



Developments in the World Economy and Implications for Africa

Introduction

The most significant changes in the world economy in 2008 were the sharp slowdown in economic growth, especially in the industrialized countries, and the worldwide rise in inflation in the first half of the year.¹ These developments were largely driven by the financial market turmoil, the housing market downturn, and high commodity prices in the first half of 2008. Currently, the world economy is facing one of the most difficult crises of recent years. According to United Nations baseline estimates, world growth declined from 3.7 per cent in 2007 to 2.5 per cent in 2008, and it is expected to decelerate to 1.0 per cent in 2009 as the second-round effects of the credit crisis of 2008 begin to take their toll on the real economy.

After peaking in mid-2008, commodity prices, especially those of oil, metals and food, have been declining and are expected to remain well below the peak levels of mid-2008 for some time. The commodity price boom ended in mid-2008 as supply started to respond to extremely high prices and demand started to fall due to the slowdown in the world economy. Commodity-exporting countries have been negatively affected by the slowdown in world growth, but for countries that are dependent on food and oil imports, the recent pressure on their balance of payments and budgets has eased somewhat.

As the economies of the industrialized countries are weakening, the trend towards deepened South-South relations is accelerating. This is attested by the many high-level summits on Africa that have been organized by such countries as India, South Korea and Turkey. In addition, trade and investment relations between developing countries are accounting for an increasing share of world totals.

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¹ Data used for this chapter were last updated in November 2008.

1.1 Europe and the United States have slipped into recession but Asia is still growing

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The financial crisis that started in 2007 following the collapse of the United States sub-prime mortgage market spread further in 2008. It has not only affected housing and financial markets in many other countries, but has also triggered what is expected to become the worst recession since the 1980s in member countries of the Organization for Economic Cooperation and Development (OECD), with their growth declining by about half a percentage point.

In 2008, the burst of the United States housing bubble quickly spread to the rest of the world through the global financial network. The credit crunch that ensued made banks less willing to lend to each other and to consumers, drying up liquidity in the process, while risk perceptions started to rise sharply. The destruction of trillions of dollars in wealth has dragged down household spending on durable goods as well as corporate investments (United Nations 2009; AfDB *et al*, 2008).

World growth is thus estimated to decline from 3.7 per cent in 2007 to 2.5 per cent in 2008 and to 1.0 per cent in 2009, according to United Nations baseline estimates, as second-round effects of the credit crisis are expected to have a serious impact on the real economy. After reaching record levels in mid-2008, commodity prices have dropped sharply due to weakened demand. It is worth noting that the financial crisis was still unfolding at the end of 2008 and thus the forecasts for 2009 quoted in this chapter are subject to significant downward revisions, because the credit crunch could last longer and monetary and fiscal rescue packages might be less effective than anticipated.

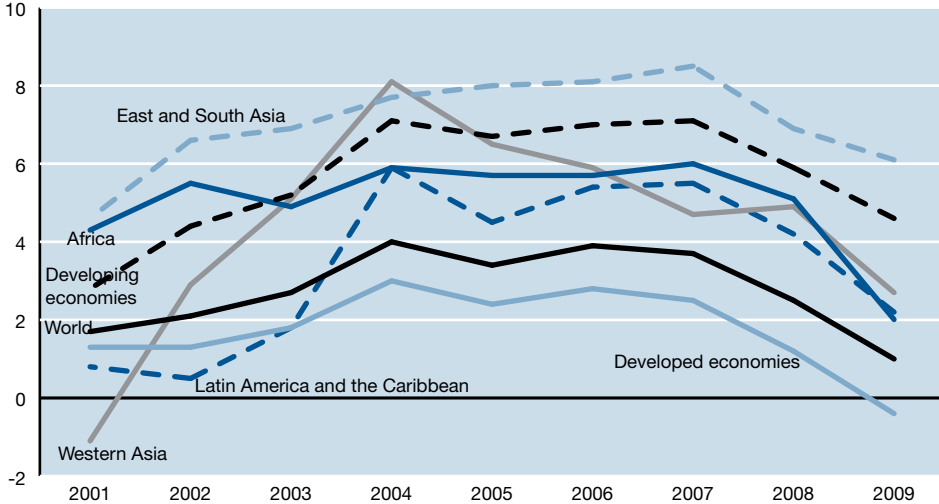
In fact, the most recent estimates show the world economy shrinking in 2009, as the growth in developing countries will not be sufficient to offset the sharp decline in industrial countries. This would then be the worst recession in the industrialized countries since World War II. Nevertheless, all forecasts call for a recovery in 2010 (United Nations 2009; World Bank 2009; IMF 2009b).

The weak dollar as well as an expansionary fiscal and monetary policy had softened the effect of the financial crisis in the USA in the first half of 2008. However, as the crisis deepened, domestic demand declined sharply, despite drastic measures by the US Treasury Department and the Federal Reserve (Fed) to stabilize the economy. Thus, most analysts had estimated that growth in the USA would decline to 1 per cent in 2008. For 2009, they expect the economy to shrink by at least 1 per cent (United Nations 2009, OECD 2008).

In 2008, as in many developed countries, the European Union (EU) grew at a rate of 1.1 per cent, under the effect of the financial crisis, which led to the collapse of several European banks. In addition, consumer confidence dropped to very low levels. Thus, growth is projected to remain low in 2009 as both domestic demand and exports are expected to remain weak (United Nations 2009).

“ The effects of the current crisis on other regions will be very strong ”

Figure 1.1
GDP growth rates of major regions, 2001-2009



Source: United Nations 2009, 2008 estimates, 2009 forecasts.
Note: The reported estimates of growth rates for world gross product are obtained using country gross domestic products at market prices in dollars as weights.

In Japan, the situation has deteriorated dramatically with a gross domestic product (GDP) growth rate of only 0.4 per cent in 2008 and 0.1 per cent for 2009, mainly due to weakened private consumption and the tight fiscal policy adopted in the first half of 2008. However, the economic downturn is expected to be less severe than in other industrialized countries, as Japanese financial institutions have only limited exposure to sub-prime loans and the level of domestic savings is high (United Nations 2009).

