AFRICA'S MACROECONOMIC PERFORMANCE AND OUTLOOK UPDATE

AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

NOVEMBER 2023

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Key Messages

- Projections for Africa's average real GDP growth for 2023 and 2024 have been revised downwards. Growth is now projected at 3.4% in 2023 and 3.8% in 2024. These growth rates are lower than predicted in the 2023 AEO launched in May by 0.6 percentage points and 0.5 percentage points, respectively. The downward revision is attributed to multiple factors – the scarring long-term effects of COVID-19, geopolitical tensions and conflicts, climate shocks, a slowdown in the global economy, and constrained fiscal space to adequately respond to shocks and preserve economic activity.

- Slower projected growth is compounded by entrenched inflationary pressures reflecting the impact of higher food and energy prices and persistent disruption of global supply chains. Policymakers are confronted with a difficult trade-off between boosting economic growth and taming inflation amid weak fiscal buffers, and monetary policy undermined by the structural nature of the current tide of inflation.

- The eruption of geopolitical tensions in the Middle East could fuel further increases in energy prices, trigger a renewed wave of inflationary pressures, and constrain global growth, with direct implications for Africa's medium and long-term growth. Growth could also be affected by crop failures across the continent due to the projected El Niño weather phenomenon and the availability of agricultural fertilizers, the prices of which continue to rise. Low crop yields have the potential to exacerbate already strained supply conditions, raising fears of food insecurity and inflationary pressure.

1. Growth Performance and Outlook

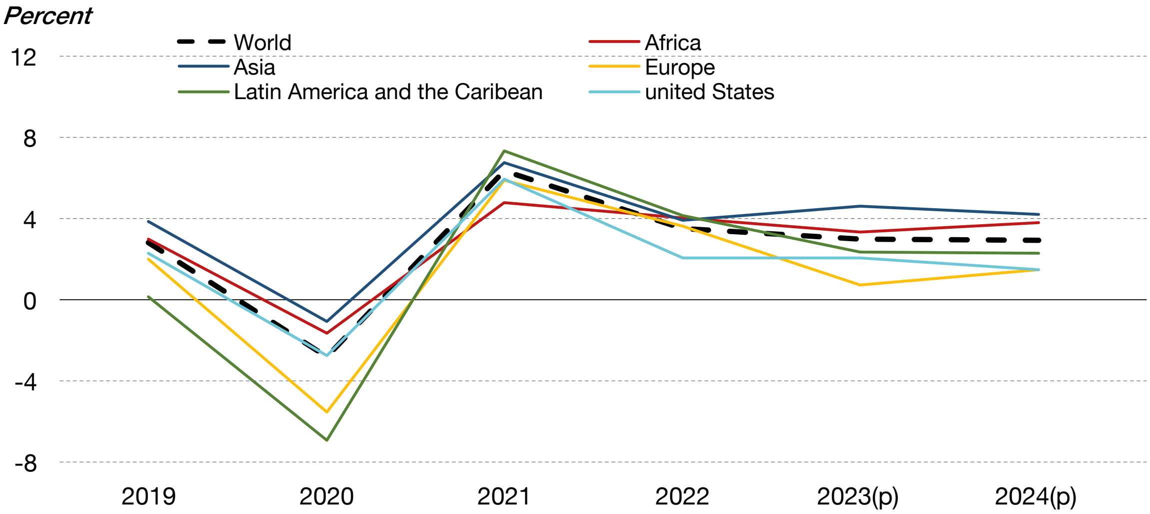
Africa's initial strong growth recovery from the COVID-19- induced deep recession has faded. The recovery has suffered several setbacks including the scarring long-term effects of the pandemic, the effects of Russia's invasion of Ukraine[1] on food and energy prices, and the impact of climate change. These factors have been compounded by other domestic and external disruptions – pockets of political instability across the continent, weak export demand due to tepid global growth, monetary policy tightening and associated increased cost of borrowing.

Average real gross domestic product (GDP) growth for Africa is now projected to decline to 3.4% in 2023, from 4.0% in 2022 (Figure 1). This growth rate represents a 0.6 percentage point reduction relative to the May 2023 AEO projection. Projected slower growth in 2023 could persist into 2024, which has also been revised downward by 0.5 percentage points to 3.8%. The revised projected real GDP growth for Africa will still be higher than the world average and that of all other regions, except Asia. According to the IMF's World Economic Outlook (October 2023), global growth is projected to average 3.0% in 2023, led by Asia at 4.6% (Figure 1).

The downward revision is broad-based, affecting 33 countries across the continent's regions (Figure 2).

- Growth in **Central Africa** is projected to decline to 4.1% in 2023 from 5.3% in 2022 and this rate is 0.8 percentage points lower than the May projection. The decline from 2022 to 2023 reflects persistent security and political challenges, particularly in Chad, the Central African Republic, and the Democratic Republic of Congo. The short-lived impasse in Gabon added to an already fragile fluid political environment in the region. A steeper recession is projected for Equatorial

Figure 1. Real GDP Growth, 2019-24



Source: African Development Bank statistics and Word Economic Outlook October 2023

Note: e- estimated; p-projected

[1] Agreed wording at the 2022 African Development Bank Group Annual Meetings in Ghana. Algeria, China, Egypt, Eswatini, Namibia, Nigeria, and South Africa, entered a reservation and proposed "Russia–Ukraine Conflict.".

Guinea, with the country failing to leverage higher oil prices by addressing contraction in oil production.

