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**Global Markets Commentary**
**January 20, 2011**

# Africa: After the Global Financial Crisis

***Key Points:***

- *Many African countries have come through the financial crisis not only better than they did in past turbulent economic times but also better than many other countries throughout the world. Rich in energy resources and raw materials, Africa is now one of the world's fastest-growing regions. Six of the world's ten fastest-growing economies over the last decade were in sub-Saharan Africa, including Angola, Nigeria, Ethiopia, Chad, Mozambique, and Rwanda.*

- *Growth in 2011 is expected to be broad based. Sub-Saharan Africa's gross domestic product (GDP) rose 4.7 percent in 2010, a trend that is expected to strengthen in 2011 and 2012, at 5.3 percent and 5.7 percent, respectively. Recent global growth data suggest that the African continent will grab seven of the top ten places for growth over the next five years.*

- *During the two decades to 2000 only one African economy (Uganda) made the top ten, against nine from Asia. Over the next five years Africa's will take the lead (see Table 1). The average African economy will outpace its emerging nation's counterparts. Looking even farther ahead, Africa's economy will grow at an average annual rate of 7 percent over the next 20 years, even faster than China, according to forecasts by Standard Chartered.*

- *Africa's changing fortunes have largely been driven by China's surging demand for raw materials and higher commodity prices. After trade grew at an average rate of 33.5 percent annually between 2000 and 2008, China became Africa's largest trade partner last year.*

- *Other factors include big inflows of foreign direct investment as well as foreign aid and debt relief. Urbanization and rising incomes will fuel faster growth in domestic demand and create a significant manufacturing center on the continent.*

- *A number of downside risks still face the African continent. Africa's commodity-driven growth may not generate enough jobs; and commodity prices could fall. So African governments will need to diversify their economies. African countries that do not depend on mineral exports will grow faster because of increased manufacturing exports.*

## Macros

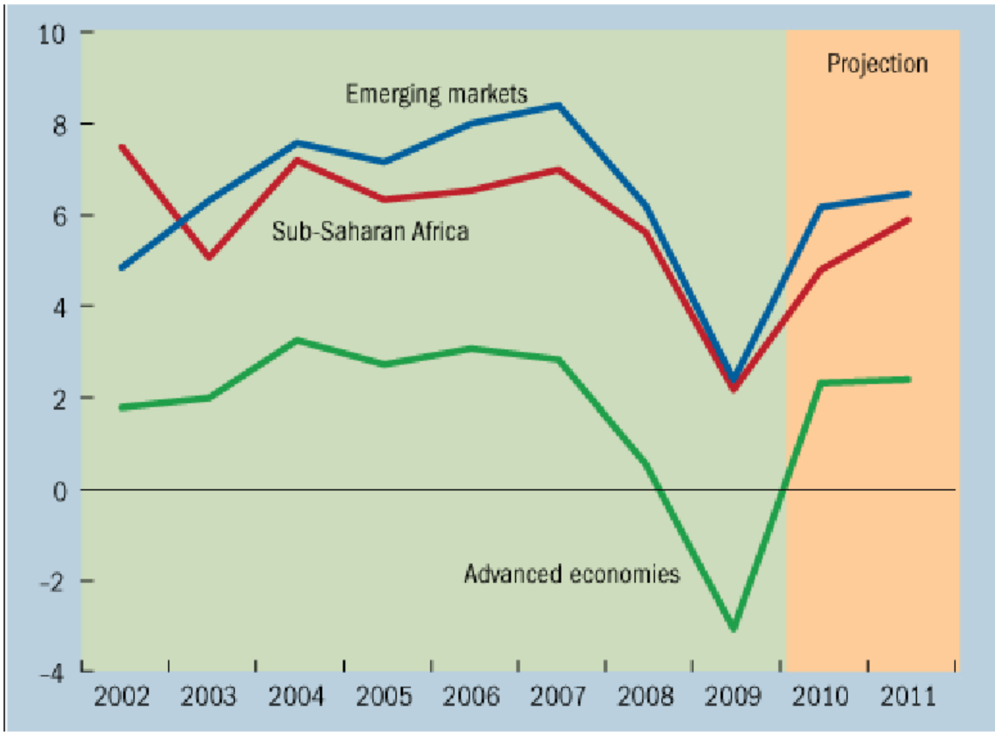
The world economy is transitioning to the next phase of recovery, a post-crisis rebound (slower) phase but still solid growth is expected this year and next. Global GDP, which expanded by 3.9 percent in 2010, is expected to slow to 3.3 percent in 2011. Economic recovery in Africa is now under way. Having demonstrated resilience during the global financial crisis, Africa's emerging market countries have good prospects for 2011 and over the long-term. Stronger monetary and budget policies (with strengthened fiscal positions, reduced debt burdens, lower inflation, and better cushions of foreign exchange reserves) together with structural reforms in many countries, helped Africa come through the global financial crisis better than in past economic tumultuous times. Foreign direct investment, particularly from Africa's new trading partners in Asia, is expected to strengthen -- and demand for African bonds, offering attractive yields relative to global bonds, is expected to increase this year. Diversification of financing sources for much-needed public investment is underway, but will require a coherent macroeconomic policy amongst monetary policy makers and more open foreign exchange regime to handle increased capital inflows. This is a prerequisite for African countries that have historically been prone to the dual problems of debt and inflation. Developed economy policy measures are leading to low yields and significant increases in public debt. These trends, coupled with strong performance and growth prospects in many emerging markets, have led investors to look to Africa for incremental returns on inefficiently priced assets. Increased transparency among many African countries has led to an increase of information, a necessary tool needed by investors in order to make prudent investment decisions. Hence, economic analysts, investors, and the media are increasingly able to target specific countries in Africa with good track records and prospects, which fosters investor confidence and active management strategies for asset managers.

