Developments in the World Economy and Implications for Africa

1

CHAPTER

AFTER A STRONG rebound in 2010, the world economy slowed in 2011 owing to increased risks and uncertainties that are expected to remain in 2012 and beyond. The negative effects of the triple crisis of 2007–2009—food, energy and finance—still linger, and the euro area sovereign debt crisis has aggravated the structural imbalances in the world economy and cast doubt on the prospects for sustained growth and a quick recovery. The shift of "toxic assets" from private sector to government balance sheets in major developed economies did not relieve the global financial system as expected, but instead worsened government fiscal positions, paced by new global financial turmoil with the onset of the euro area crisis.

The depth and complexity of the global crisis has so far defied the many policy responses applied by the major developed countries, which kept interest rates low and pursued fiscal austerity measures to restore fiscal credibility. Despite these measures, however, long-run structural problems, such as increased income inequality, dysfunctional labour markets and global imbalances, have intensified.

African economies rebounded quickly from the 2008 financial crisis as commodity prices rose and export revenues returned to pre-crisis levels, enabling them to finance the necessary investments. But with the political turmoil in North Africa, coupled with the euro area crisis, growth slowed in 2011. Still, some African countries continued to post double-digit growth, reflecting increased commodity prices and strong domestic demand.

1.1 World growth slowed and unemployment stayed high

THE WORLD ECONOMY grew at 2.8 per cent in 2011, down from 4 per cent in 2010, largely because of decreased demand and greater uncertainty (figure 1.1). Gross domestic product (GDP) growth in developed economies declined from 2.7 per cent in 2010 to just 1.3 per cent in 2011, on both demand and supply factors. Domestic demand, particularly in the developed world, stagnated owing to obstinately high unemployment and depressed consumer and business confidence, as fear of a second recession became widespread. Low growth in the developed world is expected to persist at least until the end of this year (figure 1.1).

The outlook for the world economy remains gloomy, with growth expected at 2.6 per cent in 2012.

In contrast, emerging and developing countries, as well as economies in transition, performed relatively well, but they were not immune to the fallout in the world economy: they faced rising inflationary pressures, increased income inequality and escalating social tensions.

The outlook for the world economy remains gloomy, with growth expected at 2.6 per cent in 2012. The euro area crisis is the most severe downside risk (section 1.7).

Figure 1.1

GDP growth rates of major global regions, 2005–2012 (%)

Source: *UN-DESA (2011, 2012).*

Notes: *a. Estimated; b. Forecast.*

Growth in the *European Union* (EU) levelled off from 2 per cent in 2010 to 1.6 per cent as the euro area registered only 1.5 per cent growth in 2011 (UN-DESA, 2012). The euro area crisis struck at consumer and business confidence, and lowered private consumption and investment against a backdrop of re-emerging financial turbulence and a bank credit crunch. The EU is expected to register minimal growth of 0.7 per cent in 2012, and the euro area a mere 0.4 per cent.

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Growth in the *United States* (US) declined to 1.7 per cent in 2011 from 3.0 per cent in 2010, reflecting continued sluggish private consumption and reduced government expenditure (UN-DESA, 2012). An elevated oil price, high unemployment and persistent deleveraging held down disposable household income. US growth is forecast to slip to 1.5 per cent in 2012. Downside risks lie in fiscal policy choices and the spillover effects of the euro area crisis on still fragile financial institutions. However, some positive signs have emerged in job markets, which might influence the 2012 presidential election and the subsequent economic policy orientation and the pace of the recovery.

Japan's economy switched from 4.0 per cent growth in 2010 to a contraction of 0.5 per cent in 2011, mainly owing to the shock of March's devastating earthquake and tsunami on private consumption and investment (UN-DESA, 2012). Export growth slowed, reflecting the disaster's disruption to supply chains as well as the yen's

climb. Post-disaster reconstruction expenditure and rising manufacturing confidence are, however, projected to enable the economy to rebound with 2.0 per cent growth in 2012. In the medium and long term, though, an ageing population, mounting public debt and deflationary pressures will weigh heavily on growth.

The *economies in transition* grew 4.1 per cent in 2011, as in 2010, but still below pre-crisis rates (see figure 1.1). Domestic demand remained weak, as high unemployment and increased household indebtedness constrained private consumption and investment. However, export revenue rose on high commodity prices. The economies in transition are expected to grow 3.9 per cent in 2012, yet they remain vulnerable to spillovers from the euro area crisis owing to their close economic links to that bloc.

In 2011, developed economies' overall fragility weighed heavily on developing countries' growth, which stood at 6.0 per cent, down from 7.5 per cent in 2010; growth is projected to decline further to 5.6 per cent in 2012 (see figure 1.1). Overheating worries have receded, but high unemployment and political turmoil in some countries are still threatening growth prospects. Developing countries have tried to make up for the decline of external demand by stimulating domestic demand and pursuing expansionary policies.

East and South Asia—the world's growth engine—also felt the global economic chill through slackening exports. Growth slowed to 7.1 per cent in 2011 against 8.8 per cent in 2010 (see figure 1.1), despite robust private consumption and investment. Natural disasters affected regional industrial production and supply chains. Growth is projected to further decelerate to 6.8 per cent in 2012 as external demand from developed countries stays depressed.

China and India—the two largest emerging economies—were slowed by headwinds from the world economy in the fourth quarter, though they maintained excellent growth of 9.3 per cent and 7.6 per cent, respectively, in 2011. High inflation eroded Chinese household incomes and government attempts to limit bank credit—stemming from anxieties of an overheating economy—put pressure on private investment. The major risk for China's economy comes from a possible external demand slump, which would depress export growth. China is forecast to grow 8.7 per cent in 2012.

India's buoyant private consumption was its main growth driver. Rising prices of basic foods, water and electricity have, though, become a source of public protest against government policies. India is expected to keep its growth momentum, at 7.7 per cent in 2012. Low productivity of rain-fed agriculture and a possible reversal of capital inflows are the main risks (EIU, 2011a).

Western Asia's economic growth edged up from 6.3 per cent in 2010 to 6.6 per cent in 2011 (see figure 1.1), mainly on a high oil price and greater social security spending. Increased energy export income and supportive macroeconomic policies propped up growth in oil-exporting countries, while some oil-importers saw recovery led by fiscal stimulus and domestic demand. Others contracted or stagnated because of social and political instability. Growth for the region is expected to decline sharply to 3.7 per cent in 2012 as a result of regional political uncertainties and a possible downward trend in the oil price.

Economic growth in the *Latin America and the Caribbean* (LAC) region decelerated to 4.3 per cent in 2011 from 6.0 per cent in 2010, despite the vigorous domestic demand attributable to favourable labour markets, high commodity prices, global low interest rates and currency appreciation (see figure 1.1).[1] Growth rates were divergent across the region: South American countries continued to benefit from emerging economies' commodity demand, sound economic fundamentals and increased domestic demand. Mexico and the countries in Central America and the Caribbean, in contrast, experienced slow growth, influenced by the weak US economy (EIU, 2011a). The

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LAC region is expected to slow to 3.3 per cent growth in 2012, reflecting a generally unfavourable global economy.

Africa's growth fell from 4.6 per cent in 2010 to 2.7 per cent in 2011 (see figure 1.1), mainly owing to the political turbulence in North Africa. Private investment declined with increased investor risk aversion there, though domestic demand remained robust and exports rose despite a severe drought in other parts of the continent.

