Africa Growth Prospects for 2018

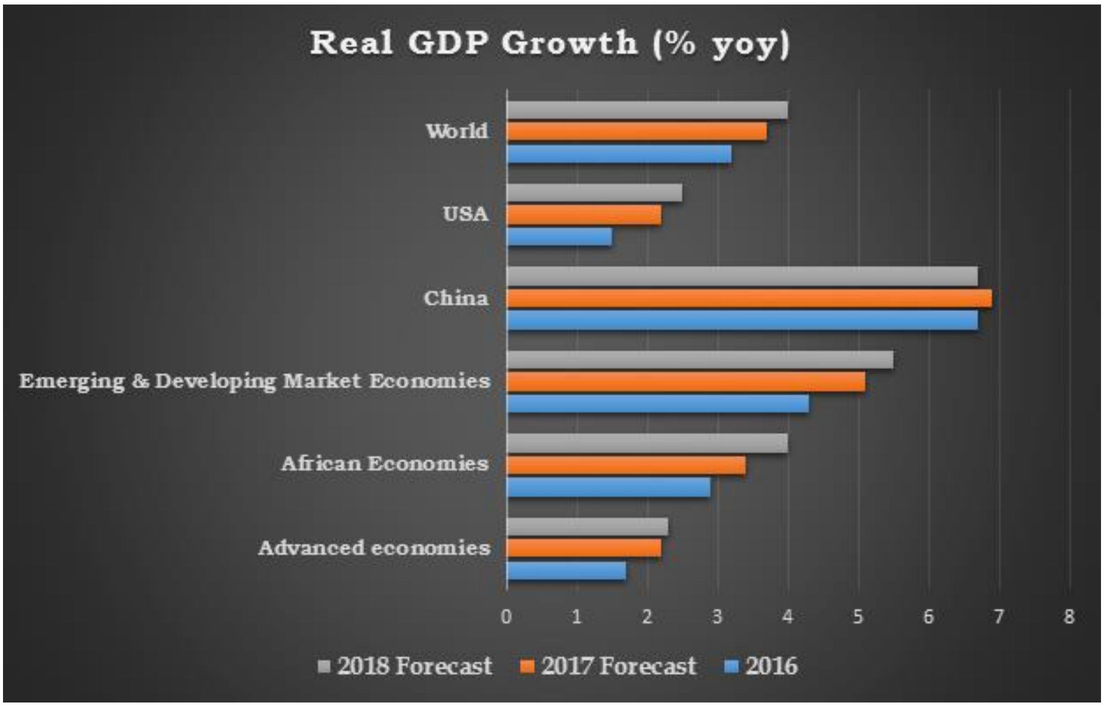
After successive downward revisions to growth forecasts which followed the contraction in global demand and the end of the commodity super-cycle—raising yet another spectre of global uncertainty and recession, especially in highly oil-dependent economies, Africa's economic growth rebounded in the second half of 2016 and strengthened further in 2017. The region as a whole achieved a growth rate of 3.4 percent in 2017, about a percentage point increase from last year. Looking ahead the growth performance of the region is projected to strengthen even more, with an average growth forecast of 4.0 percent in 2018, supported by increasing investment in a context of firming commodity prices, growth acceleration in Eastern and Northern Africa, and rebound in the largest economies in the region.

Strengthening economic expansion and forecast growth acceleration is sustaining the growth momentum enjoyed by the region since the transition into the new millennium, while at the same time pointing to increasing resilience of African economies to global economic headwinds. These improvements also reflect a combination of perfectly aligned external and internal factors. Firstly, on the external front, the global environment of weak inflation which has kept monetary policies on an accommodative path, sustaining the investment drive, is likely to persist in the near future. In addition to the spillover effects of weak commodity prices which have been acting as a major drag on inflation in advanced economies, broader slack in the labour market and inflationary expectations have also emerged as strong predictors of inflation in the medium term. And in a context of a highly correlated interactions between labour market slack and inflation, the former is likely to make it even more difficult to accelerate the process of monetary tightening, especially in a number of OECD countries where stubbornly high unemployment rates suggest that the "Phillips curve" relationship is still in effect.

Furthermore, in the short term the persistence of monetary divergence is also expected to act in favour of continued accommodative monetary policy. Even though the US Federal Reserve has been in a tightening mode, raising the target range of the federal funds rate three times in the course of last year, central banks in other leading economies are still in a stimulus mode, in part reflecting the challenges of attaining the inflation target and full employment objectives. Perhaps sustaining the rate of economic expansion in these countries where inflation is still under-shooting central bank forecasts, in a context of a persistent slack and spare economic capacity, will remain conditional upon the continued easing of monetary policy in the near term.

