Africa's Pulse

OCTOBER 2018 | VOLUME 18

AN ANALYSIS OF ISSUES SHAPING AFRICA'S ECONOMIC FUTURE

WORLD BANK GROUP

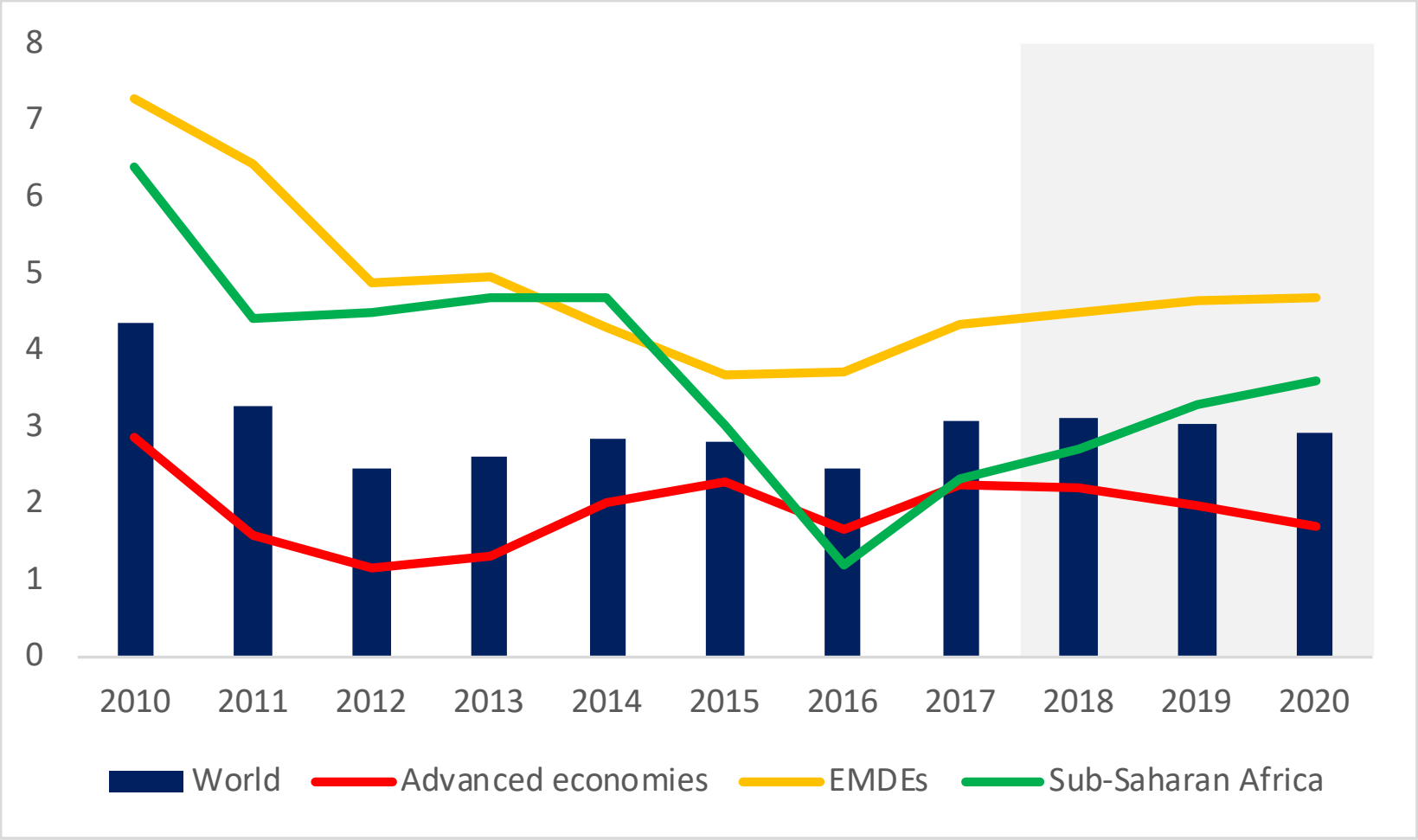
Outline of the Presentation

I. Main messages
II. Global Environment
III. Recent growth developments and outlook
IV. Risks
V. Building Resilience

I. Main Messages

1. Growth in Sub-Saharan Africa has picked up in 2018 but at a slower pace than expected and with bumps on the road to recovery.
2. Economic recovery in the region is set to continue but at a more gradual pace
3. Public debt vulnerabilities remain high amid a stronger US dollar and tightening global financing conditions for EMDEs.
4. Large shocks have reshaped the composition of capital flows into Sub-Saharan Africa. Policymakers must equip themselves to manage the new risks arising from changes in the composition of capital flows and debt.
5. The region's low productivity is attributed to inefficiencies in the allocation of resources across farms and firms, and these inefficiencies are linked to human capital misallocation.

Growth in Sub-Saharan Africa has picked up in 2018 but at a slower pace

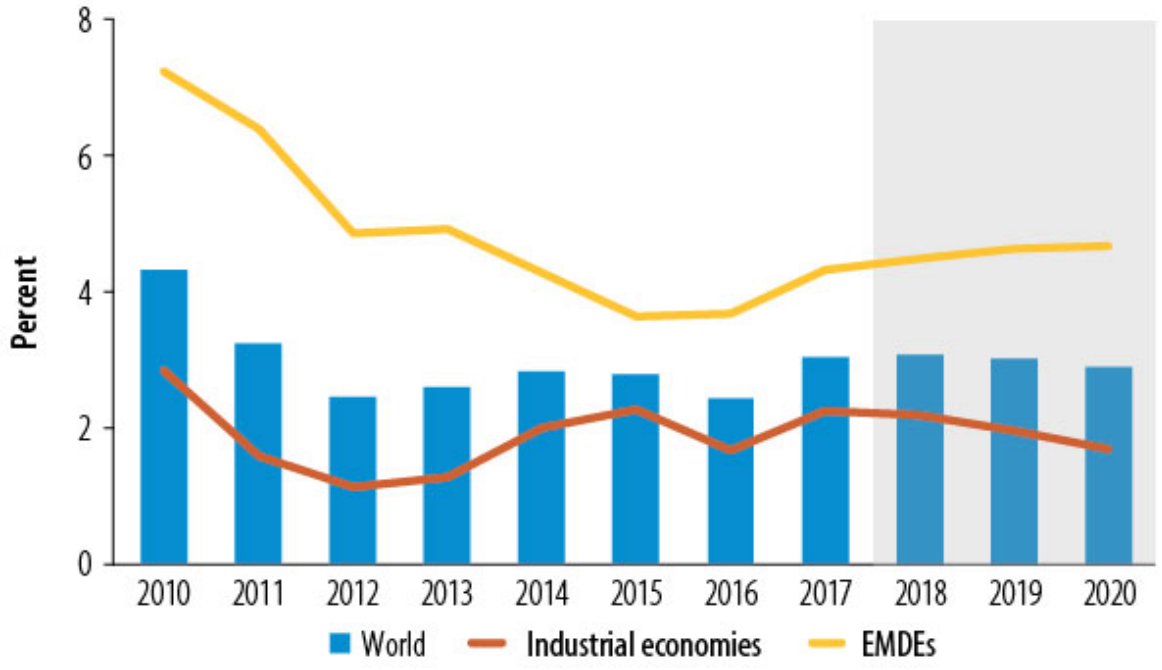


Source: The World Bank. Note: The shaded area indicates forecasts. EMDEs = emerging markets and developing economies.

