Global Counsel

17 September 2014

# Limping Lions: testing the African growth story


## Summary

*This week sees the first visit of the IMF country team to Ghana to provide policy and financial assistance to address the country's fiscal and currency problems. Coming only months after the IMF was called on to provide assistance on similar issues in Zambia, this has led some commentators to question the 'Africa Rising' narrative of which Ghana had been one of key examples. Ghanaian events do flag an important fiscal and governance caveat to the African growth story. Understanding the Ghanaian experience can help investors generate a series of tests to look beyond headline growth, and gain a more nuanced understanding of the political and policy risks facing the continent's star growth performers.*


This week sees the first visit of the IMF country team to Ghana after the government had announced at the start of August that it intended to seek IMF financial support. With the fiscal deficit predicted to reach 9-10% this year, deteriorating macroeconomic metrics had by August seen the value of the cedi fall by almost 40% since the start of the year. This marked something of a fall from grace for Ghana, which over the last five years had been held up by many as a model of the new African cohort of growth states.

Coming two months after the government of Zambia had invited the IMF to advise it on similar fiscal and currency challenges, Ghana's economic problems have led some commentators to question the wider Africa Rising narrative of which Ghana had been a leading performer. The events in Accra over the last six weeks do not support that kind of sweeping scepticism, but they do flag an important fiscal and governance caveat to the African growth story.

The fiscal stresses of Ghana and Zambia are found to a greater or lesser degree in most of the frontrunners in the African growth cohort, often for linked structural and political reasons. Current account deficits have also widened, as countries rush to compensate for years of inadequate capital investment. Generalisation across Africa comes with a strong health warning, however analysis of the Ghanaian experience provides a useful set of tests with which investors can build a more nuanced understanding of the development of the continent's star growth performers. It also warns of the dangers of focusing too narrowly on admittedly impressive growth rates.

## Off track in Accra

Both Zambia and Ghana's growth over the last five years has been driven by high international prices for their major commodities. Zambia's fortunes in particular have been tied to copper, and the country fell into fiscal distress as the price of copper dropped by around 30% since peaking at the start of 2011. Ghana's growth has in fact been more broad-based than many of its peers, with strong and growing services and SMEs sectors in addition to gold, cocoa and more recently, oil exports. However, this impressive growth led some investors to overlook macroeconomic indicators which had been showing signs of distress for some time.

Ghana's fiscal deficit began its slide almost immediately after the 2005 international debt cancellation, steadily growing the government debt stock, and accompanied by a deteriorating current account deficit (Fig 1). As commodity prices fell and undermined forecast government revenues, Ghana's existing fiscal vulnerabilities exposed the country to a stark change in market sentiment.

This change in sentiment was particularly acute for Ghana which has covered some of its fiscal shortfall through market lending in recent years. Riding the wave of rising investor confidence in Africa, Ghana issued a ten year Eurobond last year in July at 8% and two large domestic seven year bonds in August and November. It cancelled a third seven year domestic bond in May as yields rose, but last week resurrected the issue even in the midst of discussions with the IMF, successfully selling a $1 billion Eurobond at 8.1%. This remarkable success is both a statement of the resilience of risk appetite among international investors, but also of investors' perception of IMF involvement as a curb on medium term risk. However there are reasons for caution given that June saw Moody's cutting its rating on the 2013 Eurobond issue to B2, five levels below investment grade.