The fact that all major industrialized countries are expected to slide into recession at the same time is unprecedented. The effects of the current crisis on other regions will be very strong as there is little chance of their being offset. Developing regions will be mainly affected by lower demand for exports, reduced commodity prices, fewer remittances due to job losses, reduced capital inflows due to higher risk aversion, and delayed investments (AfDB *et al* 2008; World Bank and G-20 2008).

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The East and South Asia region seems so far to be less affected by the global slowdown, due to strong domestic demand, which partly offsets weakening external demand. Its growth rate, which stood at 7 per cent in 2008, is expected to hold steady at about 6 per cent in 2009. However, many individual financial institutions in the region have incurred substantial losses as a result of the financial crisis.

In China, GDP growth slowed down from 11.4 per cent in 2007 to 9.1 per cent in 2008 and is expected to decline further to 8.4 per cent in 2009. The main reasons are the slowing demand for Chinese exports in industrialized countries, the appreciation of the renminbi, and rising labour costs. In November 2008, China announced a fiscal stimulus package of \$586 billion over two years, representing about 14 per cent of GDP. The Government will stimulate domestic demand by reducing taxes, investing in infrastructure, health care and education, and promoting agriculture and environmental protection.

However, growth forecasts for China have been revised downwards for 2009 to 7-8 per cent, which will most likely affect trade and foreign direct investment (FDI) prospects for Africa. China's trade surplus actually increased in 2008 as the slump in imports was much stronger than the decline in exports, due to reduced commodity prices, weaker demand for inputs into export products and reduced domestic demand. For 2009, imports are expected to bounce back with the planned increase in infrastructure investment, which will trigger demand for raw materials and machinery (United Nations 2009; OECD 2008, World Bank 2008a).

For Western Asia, high oil prices and strong consumption and investment spending in the first half of the year contributed to a relatively high growth rate of 4.9 per cent in 2008 (up from 4.7 per cent in 2007), despite the subsequent decline in oil prices in the second half. For 2009, however, growth is only expected to be 2.7 per cent (United Nations 2009). For Latin America and the Caribbean, growth fell from 5.5 per cent in 2007 to 4.2 per cent in 2008, and it is expected to drop to 2.2 per cent in 2009. The factors that were driving growth in the first half of 2008, especially strong domestic demand and high commodity prices, were reversed as the financial crisis unfolded. Several countries are also negatively affected by lower remittances. Similarly, estimates show that GDP growth in Africa decreased from 6.0 per cent in 2007 to 5.1 per cent in 2008, and it is expected to fall to 2.0 per cent in 2009, as discussed in Chapter 2 (United Nations 2009).

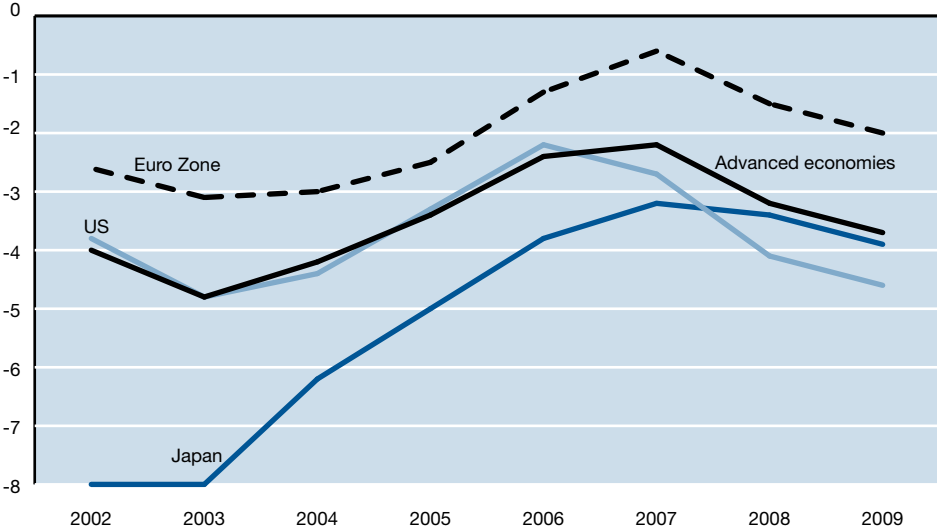
The financial crisis and its consequences have prompted governments all over the world to provide huge fiscal stimulus packages for their economies. Fiscal stimulus packages in G-20 countries are projected to represent about 1.5 per cent of GDP. The fiscal balance deteriorated in industrialized countries as a whole and in all major countries and regions (figure 1.2). This was mainly driven by lower revenues due to the growth slowdown and higher expenditure as countries had to deal with the

effects of the financial crisis. All major industrialized countries have announced fiscal measures to support their struggling industries and to stimulate demand, in order to counter the negative effects of the housing and credit crises.

Emerging economies such as China, Russia and a number of Asian countries have followed suit. However, these fiscal measures have not been well coordinated and might have limited effects due to their *ad hoc* nature. Indeed, at the end of 2008, it was highly debatable whether these measures would be sufficient to end the recession in OECD countries in 2009 (United Nations 2009, IMF 2009b).

“Fiscal measures have not been well coordinated and might have limited effects due to their *ad hoc* nature”

Figure 1.2
Central government fiscal balance for selected regions and economies, 2002-2009 (% of GDP)