Table 1. Global Outlook in Summary (% change from previous year)
*(Real GDP growth)*

| | 2010 | 2011 | 2012 |
|---|---|---|---|
| Global growth | 3.9 | 3.3 | 3.6 |
| High-income countries | 2.8 | 2.4 | 2.7 |
| Developing countries | 7.0 | 6.0 | 6.1 |
| Developing (ex China India) | 5.2 | 4.3 | 4.5 |
| East Asia & Pacific | 9.3 | 8.0 | 7.8 |
| Europe & Central Asia | 4.7 | 4.0 | 4.2 |
| Latin America & Caribbean | 5.7 | 4.0 | 4.0 |
| Middle-East & N. Africa | 3.3 | 4.3 | 4.4 |
| South Asia | 8.7 | 7.7 | 8.1 |
| Sub-Saharan Africa | 4.7 | 5.3 | 5.5 |

Source: World Bank
Calculations: Nova Capital Partners

Chart 1. GDP
*(Annual Percent Change)*



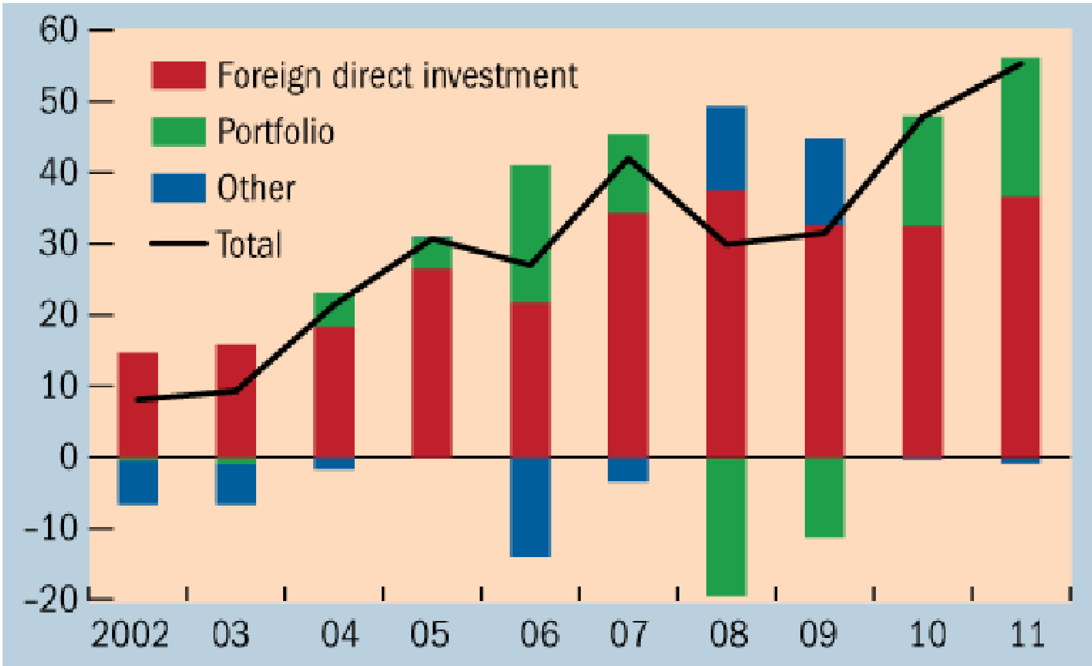

Source: IMF staff estimates; IMF African Department
Calculations: Nova Capital Partners

**<u>Market Overview</u>**

Africa is now one of the world's fastest-growing regions. The continent weathered the financial crisis well, and, by the end of 2010, many African market economies had recovered or were close to resuming the growth potential they had attained prior to the crisis. Six of the world's ten fastest-growing economies over the last decade were in sub-Saharan Africa, including Angola, Nigeria, Ethiopia, Chad, Mozambique, and Rwanda. Although growth across sub-Saharan Africa retreated during the global crisis to an average of 2 percent in 2009 from 5.6 percent the previous year, the region will bounce back to 4.7 percent this year and 5.3 percent in 2011, according to World Bank estimates. Annual growth rates of sub-Saharan countries will continue advancing toward double-digit territory as compared with the annual growth rate of more than 8 percent over the last decade. Sub-Saharan Africa's growth performance will rely in part on official and private financing flows staying at their recent elevated levels (see Chart 2). Emerging Africa is expected to see a significant rise in investment as Africa's new trading partners seek direct investment opportunities. And African countries that were forced to delay plans of securing international investments prior to and during the crisis and are now moving forward with private financing initiatives, notably for ambitious infrastructure investment programs. This much needed development will continue to support the establishment and maintenance of Africa's infrastructure.