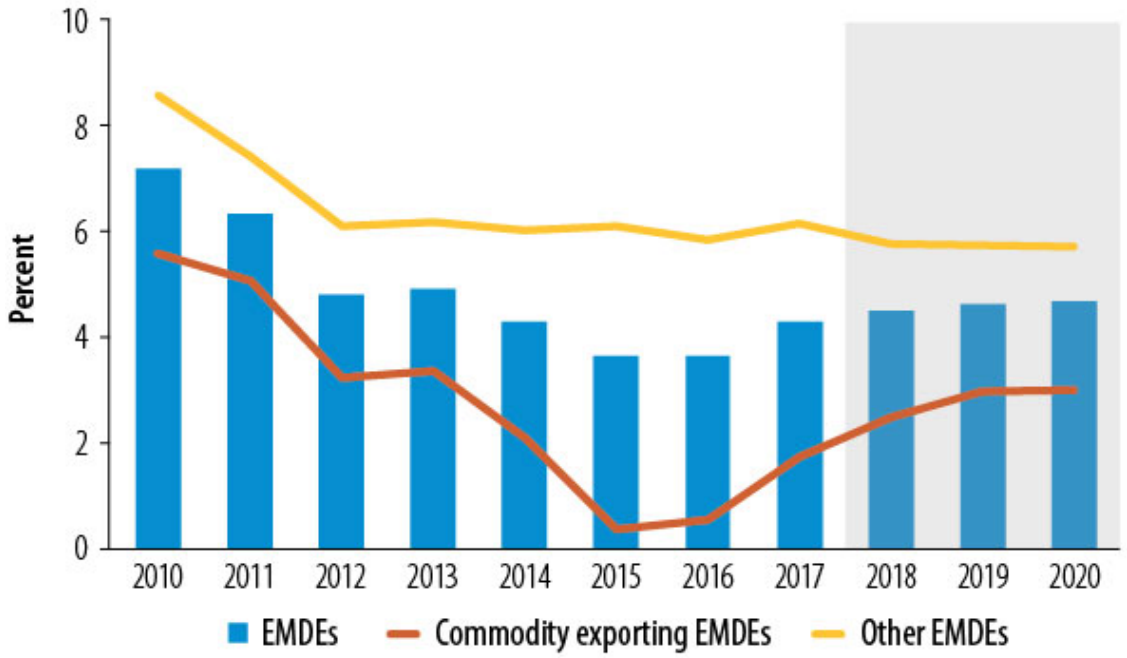
WORLD BANK GROUP

Global growth picked up in 2017 and expected to remain robust in 2018

Global GDP Growth



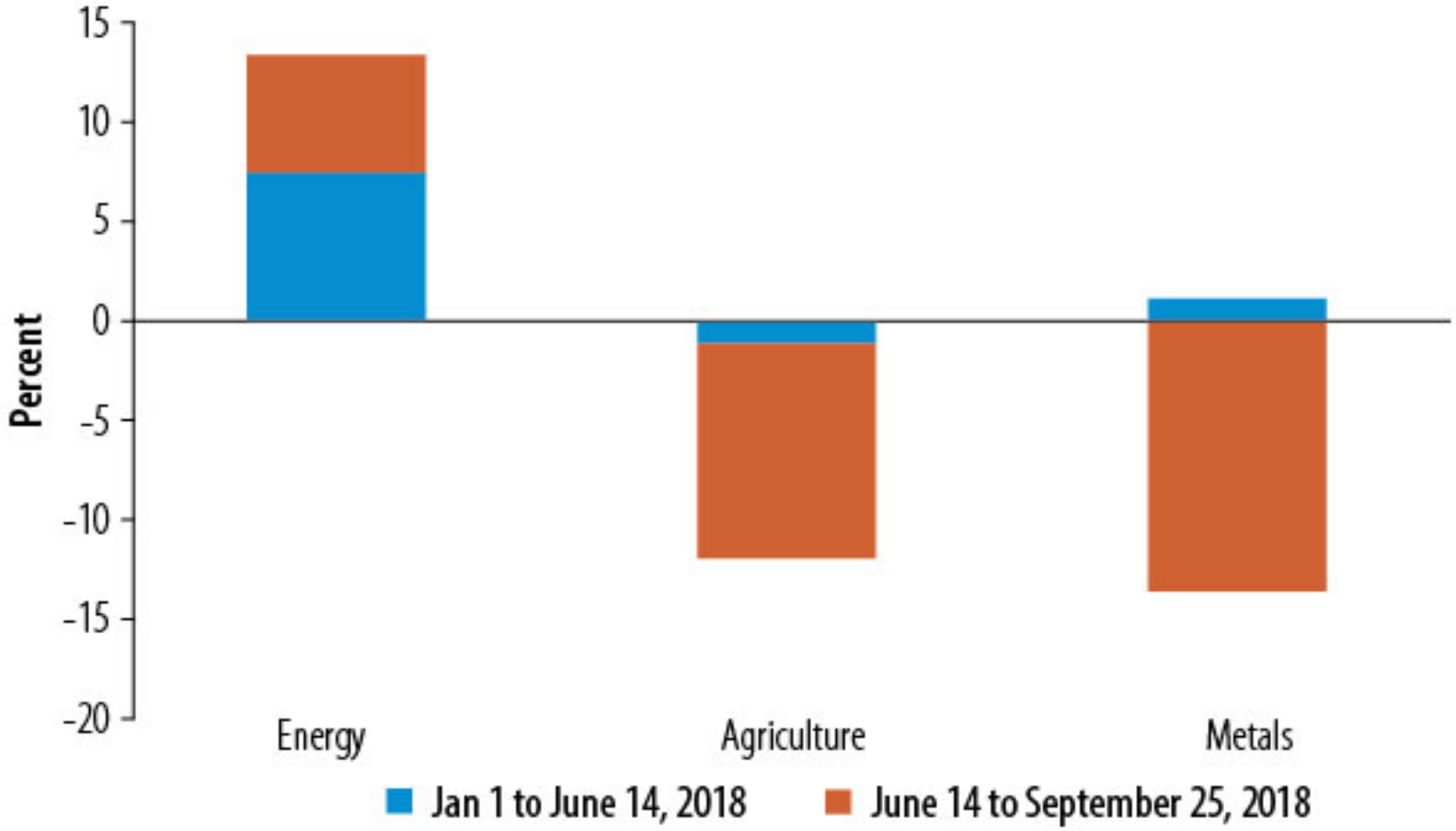
EMDE GDP Growth



Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Commodity prices remain volatile, with diverging trends

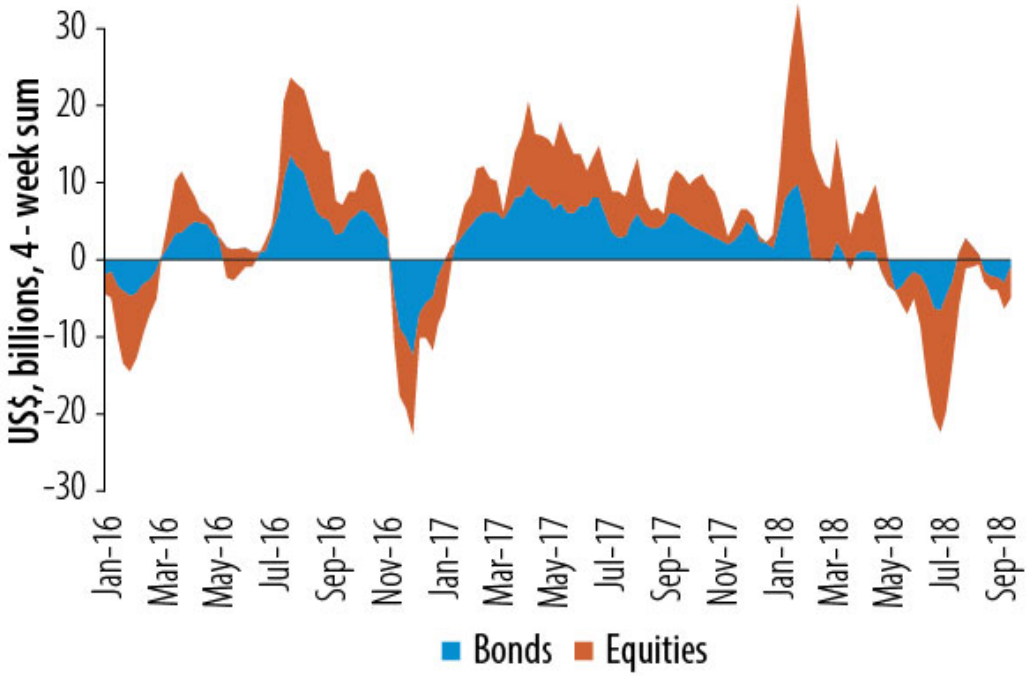
Changes in commodity prices



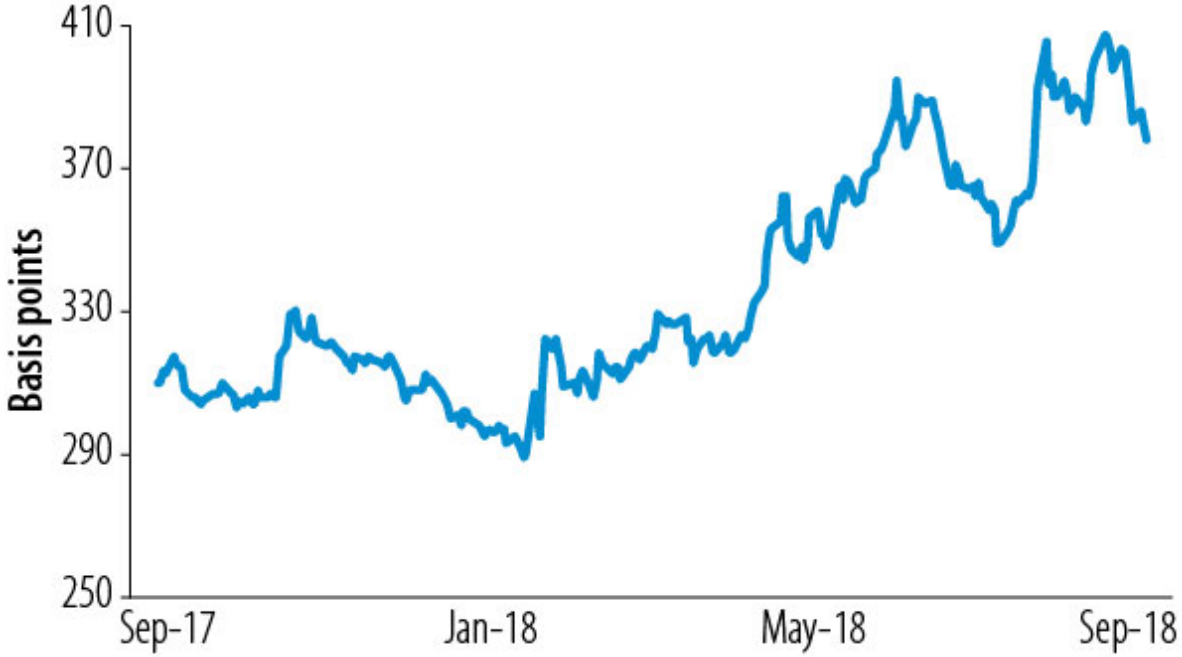
Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