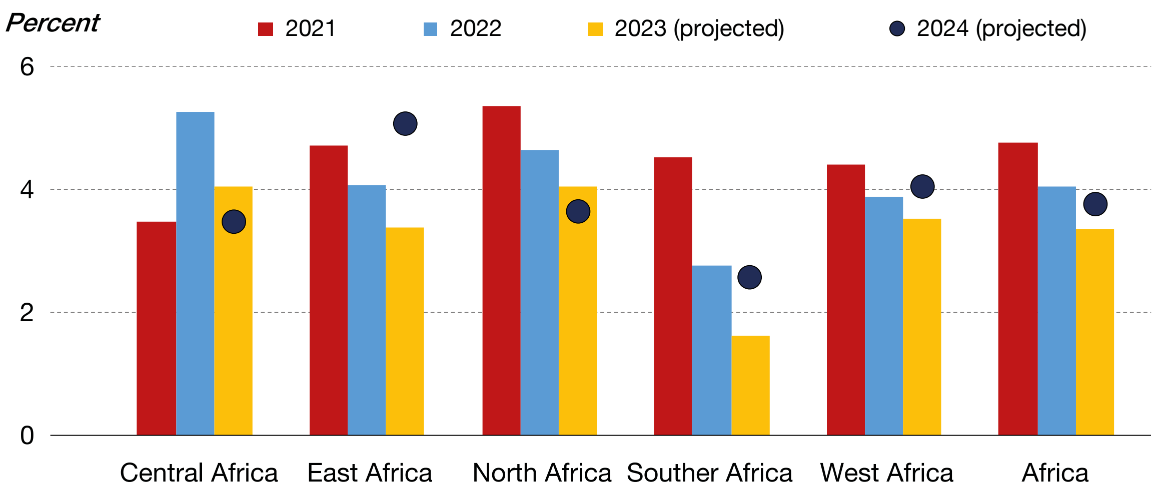
- Projected growth in **East Africa** for 2023 has been revised downward by 0.7 percentage point to 3.4% as the ongoing conflict in Sudan, coupled with rising debt vulnerabilities and high debt service costs in Ethiopia and Kenya respectively, overshadow the outlook in the region's high growth achievers – Rwanda and Tanzania. Aided by major investment drives targeting agro-industrialisation, retail, manufacturing, tourism, and the energy sector, growth in this region could rebound to 5.1% in 2024.

- **North Africa**'s growth is expected to decline from 4.7% in 2022 to 4.0% in 2023, a downward revision of 0.7 percentage points from the forecast in May 2023. North Africa has been hampered by negative terms-of-trade shocks, large currency devaluations (in Egypt), and a high inflation environment (particularly in Algeria and Tunisia) that continue to constrain economic activity.

- Growth in **Southern Africa** continues to disappoint and is projected at 1.6% in 2023 from 2.8% in 2022. The region's slower growth is mainly due to lingering weakness in South Africa, the region's largest economy, where severe electricity challenges have impacted productivity in the economy. The projected recovery to 2.6% in 2024 will not offset output losses incurred during the pandemic.

- In **West Africa**, the projected slowdown in Nigeria in 2023 could reduce the post-pandemic gains with real GDP growth forecast to decline to 2.8% from the May forecast of 3.3%. The immediate effects of the shock therapy in Nigeria in the form of fuel subsidy and exchange rate reforms have been reflected in large exchange rate depreciation and strong pass-through effects to domestic inflation highlighting the country's deep structural deficiencies. West Africa's economic challenges have also been amplified by Ghana's debt challenges and the negative impact of terrorism on the agriculture sector in Sahelian countries.

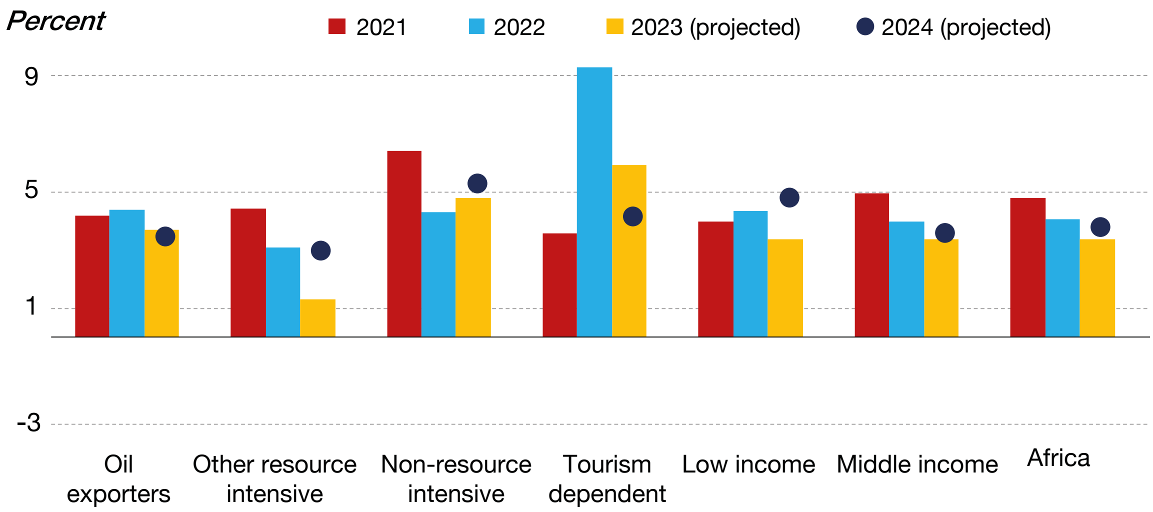
Figure 2. GDP growth in Africa, by region, 2021–24



Source: African Development Bank statistics

Across country groupings, for Africa's tourism-dependent countries, growth is projected to decline from 9.3% in 2022 to 5.9% in 2023, before moderating to 4.1% in 2024. Oil-exporting countries are expected to see a marginal decline from 4.4% in 2022 to a projected 3.7% and 3.5% in 2023 and 2024, respectively. The decline reflects the impact of technical challenges with planned and unplanned outages as well as oil production cuts amidst falling oil prices in the first half of 2023, tight global financial conditions, and high inflation that has constrained activities in non-oil sectors. Growth in non-resource-intensive economies is projected to rise to 4.8% in 2023, reflecting a 0.5 percentage point upward revision from 2022, and to rise further to 5.3% in 2024. The forecast for this grouping of countries reflects sustained efforts to enhance macroeconomic stability and infrastructure development.