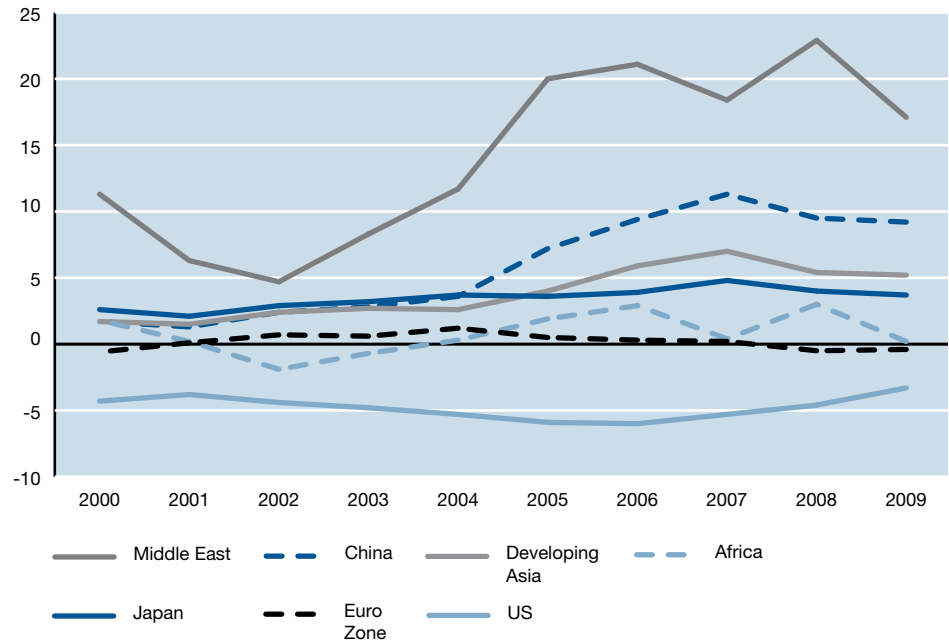
Source: IMF 2008a, 2008 estimates, 2009 forecasts.

1.2 Macroeconomic imbalances decline but remain huge

The USA experienced a sharp decline in imports due to the depreciation of its currency and slowing demand, causing its current account deficit in 2008 to drop by about 1 per cent relative to GDP (figure 1.3). However, the deficit might not decline further in 2009 as exports are expected to decrease, the dollar has appreciated and the fiscal stimulus package will further reduce public savings. In the euro zone, the small surplus in 2007 turned into a deficit in 2008 due to a slowdown in exports, while Germany and Switzerland had the largest surpluses in absolute terms (UNCTAD 2008c).

“ Over the past few years, many developing countries have accumulated large foreign reserves ”

Figure 1.3
Current account balance for selected regions and countries, 2002-2009
 (% of GDP)



Source: IMF 2008, 2008 estimates, 2009 forecasts.

Japan and developing Asia saw their current account surpluses decline in 2008. Latin America is expected to see its small surplus turn into a small deficit. The Middle Eastern countries are running the highest current account surpluses due to high oil revenues. However, these are expected to decline as oil prices fall. Africa is one of the few regions where the current account surplus increased significantly in 2008, albeit from an initially low level. The rectification of the current account imbalances has been mainly driven by exchange rate adjustments and to some extent by stronger domestic demand in the surplus countries. For 2009, the current account balances are expected to remain unchanged in most regions, except in the Middle East and the USA, where they are expected to decline further (UNCTAD 2008c; IMF 2008a).

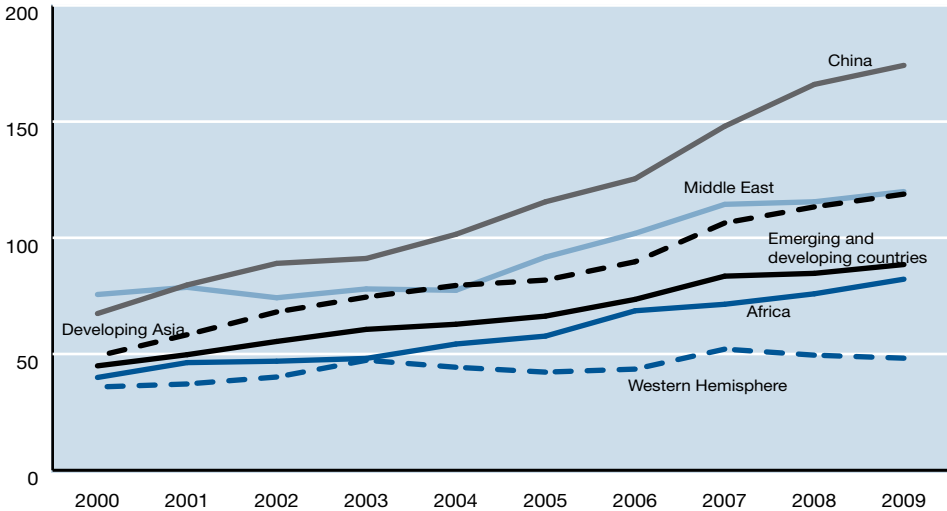
Over the past few years, many developing countries have accumulated large foreign reserves, such that global reserves tripled between 2001 and 2007 to \$6.2 trillion (figure 1.4). Eighty per cent of this global increase, which has picked up speed since 2005, was accounted for by developing countries. In 2008, official reserves of emerging and developing countries amounted to \$5.5 trillion, an increase driven partly by current account surpluses and partly by capital inflows. During the current financial crisis, countries with large reserves have been shielded somewhat from the effects

of the credit crunch, but for a number of oil and net food importers, reserves have been depleted due to the steep rise in prices for these commodities. In 2009, foreign reserves of developing countries are expected to stagnate (United Nations 2009).

In addition to official reserves, sovereign wealth funds have been accumulating assets estimated at \$5 trillion, fuelled by the increase in commodity prices and large current account surpluses in countries such as China. Like official reserves, these funds serve to stabilize fluctuations in current accounts. In addition, they are considered as savings to cover future generations for a time when natural resources are depleted. They are mainly invested in government bonds and increasingly in stocks. However, some sovereign wealth funds invested heavily in the banking sector in the USA and EU in late 2007, as banks were in urgent need of fresh capital (Griffith-Jones and Ocampo 2008; UNCTAD 2008b; IMF 2008a).

“ By the end of 2008, many commodity prices had lost all the gains obtained during the boom ”

Figure 1.4
Official reserves of emerging and developing countries and regions, 2000-2009 (% of imports of goods and services)



Source: IMF 2008a, 2008 estimates, 2009 forecasts.

1.3 World commodity prices peaked in mid-2008

Both food and mineral prices continued their sharp increase, reaching long-term peaks in the first half of 2008 (table 1.1 and figure 1.6). The price of oil hit \$147 per barrel in July 2008, but by November it had come down to below \$60 per barrel. Similarly, many metal and food prices increased substantially in the first half

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of 2008, but started declining in mid-year. They are expected to remain below the peak level of mid-2008 in the foreseeable future. By the end of 2008, most commodity prices had lost all the gains obtained during the boom. Only some prices are expected to start picking again at the beginning of 2009 (UNCTAD 2008c; United Nations 2009; OECD and FAO 2008; IMF 2009a).