EMDEs financing large capital outflows and rising financing costs

Equity and Bond Portfolio Flows



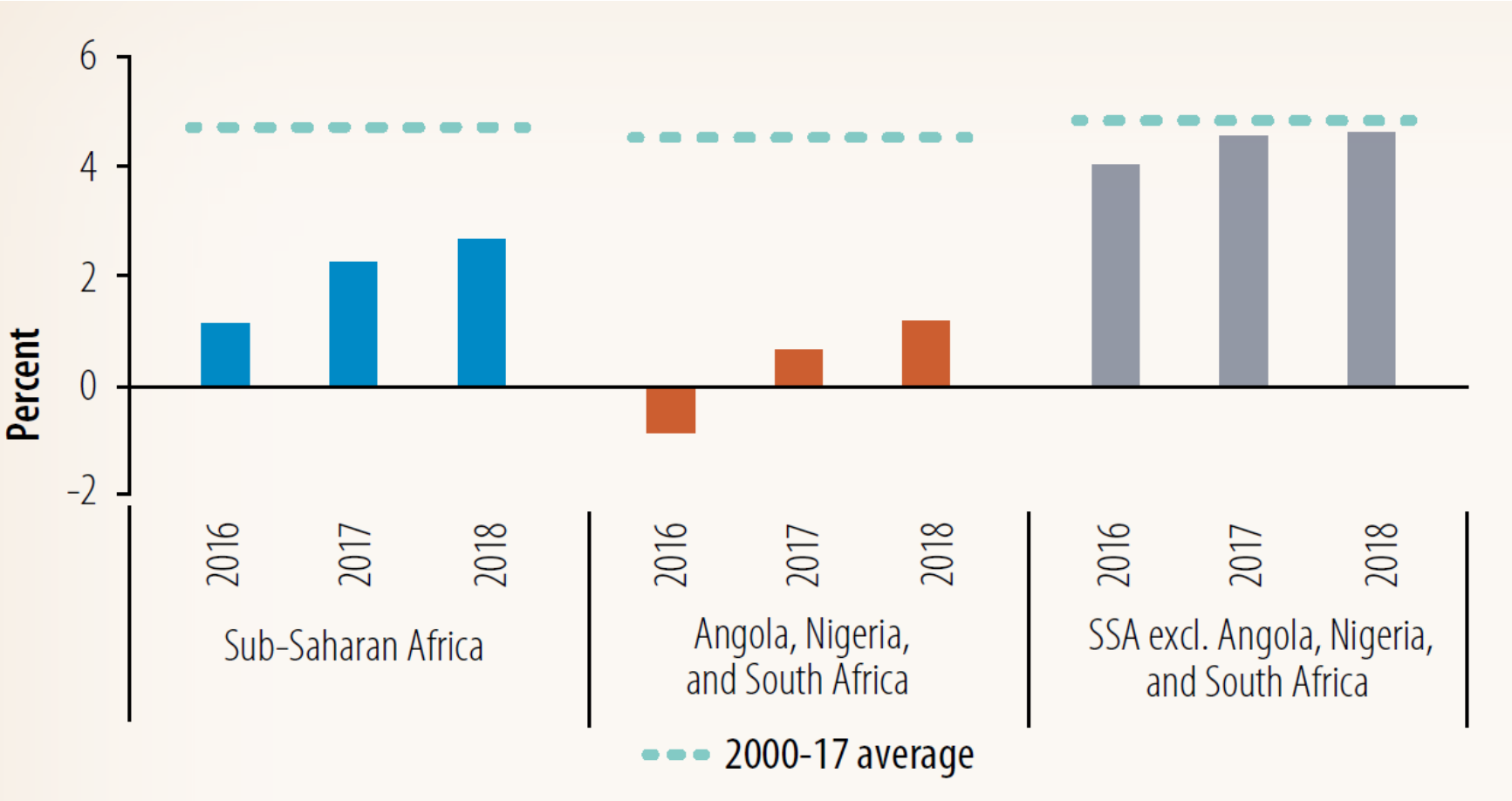
EM Sovereign Global Bond Spreads



Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Growth in the three largest economies remains sluggish while it is broadly stable for the rest of the region

GDP Growth, Sub-Saharan Africa

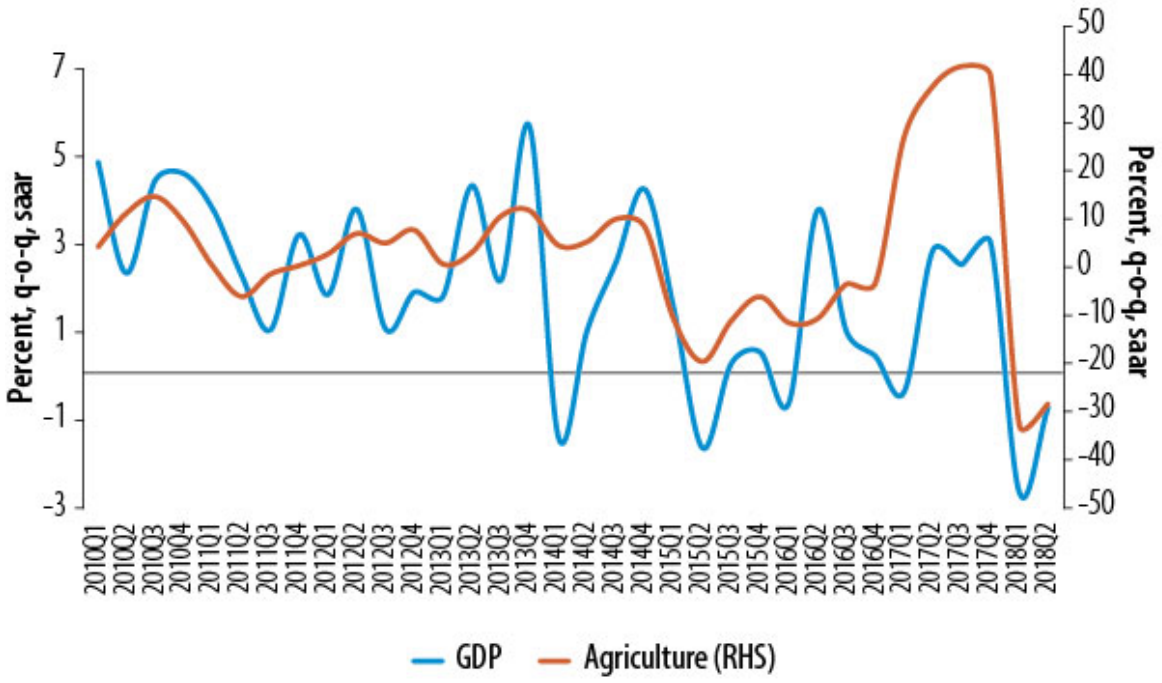


Source: The World Bank (2018) Africa's Pulse, Volume 18.

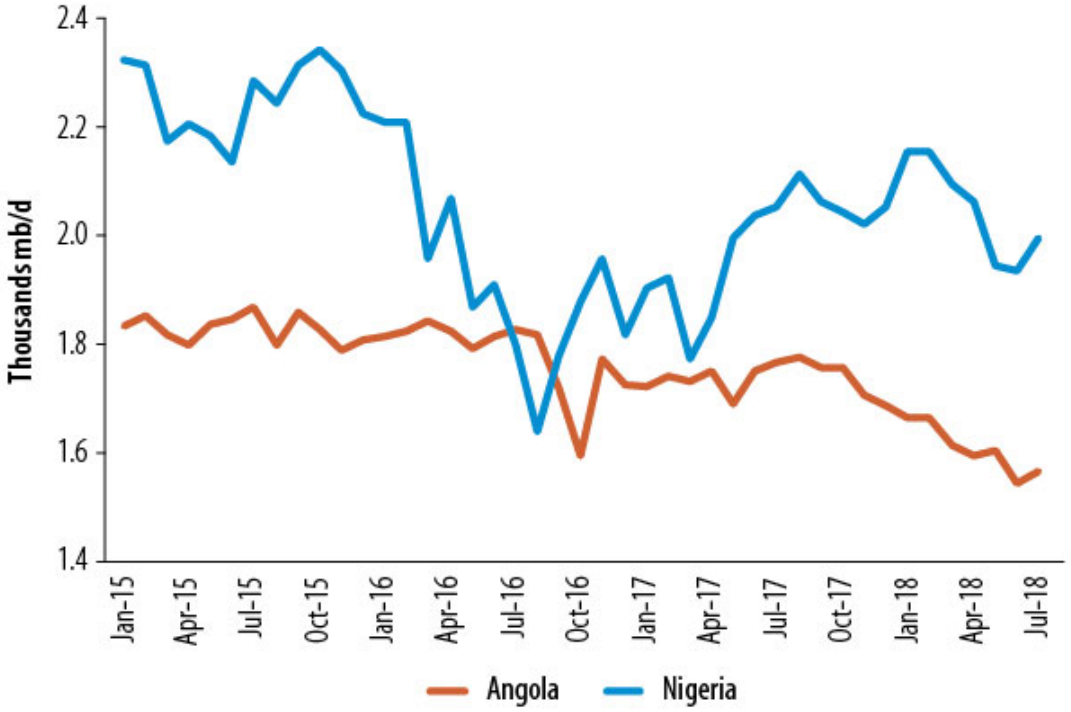
WORLD BANK GROUP

Why growth slowed in the three largest economies?

