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The global financial crisis: impact, responses and

I. Introduction

1. The global financial and economic crisis presents significant challenges for African countries. It has also exposed weaknesses in the functioning of the global economy and led to calls for the reform of the international financial architecture. Although the crisis was triggered by events in the United States housing market, it has spread to all regions of the world with dire consequences for global trade, investment and growth. The crisis represents a serious setback for Africa because it is taking place at a time when the region is making progress in economic performance and management. Since 2000, the Africa region has had an average growth rate of real output above 5 per cent and inflation has declined to single digits. There have also been significant improvements in governance and a reduction in armed conflicts, making the region more attractive for private capital flows. Net private capital flows to Africa increased from \$17.1 billion dollars in 2002 to \$81 billion dollars in 2007 (ECA and APF, 2008). The global financial and economic crisis threatens to reverse these gains in economic performance and management.

2. The current crisis is also taking place at a time when the region is slowly recovering from the negative effects of the fuel and food crisis. Against this background, the key challenge facing African countries is how to manage the current crisis to ensure that it does not reverse progress made since the beginning of the new millennium and reduce the prospects of achieving the

Consequently, there is the need to provide assistance to countries in the region to enable them to withstand the global slowdown and protect vulnerable groups.

Stock markets, banks and exchange rates

5. The impact of the crisis on Africa comes from both direct and indirect channels. The direct effects have been felt mostly through the financial sector. For example, stock market volatility has increased since the onset of the crisis and wealth losses have been observed in the major stock exchanges. In Egypt and Nigeria, the stock market indices declined by about 67 per cent between March 2008 and March 2009. Significant losses have also been observed in Kenya, Mauritius, Zambia and Botswana. The turmoil in African stock markets is beginning to have significant negative effects on the financial sector and on aggregate demand. For example, there is growing evidence that it has a negative effect on bank balance sheets and, if present trends continue, non-performing loans in the banking sector would likely increase, with dire consequences for financial stability in the region. In Ghana, the ratio of non-performing loans to gross loans increased from 7.9 per cent to 8.7 per cent between 2006 and the third quarter of 2008. In Lesotho, it increased from 2 per cent to 3.5 per cent over the same period (IMF 2009).

6. So far, bank failures have been rare in the region, largely because most African banks do not have any significant exposure to the sub-prime mortgage market and asset-backed securities. They are, however, vulnerable to contagion effects arising from the high rate of foreign

Table 1: Exchange rate changes in Africa

Country	Currency	Expected depreciation of currency against United States dollar in 2009 (%)
Seychelles	Rupee	84.2
Comoros	Franc	45.2
Zambia	Kwacha	43.4
Nigeria	Naira	27.3
South Africa	Rand	27.1
Congo, Democratic Republic	Franc	23.7
Uganda	Shilling	22.4
Ghana	Cedi	21.1
Ethiopia	Birr	19.8
Mauritius	Rupee	19.5
Madagascar	Ariary	17.9
Tunisia	Dinar	17.1
Kenya	Shilling	16.5
Namibia	Dollar	15.0
Sierra Leone	Leone	14.7
Mauritania	Ouguiya	14.3
Cape Verde	Escudo	13.8

Figure 1: Trends in price indices of major commodity groups

Source IMF online database.