Oil and mineral prices peak

At more than \$140 per barrel in mid-2008, the price of oil reached a new peak even in real terms, having more than doubled between December 2006 and July 2008. This was mainly driven by a reduction in supply in 2007 and continued growth in demand. By December 2008, the price of oil had fallen to below \$50 per barrel, mainly as demand reacted to the global economic slowdown. In addition, energy consumers switched to more energy-saving technologies and to alternative energies. Thus, high oil prices are likely to help reduce carbon emissions somewhat. However, in many developing countries, higher fuel prices had not been fully reflected in domestic prices by mid-2008, thus limiting the response in demand (UNCTAD 2008c; IMF 2008a).

As a result of high oil prices in the first half of 2008, the fuel import bill of developing countries jumped from 2.7 per cent of GDP in 2002 to about 8 per cent in 2008. In addition, high oil prices have contributed to the increase in prices of other commodities, as energy is an important input for production and transport. The decrease in demand in industrialized countries was only partly offset by increasing demand in developing countries. Global demand for oil will remain low in the medium term, and is even projected to slow down in 2009. There is considerable uncertainty over supply due to political turbulence, weather-related fluctuations in production and lags in increasing production capacity.

The Organization of Petroleum-Exporting Countries (OPEC) took several steps to reduce output towards the end of 2008 and the beginning of 2009, but this has had only temporary downward effects on prices. Earlier forecasts of oil prices went as high as \$200 per barrel in the medium term, but a range of between \$50 and \$90 seems more reasonable for 2009, in view of recent economic developments (United Nations 2009; UNCTAD 2008c; IMF 2009b).

Table 1.1**Indices of selected primary commodity prices, 2003-2009 (2000 = 100)**

Commodity	2003	2004	2005	2006	2007	2008	2009
All commodities	105.1	126.1	140.8	183.6	207.2	256.6	
Crude petroleum	102.4	133.8	189.1	227.8	252.1	343.8	170
Food and tropical beverages	103.1	116.7	127.0	149.6	162.5	228.1	
Wheat	126.8	114.9	109.2	128.5	225.9	288.0	180
Maize	118.9	124.9	109.9	136.8	189.0	253.2	170
Rice	97.9	120.6	141.2	149.0	163.1	343.6	220
Sugar	86.7	87.6	120.9	180.6	123.3	156.5	145
Coffee	80.6	92.3	131.8	144.8	166.3	192.3	160
Cocoa	197.7	174.5	173.3	179.4	219.9	287.1	240
Palm oil	142.9	151.9	136.1	154.2	251.5	305.8	160
Agricultural raw materials	112.4	123.5	132.3	152.2	169.4	202.2	
Cotton	107.1	103.6	91.5	97.0	106.8	120.8	95
Tropical logs	114.3	136.3	136.7	130.2	155.7	216.8	190
Rubber	162.0	194.9	224.4	315.2	342.3	391.3	175
Minerals, ores and metals	97.6	137.3	173.2	277.7	313.2	332.4	
Aluminium	92.4	110.8	122.5	165.9	170.3	166.1	90
Copper	96.6	152.8	198.4	361.2	392.6	383.6	180
Gold	130.3	146.6	159.4	216.6	249.7	312.4	300

Source: UNCTAD 2008a; Estimates for 2008 and forecasts for 2009 based on UNCTAD database.

The supply response in mineral production has also been weak, as exploration costs have increased due to technological and geological constraints. In addition, there is a shortage of specialists in some of these sectors. For commodities such as copper and aluminum, shortages in supply have been relatively high, leading to a further increase in price levels in the first half of 2008 (table 1.1). For most metals, prices declined in the second half of 2008 due to weakening demand and large inventories. For 2009, most metal prices are expected to remain at their end of 2008 levels (UNCTAD 2008c; World Bank 2009).

The depreciation of the dollar against the euro between 2006 and mid-2008 by 27 per cent exacerbated the price increase of both minerals and food, as most of the prices of these commodities are quoted in dollars. For example, the price of gold depends to a large extent on the value of the dollar, as it is a substitute for holding savings. Thus, the price increases in countries whose currencies appreciated against the dollar were on average only about half of the increases quoted in table 1.1. Con-

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sequently, supply and demand responses in these countries were also weaker. The recent appreciation of the dollar against many currencies contributed to the fall of commodity prices in dollar terms (UNCTAD 2008c).

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attributable to the
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Unprecedented surge in food prices ended

The surge in food prices of more than 50 per cent between December 2006 and July 2008 was caused by a number of different factors. For many food products such as maize and rice, demand is increasing over the long term, driven by population growth and higher incomes in many developing countries, especially in Asia, and increasing demand for bio-fuels. At the same time, food supply is constrained by high production and transport costs due to increasing prices of oil and fertilizer as well as severe droughts induced by climate change.

As elaborated in chapter 3, some of the increases in food prices are attributable to the recent massive increase in production of bio-fuels. In addition to its direct effects on demand for corn, grains, sugar and oilseeds, this production has reduced the amount of land available for other crops like rice. The increasing demand for bio-fuels is caused in part by higher oil prices. Subsidies and consumption targets in OECD countries have contributed considerably to rising demand for bio-fuels. Currently, about 30 per cent of the land used for corn production in the USA is used to produce bio-fuel. The impact of bio-fuel production on the current increase in food prices is estimated at more than 50 per cent (Mitchell 2008).

For a long time, food supply had been increasing faster than demand owing to improved production technology in many countries. However, in a number of developing countries, stagnating agricultural productivity was one of the key factors that led to a slowdown in growth over the last 20 years. More recently, the rising production costs resulting mainly from high energy prices led to a slower increase in supply than in demand. At first, the slowdown in production growth resulted in a decline in inventories and therefore had no major impact on prices. However, combined with lower-than-usual harvests in major exporting countries such as Australia, it eventually contributed to the price increases of 2007 and 2008 (UNCTAD 2008c; IMF 2008a).