Real GDP growth, South Africa



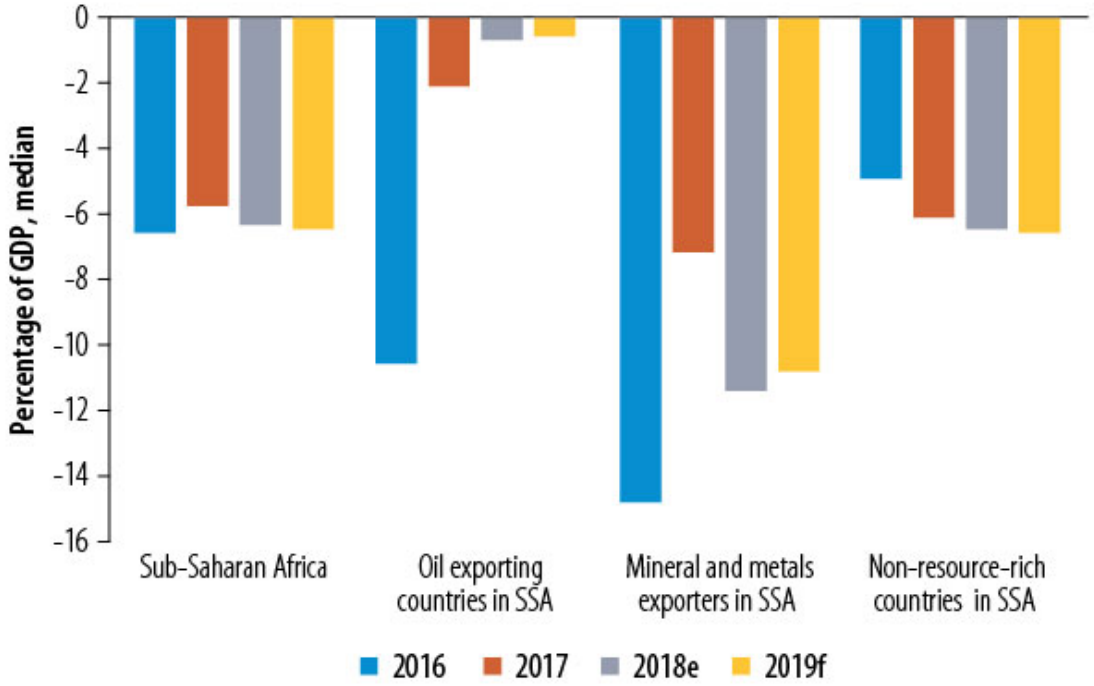
Oil Production: Angola and Nigeria



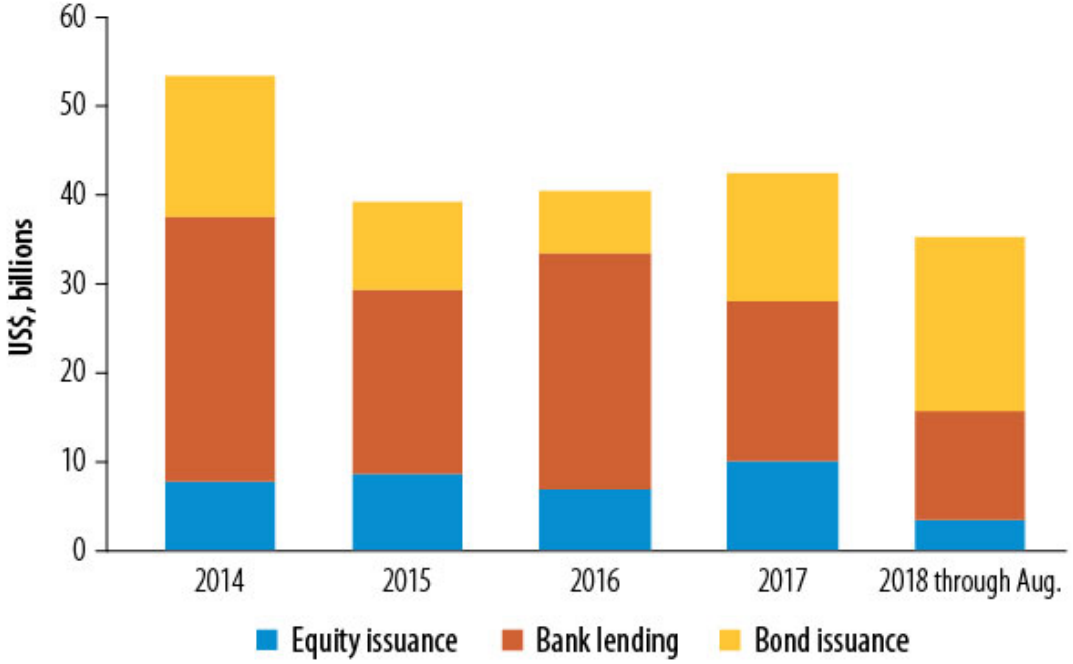
Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Current account balance widened while capital flows declined in the region