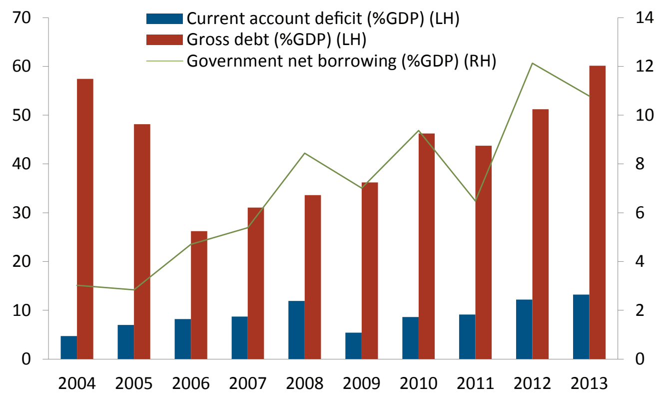


**Fig 1: Ghana macroeconomic data**
Source: IMF

As they had with the Zambian kwacha, investors moved quickly out of the Ghanaian cedi which topped the list as the worst performing free floating currency in the world in the first half of the year. These outflows and the resulting inflation have driven up import and debt service costs and prompted a sharp tightening of monetary policy. The Bank of Ghana's policy rate reached 19% in July 2014 despite slowing growth rates, again echoing the Zambian experience of interest rates rising to an all-time high of 12% in March.

Behind Accra's fiscal slide is the pressure to fund the investment aiming to trigger and sustain broader growth, particularly in infrastructure and social safety nets. Exacerbated by over-optimistic estimates of future oil revenues, the Ghanaian government's desire to both alleviate the condition of the poorest in society, as well as address the country's infrastructure gap was not matched by its ability to provide public and attract private funding.

This in turn was a product of a failure to translate rapid growth into fiscal strength. Even with a broadening base of growth, Ghana's tax revenues are only 15% of GDP and draw heavily on commodity revenues. It has simply proved unable to bear the weight of rising expenditure, both public investment in infrastructure and social safety nets, and a suite of subsidies, electoral and political sweeteners and general 'leakage'.

President John Mahama's administration has proved susceptible to these political pressures on fiscal prudence. During a series of strikes precipitated by inflation in the cost of living, public sector pay bills in Ghana rose 75% over two and a half years, and now consume around two thirds of government expenditure. Fuel subsidies also placed a heavy burden on the budget, although these were eliminated at the second attempt this year. Fiscal policy with political priorities is certainly nothing new, Ghana's fiscal deficit jumped in the election years of 2008 and particularly 2012, when the IMF estimates it doubled from 6% to over 12%.

## Lessons from Ghana

Beyond Ghana, a quick macroeconomic health check of Africa's most attractive investment prospects shows some disconcertingly familiar patterns (Figure 2). All of the leading lions of the African growth pack are running a deficit of higher than 3%, and most are running a deficit of greater than 5%. Stubbornly, and sometimes alarmingly, high current account deficits characterise many external positions. In almost every case, these figures are backed up by impressive growth rates. But as Ghana demonstrates growth is a necessary, but not always sufficient, condition of continuing macroeconomic stability and development.

For investors, Ghana can provide a number of important tests for assessing the state and sustainability of Africa's leading growth economies. First, the extent to which governments can transform growth into revenues. Across the African lions, tax revenues' low contribution to government finances will constrain their ability to service deficits and debt stocks. As a number of African countries move towards middle income status, diminishing aid flows will make this more important, including in Ghana itself where transition to middle income status has raised questions over the aid flows, which currently account for almost a third of the government budget.

| | GDP growth | Government net lending | Government debt | Current account | Inflation | Commodity dependence |
|---|---|---|---|---|---|---|
| Angola | ▼ (Yellow) | ▼ (Green) | ▲ (Yellow) | ▲ (Green) | ▲ (Red) | – (Red) |
| Botswana | ▼ (Yellow) | ▲ (Green) | ▲ (Green) | ▲ (Yellow) | ▲ (Yellow) | ▼ (Red) |
| Ethiopia | ▼ (Green) | ▼ (Yellow) | ▲ (Yellow) | ▲ (Red) | ▲ (Red) | ▲ (Red) |
| Ghana | ▼ (Yellow) | ▼ (Red) | ▼ (Red) | ▼ (Red) | ▼ (Red) | – (Red) |
| Kenya | ▼ (Yellow) | ▼ (Red) | ▲ (Red) | ▲ (Red) | ▲ (Yellow) | ▲ (Yellow) |
| Mozambique | – (Green) | – (Yellow) | ▼ (Red) | ▼ (Red) | ▲ (Yellow) | ▲ (Red) |
| Nigeria | ▲ (Green) | ▼ (Yellow) | ▼ (Green) | ▼ (Green) | ▲ (Red) | – (Red) |
| Senegal | ▲ (Yellow) | – (Yellow) | ▼ (Red) | ▲ (Red) | ▲ (Green) | ▼ (Yellow) |
| Tanzania | – (Green) | – (Yellow) | ▼ (Red) | – (Red) | ▲ (Yellow) | – (Red) |
| Zambia | ▼ (Green) | ▼ (Red) | ▼ (Yellow) | ▼ (Green) | ▲ (Yellow) | ▲ (Red) |