Yet even with the lacklustre global backdrop, Africa's economic outlook is quite positive, with growth of 5.1 per cent expected in 2012. The key downside risk lies in export revenues shrinking because of sharply lower world commodity prices and adverse weather.

Persistent high unemployment is the most pronounced outcome of the weak global economy, and the global jobs situation improved little in 2011, despite worldwide government efforts to stimulate growth (table 1.1). After a steep rise in 2009, the developed economies' and EU unemployment rate approached 9 per cent in 2010, and it kept on climbing through most of 2011 (ILO, 2011b). The world unemployment rate for youth—the most vulnerable group in a labour force—declined only marginally to 12.6 per cent in 2011, with potentially destabilizing impacts on societies (ILO, 2011c).

Table 1.1

Unemployment, 2007–2011 (%)

	2007	2008	2009	2010			2011		
				CI lower bound	Preliminary estimate	CI upper bound	CI lower bound	Preliminary estimate	CI upper bound
Region				Rate					
World	5.6	5.7	6.3	5.9	6.2	6.5	5.6	6.1	6.6
Developed economies and European Union	5.8	6.1	8.4	8.5	8.8	9.1	7.9	8.6	9.4
Central and South-Eastern Europe (non-EU) and Commonwealth of Independent States	8.6	8.6	10.4	9.1	9.6	10.1	8.9	9.7	10.6
East Asia	3.8	4.3	4.4	3.9	4.1	4.3	3.8	4	4.2
South-East Asia and the Pacific	5.4	5.3	5.2	4.8	5.1	5.4	4.5	4.9	5.3
South Asia	4.5	4.3	4.4	3.9	4.3	4.6	3.7	4.1	4.4
Latin America and the Caribbean	7	6.6	7.7	7.2	7.7	8.1	6.8	7.4	8.1
Middle East	10.5	10.2	10.3	9.6	10.3	10.9	9.3	10	10.8
North Africa	10.2	9.6	9.9	9.1	9.8	10.5	8.6	9.8	10.9
Sub-Saharan Africa	7.9	7.9	7.9	7.6	8	8.4	7.4	7.9	8.4

Source: *ILO (2011a).*

Note: *Preliminary estimates for 2010; projections for 2011; CI = confidence interval.*

High unemployment, especially among youth, characterizes Africa's labour market. Although the informal economy provides a cushion for the young unemployed, the youth unemployment crisis can only be addressed through strong, broad-based growth and comprehensive social and economic measures (UNECA and AUC, 2010). Africa boasts the youngest population among the global regions, and youth are the most precious resource for the continent's economic and social transformation. To release their potential, African governments must fulfil their commitments on youth employment and invest resources to address the key factors affecting youth employment, such as a skills mismatch and inadequate access to credit and productive resources (ILO, 2011c).[2]

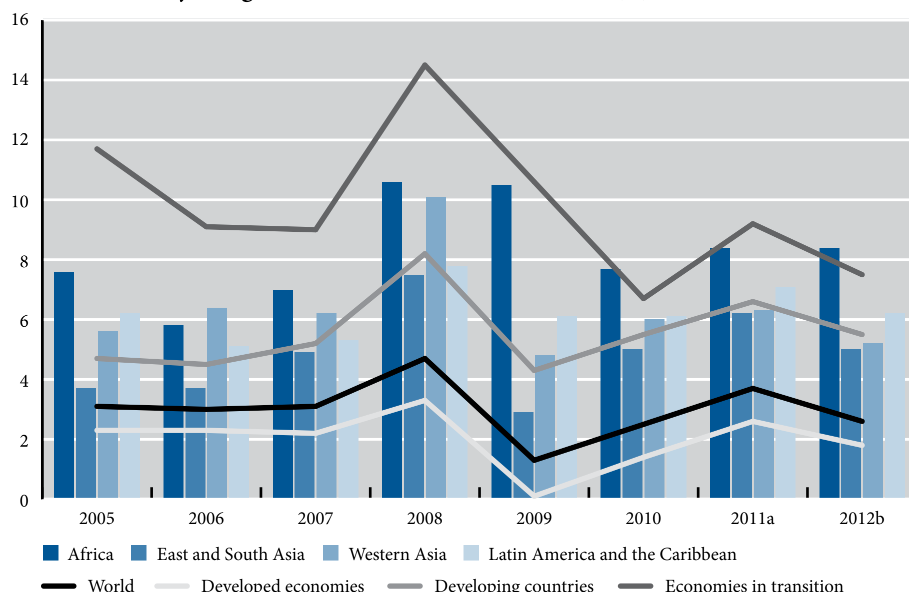
The world economic slowdown and the global employment crisis are likely to have serious implications for Africa, in both the short and medium term. They could increase pressures on African countries' long-run objectives, such as poverty reduction, by constraining government budgets, which have to be channelled to priority areas such as infrastructure, science and technology and human resource development, as well as industrialization and employment creation (chapter 4). African economies' choice of key development areas will therefore largely determine their medium-term growth trajectory.

1.2 Inflationary pressures mounted

WORLD INFLATION EDGED up from 2.5 per cent in 2010 to 3.7 per cent in 2011, but is expected to ease to 2.6 per cent in 2012, with similar trends for developed and developing economies (figure 1.2). Given such expectations and gloomy global prospects, monetary policy in major economies is likely to remain accommodative in 2012, allowing continued balance-sheet repair in the private and government sectors and supporting world economic recovery.

Figure 1.2

Inflation in major regions and economies, 2005–2012 (%)



Source: *UN-DESA (2011, 2012).*

Note: *a. Estimated; b. Forecast.*

In the developed world, inflationary pressures came mainly from high food and fuel prices (section 1.4). Inflation reached 2.6 per cent in 2011, up from 1.4 per cent in 2010, and is forecast to moderate to 1.8 per cent in 2012 (see figure 1.2).

As in 2011, developed economies are expected to maintain an accommodative monetary stance in 2012 in order to induce domestic demand and stimulate their economies. The US Federal Reserve, for instance, has decided to keep the federal funds policy rate near zero until mid-2014, while the European Central Bank cut its key interest rate twice towards the end of 2011, reflecting its concern over the euro area's growth and employment prospects. Similarly, the central bank of Japan kept its benchmark interest rate near zero and enhanced monetary easing to fight deflation and accommodate the effects of the earthquake on productivity and growth.

For the economies in transition, weakened growth prospects and receding commodity prices alleviated inflationary pressures in the second half of 2011, though inflation was still near double digits (see figure 1.2). Most countries tightened their monetary policies in the light of economic recovery and elevated food and fuel prices.

Inflation in developing countries, which have been under overheating pressures since 2010, went up to 6.6 per cent in 2011, but is forecast to recede to 5.5 per cent in 2012 (see figure 1.2). The injection of excess liquidity into the global economic system by major developed economies drove up nominal world food and energy prices, lifting imported inflation in developing countries. In response, most of the latter postponed monetary tightening or even returned to accommodative monetary policies in 2011. The Reserve Bank of India, for example, kept its benchmark interest rate on hold in December after raising it seven times to fight inflation in 2011; China's central bank lowered its reserve requirement in December, and Brazil cut its interest rate three times in the second half of 2011.

