Sub-Saharan Africa's Economic **Outlook 2020**

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Sub-Saharan Africa – tailwinds coming

Over the past 12-15 months, the global backdrop increasingly posed a headwind to the economic growth outlook for Africa. Uncertainty triggered by the US-China trade war, the removal of monetary policy support in some developed countries, together with outright tightening of monetary policy in others, contributed to downward revisions to consensus expectations for global growth.

There has been a long-standing expectation that economic growth among developed economies would decelerate in 2020 relative to 2019. At least, most forecasters have been anticipating that for a year. However, **overall GDP growth seems likely to accelerate in 2020 and 2021.**

Furthermore, we believe that global growth forecasts for 2020 and perhaps 2021 will be **revised upwards** over the course of this year. This is significant for the evolution of the economies of commodity-producing countries. The slowdown among developed countries was not the only reason economic growth in Africa's commodity producing countries failed to meet our expectations in the past year and a bit, but it admittedly was a significant factor. **It seems to have contributed to downside pressure on commodity prices in early 2019.**

However, for much of H2:19, commodity prices were bottoming out, especially base metals prices. **Copper** prices hovered around the USD6,000/MT level in late-2018. The recovery in early 2019 was cut short once prices got around USD6,500/MT in early 2019, and reverted to just below USD6,000/MT for much of H2:19.

Such downward pressure was understandable given the mounting anxiety about the global growth outlook precipitated by the US-China trade conflict. Consensus forecasts for copper prices were consistently revised lower in 2019. Yet, these have been revised higher since Dec, with consensus forecasts putting copper prices at USD6,200/MT at the end of this year, up USD450/MT from the forecast at the end of Dec.

We wouldn't be surprised to see these forecasts nudged higher this year. The theme of supply constraints keeps coming up among copper analysts. There has been occasional, isolated speculation that copper prices could rise above USD7,000/MT, although, clearly, that is not the consensus view. Be that as it may, it seems as if the risks are biased to the upside despite any volatility occasioned by geopolitical or trade shocks.

There is still plenty to suggest that oil prices will remain mostly above USD60.0/bbl over the next 4 – 6 months. Geopolitical strains, especially surrounding Iran, could keep prices elevated. Additionally, OPEC seems prepared to stick with production quotas to keep prices elevated.

Consensus forecasts for oil prices drifted marginally lower in Q4:19, with forecasts for the Brent crude oil price at the end of 2020 approaching USD60/bbl. But these are inching higher.

All this points to continued recovery among the continent's commodity producers. To be sure, some like Nigeria, require more than commodity prices to perk up. There are significant structural reforms that are required to ensure that the economy escapes persistently low growth. These reforms would need to address infrastructural bottlenecks in the economy, with the government needing to ramp up capital expenditure, among other things.

But Nigerian structural reforms, to the fuel industry for example, have progressed slowly over the past decade or so. It is difficult to pinpoint the source of such tardiness.

Perhaps those with a vested interest in the affected sectors can frustrate the legislative process that would effect these structural changes.

It is for this reason that one needs to watch several curious events in the recent past. The Central Bank of Nigeria (CBN) has been vociferous in pleading for credit extension to the real sectors of the economy to accelerate. There are various programs that are meant to stimulate domestic food production. The CBN prohibits domestic financial institutions from providing foreign exchange for the importation of certain items, among which are food items. Then, last year the federal government closed border posts connecting the country to neighbouring countries. This closure was purportedly to stop smuggling across the border. Among the items that the government wanted to target were food items. Unconventional as all these actions may be, they seem to leave policymakers with the conviction that they are helping to boost domestic food production.

The Angolan government has embarked on what could turn out to be a game-changing reform program. Since the collapse of oil prices in 2015, investment in the oil sector has been poor. The result is that oil production has been constrained, with mounting concerns among some industry players that oil production capacity may well peak and drop in the coming 5-y.

Therein lies the challenge for the government: attract investment in the sector, while simultaneously diversifying the economy away from the oil sector. To galvanise the latter, the government has indicated its intention to privatise several state-owned enterprises. To help that process along, they have made regulatory reforms to the functioning of the FX market, intent on ensuring that foreign investors can move funds in and out of the country with little hindrance. Crucially, they are not so keen to make it easy for portfolio investors in government paper.

There was drought that affected agricultural production in some countries in Southern Africa. In Zambia and Zimbabwe, the severity of the drought also constrained hydro-electricity generation. Rainfall in the current season seems to have normalised, with the volume of water flowing down the Zambezi River exceeding that of last year already, boding well for Zambian agricultural production (which contracted by 10.5% y/y and 5.1% y/y in Q1:19 and Q2:19 respectively).

Incidentally, of the countries for which there are Standard Bank or Stanbic Bank Purchasing Manager's Indices (PMIs), Zambia is the only one that has consistently shown contraction in economic activity over the past 2-y. PMIs for Ghana, Kenya, Mozambique, Nigeria and Uganda have all been mostly above 50, showing expansion in economic activity.

