Divergent Monetary Policy – Implication for sub-Saharan African Economies

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Crisis background........

- The recent financial crisis is one of the most significant macroeconomic crisis in recent times.

- Many countries suffered low investment rate, high unemployment rate and collapse of the financial market.

- Financial markets not only triggered the crisis, but played a role in transmission of shock to the real economy.

- Collapse on financial institutions, sharp decline on several assets, lack of credit, and loss of confidence in the financial system were all indicators of the grave situation.
Crisis background

- The 2008 crisis caused huge recession and outpaced conventional monetary policy response.

- With the exceptional economic conditions, Central Banks took unconventional measures to promote investment and production in advanced economies.

- The massive expansionary monetary policy in industrialized countries had global effects and international spillovers that caused emerging markets economies to change their monetary and economic policy.
Crisis background.....

- The US and UK adopted some assets buying and bond purchasing measures to resuscitate their economies

- This had implications for emerging market economies in the areas of capital inflows, bond yield, assets prices and exchange rate volatility.

- The near zero interest rate in advanced economies gave rise to capital flows into emerging markets and SSA benefited from the inflows.
Divergent Monetary Policy: Impact on SSA Economies

- While advanced economies experienced low growth, economies of emerging markets witnessed sustained growth as high interest rate attracted inflows from advanced economies.

- Quantitative Easing policies of the US FED and EU countries resulted in an unprecedented increase in monetary base, lower interest rates and flattened yield curve.

- With cheap and new capital flows into the SSA economies, many countries became highly exposed to external shocks.
Divergent Monetary Policy: Impact on SSA Economies

Real GDP for Sub-Saharan Africa 2009-2016

Source: IMF, World Economic Outlook database
Growth in SSA remain good although at a lower rate.
Divergent of growth for SSA export market, China is slowing down, while Europe and the United States are picking up.
Divergent Monetary policy – Impact on SSA Economies

• Quantitative Easing also promoted trading in the financial markets and some Sub-Saharan Africa countries raised huge amount of money from the international debt market taking advantage of the near zero interest rate.

• However, the drop in commodity prices is putting many SSA economies in a challenging position

• Most SSA African countries are commodity exporters and low commodity prices will effect the external position and financing in these countries
Falling commodity prices is constraining growth rate and affecting the fiscal position of most countries.

**Crude Oil Price (Monthly)**

### Main exports & top trading partners of selected African economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Product (% value of export)</th>
<th>Major trading Partners (% of total exports)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Angola</td>
<td>Crude Oil (96%), Diamonds (1%)</td>
<td>China (51%), US (10%), India (10%)</td>
</tr>
<tr>
<td>Côte d’Ivoire</td>
<td>Cocoa (33%), Oil (13%)</td>
<td>Ghana (9%), US (9%), Nigeria (8%)</td>
</tr>
<tr>
<td>Ethiopia</td>
<td>Coffee (23%), Vegetables (19%), Oil seeds (13%)</td>
<td>Somalia (14%), Netherlands (10%), China (9%)</td>
</tr>
<tr>
<td>Ghana</td>
<td>Oil (33%), Cocoa (27%), Gold (13%)</td>
<td>China (11%), France (10%), South Africa (8%)</td>
</tr>
<tr>
<td>Kenya</td>
<td>Tea (18%), Vegetables (11%), Oil (7%)</td>
<td>Uganda (12%), US (8%), Netherlands (8%)</td>
</tr>
<tr>
<td>Nigeria</td>
<td>Oil (76%), Natural Gas (11%),</td>
<td>India (15%), Brazil (10%), Spain (8%)</td>
</tr>
<tr>
<td>Tanzania</td>
<td>Gold (20%), Tobacco (7%), Precious Metals (6%)</td>
<td>India (16%), China (12%), South Africa (7%)</td>
</tr>
<tr>
<td>Zambia</td>
<td>Copper (61%), Base Metals (5%)</td>
<td>China (29%), Switzerland (20%), DRC (13%)</td>
</tr>
</tbody>
</table>

Source: UNCTAD.
The drop in commodity prices will affect many SSA commodity-exporting countries, and the near term outlook remain mixed.
SSA still produce the bulk of the primary commodities.

**Share of SSA Primary Commodities**

- **Platinum**
- **Cocoa**
- **Cotton**
- **Diamond**
- **Palladium**
- **Gold**
- **Tea**
- **Oil**
- **Aluminium**
- **Copper**
- **Nickel**
- **Coal**

Source: World Bank
Low oil price has negative impact for oil exporting countries

Sub-Saharan African Oil Exporters: Fiscal Balance, 2014–16

Sub-Saharan African Oil Exporters: Current Account Balance, 2014–16

Near-Term Outlook
Fiscal and external positions are now weaker than they were at the start of the global financial crisis.
Divergent Monetary Policy: Impact on sub-Saharan Africa.