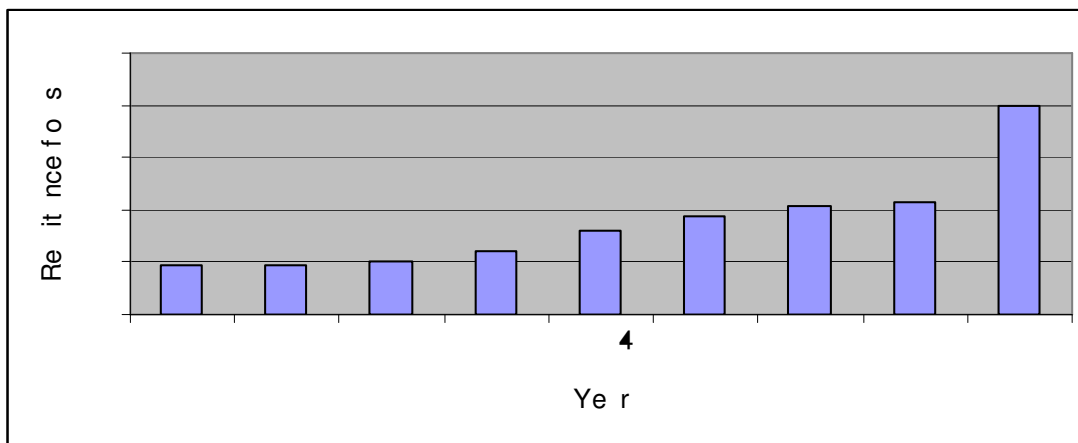
10. The volume of exports by African countries has also declined because of the financial crisis. The slowdown in economic growth in three key export markets – Europe, the United States and China – has affected the demand for exports from Africa. The growth of Africa's exports in real terms fell from 4.5 per cent in 2007 to 3 per cent in 2008. Import growth fell from 14 per cent in 2007 to 13 per cent in 2008 (table 2). Although trade figures for 2009 are not yet available, forecasts by the World Trade Organization indicate that the volume of global trade is expected to decline by 9 per cent in 2009, which will have a negative effect on Africa's exports in 2009.

11. The declines in commodity prices and export volumes have led to a decrease in export revenues in African countries. For example, in Burundi, coffee earnings fell by 36 per cent between October and November 2008. In Angola, export earnings are expected to decline from \$67 billion in 2008 to \$23 billion in 2009, while in Cape Verde, they are expected to fall from \$90 million in 2008 to \$84 million in 2009. In Côte d'Ivoire, earnings are expected to decline from \$762 million in 2008 to \$528 million in 2009.

Workers' remittances

12. Workers' remittances have played an important role in development finance in Africa since the beginning of the new millennium. For example, figure 2 shows that remittance inflows to sub-Saharan Africa increased from \$4.6 billion in 2000 to \$20 billion in 2008. A large part of inflows to sub-Saharan Africa finances household consumption and hence has a direct effect on poverty. There is some concern in Africa that the global economic slowdown will reduce the flow of remittances to the region as African migrant workers in Europe, North America and the Gulf States are laid off and return home. Recent data released by the World Bank indicate that the financial crisis will reduce remittance inflows to sub-Saharan Africa by between \$1 billion and \$2 billion dollars in 2009 relative to 2008. Liberia, Lesotho, the Gambia and Seychelles are highly vulnerable to reductions in workers' remittances because inflows represent more than 10 per cent of their gross domestic product (GDP). North African countries are also vulnerable because they receive a significant amount in remittances, although the inflows are small as a percentage of GDP.

Figure 2: Remittance inflows to sub-Saharan Africa (billion dollars)



Source Ratha and Zu (2007) and World Bank database.

Private capital flows

13. The financial crisis has diminished prospects for private capital flows to the region. In recent years, there has been a significant increase in private capital flows to the region (figure 3). Foreign direct investment (FDI) flows were \$53 billion in 2007 and \$61.9 billion in 2008. However, there are indications that FDI flows to the region would decline in 2009 because of the global economic slowdown. FDI often responds to growth with a lag and so it is not surprising that the full impact of the crisis on flows to Africa will be felt more in 2009 and beyond. Other forms of private capital flows have also been affected by the crisis. Prior to the crisis, countries such as Ghana and Gabon successfully issued bonds in international capital markets. As a result

interest rate from 10.25 per cent to 9.25 per cent. Other countries that reduced interest rates include Kenya, Mauritius, countries that fall under the ambit of the Bank of Central African States, Namibia, South Africa, Swaziland and Tunisia. It is interesting to note that while most countries responded to the crisis by reducing interest rates, the Democratic Republic of the Congo responded by raising its policy rate. In fact, the central bank has raised its policy rate four times since December 2008 in an attempt to fight inflation.