Global risk appetite: will likely support African economic growth

We expect elevated global financial markets and growth in developed economies to boost economic growth in Africa. A point worth reiterating is that capital flows to Africa will most likely support economic growth in the medium term. Of course, much of this is used for investment spending. African governments for example, can take advantage of buoyant financial markets to issue Eurobonds that are used for infrastructural development.

For the most part, **African countries face significant infrastructure deficits**. To address these, their task is made easier if market conditions are favourable. Without doubt, Risk assets have rallied tremendously since 2009, with some commentators now observing market frothiness. Yet others suggest that the US equity market rally specifically is the 'most unloved' in history. Evidently, the rally has benefited only a small section of the investing public, with large amounts of cash sitting on the side-lines. While a correction might be underway, with the scare due to the coronavirus outbreak weighing on market sentiment, **it is hard to say that the rally is ending**. This makes it more likely that African countries will be beneficiaries of these capital inflows.

African currency unions – much hype, little impact

It is worth pointing out that the East African Community (EAC), the Southern African Development Community (SADC) and the Economic Community of West African States (ECOWAS) have all, at some point or other, made a commitment to adopting a single currency by some stipulated deadline. Since 2000, all these trading blocs have made such commitments, then changed them, and recommitted to new dates.

We would not to say that these regional trading blocs won't ever promulgate common currencies. But one should separate regulatory pronouncements from political bluster. If a common currency is to be adopted in a region, then the central banks in that region would develop regulations and guidelines to effect the creation of such a common currency. Similarly, regulators for other business sectors, like pension funds, would also issue regulations affecting those industries. Once those have been communicated, compliance with them would be mandatory for all citizens of the countries in that trading block. Everything else would amount to speculation based on what may turn out mere political bluster.

But, considering that various pronouncements have been made over the last 20-y, is there any reasonable basis for one to determine if the current currency arrangements will be any different in another 5-y? Probably not. But it is perhaps a reasonable starting point to say that the probability of the status quo being maintained is closer to 100% than to 0%. Is there a way of telling if such a change, were it to happen, would be deleterious, and if so, an acceptable way of mitigating the risks now? Also, probably not.

It is always worth keeping in mind that the establishment of a common currency would be the result of a political process, a potentially long and tortuous process. This is also true of the XOF whose proposed reforms have been in the news recently. Sure, members of the Union Economique et Monétaire Ouest-Africaine (UEMOA) that use the XOF have taken decisions that will reform that arrangement. There will no longer be French representatives in the governance structures for the XOF. The region's FX reserves will be managed by the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) rather than having half of them pledged to the French Treasury. However, the latter would still guarantee convertibility of the XOF.

Notably, these changes are meant as preparation for the adoption of the ECO as a single currency for ECOWAS, which is made up of UEMOA and the West African Monetary Zone (WAMZ). Crucially, members of the WAMZ have their own currencies. Nigeria has a GDP that is about 40% of ECOWAS. Presumably, adoption of a single currency would not be a replication of the XOF mechanism for the entire ECOWAS.

After UEMOA made its announcement regarding the reform to the XOF arrangement, the WAMZ issued a statement denouncing the UEMOA announcement as unilateral. Ironically, the federal government in Nigeria has closed some border posts to neighbouring countries, hampering trade and movement of labour. It is not easy to argue that the adoption of the ECO by all members of ECOWAS is imminent.

Political risks: light electoral calendar in the next 4-m

Only a handful will hold general elections in H2:20. The Tanzanian general elections will probably generate a fair amount of noise. In the past, the ruling party tended to win rather comfortably, amid the opposition's allegations of vote-rigging.

It remains to be seen if the ruling party will put forward policy proposals that are a significant departure from current policies. Of course, a number of policy issues could turn out to be pivotal for medium-term economic performance. Perhaps chief among these is the development of the natural gas sector. But the general regulatory backdrop, that has made it difficult for foreign companies to operate in the country, is crucial too.

The Ethiopian elections will also be crucial ones to watch. If anything, they could be a clear sign of whether the Prime Minister's reform agenda has any grassroots support. He has been widely lauded outside the country for the bold reform moves he has made and for advancing peace. With respect to the latter, he went on to win the Nobel Peace Prize. That said, regional representation in government tends to be a particularly thorny issue.

An argument can be made that Ghana's elections do not represent such a huge risk. After all, the electorate has switched between the NPP, currently in power, and the NDC since multi-party democracy was introduced in 1992, giving each party 2 terms in power. So, if the NPP were to be voted out of power, then this would be a significant departure from history.