As in other developing regions, inflation in Africa is expected to decline in 2012, though low global interest rates and high food and fuel prices are still likely to subject African countries to inflationary pressures (see figure 1.2). African economies have historically had higher inflation than most other developing regions. Recent downbeat global economic trends support an accommodative monetary policy in most countries on the continent, except for those facing non-food inflationary pressures. In a longer term, however, reforms to economic structures and institutions are essential for controlling inflationary pressures on the continent.

1.3 Fiscal balances improved

THE FISCAL BALANCE improved in almost every major economy or region in 2011 (figure 1.3). Developed economies as a whole cut their fiscal deficit from 7.5 per cent of GDP in 2010 to 6.5 per cent, though the US and Japan still ran fiscal deficits close to 10 per cent.

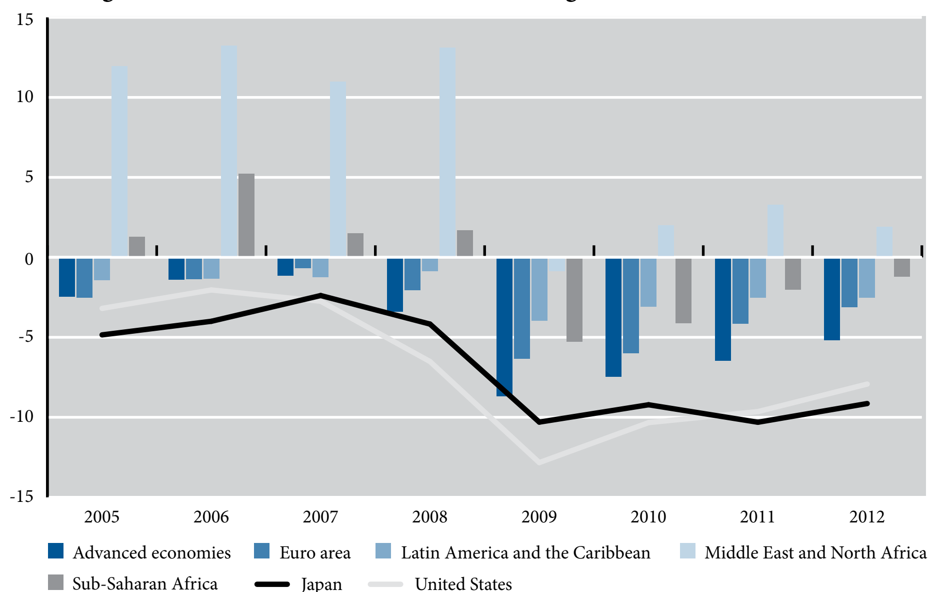
High food and fuel prices are still likely to subject African countries to inflationary pressures.

Developing economies partly rebuilt their fiscal buffers, using increased commodity export revenues.

The prospects for strengthening the position much further in 2012 do not appear promising on current forecasts, and fiscal consolidation runs the danger of stunting major developed economies' long-term growth prospects. Still, these economies are expected to continue moving that way: the euro area, for example, is forecast to register a fiscal deficit of only 3.1 per cent of GDP as members pursue austerity to regain fiscal credibility.

Figure 1.3

Central government fiscal balances for selected regions and economies, 2005–2012 (% of GDP)



Source: *IMF (2011a).*

Developing countries may see slightly worsening fiscal positions in 2012 because of reduced demand from developed countries and a possible decline in commodity prices, exacerbated by higher spending on food subsidies and social protection programmes.

Fewer fiscal policy options were available to economies globally in 2011 than the year before. Developed economies, especially the euro area, are facing greater pressure to push through with fiscal austerity, given alarmingly high debt levels. [3] Developing countries' fiscal positions are generally well managed. [4] However, owing to weakened global growth prospects, they are more likely to adopt a neutral fiscal policy stance as prolonged fiscal expansion could exhaust fiscal space, fuel inflation, crowd out private investment and threaten their long-term growth potential.

Fiscal retrenchment by the world's major economies is likely to have short- and medium-term negative impacts on African economies, mainly through two channels. First, fiscally vulnerable African countries have to face much higher demand for sovereign debt yield in global markets as investors reassess sovereign debt risks in light of the euro area crisis. Second, on the aid front, developed economies might greatly reduce and impose stricter conditions on official development assistance (ODA), including for Africa (section 1.7).

Responses to these twin challenges include strengthening economic and social development ties with new development partners from emerging economies—as well as their traditional donors—and mobilizing domestic development resources (chapter 5), especially as such strengthening may reduce African economies' over-reliance on aid flows from abroad in the long run.

In 2012, world commodity prices are expected to moderate with better supply-demand balance, mainly reflecting slower global economic activity.

1.4 World commodity prices remained high

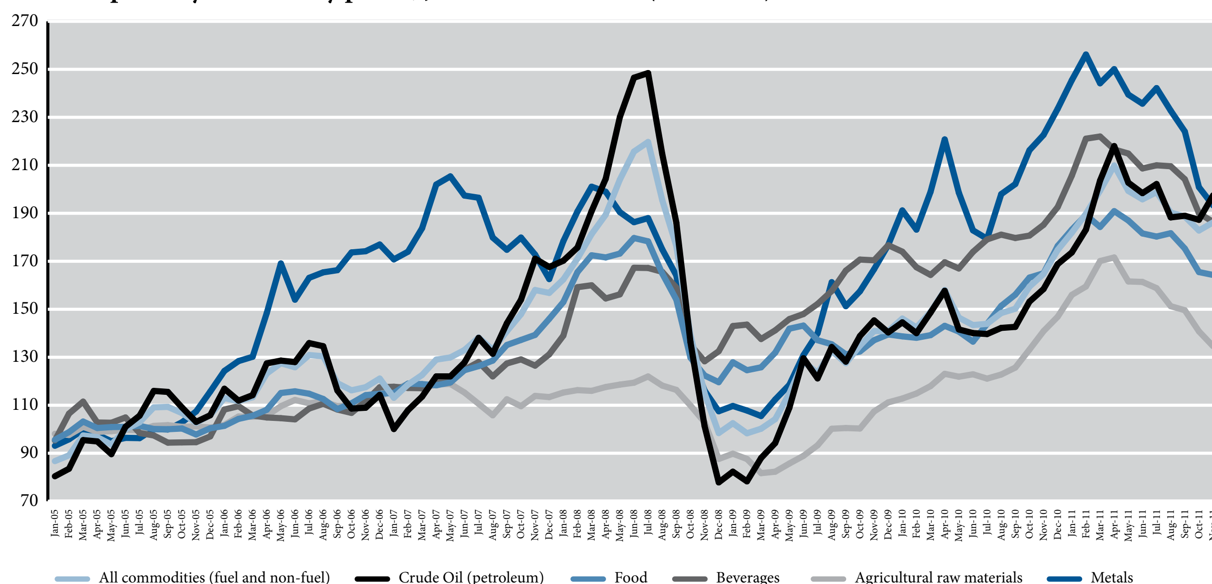
THE INDEX FOR world commodity prices approached a historical high in April 2011, and apart from crude oil, all major commodity category price indices registered record highs in the first half of 2011. The trajectories of commodity prices divide roughly into two phases: most kept their upward trend in the first quarter; in April, however, they began to decline, but still hovered at relatively high levels (figure 1.4).