Figure 3. GDP Growth in Africa, by country grouping, 2021-24

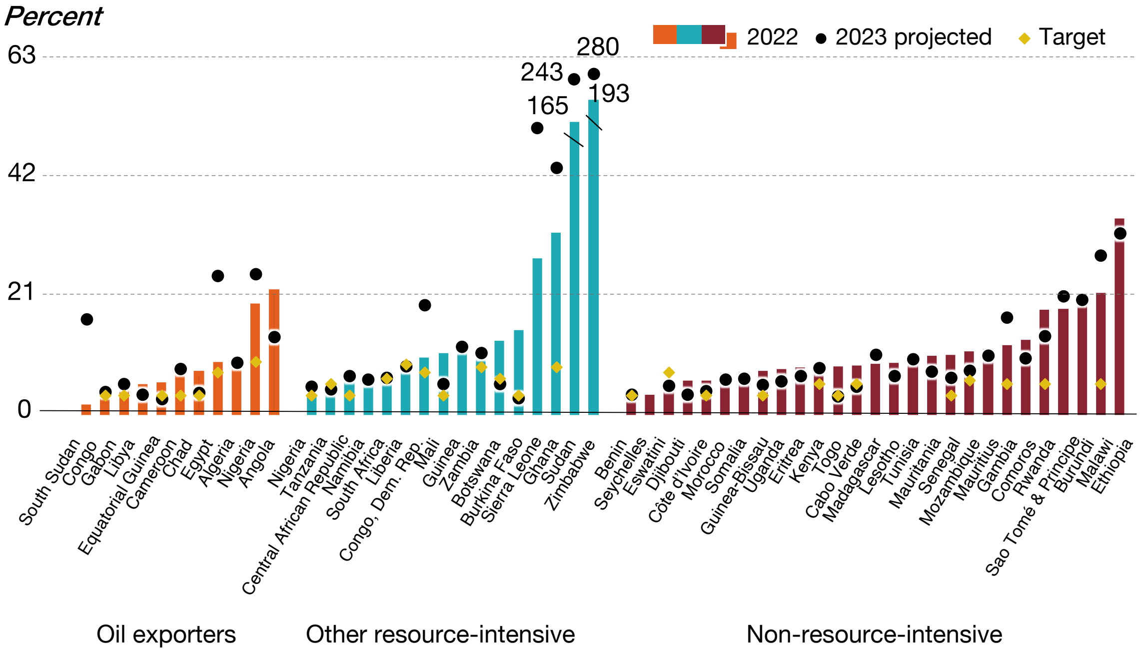


Source: African Development Bank statistics

2. Other macroeconomic developments

Heightened inflation and cost-of-living pressures. Inflation in Africa remains elevated, largely fueled by supply shocks in agriculture and imported inflation due to weak local currencies and relatively high commodity prices. These factors have amplified traditional sources of inflationary pressures from strong fiscal dominance in Africa. Average consumer price inflation is now estimated to have reached 18.5% in October 2023, up from 14.5% in 2022, the highest rate in more than a decade (Figure 4). In Egypt, Nigeria, and Ethiopia, three of the six largest African economies by nominal GDP in 2023, inflation is now above 20%. The sharp rise in prices across the continent along with limited credibility of monetary policy in some countries and weak transmission of monetary policy risk de-anchoring inflation expectations despite large doses of tight monetary policy changes. This highlights the difficulties central banks in Africa continue to face in dealing with structural sources of the current wave of inflationary pressures. For these reasons, some central banks have raised their policy rates consistently since inflation peaked in 2022 but despite these efforts, inflation remains stubbornly high and often rising (see Figure 5).