**Fig 2: Africa growth economy dashboard**
Source: IMF, World Bank WDI, UNCTAD 2013 estimates.

GDP growth [% annual]: Red <3%, Yellow 3%-6%, Green <6%. Government net lending [% GDP]: Red <-6%, Yellow -3%--6%, Green >-3%. Government debt [% GDP]: Red >40%, Yellow 20%-40%, Green <20%. Current account [%GDP]: Red <-5%, Yellow 0%-5%, Green >0%. Inflation [average consumer price % annual change]: Red >8%, Yellow 4%-8%, Green <4%. Commodity dependency [Primary commodity exports as % total exports]: Red >90%, Yellow 70%-90%, Green <70%. Upwards triangle = improving trend, downwards triangle = deteriorating trend, dash = flat trend.

Second, understanding the sources of growth is important. Ghana's continued reliance on commodity exports left it vulnerable to downturns in prices in gold and cocoa. States like Mozambique, Angola and Nigeria are even more dependent on commodity exports for both export earnings and revenues. Exposure to volatile commodity prices and the changing global economic weather calls into question their growth stability and value as diversification plays.

Third, electoral politics are an important fiscal variable, particularly where incumbents are threatened. Former Central Bank Governor Lamido Sanusi warned of 'fiscal shocks' in Nigeria ahead of the elections in February next year. Next month's elections in Mozambique may stretch finances as President Guebeza seeks to smooth the transition to his Frelimo successor Filipe Nyusi. But there are exceptions. In Tanzania the fiscal deficit widened in the approach to the 2005 and 2010 elections, however the Tanzanian government has invited the IMF to scrutinise policy in the run-up to the 2015 election. In Zambia in 2015 and Ghana in 2016, IMF stewardship is also likely to act as something of a check on fiscal electoral campaigning.

Fourth, the destination and quality of expenditure is important. Desire to support low income populations through subsidies has eroded balances across the continent. Fuel subsidies in particular have been a perennial IMF complaint among the African growth cohort, but for citizens in oil-rich economies are often one of the few benefits which trickle down. As the mass protests in Nigeria in late 2012 demonstrated, addressing them can be extremely politically fraught.

As African economies grow, vast infrastructure spending – a combination of both public and private financing - will be required to facilitate further growth. But behind the headline numbers are differing levels of capacity and efficiency in implementation. This is particularly important where countries such as Kenya, Tanzania and Angola are 'doubling down' on growth-focused investment by sustaining large public investment programmes in the face of fiscal strains. In Kenya the new regional administrative structure – a critical part of its political decentralisation - is adding to the cost of its bureaucracy. In Tanzania, there are fears that the planned port development at Bagamoyo is driven more by considerations of presidential legacy than economic logic.

Across the continent this general picture of fragile fiscal governance comes with one important qualification. Most of these economies had relatively low debt/GDP ratios when they went into deficit, so their overall debt stocks are generally low. Certainly they are low in comparison to many EU states and the US, but narrower tax bases, less diversified economies, illiquid debt markets and difficulty borrowing in domestic currencies means that the market will inevitably judge the debt sustainability of Africa's growth economies by different standards. These factors raise a further element of uncertainty over the ability to grow out of indebtedness or deficit.

The Ghanaian and Zambian experiences may mean that we have reached an inflection point in market sentiment on Africa. The focus on growth rates has dominated analysis over the last five years, but this is a reminder that under that growth is the strain of fiscal management in economies that are still developing governance capability, have small tax bases and face huge public expectations in terms of infrastructure and social spending. From here on, markets may be a little more sober in assessing the challenges.

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