Movements in 2011 stem from both the demand and supply sides. First, demand from emerging economies continued to present strong support to high commodity prices, though this effect weakened as economies cooled in the fourth quarter. Second, political unrest in the MENA region severely disrupted that region's oil supply, pushing up energy prices on the global market. And third, increasing concerns over global growth prospects and risk aversion re-emerged in the second quarter of 2011, becoming the major downward driver of prices.

In 2012, world commodity prices are expected to moderate with a better supply–demand balance, mainly reflecting slower global economic activity. However, worldwide low interest rates and growth concerns may drive global investors into commodity markets to seek higher returns, adding volatility to prices. Risks are mainly on the downside, with possible price slumps in the worst-case scenario of global recession.

Figure 1.4

Index of primary commodity prices, Jan 2005–Nov 2011 (2005=100)



Source: *IMF (2011b).*

> *Global energy markets, especially for oil, are projected to face higher nominal prices in the long run.*

Crude oil and the global energy market

After a 15-month fluctuation within a narrow upward channel, the world crude oil price picked up another major notch from September 2010, and after falling at the beginning of May, it has since fluctuated at $100–120 per barrel (see figure 1.4). In April, the Brent spot oil price hit $126.99 per barrel, more than one third higher than its 2010 closing price and only 14 per cent below its 2008 all-time high (BP, 2011). Crude oil in general showed higher volatility than other primary commodities.

Volatility in the oil price is expected to continue in 2012 and beyond. Global oil demand continued to firm in 2011, but at only 1.1 per cent after 3.2 per cent in 2010, reaching 89.2 million barrels per day (mb/d) (IEA, 2011). [5] Faltering developed economies and cooling emerging economies contributed to this moderation. In 2012, global demand is forecast at 90.5 mb/d, a 1.4 per cent rise from 2011.

Global oil supply was about 88.2 mb/d in the first three quarters of 2011, 0.9 per cent higher than the 2010 average.[6] The absence of Libya was largely made up by increased supply from Saudi Arabia. In 2012, total non-OPEC oil production is seen reaching 53.65 mb/d, up 1.7 per cent from 2011, and meeting 59.3 per cent of global demand. Still, the tight demand–supply equilibrium is unlikely to ease any time soon, even with the discovery of new sources around the world.

Despite cautious optimism for a lower oil price in 2012, global energy markets, especially for oil, are projected to face higher nominal prices in the long run, not only because of the possible further depreciation of the US dollar (in which oil is denominated), but more important, the evolution of global energy supply and demand. The Japanese nuclear power station disaster renewed anxieties around the globe over the safety of nuclear power, which in recent years has become more acceptable as a replacement for traditional fossil-fuel energy. Other main challenges for global energy use include expanding global energy access, increasing energy investments and mitigating the impact of global climate change (IEA, 2011b).[7]

Food and beverages

The world food price index recorded a historical high in April 2011, after which it showed a gently declining trend, but with increased volatility (see figure 1.4). Explanations for the food price surge included bad weather in most major agriculture-exporting countries in the later months of 2010, increased biofuel use owing to increased global energy prices, US dollar depreciation and market speculation.

Among particular commodities, the price of rice was up more than 20 per cent since May 2011, at odds with wheat and maize prices. Severe floods in Thailand, which disrupted production, and speculative sentiment in the market were responsible for the dramatic increase in the price.

The outlook for the world food price is a slight downtrend in 2012. On the supply side, high prices in 2011 are expected to have induced more agricultural investment, and the weather may also turn out to be more favourable, both of which point to rising food output in 2012. On the demand side, the stuttering world economy is likely to reduce global food imports and dampen biofuel transformation as energy prices decline. Even so, the food price is expected to remain volatile and sensitive to demand or supply shocks, partly owing to low inventories.

Despite the forecast short-term fall, however, global food prices should remain on a plateau in the long run. Food

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Increased volatility of world commodity prices presents new challenges for African countries over the re-emerging issue of food security.

supply is restricted by a shortage of arable land, rising agricultural production costs and decreasing agricultural productivity, while food demand is stimulated by increasing incomes of the emerging economies and more use in biofuel production by developed economies owing to high energy prices (OECD and FAO, 2011). The high food price and increasing volatility could pose serious challenges to food security and poverty reduction efforts, especially in least developed countries.

The world beverages price index was up 73 per cent from its trough in January 2009 and peaked in March 2011. Coffee topped at about $2.45 per pound in May 2011, with increased volatility after September. Global coffee production fell 4.3 per cent in 2010/11 (ICO, 2011). Only Africa as a region raised its coffee output, by about 20 per cent; elsewhere it declined owing to bad weather. Similarly, the price of cocoa peaked at more than $3,450 per tonne in February 2011, but then fell more than 20 per cent by October. The combination of a weaker world economy and favourable weather conditions contributed to the decline (ICCO, 2011).

Agricultural raw materials

From April 2009, the index for agricultural raw materials kept on rising and more than doubled by its peak in April 2011, but declined modestly thereafter (see figure 1.4). Strong demand from emerging economies and adverse weather drove up prices. The natural rubber price attained its highest ever level in the first quarter of 2011 owing to high demand from emerging economies and insufficient supply in rubber-producing countries. The price of cotton peaked in March 2011 with a steep rise of more than 170 per cent from the second half of 2010, and then fell during the rest of 2011.

Metals

The metals index hit a record in February 2011, and then fluctuated downward within a narrow range in the following months. Copper prices remained relatively high throughout 2011, reflecting an imbalance between global consumption and production.

The outlook for metal prices in 2012 is closely linked to global economic activity. As China accounts for about 40 per cent of global demand, the country's macroeconomic policy and its stocks have a huge impact. With the world economy likely to show lower than initially projected growth, metal consumption could fall in 2012, taking prices down with it.

Once the global crisis of 2007–2009 ended, prices of precious metals, such as gold and silver, surged. Speculative forces were believed to be the major factor. However, the continued depreciation of the US dollar, global low interest rates, and, more important, risk aversion among global investors (given the downbeat global prognosis and volatile financial markets) propped them up.[8]

On the back of increased commodity demand and prices, Africa's merchandise exports increased to 31.5 per cent of GDP on average in 2006–2010. The continent's closer trade relationship with other regions, combined with its over-reliance on primary commodity exports, has made its trade even more vulnerable to global shocks in recent years (see section 1.7). Although Africa has diversified its export destinations a little, many countries still rely heavily on developed economies. Moreover, the increased volatility of world commodity prices, especially food, presents new challenges for African countries over the re-emerging issue of food security.

1.5 World trade growth moderated and current account balances stayed largely stable

THE WORLD TRADE value of goods and non-factor services continued to recover at 13.9 per cent in 2011, but lower than the 17.1 per cent of 2010. Deceleration in trade volume was more marked (figure 1.5). Developed and developing economies' exports grew 12.4 per cent and 15.9 per cent in 2011. European export value climbed by 13.8 per cent, but volume by only 6.7 per cent, indicating a shift towards more valuable goods. Among developing regions, Africa's export growth by value fell to 8.3 per cent from 14.3 per cent in 2010, mainly owing to North African political unrest, while its imports rose sharply by 16.9 per cent, largely because of steeper global food prices.