Liquidity injections

20. Some countries have taken actions to increase liquidity in the banking system and to domestic firms. For example, in Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, the Niger and Togo, the common central bank (BCEAO) injects liquidity on a weekly basis in the regional money market. In Cameroon and Liberia, a support or guarantee fund has been created for firms. In Tunisia, the central bank has set up new deposit and credit facilities to improve flow of credit and increase liquidity in the banking system.

Recapitalization of banks and regulatory changes

21. Some countries have taken specific measures to recapitalize domestic banks. In Mali, the Government has decided to recapitalize the Banque de l'Habitat du Mali in order to increase and improve finance for housing. In Tunisia, the central bank doubled the capital for the financing of small and medium-sized enterprises in order to boost domestic investments. The Algerian Credit and Monetary Council has also issued instructions to commercial banks to increase their capital from 2.5 billion Algerian dinars to a minimum of 10 billion Algerian dinars (\$142 million) within 12 months. The council has also put in place a series of banking reforms to strengthen the financial system. The Government of Kenya has also enacted l

purchases and the creation of new posts. In Angola, the Government plans to revise its budget downward to take account of the anticipated decline in oil revenue.

Trade policy measures

24. Boosting economic growth through trade has been an important component of the response plans in several countries. Cameroon has reduced or waived import taxes on equipment, tools and goods required for research and oil exploration. In Liberia, the President has announced plans to reduce trade tariffs as well as the trade levy of the Economic Community of West African States. Tunisia has increased allotments for export business travels and Mali has introduced measures to refund to gold mining companies the value added tax and import duty due on their 2006/2007 operations. In Madagascar, the central bank has devalued the local currency to restore export competitiveness. The Government has also launched a drive to boost exports.

Improving domestic resource mobilization

25. Some African countries have used the current crisis as an opportunity to introduce reforms aimed at boosting domestic resource mobilization. In Burkina Faso, the Government intends to

of the crisis in poor countries. Giving priority to social protection and pro-poor expenditure is important in this regard.

- Official development assistance can also play an important role in augmenting shrinking domestic resource bases arising from falling exports, remittances and tourist receipts. In this regard, donors must increase aid to Africa in accordance with their Monterrey and G-8 Summit commitments.
- Strengthening developing countries' voice and representation by reforming the governance of international financial institutions is also crucially important. This has become imperative especially in the light of the increasing globalization of financial markets.

27. These recommendations were presented and discussed by African Heads of State and Government at their Summit in Addis Ababa in January 2009. At their Tunis meeting, African ministers and governors of central banks also set up the Committee of Ten Ministers and Governors of Central Banks to monitor developments, provide regular follow-up, advise ministers and governors on proposals, and contribute to the international discourse in relation to the economic impact of the financial crisis and mitigating measures. The committee held its first coordination meeting in Cape Town, South Africa on 16 January 2009 and its second meeting in Dar es Salaam, Tanzania, on 11 March 2009. These meetings have helped to build an African consensus on the crisis and on how the international community could assist countries in the region to respond to it.

Research support

28. Identifying the potential impact of the crisis and the transmission channels is critical to designing and implementing effective policy responses. In this regard, the Economic Commission for Africa (ECA) has been providing technical and research support to African countries since the onset of the crisis. ECA has also played a key role in facilitating an African consensus on the crisis by organizing high-level meetings for African countries. For example, ECA organized the ministerial meeting in Tunis in collaboration with the African Development Bank (AfDB) and the African Union Commission (AUC). ECA, AfDB and AUC are also providing support to the Committee of Ten Ministers and Governors of Central Banks. These technical assistance support and advisory services have played a crucial role in ensuring that African views and concerns are adequately presented to the international community, particular

establishment of a catalytic trust fund for African Development Fund countries to supplement their existing resources.

IV. The way forward

30. African countries have taken important steps at the national lev

general consensus on what constitutes good policy. African countries would like a redesign of the CPIA to include a category significantly weighted towards country-specific outcomes and the use of African Peer Review Mechanism (APRM) governance indicators to measure progress in governance for African countries.

34.

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