The key concern for the market is that the NPP will essentially try to buy the elections by boosting government spending, whether it be recurrent or capital expenditure. Yet the government observed the Fiscal Responsibility Act in budgeting for a 4.7% of GDP fiscal deficit this year. Admittedly, the revenue assumptions may have been somewhat optimistic, requiring that the government restrain spending. Therein lies doubts for the market: expenditure restraint, and, in an election year? Regardless, preliminary data shows that there was spending restraint in 2019, with the government achieving the originally budgeted 4.2% of GDP fiscal deficit.

Côte d'Ivoire's elections are highly unpredictable, something that is likely to keep the market apprehensive. As is the norm, coalitions will be formed in the run-up to the elections. Yet, at this stage it is not clear how these will be composed. President Ouattara, who is serving his second term, and should thus be ineligible to be president, has not announced whether he will run or not. He has previously pointed to what he considers to be grounds to allow him to run again due to the new constitution introduced in 2016. Apparently, he will announce his intentions in Jul.

Furthermore, Guillaume Soro, the former President of the National Assembly who fell out with President Ouattara and has been positioning himself for a presidential run, faces an arrest warrant. The public prosecutor alleges that he was involved in a coup plot last year. Recall, it was Soro and his fighters that turned the tide against Laurent Gbagbo during the civil war in 2010, allowing Ouattara to capture the presidency.

FX outlook

In the past 4-m, the currencies that depreciated the most were the AOA that depreciated by 25%, the ZMW that depreciated by 10.1%, and the ETB that depreciated by 7.9%.

The USD/AOA move is still mostly policy-determined. Even though the directional bias to the pair is still to the upside, policymakers are looking to provide enduring support to the economy as elaborated above.

Since trading mostly in a 9.50 – 10.30 range between Mar 16 and Sep 18, USD/ZMW has risen in a stepwise fashion to trade in a range of 14.00 – 15.00 since the beginning of the year. All told, the pair has risen at about a 29% annualised pace since Sep 18.

It is hard to see this rising trajectory terminating or reversing. To be sure, copper prices have recovered somewhat. It seems highly probable that the hydro electricity generation will improve over the next 2-y. This revival might be sufficient to bolster copper production as well, in addition to agricultural production, thereby supporting the BOP. Copper export volumes fell by just over 20% y/y in the 11-m to Nov 19, with electricity supply constraints probably a factor behind this decline. However, there is no end in sight to the strong demand for FX to fulfil the government's external debt service obligations. The Bank of Zambia made some USD1.17bn in external debt service payments in the first 11-m of 2019. Budgeted external debt service payments are budgeted to be in excess of USD1.5bn in 2020.

The ETB is not typically among the currencies that depreciate the most on the continent. But the pace of depreciation has picked up in recent months. Usually, the central bank devalues the ETB by a large amount once every few years, then keep the pace of depreciation fairly low, about 5% on an annualised basis.

The movement of the exchange rate in recent months seems like quite a departure from this. Perhaps this departure is understandable given the economic reform program of the government. This program is being supported by a 3-y Extended Credit Facility and an Extended Fund Facility from the IMF. Among the aims of the program are exchange rate reforms to address FX shortages and increase FX flexibility.

The 13.1% depreciation of the GHS in 2019 is the first double-digit pace of depreciation since the 13.9% depreciation in 2015. Of course, 2015 was a pre-election year. The GHS depreciated by 9.2% in 2016. Arguably, the market may have been somewhat mollified by the existence of an IMF-funded program at that time. The government was on a fiscal consolidation path.

Could the upcoming elections in 2020 be a factor pushing USD/GHS materially higher? While, many investors have expressed trepidation at the prospect of an election while the government is without an IMF-funded program, such trepidation has not translated into a notable reduction in exposure to GHS bonds. The Central Securities Depository indicates that foreigners were holders of GHS29.07bn in GHS bonds in Dec, compared with GHS27.26bn in Nov. Throughout 2019 the average was close to GHS27.5bn. The peak was GHS29.22bn in Apr 18.

Of course, the BOG was steadfast in its determination to intervene to keep USD/GHS from rising in a disorderly fashion. It has helped that the government has been willing to issue Eurobonds quite early in the year, granting the BOG the ability to boost FX reserves and use those to intervene in the FX market. The government aims to issue Eurobonds early this year, as it did last year.

The East African shillings continue to exhibit broad stability. We see little impetus to change this over the next 4 – 6 months. The KES might enjoy some support in early Q1:20 due to flower export sales. That might reverse somewhat in Q2:20 due to dividend payments.

There will be elections in early 2021 in Uganda. Pre-election noise has typically exerted some pressure on the UGX. But this typically fizzles out closer to elections. The desire of policymakers to maintain USD/NGN in a narrow 360 – 365 range is undiminished. If oil prices hold around USD60/bbl, there shouldn't be much trepidation on their part. However, FX reserves have fallen rather sharply, to just under USD38.3bn in early Jan from over USD45.0bn in Jul. Import demand has picked up notably, fuelled by capital imports as some capital expenditure projects advance.

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