Figure 1.5

Annual average growth of export values by region, 2005–2012 (%)

Source: *UN-DESA (2012).*

Notes: *a. Estimated; b. Forecast.*

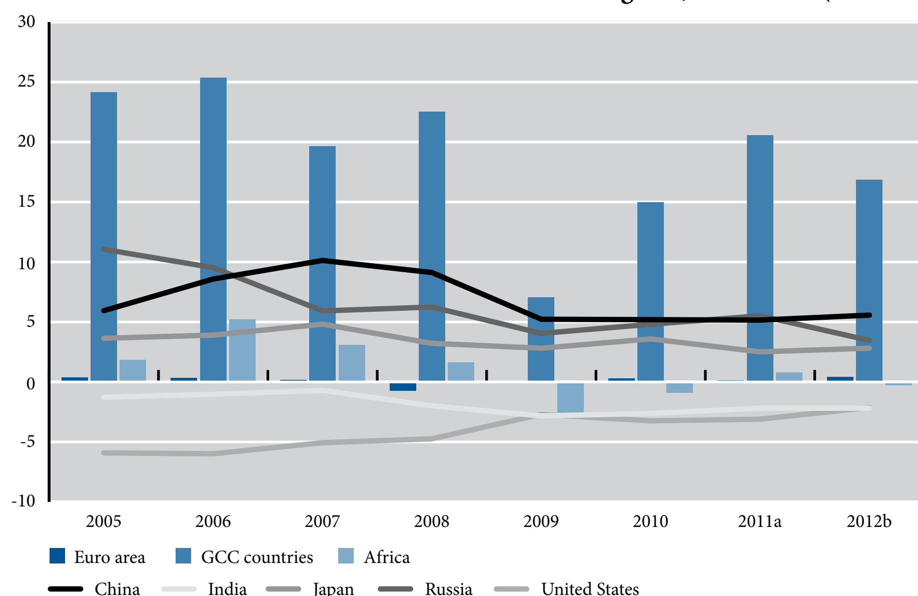
Intraregional trade (that is, within a single global region) increased owing to the rise of emerging countries in recent years, though it still accounted for only 11 per cent of total trade for Africa in 2010, against 65 per cent for the EU (WTO, 2011).[9] Nevertheless, developed economies still dominate world exports' value addition (UNCTAD, 2011b).

The outlook for world trade growth in 2012 at a slower 9.2 per cent is overshadowed by divergent growth prospects. Export growth in developed economies is forecast to fall sharply to 4.8 per cent while the developing countries maintain their momentum at 15.2 per cent. Europe's exports are estimated to rise by only 4.6 per cent. Western Asia's export growth is expected to decline, but to a still-solid 9.7 per cent in 2012. With high unemployment across the globe, intensified protectionism is likely to emerge as the biggest challenge for world trade in 2012.

Trade patterns among the world's major economies and regions determined their largely stable current account balances in 2011 (figure 1.6). The US still ran a huge deficit against China's surplus, while the euro area's current account was in near balance. Japan's surplus narrowed, reflecting the earthquake's impact on its trade and post-disaster reconstruction. The surplus in the Gulf Cooperation Council (GCC) countries rose by more than a third, propelled by high oil prices. Russia's surplus widened only a little, as the non-oil sector deteriorated (EIU, 2011a).

Figure 1.6

Current account balances for selected countries and regions, 2005–2012 (% of GDP)



Source: *IMF (2011a); authors' calculations.*

Notes: *a. Estimated; b. Forecast.*

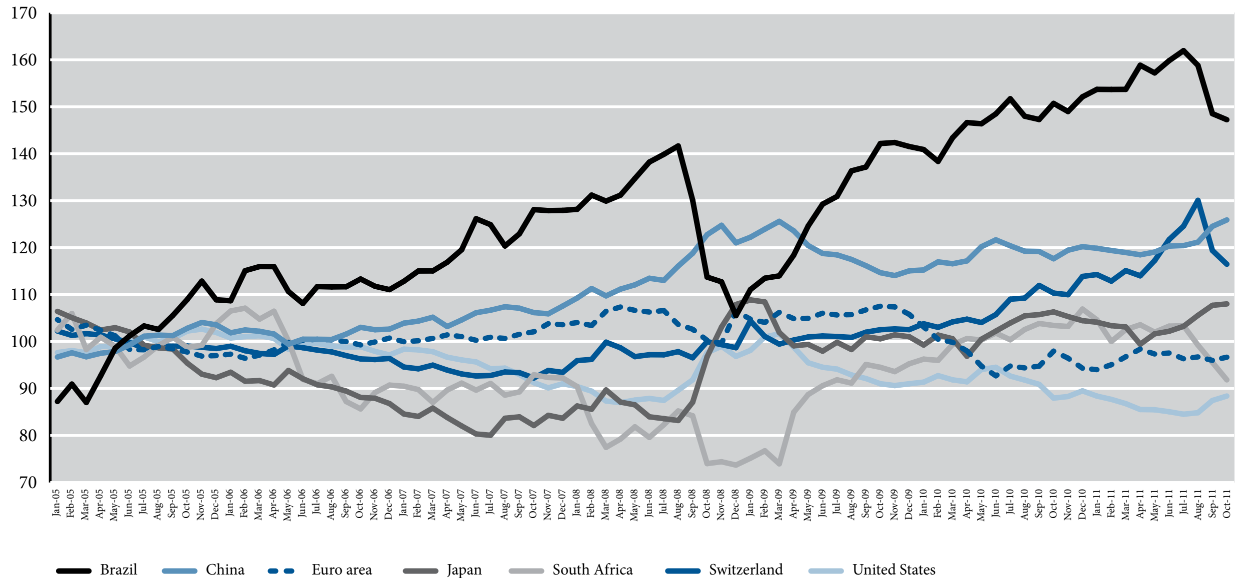
1.6 The US dollar depreciated as risk aversion dominated capital flows

THE US DOLLAR depreciated in the first three quarters of 2011 but reversed trend in the last, accompanied by increased real exchange rate volatility of major world currencies that was largely attributable to shifts in US monetary policy and the worsening euro area debt crisis (figure 1.7). Near zero interest rates in the US and global investors' worries over further quantitative easing by the Federal Reserve kept the dollar weak and many emerging countries' currencies strong. However, growing risk aversion from August as the euro crisis intensified buttressed the dollar and prompted sharp falls in emerging currencies. The Japanese yen and Swiss franc appreciated sharply late in the year, reflecting their safe haven status, when US sovereign debt was downgraded in a historic move and the euro area crisis continued to deepen.

FDI to Africa recovered only modestly in the first half of 2011.

