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Africa is more integrated in global financial flows[1]

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The past two decades have been marked by renewed optimism for Africa with several countries in the region enjoying high growth rates. Ranking high amongst the many positive factors (rapid urbanization, a growing middle class, etc.), is Africa's increasing trade and financial integration with the rest of the world. All types of funding (foreign investment, bank financing, etc.) have risen rapidly since the mid-2000's. However, the economic performance in terms of productivity catch-up with more developed markets has yet to materialise, and the continent still falls well short of its full growth potential.

From pessimism to optimism

Over the past two decades, the overall sentiment on Africa turned from "Afro-pessimism" in the 80's and the 90's, to various shades of "Afro-optimism" since the beginning of the 2000's. This shift reflects the acceleration of annual growth rates in the region: up from around 2.5% in the 80's and 90's, to 5% in the 2000's and 4% since 2010. With the exception of Asia, African markets have been among the strongest and most resilient over the past two decades.

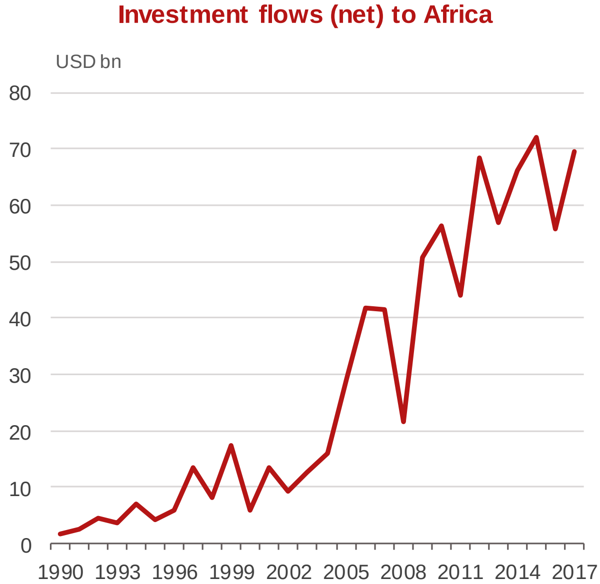
One often-cited illustration of this shift is the changing front page covers of The Economist on the region; "The hopeless continent" in 2000, "Africa rising" in 2011, followed by an upbeat "Aspiring Africa" in 2013. Still on an anecdotal level, by the turn of the 2010's, Africa appeared as an anchor theme for several private companies, as illustrated by McKinsey publishing its "Lions on the move" seminal report in 2010.

[1] *A first version of this article was published as a SUERF policy note (https://www.suerf.org/policynotes/4065/africa-needs-investments-beyond-its-pockets-of-growth).*

Chart 1

Source: SG Economics and Sector Research

Chart 2



Source: SG Economics and Sector Research

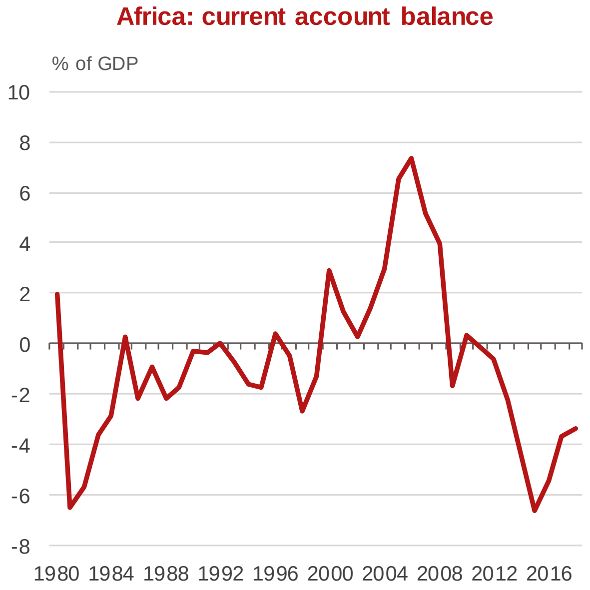
Growth unlocked by global integration

The acceleration in regional growth has been fuelled by global trade and financial integration, as Africa started to attract higher financial flows. Foreign direct investments – FDI – and portfolio investments increased only marginally on net terms during the 1990's, from USD 2bn in 1990 to USD 13bn in 2003, but then took off in 2004 and have averaged approximately USD 65bn per year since 2012. The geographical distribution of these private investment flows also tends to be more balanced than in the past: while resource-intensive countries used to receive the bulk of investment flows, the share of smaller, poorer or non-resource countries has been increasing over the last decade.

