Building a resilient Africa

Commodity exporters need strong financial systems

Cedric Mbeng Mezui, African Development Bank

Over the past two decades Africa's image has been transformed. A continent that used to be seen as a disaster area is now viewed as a land of promise.

This evolution has been captured by the headlines of The Economist newspaper: in 2000 Africa was 'The Hopeless Continent' but by 2013 it had been transformed into 'The Hopeful Continent'. In April last year it was 'The 1.2 billion opportunity' – a reference to Africa's population.

Africa's strengths are its young workforce and its enormous pool of natural resources. But, excluding the extractive industries, average economic growth across the continent remains anaemic. Africa's annual real GDP growth was on average 5.4% between 2000-10, and then 3.3% up to 2015.

Procyclical government spending

For most African countries that rely on exports of raw materials, the commodity boom is over. Structural weaknesses, which made their fiscal policies vulnerable, meant that they entered the current commodity slump with larger fiscal deficits than those they had at the onset of the financial crisis.

Africa is a net importer of agricultural products, with agricultural exports consisting mainly of a small number of primary commodities and reliant on preferential access to a few markets in developed countries.

In countries where governments are heavily dependent on commodity revenues, commodity price shifts tend to cause large fluctuations in the government's coffers. As a result, expenditure in these countries has been intensely procyclical.

Two basic indicators of fiscal vulnerability are the share of commodity revenues in total government revenues and the procyclical nature of government spending.

Reducing external vulnerabilities

In that context, the key challenge for commodity exporters is to deal with increasing levels of nominal debt, a high share of external to total public debt and depreciating currencies and increasing debt servicing costs, all of which trail fluctuations in the commodity markets (see Chart).

Factors for downside risks are the China slowdown, weak global growth, a change in global economic activity from manufacturing to services, the strong dollar, rising US interest rates and commodity supply growth.

If Africa is to make itself less vulnerable to fluctuations in international markets, it has to strengthen local financial systems and harness its assets to promote sustained and inclusive endogenous growth.

This requires a combination of factors, and the continent's positive demography is a good starting point.

With the median age in Africa around 18, pension funds and insurance companies have 40 years to accumulate savings before they need to start paying out. This would provide an immense reservoir of long-term capital for the financing of the real economy, as well as a consumer base.

Growth can be boosted further by the local processing of raw materials to increase the added value of products and meet domestic demand.

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Encouraging domestic trade and domestic demand will help to make growth more endogenous. Commodity-exporting nations tend to have outward-orientated growth and this is an issue that needs to be addressed. From 2007-11 just 11% of merchandise exports from African countries stayed on the continent compared with 50% in developing Asia, 21% in Latin America and the Caribbean, and 70% in Europe.

Benefits of establishing exchanges

African governments need to promote the development of derivatives and commodity exchanges. These can help deliver improved market transparency; financing of commodity chain and financial market participants; hedging and risk management; and provide the financial resources for private sector participation in Africa's infrastructure development.

The secondary effects of establishing exchanges include job creation and enhanced cross-border economic integration as they offer venues for the mitigation of key financial and trade risks.

If the continent is to realise its promise, African countries need a long cycle of economic growth, mainly driven by innovation. To achieve this, these economies should give priority to deepening their financial systems. Unless they do this, fluctuations in the international landscape will always dictate the continent's economic and financial agenda. ■

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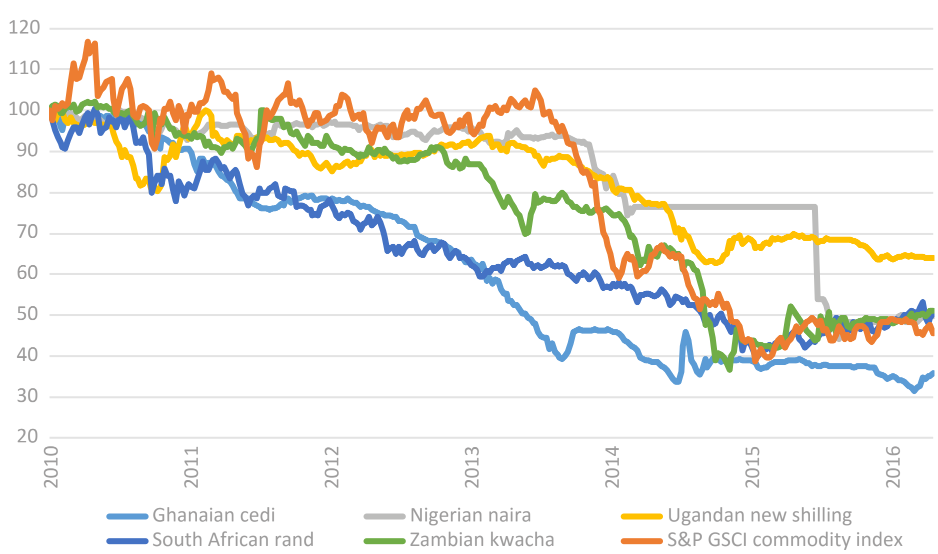
Commodity exporters' currencies depreciate as prices fall

Dollars per currency and S&P GSCI Commodity index, December 2010 = 100



Source: Thomson Reuters, OMFIF analysis