see the April 2015 Regional Economic Outlook: Sub-Saharan Africa; and IMF 2015). Second, this isolates the results from the impact of 2007–08 and 2010–11 food price shocks.

Exchange rate flexibility has increased in the 22 countries. When faced with foreign exchange pressures, central banks allowed more exchange rate flexibility in the 2012–16 period compared with a decade earlier, when foreign exchange market interventions were used more often to counteract such pressures (Figure 1.3.1).

This change in central bank behavior is consistent with the transition to forward-looking monetary policy frameworks. Twelve sub-Saharan African countries now publish policy and interbank rates (Table 1.3.1), but only seven of these—where average interbank rates differed from the policy rate by less than 300 basis points in absolute terms during 2012–16—can be considered to have de facto interest-based monetary frameworks. These include the three countries with explicit inflation targets (South Africa, 2001; Ghana, 2007; and Uganda, 2011) as well as Kenya, Mauritius, Rwanda, and Zambia. In the other countries, the link between policy rates and interbank rates does not currently appear sufficiently strong for the monetary policy signals to be transmitted efficiently.

This box was prepared by Emre Alper.
The average rate of inflation and its volatility in these seven sub-Saharan African countries with de facto interest-rate-based operational frameworks declined in the last decade (Figure 1.3.2). Such an improvement is not apparent in the other 15 countries, where the average rate of inflation and its volatility were higher in both periods.

The volatility of real GDP growth appears to be lower in countries with interest-rate-based operational frameworks, possibly also reflecting central banks’ concern for output stability. Nevertheless, output volatility appears to have declined in both groups. And there is no evidence that countries with interest-based operational frameworks achieved their inflation objectives at the expense of output stabilization.

Formal statistical analysis, following Ball and Sheridan 2003 and the September 2005 World Economic Outlook, appears to support the visual impressions from the plots in Figure 1.3.2, although the small sample size renders some of the results inconclusive.

These observations are subject to caveats. First, the reliance on a small sample of countries and a relatively short time span prohibits robustness checks of the results. Second, reverse causality is a possibility insofar as countries that experience lower output volatility may be more likely to adopt inflation-targeting regimes.

Nevertheless, the assessment suggests that countries that follow through on their policy decisions, notably by conducting consistent liquidity operations in support of their policy rate decisions, appear to reap palpable benefits. Therefore, countries that aspire to adopt forward-looking monetary policy frameworks, in addition to communicating their policy stance by setting a policy rate, are also well advised to keep interbank rates within a narrow corridor around it. This calls for strengthening interbank money market and foreign exchange market operations, liquidity management, and the analytical and communication capacity of central banks.

Figure 1.3.2. Sub-Saharan Africa: Inflation and Growth Performance

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook database; and IMF staff calculations.

Note: Excludes countries with explicit fixed exchange rate arrangements since 2012. Average inflation rates less than 40 percent are plotted. Volatility is measured by the five-year standard deviation.
REFERENCES