The rise in food prices has even affected such commodities as rice that are not directly influenced by demand for bio-fuels or by adverse weather conditions. This is due to substitution effects and adverse policy measures. For example, demand for bio-fuels led to the shift of production from rice, wheat and soybeans to maize. Likewise, substitution effects can be felt in demand as consumers switch from maize to soybean when the price of the former increases (IMF 2008a).

Policy measures to protect domestic consumers from higher food prices have also contributed to the price increases. A number of countries have introduced producer price controls to make cheaper food available on the domestic market. Despite the possibility of targeting through the selection of basic foodstuffs, this might still benefit the richer consumers disproportionately, because of substitution effects. In Egypt, for example, subsidized bread has been diverted to feed animals, thereby exacerbating the shortages. In effect, price controls reduce the incentives for producers to increase supply, thus contributing to shortages and further price increases.

Likewise, export restrictions might increase the domestic availability of food in the short term, but they are not targeted towards the poor and therefore reduce incentives for agricultural producers to increase production. In addition, they reduce supply on the international market and drive up prices further. Due to these adverse effects, such measures should be avoided as much as possible and should only be used by countries that do not have the capacity to introduce more comprehensive measures. Specific measures such as targeted subsidies and expanded social protection are better able to help the poor cope with higher food prices.

One feature of the recent development in commodity prices is the increasing volatility and uncertainty about short-term trends. Volatility has increased over the past 30 years due to the low short-term elasticity of demand and supply. It might even increase further due to the higher variability of weather patterns as a consequence of climate change. This higher volatility reduces investment in the agricultural sector and puts a heavy burden on governments for their financial planning. Speculation by financial investors has most likely further increased volatility. It has been driven by the recent turbulence in financial markets as investors try to diversify their portfolios (UNCTAD 2008c).

As figure 1.5 shows, food prices peaked in June 2008 and declined by more than 50 per cent on average during the second half of the year. At the end of 2008, they stood at the level of 2005 but were still considerably higher than the 2000 level. In addition, the decline in world market prices has slowly worked its way into domestic prices in many developing countries. Hence, the issues of stabilizing food prices at reasonable levels and increasing agricultural productivity still remain very relevant, especially for Africa (see part II of this report).

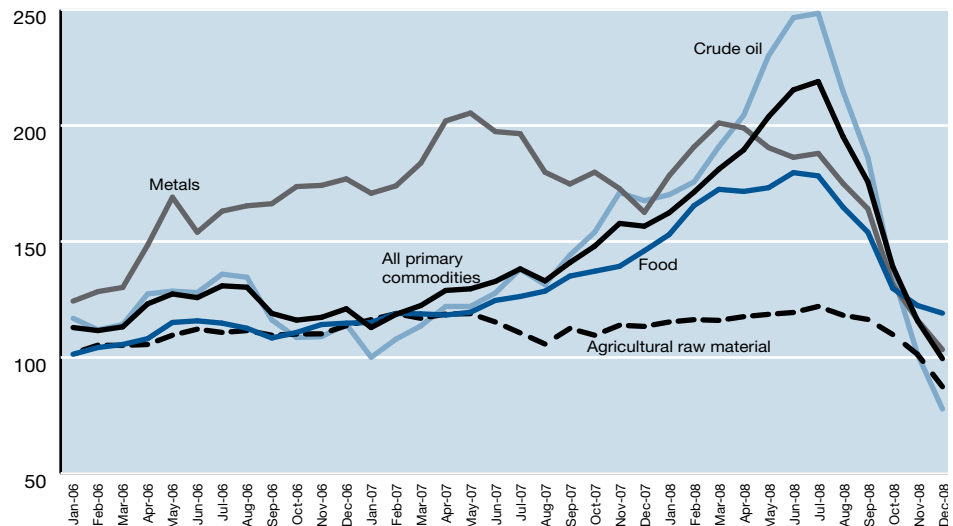
The medium-term prospects for global food prices are likely to be lower than the 2008 levels, but higher than those seen at the beginning of the century. However, prices are likely to resume their decline in real terms, albeit at a slower rate than before the recent surge. Maize and sugar prices, which are directly affected by demand for bio-fuels, are expected to increase further in 2009, whereas most other food and beverage prices are expected to remain relatively stable. It is expected that the increase in

“ Higher volatility of food prices reduces investment in agriculture ”

supply will come mainly from productivity gains and less from an increase in areas under cultivation (FAO and OECD 2008; United Nations 2009).

“ Inflation rates for 2009 are expected to fall back to their 2007 levels in most regions ”

Figure 1.5
Indices of primary commodity prices, 2006-2008 (2005=100, in \$US)



Source: IMF 2009a.

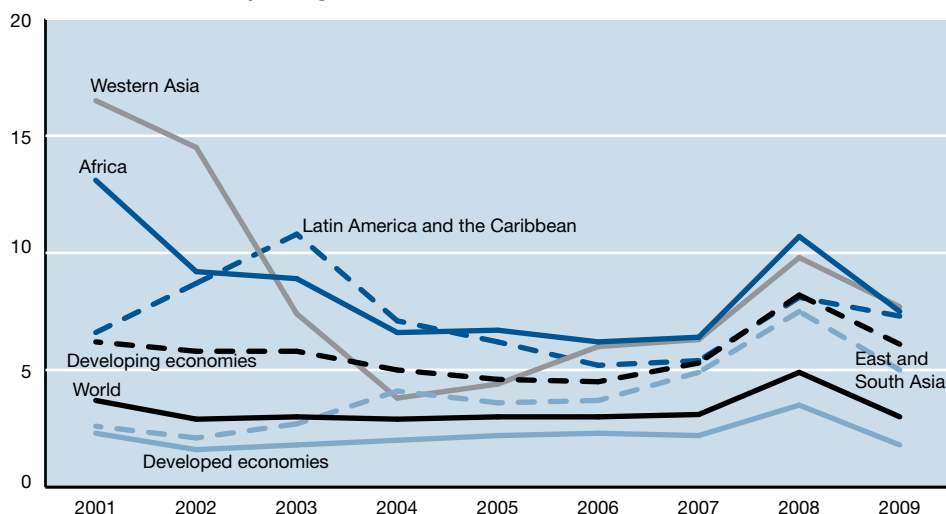
1.4 Global inflation increased significantly in line with commodity prices