Current Account Balance



Capital Flows

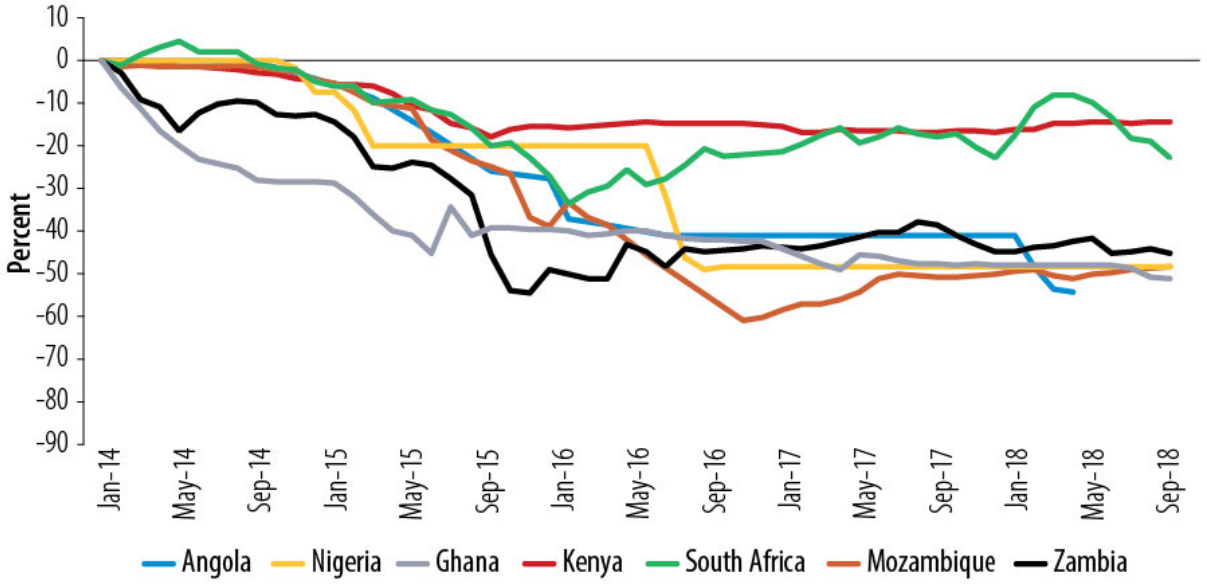


Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

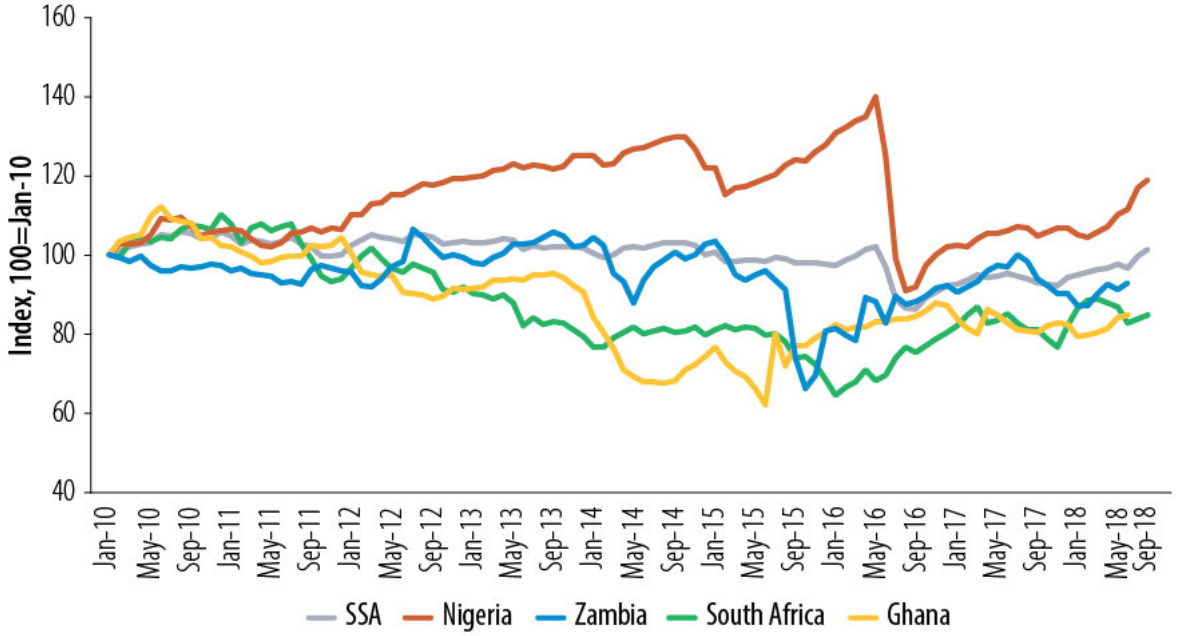
Exchange rates depreciated across the region in 2018

Nominal Exchange Rate

LCU/US$, % change since 1/1/2014



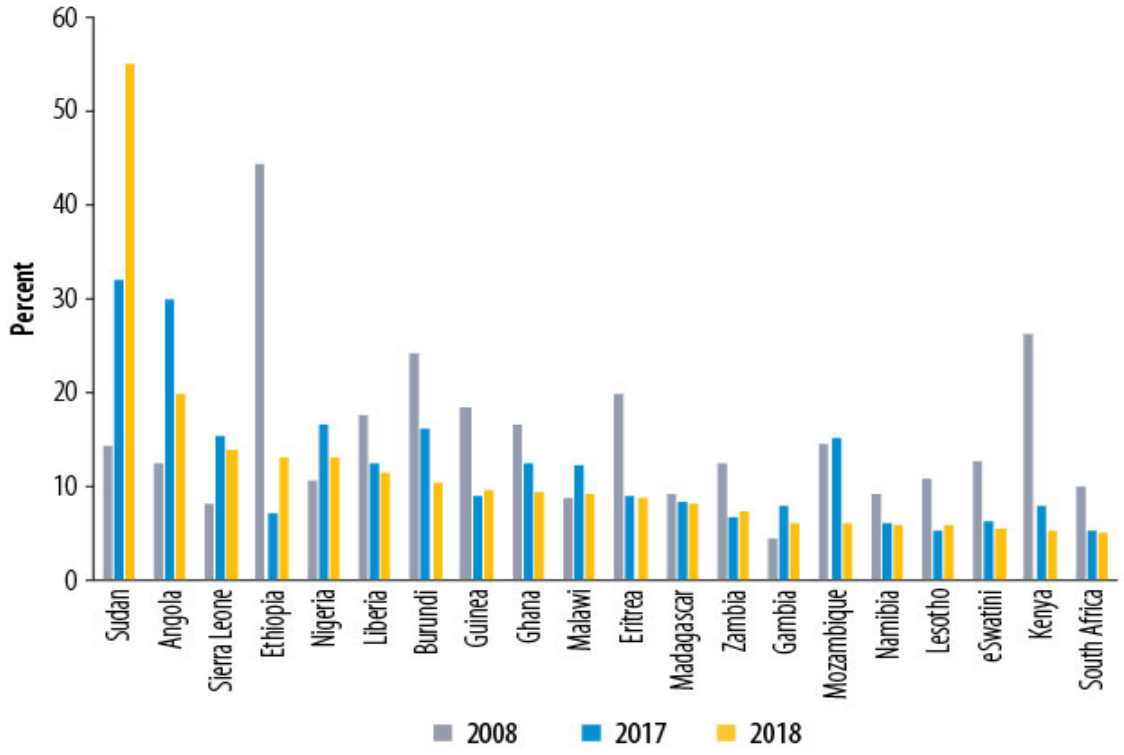
Real Effective Exchange Rate



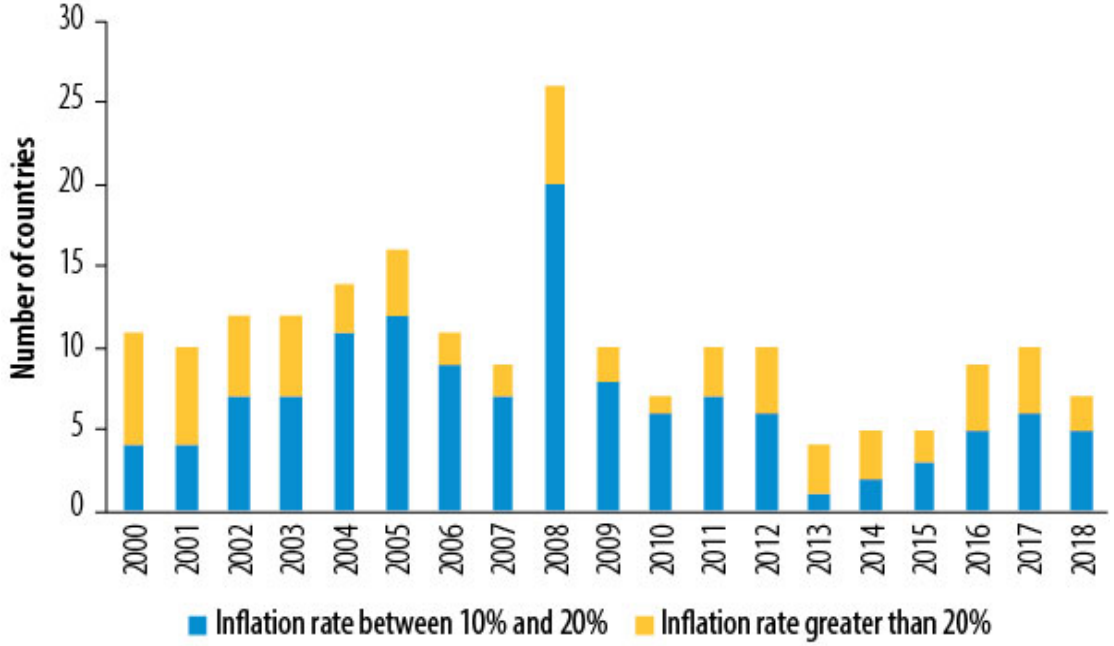
Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Inflation is receding in most African countries