Figure 1.7

Real effective exchange rates for major economies, Jan 2005–Oct 2011, index (2005=100)



Source: *IMF (2011b).*

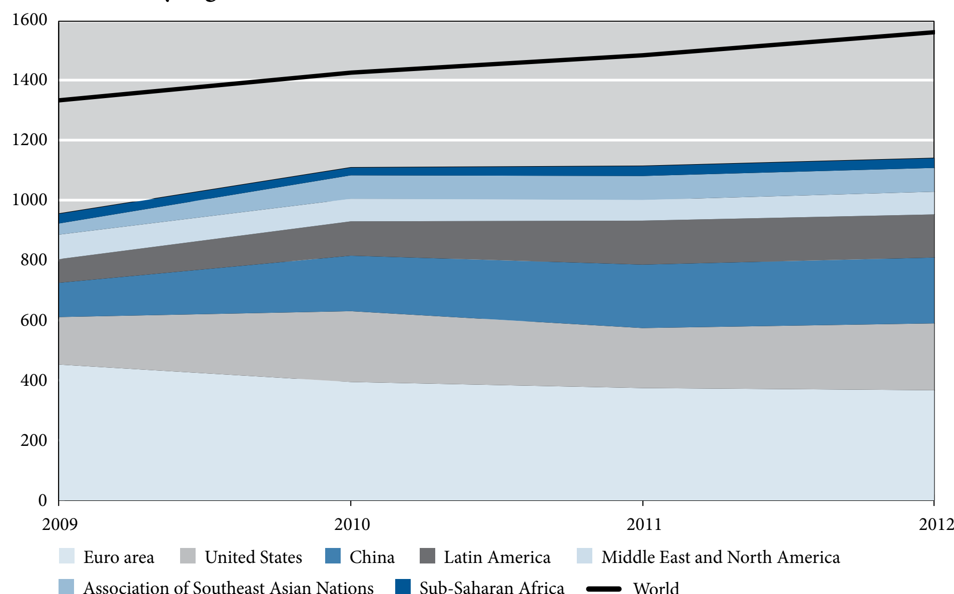
Global foreign direct investment (FDI) flows continued to recover in 2011, but less quickly than in 2010, largely reflecting uninspiring global growth prospects and high investors' greater risk aversion (figure 1.8). In the first half of 2011, they increased by 2 per cent sequentially. Again a divergence appeared between developed and developing economies: FDI flows to the former contracted by 3.9 per cent but to the latter they rose by 7.3 per cent (UNCTAD, 2011a). FDI to South and East Asia remained strong, though to the US and Western Asia it fell by nearly a half and a third, respectively, reflecting investors' concerns over US growth prospects and political uncertainties in the MENA region.

FDI to China surged in the first half of 2011, especially for mergers and acquisitions (M&A). "Green" investment declined worldwide but saw an over 55 per cent rise in the LAC region by September 2011. FDI to Africa recovered only modestly in the first half of 2011, and increased flows to South Africa were largely offset by smaller flows to North Africa.

> *Low global interest rates may boost FDI to Africa as the continent offers expected higher returns than most other developing regions.*

Figure 1.8

FDI inflows by region and selected economies, 2009–2012 ($ billion)



Source: *EIU (2011a).*

Uncertainties in the world economy are likely to prevent a strong rebound of global FDI in the immediate future, though developing economies and economies in transition are expected to consolidate their positions as favoured destinations. As emerging economies upgrade their industrial structures, high-tech sectors are likely to receive further FDI inflows.

Low interest rates worldwide may boost FDI to Africa, as the continent offers expected higher returns and far greater investment opportunities than most other developing regions, given the last decade's relatively fast economic growth and improved economic governance.

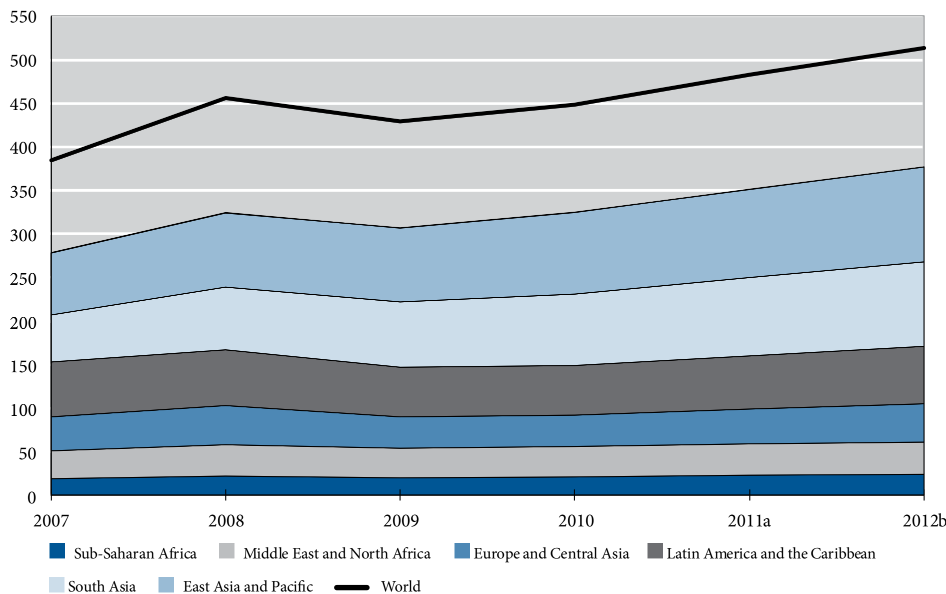
For many African countries dependent on aid, a possible decline in aid flows could pose serious challenges in the short term.

Portfolio investment saw a steep decline in 2011, mirroring the world's pessimistic growth outlook. The Morgan Stanley Capital International world stock index slumped by 9.2 per cent, while component indices for developed and emerging markets fell by 7.5 and 19.7 per cent in US dollar terms (EIU, 2011b).

Remittances, however, recovered almost to their pre-crisis levels by 2011, even if growth was slow relative to recipient countries' inflation. Volumes varied among developing regions, mainly owing to the political and economic situations of the source countries. Political unrest in MENA curtailed flows to sub-Saharan Africa and South Asia, while the slow US and Japanese economies affected flows to the LAC region and East Asia, respectively. However, high oil prices helped workers in Russia to lift their remittances to Europe and Central Asia, and those in the GCC countries to boost theirs to South Asia. Gloomy global growth prospects weigh on the outlook for 2012 (figure 1.9).

Figure 1.9

Remittance inflows by major recipient region, 2007–2012 ($ billion)



Source: *World Bank (2011).*

Notes: *a. Estimated; b. Forecast*

Global ODA climbed 6.5 per cent in 2010, but is expected to grow only 1.3 per cent on average in 2011–2013 because of slower growth prospects in donor countries.[10] Disbursements of ODA in 2010 were still well below commitments and are expected to remain far below the United Nations target of 0.7 per cent of donor countries' gross national income by 2015.

For many African countries dependent on aid, a possible decline in aid flows could pose serious challenges in the short term as many planned projects may have to be abandoned or scaled back. Hence mobilizing, using and distributing financial resources better are key challenges for African economies to sustain or accelerate their growth (chapter 5). Another short-term problem also looms large—the effects on Africa of the debt crisis in the euro area.

1.7 Euro area crisis could seriously affect Africa

THE EURO AREA sovereign debt crisis presents the most severe downside risk for the world and for Africa in 2012 and beyond. Analysis by the Organisation for Economic Co-operation and Development (OECD) suggests that prospects for a quick recovery are dismal and that other regions around the world, including Africa, may feel negative impacts, collectively reflected in decelerating growth.[11]

As Europe has traditionally been Africa's most important export destination and source of capital, the impact of the crisis through the channels of trade, FDI, remittances and aid is now discussed. Beyond these impacts,

The euro area sovereign debt crisis presents the most severe downside risk for global growth in 2012 and beyond.

Africa's banks may feel pressure from globally tightened credit markets and limited liquidity, while some African countries' currencies are expected to depreciate and show greater volatility.

Trade

Trade is expected to be the most prominent channel of the debt crisis's impact on Africa.[12] In 2010, Africa's merchandise exports to the EU represented 10.3 per cent of its GDP and 36.2 per cent of its total exports. North America and Asia took 16.7 and 24.2 per cent of African exports, respectively (WTO, 2011).