Figure 4. Consumer prices inflation, 2021-2022, by country

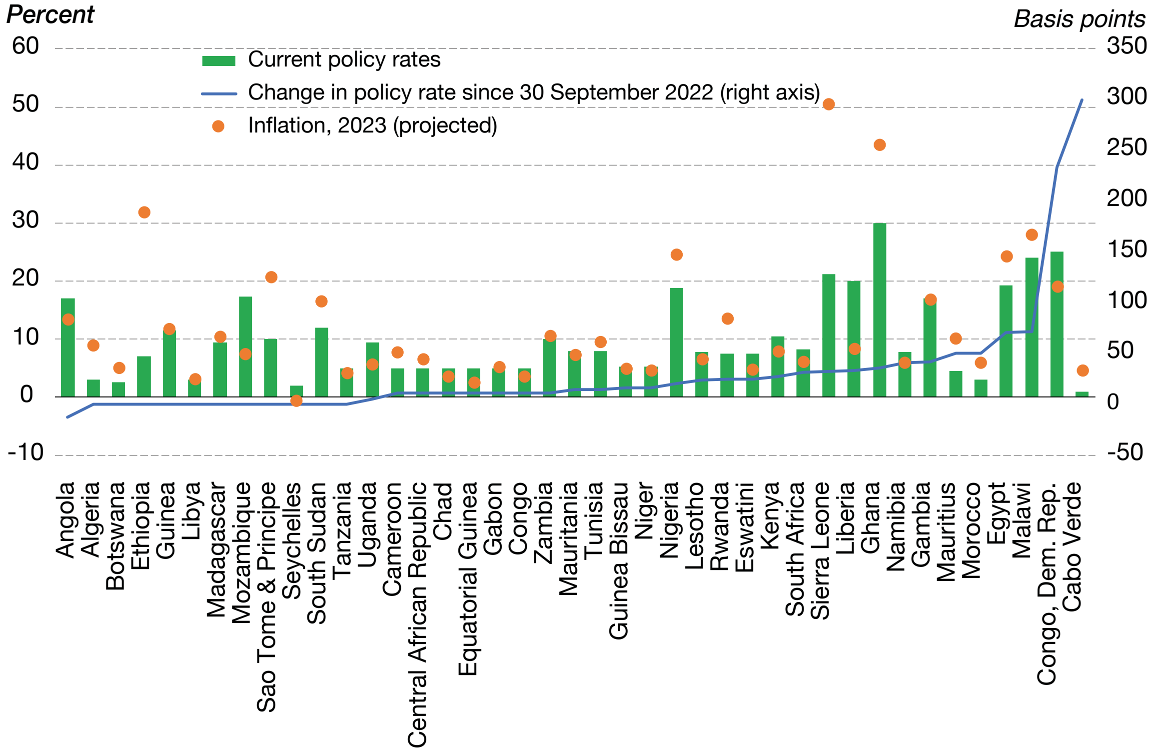


Source: African Development Bank statistics

Note: Values for Zimbabwe and Sudan have been truncated for a better visibility of others countries

[1] Agreed wording at the 2022 African Development Bank Group Annual Meetings in Ghana. Algeria, China, Egypt, Eswatini, Namibia, Nigeria, and South Africa, entered a reservation and proposed “Russia–Ukraine Conflict.”.

Figure 5. Current policy rates and changes since 30 September 2022, by country

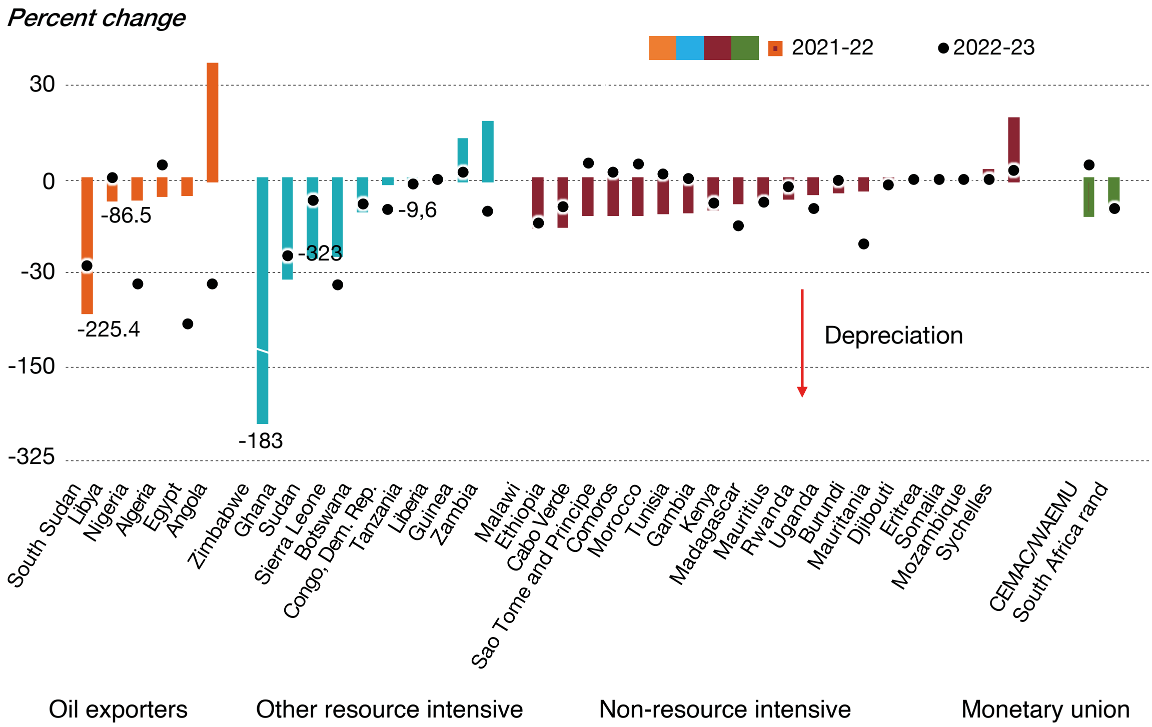


Source: African Development Bank statistics

Africa's deteriorating inflation picture contrasts with the gains made in the rest of the world, largely stemming from weak transmission of monetary policy across the continent relative to advanced economies and structural weaknesses. Global headline inflation has declined by more than half, from its peak of 11.6% in the second quarter of 2022 to 5.3% in the second quarter of 2023. China is facing an era of deflation while aggressive monetary policy tightening has delivered lower inflation in the United States and euro area to 2.7% and 2.8%, respectively (IMF, 2023).