Establishing a benchmark bond yield will also help speed the development of capital markets and financial services for the African private sector. But while such financing is welcome, it also comes with at least two requirements. First, countries will need to manage new debt carefully, limiting market financing to high-return projects, to avoid the risk of future debt crises. Second, these emerging African countries, as many emerging market economies have done before, will confront the task of making their economies robust to capital flow surges in the face of historical volatility.

Chart 2. Private financing flows
*(Billions of dollars)*




Source: IMF, World Economic Outlook
Analysis and Calculations: Nova Capital Partners

Recent global growth data suggest that the African continent will grab seven of the top ten places for growth over the next five years. During the two decades to 2000 only one African economy (Uganda) made the top ten, against nine from Asia. Over the next five years Africa's will take the lead (see Table 1). The average African economy will outpace its emerging nation's counterparts. Looking even farther ahead, Africa's economy will grow at an average annual rate of 7 percent over the next 20 years, even faster than China, according to forecasts by Standard Chartered.

The region's resilience stems from sound economic policy implementation before and during the 2007–09 global financial crisis. This allowed authorities to use fiscal and monetary policies to hedge against and absorb the adverse effects arising from the shocks in world trade, prices, and financial flows. Furthermore, evidence suggests that monetary policy in Africa may have more power to influence monetary conditions than previously assumed because of the buffers created before the global financial crisis. Low growth rates recorded on the continent will be enhanced by stronger policy environments and political stability. Because of the fragile nature of the global recovery—which created the short-term risks of tension in financial markets, large and volatile capital flows, and a hike in food prices—risks remain weighted on the downside but will be mitigated by robust fiscal frameworks for directing resources towards priority spending needs.

On the upside, strong domestic demand growth among African countries is occurring (and supported by a pick-up in commodity prices, and to a lesser extent in remittances and tourism) though persistent financial sector problems in some African countries are still a threat to growth and require urgent policy actions.