Africa's merchandise export composition and destinations can help to gauge the impacts of the crisis on the continent's exports (table 1.2).[13] Fuels and mining products remained Africa's major merchandise export items in 2010, and Europe was the most important destination for all merchandise exports. Asia and North America took large portions of Africa's fuels and mining exports. Intra-African trade had noticeable shares in all product categories except fuels and mining. In recent years, Africa's export destinations have been diversifying with increased engagements with emerging partners, which might provide a cushion for the expected decline in the continent's exports to Europe.

Table 1.2

Africa's exports of merchandise products by region, 2010

	Agriculture		Food		Fuels and mining		Manufactures	
	Value ($ billion)	Share (%)	Value ($ billion)	Share (%)	Value ($ billion)	Share (%)	Value ($ billion)	Share (%)
World	55	100	44	100	333	100	95	100
EU	20	37.1	17	37.9	118	35.3	40	42.3
Africa	11	19.1	9	21.3	24	7.3	23	24.0
Asia	9	15.5	5	10.4	94	28.3	13	14.2
Middle East	6	11.7	6	14.1	3	0.9	5	5.8
North America	3	5.0	2	5.3	73	22.0	9	9.1
Commonwealth of Independent States	1	2.4	1	2.9	0	0.1	0	0.2
South and Central America	0	0.9	0	0.7	11	3.3	2	2.2

Source: *WTO (2011).*

The euro area crisis is expected to weigh heavily on ODA to Africa because the EU is the largest aid provider to the continent.

A knock-on effect on trade may worsen various African countries' fiscal positions. Oil revenues are a major source of financing for primary fiscal deficits in some countries on the continent. Also, African countries that are heavily reliant on trade and resource tax revenues may suffer from lower commodity demand from the EU (and the world), especially those running high fiscal deficits.

FDI

FDI flows from the EU to Africa are relatively stable compared with those from other parts of the world, and have generally kept on rising over the past few years. However, Africa may face decreased FDI from both the EU and other parts of the world in the short term because of the sovereign debt crisis and resultant slowdown in global growth.

FDI flows to Africa accounted for 3.9 per cent of the world total in 2006–2010. Africa has recently diversified its sources of FDI to emerging economies more, and this may mitigate the worst effects of the euro area debt crisis. For example, China's FDI to Africa reached about 7.5 per cent of the continent's total receipts in 2008 (AfDB et al., 2011).

The baseline scenario foresees no severe deterioration of world FDI to Africa. Africa's relatively high growth and its investment returns support the continent's attraction to global investors—assuming that the crisis does not greatly increase risk aversion globally.

Remittances

Remittances are the second-largest type of capital flows to Africa, and the euro area crisis has already taken a toll—remittances to MENA countries increased the least among regions of the world in 2011, though the situation was still favourable for sub-Saharan Africa in 2011. Western Europe had the largest proportion of remittances to Africa among global regions, with 41 per cent and 39 per cent for sub-Saharan Africa and MENA, respectively, in 2010 (World Bank, 2011).

The baseline scenario foresees subdued remittance growth to Africa in the near future, reflecting the process of economic adjustment and reform in the euro area, which will push down wages and keep unemployment high. As a result, Africa's private consumption is likely to decline and its current account balances to deteriorate generally.

Aid

Another important source of capital to Africa, ODA, is essential for development programmes in some African countries. In 2000–2009, Africa on average received 42 per cent of the ODA disbursed by OECD Development Assistance Committee (DAC) countries, and 49 per cent of that from EU institutions (OECD, 2011b). In 2008, ODA net disbursements accounted for 2.8 per cent of Africa's GDP. Although the ratio of ODA to African GDP overall is small, ODA is critical to some African economies. Indeed, about two thirds of African countries depend on ODA to some extent, and many African countries are heavily reliant on ODA to finance their public spending and capital budgets.

The euro area crisis is expected to weigh heavily on ODA to Africa because the EU is the largest aid provider to the continent. Among the most severely affected EU countries in the crisis, Ireland and Portugal had over 80 per cent and 60 per cent of their ODA channelled to Africa in 2007–2009, respectively. France also directed 63 per cent of its ODA to Africa in the same period. A handful of countries, such as France and Italy, had already reduced bilateral assistance to Africa because of the global economic crisis.

Africa may face decreased FDI from both the EU and other parts of the world because of the sovereign debt crisis in Europe.

Global rebalancing presents opportunities and challenges to Africa.

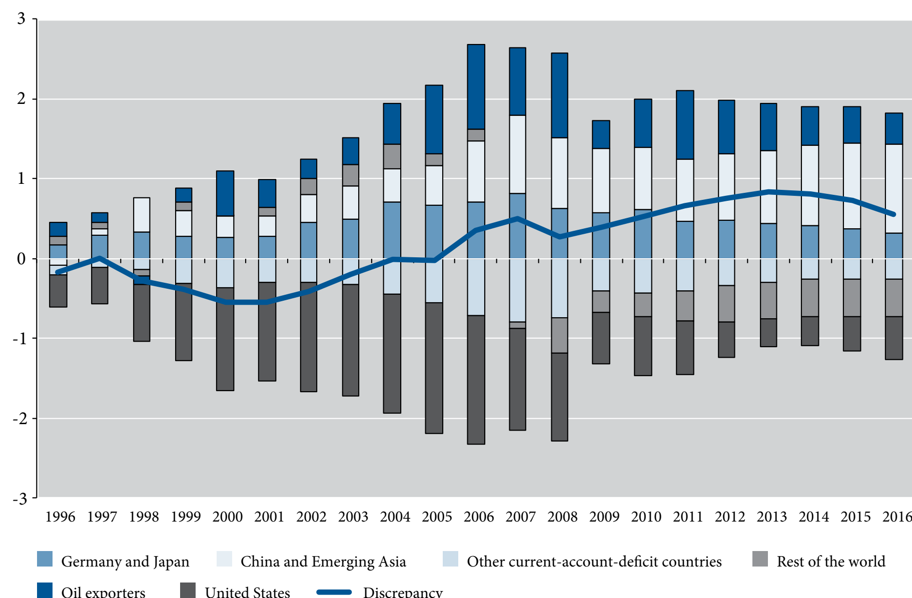
The expected slowdown of ODA to Africa could pressure social sectors, especially health, education and population programmes as well as water and sanitation, undermining poverty reduction efforts especially in low-income and fragile States.

1.8 Global rebalancing remains a major policy concern

GLOBAL IMBALANCES ARE seen in current account deficits or surpluses of the major economies and regions of the world, which since the "great recession" of 2009 have narrowed substantially, but they remain a serious threat to sustaining global economic growth over the long run (figure 1.10 and box 1.1). In an open world economy, imbalances are a natural phenomenon as capital tends to flow to countries with the highest expected returns.[14] But running persistent large current account surpluses or deficits is unsustainable for an economy, as a deficit economy will finally be unable to finance its consumption or investment through capital inflows at the yield that global investors demand. In 2011, the US still ran the world's largest current account deficit—$467.6 billion, against a maximum of $800.6 billion in 2006—while China, Japan, Germany and oil-exporting countries constituted its major surplus counterparts.

Figure 1.10

Global imbalances, 1996–2016 (% of world GDP)



Source: *IMF (2011d).*

Box 1.1 Do global imbalances matter?

The current account balance is the difference between national saving and investment (public and private), and there are "good" and "bad" imbalances (Blanchard and Milesi-Ferretti, 2009).