Inflation: Selected Countries



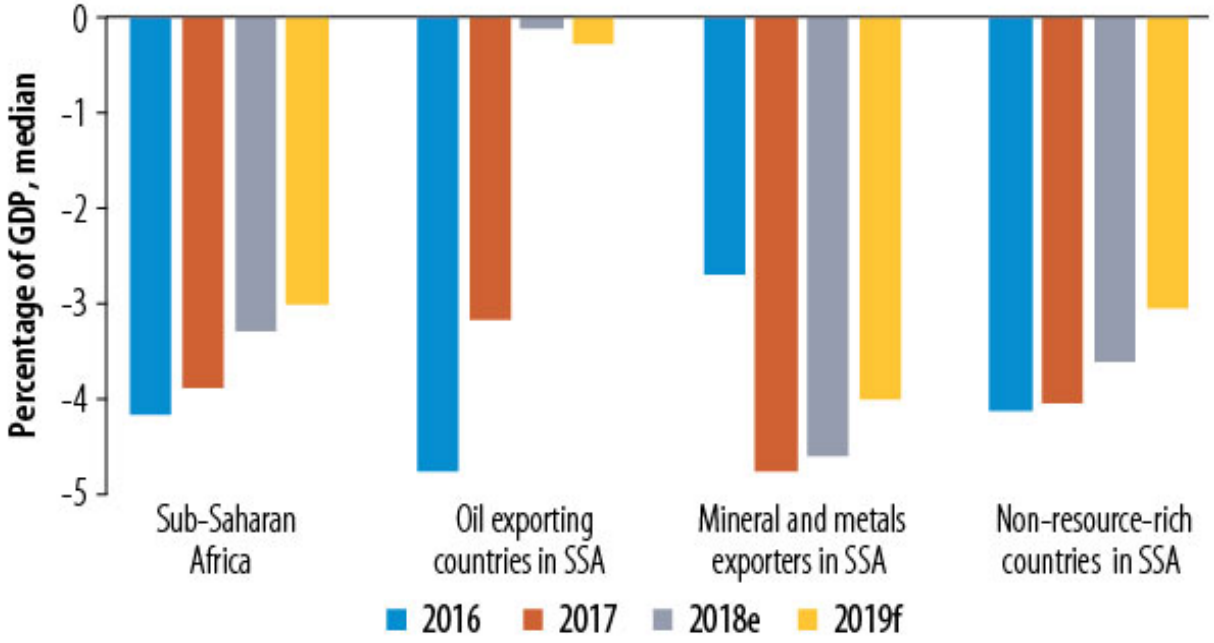
No. Countries w/ 2-digit inflation



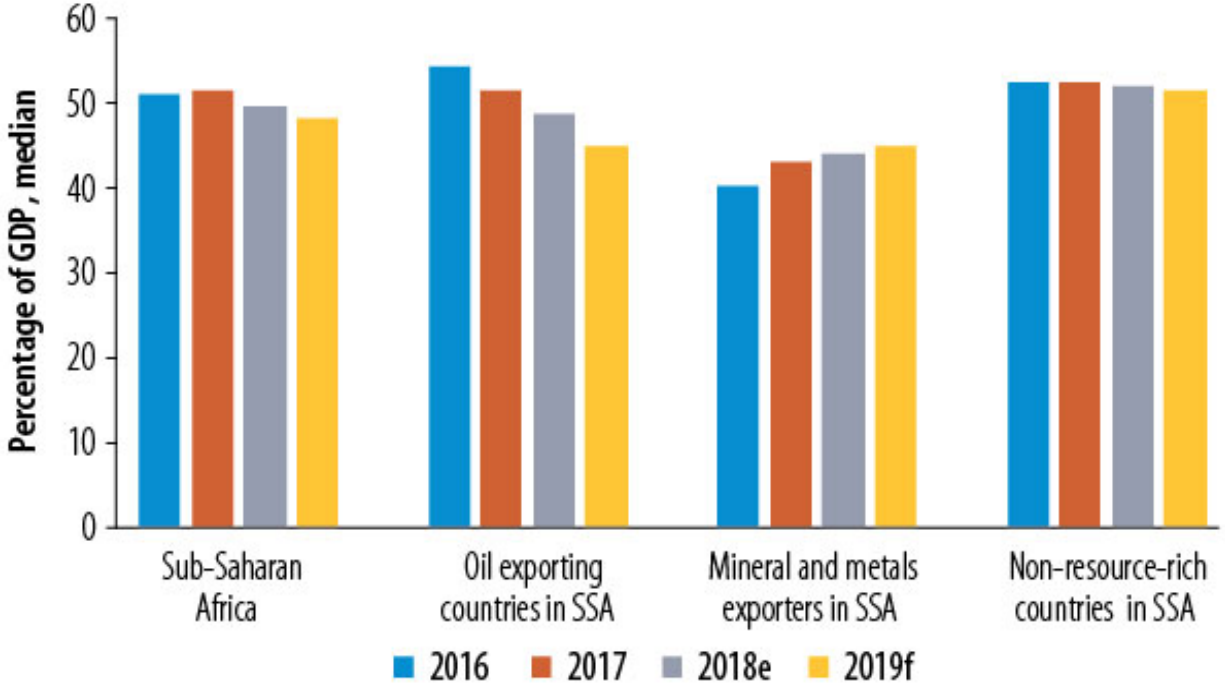
Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Fiscal deficits narrowed but public debt levels remain high in 2018

Fiscal Balance



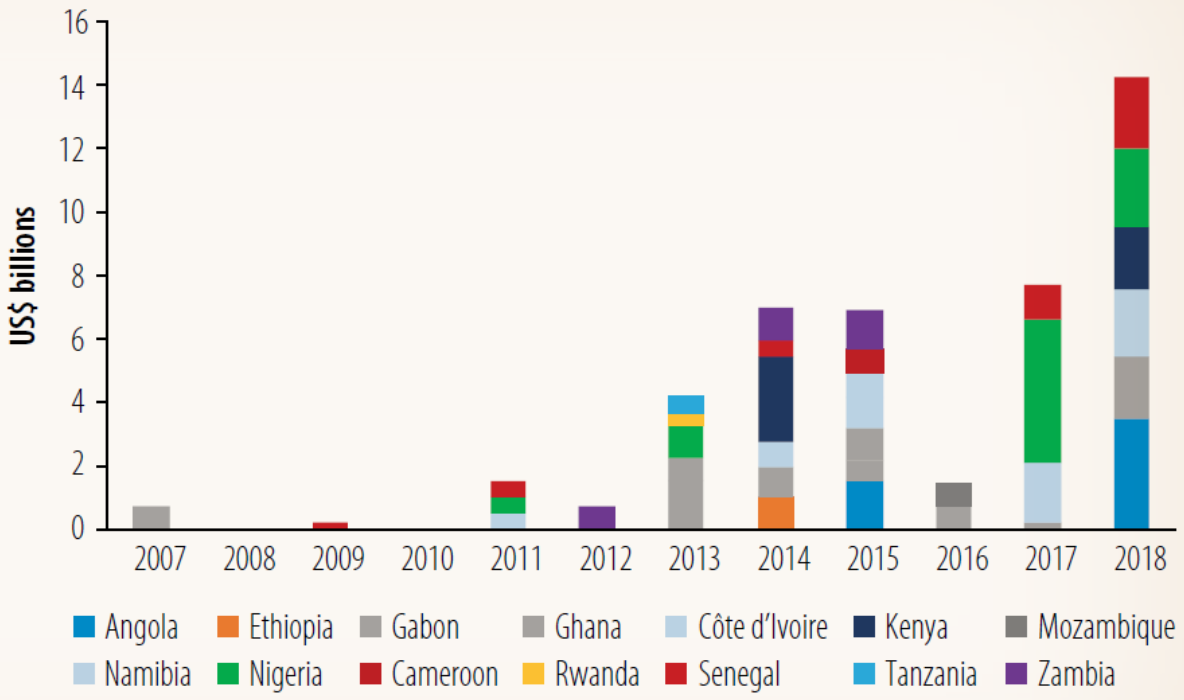
Public Debt



Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

SSA Frontier economies continue tapping international bond markets

International Bond Issuances in SSA LICs and LMICs (US$, billion)



Source: Bloomberg.

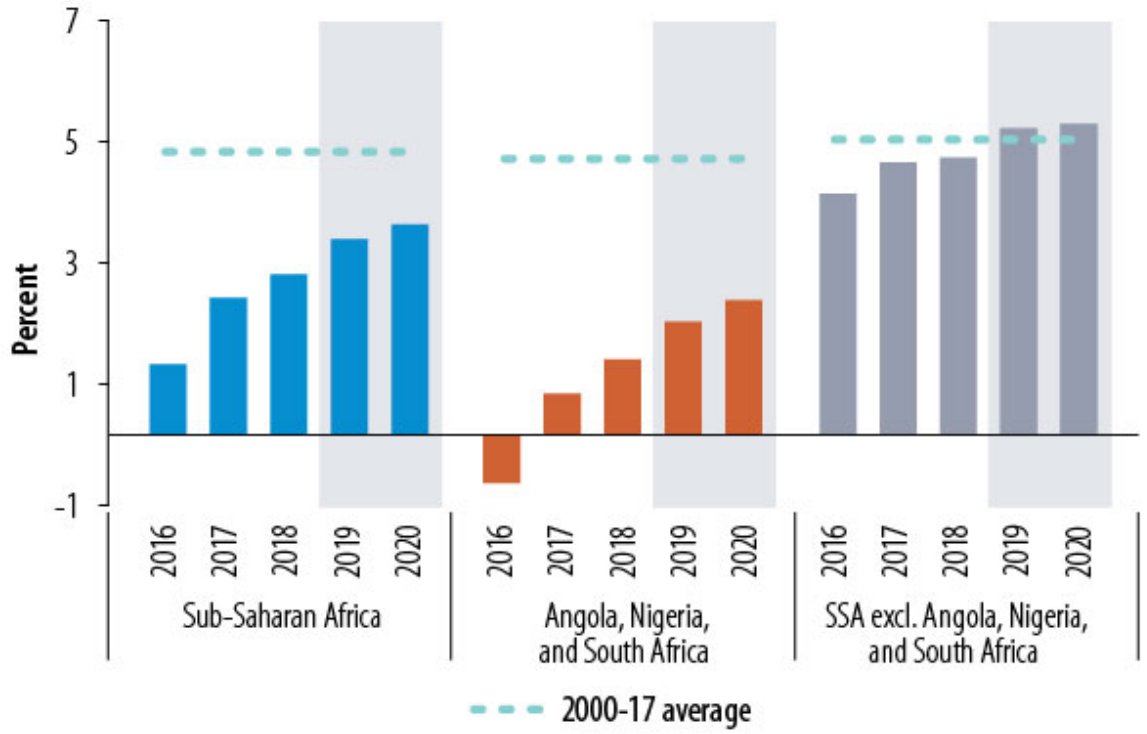
Note: LICs = low-income countries; LMICs = lower-middle-income countries; SSA = Sub-Saharan Africa.