Table 1. World's ten fastest-growing economies
(*Annual average GDP growth, %*)

| 2001-2010† | | 2011-2015‡ | |
|---|---|---|---|
| **Angola** | **11.1** | China | 9.5 |
| China | 10.5 | India | 8.2 |
| Myanmar | 10.3 | **Ethiopia** | **8.1** |
| **Nigeria** | **8.9** | **Mozambique** | **7.7** |
| **Ethiopia** | **8.4** | **Tanzania** | **7.2** |
| Kazakhstan | 8.2 | Vietnam | 7.2 |
| **Chad** | **7.9** | **Congo** | **7.0** |
| **Mozambique** | **7.9** | **Ghana** | **7.0** |
| Cambodia | 7.7 | **Zambia** | **6.9** |
| **Rwanda** | **7.6** | **Nigeria** | **6.8** |

Source: IMF
Analysis and Calculations: Nova Capital Partners
*Excluding countries with less than 10m population and Iraq and Afghanistan
†2010 estimate
‡IMF forecast

## Short-Term Risks for African Countries

A number of risks still face the African continent. Africa's commodity-driven growth may not generate enough jobs; and commodity prices could fall Hence, African governments need to diversify their economies. African countries that do not depend on mineral exports will grow faster because of increased manufacturing exports. The global financial crisis has left higher unemployment rates in some African countries. Commodity price volatility, especially in terms of food, could constitute a serious risk to the growth of many African countries. A hike in energy prices, while contributing to economic output, could cause real food prices in Africa's emerging countries to rise substantially and therefore hurt consumption. However, while food prices have been on the rise, the increase is much less in real terms than in nominal terms. Currently, real prices are still lower than the peak in 2008 and should prevent the food and fuel price spikes seen earlier. Careful monitoring and vigilance by country authorities will be required given the chance of a more serious problem reemerging cannot be ruled out.

Fiscal balances have deteriorated, particularly in the region's middle-income and oil exporting countries. After declining real GDP per head for many years, by 1980 Africans had an average income per head almost four times bigger than other developing countries—for example, China. Today most of those same developing countries are more than three to four times richer. Africa's rapidly rising population still dampens its growth.

However, real income per head has risen by an annual rate of 3 percent since 2000—almost twice as fast as the global average.

With new financial resources—from natural resources revenues, the growing access to private capital, increased tax effort, additional official development assistance, and a new stream of international investors looking for a yield in the growing alternative energy market on the contient—African countries will need to fund transformative investments. Solid investment projects, especially in transportation and power (both traditional and renewable sources), could radically improve growth prospects and the ability to efficiently deliver public services. Most countires will need strong capital inflows. Sub-Saharan Africa alone, for example, will need roughly US$93 billion a year, of which a third remains unfunded, according to the World Bank. Besides more financing, tackling the infrastructure gap will take a concentrated effort to improve how public investment projects are selected and managed. Many African countries have only recently emerged from comprehensive debt relief and will need to be mindful of the debt-sustainability ramifications of new financing. However, many African countries with IMF-supported programs will find additional flexibility from the IMF's new debt limits policy, which has been tailored to streamline debt management capacity. And although the capital flows trend is a positive development if these flows are not managed wisely, they can destabilize movements in exchange rates, commodity prices, and asset-prices. Of the African countries that received the bulk of capital flows over the last few years, several have seen their real-effective exchange rates rise by 20 or more percent since January 2009. Many have introduced various financial and regulatory measures to limit inflows and upward pressure on currencies, but these have not always worked as desired.

Another concern is Africa's reliance on continued growth in other developing nations. With the recent and expanding intertwinement of global markets between developed and developing countries, if growth in global markets falls short of expectations, the effects will be felt in Africa. This is potentially worrisome because most African countries are currently in the process of creating new monetary policies and rebuilding buffers that helped to mitigate the adverse effects of the last crisis. Creating new monetary policy and rebuilding these buffers is therefore critical to sustained growth and stability on the continent. For the longer-term, most African countries will need to shift focus from short-term crisis management toward measures that address underlying structural challenges.