On the flip side of this reality, the continent's current account deficit started to become more "volatile" when growth accelerated, registering large surpluses when commodity prices were high, in particular oil, and – conversely – important deficits when oil prices declined. African countries remain exposed to cycles in primary commodity prices because, being less industrialized, they are sensitive to the price of their commodity exports, and also because food is a greater share of their domestic consumption.

Further reflecting this greater integration is the development of banking intermediation across the continent, both on "international" and "domestic" terms. BIS-reporting banks' exposure to the continent has risen significantly since Africa took off, with the stock of international claims (cross-border claims plus local claims in foreign currencies) on African counterparties jumping from around USD 75bn in 2000 to close to USD 200bn in 2018. This trend has proven surprisingly resilient so far, being only slightly dented by adverse events such as the global financial crisis, followed by the sharp tightening of compliance rules worldwide, or by changes in international banks' strategies, pulling back from Africa.

Chart 3



Source: SG Economics and Sector Research

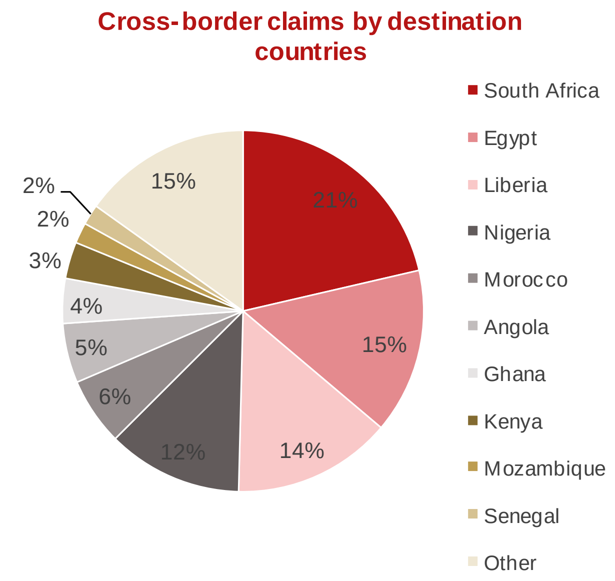
Chart 4

Source: SG Economics and Sector Research

International banks exposure to Africa is relatively balanced among countries with the major economies hosting the largest exposures. Liberia's status as a flag of convenience explains why the country accounts for almost 15% of the stock of international claims; Algeria's policies aimed at "self-reliance" explain the sharp decrease in the country's share of international banks' exposure (from more than 20% of the total stock in 1990 to less than 1% currently).

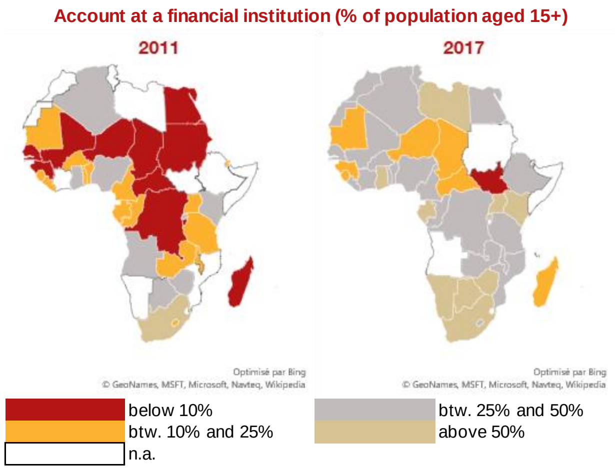
Banking intermediation has also significantly progressed on the domestic level, sometimes with the participation of international banks. Both credit intermediation (credit to the private sector as % of GDP) and financial inclusion (% of adults having an account at a formal financial institution) have regularly increased in the region over the past decade. Moreover, Africa has been on the forefront of innovative ways to "bank" its population, such as mobile banking or micro-finance.