African currencies continue to weaken. As interest rates and uncertainty remain high globally, African currencies continue to depreciate against the US dollar. The depreciation was widespread (Figure 6). All of Africa's leading commodity-exporting countries except Libya, Guinea, and Algeria experienced sustained exchange rate depreciations as commodity prices retreated from their 2022 peak. In Nigeria, the local currency depreciated by as much as 36% after the central bank lifted restrictions on rate setting in May 2023. Many analysts and policymakers have interpreted the depreciation as a market correction after years of the central bank's reluctance to dismantle the country's multiple exchange rates system. In non-resource-intensive countries, Burundi recorded the highest depreciation rate (20.7%), as low currency reserves, global uncertainty, and the cash restriction announcement by the central bank contributed to the depreciation of the Burundi Franc in parallel markets.

Figure 6. Exchange rate changes, by country 2021–22 and 2022–23



Source: African Development Bank statistics

3. Forces shaping the medium-term economic outlook

Africa's economic outlook will continue to be influenced by global and regional factors, including persistent inflationary pressures in many countries, the sluggish recovery of the global economy affecting Africa's exports, commodity price dynamics, developments in the Chinese economy, and geopolitical tensions.

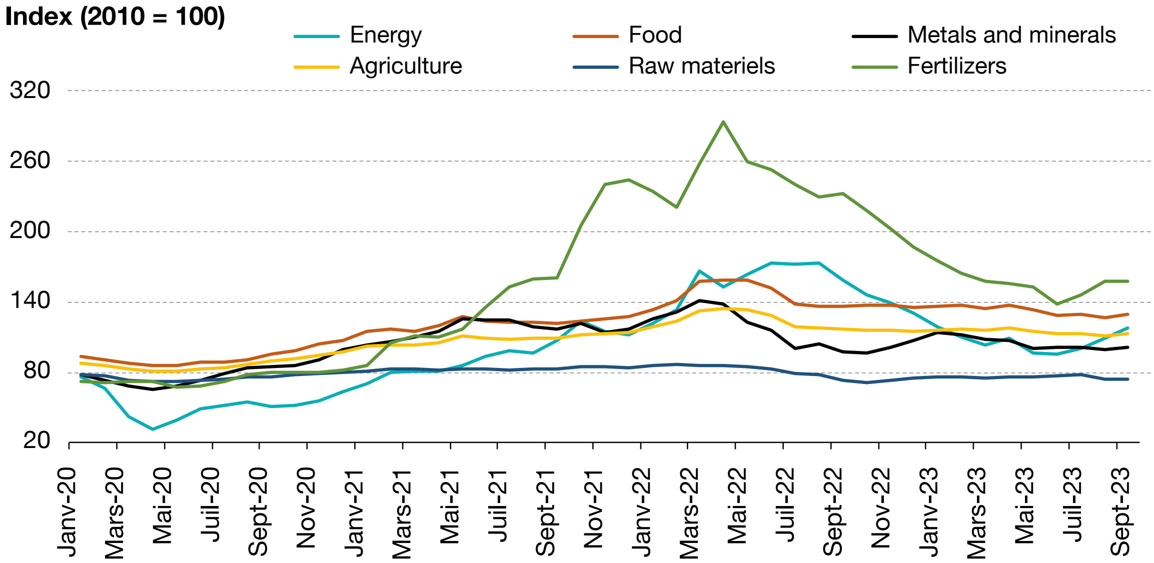
Persistence of inflationary pressures prevail in many African countries. Inflation persistence will continue to weigh heavily on the continent's medium-term economic performance. Inflation is a tax on the poor and any further steep increases could provide fertile ground for social tensions. To combat persistent supply-induced inflationary pressures, African countries will need to rethink their policy toolkit. While interest rate hikes bode well as a conventional monetary policy instrument, policymakers should focus their efforts on tackling domestic supply constraints, which have worsened against the backdrop of high international commodity prices. A further rise in interest rates has the potential to further weaken economic recovery.

Slow global recovery is impacting demand for Africa's exports. Global growth is expected to decline this year and next and remain below historical trends. Growth in the world economy is projected to decline from an estimated 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024. The projected slowdown in the Chinese economy relative to historical norms (4.1% in 2023-24 compared to an average of 6.7% in the last five years preceding the global health pandemic) puts additional strain on African countries, many of which are dependent on the Chinese market for their exports (China-Africa trade volume is estimated at US$ 251 billion in 2021). Faltering Chinese demand for exports will weaken global demand and economic growth in many countries, including most commodity exporters in Africa. Recent analysis shows that a 1 percentage point decline in China's real GDP growth rate leads to about 0.25 percentage points decline in sub-Saharan Africa's total GDP growth within a year (IMF, 2023).

Commodity prices remain elevated, and the outlook is uncertain. Although commodity prices have declined sharply from their record peaks in 2022, they remain higher than the levels at the height of the pandemic in 2020 (Figure 7). By June 2023, the energy price index had declined by 45% from its June 2022 historical peak. However, in the third quarter of 2023, the energy price index increased sharply by 23% due to supply curbs by OPEC+ (Organization of the Petroleum Exporting Countries plus selected non-member countries). The food price index has followed a similar but less steep trend, declining by 18 percentage points during the third quarter of 2023. Prices could remain higher for longer, with growing uncertainty due to ongoing geopolitical tensions, crop failures and effects of El Niño, and the availability of agricultural fertilizers, the prices of which continue to rise.

A prolonged and intensified geopolitical tension in the Middle East and Russia's invasion of Ukraine could trigger a second wave of supply disruptions with attendant pressure on commodity prices. However, structural weaknesses such as disrupted supply chains, low investment, and insecurity could prevent Africa's net commodity-exporting countries from taking full advantage of relatively high prices, further weakening medium-term growth prospects.

Figure 7. Global Commodity price indices, January 2020–Sept 2023



Source: Staff calculations based on the World Bank Commodity database.