Though the overall inflation outlook remains moderate (with only 6 countries showing double-digit inflation in 2010 compared with 27 countries just two years earlier), there are downside risks in food, fuel, and other commodities, which suggests a rerun of the 2008 food and fuel price crisis that was only extinguished by the global financial crisis. These risks call for continued effort on agricultural policies on the supply side, and efficient social safety nets on the demand side.

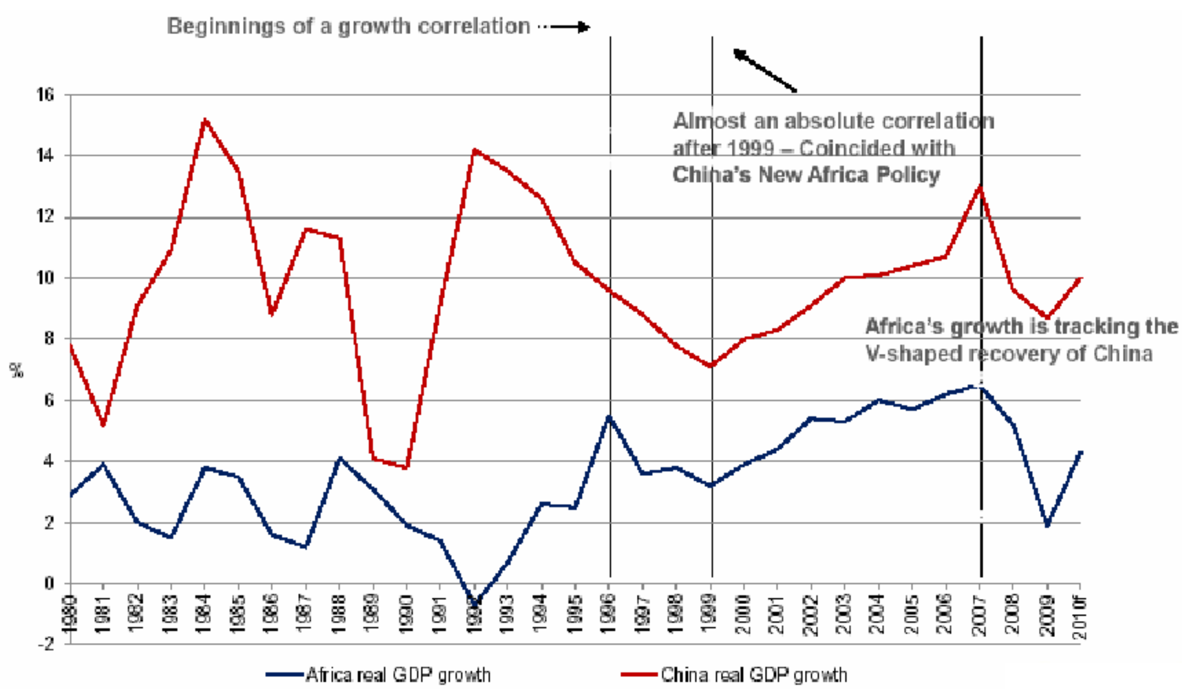
Notwithstanding the rapid gains of the last decade, poverty, often extreme, remains pervasive in Africa. In many African economies, growth has been modest given the size of the 2008 downturn. As a result, despite several years of aggressive fiscal and monetary policy stimulus, unemployment remains high and aggregate growth is being held back by necessary post-crisis restructuring. In far too many places, more rapid growth has not yet translated into local employment opportunities, a better social safety net, or a higher quality of life. In addition, weak governance, limited administrative capacity, or political instability (and even outright conflict) have suppressed or reversed per-capita-GDP gains. In 2011, the IMF will continue to assist its African members to make their macro and foreign exchange policies robust to capital flows, to manage the burden of new debt, and to exploit new natural resource and infrastructure investment opportunities. However, expansionary fiscal policies will need to be tempered to make sure that public finances return to a sustainable path and public debt levels remain manageable.

The upside to the debt burden: From 2000 to 2009, China cancelled more than 300 debts of 35 African countries worth US$2.9 billion and other creditor nations will follow this trend.