In the good cases, countries with ageing populations tend to record a high savings rate and thus a current account surplus, while those with high investment returns, often coming under the term "deeper and more liquid financial markets", run deficits.

Domestic or systemic distortions or risks result in bad imbalances, which must be addressed. High precautionary saving causes domestic distortion. For example, an over-reliance on export-led growth and an undervalued currency are systemic distortions.

Good imbalances can interact with distortions to create risks, however. The evolution of global imbalances during 1996–2009 illustrated the combined effects of good and bad factors. Although global imbalances were not the cause of the 2007–2009 global crisis, they were "a critically important co-determinant" (Obstfeld and Rogoff, 2009).

Long-run large global imbalances have been a major policy concern in G-20 meetings since the global crisis. Global rebalancing needs close and effective economic coordination among countries and regions. For example, during its April 2011 meeting in Washington, DC, the G-20 agreed to "promote external sustainability" and encourage its member countries to implement policies to "reduce excessive imbalances and maintain current account imbalances at sustainable levels". The G-20 indicators to evaluate key imbalances include public debt and fiscal deficit, private saving and private debt, and the external position.

The first sustainability assessment report advised that major advanced economies should shift "from public-to private-demand-led growth", and emerging economies from "external-to domestic-demand-driven growth" (IMF, 2011g). It also advised that, individually, economies with large deficits should adopt fiscal consolidation, raise their private savings rate and encourage exports, and those with corresponding surpluses should try to eliminate distortions (to lower their national savings rates) or to boost investment (to reduce corporate savings).

Global rebalancing is likely to have significant implications for low-income countries (LICs), which include around half of African economies. Rebalancing tends to increase global manufacturing product prices, while worsening terms of trade for most LICs. This is expected to lower domestic consumption and investment while raising net exports in LICs. Labour-intensive products by LICs are expected to expand, which may help them to diversify their economic base and to benefit from technology and skills spillovers in a longer term (IMF, 2011c).

Rebalancing presents certain risks to LICs, however. Inflexibilities in major economies' markets may redistribute global welfare, to the detriment of LICs. Moreover, to benefit from the process, LICs need to invest more in their infrastructure and improve economic policy design and regulation, so as to enhance their investment environment and attract FDI inflows (Yang, 2011).

Hence global rebalancing presents opportunities and challenges to Africa. As an essential element of the long-run solution to the global crisis, rebalancing has suffered

African countries need to pursue economic diversification and structural transformation vigorously in order to reduce vulnerability to external shocks.

some setbacks with divergent short-term policy objectives among the major world economies recently, pointing to the benefits of injecting a development dimension to global rebalancing. This implies an important role for Africa, complementary to its ambition to become a global growth pole.

Before it can realize this ambition, however, Africa needs to meet growth and structural transformation imperatives (chapter 3), address constraints in infrastructure, technology, human resources and governance (chapter 4), and mobilize and apply financial resources more effectively (chapter 5).

1.9 Conclusions and policy recommendations

THE WORLD ECONOMY is entering a period full of uncertainties and challenges. In the short term, the euro area sovereign debt crisis might push the global economy into another prolonged and deep recession or slow global growth, at steep social cost. High unemployment and rising food and energy prices have already widened income inequality and stirred up widespread discontent and social instability around the planet. The failure of developed-country governments to provide long-lasting solutions to correct global imbalances deepens the malaise.

Africa is not immune to the global crisis, though it is now in a much better position to deal with external shocks. The expected global economic slowdown may well cut demand for its commodity exports, reduce prices and thus hurt its export revenues, but increased output alongside its gradual moves to diversify its exports—as well as recently improved intraregional trade—can help the continent to better weather adverse global developments. ODA shortfalls could threaten many aid-dependent African countries' social development programmes, but could also encourage the continent to mobilize more domestic resources and reduce over-dependence on foreign financial assistance.

In view of these risks and challenges, African governments should implement growth-supportive macroeconomic policies in the short run, while adopting long-term development perspectives. To be more specific, they should increase their investments in programmes such as education, health and infrastructure that can enhance their economies' long-term growth potential in the bounds of their fiscal space. Monetary policy needs to be accommodative to support growth, but must be combined with income policies to provide a minimum social security cushion for the weakest groups in society, so as to consolidate the achievements in reducing poverty over the last decade.

In the long term, Africa's governments need to pursue economic diversification and structural transformation vigorously in order to reduce vulnerability to external shocks, such as the euro debt crisis or volatility in commodity prices. Moreover, African countries must continue to diversify their export destinations and expand economic partnerships, including those with new development partners, while deepening intra-African trade and investment.

Crucially, African countries can grow faster by unleashing their productive potential—by aggressively investing in infrastructure and human capital, and by promoting good governance (chapter 4). This will require strong political leadership and a firm institutional framework to fulfil the broad, transformative long-term agenda.

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Notes

1 The appreciation trend reversed in the last quarter of 2011 and currencies depreciated against the dollar in most LAC countries.

2 The 12th ILO African Regional Meeting stressed the urgency of the high youth unemployment problem in Africa and emphasized that it should be addressed through demand and supply measures.

3 In the first quarter of 2011, the euro area government debt ratio was 86.7 per cent of GDP, with Greece, Italy, Ireland, Portugal, Germany and France at 149.6 per cent, 119.9 per cent, 102.7 per cent, 94.0 per cent, 82.5 per cent and 84.4 per cent, respectively (Eurostat, 2011). Italy's government bond yield went over 7 per cent in November 2011, a dangerous level for fiscal sustainability.

4 China revised its end-2010 gross general government debt ratio up to 34 per cent in 2011. China had earlier been thought of as among those with the lowest government debt, but approached group average after this revision (IMF, 2011e). The asset bubble in China aroused concerns over its local government debt, and the huge fiscal stimulus introduced to counter the crisis may have increased State-owned banks' vulnerability (IMF, 2011f).

5 The figure was under the assumption of 3.8 per cent global growth. In another IEA scenario of 2.6 per cent 2011–2012 global growth, which is close to ours, the global oil demand in 2011 was 89.0 mb/d. In 2012, it is expected to arrive at 89.3 mb/d.

6 Authors' calculations based on IEA (2011a).

7 The Rio+20 Summit scheduled for mid-2012 will shed light on energy investments in developing countries in the context of the green economy (United Nations, 2010).

8 The Chicago Board Options Exchange Gold ETF Volatility Index went up sharply in August 2011 and remained high, suggesting concerns over global growth prospects.

9 Africa's intraregional trade has improved a little (section 2.3).

10 ODA figures and discussion in this paragraph are mainly from UN-DESA (2011).

11 OECD (2011a) presents four scenarios in resolving the sovereign debt crisis. The baseline scenario outlines an orderly default. In the downside scenario, disorderly defaults could happen, but do not mean the breakup of the euro area (the worst-case scenario, not shown). The upside scenario relies on major compromises and political breakthroughs among euro area countries, but has a relatively low probability.

12 The following trade analysis relates to Africa's merchandise trade only, as exports of commercial services were no more than 14 per cent of merchandise exports (by value) in 2010.

13 Section 2.3 discusses Africa's export composition by period.

14 The current and capital accounts are the two sides of a country's balance of payments, which by definition must balance. A current account deficit, for example, means that the country must sell its assets or borrow to buy goods and services abroad.