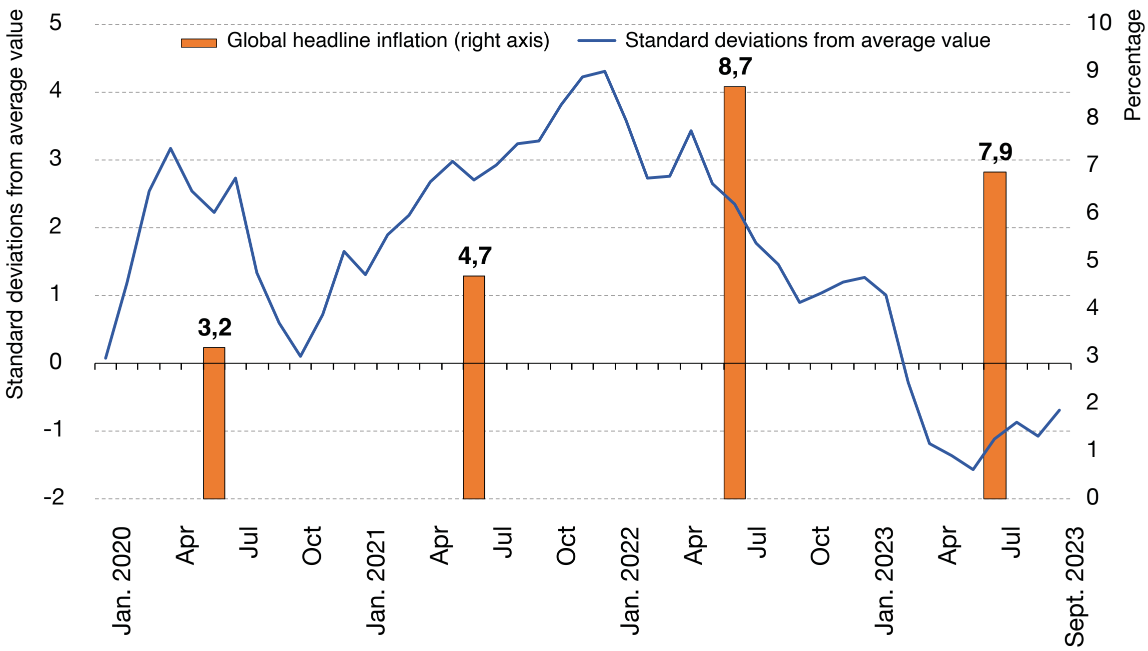
4. Risks to the Outlook

Africa's projected medium-term growth outlook is subject to significant headwinds as highlighted above. Both global and domestic risks remain elevated with the potential to further unravel the recovery. However, Africa's growth outlook could improve provided the global economy remains resilient, headline inflation declines, implementation of multiyear infrastructure projects on the continent remains uninterrupted, sustained progress is made on debt restructuring and fiscal consolidation, and Chinese policies to revive growth are intensified.

UPSIDE RISKS

- ***Global inflationary pressures may fall faster than expected***. Largely reflecting the steep drop in energy prices from late 2022 through mid-2023, global headline inflation is set to fall from an annual average of 8.7% in 2022 to 6.8% in 2023 and further through 2024 (Figure 8). Inflationary pressures in Africa could ease as global supply conditions improve. After reaching a peak of 4.3% in December 2021, volatility – measured by the standard deviation – of the Global Supply Chain Pressure Index has declined steadily since January 2022 and is now below the long-term average (see Figure 8). The decline in volatility signals the easing of inflationary pressures. These developments, if they materialize, would support global and regional economic growth by restoring household purchasing power and spurring global demand.

Figure 8. Global headline inflation and Supply Chain Pressure Index (GSCPI)

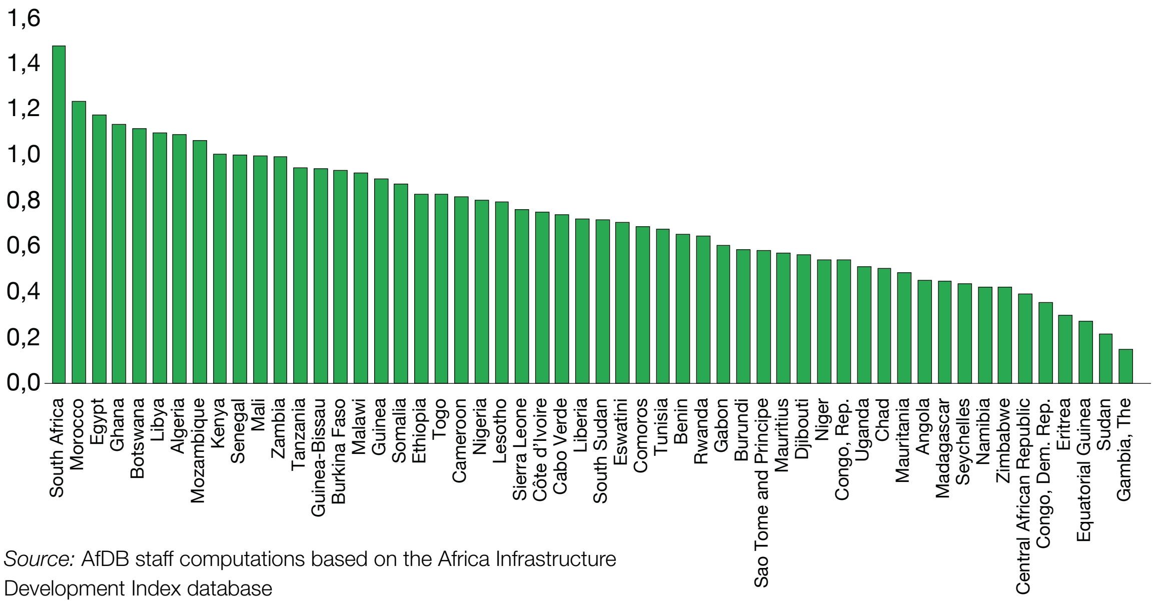


Sources: Bureau of Labor Statistics; Harper Petersen Holding GmbH; Baltic Exchange; IHS Markit; Institute for Supply Management; Haver Analytics; Refinitiv; authors' calculations.