Reflecting these concerns, the European Central Bank has made the commitment to extend the bond-buying programme it adopted after the global financial crisis to lower longer-term interest rates out on the yield curve and combat the growing threat of deflation across the Eurozone well into 2018, perhaps to cement the region's ongoing economic recovery. Similarly, as long as inflation is below the institutional target, the Bank of Japan is likely to stick with its yield curve control regime. In the same vein, and despite the risk associated with rising sovereign and corporate debt, the People's Bank of China is likely to continue with some level of easing of monetary policy in order to remain on a strong growth trajectory if the government is to meet the stated policy objective of doubling the country's real GPD over the decade ending in 2020.

Secondly, the exceptionally favourable global economic environment of synchronized global expansion is perhaps the most important and direct catalytic driver sustaining the growth momentum enjoyed by the region and supporting the forecast growth acceleration. Global growth which picked up in the second half of 2016 and accelerated last year to reach 3.7 percent (up from 3.2 percent in 2016), firming commodity prices in the process, is forecast to strengthen further. In the short term, the combination of continued easy financial conditions and supportive fiscal policies will probably maintain the world economy on financial steroid, and perhaps sustain it on a self-reinforcing trajectory of accelerating global growth.



Source: The African Export-Import Bank.

Under that favourable global economic and financial environment, global growth is forecast to accelerate to about 4 percent in 2018 and could sustain global demand in the short—and medium term, especially with the expected rebound in leading emerging economies such as Brazil, Nigeria and Russia, but also as a result of the synchronized and broad-based nature of economic expansion. For the first time in more than a decade, growth acceleration has been witnessed in the overwhelming majority of countries around the globe, including both advanced and developing economies. In effect, although emerging markets and developing economies are still the leading drivers of global growth, the strong performance achieved over the last few quarters has been largely due to the synchronized upturn in economic activities and growth acceleration not only in developing, but also advanced economies, especially following the recent cyclical upswing in Europe (see Figure).

On the internal front, the forecast growth acceleration reflects the increasingly favourable environment of strengthening domestic demand lifted by softening inflation and a supportive macroeconomic environment. The capacity of African governments to undertake difficult economic reforms, including exchange rate adjustments which have stabilized most currencies in real effective terms, large reductions in public spending as well as drastic and permanent cuts in energy subsidies, despite inherent implications for social welfare, has reduced the risks of macroeconomic management challenges and debt overhang which in the past were associated with twin deficits. Despite the growing number of countries taking advantage of the generally accommodative international capital market conditions, including through sovereign bond issuance, debt-to-GDP ratios remain relatively low across the region, significantly below world averages, and current account deficits are narrowing, even in hard-hit oil-exporting economies.

The successful implementation of economic reforms has strengthened the foundation of macroeconomic stability and is driving investment in support of growth. In addition to improving the investment climate, these reforms are enabling countries in the region to either sustain robust rates of economic growth or shorten the length of recessions triggered by the contraction in global demand and exposure to recurrent adverse commodity terms of trade shocks (more recently illustrated by the end of the commodity super-cycle). After the relatively weak performance observed in 2017, especially in some of the leading natural resource-dependent economies, growth is forecast to strengthen in the region’s largest economies—Angola, Egypt, Nigeria and South Africa.

For instance, in Nigeria (Africa’s biggest crude oil producer) where exports of crude oil account for approximately 70 percent of government revenue and 90 percent of foreign exchange earnings, economic growth which contracted by 1.6 percent in 2016—the country’s first recession in more than two decades—rebounded in the second quarter of 2017. The economy grew at an annualized rate of 1 percent in 2017, after five consecutive quarters of economic contraction, starting in the first quarter of 2016. The country’s growth forecast points to further strengthening, with aggregate output expanding by more than 2.5 percent in 2018, on the back of increasing investments, rising oil production and labour inputs.

The asymmetric nature of external shocks hitting the region is another important driver of increasing resilience of African economies. While the collapse in oil prices has been a negative shock for leading oil-exporting countries, it has also improved the macroeconomic environment and external sector in a number of countries, especially large oil-importing and energy-intensive economies. Some of these countries are drawing on oil windfalls to finance the large-scale infrastructure investments which are driving output expansion and sustaining the region on the path to structural transformation. According to the most recent forecast, two of the top five fastest-growing economies in the world are African. Ethiopia and Côte d'Ivoire, which achieved growth rates of 8.5 percent and 7.7 percent respectively, were the second and third fastest-growing economies in the world in 2017.