In the first half of 2018, six frontier economies in the region raised a record US$14.3 billion in Euro bonds

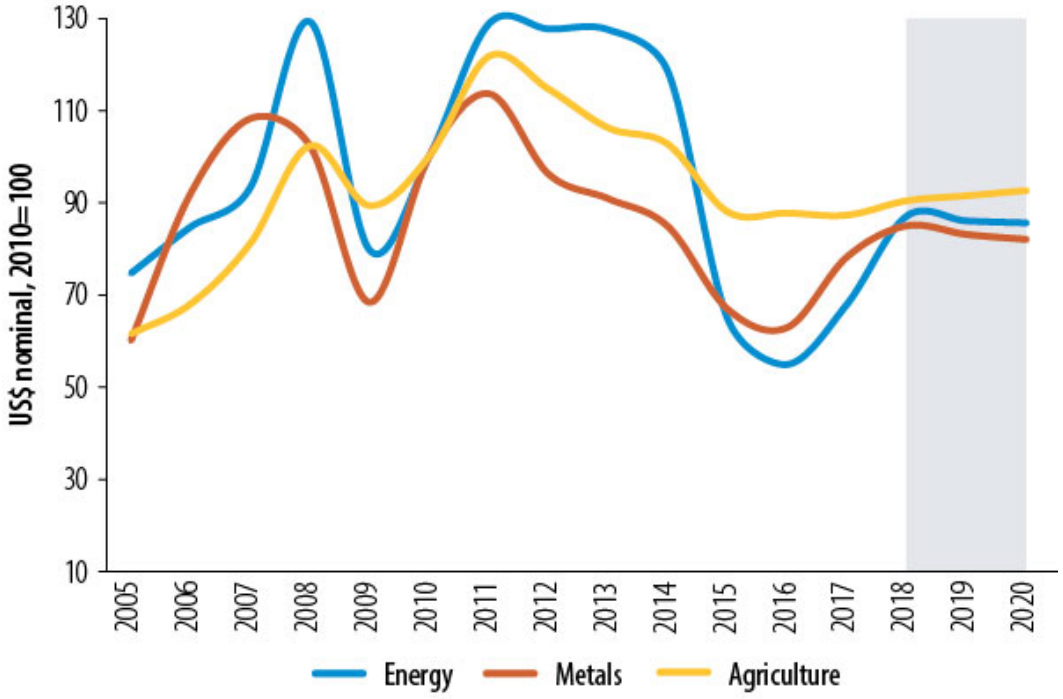
Source: The World Bank (2018) Africa's Pulse, Volume 18.

Economic recovery in the region is set to continue but at a more gradual pace

Growth Forecast: GDP



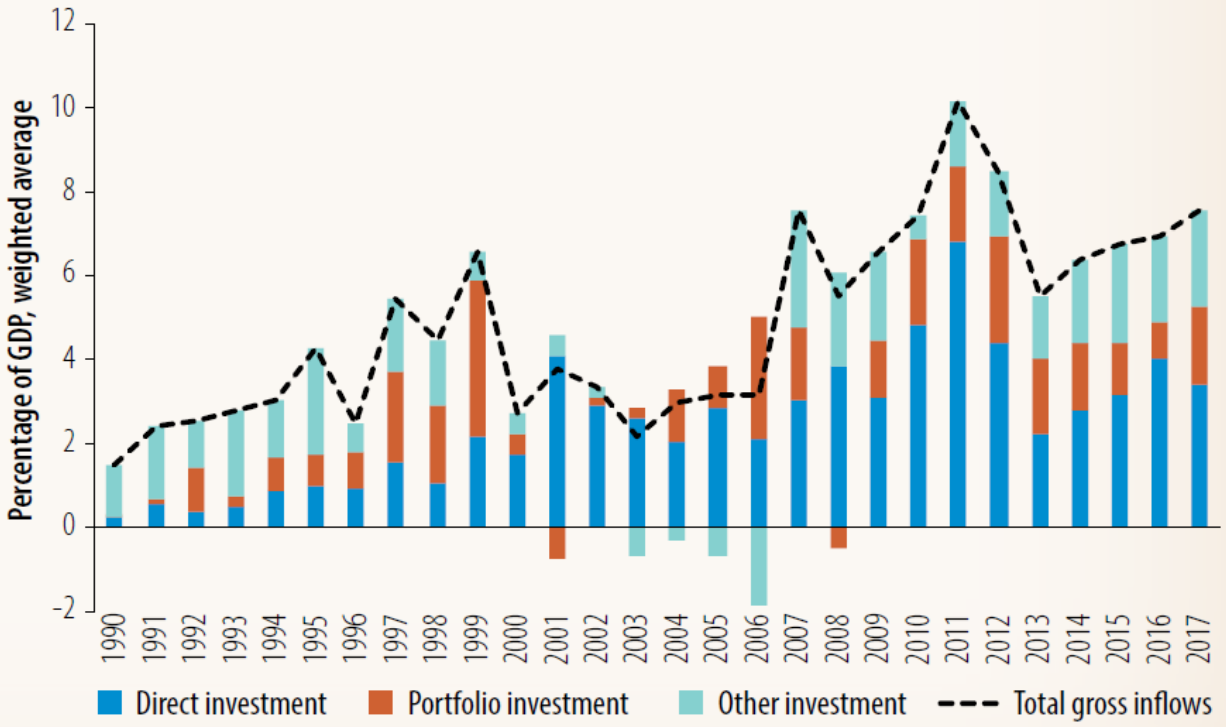
Commodity Price Forecasts



Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Large global shocks have reshaped the composition of capital flows into Sub-Saharan Africa

Evolution of Gross Capital Flows into Sub-Saharan Africa



Source: International Monetary Fund Balance of Payments BPM 6.0.

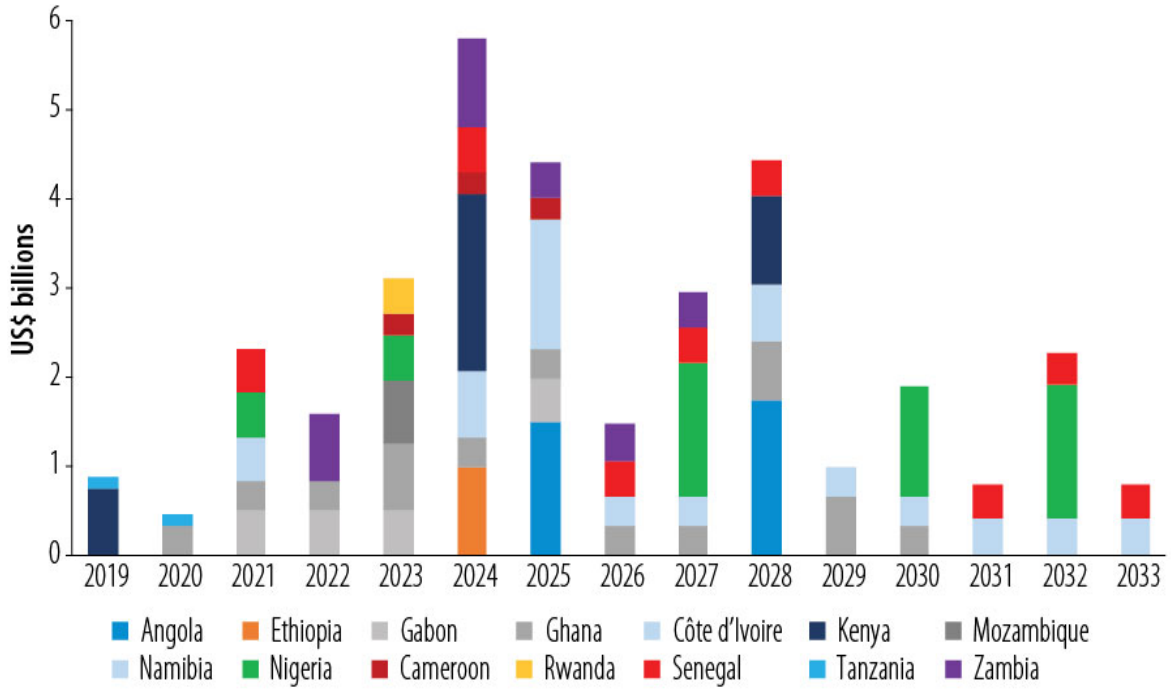
Note: Aggregate figures represent GDP-weighted averages of the ratio of gross capital inflows to GDP across countries in Sub-Saharan Africa. GDP = gross domestic product.

Compared with the global financial crisis, the European sovereign debt crisis hit Sub-Saharan Africa harder.