The sharp increase in commodity prices that started in 2007 and accelerated in the first half of 2008 pushed up average prices in all regions of the world by the end of 2008 (figure 1.6). Average world inflation increased from 3.5 per cent in 2007 to about 6 per cent in mid-2008, the highest rate since the late 1990s. As world demand declined in the wake of the financial crisis, prices for most commodities also declined, thus easing inflationary pressures. Inflation rates for 2009 are therefore expected to fall back to their 2007 levels in most regions. The strength of the impact of changing food and oil prices on inflation depends on the composition of consumption. Increases in food prices have a stronger impact on inflation in developing countries because their food products represent a much higher share of the consumption basket. However, increases in energy prices have a stronger effect on inflation in industrialized countries (United Nations 2009; OECD 2008; IMF 2008a).

In the first half of 2008, the European Central Bank (ECB) kept interest rates high, as headline inflation was more than double its target of 2 per cent. Most central banks were reluctant to increase interest rates, since the increase in inflation was mainly due to external circumstances rather than a robust expansion in domestic demand. As the global economy was generally slowing down, it was seen as appropriate to wait for a trend reversal in commodity prices, something that finally occurred in mid-2008. In Europe and Japan, wage increases in particular were largely contained, leading to a stable underlying inflation rate, but in the United States, underlying inflation started to pick up in mid-2008.

“With inflationary pressures waning, central banks have lowered interest rates”

Figure 1.6
Inflation rates in major regions and economies, 2001-2009



Source: United Nations 2009, 2008 estimates, 2009 forecasts.

In addition to declining commodity prices, weakening demand and lower capacity utilization rates are expected to bring inflation down in 2009. Towards the end of 2008 and the beginning of 2009, all major central banks cut interest rates to historically low levels: the Fed to 0 per cent and the Bank of Japan to 0.1 per cent in December 2008, the Bank of England to 1.5 per cent and ECB to 2 per cent in January 2009 (OECD 2008; UNCTAD 2008c; ECB 2009).

Up to mid-2008, the central banks of several developing countries, including Brazil and India, increased interest rates to contain inflation and reduce the second-round effects of rising nominal wages. These effects on core inflation were mainly occurring in countries where demand growth has been strong and inflation expectations are increasing due to the low credibility of monetary policy. With the easing of many commodity prices, especially those of oil and some major food items, inflationary pressures have been reduced and central banks in Asia have lowered interest rates.

“ External borrowing costs for developing countries have increased dramatically since September 2008 ”

For developing countries, inflation is expected to decline to 6.1 per cent in 2009 compared with 8.2 per cent in 2008. The same pattern is observable in all regions of the world, although the decline in inflation is less rapid in Western Asia and Latin America due to higher inflationary expectations (figure 1.6; UNCTAD 2008c; IMF 2008a; United Nations 2009).

External financing costs for developing countries have increased dramatically since September 2008. Spreads on emerging market bonds doubled within a few weeks and have remained at a very high level for most countries, reflecting general risk aversion as opposed to country-specific risk perceptions. The measures taken by the governments and central banks of industrialized countries to contain the recent financial crisis eased constraints in the financial markets somewhat, but were not sufficient to re-establish confidence (figure 1.7).

Emerging markets remain vulnerable to continued de-leveraging and credit retrenchment. At the G-20 meeting of November 2008, Heads of State and Government agreed to strengthen transparency and accountability, enhance regulations, promote integrity in financial markets, reinforce international cooperation and reform international financial institutions, but these commitments could not stop the decline in share or commodity prices (World Bank and G-20 2008; IMF 2009b).

Table 1.2
Indicators of financial market stress and bank credit default swap rates

	Before August 2007		August 2007 to 12.09.2008		15.09.2008-14.10.2008	
	Average	Standard deviation	Average	Standard deviation	Average	Standard deviation
United States	21	6	158	97	271	60
Euro zone	13	4	79	33	170	24
United Kingdom	10	3	97	33	177	33

Source: OECD 2008.

1.5 Global interest in Africa is broadening

In 2008, several high-level meetings were organized with Africa's concerns high on the agenda. In April 2008, the India-Africa Forum Summit was held in New Delhi with 14 Heads of State and Government and representatives of regional bodies. A comprehensive Africa-India Framework for Cooperation was established, covering economic cooperation in such areas as agricultural development, political cooperation, science and technology, social development, tourism, infrastructure, energy and environment, and media and communication. A joint plan of action and implementation mechanism is to be developed within a year. One of the stated aims of

the framework is to reinforce South-South cooperation to enable Africa and India to have greater leverage in international forums.

In May 2008, the fourth Tokyo International Conference on African Development (TICAD-IV) took place in Yokohama, with representatives from 51 African countries, including 40 Heads of State and Government as well representatives of African organizations and from many Asian countries. Japan pledged to double its official development assistance (ODA) over the next five years, focusing on infrastructure and agricultural development.

The first Turkey-Africa Cooperation Summit was held in Istanbul in August 2008 with the participation of representatives of 50 African countries, among them several Heads of State and Government. Turkey's trade and investment relations with Africa have increased dramatically over the past few years and Africa is a major market for Turkish contractors. Turkey has also formalized relations with AU and with AfDB.