**<u>Growth Drivers</u>**

African trade is already shifting toward the dynamic emerging markets, notably China (the world's second-largest economy) which continues to evolve quickly. Africa's changing fortunes have largely been driven by China's surging demand for raw materials and higher commodity prices needed to fuel its expanding economy. China became Africa's largest trade partner last year after a revival in two-way trade (exchanges declined due to the global financial crisis) and a number of prospective mineral and infrastructure deals on the table are underlining the central place that Chinese investment, financing and commodity demand are assuming in Africa's future. Sino-African economic and trade cooperation is entering an expansionary phase with trade between China and Africa, after growing by an average of 30 percent a year over the past decade, surging 43.5 percent year-over-year in the first 11 months of 2010 (likely exceeding US$100 billion in 2010) and is expected to exceed US$110 billion in 2011, according to Bloomberg. In fact, in 2010 all forms of Chinese financing more than matched inflows from all traditional sources. Altogether, in the past decade Sino-African trade has increased 10-fold (from US$10 billion to more than US$100 billion) and has overtaken the U.S and Europe as the largest trading partner in some of the continent's most important economies. This is creating an absolute correlation between the continent and China (see Chart 3).

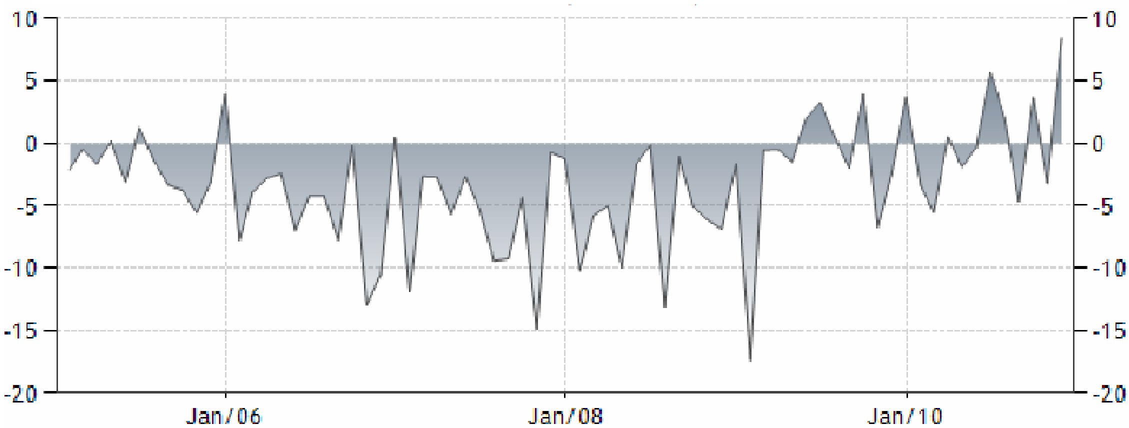
Chart 3. China Africa growth coupling




Source: IMF; University of Pretoria, China Africa Network
Analysis and Calculations: Nova Capital Partners

This shift in increased trade is occurring rapidly and will pick up steam this year in many countries, especially South Africa, Nigeria, and Angola. For example, South Africa's trade balance moved to a surplus of ZAR 8.4 billion in November 2010 compared to a ZAR 3.2 billion deficit in October (see Chart 4). Economists were expecting the deficit to widen to ZAR 3.5 billion. Instead, during the month, exports rose 20.8% month-on-month, while imports fell 2.4%. Exports value totaled ZAR 60.2 billion and imports amounted to ZAR 51.8 billion. The cumulative deficit for the first eleven months of the year was ZAR 5 billion compared to ZAR 29.5 billion last year. Exports of precious and semi-precious stones and metals decreased 16% from October, while shipments of mineral products increased 61%. Exports of vehicles, aircraft and vessels grew 2% over the previous month.