Chart 5



Source: SG Economics and Sector Research

Chart 6



Source: SG Economics and Sector Research

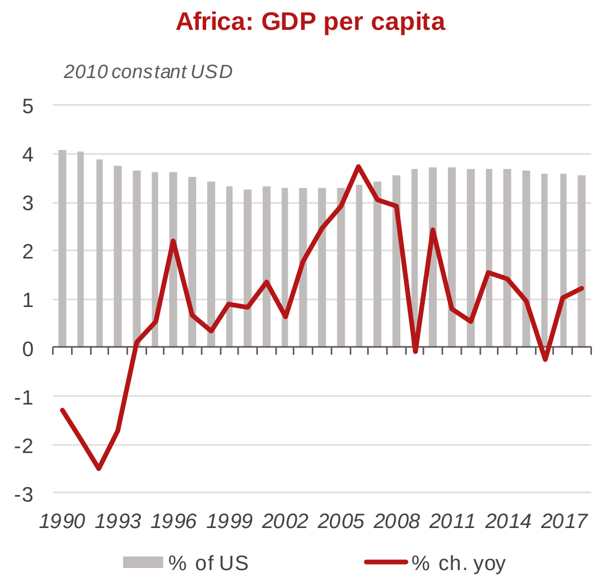
Catch up of GDP per capita is less impressive

Africa's population is growing fast and has started a demographic transition. Within the coming decades it is expected to register the benefits of a more favourable demographic structure, with the working age population growing faster than the total population thus pushing down dependency ratios. However, most sub-Saharan countries are still at the very early stages of this demographic transition, which also appears to be slow when compared to past trajectories of Asia or Latin America. The population is expected by the United Nations to be growing by more than 2% per annum at least until 2050.

As a result, the impact of this demographic dividend has to date been low in terms of GDP per capita. Africa's "take-off" has translated in relatively meagre increases in real GDP per capita, below 3% per annum since 1990 except for a brief period in in 2006 and 2007. In terms of catch up with mature markets, it is hardly noticeable. Africa's GDP per capita has remained broadly stable, as a percentage of the US level, over the past 30 years, because of the combination of growth in the US and of a structural depreciation trend of African currencies fuelled by recurrent current account deficits.

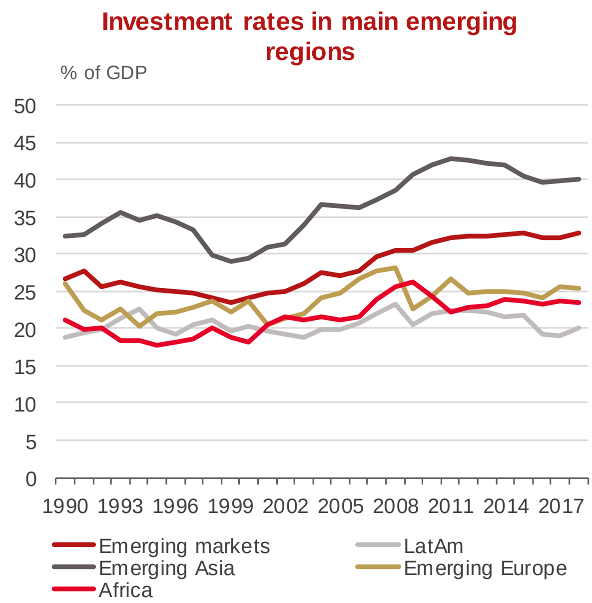
Raising investment rates is therefore key to increase the growth potential. The levels of investment as a % of GDP have remained significantly below those of Emerging Asia and barely in line with those registered in Latin America or Emerging Europe. This is a significant drag on growth, considering also that the level and quality of infrastructure is lagging far behind other regions, particularly in Sub-Saharan Africa.

Chart 7



Source: SG Economics and Sector Research

Chart 8



Source: SG Economics and Sector Research

In terms of potential "catch-up" with more mature markets, the outlook remains thus heterogenous among but also within countries. Much hope is being put in the combination of more business-friendly policies and new technologies to solve the infrastructure bottlenecks. This could ensure leapfrogging for the more productive and inclusive clusters of growth. Conversely, and depending on the quality of their governance, other regions and countries could be stuck in a standstill if they do not attract the right kind of productivity enhancing investments.

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