Note: Index scaled by its standard deviation. The Global Supply Chain Pressure Index (GSCPI) is a new measure of supply chain conditions, provided by the Federal Reserve Bank of New York. It is calculated by combining variables from several transportation and manufacturing indices, such as those related to delivery times, prices, and inventories.

- ***Continued implementation of multi-year infrastructure projects***. Investment in infrastructure, especially in climate resilient and green projects could support Africa's post-pandemic recovery and lay the foundations for long-term inclusive development. The Africa Infrastructure Development Index (AIDI)[2], which provides consolidated and comparative information on the status and progress of infrastructure development in African countries, shows that most African countries made considerable progress from 2021 to 2022, led by South Africa (1.48 improvement), Morocco (1.23), and Egypt (1.17) (Figure 9). Sustaining these gains could further boost Africa's economic growth in the short to medium term since investment in physical infrastructure has multiplier effects on trade and jobs.

Figure 9. Africa Infrastructure Development Index – differential score between 2022 and 2021



Source: AfDB staff computations based on the Africa Infrastructure Development Index database

- ***Progress with debt restructuring and fiscal consolidation***. After more than three and a half years of increasing debt vulnerabilities across the continent, there is a glimmer of hope as governments and private creditors finally take the first steps toward debt restructuring. In Zambia, for example, which defaulted on its debt in 2020, official bilateral creditors led by China ended a months-long struggle and in October 2023 signed a memorandum of understanding that binds the agreement reached in June 2023 to restructure US$ 6.3 billion of Zambia's debt. This progress offers some optimism for Ghana and Ethiopia, two other applicants of the G20 debt moratorium. If successful and extended to all countries in debt distress or at high risk of debt distress, debt relief initiatives could provide financial fiscal breathing space needed to spur growth, reinforcing domestic efforts of fiscal consolidation, after a series of economic shocks.

[2] The AIDI Index (with a scale of 0 to 100, 100 being the best) is produced by the African Development Bank, and serves a number of key objectives, principally: (i) to monitor and evaluate the status and progress of infrastructure development across the continent; (ii) to assist in resource allocation within the framework of ADF replenishments; and (iii) to contribute to policy dialogue within the Bank and between the Bank, RMCs and other development organizations

- ***A possible easing of monetary policy***. Economic growth and outlook in Africa, as well as in other regions in the world, continued to be held back by policy tightening. The full impact of global monetary policy tightening is now being felt in many countries with a longer lag than previously expected. In Africa, this has led to downward revision in projected GDP growth for 2023-24 compared relative to the 2023 AEO. Given the structural nature of global inflation, further monetary policy tightening may not be a viable option in many countries. The pause in interest rate hikes by major global central banks signals that aggressive tight policies of the past year and half may be giving way to an easing policy stance. If this pattern continues, it could lead to better-than-expected global and regional GDP growth in the short to medium term.

- ***Policy support to reignite growth in China***. Other upside risks include stronger and more effective policy stimulus in China to reverse the recent slowdown in domestic demand growth. Stronger policy support in China than currently envisaged, particularly through means-tested transfers to households, could support the recovery and trigger positive spillovers globally, especially in African countries for which China remains an important trading partner.

DOWNSIDE RISKS

- ***A sluggish global economic recovery*** is projected for 2023 and 2024 on account of persistently sticky inflation which could keep global interest rates higher for a longer period. Commodity price pressures and higher global energy prices due to restrictions in oil production and exports may also necessitate a tighter global monetary policy, resulting in slower-than-expected global growth including in China—Africa's largest importer of commodities. This could reduce demand for Africa's exports and as well as shrink inward foreign direct investment, further constraining growth on the continent.

- ***A prolonged tightening of global financial conditions*** could further put depreciation pressure on domestic currencies, increase debt service costs, and exacerbate the continent's funding squeeze with more countries falling into high risk of debt distress or in debt distress situations. Higher debt service payments would further reduce fiscal space and shrink growth-promoting government spending in social sectors. Moreover, depreciation of domestic currencies could fuel inflation further and trigger restrictive monetary policy with risks to medium-term growth and strains in the financial system.

- ***A deepening of geopolitical tensions*** could lead to deeper disruption of global trade and international investment. If geopolitical tensions were to escalate, African countries could be hit by higher import prices or even lose access to key export markets. The losses could be compounded if capital flows between trade blocs are cut off due to geoeconomic fragmentation. According to IMF estimates, Sub-Saharan Africa alone could experience a permanent decline of up to 4% of GDP after 10 years due to geopolitical tensions and stand to lose an estimated US$10 billion of foreign direct investment (FDI) and official development assistance inflows.[3] The reduction in FDI eventually in the long run could also hinder much-needed technology transfer. Furthermore, for countries looking to restructure their debt, deepening geoeconomic fragmentation could also worsen coordination problems among creditors and delay debt restructuring processes.