Chart 4. South Africa balance of trade
(ZAR/Billion ZAR)




Source: Trading Economics
Analysis and Calculations: Nova Capital Partners

Mutual investment between China and Africa is expanding rapidly amid bilateral efforts to promote cooperation. Beijing had invested a total of US$9.3 billion in direct investment into 49 African countries by the end of 2009, covering several sectors—including mining, financing, manufacturing, construction, tourism, agriculture, forestry, animal husbandry, fishery and others—while accumulated direct investment by African countries (mainly from Mauritius, South Africa, Seychelles, Nigeria and Tunisia) in China hit US$9.93 billion over the same period. Chinese enterprises expanding their businesses to Africa is also increasing rapidly, with state-owned large and medium-sized enterprise, as well as Chinese private firms and individuals, investing and starting new businesses in Africa.

The boom in Sino-African trade led to the signing of bilateral agreements between the Chinese government and 33 African countries regarding the promotion and protection of investment and endorsed agreements with 11 countries to lower trade barriers (for example, avoiding double taxation). China has been pushing forward the construction of overseas economic and trade cooperation zones in Africa. Currently, six related projects are under way in Zambia, Mauritius, Nigeria, Egypt and Ethiopia with investment in infrastructure construction (for roads, dams, pipelines, and railways) totaling US$250 million. One example is the African Union’s headquarters, located in Ethiopia, which is being built by the Chinese.

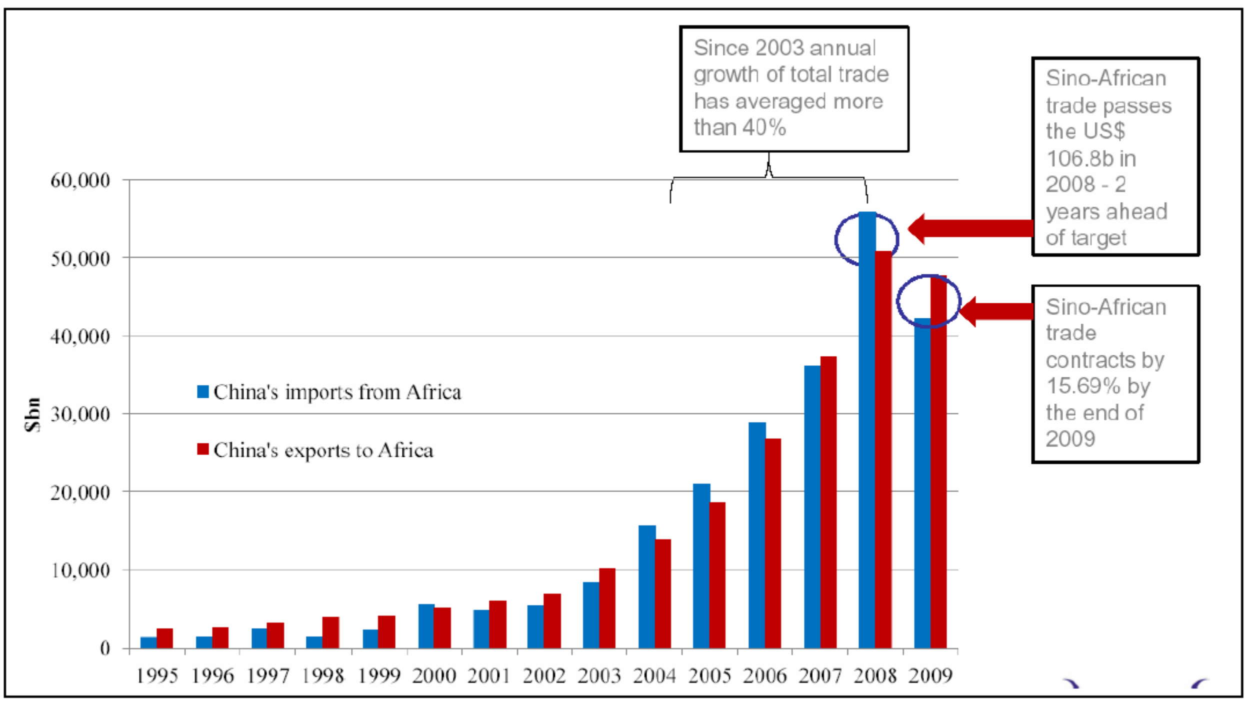
Likewise, African enterprises have been investing more vigorously in China in recent years as the African economy develops and China's market potential grows. Mauritius, South