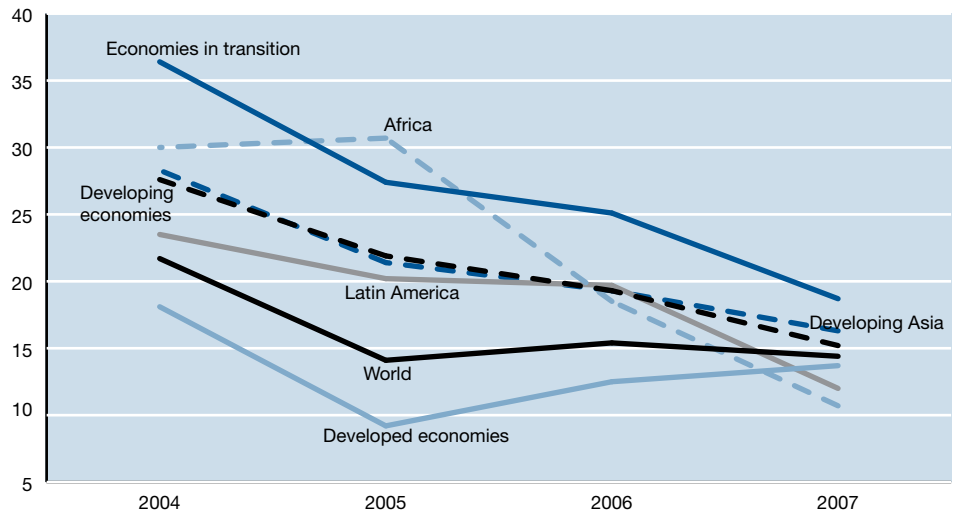
In October 2008, a ministerial conference on economic cooperation between South Korea and Africa was held to discuss major economic development issues and share South Korea's economic development experiences with African partners. Other middle-income countries such as Brazil are also intensifying their economic and diplomatic ties with Africa. These developments are taking place against the recent backdrop of high growth in Africa, increasing demand for commodities, especially in emerging economies, and the search for low-cost locations for investments in simple manufacturing. They have helped halt the trend of Africa's declining share of world trade and foreign direct investment (FDI) flows.

World trade expanded less in 2007 than in previous years, which is reflected in lower export growth rates in almost all regions, except developed economies (figure 1.7). However, there are fundamental differences between countries, as the increase in commodity exports was mainly driven by price hikes, whereas exports of manufactured goods expanded because of higher trade volumes. Exports of economies in transition grew the fastest, followed by those of developing Asia. Africa had the slowest growth rate at 10.7 per cent, despite the increase in most commodity prices. Growth in world trade slowed in 2008 to around 6 per cent, due to lower demand in OECD countries. Another important factor that restricts exports is the drying up of short-term export credit, as about 90 per cent of trade is financed with short-term credit. (Massa and te Velde 2008).

“ Growth in world trade slowed in 2008 and will decline in 2009 with declining short-term export credit ”

“ FDI flows declined by 21 per cent in 2008 ”

Figure 1.7
Annual average growth rates of exports by region (%)



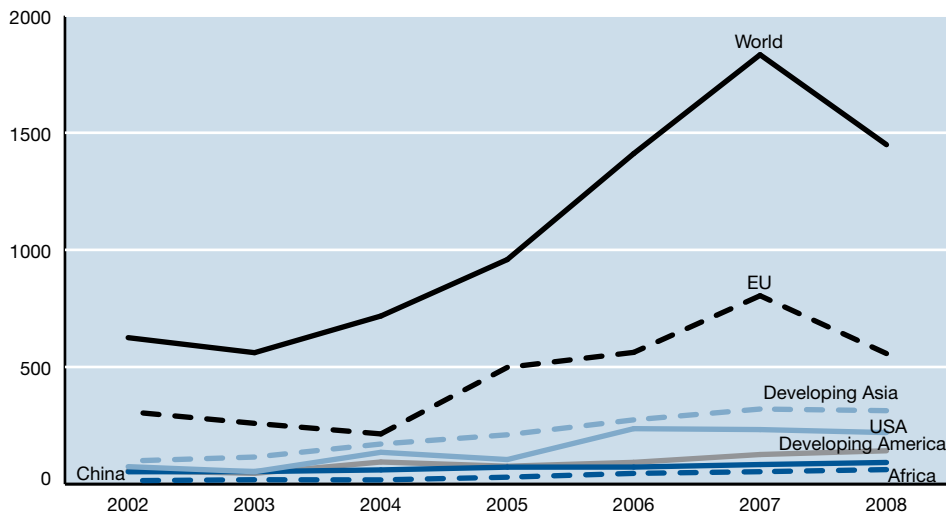
Source: UNCTAD 2008a.

A further 2 per cent decline in overall trade is expected for 2009, for the first time since 1982. Some countries such as Russia and India have already started to raise tariffs and others are increasingly using anti-dumping rules to protect their domestic industries from the sharp decline in demand. The result could be a doubling of average tariffs, as most of the tariff reductions over the past decade are not bound to be maintained under the World Trade Organization (WTO). (See UNCTAD 2008c; World Bank 2009; United Nations 2009).

In 2007, FDI inflows increased by 30 per cent, reaching an all-time high of \$1,833 billion. However, in 2008, world FDI flows declined by 21 per cent due to the global economic downturn, generally tighter credit conditions, and more risk-averse investors with deepening financial crisis (figure 1.8). EU played an important role both in the surge in 2007 and in the fall in 2008. FDI into the USA already declined in 2007 and continued this trend in 2008. The USA remained the largest recipient country, as the depreciation of the dollar reduced the cost of FDI in the country. The total FDI inflows into industrialized countries dropped by 33 per cent in 2008, whereas for developing countries, they increased by 4 per cent on average. Africa and Latin America recorded growing FDI inflows mainly in the first half of 2008. For 2009, capital flows are expected to drop further. Net private debt and equity flows to developing countries are also expected to decline by half from \$1 trillion in 2007 to \$530 billion in 2009, slowing down investment growth dramatically (UNCTAD 2009; World Bank 2009; United Nations 2009).

Figure 1.8

FDI inflows by region and for selected countries and regions, 2002-2008



Source: UNCTAD 2009; 2008 figures are preliminary estimates.

In 2007, the trend of increasing FDI flows between developing countries continued with Asia being the main source of FDI for other developing regions. However, even African transnational corporations (TNCs) expanded their activities inside and outside the region. FDI flows to Africa grew to a new record of \$53 billion in 2007, increasingly targeting extractive industries due to the increase in commodity prices. Overall, the service sector still accounts for the largest share of global FDI stocks, whereas the share of manufacturing is declining and the share of agriculture remains very low (UNCTAD 2008b).

Remittance flows to developing countries also grew by 7 per cent to \$283 billion in 2008, up from \$265 billion in 2007. The increase in remittances was strongest in South Asia, followed by the Middle East, North Africa and sub-Saharan Africa (SSA). However, this increase was much slower than in previous years due to the growing unemployment and weakening economies in industrialized countries. For 2009, a loss of 20 million jobs globally is expected, which might affect migrants disproportionately.