[3] https://www.imf.org/en/News/Articles/2023/04/27/cf-economic-growth-in-ssa-could-permanently-decline-if-geopolitical-tensions-escalate

- ***Domestic headwinds*** have increased across Africa including debt distress and fiscal risks, conflict, political instability in some countries, and climate shocks. While governments in many countries are working hard to address macroeconomic imbalances, including through fiscal consolidation, the overall fiscal deficit is projected to widen to 4.3% of GDP in 2023 and 4.2% in 2024, from 4.1% in 2022. Across Africa, fiscal accounts remain under pressure, and in South Africa, for instance —Africa's largest economy—the deficit is expected to widen to 6.2% of GDP in 2023 and 6% in 2024, from 4.2% in 2022, reflecting the materialization of contingent liabilities, spending on the Social Relief Distress grants, and increased interest payments. The recent removal of fuel subsidies in Nigeria could provide fiscal savings for the federal government but pressures to offer accompanying relief plans for households and small businesses could offset these gains. Debt distress in Ghana and Zambia and delays in the debt restructuring process could further increase refinancing risks.

- ***The risk of increased conflicts and political instability*** in some countries could impose large economic and social costs. Moreover, it could increase countries' fragility and pose significant strains on their public finances, lowering revenue, raising military spending, and shifting resources away from development and social spending. Political instability can lead to sanctions from regional and international communities and depress economic activity due to trade disruption. For instance, recent military coups in Burkina Faso, Mali, Guinea, Gabon, and Niger and coup-related sanctions from regional blocs have disrupted economic activity and imposed significant social costs. Political instability and concerns over violations of human rights have led to the recent removal of Uganda, Gabon, Niger, the Central African Republic, Burkina Faso, Mali, and Guinea from the special US-Africa trade -the African Growth and Opportunity Act (AGOA). The removal of these countries has consequences on import prices and the export of more than 1,800 products that had duty-free access to the US market. Internal conflicts and violence could also result from rising fuel prices and those of other commodities due to weaker domestic currencies and domestic reforms. For instance, the removal of fuel subsidies in Nigeria, Kenya, and Angola and the resulting social costs has led to social unrest against the government policy.

- ***Climate shocks*** constitute yet another important risk factor to economic activity in Africa. Indeed, climate change poses grave threats to countries across Africa—but especially transition states. These countries suffer more from floods, droughts, storms, and other climate-related shocks than other countries, where they have contributed the least to climate change. Recent empirical evidence finds that climate change inflicts more lasting macroeconomic costs in Africa's transition states with cumulative losses in gross domestic product reaching about 4% three years after extreme weather events. That compares with around[4] 1% in other countries (Jaramillo et al. 2023).

[2] Jaramillo, L., Cebotari, A., Diallo, Y., Gupta, R., Koshima, Y., Kularatne, C., Lee, D., Rehman, S., Tintchev, K and Yang, F. (2023). "Climate Challenges in Fragile and Conflict-Affected States." IMF Staff Climate Note 2023/001, International Monetary Fund, Washington, DC.

Policy recommendations

African countries continue to feel the impacts of recent global and domestic shocks that have weakened macroeconomic fundamentals. Addressing the effects of these shocks will require a mix of short and medium to long-term policies.

- ***In the short-term, coordinated monetary and fiscal policies and a reduction in fiscal dominance will be essential to rebuild buffers against shocks:*** Fiscal dominance and central bank financing of the budget, which undermines the central banks' credibility to fight inflation, should also be contained making sure monetary and fiscal policy are moving in the same direction. Given prevailing financial conditions, if bolder and more transformative policies are not implemented, the current aggressive monetary policy stance in Africa could lead to further slowdowns, if not contractions, in the continent's economies.

- ***Over the medium term, addressing supply constraints will help support growth recovery:*** Policies to deal with supply constraints including addressing structural weaknesses so that households and businesses have access to reliable electricity, water, internet, and efficient transportation systems would help boost and sustain the momentum of growth recovery. However, under the prevailing tight fiscal space and debt vulnerabilities, these policies and investments will need to be targeted, prioritized, and sequenced for them to be effective.

- ***Structural reforms are needed in the medium term to strengthen the impact of monetary and fiscal policies in fighting inflation:*** Despite recent interest rate hikes on the continent, inflation remains high. This highlights some of the limitations of monetary policy transmission in Africa, where domestic supply constraints and external forces have been the main drivers of this inflation push. Nevertheless, additional interest rate hikes pose a risk of further reducing aggregate demand without bringing inflation down. To sustainably reduce inflationary pressures, African countries should remove hurdles that prevent domestic supply from responding to higher prices, and boost labor productivity via infrastructure and human capital investment. They should also accelerate the implementation of the mechanisms needed to dampen the effects of these supply shocks, such as greater diversification and financial sector development, including financial instruments dedicated to climate finance. Central banks could also make greater use of the exchange rate as a shock absorber while carefully monitoring the impact of currency depreciation on domestic prices.

- ***Strengthening fiscal resilience to climate risks and disasters:*** Strengthening fiscal resilience to climate risks and disasters will help limit the negative impact on growth when these risks materialize. Greater fiscal resilience will allow greater recourse to counter-cyclical fiscal measures following climate-related disasters and shocks. However, limited fiscal resilience impairs the government's ability to promote a rapid and robust economic recovery, which could amplify the impact of the first shock on growth.

- ***In the medium to long run, strong governance reforms should be implemented to address the looming debt crisis:*** Although the debt relief initiatives currently underway provide the financial breathing space needed to boost growth in some countries, a series of economic shocks, and recent debt trends in many African countries have reignited the need for strong governance reforms to strengthen debt management capacity. Achieving this requires building strong budget institutions to efficiently mobilize more domestic resources and utilize them prudently, as well as conducting sound public expenditure monitoring and debt management. Moreover, strengthening the nexus between debt, growth, and governance would help to maximize the growth dividends of debt-financed public investments.

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