Africa, Seychelles, Nigeria and Tunisia are major African investors in China with investment areas ranging from petrochemical engineering, machinery to electronics and transportation. China is not the only country making advances. Many African countries are increasingly forming agreements with other emerging countries—for example, India, Brazil, South Korea, and Malaysia—drawn to the continent's mineral wealth and billion-strong market of potential consumers, many of whom need mobile phones. Recently, IBM and Bharti Airtel announced the completion of contract negotiations for technology services spanning 16 African countries. As part of the 10-year agreement signed in December 2010, IBM will deploy and manage the information technology (IT) infrastructure and applications to support Airtel's goal of providing affordable and innovative mobile services throughout Africa, which is now the world's fastest growing mobile market.

Foreign direct investments in Sub-Saharan Africa grew by 17 percent in 2010 after a 12.3 percent decline in 2009. This trend confirms Africa's position as a preferred destination for foreign capital.

Traditional partners (such as France, the U.S. and multinational mining companies) will be vying vigorously to defend existing partnerships over oil, influence, and to access new and evolving markets.

Chart 5. Sino-Africa trade growth




Source: IMF; University of Pretoria, China Africa Network
Analysis and Calculations: Nova Capital Partners

Lastly, the growth of the renewable energy market on the continent will not only provide clean forms of energy but millions of new jobs. International institutional investors will work with government authorities committed to green economic development to engineer, procure, and construct renewable energy systems across the continent, which will provide low risk, high yield stable cashflows. For example, Nigeria recently signed several agreements with international renewable energy companies to build the first Green City in Africa and to build the first hybrid manufacturing base in the country. The country has an ambitious 2015 target to roll-out hybrid vehicles and to move completely away from vehicles run by fossil fuels.

**Beyond 2011: Focusing on Structural Challenges**

For the mid and long-term, African countries will need to shift focus from short-term crisis management toward sustainable measures that resolve underlying structural challenges, which include:

- Implementing cogent long-term plans for maintaining fiscal sustainability
- Implementing fiscal measures that re-employ displaced workers (from the crisis)
- Strengthening regulatory measures for the financial sector
- Supporting policies that permit market driven exchange rates to adjust
- Reducing the volatility of major reserve currencies in order to sustain confidence

## Conclusion

Many African countries have come through the financial crisis not only better than they did in the past but also better than many other countries throughout the world. Stronger monetary and budget policies, together with structural reforms in many countries, helped Africa weather the global financial crisis, positioning the continent for robust growth. Several factors helped African economies pull through the crisis.

First, many African countries created stronger policies prior to the global crisis, which helped mitigate the impact of the downturn. This led to strengthened fiscal positions, reduced debt burdens, lower inflation among many countries that have struggled with chronic inflation, and well-constructed buffers for foreign exchange reserves.

Second, because fiscal deficits and debt positions had on the whole improved, many sub-Saharan countries were able to not only leverage fiscal policies to prevent the crisis from worsening but were able to maintain (and surprisingly even increase) public spending—at a time when revenue was falling rapidly. That is, fiscal policy was countercyclical in two-thirds of sub-Saharan African countries in 2009, according to the IMF.

Third, with inflation controlled, many African countries restructured and set favorable interest rate policies, which also mitigated the overall impact of the crisis. Where exchange rates enjoyed flexibility, countries encouraged the free market mechanism of adjustment, which softened adverse shocks and contributed to resilience.

As a result, many African countries generally were able to support social spending during the crisis, using a number of strategies. For example, most countries were able to maintain (and oftentimes increased) health and education expenditures at pre-crisis levels; construct and implement conditional cash transfers; and innovate in the area of social protection, including public works programs and food security initiatives. These measures were successful and allowed African countries to avoid protectionism, keeping barriers low and continued to pursue policies encouraging foreign investment and increase trade with new partners in the emerging and developed markets.

These new partners will continue to demand goods that Africa can supply with comparative advantage, which will provide support to both developed and developing countries and give investors more opportunities to find higher yields in Africa's emerging and frontier markets. Priorities will include negotiating equitable deals with developed country multinational firms, managing revenue windfalls with caution, and finding new ways of putting displaced workers back to work and creating more jobs in the renewable energy sector.

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