However, the net effect of the crisis on migration is uncertain as both pull factors such as employment opportunities in receiving countries and push factors such as prospects for earning money in developing countries are affected. Overall remittance flows to developing countries are expected to decline by 6 per cent. However, they are still expected to be less affected by the financial crisis than other flows (World Bank 2008).

“ Remittance flows to developing countries grew by 7 per cent in 2008, but are expected to decline ”

1.6 Effects of the financial crisis on Africa and the policy response

“
The financial crisis and the global economic recession present serious challenges for Africa
”

The financial crisis and the global economic recession are likely to have both direct and indirect effects on Africa. Owing to the relatively weak integration of African financial markets into the global market, the direct effects are likely to be moderate. In a number of countries such as South Africa, Egypt, Nigeria and Kenya, the financial sector has been affected as stock prices have declined dramatically. The reversal of portfolio inflows makes the rollover of government bonds more difficult and for those countries with a high share of foreign banks such as Mali, Tanzania, Rwanda, Uganda, Mozambique and Zambia, the risk of capital withdrawals persists (Massa and te Velde 2008).

The global financial crunch makes it difficult even for large African companies to borrow on international markets. Domestic banking systems are also affected by the global financial instability and liquidity shortage, such that they are unlikely to provide significant financing in the short term. This leads to contraction in domestic credit to the private sector, thereby compromising their profitability, at least in the short term, and further reducing the value of stocks on the markets.

Falling stock prices and the credit crunch may bring about a sharp contraction of domestic consumption through the wealth effect associated with declining stock prices and disposable income. At the same time, difficulties in financing investment projects will force some domestic firms to increase tariffs and prices. For instance, South Africa's State electricity supplier, Eskom, has already announced that its tariffs will increase because it can no longer finance its long-term investment plan through international capital markets. Since demand for electricity is typically inelastic, this increase in tariffs will be largely borne by the final consumer.

The indirect effects of the crisis can be significant and multifaceted. They stem mainly from the world economic recession and falling commodity prices and exports, slow and unpredictable capital inflows, and exchange rate volatility. In addition to lower growth, these factors can create significant internal and external economic imbalances as well as slow progress towards achieving the Millennium Development Goals (MDGs). However, the impact of the global financial crisis on inflation should be marginal. As mentioned previously, slowing global demand will result in lower prices for Africa's commodity exports.

Other important export sectors such as non-traditional agriculture will also be adversely affected by the financial crisis and ensuing global recession. Tourism, on the other hand, will be affected not just by the crisis, but also by high oil prices and air transport costs. Thus, current account deficits are expected to widen, while lower

revenues from exports will put a strain on government expenditure (Massa and te Velde 2008).

The indirect effects of the financial crisis are also expected to be significant, with falling ODA flows and lower FDI and remittances. Even if industrialized countries keep aid as a percentage of gross national income (GNI) constant, the recession in those countries will result in lower absolute aid flows. The financial crisis will also weaken many African countries, especially mineral exporters. It is expected that the real currency appreciation experienced by African countries in recent years will be offset, thereby improving the competitiveness of African exports. On the other hand, imported inflation might offset the stabilizing effects of the decline in international commodity prices, and the overall effect of the crisis on domestic inflation should be marginal. The global recession will cool down inflationary pressures, while monetary policy is likely to be more expansionary in response to the crisis.

The worldwide recession and weak growth in Africa will slow down the pace at which the continent approaches the MDG targets. The drop in ODA and the difficulties in mobilizing domestic resources through public budgets exacerbate this effect. Disposable income of households will also decrease as a consequence of reduced remittances. The number of those hit by the food crisis is also likely to increase. Overall, Africa might therefore experience an increase in the number of its poor citizens and a decrease in the living standards of the most vulnerable segments of its population.

Clearly, the financial crisis will force African countries and their partners to consider both short-term and long-term mitigating policy actions. These should include: strengthening financial sector regulations, especially in relation to banking surveillance and supervision; reducing vulnerability to international shocks through economic diversification and improved management of income from natural resources; and improving the mobilization of domestic resources in the face of declining and volatile external flows.

1.7 Conclusions

The fact that all major industrialized countries were sliding into recession and were mired in a financial crisis at the end of 2008 is an occurrence that has not been witnessed since the Great Depression of the 1930s. Recovery in industrialized countries is only expected towards the end of 2009. As the financial crisis is going to have significant negative effects on all developing regions, further coordinated action by industrialized and emerging economies should not only bring relief to their own economies but also take into account the needs of countries that do not have the

“ Deepening global slowdown and slowing growth in Africa hampers progress towards achieving the MDGs. ”

means to protect themselves against the unfolding turmoil. This might include extension of rescue packages to poorer countries.

“ Higher food prices also present an opportunity for increasing investment in agriculture. ”

Although the surge in food prices subsided and even started retreating in mid-2008, prices have remained relatively high, presenting a number of challenges for developing countries in general and Africa in particular. For example, food importers are confronted with higher trade and fiscal deficits, while the increasing volatility of commodity prices is increasing the level of uncertainty, which in turn has a negative impact on investment and production. In addition, fiscal and financial planning becomes more difficult, which is especially problematic for countries with weak institutions and capacity gaps. However, higher food prices also present an opportunity for increasing investment in agriculture and thus reducing poverty in the medium term, as discussed in the second part of ERA 2009.

While the world financial crisis will undoubtedly have significant direct and indirect economic and social effects on Africa, policy responses will depend on the nature of these effects and on the financial position of each country. African countries with accumulated reserves from the recent commodity boom should use these reserves to boost domestic demand and mitigate the impact of the crisis on their economic and social development. Countries with limited reserves and high dependence on donor support are likely to suffer the most.

In addition to better macroeconomic and public sector management, these countries need the support of donors and multilateral development institutions in order to sustain the economic and social achievements of the last few years. In this regard, industrialized countries should consider using a fraction of their financial rescue and economic stimulus packages to help finance transfers to the hardest-hit poor countries.

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