Portfolio flows have become increasingly volatile, and the region has recently experienced net outflows.

Sub-Saharan Africa: Bond and Equity Flows to Emerging and Frontier Economies
(Millions of U.S. dollars, cumulative since January 2009)

Source: Haver.
Note: Data until August 12, 2015.
Divergent Monetary Policy: Impact on sub-Saharan African Economies

After sharp rise in 2013-14, the pace of sovereign bond issuance has slowed down.

Sub-Saharan Africa: Outstanding International Sovereign Bonds for Markets Access Economies Excluding South Africa

Sources: Bank for International Settlement Quarterly Review; Bloomberg, L.P.; EPFR.
Note: Market access economies includes Angola, Côte d'Ivoire, Ethiopia, Ghana, Gabon, Kenya, Mauritius, Nigeria, Rwanda, Senegal, Tanzania, Uganda, and Zambia. Data until August 18,2015
Sovereign spreads have widened and domestic currencies against the USD has weakened.
Divergent Monetary Policy: Impact on sub-Saharan African Economies

Most countries expanded fiscal space

Source: IMF, World Economic Outlook.

Public Expenditure and Sources of Financing

Sub-Saharan Africa excluding Nigeria

- Weighted average, percent of GDP
- 2000-04: Capital expenditure, interest expenditure, other current expenditure, compensation of employees
- 2011-14: Capital expenditure, interest expenditure, other current expenditure, compensation of employees


- Median, percent of GDP
- Average 1995-2000
- 2014
- Potential

Source: IMF, World Economic Outlook database.

Note: Middle East and North Africa includes Pakistan and Afghanistan.
Impact Divergent Monetary Policy on the Nigerian Economy

Inflation has been itching up even as reserve dwindles

Source: CBN Statistical database
Divergent Monetary Policy: Near-term Outlook for sub-Saharan African Countries

- The recovery in advanced economies like US, UK and Euro zone areas will be sustained.

- The European Central Bank has taken many steps to increase the degree of policy accommodation, including an expansion of its bond-buying program.

- The Bank of Japan has continued with very accommodative monetary policies, including a 0% interest rate and purchases of Japanese government bonds and other assets.

- The slow down in the Chinese economy despite liquidity injection will have a spillover effect on SSA economies especially in terms of commodity prices.
Divergent Monetary Policy: Near Term Outlook for sub-Saharan Africa

Minimal impact of FED rate hike expected for the region in the short term

- The anticipated rate hike has been priced in, and would not have much of an economic impact on the region.

- Risk to the regional outlook will be more effected by slow down in growth on China, increased production of shale oil in the USA, and geopolitical tension in the middle East (Iran deal, Libyan peace deal etc.)

- Further decline in oil price could exacerbate upside risks to exchange rate on many countries and result in dislocations and inflationary pressures

- Anticipated rate hike could foster another round of offshore positioning. Foreign investors may unwind fixed income and/or equity holding resulting in upward pressure on the domestic currency. This coupled with lower buffers from low commodity prices would put downward pressure on the domestic currency
Divergent Monetary Policy: Near term Outlook for sub-Saharan Africa

- Many SSA countries are better prepared now than at the start of the crisis due to hard lessons learned and some reforms implemented, although more needs to be done in some countries to strengthen institutional structures. Some of the reforms include
  - Fuel subsidy reform,
  - Tax measures, including increasing tax rates, and
  - Greater exchange rate flexibility, where feasible

- Domestic fundamentals are more likely to be the most important determinants of how SSA economies financial conditions respond to FED normalization policy

- Therefore, it is important that SSA economies continue to build strong system institution and strengthen financial system stability to be better prepared for the further FED actions.
Divergent Monetary Policy: Concluding Remarks

- As global markets anticipate rate hike by the FED, it is important that its global implication is considered and forward guidance given.
- Policy decisions should not be isolated, but most be consultative, gradual and predictable to avoid negative feedback effects for the US economy and the global economy.
- Emerging market economies have sustained global growth during the crisis, and policies coordination is essential to avoid dislocation and strengthen financial system stability.
- Emerging markets should be prepared to manage capital flow volatility, build fiscal buffer and safeguard its financial system to weather the storm.
- Market during the taper tantrum of Spring 2013 underscores the importance of transparency and effective communication by the FED on the timing and magnitude of the normalization.