But the resilience of African economies is also attributed to a number of other factors, most notably growing cross-border trade and investments which are reducing the exposure of the region to adverse global volatility and external shocks. A growing number of African industrialists are playing an increasingly important role in the process of economic growth and investment. In particular, they are injecting the patient capital which is required to drive the process of structural transformation and mitigate the risk of sudden stop and capital outflows triggered by the challenging global environment of rising uncertainty and volatility. Most recent estimates place annual intra-regional investment at US$15 billion, over 24 percent of total foreign direct investment to the region. Moreover, cross-border investment undertaken by African entrepreneurs and industrialists is directed primarily towards labour-intensive manufacturing industries which are both growth and welfare-enhancing.

Still, the forecast growth acceleration is also a reflection of increasing diversification of both destination of exports and sources of growth as an increasing number of countries in the region take steps to accelerate the process of structural transformation of their economies and boost intra-African trade. It used to be said "when Europe sneezes Africa catches a cold", in part reflecting the level of structural dependency of African economies which for a long time into the post-independence era were exclusively appended to Europeans'. The rise of developing market economies, especially those in Asia, and expanding intra-regional trade enabled Africa to sustain robust rates of economic growth in the post-great recession even as Europe was undergoing one of the longest deflationary periods, fuelled by fiscal and sovereign debt crisis, on its growth trajectory.

Although the synchronized and broad-based nature of global expansion reduces the risks of sudden contraction, which in the past has been exacerbated by the deficit of diversification both in terms of sources of growth and geographical destination of trade, African economies continue to face a number of downside risks. In particular, accelerating the pace of tightening of global financial conditions could decrease the risk appetite and exacerbate capital outflows. At the same time, a shift towards inward–looking policies could derail the improving global economy through investment and trade channels. In the short and medium term, the materialization of these risks will depend on both the pace of monetary policy normalization and the growth and trade dynamics between the US and China—the two largest economies which together account for about 40 percent of global growth and more than 22 percent of global trade.

Reflecting that shift towards a bipolar world in the global economic arena, sustaining the rate of economic expansion in China, where last year's unexpected growth reacceleration drove the turnaround in industrial production and trade, leading to the mild recovery in commodity prices and putting the world economy on a path to growth acceleration, is the first challenge. Rising to that first challenge is particularly important, especially for the Africa region where primary commodities continue to account for the lion's share of trade and growth, with oil-exporting countries alone accounting for more than 50 percent of aggregate gross domestic product. The second challenge, correlated with the first one in that it could affect the growth outlook in China, is geopolitical in nature and relates to the potential implications of protectionist policies for global and African economies.

A shift towards inward-looking policies in advanced economies could reduce cross-border trade and investment flows and in the process exacerbate capital outflow pressures on developing markets. At the same time, it could put downward pressures on commodity prices and weaken the current growth momentum. Although highly unlikely in the short term because economic confidence has been growing across most countries and remains on a rising trend, such a scenario cannot be ruled out completely. The dynamics of commodity prices and global demand still depends largely on China—Africa's single largest trading partner and global industrial powerhouse which accounts for almost 50 percent of world's total metal consumption. Should protectionist policies be mainstreamed and lead to a trade war, then the potential implications for African and global economies could be significant if these policies result in sustained contraction in global demand and trade.

The third challenge relates to the dynamics of the business cycle in the US. The increase in wages and steady decline in profit margins off peak levels recently witnessed in the US could well suggest that the US economy is already transitioning from the mid—to the late-cycle phase after a decade of uninterrupted economic expansion. However, the relatively steep yield curve and continued supportive credit conditions in a context of weak inflation suggests that the transition could be slow and even long. This favourable short-term outlook for the US economy is further supported by implied earnings growth estimates from stock prices which point to strengthening growth after the overhauling of the US tax system last December.

In this context, the biggest downside risk to the forecast growth acceleration in the short term is largely geo-political and hinges on the dynamics of the trade relationship between China and the US. Against this background, strengthening the existing framework for bilateral cooperation and policy coordination between the two leading drivers of global growth and trade to ensure a stable flow of goods and services and continued expansion of global value chains will be essential if the world is to remain on the current trajectory of synchronized global expansion and forecast growth acceleration.

Perhaps the synchronized growth acceleration witnessed over the last few quarters has been largely due to the positive externalities inherent with concurrent growth acceleration enjoyed by both the US and China. If a rising tide is destined to lift all boats, then the combined effects of two rising tides are likely to be even more significant and broad-based. In the short term, robust and strong economic growth in both China and the US is good for global growth and will sustain the forecast growth acceleration in Africa and globally. In the medium and long term, deepening the ongoing process of economic integration and the structural transformation of African economies, speeding ongoing efforts to address infrastructure bottlenecks and accelerating the diversification of exports are all essential to sustain the current growth momentum. These will mitigate the exposure of the region to recurrent adverse commodity terms of trade shocks, to global volatility and the reversal in capital flows which could be triggered by monetary policy normalization in advanced economies.

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