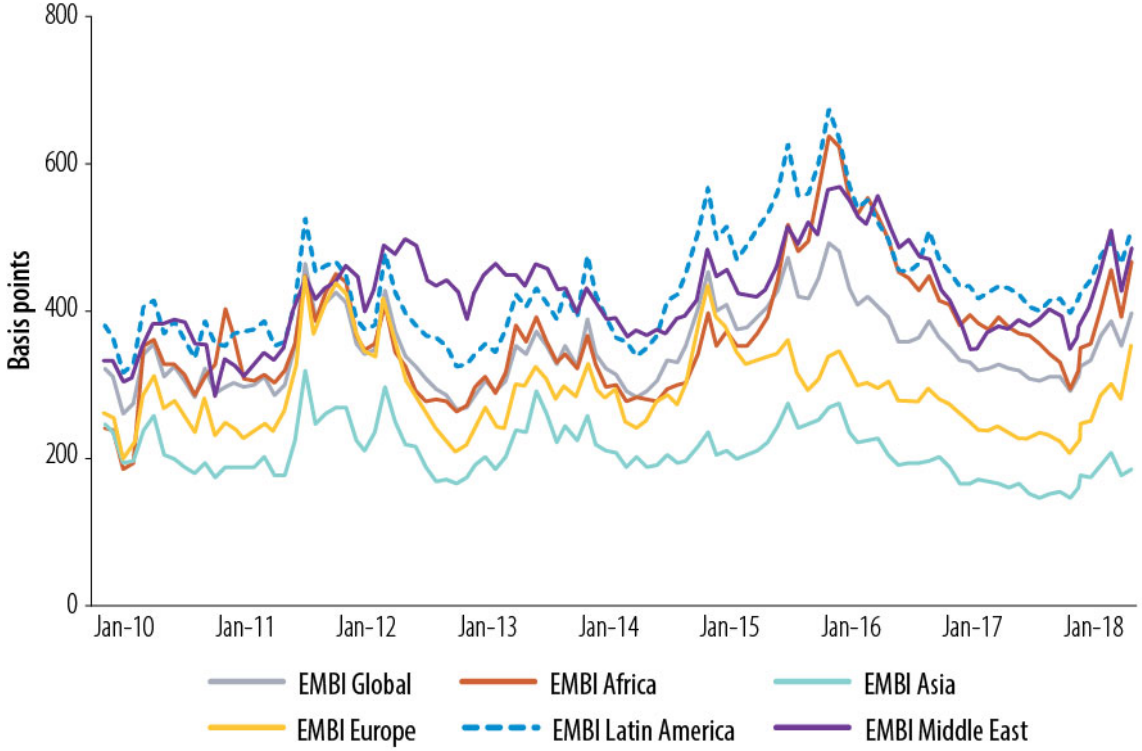
Source: The World Bank (2018) Africa's Pulse, Volume 18.

Refinancing risks and higher borrowing costs for SSA countries

SSA International Bond Redemptions



EMBI Bond Spreads



Source: The World Bank (2018) Africa's Pulse, Volume 18, October.

Building Resilience in Sub-Saharan Africa

Deepen reforms that build resilience at the regional and domestic level

[1] Foster intra-regional trade

- Enhance connectivity across markets in the region
- Risk management mechanism to protect SSA countries from trade tensions outside the region

[2] Financial sector development

- Stable macroeconomic environment: Strengthen fiscal framewrks
- Foster the development of local currency debt markets
- Improve business environment, economic diversification

Building Resilience in Sub-Saharan Africa

[3] Policies that boost productivity

- TFP contribution to growth has been modest in SSA
- Low productivity attributed to inefficiencies in the allocation of inputs across producers: "*misallocation of resources*"
- Misallocation of human capital reflects
  - Inefficiencies in the occupational choice of individuals
  - Barriers to technological adoption
  - Reduced learning-by-doing effects and knowledge spillovers
- Policies that alleviate misallocation may help boost productivity
  - Reduce distortions in credit and land market allocation, secure property rights, among others.

Supplemental Material

Resource misallocation

Low productivity in Sub-Saharan Africa is attributed to inefficiencies in the allocation of resources across firms and farms.

- Factors of production are not allocated to their most effective use.
- Distortions that prevent growth of the most productive firms.

Illustration (Côte d'Ivoire):

- Manufacturing SMEs employ about 90% of manufacturing labor force.
- Yet, most productive firms are 7 times as productive as the least productive firms.
- Eliminating misallocation would potentially increase TFP by 31%

Significant productivity gains in agriculture by raising the efficiency of input usage

Agricultural output gains of closing the actual-potential yield gap across countries in Sub-Saharan Africa

	Percent change in Yield		
Input Use Water Supply	Low Rainfed	High Rainfed	High Irrigated
Congo, Dem. Rep.	-36	88	102
Ethiopia	32	367	450
Kenya	40	314	380
Nigeria	-16	174	230
Tanzania	47	347	442

Source: Sinha and Xi (2018)

Misallocation of capital and land in Malawi

Most productive farmers (Quintile V) do not command significantly more inputs than the least productive ones (Quintiles I and II)

	Distribution of farmers by productivity				
	I	**II**	**III**	**IV**	**V**
Farm productivity	0.75	2.10	3.72	6.39	21.50
Inputs:					
- Land	1.19	0.87	1.01	1.03	1.99
- Capital	55.93	25.35	21.84	24.70	26.71
Output	0.14	0.39	0.69	1.20	4.78

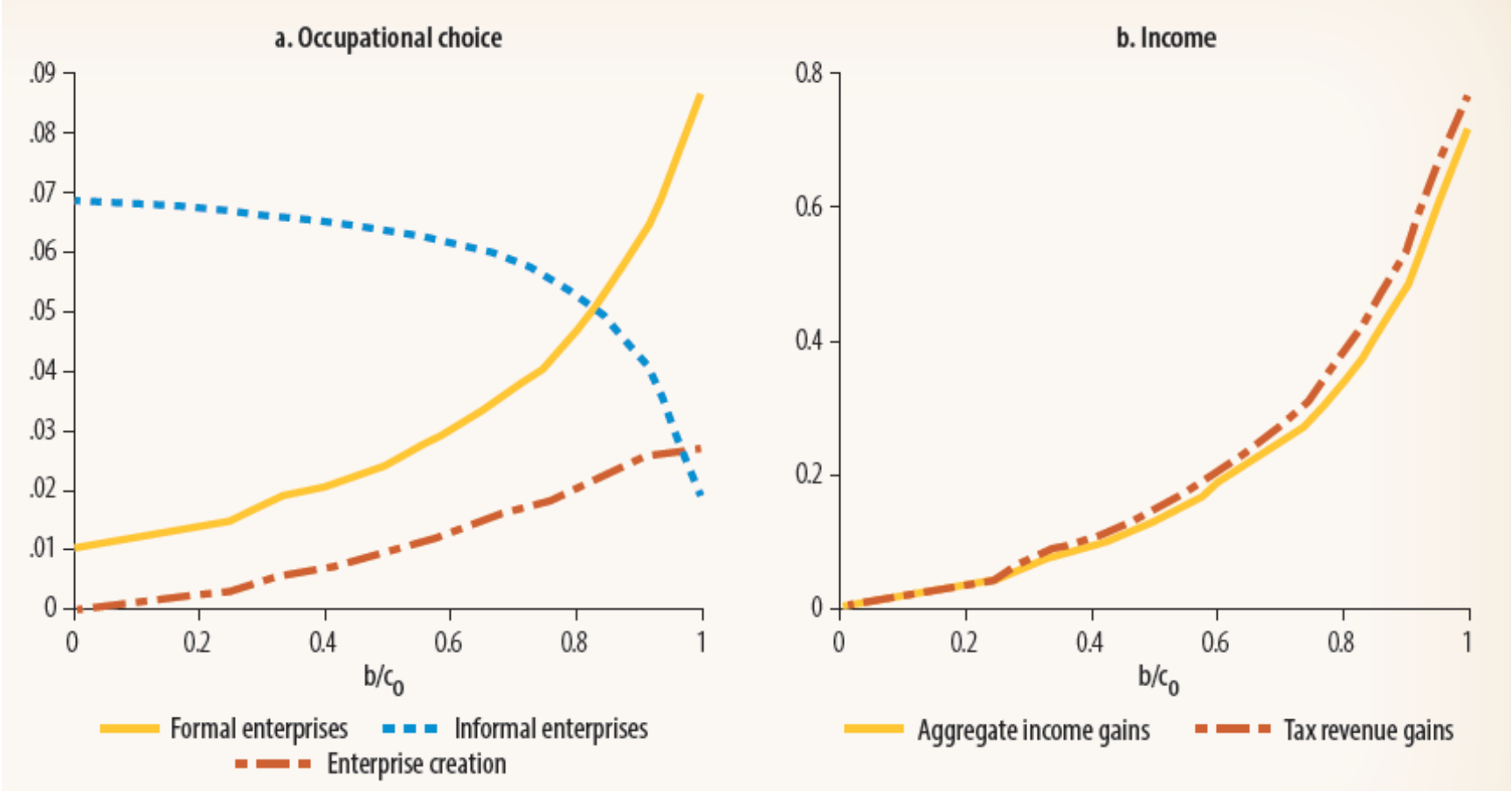
Notes. Households are ranked by farm productivity. Land, capital, and output are in per hour terms.
Source: Restuccia and Santaeulalia-Llopis (2017)

Misallocation of Human Capital

- The misallocation of human capital is attributed to policies and institutions that lead to inefficient occupational choices –i.e. driving the most talented individuals away from their most productive use.
  - Rent seeking vs. Entrepreneurship
  - Formal vs. Informal Entrepreneurs.
  - Agricultural vs. Non-Agricultural Occupations
- Labor market regulations, barriers to human capital investment, social norms and their interplay may lead to an inefficient allocation of human capital.
- Low levels of human capital compounded by misallocation of resources translate into lower labor productivity

Reducing registration costs leads to efficient allocation of skills

Impact of a registration reform in Cameroon



Notes. Panel a depicts the fraction of formal enterprises, informal enterprises and new enterprise creation. Panel b indicates the variation In aggregate income gains (total income gain and tax revenue gains attributed to the reform). Source: Nguimkeu 2015.